No. 06-4757(L)

06-5190-cv(XAP)

UNITED STATES COURT OF APPEALS
***for the* SECOND CIRCUIT**

STEPHANIE HIRT, BARBARA SEAY, ANN NUSSBAUM,
SUSAN CHWAST and LORETTA RONZCA,
***Plaintiffs-Appellants-Cross-Appellees*,**

v.

THE EQUITABLE RETIREMENT PLAN FOR EMPLOYEES,
MANAGERS AND AGENTS and THE OFFICERS COMMITTEE
ON BENEFIT PLANS, As Plan Administrator,
***Defendants-Appellees-Cross-Appellants*.**

On Appeal From The United States District Court
For The Southern District Of New York

BRIEF *AMICUS CURIAE* OF PENSION RIGHTS CENTER
IN SUPPORT OF PLAINTIFFS-APPELLANTS

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CORPORATE DISCLOSURE STATEMENT

The Internal Revenue Service has determined that the Pension Rights Center is organized and operated exclusively for the purpose of charitable and educational undertakings pursuant to Section 501(c)(3) of the Internal Revenue Code and is exempt from income tax. The Pension Rights Center is also organized and operated as a non-profit corporation pursuant to the provisions of Title 29 of chapter 6 of the District of Columbia Code 1951.

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IDENTITY AND INTEREST OF AMICUS CURAIE

For the past 30 years, the Pension Rights Center, a Washington, D.C. non-profit organization that promotes and protects the pension rights of employees, retirees and their families, has provided legal representation, informal assistance, and information to pension plan participants and beneficiaries across the country to ensure they receive the benefits they were promised, calculated in accordance with the law. With the consent of all parties, the Center submits this brief on behalf of Appellants in support of reversal of the District Court's ruling as to the proper interpretation of ERISA § 204(b)(1)(H).

This case is of exceptional importance to the Center and the many millions of Americans who have been and will be harmed by decisions like Judge Hellerstein's below, Judge Easterbrook's for the Seventh Circuit panel in *Cooper v. IBM Personal Pension Plan,* 457 F.3d 636 (7th Cir. 2006), and Judge Greenberg's for the Third Circuit panel in *Register v. PNC Financial Services Group*, 477 F.3d 56 (3d Cir. 2007). These decisions, however well-intentioned, should not command this Court's respect. They are candidly driven entirely by what these courts think "sensible." *Cooper,* 457 F.3d at 639; *Register,* 477 F.3d at 69. They are *ad hoc*: they create a special exemption from ERISA's defined benefit accrual standards for defined benefit plans of the "cash balance" variety

without the slightest textual, contextual or legislative historical basis for doing so. They are result-oriented – to the point that they declare two completely differently-worded age discrimination tests, one applicable solely to formula-driven defined benefit plans, the other applicable solely to account-based defined contribution plans, as meaning the same thing – at least when it comes to cash balance plans. And they bestow upon cash balance plan sponsors retroactive immunity for past violations of the statute when, despite years of vigorous lobbying, sponsors were famously unable in the Pension Protection Act of 2006 to convince Congress to legislate such amnesty.

What those elected officials knew to be bad politics turns out to make even worse law. As a number of district court judges in this Circuit have persuasively explained, Judge Easterbrook's decision in *Cooper* (generally considered to make the best case that can be made for cash balance plan sponsors' desired outcome) is flatly inconsistent with the statute on the books before 2006 and this Court's analysis in *Esden v. Bank of Boston*, 229 F.3d 154 (2d Cir. 2000). And it is *Esden* that controls – and *Esden*, not *Cooper*, *Register* or the decision below, that got it right. According to renowned cash balance plan expert, Cardozo School of Law Professor Edward A. Zelinsky, Judge Easterbrook's analysis was "wrong on the merits" "when it declared cash balance pensions, hybrid defined benefit

arrangements, to be materially the same as defined contribution plans." Edward A. Zelinsky, "*Cooper v. IBM Personal Pension Plan: A Critique*," in Alvin D. Lurie (ed.), New York Univ. Rev. of Employee Benefits and Exec. Comp. (2007) (forthcoming), available at http://ssrn.com/abstract=926560 ("*Cooper* Critique") at 30.

The Center trusts that this Court, which has shown the premium it places on fidelity to the statutory text as exemplified by its decision in *Esden*, will leave policy-making to elected officials, ignore the sky-is-falling predictions of cash balance sponsors who knew the risks they were running when they adopted these pension-slashing formulas in the first place, and apply the law as it appeared on the books during the period relevant to this lawsuit.

SUMMARY OF ARGUMENT

The issue before the Court is whether Equitable's pension plan, an ERISA-governed retirement plan of the so-called "cash balance" variety, violated § 204(b)(1)(H)(i) of ERISA before that provision was amended by the Pension Protection Act of 2006 to effectively exempt cash balance plans.

To be frank, there really never has been much of a *legal* issue to debate. Section 204(b)(1)(H)(i) provides:

> 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.

