Age Discrimination or Merely the Time Value of Money?

By Thomas G. Moukawsher

Cash balance plans are much discussed but little understood. When the Southern District of Illinois ruled in favor of plan participants claiming age discrimination in *Cooper v. IBM Pers. Pension Plan,* 274 F. Supp. 2d 1010 (S.D. Ill. 2003), the decision set off a firestorm of controversy. The Seventh Circuit's reversal (457 F.3d 636 (7th Cir. 2006)), combined with recent legislation, left many cash balance proponents breathing sighs of relief and observers puzzled over what the age discrimination claim is and what the court of appeals ruling means to cash balance litigants.

All of the hubbub—the claim, the ruling, and the billions of dollars at stake—turn on an obscurity: the definition of the statutory term "rate of benefit accrual." Because there is still no consensus about what these words mean and because other cases are percolating in other circuits, the *Cooper* case is unlikely to be the last word.

To understand the definition controversy, one should first learn a little about how the plans work. Cash balance plans mimic defined contribution plans (e.g., 401(k) plans) but are actually defined benefit plans (traditional pension plans). Cash balance plans use individual accounts funded by annual contributions based on a percentage of pay and interest credits on the account balance, but the accounts are hypothetical and the typical benefit delivered is an age-65 annuity purchased with the hypothetical contents of the "account."

Cash balance plan advocates point to the portability of the benefits, the simplicity in describing the benefits as an account balance, and the plans' insurance by the Pension Benefit Guaranty Corporation (which does not insure defined contribution plans).

Opponents criticize the plans for eliminating early retirement subsidies and deplore the loss of the large benefit accruals participants earn as they near normal retirement age. In the case of the IBM plan, for example, the annual increase in an employee's pension annuity would decrease dramatically as the employee approached retirement age, since the hypothetical contributions in later years would have fewer years to earn interest.

Still, the question of whether the plans are discriminatory rests on the definitions in the Employee Retirement Income Security Act (ERISA) anti–age discrimination provisions. For defined benefit plans, ERISA § 204(b)(1)(H) prohibits age discrimination as follows:

> a defined benefit plan shall be treated as not satisfying the requirements of this paragraph if, under the plan, an employee's benefit accrual is ceased, or *the rate of an employee's benefit accrual is reduced, because of the attainment of any age* [emphasis added].

For defined contribution plans, ERISA § 204(b)(2)(A) prohibits age discrimination as follows:

> A defined contribution plan satisfies the requirements of this paragraph if, under the plan, allocations to the employees' account are not ceased, and the *rate at which amounts are allocated to the employee's account* is not reduced, because of the attainment of any age [emphasis added].

Writing for the Seventh Circuit in *Cooper*, Judge Easterbrook unhesitatingly tackled the perceived differences between the two age discrimination provisions, rejecting the district court's construction that when the defined benefit plan section uses the words "rate of benefit accrual," it means that age discrimination is judged by comparing changes to the "accrued benefit"—the age-65 annuity—of younger and older employees. Since nobody disputes that younger people can buy larger age-65 annuities with their dollars than older employees, accepting the district court view of the words would have led Judge Easterbrook to accept that cash balance plans discriminate.

The judge would have none of it. As though the reason was obvious, he said the two definitions "appear to say the same thing, except that the rule for defined-benefit plans tells us what is not allowed while the rule for defined contribution plans tells us what works." The rest of the decision flowed from his unexplained premise that the "rate of benefit accrual" means the same thing as "the rate at which amounts are allocated to the employee's account."

Ultimately, Judge Easterbrook held that the IBM plan does not discriminate based on age by measuring its "rate of benefit accrual" as a function of the age-indifferent benefits put *into* the hypothetical cash balance accounts, rather than the age-65 annuities that come *out* of the hypothetical accounts.

The Seventh Circuit rejects a challenge to cash balance plans.

This made sense to him because he saw the difference in the resulting annuities as reflecting only the time value of money, not age discrimination. Younger employees have more time to earn interest on their accounts than older employees. Judge Easterbrook saw this as not age discrimination but simple economic reality: "As long as we think of 'benefit accrual' as referring to what the employer imputes to the account . . . there is no statutory difference between the treatment of economically equivalent defined-benefit and defined-contribution plans."

It is hard to believe that Judge Easterbrook's decision will be the last word here. His failure to explain why the two definitions mean the same thing leaves the court's opinion too thin to convince other courts troubled by the plans and—equally problematic—too slender a support for courts that would otherwise wish to rally behind his opinion as the definitive word on the subject.

The District of Connecticut and the Southern District of New York have broken the *Cooper* district court's distinction as the only decision supporting the cause of action: respectively, *Richards v. FleetBoston Fin. Corp.* and *In Re J.P. Morgan Chase Cash Balance Litigation*. Decisions taking the opposite view are pending before the Second, Third, and Ninth Circuits: respectively, *Hirt v. Equitable*, *Register v. PNC*, and *Hurlic v. S. Calif. Gas Co*.

Additionally, cash balance plans face more than discrimination challenges. Plan participants also claim many sponsors failed to give disclosures like the minimum summary plan descriptions required under ERISA § 102 or the ERISA § 204(h) notice required when benefits are significantly reduced. *See,* e.g., the discussion in *Richards*. No court of appeals has ruled on these disclosure issues yet and many of the rulings will depend on the particular facts of each case.

The Pension Protection Act of 2006, passed by Congress last summer, makes essentially prospective changes that will effectively bar age discrimination claims against new cash balance plans. *Cooper* will continue to provoke discussion about existing cash balance plans, however, and it is safe to say we will be hearing about them for a few more years. ■

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