

No. 05-3588

United States Court of Appeals
For the Seventh Circuit

KATHI COOPER, BETH HARRINGTON
and MATTHEW HILLESHEIM,
Plaintiffs - Appellees,

v.

IBM PERSONAL PENSION PLAN
and IBM CORPORATION,
Defendants - Appellants.

**On Appeal from the United States District Court
for the Southern District of Illinois
In No. 99-cv-00829-GPM, Chief Judge G. Patrick Murphy**

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Oral Argument Requested

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I. THE CBF COMPLIES WITH § 204(b)(1)(H).

Plaintiffs stake their entire case on the proposition that this Court should read the defined term “accrued benefit” into § 204(b)(1)(H). On that basis alone, they ask this Court to adopt an economically nonsensical interpretation of the statute that would strike down pension plans as age discriminatory merely for using an interest rate to adjust an employee’s pension benefit for the passage of time.

Plaintiffs’ argument fails for two fundamental reasons. First, reading the defined term “accrued benefit” into § 204(b)(1)(H) would be incompatible with the text and purpose of the provision and with settled rules of statutory construction. Second, even if plaintiffs could show that the statute refers to an “accrued benefit,” they still could not show that the CBF reduces an employee’s rate of benefit accrual “because of the attainment of any age.” Plaintiffs’ strained interpretation of § 204(b)(1)(H) also conflicts with the Treasury Department’s authoritative construction of the statute and leads to absurd and devastating consequences for the pension system.

A. Plaintiffs Err in Reading the Defined Term “Accrued Benefit” Into § 204(b)(1)(H).

1. The statutory text.

Although plaintiffs urge this Court to read the defined term “accrued benefit” into § 204(b)(1)(H), they do not defend the district court’s flawed rationale that Congress must have omitted the term for grammatical reasons. Instead they argue that “accrued benefit” should be read into § 204(b)(1)(H) because, although

the term does not appear in that provision, it appears in the neighboring provisions in §§ 204(b)(1)(A) through (G). *Pls. Br.* 19-22.

This argument inverts a settled rule of statutory construction. Where Congress uses a defined term like “accrued benefit” in certain portions of a statute but omits it from others, the selective inclusion and exclusion of the term is presumed to be deliberate. *IBM Br.* 30-33. Moreover, since the key terms used in § 204(b)(1)(H) – “benefit accrual” and “rate of an employee’s benefit accrual” – are not defined, those terms should be given their ordinary meaning and not a specialized one. *Id.* Plaintiffs do not dispute that when these terms are given their ordinary meaning, the CBF complies with § 204(b)(1)(H). *Id.* at 24-27.

Plaintiffs’ argument is not improved by their misleading suggestion that the phrase “rate of benefit accrual” appears “multiple times” in ERISA paragraph 204(b)(1), and refers “on each occasion” to an employee’s “accrued benefit.” *Pls. Br.* 19. In reality, subparagraphs 204(b)(1)(A) through (G) do not refer even once to an employee’s “benefit accrual,” “rate of benefit accrual,” or “rate of an employee’s benefit accrual.” Moreover, where these provisions refer to benefits payable at normal retirement age, they do so by making *explicit* use of the defined terms “accrued benefit” or “normal retirement age.” Subparagraph (B), for example, refers *explicitly* to the “annual rate at which [an employee] can accrue the retirement benefits payable at normal retirement age.” 29 U.S.C. § 1054(b)(1)(B) (emphasis added). This is precisely the type of language that Congress would have used in § 204(b)(1)(H) if it had intended that provision to refer to the rate of accrual of an age 65 benefit. *IBM Br.* 32-33.

Plaintiffs are wholly unable to explain why, under their interpretation of the statute, Congress explicitly used the defined terms “accrued benefit” and “normal retirement age” in subparagraphs (A) through (G), but omitted them from subparagraph (H). Defendants, on the other hand, have a persuasive explanation: subparagraph (H) serves a different purpose than its neighbors. Subparagraphs (A) through (G) – each of which was part of ERISA as originally enacted in 1974 – focus on protecting an employee’s benefit accruals *prior* to normal retirement age. For example, the anti-backloading rules set forth in subparagraphs (A) through (C) prevent an employer from configuring an employee’s pre-retirement age accruals so that they are “worth very little unless the employee stays with the company until normal retirement age.” *Berger v. Xerox*, 338 F.3d 755, 762 (7th Cir. 2003); *see also IBM Br.* 5.

