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The Seventh Circuit Reverses the Disastrous IBM Cash Balance Plan Ruling

By Stephen Harris and Ethan Lipsig

On August 7, 2006, cash balance plan sponsors breathed a collective sigh of relief when the Seventh Circuit ruled that IBM's cash balance plan did not violate the age discrimination proscriptions set forth in the Employee Retirement Income Security Act (ERISA). *Cooper v. IBM Personal Pension Plan*, -- F.3d --, No. 05-3588, 2006 WL 2243300 (7th Cir. Aug. 7, 2006). In reversing the district court, the 7th Circuit became the first circuit court to weigh in on this issue. By ironic coincidence, Congress passed the Pension Protection Act at just about the same time, creating a prospective age discrimination safe harbor for cash balance plans, effective June 29, 2005. President Bush is expected to sign this law in a few days. These two developments do great damage to the theory that cash balance plan designs necessarily discriminate on account of age, even if they do not nail the lid on the coffin on it for the period before June 29, 2005.

Cash balance plans are defined benefit plans. ERISA Section 204(b)(1)(H) provides that:

> a defined benefit plan shall be treated as not satisfying the requirements of this paragraph [prohibiting age discriminatory benefits] 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.

In 2003, the district court held that IBM's cash balance plan violated this provision. In reaching this conclusion, the district court recognized that ERISA does not define the term "benefit accrual." Therefore, the court borrowed ERISA Section 3(23)'s definition of the term "accrued benefit":

> [The term "accrued benefit" means with respect to a defined benefit plan] the individual's accrued benefit determined under the plan and . . . expressed in the form of an annual benefit commencing at normal retirement age.

This approach made it a foregone conclusion that IBM plan benefits discriminated on account of age. Obviously, a 20 year old participant whose account is credited with $500 would have a larger annual benefit based on that contribution at age 65 than a 45 year old participant credited with the same $500. This is due to the time value of money; the 20 year old would have 25 more years of interest credits than the 45 year old.

On appeal, the Seventh Circuit disagreed with the fundamental premise of the district court's analysis – that the time value of money constitutes illegal age discrimination – and reached a very different conclusion – that IBM's cash balance plan did not violate Section 204(b)(1)(H). In doing so, the Seventh Circuit noted that defined contribution plans do not illegally discriminate on the basis of age under ERISA Section 204(b)(2)(A) (the defined contribution plan analog of Section 204(b)(1)(H)), even though younger participants have the opportunity to earn more because of the time value of money than older participants. The Seventh Circuit agreed with IBM that Section 204(b)(1)(H) "does not whimsically require a court to find age discrimination for a defined benefit plan when materially identical statutory language allows functionally identical defined contribution plans to operate without any taint of discrimination." *Cooper*, 2006 WL 2243300, at *5.

The lynchpin of the Seventh Circuit's decision is its holding that the term "benefit accrual" does not mean the same thing as "accrued benefit," but actually means "what the employer puts in (either in absolute terms or as a rate of change)." *Id.* at *2. In support of this conclusion, the Seventh Circuit agreed with the Treasury Department's proposed cash balance plan regulations, which define the term "benefit accrual" as "the additions to the participant's hypothetical account for the plan year."

One other issue that has concerned many practitioners is whether employers that switch from one non-discriminatory benefit plan structure to another might face disparate impact claims if the new benefit structure is comparatively worse for older plan participants. Although there are few cases on point, the Seventh

Circuit's *Cooper* decision flatly states that such changes are non-discriminatory. *Id*. at *6 (stating that "[r]eplacing a plan that discriminates against the young with one that is age-neutral does not discriminate against the old. . . . An employer is free to move from one legal plan to another legal plan, provided that it does not diminish vested interests . . . .").

On the second Tuesday of each month, our ERISA Practice Group hosts a complimentary teleconference, the ERISA Litigation Forum, at which we discuss recent ERISA litigation developments. We invite you to join us on September 12, 2006 for our 12:00 EDT call, during which we will discuss the IBM cash balance plan decision, the Coan decision in the Second Circuit, and the Maryland "Wal-Mart" case. Please visit www.paulhastings.com/events and select "teleconference" from the "event type" dropdown for more information.

If you have any questions regarding this alert, please contact any of the following members of the ERISA Practice Group:

Stephen H. Harris 213-683-6217
stephenharris@paulhastings.com

Ethan Lipsig 213-683-6304
ethanlipsig@paulhastings.com

J. Mark Poerio 202-551-1780
markpoerio@paulhastings.com

Caroline Elkin 213-683-6204
carolineelkin@paulhastings.com

Scott M. Flicker 202-551-1726
scottflicker@paulhastings.com

Eric R. Keller 202-551-1770
erickeller@paulhastings.com

Patrick W. Shea 203-961-7403
patrickshea@paulhastings.com

Jeffrey D. Wohl 415-856-7255
jeffwohl@paulhastings.com

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