DOES THE CASH EVER BALANCE AFTER CONVERSION?: AN EXAMINATION OF CASH BALANCE PENSION PLAN CONVERSIONS AND ADEA CLAIMS

Joshua A. Rodine

The author, Mr. Rodine, addresses the relationship between the Age Discrimination in Employment Act (ADEA), which protects employees from discrimination on the basis of age, and employers' conversions from defined benefit pension plans to cash balance pension plans. In recent years, economic forces have driven many employers to convert to cash balance pension plans, which are more favorable to younger workers. Mr. Rodine explores the legality of cash balance conversions under the ADEA. The author analyzes the cases that have considered whether the ADEA requires disparate impact analysis to be applied to cash balance conversions. Mr. Rodine concludes that the legislature should act to resolve the controversy surrounding the legality of cash balance conversions and the issue of age discrimination.

Joshua A. Rodine is a Notes Editor 2001–2002, Member 2000–2001, *The Elder Law Journal*; J.D. 2002, University of Illinois, Urbana-Champaign; M.A. 1999, University of Maryland, College Park; B.A. 1996, University of California, Santa Barbara.

The author wishes to thank: Professor Kaplan for introducing him to this complex and very topical area of the law; Professor Zelinsky for his helpful commentary; the Board of Editors and the members of The Elder Law Journal; Mike Reig; Erin Ziaja; and his parents for their assistance, patience, and support.

I. Introduction

The notion that one will remain with a single employer for the duration of one's professional life has become antiquated. Gone are the days when individuals expected to spend thirty years in one job, receiving a retirement party and a gold watch at the end of one's service. In this modern culture of headhunters, ever expanding economies, and greater professional mobility, it is far more likely that an individual will work for a number of employers during the individual's lifetime.[1]

Current employment trends have given rise to a variety of statutes regulating this modern employment environment. The Age Discrimination in Employment Act (ADEA)[2] was enacted by Congress in an attempt to protect the country's older workers from being discriminated against on the basis of age.[3] Because people are both living and working longer, they have come to depend more heavily on retirement benefits.[4] Consequently, Congress enacted the Employee Retirement Income Security Act (ERISA)[5] to regulate the vesting and accrual of pension benefits.[6] The Internal Revenue Service (IRS) has also

1. *See* Edward A. Zelinsky, *The Cash Balance Controversy*, 19 VA. TAX REV. 683, 731 (2000). "Forty percent of 1,383 employees polled for CareerPath.com., an Internet newspaper-jobs site, say they are likely to change jobs this year." *Id.* at 762 (citation omitted).

2. 29 U.S.C. §§ 621–34 (1994). "It shall be unlawful for an employer—(1) [t]o fail or refuse to hire or to discharge any individual or otherwise discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's age . . . ." *Id.* § 623.

3. MARK A. ROTHSTEIN, EMPLOYMENT LAW § 2.37 (2d ed. 1999).

4. *Cf.* John Thacher McNeil, Note, *The Failure of Free Contract in the Context of Employer-Sponsored Retiree Welfare Benefits: Moving Towards a Solution*, 25 HARV. J. ON LEGIS. 213, 219 (1988) (discussing the need for expanded retiree medical benefits as a function of increasing life spans).

5. 29 U.S.C. §§ 1001–1461.

6. ROTHSTEIN, *supra* note 3, § 10.2.

> Each pension plan shall provide that an employee's right to his normal retirement benefit is nonforfeitable upon the attainment of normal retirement age and in addition shall satisfy the requirements of paragraphs (1) and (2) of this subsection.
>
> (1) A plan satisfies the requirements of this paragraph if an employee's rights in his accrued benefit derived from his own contributions are nonforfeitable.
>
> (2) A plan satisfies the requirements of this paragraph if it satisfies the requirements of subparagraph (A) or (B).
>
> (A) A plan satisfies the requirements of this subparagraph if an employee who has completed at least 5 years of service has a nonforfeitable right to 100 percent of the employee's accrued benefit derived from employer contributions.

become involved in the evolution of the American workforce as the agency charged with enforcement of congressionally mandated conditions that must be met for employers to receive protection under various types of pension plans.[7]

The above regulatory background, in conjunction with the efforts of employers to evolve with their workforces, has given rise to controversial pension programs, some of which have become the subject of litigation.[8] Claims have been brought by older employees who have alleged that their employers' pension plans, and plan conversions, are impermissibly discriminatory under the ADEA inter alia.[9]

The purpose of this note is to determine whether appellate and district courts considering possible conflicts between employers' pension plans, and plan conversions, and the ADEA have been correct in their holdings,[10] as well as to provide a recommendation to future

> (B) A plan satisfies the requirements of this subparagraph if an employee has a nonforfeitable right to a percentage of the employee's accrued benefit derived from employer contributions determined under the following table:
> if years of service is 3, the nonforfeitable percentage is 20; if years of service is 4, the nonforfeitable percentage is 40; if years of service is 5, the nonforfeitable percentage is 60; if years of service is 6, the nonforfeitable percentage is 80; if years of service is 7 or more, the nonforfeitable percentage is 100.

29 U.S.C. § 1053(a) (1994 & Supp. IV 1998).

7. *E.g.*, I.R.C. § 401(a)(4) (1994 & Supp. IV 1998).

> (a) Requirements for qualification.—A trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust under this section—
> (4) if the contributions or benefits provided under the plan do not discriminate in favor of highly compensated employees (within the meaning of section 414(q)).

Id.

8. *See* Goldman v. First Nat'l Bank of Boston, 985 F.2d 1113 (1st Cir. 1993); Eaton v. Onan Corp., 117 F. Supp. 2d 812 (S.D. Ind. 2000).

9. *See* sources cited *supra* note 8. Even when not giving rise to litigation, the threat of suit based on the above claims has been sufficient to cause employers to modify proposed pension plan conversions. *See infra* text accompanying notes 119–23.

10. Neither of the courts addressing the issue have found either the plans themselves, nor the consequences of plan conversion to be violative of the ADEA. *See* sources cited *supra* note 8. It will later be argued that the holdings of these cases must be limited to the facts specific to them. As a consequence of such limiting precedential value, and the expansion of a disparate impact analysis to the ADEA that will be argued for as well, the Supreme Court should, when confronting fact patterns differing from *Goldman* and *Eaton*, find the conversion of pension plans from traditional defined benefit to cash balance violative of the ADEA. *See infra* Part IV.

courts that will no doubt encounter similar issues. Part II of the note briefly examines the legal and historical background against which the ADEA was passed, as well as the relevant economic factors underlying pension plan conversions.[11] Part III presents, in greater detail, the specifics of the pension plans at issue.[12] Part III also examines the precedential basis for the cases alleging ADEA violations based on conversions to cash balance plans and, with an emphasis on predicting future outcomes, the holdings in these recent cases.[13] In Part IV, it will be suggested that the issues surrounding the legality of cash balance plan conversions should be resolved in the legislature;[14] if not for the ambiguities present in the language of 29 U.S.C. § 623,[15] and I.R.C. § 411,[16] there would be no legal controversy surrounding plan conversions.[17] Additionally, a recommendation is made as to how the courts should treat future cases should legislative resolution of the issue prove impossible.[18] Part V summarizes the foregoing sections and provides a brief restatement of the conclusions reached in Part IV.[19]

II. Background

A. Age Discrimination in Employment Act

1. PURPOSE

In 1967, in response to a study conducted by the Secretary of Labor, Congress enacted the ADEA.[20] The Act was passed on the heels

