



## **MOST COURT DECISIONS VALIDATE CASH BALANCE AND HYBRID PLANS**

**Of the several court cases that have decided the issue of whether cash balance and hybrid plans are inherently age discriminatory, only one court – which ignored judicial and regulatory precedent – ruled against the hybrid plan design.** Due to the conflict created by this one aberrant decision, sponsors of cash balance and hybrid plans are now exposed to significant and unwarranted litigation risks. The decision of one rogue court has created uncertainty, increased the risk of litigation, and, consequently, jeopardized the retirement security of millions of workers.

In 2000, an Indiana district court issued the first decision on whether cash balance and hybrid plans were inherently age discriminatory. **In *Eaton v. Onan Corp.*, 117 F. Supp. 2d 812 (S.D. Ind. 2000), the 7<sup>th</sup> Circuit ruled that cash balance plans do not violate either ERISA or the ADEA.** Rather, the court concluded that the age discrimination provisions were satisfied because the change in employees' plan accounts from year to year did not depend upon age and, therefore, did not discriminate against older workers.

Three years later, another court in the same district sent shockwaves through the benefits community by finding that cash balance and hybrid plans were inherently age discriminatory. **The judge's decision in *Cooper v. IBM Per. Pension Plan*, 274 F. Supp. 2d 1010 (S.D. Ill. 2003) ignored the precedent set in *Eaton* by ruling against cash balance and hybrid plans.** The implication of the ruling in *Cooper* is that all cash balance and hybrid plans are *per se* invalid.

Most recently, however, a Maryland court has confirmed the *Eaton* precedent. **In *Tootle v. ARINC, Inc.*, 222 F.R.D. 88 (D. Md. 2004), the court ruled that cash balance and hybrid plan designs are valid under the age discrimination provisions of ERISA.** The judge in *Tootle* relied upon the detailed analysis in *Eaton* which detailed the legislative history and statutory interpretation of the ERISA age discrimination provisions to find that those provisions do not bar cash balance and hybrid plans.

In addition, there have been other court cases that, while not ruling directly on the issue, have found that cash balance and hybrid plans are not age discriminatory. For example, *Campbell v. BankBoston, N.A.*, 327 F.3d. 1 (1<sup>st</sup> Cir. Mass. 2003) was decided on procedural grounds, but the court still concluded that hybrid plans are not age discriminatory.

Thus, there is a consensus from the courts, based on legislative intent, statutory interpretation, and economic principles that cash balance and hybrid plans are not inherently age discriminatory. **Congress should not allow one case that ignored legal precedent to continue to put retirement plans and workers' retirement security at risk.** We urge Congress to provide certainty for plan sponsors and workers that cash balance and hybrid plans are valid and appropriate retirement savings vehicles.

Detailed explanations of the cases follow.

*Eaton v. Onan Corp.*, 117 F. Supp. 2d 812 (S. D. Ind. 2000)

Claim: The cash balance design violates the age discrimination provisions under ERISA and the ADEA because the rate of benefit accrual declines with an employee's age.

Holding: Using statutory interpretation, legislative history, and public policy analysis, the court ruled that cash balance plans do not violate either the ADEA or ERISA prohibitions on age discrimination.

Analysis: The plaintiffs argued that the cash balance plan discriminated against older workers because benefit accruals decreased as workers grow older. The defendant countered with two arguments. The first was that the relevant age discrimination provisions of ERISA and the ADEA apply only to employees beyond normal retirement age. The second argument was that *even if* these age discrimination provisions applied to participants under normal retirement age, the statute does not require that the rate of benefit accrual be measured solely in terms of change in the value of an annuity payable at normal retirement age. The court agreed with both of the defendant's arguments. The court found that the legislative history of the age discrimination provisions indicated that such provisions only apply to benefit accruals beyond normal retirement age. The court then went on to find that, in a hybrid plan, the rate of benefit accrual could be defined as the change in the employee's cash balance account from one year to the next, rather than as an annuity payable at normal retirement age. In reaching its conclusion, the court looked at the legislative history of the relevant provisions, including the conference reports and floor statements from sponsors of the provisions. Moreover, the court considered the public policy for both the plaintiff's and defendant's arguments and determined that the plaintiff's arguments did not have any public policy merit.

Facts: In 1994, the Onan board of directors formally amended the Onan Pension Plan, retroactive to 1989, converting its defined benefit retirement plan to a cash balance design. As originally adopted, the Plan used a "final average pay" design, in which a participant's accrued benefit was based, in part, on the participant's highest five consecutive plan years of compensation completed within the ten most recent years of employment. Under the terms of the converted Plan, each participant's accrued benefit as of December 31, 1988, under the prior final average pay formula, was converted to an opening account balance for a hypothetical individual account. Thereafter, each participant's hypothetical account balance in the Plan received "pay-based credits" for each year of service, as well as interest credits, or hypothetical earnings, on those pay-based credits.