By contrast, subparagraph (H) – adopted twelve years later than its neighbors – was intended to assure that employees would be able to continue earning benefits *after* normal retirement age. *IBM Br.* 5-7. Plaintiffs do not deny that if subparagraph (H) had referred to a participant’s “accrued benefit” – *i.e.*, to the benefit payable *at* normal retirement age – it would not have fulfilled the Congressional purpose of protecting continuing accruals *after* that age. *Id.* at 33. Plaintiffs spend seven pages arguing that § 204(b)(1)(H) does not apply *solely* to benefits earned after normal retirement age, but they do not dispute that, at a minimum, the *primary* purpose of the statute was to end the practice of denying additional accruals after that age. *Id.* at 5-7.

Plaintiffs' position is not salvaged by their reference to the introductory clause of § 204(b)(1)(H), which states that, “[n]otwithstanding the preceding subparagraphs,” a plan that violates subparagraph (H) “shall be treated as not satisfying the requirements” of paragraph 204(b)(1). This language does not “incorporate” the term “accrued benefit” from the prior subparagraphs (*Pls. Br.* 19); rather, it countermands the affirmative statement in subparagraphs (A) through (C) that compliance with any one of those three provisions is sufficient to “satisf[y] the requirements” of paragraph 204(b)(1) in their entirety. 29 U.S.C. §§ 1054(b)(1)(A)-(C). Congress had to countermand this language in order to establish subparagraph (H) as a new and independent requirement of paragraph 204(b)(1).

Finally, plaintiffs' argument is refuted by subsection (v) of § 204(b)(1)(H), which states that the “subsidized portion of any early retirement benefit” may be “disregarded” in applying § 204(b)(1)(H). 29 U.S.C. § 1054(b)(1)(H)(v). This provision would be meaningless if § 204(b)(1)(H) applied only to benefits payable at age 65, because benefits paid at that age are not paid “early” and by definition *cannot* contain early retirement subsidies. *IBM Br.* 34.

Plaintiffs assert that subsection (v) has meaning because it “eliminates a potential confusion” between an employee’s “accrued benefit” and his “normal retirement benefit” – the latter of which, according to plaintiffs, can include an early retirement subsidy. *Pls. Br.* 26-27. But plaintiffs are simply wrong in asserting that a “normal retirement benefit” can contain an early retirement *subsidy*. *See* 26 C.F.R. § 1.411(a)-7(c)(6) Example (1) (providing that “actuarial subsidies are ignored” in determining a normal retirement benefit). Indeed, the very same

lawyers who represent the plaintiffs in this action correctly persuaded the court in *Laurenzano v. Blue Cross and Blue Shield of Mass., Inc.*, 134 F. Supp. 2d 189, 201 (D. Mass. 2001), that “there is no such thing as a *subsidized* normal retirement benefit, just as there is no such thing as a *subsidized* accrued benefit.” (Emphasis in original). Furthermore, adding a subsection stating that early retirement subsidies may be disregarded for purposes of § 204(b)(1)(H) would be a *bizarre* way to “eliminate a potential confusion between ‘normal retirement benefit’ and ‘accrued benefit.’” *Pls. Br.* 26. The way to clear up confusion on that point (if there were any) would have been to *use* the term “accrued benefit” in the statute.¹

2. The ordinary meaning of “rate of an employee’s benefit accrual.”

Plaintiffs assert that § 204(b)(1)(H) would be “incoherent” if it referred to anything other than an employee’s age 65 “accrued benefit,” *Pls. Br.* 21, but that plainly is not true. The “coherent” alternative construction – and the one supported by the text, legislative history, and purpose of § 204(b)(1)(H) – is that the provision

¹ Plaintiffs’ reference to a provision requiring plans to provide employees with advance notice of a reduction in their rate of “future benefit accrual” also fails to advance their argument. *Pls. Br.* 25 (citing 29 U.S.C. § 1054(h)). Plaintiffs cite a superceded 1998 regulation interpreting this provision as applying to age 65 benefits, but Treasury has stated that its interpretation of the notice provision “does not indicate any possible outcome” on its interpretation of § 204(b)(1)(H). 68 Fed. Reg. 17,277, 17,278 (2003). Moreover, benefits that are not part of a participant’s “accrued benefit” are subject to the notice requirement. *See* 29 U.S.C. § 1054(h)(9) (early retirement subsidies). Finally, plaintiffs themselves argued in the court below that the same language that appears in the notice provision – “future benefit accrual” – does *not* refer to the age 65 accrued benefit in a requirement relating to partial plan terminations, and a federal court has agreed with them. *See* Docket Entry No. 225, at 15-16 (plaintiffs’ brief arguing that “future benefit accrual” in 26 C.F.R. § 1.411(d)-2(b)(2) does not mean the age 65 “accrued benefit”); *In re Gulf Pension Litig.*, 764 F. Supp. 1149, 1176-77 & n.33 (S.D. Tex. 1991) (declining to equate “future benefit accrual” with the defined term “accrued benefit”).