11. *See infra* Part II.
12. *See infra* Parts III.A, III.B.
13. *See infra* Parts III.C, III.D.
14. *See infra* Part IV.
15. *See* 29 U.S.C. § 623(a) (1994). The language, "because of such individual's age," has proved particularly problematic for the courts in dealing with claims brought under the ADEA. *E.g.*, Hazen Paper Co. v. Biggins, 507 U.S. 604 (1993); *cf.* City of Los Angeles, Dep't of Water & Power v. Manhart, 435 U.S. 702 (1978) (holding that conceding discrimination on the basis of actuarial data does not avoid the Title VII requirement that an employer not discriminate "because of" sex).
16. I.R.C. § 411(b)(1)(H)(i) (1994). "Notwithstanding the preceding subparagraphs, 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*." *Id.* (emphasis added).
17. As will later be discussed, current congressional proposals would mitigate the confusing application of the language in the aforementioned statutes by specifying particular employer actions that would be violative of said statutes. *See infra* Part IV.
18. *See infra* Part IV.
19. *See infra* Part V.
20. MACK A. PLAYER, EMPLOYMENT DISCRIMINATION LAW § 6.01(a) (1988).

of the 1964 Civil Rights Act,[21] and for this reason they are extremely similar in coverage and scope.[22] Much like congressional intent re-

21. 42 U.S.C. § 2000e-2 (1994).

22. PLAYER, *supra* note 20. The similarity between the Civil Rights Act and the ADEA is illustrated by the similarities between the definitions of "employer" and "employer practices" in the statutes. The Civil Rights Act provides:

> (b) The term "employer" means a person engaged in an industry affecting commerce who has fifteen or more employees for each working day in each of twenty or more calendar weeks in the current or preceding calendar year, and any agent of such a person, but such term does not include (1) the United States, a corporation wholly owned by the Government of the United States, an Indian tribe, or any department or agency of the District of Columbia subject by statute to procedures of the competitive service (as defined in section 2102 of Title 5), or (2) a bona fide private membership club (other than a labor organization) which is exempt from taxation under section 501(c) of Title 26, except that during the first year after March 24, 1972, persons having fewer than twenty-five employees (and their agents) shall not be considered employers.

42 U.S.C. § 2000e-2(b) (1994).

> (a) Employer practices
> It shall be an unlawful employment practice for an employer—
> (1) to fail or refuse to hire or to discharge any individual, or otherwise to discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's race, color, religion, sex, or national origin; or
> (2) to limit, segregate, or classify his employees or applicants for employment in any way which would deprive or tend to deprive any individual of employment opportunities or otherwise adversely affect his status as an employee, because of such individual's race, color, religion, sex, or national origin.

Id. § 2000e-2(a). The ADEA provides:

> (b) The term "employer" means a person engaged in an industry affecting commerce who has twenty or more employees for each working day in each of twenty or more calendar weeks in the current or preceding calendar year: *Provided*, that prior to June 30, 1968, employers having fewer than fifty employees shall not be considered employers. The term also means (1) any agent of such a person, and (2) a State or political subdivision of a State and any agency or instrumentality of a State or a political subdivision of a State, and any interstate agency, but such term does not include the United States, or a corporation wholly owned by the Government of the United States.

29 U.S.C. § 630(b) (1994).

> (a) Employer practices
> It shall be unlawful for an employer—
> (1) to fail or refuse to hire or to discharge any individual or otherwise discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's age;
> (2) to limit, segregate, or classify his employees in any way which would deprive or tend to deprive any individual of employment opportunities or otherwise adversely affect his status as an employee, because of such individual's age; or

garding the Civil Rights Act, the ADEA was intended by Congress to prohibit the creation of arbitrary barriers to the securing and retention of employment, as well as the conditions thereof, that were related to the individual's age.[23]

2. PROTECTED CLASS

When the Act was first passed, it protected employees who were at least forty and not more than sixty-five years old.[24] The Act was amended in 1978 and protection was made available to employees between the ages of forty and seventy.[25] In 1986, Congress removed the upper limit on protection so that now, with relatively few exceptions, all employees over the age of forty are protected by the Act.[26]

3. PROHIBITED ACTIONS

As previously mentioned, the Act is designed to prevent discrimination on the basis of age.[27] Specific actions prohibited by § 623(a) of the Act include failing or refusing "to hire or to discharge any individual or otherwise discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's age."[28] The Act also prohibits the "limit[ing], segregat[ing], or classify[ing of] employees in any way which would deprive or tend to deprive any individual of employment opportunities or otherwise adversely affect his status as an employee, because of such individual's age."[29]

B. Pension Plans

1. DEFINED BENEFIT PLANS

The defined benefit pension plan has been, until recently, the most common type of retirement plan.[30] Under this type of plan,

---

(3) to reduce the wage rate of any employee in order to comply with this chapter.

Id. § 623(a).

23. 29 U.S.C. §§ 621, 623.
24. PLAYER, *supra* note 20, at § 6.01(c).
25. *Id*.
26. *Id*.
27. 29 U.S.C. § 621.
28. *Id.* § 623(a)(1).
29. *Id.* § 623(a)(2).
30. Howard Shapiro & Robert Rachal, *Litigation Issues in Cash Balance Plans*, Benefits Link, *at* http://www.benefitslink.com, at I (last visited Nov. 21, 2000). As

upon retirement the employee receives an annuity that is usually a function of the employee's salary and the employee's years of service.[31] These plans are generally thought to favor older workers because of the formula that is applied to the above criteria.[32]

2. PLAN CONVERSION MOTIVATED BY ECONOMICS

The most typical reason offered by employers for the conversion from a defined benefit plan to a cash balance plan is the latter's appeal to younger workers.[33] Because of the calculation and payment of benefits under a cash balance plan, i.e., employees leaving a company prior to retirement receive higher benefits than under a defined benefit plan,[34] the cash balance plan is thought to be more desirable for those employees that will be working for a number of employers over the course of their professional careers.[35] However, upon examining the implications of this type of plan versus the traditional defined benefit plan, it becomes clear that the motivation for adopting such plans is to save money.[36]

III. Analysis

A. Defined Benefit Plans

1. "BACK LOADING"

The typical defined benefit pension plan is also known as a "final average" plan because of the formula used to derive the annuity payable to the employee upon retirement.[37] The formula requires taking an average of the employee's final years of employment and multiplying it by a factor representing some fraction of the number of years of service.[38] The emphasis, under the defined benefit plan, on the final years of service has caused the traditional plan to be thought

---

will be noted later, since the first conversion to a cash balance pension plan in 1985, twenty-two of the Fortune One-Hundred companies have abandoned their traditional defined benefit plans in favor of the newer cash balance plan. *Id*.