*Cooper v. IBM Pers. Pension Plan*, 274 F. Supp. 2d 1010 (S.D. Ill. 2003)

Claim: Two different plan amendments to the IBM pension plans, one converting the plan to a pension equity plan (PEP) and a subsequent amendment converting it to a cash balance plan, violated the age discrimination prohibitions of ERISA based on the accrual of interest credits.

Holding: Cash balance plans and PEPs violate the age discrimination provisions under ERISA because older workers have less time to accrue interest credits.

Analysis: Without discussing prior judicial precedent or legislative history, the court concluded that PEPs and cash balance plans violate the literal terms of ERISA because the formulas reduced benefit accrual on account of an employee's age. Ignoring the analysis undertaken by the *Eaton* court of the same provisions, this court concluded that statutory interpretation required that the accrued benefit be expressed as the normal retirement benefit. Therefore, because older workers would have less time to earn interest credits, their normal retirement benefit would be lower than a younger worker with the same years of service. The court acknowledged that the accrual of the employee's immediately payable benefit increased, but rested its opinion on the fact that accrual of the age 65 annuity decreased. In addition, the court also admitted that "[f]rom an economist's perspective [supporters of cash balance plans] have a good argument. A dollar today is worth more than the promise of a dollar a year from now." Nevertheless, the court ruled against the plan designs.

Facts: Kathi Cooper had been a plan participant since 1979 when her employment with IBM began. Before 1995, the IBM Plan provided benefits in the form of a lifetime annuity and a cash balance accumulation. On January 1, 1995, IBM's Board of Directors enacted an amendment to the Plan which adopted a pension equity plan. Under the pension equity formula, participants earned a specific number of "base points," determined by the employee's age in the year worked. Effective July 1, 1999, IBM converted the Plan to a cash balance formula. Under the cash balance formula, participant's accumulated monthly "pay credits" at a rate of 5% of the employee's salary and "interest credits" at a rate one percentage point higher than the rate of return on one-year treasury securities. The plaintiffs claimed that the Plan was age discriminatory based on how interest credits accrued on a participant's balance until the attainment of normal retirement age. Nonetheless, no specific employee was found to have suffered a reduction in benefits since the Plan contained a provision specifically disallowing a reduction in the accrued benefit.

*Tootle v. ARINC, Inc.* 222 F.R.D. 88 (D. Md. 2004)

Claim: ARINC's conversion to a cash balance plan violated the age discrimination provisions under ERISA because the manner in which accrued benefits were calculated favored younger workers.

Holding: ERISA's age discrimination provisions do not bar all cash balance plans. And, specifically, the ARINC conversion did not violate the age discrimination provisions of ERISA.

Analysis: The judge relied upon the analysis used in *Eaton* to determine that ERISA's age discrimination provisions do not prohibit cash balance plans. As in *Eaton*, the judge found that ERISA allows for more than one method to determine the accrued benefit and explained two specific options for determining whether accrued benefits in cash balance plans violate the age discrimination provisions. The first option uses the provision for defined contribution plans which determines the accrued benefit as the balance of the individual's account and looks for discrimination in the rate at which amounts are allocated and the changes over time in an individual's account balance. The second is the method used in the *Eaton* case which measures the accrued benefit by the changes in an individual's account balance from year to year. Under both of these methods, the court found that ARINC's cash balance plan did not violate the age discrimination requirements of ERISA.

Facts: Dan Tootle worked for ARINC, Inc. from 1996 through 2002, when he was terminated. In 1999, ARINC converted its defined benefit pension plan to a cash balance plan. As part of the conversion, all employees that were transferred to the new cash balance plan received transition credits. A certain group of employees were offered a choice between the plans. Tootle was offered this choice (although it is disputed whether he met the qualifications for this choice) and decided to switch to the cash balance plan. Upon being terminated in 2002, Tootle received a lump sum benefit from the cash balance plan of \$94,772.24. If he had remained under the traditional defined benefit plan, he would have received a lump-sum equivalent of \$80,438.42.

*Campbell v. BankBoston, N.A.*, 327 F.3d 1 (1<sup>st</sup> Cir. Mass. 2003)

Claim: Campbell claimed that in converting from a traditional defined benefit plan to a cash balance plan, BankBoston violated the ADEA.

Holding: The ADEA claim failed on procedural grounds. However, the court did conclude that the claim would have failed on the merits because Campbell alleged a “disparate impact” theory which is unavailable under the ADEA.

Analysis: Campbell claimed that because older workers have a shorter amount of time for interest to accrue on their cash balance plan retirement accounts, the cash balance plan violated the ADEA. The court responded that a disparate impact theory is not available under the ADEA. Moreover, the court concluded that one statement about older employees costing more money was an “arithmetic truth” and not prima facie evidence of discriminatory intent.

Facts: James Campbell worked for BankBoston over 37 years until 1998. In 1997, BankBoston converted its retirement plan to a cash balance plan. The accrued benefits under the old plan were converted by calculating their present value and crediting that amount as an opening balance in the new cash balance system.