asks whether the rate of benefit accrual *specified in the plan's benefit formula* is reduced because of the attainment of any age. *IBM Br.* 24-29. That is the ordinary meaning of a provision that asks whether, “under the plan,” the “rate of an employee’s benefit accrual” is reduced because of the attainment of any age. *Id.*

Plaintiffs do not dispute that the CBF complies with this plain meaning interpretation of the statute, nor could they. The CBF provides a benefit based on two non-age-based factors: pay credits and interest credits. Pay credits are always provided at a rate of five percent of pay, and interest credits are always provided at a uniform rate. *IBM Br.* 25. Under this benefit formula, there is never a “reduc[tion]” in an employee’s rate of benefit accrual, much less a reduction because of the attainment of any age. Rather, employees continue earning benefits “in exactly the same way” from the day they are hired until the day they retire. *Lunn v. Montgomery Ward & Co.*, 166 F.3d 880, 883 (7th Cir. 1999). The well-reasoned decisions in *Register v. PNC Fin. Servs. Group*, 2005 WL 3120268 (E.D. Pa. Nov. 21, 2005) and *Eaton v. Onan Corp.*, 117 F. Supp. 2d 812 (S.D. Ind. 2000), uphold cash balance plans under § 204(b)(1)(H) for these reasons.

Plaintiffs cite *Berger v. Xerox*, 338 F.3d 755, in support of their argument that § 204(b)(1)(H) refers to the rate of accrual of an employee’s age 65 “accrued benefit,” but *Berger* supports the opposite conclusion because it addressed a provision that actually *uses* the defined term “accrued benefit.” *Berger* construed the lump sum payment rules in ERISA and the IRC, which provide that a lump sum distribution of benefits from a pension plan must be the “actuarial equivalent” of an employee’s “accrued benefit.” *See id.* at 759 (citing 29 U.S.C. § 1054(c)(3)); 29 U.S.C.

§ 1054(c)(3) (alternative forms of benefit and age 65 “accrued benefit” must be the “actuarial equivalent” of each other); 26 C.F.R. § 1.417(e)-1(d)(1) (same). *Berger* supports the proposition that where, as in the lump sum payment rules, an ERISA provision expressly uses the defined term “accrued benefit,” a cash balance plan must comply with that provision on the basis of the benefit an employee could receive at age 65. But *Berger* does not support a similar conclusion where, as in § 204(b)(1)(H), Congress omits the term “accrued benefit” from the statute.

Although plaintiffs imply otherwise in their discussion of *Berger*, ERISA and the IRC expressly contemplate defined benefit plans that do not state a participant’s benefit accruals in terms of an age 65 “accrued benefit.” *See* 26 U.S.C. § 411(c)(3); 29 U.S.C. § 1054(c)(3); 26 C.F.R. § 1.411(a)-7(a)(1)(ii). For purposes of subjecting such plans to statutory requirements that apply to an age 65 “accrued benefit,” the Treasury Department has specified a means of translating the benefit accruals provided by a plan into the form of a statutory accrued benefit. *See* 26 C.F.R. § 1.411(a)-7(a)(1)(ii). Where a statutory requirement is *not* stated in terms of an “accrued benefit,” however, there is no “general” requirement to perform such a translation. Rather, in the absence of an explicit statutory requirement, ERISA gives employers discretion to design their pension plans as they see fit. *IBM Br.* 4.

Plaintiffs also argue that the CBF should not be permitted to satisfy § 204(b)(1)(H) based on the rate of growth of an employee’s “account balance,” which they deride as a “fiction.” *Pls. Br.* 22-23. And they accuse IBM of trying to satisfy the age discrimination provision applicable to defined contribution plans – which refers to the rate of contributions to an employee’s “account” – rather than the

provision applicable to defined benefit plans. *Id.* at 23-25. In fact, however, IBM does not contend that a participant's "account balance," as such, is the basis for determining compliance with § 204(b)(1)(H). Rather, IBM contends that cash balance plans – like any other defined benefit plan – should be analyzed under § 204(b)(1)(H) based on the plan's *benefit formula*. The benefit formula in a cash balance plan generally states a rate of benefit accrual in terms of a percentage of pay and an interest rate – here, five percent of pay, plus interest at a uniform rate. An employee's *account balance*, on the other hand, is simply a convenient way of communicating the value of the benefit an employee has earned under the benefit formula. The *benefit formula* in a cash balance plan, like any other defined benefit formula, is not a fiction at all; it is what actually determines an employee's benefit. *See IBM Br.* 12.