31. Zelinsky, *supra* note 1, at 687.
32. Jonathan Barry Forman, *Professor Responds to Cash-Balance Pension Plan Article*, 20 TAX NOTES 141, Feb. 1, 1999.
33. *E.g.*, Zelinsky, *supra* note 1, at 707.
34. *Id.* at 699–700.
35. *See*, *e.g.*, Shapiro & Rachal, *supra* note 30, at II.A. This is setting forth the portability argument.
36. *E.g.*, Forman, *supra* note 32.
37. *E.g.*, Zelinsky, *supra* note 1, at 687.
38. *Id*.

of as "backloaded," i.e., employees accrue the bulk of their pension benefits in their final years of employment, when their salaries are higher.[39]

Suppose an employer has a defined benefit plan in place that operates using the following final average formula to calculate an individual's annuity upon retirement:

{[(salaries for years 1 + 2 + 3 before retirement)/3] x .5} x (number of years of service)/30.[40]

If an employee has worked at annual salaries of $20,000, $25,000, and $30,000 and has only been employed for those three years, the employee's annuity upon retiring would be $1250. If the same employee worked for this company for thirty years and received moderate salary increases, such that in the final three years of employment the employee's salary was $70,000, $75,000, and $80,000, the annuity upon retiring would be $37,500. Two things account for the disparity between the two annuities. As the employee works longer for the company, the years of service fraction becomes larger. Also, with the increases in salary that normally accompany extended employment, the "final average" increases. A change in either of these factors, independent of the other would produce a significant increase in the annuity to be received upon retirement. But, when combined, it becomes clear why the traditional plan is thought to be "backloaded"; it is only at the end of a career that one begins to "accrue" substantial benefits.[41]

2. OTHER STRUCTURAL FEATURES

Under a traditional defined benefit plan, an employer pays money into a fund that will produce the annuity the employee is entitled to upon retirement. This means that as the employee reaches retirement age, the employer is forced to contribute more money on an annual basis.[42] This is a function of the time value of money; as the time period until retirement decreases, the money put into the fund by the employer has less opportunity to accumulate interest, thereby resulting in a greater burden being placed on the employer to make sure the necessary annuity funds are available upon an employee's retirement.[43] Because the employer is obligated to devote a greater amount

39. *Id*. at 688.
40. *Id*. at 688 & n.9.
41. *Id*. at 689.
42. *Id*. at 690.
43. *Id*. at 690–91.

of cash flow to funding its pension fund, there is an undesirable opportunity cost created.

The above fact, regarding how the funds become the annuity, makes traditional defined benefit plans unattractive to some employers. But, there is an additional risk borne by employers under a defined benefit plan that intensifies the above problem. Because a traditional plan guarantees the annuity beginning upon retirement, but not the interest rate at which the fund will grow, since this is a function of whatever the current interest rate may be, the employer bears the additional burden of funding a plan subject to variable interest rates.[44] It should be noted that while the employer risks the possibility of a decrease in the interest rate, thereby necessitating larger contributions, the employer also stands to gain if the interest rate on the fund increases. This benefit to the employer is a result of the employer being able to contribute less for each employee because the interest rate is growing the fund faster than is necessary to ensure that each employee's retirement annuity is available upon retirement.[45]

B. Cash Balance Plans

Although the cash balance plan has only been in use since 1985,[46] at present it is estimated that twenty-two of the Fortune 100 companies have adopted such plans.[47] These plans are classified by the IRS as defined benefit plans, but, because they are significantly different, structurally, they have proved very attractive to some employers.[48]

1. "FRONT-LOADING"

As previously discussed, defined benefit plans have been referred to as "back-loading" because of the benefit accrual emphasis that is placed on an employee's later years of service and the salary received during these years.[49] Unlike the traditional defined benefit plan, the cash balance defined benefit format has been characterized as "front-loaded."[50] This description is applied to the plans because

44. *E.g.*, Shapiro & Rachal, *supra* note 30, at II.A.
45. *Id*.
46. *See* Lee A. Sheppard, *The Down-Aging of Pension Plans*, 6 TAX NOTES 6, Jan. 11, 1999.
47. Shapiro & Rachal, *supra* note 30, at I.
48. *Id*. at II.A.
49. *See supra* note 38 and accompanying text.
50. Sheppard, *supra* note 46.

the size of the annuity received upon retirement is primarily a function of benefits received in the early years of employment.[51]

2. PAY CREDITS AND INTEREST CREDITS

The general structure of a cash balance plan is that each employee has a hypothetical account that is annually credited with both pay and interest credits.[52] If an employee is receiving a salary of $25,000 and the plan provides for an annual contribution of fifteen percent of the employee's salary, the employee's "pay credit" for that year would be $3750. The plan will have a specified interest rate that attaches to the employer's annual contribution based on salary.[53] If the hypothetical interest rate for the above plan is six percent, in the first year of participation the "interest credit" applied to the employee's account would be $225. This means that at the end of the first year of participation the employee's hypothetical account would reflect a balance of $3975. At this point, it is important to note the actual difference between the cash balance approach and the defined benefit approach. In the first year of employment under a defined benefit plan, the same employee would be entitled to an annuity of $417.[54] Such an annuity would only have a present value of $380.78.[55] Under the cash balance scheme, an employee that decided to retire after this first year of employment would receive $3633.[56] The difference can be accounted for by the fact that the employee under the cash balance scheme receives both principal and credit for the anticipated interest on the annual contribution now, whereas the employee under the traditional defined benefit scheme does not receive either principal or interest until the annuity begins.

3. WEAR AWAY

Some cash balance plans contain a feature that does not permit an employee to begin accruing benefits immediately after conversion

51. *See id*.
52. Zelinsky, *supra* note 1, at 693.
53. *See id*.
54. Applying the above defined benefit formula: ($25,000 x .5) x 1/30 = $417.
55. The actuarial and interest rate assumptions here are borrowed from Zelinsky, *supra* note 1, at 690 n.17, 697 n.49. Applying the formula for present dollar value: $417 x (9.196/(1.08^{30})) = $381.
56. Applying the formula for present dollar value: $3975 x (9.196/(1.08^{30})) = $3633.

from a traditional defined benefit plan.[57] This feature of cash balance plans requires an employee's hypothetical account to equal the amount of the employee's previously accrued benefit before the employee can begin to accrue additional pension funds.[58] If an employee under a traditional defined benefit plan earned an annuity equal to a present dollar amount of $25,000, and the new cash balance scheme, when applied retroactively to the beginning of the employee's employment provided the employee with a hypothetical account balance of $17,000, the employee would not be eligible to accrue any new benefits until her hypothetical account balance was $25,000.[59] In some instances, companies converting from traditional defined benefit plans to cash balance plans begin employees' accounts at zero.[60] This means it would take even longer for an employee to begin to accrue new benefits under the conversion. It is this period during which the employee accrues no new benefits that is described as "wear away," because the employee does not begin to accrue new benefits until the difference between the plans has worn away.[61]

C. Disparate Impact Analysis

1. *GRIGGS V. DUKE POWER CO.*[62]

Title VII of the Civil Rights Act of 1964 prohibits employers from "fail[ing] or refus[ing] to hire . . . any individual, or otherwise to discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's race, color, religion, sex, or national origin."[63] The phrase "because of" traditionally has required showing that the employer intended to discriminate when adopting the adverse consequence-producing action.[64] The Court's holding in *Griggs v. Duke Power Co.* made clear that an individual could pursue an action under Title VII, § 703 even when the employer's policy was facially neutral, i.e., the employer's motivation was not a factor.[65]

57. Zelinsky, *supra* note 1, at 702.
58. *Id*.
59. *See* Shapiro & Rachal, *supra* note 30, at III.A.2.
60. Zelinsky, *supra* note 1, at 702.
61. Shapiro & Rachal, *supra* note 30, at III.A.2.
62. 401 U.S. 424 (1971).
63. 42 U.S.C. § 2000e-2(a)(1) (1994).
64. PLAYER, *supra* note 20, at 270.
65. *See Griggs*, 401 U.S. at 430.