The purported interpretive mystery is whether this provision forbids a pension plan from reducing the rate at which *benefits* accrue under the plan on account of age, or whether the standard applies to the rate at which hypothetical *contributions* are allocated to a participant's hypothetical cash balance "account." This is hardly a serious legal question. The answer is plain on the face of the statute: Benefits means benefits.

As indicated above, the real issue has been and remains a political one. Beginning in 1985, large corporations like Bank of America began adopting a newfangled type of pension plan dubbed a "cash balance" plan by the consultants who literally invented them out of whole cloth. With the 1986 enactment of ERISA § 204(b)(1)(H), however, cash balance plan sponsors had a problem because it became increasingly clear that benefit accruals under these plans often failed to meet the age-based accrual standards set forth in the statute. While even many employer-side pension attorneys acknowledged the problem, cash balance plan sponsors cried (as they do to this day) that it would lead to "catastrophic" results if they were held to the letter of the law.

The response of the aggrieved cash balance sponsors was to do what any well-heeled group of citizens could be expected to do in a similar situation: They

went to Washington seeking to change the law. But the change sponsors were seeking was (and remains) very controversial, so for many years their efforts met with no success. Finally, only last year, after many years of intense lobbying, did they finally win a large measure of relief. In the Pension Protection Act of 2006, Congress changed the law to prospectively exempt cash balance plans from ERISA § 204(b)(1)(H)(i). However, significantly, Congress stood its ground and as part of a political compromise explicitly refused to provide amnesty for past violations of the statutory standard: sponsors were told they would have to face the music for any past transgressions of the law that had been on the books.

Unfortunately, some courts have now taken it upon themselves to provide the amnesty Congress explicitly refused to grant and readjust expectations held by participants in the pension plans. While these courts have paid lip service to the statute, the true basis of decisions like *Cooper* and *Register* and the District Court's decision below is not what the statute says but rather what these courts think "made sense" in the context of purportedly "hybrid" pension plans like cash balance plans.

Typifying the response of some courts which have taken it upon themselves to champion cash balance plan sponsors' cause, the Third Circuit in *Register* recently argued that it was entitled to adjust the statute to accommodate cash

balance plans because "Congress enacted ERISA [§ 204(b)(1)(H)] . . . before the creation of cash balance plans." *Register,* 477 F.3d at 63. Putting aside for the moment the question of the legitimacy of this approach to statutory construction, the truth is that cash balance plans were well-known to the Congress which enacted ERISA § 204(b)(1)(H) in October 1986. While sponsors themselves often note in other contexts that the first cash balance plan was adopted in 1985 by Bank of America, less often remarked (or remembered, now 20 years later) is that the Bank's move was widely publicized and discussed at the time, in both the popular media and the specialized pension press[1] – publications which Congress, which has made substantive modifications to ERISA and parallel provisions of the Tax Code perennially since 1974, should be presumed to monitor.

While these newspaper and magazine articles obviously would not have addressed whether cash balance plans might run afoul of an age-based accrual rule applicable to all defined benefit plans that Congress had not yet written, the fact of the matter is that many of the articles did note that the new designs could be disadvantageous to older workers. *See, e.g.,* "Cash Balance Gives Workers Fast Vesting, But Cuts the Size of Long-Term Pensions," *The Wall Street Journal,*

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[1] This includes a technical examination of the Bank's plan by a leading actuary in a publication that circulates widely on Capitol Hill. "Guaranteed Account Balance Plans," Vincent Amoroso, F.S.A., Oct. 28, 1985, *BNA Pension Reporter.*

March 26, 1986; "Cash Balance Pension Plans," *The New York Times,* Aug. 17, 1985; "Putting the Traditional Pension Out to Pasture," *Business Week*, May 5, 1986; "Are cash balance plans the wave of the future?," *Institutional Investor*, June 1986; "Strengths and Weaknesses of Account Balance Plans," *Compensation & Benefits Management,* September 1986; "New design in pensions," *Dun's Business Month*, Jan. 1986; "The Battle of the Hybrid Pension Plans," *Employee Benefits Journal*, June 1986; "Account Balance Plans Are Not for All Companies," *Journal of Compensation and Benefits*, Jan. 1986; "New on the pension scene: the cash-balance plan," *Compensation & Benefits Review*, Jan. 1986.[2]

The point is that, however newfangled, cash balance plans were to Congress just another species of defined benefit plan, entitled to no special or separate treatment or categorization. Hence, Congress made *all* defined benefit plans, including defined benefit plans of the "cash balance" variety, subject to ERISA § 204(b)(1)(H). That is what "made sense" to Congress in 1986 when it wrote the standard at issue in this case.

Whether it makes sense from a policy perspective for Congress to treat cash balance plans like any other defined benefit plan under § 204(b)(1)(H) is an issue over which reasonable people can disagree. The declining pattern of benefit

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[2] All of these articles and others from 1985-October 1986 are available to the Court via Westlaw or Lexis/Nexis.

accruals under many cash balance plans may make "sense" for employers who are trying to reduce pension costs – but it makes much less sense to the older employees whose pension benefits have been slashed as a result. Where one stands on the policy issue largely depends on where one sits. But policy is not the issue here. What makes sense is the domain of Congress. *See Esden*, 229 F.3d at 171 ("[the] dispute it not over what a 'better' regulatory regime, more accommodating to the design objectives of cash balance plans might look like; the dispute is over how to apply the existing regulations to this Plan").