IBM's construction of § 204(b)(1)(H) dovetails with the statutory distinction between defined benefit plans and defined contribution plans. Defined contribution plans provide a benefit based on contributions and investment returns allocated to individual accounts; Congress therefore subjected such plans to an age discrimination requirement that focuses on the allocations to an employee's account. 29 U.S.C. § 1054(b)(2). Defined benefit plans, by contrast, provide benefits prescribed by a benefit formula; § 204(b)(1)(H) therefore subjects these plans to an age discrimination requirement that focuses on the plan's benefit formula.

B. Plaintiffs Fail to Show a Reduction in an Employee’s Rate of Benefit Accrual “Because of the Attainment of Any Age.”

Even if plaintiffs were correct that “accrued benefit” should be read into § 204(b)(1)(H), they still could not show that the CBF reduces an employee’s rate of benefit accrual “because of” the attainment of any age.

1. Plaintiffs conflate the passage of time with age.

In order to show a reduction in an employee’s rate of benefit accrual “because of” the attainment of any age, a plaintiff must show that age itself, and not a non-age factor, causes a reduction in an employee’s rate of benefit accrual. *IBM Br. 26*. Here, plaintiffs essentially concede (as they must) that the CBF does not use age itself to reduce an employee’s accruals. The CBF provides benefits based on two non-age-based factors: an employee’s pay and an interest rate. There is no age at which either of these factors is varied or reduced; pay credits always accrue at a rate of five percent of pay, and interest credits always accrue at a uniform rate. The CBF thus complies with § 204(b)(1)(H) for the same reason as the plan upheld in *Lunn*: employees continue earning benefits “in exactly the same way” from the day they are hired until the day they retire. *Lunn*, 166 F.3d at 883.

Plaintiffs argue that if one focuses on the size of the benefit an employee will have *at age 65*, then the interest credits provided by the CBF are directly correlated with an employee’s age, because an employee’s current age determines how much interest an employee can accrue by age 65. *Pls. Br. 46*. This analysis is circular. It merely shows that, when one asks the age-based question, “how large a benefit will an employee have *at age 65*,” the answer for many defined benefit plans – the CBF included – correlates with an employee’s current age. Even

if plaintiffs were correct that § 204(b)(1)(H) refers to an employee's age 65 benefit (and they are not), this circular reasoning would not show a reduction in an employee's rate of benefit accrual "because of" the attainment of any age.

Plaintiffs' argument overlooks the fact that the interest credits provided by the CBF are not provided on the basis of an employee's *age*; they are provided based on the passage of *time*. Employees of all ages are credited with precisely the same amount of interest if they wait the same amount of *time* to receive their benefits. *IBM Br.* 12-13, 26; A 123-24. Moreover, the CBF does not stop crediting interest once an employee attains age 65 or any other age; it goes on crediting interest for as long as an employee defers the receipt of benefits. *IBM Br.* 25. The CBF even continues crediting interest once an employee dies until the employee's benefits are paid to a beneficiary. *Id.* If an employee does not even have to be *alive* to earn interest credits, interest plainly is not credited because of the employee's attainment of any age.

Further proof that interest credits are provided based on the passage of time, and not an employee's age, lies in the fact that the *present value* of the benefits provided by the CBF is the same for employees of all ages. (A 90-96; 130-33.) Plaintiffs complain that a present value analysis is inappropriate because the words "present value" do not appear in § 204(b)(1)(H), but they ignore the fact that the words "because of the attainment of any age" *do* appear in the provision. In order to establish discrimination "because of" the attainment of any age, the effects of age must be isolated from the effects of non-age variables such as differences in salary, length of service, and the amount of time an employee waits to receive a

benefit. *IBM Br.* 26-27. Here, discounting age 65 benefits to present value gives effect to the “because of” language in the statute by isolating the effects of age from the effects of the passage of time. *IBM Br.* 26-27, 36-37; A 92-94, 130-33.

Arizona Governing Committee v. Norris, 463 U.S. 1073 (1983), does not support a contrary conclusion. *Norris* addressed a pension plan that used sex-based mortality tables to provide men with larger retirement annuities than women. The employer defended this practice on the ground that, *on average*, men and women received benefits of equal value, since women tend to live longer than men. *Id.* at 1083-85. The Court rejected the argument, observing that it relied on a sex-based generalization – the generalization that *all* women live longer than *all* men – that discriminated against individual women who did not conform to the generalization. *Id.* Contrary to plaintiffs’ assertion, *Norris* did not object to the use of an “actuarial analysis” as such; it merely condemned an analysis that was often inaccurate in individual cases and that discriminated against women on the basis of a sex-based generalization. Here, the CBF does not employ an age-based generalization, and no one disputes the accuracy of defendants’ present value analysis. (A 90-94.)