According to *Griggs,* the employee must first prove that a device or system used by the employer adversely impacts one of the protected classes.[66] After making this initial showing, the prima facie case, the burden shifts to the employer, such that the employer must then show that use of the device or system is a matter of "business necessity."[67] To satisfy this burden, the employer must prove that a "manifest relationship" exists between the adversely impacting device and a "bona fide and significant business purpose[]."[68] If the employer is successful in carrying this burden, the employee is afforded the opportunity to present evidence that the employer had available to it devices that would have served the desired ends while not having an adverse impact on a protected class.[69]

a. Prima Facie Case An employee has two primary ways of demonstrating that a device has an adverse impact on a protected class.[70] The employee may make a statistical showing that the "pool" of which the employee is a member is adversely impacted by the device.[71] In *Griggs,* the employer had a hiring requirement mandating that applicants have high school diplomas.[72] The plaintiffs in that case were able to show that of the relevant pool of applicants, consisting of people in the employer's state, thirty-four percent of white men had diplomas, and only twelve percent of black men had the required diplomas.[73] The Court found this evidence to be sufficient to establish that the hiring device used by the employer had an adverse impact on a protected class.[74]

b. Burden Shifting As noted above, once the plaintiff/employee has shown a device to have an adverse impact on a protected class, the burden of persuasion shifts to the defendant/employer to prove that use of the device is a matter of business necessity.[75] The concept

66. PLAYER, *supra* note 20, at 356.
67. *Id*.
68. *Id*.
69. *Id*.
70. *Id*. at 357. For the purpose of this note, only one of these methods of establishing the prima facie case will be considered.
71. *Id*. at 358.
72. *Id*.
73. *Id*.
74. *Id*.
75. *See supra* text accompanying notes 65–68.

of business necessity has not been well defined by the Supreme Court, and for that reason it is difficult to articulate exactly what it means to show a "manifest relationship" between a device and a business purpose.[76] However, it should be noted that rarely have the courts found an employer's claim of financial necessity sufficient to meet the burden.[77] Assuming an employer is able to satisfy the burden of proving business necessity, the burden shifts back to the employee who must now prove that the device in question is not necessary for the employer to be able to operate safely and efficiently.[78]

2. APPLICABILITY TO THE ADEA

a. Disparate Impact Analysis Related to Gender Under Title VII In *City of Los Angeles, Department of Water & Power v. Manhart*,[79] the Court applied a disparate impact analysis to the employee's claim that the employer had discriminated against her "because of" sex by requiring female employees to pay more into a pension fund than male employees.[80] The plaintiff argued that the employer's requirement, which resulted in smaller take home pay for the women, violated Title VII because it discriminated on the basis of sex.[81] The employer countered by arguing that it was permissibly discriminating on the basis of the actuarial data, which happened to manifest a positive correlation to gender. In other words, the employer was not discriminating against women as a class, but rather those individual employees that happened to be women.[82] The Court's decision to apply a disparate impact analysis in *Manhart* made two things clear: (1) it will be difficult for an employer to craft a defense around actuarial data, arguing that the alleged discrimination is not "because of" protected class membership,[83] and (2) cost does not constitute a valid business necessity defense.[84]

76. *See* PLAYER, *supra* note 20, at 367.
77. *E.g.*, Watson v. Fort Worth Bank & Trust, 487 U.S. 977, 998 (1988) (stating that cost or other burdens imposed by implementing nondiscriminatory alternatives are relevant to determination of effectiveness).
78. PLAYER, *supra* note 20, at 356.
79. 435 U.S. 702 (1978).
80. *See id*.
81. *See id*.
82. *See id*. at 702–03.
83. *See id*. at 716; *see also* Ariz. Governing Comm. v. Norris, 463 U.S. 1073 (1983) (holding that employer offering employees choice of company to receive benefits from, all of whom pay lower benefits to women than men who have made equal contributions, constitutes illegal discrimination under Title VII). *But see*

b. Relation Between Title VII and the ADEA In subpart II.A.1. of this note, the similarities between Title VII and the ADEA were briefly discussed.[85] It was noted that the Acts are virtually identical in terms of scope and substance.[86] For this reason the courts have applied the prohibition against discrimination in "compensation, terms, conditions, or privileges of employment, because of such individual's age"[87] in ways similar to that under Title VII.[88] There are, however, significant differences; a disparate impact analysis under the ADEA does not require a showing of "business necessity" when the burden has shifted to the employer, rather, the employer must show that some "reasonable factor[] other than age" was the basis for use of the device, or action, in question.[89]

The classic example of a reasonable factor other than age, and one often cited by cash balance plan defenders,[90] can be found in *Hazen Paper Co. v. Biggins*.[91] In *Hazen Paper*, the Court held that termination of an employee because the employee's pension was about to vest did not constitute a violation of the ADEA.[92] The Court reached this result because "age and years of service are analytically distinct," such that discharging an employee on the basis of the latter was permissible on grounds of being a reasonable factor other than age.[93]

c. Disparate Impact and the ADEA—the Holdings Although Title VII of the Civil Rights Act has been amended to specifically authorize

Abenante v. Fulflex, Inc., 701 F. Supp. 296, 300 (D.R.I. 1988) (holding that it is unlikely that Congress intended for the ADEA to prohibit the use of actuarial data).

84. PLAYER, *supra* note 20, at 173.
85. *See supra* note 22 and accompanying text.
86. *Id*.
87. 29 U.S.C. § 623(a)(1) (1994).
88. PLAYER, *supra* note 20, at 542.
89. *Id*. at 543.
90. *See*, *e.g.*, Morton Bahr, *Employment Lawyer's Remarks at Senate Hearing on Pension Plans*, 183 TAX NOTES 25, Sept. 22, 1999; Michael S. Horne, *ERISA Industry Committee Report on Legality of Cash Balance Plans*, 183 TAX NOTES 33, Sept. 22, 1999.
91. *See* Hazen Paper Co. v. Biggins, 507 U.S. 604 (1993).
92. *Id*.
93. *Id*. at 611. It should be noted that this case was brought under a disparate treatment theory and not one of disparate impact. *See id*. at 609. The Court noted that it had never decided whether a theory of disparate impact could be supported by the ADEA. *See id*. at 610. Defenders of cash balance plans have taken the holding in *Hazen Paper* to suggest that a disparate impact analysis is in fact inappropriate under the ADEA. *See* sources cite *supra* note 91.

claims brought using a disparate impact analysis,[94] no similar amendment has been made to the ADEA. The lack of legislation recognizing disparate impact analysis under the ADEA, and the fact that the Supreme Court has not issued a decision indicating the acceptability of such an analysis, makes it very much an open question as to whether the ADEA should be read to accept such an analysis as the basis for a claim.[95] In spite of the fact that the Supreme Court has not issued a dispositive opinion recognizing disparate impact analysis under the ADEA, a number of circuit courts have held that the ADEA does recognize such an analysis.[96]

3. RULING OUT THE "BOTTOM LINE" ARGUMENT

In *Connecticut v. Teal*,[97] the Court considered whether the "bottom line" could be used as a defense to a disparate impact claim and, also, if it could be used to preclude an employee from establishing a prima facie case of discrimination.[98] The relevant "bottom line" in *Teal* was the fact that although a promotion process disparately impacted black applicants at the first stage, ultimately a higher percentage of blacks than whites received the promotion.[99] The Court held that the bottom line was not sufficient to defend against the disparate impact claim.[100] Because the language of Title VII explicitly protects "any individual," and congressional intent was for the statute to have this effect, the fact that a device does not adversely impact all members of a protected class will not act as a defense once an employee has established a prima facie case of discrimination.[101]

94. 42 U.S.C. § 2000e-2(k) (1994).

95. *See supra* note 92; *cf.* DiBiase v. SmithKline Beecham Corp., 48 F.3d 719, 732 (3d Cir. 1995) (noting that the viability of a disparate impact claim under the ADEA is doubtful following the Supreme Court's decision in *Hazen Paper*).