Congress, for good and sufficient reasons, saw fit in ERISA to make a sharp distinction between retirement plans of the defined *benefit* variety and plans of the defined *contribution* variety. As a number of district court judges in this Circuit have observed, the "rigidly binary" structure of ERISA made it clear that, absent an explicit exemption of the type enacted in 2006, ERISA § 204(b)(1)(H) applied to the "benefits" of the type that are *in fact accrued* under a cash balance plan and not to the *hypothetical* "contributions" made to *hypothetical* cash balance "accounts."

In accepting the enormous tax subsidies the Federal Government doles out each year for qualified retirement plans (in an amount exceeding the cost to the fisc of even the home mortgage interest deduction), plan sponsors like Equitable agreed

to play by the rules – but they didn't. That is why Congress refused to make the PPA 2006 exemption retroactive: because, plan sponsors like Equitable having thumbed their nose at the law Congress wrote, they are undeserving of sympathy or to be bailed out, at the expense of their employees, of a problem entirely of their own making.

ARGUMENT

Recognizing that it is Judge Hellerstein's decision this Court is reviewing, the Center nevertheless believes it can best contribute to the debate by focusing on Judge Easterbrook's opinion in *Cooper* which post-dates Judge Hellerstein's decision, and which the Third Circuit panel in *Register* adopts as its own.

I. *Cooper* Is Wrong On The Merits.

A. Cash Balance Plans are Not "Phantom Defined Contribution Plans."

According to Judge Easterbrook, a cash balance plan is best understood not as a defined benefit pension plan but as "a phantom, defined contribution plan." 457 F.3d at 638. Based on this erroneous premise, Judge Easterbrook found no basis in law or policy to treat cash balance plans differently from "real" defined contribution plans. *Id.* This Court's binding precedent is to the contrary. *Esden* explained that while "cash balance plans are designed to imitate ***some*** features of defined contribution plans, they are nonetheless defined benefit plans under

ERISA" that are subject to a distinct regulatory structure. 229 F.3d at 158 (emphasis added).

Among the most significant distinctions between defined benefit and defined contribution plans is that the benefit under a defined benefit plan cannot be defined as simply the balance of a participant's individual account, but must be determined by reference to an objective formula set out in the plan. More precisely, ERISA provides that the benefit under a defined benefit plan is "the individual's accrued benefit determined under the plan and, except as provided in section 204(c)(3), expressed in the form of *an annual benefit commencing at normal retirement age*." ERISA § 3(23)(A) (emphasis added).

The purpose and operation of the hypothetical "accounts" under a cash balance plan are therefore much different than the real accounts found under a defined contribution plan. Whereas under a defined contribution plan, a participant's current account balance *is* his "accrued benefit," a participant's hypothetical "account" balance under a cash balance plan is merely a computational construct (expressed as a dollar amount) that serves as the starting point from which the retirement *benefits* that are in fact promised by the plan are determined. *E.g., Lyons v. Georgia-Pacific Corp. Salaried Employees Retirement Plan*, 221 F.3d 1235, 1251 (11th Cir. 2000) ("Unlike a defined contribution plan,

the 'accrued benefit' under this Plan is not the amount in the Participant's Personal Account, but rather an amount *derived from* that hypothetical account") (emphasis in original). Judge Easterbrook's analysis was thus destined to go wrong at the start: to the extent he even acknowledges it, he never **follows through** on the principle that the hypothetical "accounts" are not real and that the "cash balances" do not in and of themselves represent the amounts due participants but are mere devices used to *establish* a defined benefit promise that is lawful under ERISA.

Under ERISA, a participant's "accrued benefit" under a cash balance plan at any moment is equal to the current balance in his or her cash balance "account" ***projected*** with interest to the participant's normal retirement age ("NRA") (if the participant has not yet attained that age), then converted to an annuity using actuarial assumptions set forth in the plan. Expressed as a mathematical formula:

$$\textbf{\textit{Accrued Benefit}} = [(\text{Current “Acct.” Balance}) \times (1 + i)^{\text{NRA} - \text{current age}}] \times \text{AF}$$

where "i" is the plan's interest crediting rate and "AF" is the relevant annuity factor set forth in the plan used to convert a hypothetical account balance at age NRA to a lifetime annuity stream. *See, e.g.*, IRS Notice 96-8; *Esden*, 229 F.3d at 163-64.

The point is, a participant's hypothetical current "account" balance under a

cash balance plan is not an accurate representation of the "benefit" he has accrued to date – which by law is the only thing a participant can accrue under a pension plan. The *benefit* a participant has accrued as of any date before retirement age is the projected annual benefit payable at age 65 equal to his current "account" balance *plus* the stream of future interest credits promised through normal retirement age, expressed as an age-65 annuity. What the current "account" balance reflects is the mathematical *present value* of this benefit – but it is not the benefit itself.