At bottom, plaintiffs are arguing that age and interest both increase with the passage of time, and as a result there is a direct correlation between the two. This is not enough to establish that the CBF reduces an employee’s interest credits “because of” an employee’s age. *See Lunn*, 166 F.3d at 883-84. *Lunn* makes clear that tying benefits to “the performance of the stock market” is a “legitimate” practice in a defined benefit plan – even though stock market earnings increase over time in the same manner that interest credits do. *Id.* at 882. *Lunn* also explains

that the practice of integrating a defined benefit plan with social security – *i.e.*, reducing an employee’s pension benefit based on his social security benefit – is not a reduction in benefit accruals because of the attainment of any age, even though social security benefits are directly linked to age. *See id.* at 883-84. Likewise here, plaintiffs’ efforts to show that there is a link between interest and age when one looks at an employee’s “age 65 benefit” does not obscure the fact that the two are analytically distinct, or that interest credits are not provided “because of” an employee’s attainment of any age.²

Consistent with this conclusion, the Treasury Department has repeatedly indicated that it is lawful for a cash balance plan to credit employees with interest at a rate that does not vary with age. *See infra* at 15-17. Indeed, Treasury guidance *requires* that interest credits be provided in precisely the form that plaintiffs say is age discriminatory. Specifically, IRS Notice 96-8 and the anti-backloading rules require cash balance plans to “guarantee” an employee’s right to earn interest credits through normal retirement age even if the employee stops working for the plan sponsor before that age (although, for employees who elect to receive their benefits prior to normal retirement age, future interest credits are

² *See also Hazen Paper Co. v. Biggins*, 507 U.S. 604, 611 (1993) (“an employee’s age is analytically distinct from his years of service.”); *Lyon v. Ohio Education Ass’n*, 53 F.3d 135, 140 (6th Cir. 1995) (age and proximity to retirement are distinct). *Abrahamson v. Board of Educ.*, 374 F.3d 66 (2d Cir. 2004), and *Arnett v. CALPERS*, 179 F.3d 690 (9th Cir. 1999), *vacated and remanded*, 528 U.S. 1111 (2000), are inapposite. In *Arnett*, disability benefits were capped based “solely” on an employee’s age. 179 F.3d at 692. In *Abrahamson*, age likewise was determinative of whether certain employees could receive a future severance benefit. 374 F.3d at 73. Here, by contrast, all employees earn the same amount of interest credits if they wait the same amount of time to receive a benefit.

generally canceled out in the discounting process). See IRS Notice 96-8, 1996-1 C.B. 359 (A 645-48).

Under plaintiffs' interpretation of § 204(b)(1)(H), it is the CBF's "guarantee" of future interest credits that makes those credits problematic. If interest credits were *not* guaranteed – that is, if they continued to accrue only as long as an employee continued working for IBM – younger employees would not appear to earn an age 65 benefit at a faster rate than older employees, because interest credits would only accrue with each additional year of service to IBM. (A 132-33.) Thus, plaintiffs are reduced to arguing that the CBF violates § 204(b)(1)(H) because it "guarantees" an employee's interest credits *as the law requires*. This is further proof that plaintiffs' interpretation of the "because of" language in § 204(b)(1)(H) cannot be right. The statutory scheme should be construed as "an harmonious whole" – not in a manner that places one legal requirement at odds with another. *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000).

2. Plaintiffs' table does not support their argument.

Plaintiffs present a table showing that the CBF provides a younger employee with a "larger" age 65 benefit for a year of service than an older employee – a result that occurs solely because younger employees have more time than older employees to accumulate interest before reaching age 65. *Pls. Br.* 11. Plaintiffs imply that their table shows a reduction in age 65 benefit accruals "because of" the attainment of any age, arguing that if a traditional defined benefit plan provided the age 65 accruals shown in the table, the plan would violate § 204(b)(1)(H). *Id.*

Plaintiffs ignore a key difference between the CBF and the traditional plan they describe. If a defined benefit plan consisted of nothing more than the schedule of accruals shown in plaintiffs' table, the plan's benefit formula would be explicitly age-based, and age itself would be responsible for the declining pattern of age 65 accruals. By contrast, where a plan uses a non-age factor such as an interest rate or a cost-of-living index, and this non-age factor is what produces the pattern of age 65 accruals that appears in plaintiffs' table, there is no reduction in age 65 accruals "because of" the attainment of any age. *See supra* at 9-13.

This is confirmed by the fact that indexed career pay plans and variable annuity plans have never been treated as violating § 204(b)(1)(H). Indexed career pay plans are traditional defined benefit plans that use an index such as the Consumer Price Index to adjust an employee's benefit for the cost of living. *IBM Br.* 40-41 & n. 7; A 427-28; SA 59. Since a younger employee will invariably receive more cost-of-living increases than an older employee by the time they each reach age 65, such plans produce precisely the same pattern of accrual of an age 65 benefit that appears in plaintiffs' table. (A 427-28.) The same is true of variable annuity plans – traditional defined benefit plans that index an employee's retirement annuity according to the rate of return in an investment fund. (*Id.*) Variable annuity plans, indexed career pay plans, and cash balance plans *all* produce the pattern of accrual of an age 65 benefit shown in plaintiffs' table. In each case, however, a non-age factor such as a cost-of-living index, a rate of return, or an interest rate – and not an employee's age – "causes" this pattern of accrual.