96. *See* Smith v. City of Des Moines, Iowa, 99 F.3d 1466, 1470 (8th Cir. 1996); EEOC v. Local 350, Plumbers & Pipefitters, 998 F.2d 641, 648 (9th Cir. 1992); Geller v. Markham, 635 F.2d 1027, 1032 (2d Cir. 1980). *But see, e.g.*, Mullin v. Raytheon Co., 164 F.3d 696, 703–04 (1st Cir. 1999); Ellis v. United Airlines, Inc., 73 F.3d 999, 1009 (10th Cir. 1996).

97. *See* Connecticut v. Teal, 457 U.S. 440 (1982).

98. *See id*. at 440.

99. *See id*. at 444.

100. *Id*. at 442.

101. *See id*. at 454–55.

D. *Goldman*[102] and *Eaton*[103]

Despite cash balance plans having been actively used since 1985,[104] to date there have only been two cases litigated on the issue of whether cash balance plan conversions violate the ADEA.[105] Both courts addressing the issue have concluded that based on the facts of the respective cases, the cash balance plan conversions did not violate the ADEA.[106]

The first case reaching a court of appeals was *Goldman v. First National Bank of Boston*.[107] In this case, the employer introduced a new pension plan, a cash balance plan, that called for "decreasing percentages of salary" to be deposited to employee "accounts" upon reaching a specified number of years of service.[108] The plan also had a stated purpose of making the employer's plan "more attractive to the 85% of Bank employees for whom the former pension plan represented 'a benefit for the distant future.'"[109] The plaintiff argued that such a plan gave rise to an inference of impermissible discrimination based on age.[110] The court did not take note of the stated purpose of the pension plan conversion, but it did state that the facts pointed to by the plaintiff would only give rise to the inference of discriminatory animus, necessary for maintaining the action,[111] if it could be shown that the benefit the employee would receive under the new plan would be less than that to be received under the old plan.[112]

Under the employer's new plan, three classes of employees were defined: "fifty-five or older with ten years of service," "any age with

102. Goldman v. First Nat'l Bank of Boston, 985 F.2d 1113 (1st Cir. 1993).
103. Eaton v. Onan, 117 F. Supp. 2d 812 (S.D. Ind. 2000).
104. *See* Sheppard, *supra* note 46.
105. *See Goldman*, 985 F.2d at 1113; *Eaton*, 117 F. Supp. 2d at 812.
106. *Id*.
107. 985 F.2d at 1113.
108. *Id*. at 1119–20.
109. *Id*. at 1120.
110. *Id*. at 1119.
111. Because the court decided the case on a disparate treatment analysis the burden-shifting approach of *McDonnell Douglas Corp. v. Green* is applicable. McDonnell Douglas Corp. v. Green, 411 U.S. 792 (1973). This burden-shifting model allows the plaintiff an opportunity to rebut the defendant's articulated non-discriminatory reasons for the actions in question. *See id.* The burden-shifting model found in *Griggs* is also used in cases of individual disparate treatment when there is no direct evidence of such illegal discriminatory treatment. *See* PLAYER, *supra* note 20, at 328–29.
112. *Goldman*, 985 F.2d at 1120.

twenty years of service," and all others.[113] The plan required that upon retirement, for employees in either of the first two classes, benefits be calculated under both plans and that the employee receive the greater of the two benefits.[114] Because the employer's new plan had safeguards built in to prevent a loss in benefits to the employee, the court found that the facts adduced were insufficient to prove the employer's reasons for introducing the new plan[115] pretext for impermissible discriminatory practices.[116]

The second case litigated on the issue of pension plan conversion and ADEA violations was *Eaton v. Onan Corp*.[117] In this case, the plaintiffs attempted to make a disparate impact argument in support of their discrimination claim.[118] When converting from its prior, traditional, defined benefit plan to the new cash balance plan, the employer included a provision requiring that employees who had been participants in the old plan receive either a "minimum annuity," a "grandfather annuity," or the equivalent of the amount in their cash balance accounts upon retirement.[119] The plan prohibited employees taking either the grandfather annuity or the minimum annuity from receiving the benefit as an actuarially determined lump sum.[120]

The plaintiffs in *Eaton* argued that because everyone not entitled to receive either the minimum annuity or the grandfather annuity could receive the benefit upon retirement as a lump sum, the provision violated the ADEA by providing for a difference in benefits.[121] As noted above, the court treated this argument as one of disparate impact,[122] and rightly so. The court rejected the argument because the case was brought in the Seventh Circuit, and that circuit had previously held that "disparate impact claims are not cognizable under the

113. *See id*. It should be noted that the third class of employees defined is implied by the fact that nothing is explicitly stated about any class of employees other than the two classes explicitly defined. *See id.*

114. *See id*.

115. *See id*. at 1118. The employer claimed to be converting its plan to reduce costs. *Id.* Recall that although courts will rarely recognize financial necessity as sufficient to meet the "business necessity" burden of a disparate impact analysis, the cost of implementing a nondiscriminatory alternative device or plan may properly enter the employer's calculus. *See supra* note 76 and accompanying text.

116. *See Goldman*, 985 F.2d at 1120.

117. 117 F. Supp. 2d 812, 812 (S.D. Ind. 2000).

118. *Id*. at 837.

119. *Id*. at 820–21.

120. *Id*. at 821.

121. *Id*. at 837.

122. *Id*.

ADEA."[123] The court also addressed the plaintiffs' argument from the "bottom line" perspective.[124] The court stated that because receipt of the annuities (grandfather or minimum) was a benefit denied to younger employees, despite the prohibition on receiving the annuities as actuarially determined lump sums, "[i]f this is discrimination, it is discrimination in favor of older workers, not against them."[125] It should be noted that had the Seventh Circuit Court of Appeals recognized a disparate impact action under the ADEA, the court's statement would have violated the Supreme Court's ruling against the use of the "bottom line" defense in *Teal*.[126]

To restate the foregoing, in *Goldman* the court determined that because the conversion provided for employees to receive their maximum entitled benefit under either the old or the new plans, the conversion did not run afoul of the ADEA.[127] In *Eaton*, the conversion did not violate the ADEA because the employees could only state a cause of action under a disparate impact analysis, and such an analysis is not recognized by the jurisdiction in which the case was decided.[128]

The effect of *Goldman* and *Eaton* can be seen in the way that other companies are structuring their conversions from the traditional defined benefit format to the cash balance format.[129] At International Business Machines, Corp. (IBM), a cash balance conversion was announced in July of 1999.[130] This plan would have applied to all employees and would have resulted in consequences typical of cash balance plan conversions; the conversion would subject older employees to lower rates of accrual and wear away periods.[131] After many complaints from older employees who anticipated the negative effects of the conversion, IBM decided to allow employees over forty years of

123. *Id*. (citations omitted).
124. *Id*.
125. *Id*.
126. *See* sources cited *supra* note 90.
127. *See supra* notes 107–14 and accompanying text.
128. *See supra* notes 115–21 and accompanying text.
129. *See, e.g.*, Richard A. Oppel Jr., *I.B.M. Does an About-Face on Pensions*, N.Y. TIMES, Sept. 18, 1999; Ellen Schultz & Rhonda Rundle, *Utility's Pension Plan Allowing Choice Offers Contrast to the Bitterness at IBM*, WALL ST. J., Sept. 23, 1999. It should be noted that the Schultz and Rundle piece was published after the change at IBM had taken place. Considering that this is not addressed explicitly in the piece, the title of the article should be assumed to refer to the "bitterness" at IBM prior to the decision to allow employees to retain their benefits under the old plan.
130. *See* Schultz & Rundle, *supra* note 129.
131. *See* Oppel, *supra* note 129.

age and with at least ten years of experience to choose which plan they wished to work under.[132] Having this type of option available makes the plan look very much like that in *Goldman*.[133] By making such a change, IBM positioned itself to be able to rely on the aforementioned cases as persuasive authority should litigation have arisen.