Thus, Judge Easterbrook's error (and Judge Hellerstein's and the *Register* panel's) was to fail to distinguish between **the "benefit"** that is promised under a cash balance plan **and *its present value***, reflected by the "account" balance. Stated another way, his mistake was to confuse the manner in which cash balance plans actually operate in fact (as required by law) and the simplified version of cash balance plan mechanics typically presented to employees. He focused on the "defined contribution" packaging, instead of what was inside the box. The result, unfortunately, was that Judge Easterbrook applied the law to a phantom set of "facts" – with predictable results.

Start with Judge Easterbrook's conclusion that the phrase "benefit accrual" means "what the employer puts in." This is correct in the sense that he means the

ERISA age discrimination provisions compare the annual *accretions* to employees' benefits under a plan, not the amounts accumulated to date – *i.e.*, ERISA § 204(b)(1)(H) requires a comparison of incremental "benefit *accruals*" not of the "accrued benefits" that have been earned to date (a different provision, not at issue here, ERISA § 204(b)(1)(G), tests for that). But this was not the interpretative breakthrough Judge Easterbrook or the *Register* court make it out to be: it does not prove that "benefit accruals" means "contributions."

"Benefit accruals" means "contributions" only if one accepts the mistaken proposition that the "inputs" to a cash balance plan are the employer's hypothetical "contributions" to participant "accounts." But, as demonstrated above, that is not the case. The inputs to a defined *contribution* plan are cash contributions to a participant's account. The inputs to a cash balance defined *benefit* plan, on the other hand, are promises – more precisely, *benefit* promises. These promises under a cash balance plan are conveyed to participants in terms of their present value – represented conceptually by hypothetical "account balances" – for ease of understanding. But the "account" construct is just that: a tool for employers to convey the benefit promise that is actually accruing under a pension plan in terms that may be more accessible to participants.

It is easy to see how Judge Easterbrook was seduced by the cash balance

form. Cash balance “accounts” are designed to appear as though they operate like the real accounts under a defined contribution plan. But cash balance “accounts” are not simply defined contribution accounts by a different name. Because the “account balances” are mere reflections of the *present value* of the benefits actually promised under the plan, amounts credited to an employee’s “account” are really increases to the amount of the promised benefit at age 65. More precisely, each dollar credited to a participant’s “account” reflects an increase in the promised age-65 benefit by the amount that has a present value of one dollar. So when a 25-year-old participant in a cash balance plan with a 6% “interest” crediting rate is told that his “account balance” has increased by $1, what really has happened is that his promised benefit at age 65 has increased by $10.29 – the future value of $1 at age 65 assuming a 6% interest rate. This is not just one way of looking at cash balance accounts, it is black letter law: A cash balance plan is a defined benefit plan, which means the <u>only</u> permissible “inputs” are *promises* to pay benefits.

Surely, Equitable will not dispute that the “inputs” that are tested under a traditional pension plan are the annual increases in the benefits. To its credit, this Court in *Esden* recognized that just because a cash balance plan uses a different formula (one based on hypothetical account balances instead of years of employment times ending salary) to calculate benefits does not mean the relevant

"inputs" are not still the annual increases in benefit promises, the only legal currency of any defined benefit plan. *Esden* understood this important fact about the way cash balance plans operate – *i.e.*, that the "inputs" to a cash balance plan are really benefit promises that include the impact of future "interest credits" that accrue along with each pay credit. And quite relevant to the case at bar, the Court concluded that:

> As accrued benefits, not only are the **interest credits** nonforfeitable once vested, see ERISA § 203(a)(2); *I.R.C. § 411(a)(2)*, but they **must also be taken into account in determining whether a cash balance plan complies with the benefit accrual requirements under ERISA section 204(b)(1)** and Code section 411(b)(1).

229 F.3d at 167 n.18.

The context in which the Court expressed this conclusion makes it crystal clear what the Court meant: *future* interest credits through normal retirement age must be taken into account *currently* when measuring increments to a participant's benefit for purposes of applying ERISA's "benefit accrual" standards – of which § 204(b)(1)(H) is certainly one. If the Court stands by this conclusion, this case is over: Equitable loses.

B. "Benefits" Unambiguously Refers to Benefits, Not Contributions.

What about Judge Easterbrook's point that had Congress intended defined benefit plans to be tested for age discrimination only on the basis of the benefits

that actually accrue under such plans, Congress would have said so more clearly?

Congress could scarcely have been clearer. Consistent with ERISA's binary structure, ERISA has two distinct age discrimination standards, one of which applies to defined *benefit* plans and the other to defined *contribution* plans:

Defined Benefit Plans **ERISA § 204(b)(1)(H)(i)**	**Defined Contributions Plans** **ERISA § 204(b)(2)(A)**
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.	A defined contribution plan satisfies the requirements of this paragraph if, under the plan, allocations to the employee's 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.