C. Plaintiffs' Arguments Are Inconsistent With Authoritative Treasury Guidance.

Plaintiffs have no effective response to the Treasury Department's consistent and repeated pronouncements that (1) cash balance plans are lawful, and (2) it is not only permissible but necessary for cash balance plans to provide guaranteed interest credits. *IBM Br.* 9-11, 44-47. These pronouncements include the following:

IRC § 401(a)(4) Regulations. Plaintiffs ignore the Treasury Regulations requiring cash balance plans to provide guaranteed interest credits (as the CBF does) to qualify for a safe harbor under the IRC § 401(a)(4) nondiscrimination rules. *IBM Br.* 10. Treasury adopted these regulations subject to an express Congressional mandate to "coordinate" the nondiscrimination rules with IRC § 411(b)(1)(H), and the regulations make clear that they *were* so coordinated. *Id.* at 45 & n.10. They therefore reflect Treasury's considered view that provision of guaranteed interest credits does not reduce benefit accruals because of age.

The Preamble to the § 401(a)(4) Regulations. Consistent with its obligation to "coordinate" the two sets of rules, Treasury expressly stated in the 1991 Preamble to the § 401(a)(4) regulations that guaranteed interest credits do not cause a cash balance plan to violate IRC § 411(b)(1)(H). *IBM Br.* 10-11. Plaintiffs assert that the regulations introduced by the Preamble were "subsequently withdrawn" and then "reproposed" without the Preamble, *Pls. Br.* 33, but this is wrong. Treasury simply delayed the effective date of the regulations and amended other, unrelated portions of the regulations. *Id.* at 10, n.2. There was no need for

the subsequent Preamble to address matters that remained unchanged. That Treasury did not recant the earlier Preamble is shown by the 1999 Congressional testimony of the IRS Chief Counsel reiterating the 1991 Preamble statement regarding guaranteed interest credits. (SA 185-86.)

Notice 96-8. IRS Notice 96-8 expressly establishes safe harbor interest crediting rates that enable cash balance plans to make lump sum payments equal to a participant's account balance without violating the lump sum payment rules. (The CBF uses one of these interest rates.) *IBM Br.* 11, 46-47. Implicit in these instructions is Treasury's recognition that cash balance plans, and the crediting of interest at the approved rates, are otherwise lawful. Plaintiffs make the implausible suggestion that the Notice provides no basis for inferring any conclusion on the part of Treasury about whether the use of such an interest rate renders a plan inherently unlawful under the age discrimination rules of the IRC and ERISA. *Pls. Br.* 35. But if Treasury agreed with plaintiffs' view that the guaranteed interest credits provided by cash balance plans are inherently age discriminatory, promulgating a set of approved interest crediting rates for purposes of the lump sum payment rules would have perversely encouraged plan sponsors to violate the age discrimination rules.

Treasury's Current Views. As plaintiffs acknowledge, Treasury continues to take the position that neither cash balance plans nor cash balance plan conversions are inherently age discriminatory. *Pls. Br.* 47 n.24. The proposed 2002 regulations provided that guaranteed interest credits would not cause a cash balance plan to fail § 204(b)(1)(H), *see* 67 Fed. Reg. 76123, 76126 (2002), and

subsequent Treasury budget statements have reiterated this position. *See, e.g.,* Department of Treasury, *General Explanations of the Administration's Fiscal Year 2006 Revenue Proposals* 82 (2005), <http://www.treas.gov/offices/tax-policy/library/bluebok05.pdf> (stating that “cash balance plans . . . are not inherently age discriminatory”). Contrary to plaintiffs’ insinuation, Congressional action suspending Treasury’s efforts to address cash balance issues does not reflect a different view. *See* H.R. Rep. No. 108-401, at 1181 (2003) (“The purpose of the prohibition is *not* to call into question the validity of . . . cash balance” plans) (emphasis added).

Plaintiffs note that in 1999 the IRS put a hold on the issuance of advisory letters approving the *conversion* of plans into cash balance plans, *Pls. Br.* 8, but they fail to acknowledge that Treasury continues to issue advisory letters approving *new* cash balance plans, *see* A 137, *Treas. Ann.* 2003-1, 2003-1 C.B. 281, *ABC Br.* 11-12. Although debate continues regarding issues of “wearaway” and “choice” in *conversions* to cash balance plans (issues that plaintiffs settled in the court below), Treasury’s considered view, as consistently expressed from 1991 to the present, is that cash balance plans are lawful.