The impact of the *Goldman* and *Eaton* holdings can also be seen in the way the Northern States Power Company (Northern) structured its conversion to a cash balance plan.[134] The Northern conversion took the option found in the *Goldman* and *Eaton* cases a step further by providing that *every* employee would be able to choose whether to be subject to the old traditional defined benefit plan or the new pension equity plan.[135] As was the situation with IBM, Northern, by adopting a choice option, has brought itself in line with the holding of *Goldman*, and thereby mitigated the possibility of ultimately harmful ADEA litigation arising out of the conversion process.

E. Cash Balance Plans Revisited

1. WEAR AWAY PROVISIONS

The above described wear away provisions[136] have been criticized on the ground that they treat younger and older employers unequally.[137] Claims of unequal treatment are based on the theory that if one group of employees is accruing retirement benefits, while a similarly situated group of employees is not accruing such benefits, the groups are not being treated equally.[138] Although this criticism is initially very appealing, there is a strong counter argument that even if conceded that the treatment is unequal, it is protected by the ADEA.[139]

132. *See id*.
133. Recall that in *Goldman* the employees' pensions were calculated under both the old (traditional defined benefit) and new (cash balance) plans and employees were to receive the greater benefit. *See supra* note 110 and accompanying text.
134. *See* Schultz & Rundle, *supra* note 129.
135. *See id*. The authors note that the pension equity plan (PEP) is "a cousin of the cash-balance" plan. *Id*. Unlike the cash balance plan which creates a hypothetical account containing pay and interest credits, the PEP creates an employee account containing a cumulative annual percentage of the employee's final average salary. Zelinsky, *supra* note 1, at 694.
136. *See supra* Part III.B.3.
137. Rep. Bernard Sanders, *Stop Issuing Determination Letters*, 171 TAX NOTES 36, Sept. 3, 1999.
138. *See id*.
139. *See* Horne, *supra* note 90.

The argument is that the unequal treatment, via the wear away, "is a function of length of service, not age."[140] As indicated in subpart III.C.2.b. of this note, disparate impact analysis under the ADEA permits reasonable factors other than age to serve as a defense to a successful prima facie showing of discrimination.[141] The Court in *Hazen Paper* made it quite clear that proximity to pension vesting, although correlated with age, is analytically distinct.[142] Inasmuch as "proximity to pension vesting" and "years of service" are virtually indistinguishable, it is likely that disparate impact claims under the ADEA that focus their attack on wear away provisions will fail, when the claims rely on precedent for support.[143]

Shapiro and Rachal, following statutory language and precedent, argue that an employer's *knowledge* that a plan's design, one that includes a wear away provision, will have an adverse impact on older employees should be insufficient to state a claim of discrimination.[144] They argue that the employee must show that the employer *intended* for the design to adversely impact the protected class.[145] This argument may not, however, be sufficient to keep disparate impact claims under the ADEA out of court. If the employer knows that the new design will be attractive to, and will attract, younger employees, and that it will encourage older employees to retire to avoid wear away years, then the adoption of the design is "because of age."

2. RATE OF ACCRUAL

Each of the three major statutes regulating pension benefits, the ADEA, ERISA, and the Internal Revenue Code (IRC), contains a provision prohibiting a reduction or cessation of benefit accrual because of a plan participant's age.[146] Because of the ambiguity associated

140. *Id*.
141. 29 U.S.C. § 623(f) (1994).
142. Hazen Paper Co. v. Biggins, 507 U.S. 604, 611–12 (1993).
143. *See* Horne, *supra* note 90.
144. Shapiro & Rachal, *supra* note 30, at III.A.3.
145. *Id*.
146. 29 U.S.C. § 623(i)(1)(A); I.R.C. § 411(b)(1)(H)(i); 29 U.S.C. § 1054(b)(1)(H)(i).

> Except as otherwise provided in this subsection, it shall be unlawful for an employer, an employment agency, a labor organization, or any combination thereof to establish or maintain an employee pension benefit plan which requires or permits—in the case of a defined benefit plan, the cessation or an employee's benefit accrual, or the reduction of the rate of an employee's benefit accrual, because of age . . . .

with the crucial language relating to the rate of benefit accrual, there has been much scholarly debate on how the language at issue should be interpreted.[147]

a. Rate of Accrual as an Annuity It has been argued that when rate of accrual is assessed by treating the employee's benefit as an annuity to commence upon normal retirement age, then cash balance plans fail to satisfy the provisions of the aforementioned statutes.[148] The reason the plans are thought to violate the statutory rate of accrual provisions is because the benefit, calculated as an annuity, received by the plan participant is the result of an actuarial calculation, and this is "purely a function of [the participant's] age."[149]

The above proposition can be demonstrated by considering three employees, ages thirty-five, forty-five, and fifty-five, who receive equal salaries and, consequently, pay credit contributions to their notional cash balance accounts for a particular year.[150] If the employees each receive a pay credit contribution of $5000, the amount of the annuity received varies greatly: the thirty-five-year-old employee will receive an annuity of $5471,[151] the forty-five-year-old employee will receive an annuity of $2534,[152] and the fifty-five-year-old employee

29 U.S.C. § 623(i)(1)(A). "In general.—Notwithstanding the preceding subparagraphs, 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." I.R.C. § 411(b)(1)(H)(i). "Notwithstanding the preceding subparagraphs, 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." 29 U.S.C. § 1054(b)(1)(H)(i).

147. *See* Rosina B. Barker & Kevin P. O'Brien, *Cash Balance Plans: Are Wear-Away Transitions Legal Under the ADEA?*, BENEFITS L.J., Spring 2000, at 1–8 [hereinafter Barker & O'Brien, *Cash Balance Plans*]; Rosina B. Barker & Kevin P. O'Brien, *Do Cash Balance Plans Violate the ADEA?*, BENEFITS L.J., Summer 2000, at 75–96 [hereinafter Barker & O'Brien, *Violate the ADEA?*]; Jonathan Barry Forman & Amy Nixon, *Cash Balance Pension Plan Conversions*, 25 OKLA. CITY U. L. REV. 379 (2000); Shapiro & Rachal, *supra* note 30; Richard C. Shea et al., *Age Discrimination in Cash Balance Plans: Another View*, 19 VA. TAX REV. 763 (2000); Zelinsky, *supra* note 1.

148. *See*, *e.g.*, Zelinsky, *supra* note 1, at 733–34.

149. Sheppard, *supra* note 46.

150. The following example is borrowed from Zelinsky, *supra* note 1, at 733–34. The calculations to follow make use of the interest rate and actuarial assumptions provided by Zelinsky. *See supra* note 54.