As the highlighted phrases under the two provisions make clear, far from "say[ing] the same thing," *Cooper,* 457 F.3d at 638, the standards are quite different: Defined benefit plans may not reduce the rate of an employee's "benefit accrual" because of age, while defined contribution plans may not reduce the rate at which "amounts are allocated," *i.e.*, contributed, to participant accounts. Judge Easterbrook's position that the two standards are "functionally identical" – at least in the cash balance context – is not persuasive, as numerous courts and commentators have remarked. *E.g., Cooper* Critique at 24 ("If these two provisions say the same thing, why did the draftsmen write and Congress add to [ERISA] two different provisions addressing pension age discrimination?"); *In re*

J.P. Morgan Chase Cash Balance Litigation, 460 F. Supp. 2d 479, 489 (S.D.N.Y. Oct. 30, 2006) ("It is difficult to imagine that in this case, where Congress has set forth one standard applicable to defined-benefit plans and another standard applicable to defined-contribution plans, they meant both provisions to mean the same thing"); *In re Citigroup Pension Plan ERISA Litigation*, 2006 WL 3613691, *11-12 (S.D.N.Y. Dec. 12, 2006) (same).

But back to Judge Easterbrook's point: Why, if Congress intended defined benefit plans to always be tested for age discrimination based on the increment to an employee's promised retirement benefit, does § 204(b)(1)(H)(i) refer to "benefit" accruals instead of "accrued benefit" accruals? In other words, why didn't Congress write the statute to provide that:

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

It is obvious why Congress did not adopt this formulation: It would have been incorrect (not to mention redundant) to refer in the statute to an employee's "accrued benefit accrual." *A pension plan participant does not accrue "accrued benefits" any more than a loan accrues "accrued interest.*" A loan accrues "interest." The interest that has accrued to date is called "accrued interest." In a similar fashion, a participant in a pension plan accrues "benefits," not "accrued

benefits." In other words, the term "accrued benefits," like the term "accrued interest," is a term that is properly used to reflect an amount that has accumulated to date. It answers the question: "How much have you earned to date?" But what accumulates – or *accrues* – are "benefits." The reference to "benefit accruals" is perfectly appropriate.

Congress had another more substantive reason for using the term "benefit accruals" in § 204(b)(1)(H)(i). What Judge Easterbrook and other courts have overlooked is the perfectly rational explanation that Congress elected to use the generic term "benefit" in the age discrimination statute because it wanted to extend protection against age discrimination to the accrual of ***any*** **benefits** an employee could earn under a pension plan, **not just** the "retirement-type" benefits that (once earned) qualify as **"accrued benefits"** within the meaning of ERISA § 3(23)(A).

Not all benefits that a participant can earn under a pension plan strictly qualify as "accrued benefits" within the meaning of § 3(23)(A). Rather, some benefits like incidental death benefits and certain medical benefits are considered "ancillary" benefits, *see, e.g.,* Treas. Reg. § 1.401-1(b)(1)(i), with respect to which not all of ERISA's most stringent "accrued benefit" protections apply (such as the rule against "cutback," *see* ERISA § 204(g)). By using the term "benefits" instead of "accrued benefits" in § 204(b)(1)(H)(i), Congress implemented its desire to

extend protection against age discrimination to the accrual of these ancillary benefits as well as to the accrual of traditional "retirement-type" benefits.

This is exactly how the two federal agencies charged with interpreting and enforcing § 204(b)(1)(H) have understood Congress's intent from the start. In regulations proposed shortly after § 204(b)(1)(H) was added to ERISA in 1986, the IRS and the Treasury Department proposed regulations reflecting their understanding that Congress intended ERISA's age discrimination standard to apply to the accrual of "**all benefits**" provided under a defined benefit plan:

> ***including accrued benefits***, benefits described in [IRC] section 411(d)(6), ancillary benefits and other rights and features provided under the plan.

Prop. Treas. Reg. § 1.411(b)-2(d)(1) (emphasis added) (published 16 months after § 204(b)(1)(H) was added to ERISA in October 1986 by Pub. L. 99-509, 100 Stat. 1874, 1975 (1986)); Fed. Reg. Vol. 53, No. 69, p. 11876 (April 11, 1988).

This further undermines the *Cooper-Register* benefits-can-mean-contributions view of the world: as the proposed Treasury Regulations indicate, Congress did not use the term "benefits" because it intended for certain defined *benefit* pension plans to be tested for age discrimination based on contributions. Rather, Congress used the broader term because it wanted to prohibit age-

discriminatory accruals of *all benefits*. Particularly devastating to Judge Easterbrook's position is that the proposed regulations specify that among the "benefit accruals" that must satisfy the § 204(b)(1)(H) standard are **annual increments to a participant's "accrued benefits,"** Prop. Treas. Reg. § 1.411(b)-2(d)(1) – exactly as the majority of district courts in this Circuit have correctly held. The regulations thus directly contradict Judge Easterbrook's position that § 204(b)(1)(H) is not concerned with increments to a cash balance plan participant's "accrued benefit."