D. The District Court’s Interpretation of § 204(b)(1)(H) Has Absurd and Devastating Consequences for the Pension System.

Plaintiffs’ assertion that defendants have “waived” any arguments based on the consequences of the district court’s interpretation of § 204(b)(1)(H) is frivolous. *Pls. Br.* 46 Defendants waived only the right to contest their obligation to pay “the Settlement Benefits due under this Agreement.” (A 616.)

Plaintiffs do not dispute that the district court adopted an economically nonsensical theory of age discrimination; nor could they. The CBF provides employees of all ages with benefits of precisely equal economic value. (A 90-95.) The district court's ruling is based solely on the fact that younger employees have more time to accumulate interest credits than older employees before reaching age 65. In order to comply with the district court's interpretation, the CBF would have to provide older employees with accruals as much as *ten or twenty times more valuable* than those of younger employees. *IBM Br.* 38-40; A 504-05, 520.

Nor can there be any serious dispute that adoption of the district court's interpretation of § 204(b)(1)(H) would deal a devastating blow to the pension system. Plaintiffs *do not deny* that the district court's interpretation would strike down over 1,500 cash balance plans across the country and would outlaw indexed career pay plans, variable annuity plans, and pension equity plans as well. *See IBM Br.* at 40-43; *ABC Br.* 8, 15-18; *Register*, 2005 WL 3120268, *6 (under the district court's decision in *Cooper*, "all cash balance plans violate the ERISA age discrimination provision by virtue of their design"); A 513-15.³ Contributory defined

³ Plaintiffs' amici assert that a cash balance plan *theoretically* could satisfy the district court's interpretation of § 204(b)(1)(H) if it provided older employees with vastly larger pay credits than younger employees, but this would require a plan to engage in a monstrous amount of reverse age discrimination, and it appears that no cash balance plan does so. (A 136, 513, 520.)

benefit plans would likewise be invalidated; plaintiffs' assertion that these plans are exempt from § 204(b)(1)(H) is erroneous.⁴

Variable annuity plans, indexed career pay plans, and contributory defined benefit plans are accepted types of defined benefit plans that long preceded the enactment of § 204(b)(1)(H). *IBM Br.* 40-41 & n.7. Section 204(b)(1)(H) was not intended to outlaw these accepted types of plans or to prohibit the benign practice of using an interest rate to adjust an employee's benefit; it was merely intended to end the practice of denying additional benefit accruals to employees who work beyond normal retirement age. *Id.* at 5-7; 43-44. This Court should not assume that Congress was "hid[ing] elephants in mouseholes" when it adopted § 204(b)(1)(H). *Whitman v. Am. Trucking Ass'n*, 531 U.S. 457, 468 (2001). Nor should it interpret ERISA in a manner that "burdens arbitrarily an accepted form of retirement package," *Lunn*, 166 F.3d at 884.

Adoption of the district court's interpretation would also impose hundreds of billions of dollars of unfunded liability on the pension system. *IBM Br.* 42-43; *ABC Br.* 19-22. Plaintiffs assert that these figures are "speculative" because the district court did not adopt a remedy, but they fail to explain how the court could have done anything other than correct the violation of law that it found in its opinion. Such a correction would require older employees to be credited with just as much interest by the time they reach age 65 as younger employees would receive by

⁴ Contributory defined benefit plans are a type of defined benefit plan, not a type of defined contribution plan, and are therefore subject to § 204(b)(1)(H). *See* 29 U.S.C. § 1054(c)(2)(B); IRS Notice 88-126, 1988-2 C.B. 538 (A 678-79); *ABC Br.* 16.

age 65.⁵ Hundreds of billions of dollars is a conservative estimate of the nationwide costs of such a correction. (A 513-16.)

Plaintiffs' statement of "facts" suggests that the Court should ignore these devastating consequences because, in plaintiffs' view, sponsors of cash balance plans knew or should have known that these plans were age discriminatory. But contrary to this Court's rule that "[t]he statement of facts shall be a fair summary without argument or comment," Seventh Cir. R. 28(c), plaintiffs' statement of "facts" is a highly slanted presentation that relies on unauthenticated hearsay,⁶ fails to acknowledge that a quoted statement was offered only as a position that "can be argued,"⁷ fails to describe cited documents accurately,⁸ and misleadingly implies

⁵ The oral argument colloquy cited by plaintiffs at most indicates the district court judge's skepticism about the plaintiffs' proposed "annual" correction; it does not reject the less expensive "cumulative" correction that formed the basis of the liability projections. (A 503-05, 512-16.)