151. Applying the normal retirement age annuity formula: ($\$5000 \times 1.08^{30})/9.196 = \$5471$.

152. Applying the normal retirement age annuity formula: ($\$5000 \times 1.08^{20})/9.196 = \$2534$.

will receive an annuity of $1174.[153] As indicated by the calculations, the only way of accounting for the difference in the annuity received by the employees is the age of each employee.[154] Some have argued, however, that the disparity in annuities is merely correlated with age, and is actually a function of the compounding effect of interest.[155] If this is true, then the reduced rate of benefit accrual could be attributed to a "reasonable factor other than age," and an employer would have a defense to charges brought under the ADEA. This position seems to find some support in Proposed Treasury Regulation section 1.411(b)-2(a) which states:

> A defined benefit plan is not considered to discontinue benefit accruals or reduce the rate of benefit accrual on behalf of a participant because of the attainment of any age in violation of section 411(b)(1)(H) . . . solely because of a positive correlation between increased age and a reduction or discontinuance in benefit accruals or account allocations under a plan.[156]

If the above regulation is adopted in its current form, this should prove dispositive of the current issue surrounding the meaning of "rate of benefit accrual."

b. Rate of Accrual in Light of I.R.C. § 411(a)(7) The foregoing makes it appear as though cash balance plans necessarily violate the statutory provisions against reducing rate of benefit accrual because of age.[157] Recall that the foregoing argument assumed that the rate of accrual was assessed in terms of an annuity.[158] If, as has been suggested by a number of authors on the subject, rate of accrual is evaluated in

---

153. Applying the normal retirement age annuity formula: ($5000 x 1.08^{10})/9.196 = $1174.

154. Zelinsky, *supra* note 1, at 734.

155. *See* Shapiro & Rachal, *supra* note 30, at III.A.1.

156. Prop. Treas. Reg. § 1.411(b)-2(a), 53 Fed. Reg. 11876–11879 (Apr. 11, 1988). It should be noted that the above regulation has not been drafted in final form. Moreover, because cash balance plans did not enjoy the popularity at the time of drafting that they are currently experiencing, it is reasonable to think that the regulation may be changed to accommodate cash balance plans when presented in final form. *See* Sheppard, *supra* note 46.

157. It should be noted that this statement is only true when applied to the current structuring of the vast majority of cash balance plans. Zelinsky points out that if a cash balance plan varied the salary component of the annual contribution, such that the closer an employee was to normal retirement the greater the employer contribution would be, this could be used to offset the difference in the annuity to commence at normal retirement age that is a function of the interest accrued between the time of contribution and normal retirement age. *See* Zelinsky, *supra* note 1, at 734–35.

158. *See supra* note 145 and accompanying text.

terms of something other than an annuity commencing at normal retirement age, then cash balance plans do not violate the statutory prohibitions against reducing the rate of a plan participant's benefit accrual.[159]

Section 411(a)(7)(A)(i) of the IRC defines "accrued benefit" as "the employee's accrued benefit determined under the plan . . . expressed in the form of an annual benefit commencing at normal retirement age."[160] Because Congress chose not to use the "accrued benefit" language in § 411(b)(1)(H), it has been argued that "benefit accrual" should not be given the same meaning as the former phrase.[161] Another possible way to read the prohibition against reducing an employee's rate of benefit accrual because of her age[162] is that employers are prohibited from reducing their cost in providing the benefits because of the employee's age.[163]

The ADEA includes a provision allowing employers to engage in otherwise prohibited actions while observing the terms of a bona fide benefit plan.[164] This provision states:

> It shall not be unlawful for an employer . . . (1) to take action otherwise prohibited under subsection (a) . . . (B) to observe the terms of a bona fide employee benefit plan—(i) where, for each benefit or benefit package, the actual amount of payment made or cost incurred on behalf of an older worker is no less than that made or incurred on behalf of a younger worker . . . .[165]

As previously noted, under a cash balance plan, the employer contributes a fixed percentage of both salary (pay credit) and interest (interest credit) to the notional accounts of all employees.[166] Applying the "equal cost" language of the ADEA provision above to the phrase "rate of benefit accrual," the employer cannot be said to be discriminating against the older employee simply because the annuity re-

159. *See* Barker & O'Brien, *Violate the ADEA?*, *supra* note 147; Forman & Nixon, *supra* note 147, at 416–22; Shea et al., *supra* note 147.

160. I.R.C. § 411(a)(7)(A)(i) (1994).

161. *See* Barker & O'Brien, *Violate the ADEA?*, *supra* note 147, at 79; Forman & Nixon, *supra* note 147, at 421–22; Paul J. Sax, *Members of ABA Tax Section Say Cash Balance Plans Are Not Discriminatory*, TAX NOTES, July 6, 2000, at III.B.b (making the interesting point that if "benefit accrual" is given the same meaning as "accrued benefit," the interpreter of the statute is left to contend with the way that "rate" should be read in conjunction with the former phrase).

162. I.R.C. § 411(b)(1)(H).

163. *See* Barker & O'Brien, *Violate the ADEA?*, *supra* note 147, at 81; Sax, *supra* note 161, at III.B.c.

164. *See* 29 U.S.C. § 623(f)(2)(B)(i) (1994); Sax, *supra* note 161, at III.B.c.

165. 29 U.S.C. § 623(f)(2)(B)(i).

166. *See supra* note 46 and accompanying text.

ceived is less than that received by the younger employee.[167] This lack of discrimination is a function of the fact that the contributions made to the older employee's notional account are made at a fixed rate, the same rate that is used to determine contributions made to the younger employee's notional account.[168]

IV. Resolution

A. Legislation

The suggestion has been made that perhaps the best way to resolve "The Cash Balance Controversy," would be to amend I.R.C. § 411(b)(1)(H) such that the "rate of accrual" would become a function of contributions made by employers, as opposed to the annuities these contributions yield.[169] This proposal is very much in keeping with the idea that an "equal cost" analysis should be applied in interpreting the phrase "rate of benefit accrual."[170] Where it differs is that it would not leave the courts with the unenviable task of interpreting the current ambiguous language.[171]

Although there is no clear consensus on how to deal with construing the "rate of benefit accrual" language,[172] there appears to be agreement in Congress that wear away provisions in conversion plans are both problematic and likely a violation of the discrimination provisions of ERISA, and the IRC.[173] In *Senate Report 411*, the Committee on Finance declared that "the Internal Revenue Code and ERISA should contain requirements designed to prevent the use of 'wear away' provisions in [cash balance pension plan] conversions."[174] The

167. *See* Sax, *supra* note 161, at III.B.c.

168. *See* Shapiro & Rachal, *supra* note 30, at III.A.1.

169. *See* Zelinsky, *supra* note 1, at 759. Professor Zelinsky also suggests that Congress place a cap on wear away provisions. *Id.* at 760. Although such a cap would serve to mitigate the adverse effect that such conversions have on older and longer service employees, any wear away whatsoever is going to adversely affect the employees' benefit accrual because there will be a period of time during which no new benefits are accrued.

170. *See supra* note 164 and accompanying text.

171. *See supra* note 166 and accompanying text. By taking interpretation out of the hands of the courts, and leaving the legislature to enact language specifying its intent, there is sure to be less room for conflicts between the circuits. Moreover, the law would serve its purpose of providing the citizenry with meaningful expectations as to what protections the law provides.

172. *See supra* Part III.E.2.

173. *See* S. REP. NO. 106-411, at 51 (2000); H.R. REP. NO. 106-760, at 11 (2000); Sanders, *supra* note 137.

174. *See* S. REP. NO. 106-411, at 51–52.

House Committee on Rules made similar statements in *House Report 760* when it stated:

> It is the sense of the House of Representatives that pension plan participants whose plans are changed to cause older or longer service workers to earn less retirement income, including conversions to "cash balance plans," should receive additional protection under the Internal Revenue Code of 1986 . . . . In particular, the tax laws, at a minimum, should provide that . . . pension plans that are changed to a cash balance or other hybrid formula not be permitted to "wear away" participants' benefits . . . .[175]

It should be noted that neither of the above statements mention amending the ADEA to prohibit wear away provisions. This is particularly odd when one takes into account the fact that the wear away provisions are directly related to the rate of benefit accrual issues and that Congress intended for the "rate-of-benefit-accrual rule" to carry the same meaning for the ADEA, ERISA, and the IRC.[176]

Representative Bernard Sanders has stated that wear away provisions are "discriminatory against older employees since those employees are receiving unequal treatment compared to generally younger employees."[177] The foregoing remarks and the observation that Congress intended for the three relevant statutes to be read in the same way,[178] leads one to the conclusion that, irrespective of how the language of the statutes currently reads, each statute should be taken to prohibit wear away provisions in cash balance conversion situations because of the discriminatory effect on workers protected by the ADEA.