In sum, there is nothing suspicious about Congress's decision to phrase the age discrimination standard in terms of "benefit" accruals instead of "accrued benefit" accruals. Rather, the phrasing is perfectly consistent with Appellants' position and indeed shows that the benefits that must be tested for age discrimination are *all* benefits that accrue under a defined benefit plan, **especially** the retirement-type benefits that, once earned, constitute an employee's protected "accrued benefit."

C. Future Interest Credits Accrue Along with Each Pay Credit.

Knowing his analysis cannot be reconciled with that of this Court in *Esden* and Judge Posner in *Berger v. Xerox Corp. Retir. Income Guar. Plan*, 338 F.3d 755 (7th Cir. 2003), Judge Easterbrook tries to sideline these decisions by arguing

they do not say what plaintiffs say they say. According to Judge Easterbrook, future interest credits become accrued benefits only when a participant terminates before retirement age and requests an early payout, but not before. *See Cooper,* 457 F.3d at 640-41.

This "springing accrued benefit" theory is flatly inconsistent with *Esden*, *Berger* – and ERISA. As this Court made clear in *Esden*, the ERISA lump-sum payment rule that Judge Easterbrook describes as requiring a payment equal to "the actuarial equivalent of the annuity that would be available at normal retirement age," *id.*, is actually a rule that requires a lump sum payment equal in value to the participant's "accrued benefit." *See* ERISA § 204(c)(3); *Esden,* 229 F.3d at 168. A participant's "accrued benefit" under a cash balance plan *is* "the actuarial equivalent of the annuity that would be available at normal retirement age" – so Judge Easterbrook's statement of the rule is not wrong. But Judge Easterbrook states and then discusses the rule in a way that leaves the impression that "the actuarial equivalent of the annuity that would be available at normal retirement age" is something *derived* from the accrued benefit only if and when a participant asks for an early payout – rather than *being* the accrued benefit that is already there, whether the participant asks for an early payment or not. The implication is that in the normal course, what the participant has really earned is the amount in

his "account," and only when the participant terminates before retirement age must that account balance be projected up to age 65 and then discounted back.

But that's not right. As *Esden* and *Berger* teach, ERISA and IRS Notice 96-8 provide that a cash balance plan participant's accrued benefit is *always* the annuity available at retirement age – *i.e.*, the participant's current "account" balance plus future interest credits through retirement age That annuity is his ERISA-defined accrued benefit whether he asks for a lump sum or not. The retirement annuity does not suddenly become the participant's accrued benefit only when he asks for an early distribution – it is his "accrued benefit" all along. (The only requirement that springs to life when a participant requests an early distribution is that the plan calculate the present value of that benefit, step (b) in Judge Easterbrook's description. But the underlying accrued benefit is not something that springs to life only when an employee asks for it.)

If a participant's accrued benefit *today* factors in interest credits promised to be paid in the future, it means that Judge Easterbrook's understanding of when cash balance interest credits are credited to a participant's cash balance "account" is incorrect: The entire stream of promised interest credits through retirement age *accrues* and is therefore by definition *credited* to the account as soon as the underlying pay credits are allocated to a participant's account. This changes

everything. It means that the guaranteed stream of future interest credits that are stapled to each pay credit must be taken into account of – are part of – Judge Easterbrook's "annual addition to the pot." This is exactly what the IRS was getting at in Notice 96-8, when it said that

> an employee's accrued benefit as of *any date* before attainment of normal retirement age is based on the employee's **hypothetical account balance** as of normal retirement age, **including *future* interest credits to that age**.

The IRS's instruction is clear: On "any date" (not just when a participant asks for an early payout), what a participant has earned to date (his "accrued benefit") under a cash balance plan is reflected by his hypothetical "account balance" at age 65, which *includes* future interest credits payable through that age. In other words, the future interest credits that are stapled to each pay credit are part of the employee's entitlement *now*, as soon as the pay credits hit the employee's "account."[3]

The result is a violation of ERISA § 204(b)(1)(H). When a dollar of pay credits is allocated to a young employee's account for a year of work, his benefit accrual – the addition to the pot – includes the pay credit plus the promised stream

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[3] Nor could it be otherwise, as this Court explained in *Esden* and as the IRS explained in Notice 96-8: if the interest credits were not immediately part of the guaranteed accrued benefit, the plan would fail ERISA and the Tax Code's service-based accrual rules, *i.e.,* the plan would be impermissibly backloaded. 229 F.3d at 167 n.18.

of future interest credits through age 65. The same is true for a similarly-situated older employee. Because the promised future interest stream per dollar of pay credit is longer and thus larger for a younger employee (who is farther from age 65) than a similarly-situated older employee, the younger employee's addition to the pot will always be larger. This violates the rule under ERISA § 204(b)(1)(H), which says an older employee's benefit accrual may not be larger than a younger employee's accrual merely because of their difference in age.

Judge Easterbrook complains that this cannot possibly be the correct result because it "treats the time value of money as age discrimination" which is "not sensible" and makes "[a]ll sorts of things go wrong." But the strawman example on which *Cooper* relies to purportedly demonstrate this fact shows only the unsurprising fact that if an older employee with a greater initial "accrued benefit" earns an additional $500 benefit for working during a year, the $500 benefit accrual represents a smaller percentage increase in his accrued benefit than the percentage increase that would be experienced by a younger employee who accrued the same $500 on top of his smaller initial accrued benefit. This plainly should not be treated as age discrimination, points out Judge Easterbrook – each employee received the same $500 benefit increase – so it proves that plaintiffs must be wrong when they assert it is improper to measure age discrimination by

reference to percentage increases in employees' accrued benefits.

Plaintiffs agree that age discrimination should not be measured by reference to percentage increases in employees' benefits. This theory of age discrimination has never been asserted by employees in any lawsuit – as Judge Easterbrook confirms in failing to attribute it to any case or commentator anywhere. The example purports to show the problems with using the annual pension at retirement age as the standard for testing age discrimination. But what Judge Easterbrook failed to recognize was that this example would turn out no differently if discrimination were instead measured by increases in "contributions" to a participant's "account." Examined critically then, the example has nothing to do with the "retirement annuity" vs. "account" dispute. All it demonstrates is that age discrimination should not be tested by reference to percentage increases in an employee's benefit accruals, whether those accruals are represented by a retirement annuity or account balance – something both sides agree on.

The irony with Judge Easterbrook's policy-based attack on Appellants' position is that, not only is Appellants' interpretation of the statute the only one consistent with its plain and obvious meaning, but it is also the "more sensible approach." Allowing a *defined benefit* plan to effectively use *defined contribution* plan standards to test for age discrimination – the approach adopted by *Cooper* and

Register – would allow blatant age discrimination with the stroke of a plan sponsor's pen in any of the existing 30,000 defined benefit plans governed by ERISA. That is because *any* defined benefit formula can be expressed in terms of a "cash balance" equivalent: An actuary need merely convert the accrued-to-date normal retirement benefit to its current lump sum present value and call that value an "account."[4]

A traditional defined benefit plan that has been restated in this manner to express benefits in terms of their present-value "cash balance" equivalents could with impunity structure its benefit formula so that the rate of accrual explicitly drops over time solely on account of age – as demonstrated in Appellants' opening brief at 27-28. The courts in *Cooper* and other cases that reached a similar result were not presented with the *truly* "illogical" results of the snake oil they were being sold. ERISA should not be so easily hoodwinked.[5]

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[4] *See, e.g.,* Paul Strella, *Specialized Qualified Plan – Cash Balance, Target, Age-Weighted and Hybrids*, Tax Management Portfolio No. 352-3rd (2005) at 73 ("Although most cash balance plans are designed to look like an account based defined contribution plan, they can also be designed to look like a traditional career average pay defined benefit plan with an indexed annuity benefit," and *vice versa*).

[5] It is possible that Judge Easterbrook understood the potential for mischief illustrated in the plaintiffs' brief but was not troubled because of his apparent view that age discrimination should be tested based not on promised benefit outputs but on "the rate at which *value* is added (or imputed) to" participant accounts, 457 F.3d at 639 (emphasis added). Judge Easterbrook appears to take the position that a cash balance plan (or presumably any other type of pension plan) should not be

D. ***Esden's* "Rigidly Binary" Characterization was Correct.**

Judge Easterbrook also attempts to undermine this Court's conclusion in *Esden* that "however 'hybrid' in design a cash balance plan may be, it remains subject to a regulatory framework that is in many regards rigidly binary." *Esden*, 229 F.3d at 159 n.6. In direct contrast to *Esden's* understanding of ERISA's structure, Judge Easterbrook states his view that the standards governing age discrimination under defined benefit and defined contribution plans are "materially identical," and "say the same thing." 457 F.3d at 641, 638; *id.* at 641(also referring to cash balance plans as "functionally identical" to defined contribution plans). The statute is plain and the evidence plentiful that this Court got it right in *Esden*: Judge Easterbrook's "close-enough" approach does not withstand scrutiny.

For instance, Professor Zelinsky observes that elsewhere in ERISA, "[w]hen

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considered age discriminatory as long as the <u>cost</u> of providing benefits to similarly-situated employees is equivalent. However, as even prominent employer-side cash balance experts have recognized, "the equal cost/equal benefit analysis" that applies under the Age Discrimination in Employment Act to health insurance and certain other types of benefits "generally does not apply to retirement plans." Strella, *supra* note 5 at 99. This is evident under ERISA § 204(b)(1)(H)(i), which requires age discrimination to be tested on the basis of "benefits," not the "cost of benefits" or the "present value of benefits." So while Judge Easterbrook's preferred approach might have the support of some economists and policy-makers, it is not the approach Congress chose in 1986. In any event, Equitable's cash balance plan likely would fail even Judge Easterbrook's equal value test: The guarantee of a 40-year tax-deferred, bankruptcy-proof stream of "interest" credits promised under Equitable's cash balance plan to a 25-year-old is certainly more valuable than the 5-year guarantee of such credits promised to a 60-year old.

a single policy applies to both defined benefit and defined contribution plans, a single statutory provision does the job for both kinds of retirement arrangements. [D]ifferent statutory provisions are used for defined contribution and defined benefit plans only to implement different policies for each." *Cooper* Critique at 24-25 (providing examples).