Representative Sanders has clearly articulated the problem with wear away provisions, but the argument he would make will likely encounter problems before a court if made prior to amending the relevant statutes. In *Criley v. Delta Air Lines*,[179] the Second Circuit was willing to recognize an ADEA cause of action based on a disparate impact theory, but the court required that the disparate impact be experienced by all members of the protected class, i.e., workers over forty years of age.[180] Were Representative Sanders's argument made before this court, he would have problems if there were recent hires in the company being sued that were members of the protected class.

175. *See* H.R. REP. NO. 106-760, at 11.
176. *See* Barker & O'Brien, *Cash Balance Plans*, *supra* note 147, at 3–4.
177. Sanders, *supra* note 137.
178. *Id*. (citation omitted).
179. 119 F.3d 102 (2d Cir. 1997).
180. *Id*. at 105.

This would be problematic because, although members of the protected class, these older employees would not be affected by the wear away provision because of their short tenure under the old plan.[181]

Another approach to the problems associated with cash balance conversions is to rule the conversion a termination of the prior defined benefit plan and the subsequent institution of a defined contribution plan.[182] This approach satisfies the concerns about how to treat the "benefit accrual" language, because in the defined contribution context discrimination is evaluated according to the "equal cost" or contribution models, as opposed to annuities to be collected upon reaching normal retirement age.[183] The plan participants would also no longer be subject to wear away because the IRC provides that upon termination of a defined benefit plan, any previously accrued benefits become nonforfeitable,[184] and the participants would begin to immediately accrue benefits under the new defined contribution plan.

B. Judicial Decisions

As previously noted, the Supreme Court has yet to take a dispositive position on the issue of the applicability of disparate impact claims brought under the ADEA.[185] While there is compelling reason to think that the Court would extend the Title VII "bottom line" analysis of *Teal* and the actuarial arguments in *Manhart* to a disparate impact claim brought under the ADEA,[186] scholarly work in the area suggests that the Court is unlikely to make such a move.[187]

In *Griggs*, the Court noted that congressional intent in enacting the Civil Rights Act of 1964 was to remove "artificial, arbitrary, and

181. This is not to suggest that these employees would experience no detriment through the plan conversion, but it is highly likely that there would be younger employees with greater years of service that would be more adversely affected by the conversion to a cash balance plan with wear away provisions.

182. This is the approach suggested by Sheppard, *supra* note 46. Although this may be the most sensible solution to the problem, Sheppard rightly notes that such an approach could only reach fruition through legislation. *Id.*

183. Zelinsky, *supra* note 1, at 760.

184. I.R.C. § 411(d)(3)(B) (1994). "[U]pon complete discontinuance of contributions under the plan, the rights of all affected employees to benefits accrued to the date of such termination, partial termination, or discontinuance, to the extent funded as of such date, or the amounts credited to the employees' accounts, are nonforfeitable." *Id.*

185. *See supra* Parts III.C.2.a–b.

186. *See supra* Parts III.C.2.a, III.C.3.

187. Michael C. Sloan, Comment, *Disparate Impact in the Age Discrimination in Employment Act: Will the Supreme Court Permit It?*, 1995 WIS. L. REV. 507, 511.

unnecessary barriers to employment when the barriers operate invidiously to discriminate on the basis of racial or other impermissible classification."[188] As a means to this end, the Court recognized the disparate impact theory of liability under Title VII.[189] When enacting the ADEA, Congress found that "the setting of arbitrary age limits regardless of potential for job performance has become a common practice, and certain otherwise desirable practices may work to the disadvantage of older persons"[190] and stated that "[i]t is therefore the purpose of this chapter to promote employment of older persons based on their ability rather than age; to prohibit arbitrary age discrimination in employment."[191] Given that the intentions of Congress were remarkably similar in enacting both pieces of legislation, and it was on the basis of congressional intent that the Court extended disparate impact analysis to Title VII, it seems that the Court should follow its own precedent and find cash balance plan conversions containing wear away provisions to be violative of the ADEA.

It is clear from cases like *Griggs* that the Court will give great deference to an agency charged with administering the law at issue before the Court.[192] This is somewhat troubling in the case of cash balance plan conversions. The Equal Employment Opportunity Commission (EEOC) has yet to issue guidelines with respect to ADEA claims and cash balance conversions, and it appears that the agency will wait until the IRS has issued final regulations on age discrimination before adopting any new regulations.[193] By waiting for the IRS to issue regulations, the EEOC is effectively abdicating its responsibility with respect to the administration of the ADEA. This becomes particularly troubling when one considers that if the EEOC does wait for the IRS to issue regulations and then simply follows suit, the course of age discrimination law will be determined by a taxing agency.

If the legality of cash balance pension plan conversions, as relates to age discrimination, is not settled by the legislature, which is where the issue should be resolved,[194] the Court should limit its holdings in *Goldman* and *Eaton*[195] to the facts of those cases. Support for

188. Griggs v. Duke Power Co., 401 U.S. 424, 431 (1971).
189. *Id.*
190. 29 U.S.C. § 621(a)(2) (1994).
191. *Id.* § 621(b).
192. *See Griggs*, 401 U.S. at 433–34.
193. Sheppard, *supra* note 46.
194. *See supra* Part IV.A.
195. *See supra* Part III.D.

this suggestion can be found in a statement made by Charles O. Rossotti, the commissioner of the IRS. Regarding the lawfulness of cash balance conversions, Mr. Rossotti has said, "'[I]t is a very complex issue, and very fact-specific to each plan and how the conversion is done. Some conversions may be very, very reasonable, and others may not be.'"[196] In the aforementioned cases, those employees protected by the ADEA were not discriminated against because the conversion provided for them to either receive the greater benefit under the old and new plans, as was the case in *Goldman*, or they were entitled to receive a benefit that was denied the younger employees, as was the case in *Eaton*.[197]

V. Conclusion

Because the cash balance pension plan is economical for employers in both the short term, i.e., the investments the employer is required to make on behalf of employees, and the long term, i.e., it serves the employer's interest of attracting and retaining new younger employees, there can be little doubt that such plans will only continue to gain greater favor with employers. This means in the coming years there are likely to be an increasing number of employers who convert their defined benefit pension plans to the cash balance format. Perhaps the simplest way to resolve the conversion/discrimination issue is through the courts. But, as has been discussed above, the desired result of protecting older employees from the deleterious effects of wear away provisions will not be met this way because of the Supreme Court's inclination to resist extending disparate impact analysis to the ADEA. It seems the only way to achieve any balance between the interests of the employers, and the employees, both young and old, is through legislative action.

196. Richard A. Oppel Jr., *Cash-Balance Pension Plans Under Scrutiny by Tax Agency*, N.Y. TIMES, Sept. 17, 1999, at C1. "Then the watchman reported . . . 'The driving is like the driving of Jehu son of Nimshi, for he drives furiously.'" 2 *Kings* 9:20 (Oxford Study Edition). Just as the watchman was only able to determine that it was in fact Jehu approaching after a bit of inspection, so too will a court be able to determine if a cash balance plan conversion is discriminatory only after analyzing the facts of the conversion.

197. *See supra* Part III.D.