Take, for example, § 401(a)(4) of the Internal Revenue Code, which contains Title II of ERISA. Section 401(a)(4) imposes a discrimination test that is similar in many ways to the discrimination test that applies under ERISA § 204(b)(1)(H) – only it prohibits a pension plan from discriminating against *non-highly compensated* employees instead of against *older* employees. Section 401(a)(4) is a single provision that applies to both defined contribution and defined benefit plans: it explicitly permits each type of plan to be tested for income discrimination on the basis of *either* "contributions or benefits."

Contrast this with the two distinct standards that Title I of ERISA sets forth for purposes of testing age discrimination: ERISA § 204(b)(1)(H) requires a defined benefit plan to be tested based on *benefits*; a separate provision, ERISA § 204(b)(2), requires a defined contribution plan to be tested based on *contributions*. If Congress meant the two standards to be interchangeable, it would have followed the model of IRC § 401(a)(4) and written a single rule setting forth a

uniform standard applicable to both types of plans. The fact that Congress did not do so undermines Judge Easterbrook's analysis: IRC § 401(a)(4) demonstrates that Congress knows how to write a discrimination test that establishes the same testing standard for both defined contribution and defined benefit plans.

Section 401(a)(4) is interesting here for a different reason as well. For purposes of testing its cash balance plan for *income* discrimination under IRC § 401(a)(4), Equitable almost certainly measures "benefits" by reference to the projected age-65 annuity – not account balances. Equitable does this because it can then take into account the value of the future interest credits promised to younger, typically lower-paid employees – which means the "benefits" accrued by these low paid employees are much larger for purposes of the test than if only the current account balances were used. So although Equitable presumably takes future interest credits into account when it helps them (*i.e.*, for purposes of testing *income* discrimination) – it seeks to ignore the same interest credits when it hurts them (*i.e.*, for purposes of testing age discrimination). But there is absolutely no basis in law or policy for the different treatment. Equitable should not be able to have it both ways.

Cash balance apologists often use the regulations promulgated under IRS § 401(a)(4) to make a different point. Because the regulations address cash

balance plans, they argue, the IRS must not think cash balance are *per se* unlawful. We agree that cash balance plans are not *per se* unlawful. (*See also* Appellants' opening brief p. 30 and AARP's brief making the same point). As Professor Zelinsky has explained, a cash balance plan that provided pay credits that increased at the same rate as interest credits decreased, it would not have discriminated based on age. Zelinsky, *The Cash Balance Controversy*, 19 Va. Tax Rev. 683, 734-35 (Spring 2000). The problem is that Equitable decided not to structure its plan that way.

CONCLUSION

Ever since the first cash balance plan conversions in 1985, cash balance sponsors and their advisors have been concerned that the plans violate ERISA's age discrimination standards. For almost as long, they have been trying to change the law to "legalize" designs implemented recklessly. In the Pension Protection Act of 2006, sponsors' efforts finally paid off, in part, and Congress changed the law prospectively. However, despite vigorous lobbying, sponsors did not receive the requested retroactive amnesty. Instead, Congress sent a clear message that the change in law applied prospectively only – sponsors would have to face the consequences of their past behavior.

Judge Easterbrook, evidently in agreement with the new standard Congress

established for periods after June 29, 2005, concluded that it was not "sensible" to hold sponsors to a different standard for periods before PPA's effective date. He therefore decided to do what Congress had expressly declined to do in PPA, and extended amnesty to plans within the Seventh Circuit for past noncompliance – bailing out plan sponsors at the expense of their employees. This Court should not do the same.

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Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

Pursuant to Federal Rule of Appellate Procedure 32(a)(7)(c), the undersigned certifies that this brief complies with the type-volume limitations of Federal Rule of Appellate Procedure 32(a)(7)(B).

1. Exclusive of the exempted portions of the brief, as provided in Fed. R. App. P. 32(a)(7)(B)(iii), this brief includes 6,892 words. As permitted by Fed. R. App. P. 32(a)(7)(c), the undersigned relied upon the word count of this word-processing system in preparing this certificate.

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6). This brief has been prepared in proportionally-spaced typeface using Word in 14 point type, Times New Roman font.

Dated: March 29, 2007

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CERTIFICATE OF FILING AND SERVICE

I do hereby certify that the foregoing brief for Amicus Curaie Pension Rights Center was submitted in PDF version to Clerk of the Court as well as the original and nine copies of the Brief to be served by Federal Express overnight delivery and an electronic PDF version of this brief were emailed to all parties along with two copies.

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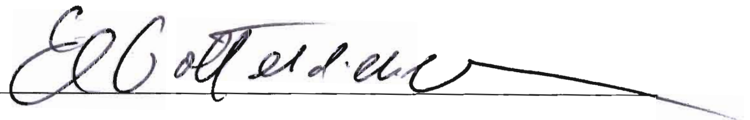
(Your Signature)

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