⁶ The documents at SA-5, SA-53, and SA-61 are unauthenticated hearsay and thus inadmissible on summary judgment. See *Eisenstadt v. Centel Corp.*, 113 F.3d 738, 742 (7th Cir. 1997); *Woods v. City of Chi.*, 234 F.3d 979, 988 (7th Cir. 2000).

⁷ See SA 58 (noting that "it can be argued" that a cash balance plan produces a declining rate of benefit accrual). The author of the document, Paul Strella, later opined that the analysis necessary to condemn cash balance plans as age discriminatory "would be inconsistent with and contrary to the principal goal of the statute." (SA-59.)

⁸ The "Grandfathered Participants Age Discrimination Analysis" cited by plaintiffs (at 10) was not an analysis of whether the CBF is age discriminatory; it was an analysis of whether *excluding* older employees from the CBF might be viewed as age discriminatory. IBM originally intended to "grandfather" all older and longer-service employees into the plan's prior benefit formulas, but because its analysis showed that some of these employees might be *better off* under the CBF, it gave these employees a choice between the prior formulas and the CBF. (A 675-77.) Plaintiffs' appendix omits the portions of the document that show this result and that examine forms of benefit other than the age 65 annuity benefit. See Exhibits accompanying Docket No. 124 (including complete version of the document).

that the alleged views of obscure individuals reflect the views of the mainstream benefits community.⁹

Plaintiffs' error-ridden statement of "facts" cannot obscure the reality that there is a broad consensus among employers and pension practitioners – nurtured and sustained by repeated actions of the Treasury Department – that cash balance plans are lawful. This is shown by the fact that there are over 1,500 cash balance plans currently in existence, sponsored by a wide range of institutions including universities, hospitals, charities, state and local governments, and the nation's largest employers. *IBM Br.* 41-42; A 531.

II. THE ACBF COMPLIES WITH § 204(b)(1)(H).

Plaintiffs argue that the ACBF is unlawful because it had the effect of providing a larger "one-time increase" in benefits to younger employees than to older employees. This argument fails because the ACBF merely established an age-neutral benefit floor for all transition employees.

A. The ACBF Established an Age-Neutral Benefit Floor for Transition Employees.

Employees transitioning to the CBF received an opening account balance equal to the greater of the amounts produced by two formulas: (1) the Present Value Formula, which provided an account balance equal to the present value of the benefit that an employee had earned under the prior benefit formulas,

⁹ For example, plaintiffs cite a document as a purported reflection of the views of a "cash balance practitioners' group," but the document in question is unauthenticated hearsay, and purports to be only a "DRAFT" prepared by two Minnesota lawyers, not a statement on behalf of a group. (SA-11.)

or (2) the ACBF, which provided an approximation of the account balance that an employee would have had if the CBF had “always” been in effect. *IBM Br.* 13-14. The purpose of the ACBF was to assure that, as a result of the transition between formulas, an employee would not end up with a retirement benefit smaller than the benefit he would have earned if he had spent his entire career under *either* the CBF or the prior benefit formulas. (A 421-23, 448.)

Plaintiffs use two sample employees to illustrate the operation of the transition formulas. *Pls. Br.* 13. For the two employees used by plaintiffs and one other described in their expert report, the formulas work as follows:

Opening Account Balances for Three Employees With the Same Service and Earnings Records			
(1) Age	38	46	50
(2) Years of Service	9	9	9
(3) Average Compensation (as defined by the ACBF)	\$43,904	\$43,904	\$43,904
(4) Opening Balance Under ACBF	\$19,757	\$19,757	\$19,757
(5) Opening Balance Under Present Value Formula	\$15,762	\$24,775	\$29,475
(6) Actual Opening Balance (greater of line 4 and line 5)	\$19,757	\$24,775	\$29,475

(A 438.)

As the table demonstrates, the ACBF provided employees with a minimum opening account balance calculated without regard to age. (A 448-50.) It did so by using a non-discriminatory formula – 5% of an employee’s pay multiplied by an employee’s years of service – that takes no account of an employee’s age. The

Present Value Formula, on the other hand, provided older employees with larger opening balances than similarly situated younger employees, because the benefit formulas that preceded the CBF had provided more valuable benefits to older employees. (*Id.*) Thus, the ACBF established an age-neutral minimum benefit for all transition employees, and the Present Value Formula preserved the favorable treatment that older employees had enjoyed under the prior benefit formulas. (*Id.*)

B. The ACBF Is Lawful.

The ACBF complies with § 204(b)(1)(H) because it does not vary or reduce an employee's accruals based on the attainment of any age. *IBM Br.* 47. Plaintiffs nonetheless argue that the ACBF is unlawful because it often had the effect of providing a "one-time benefit increase" to younger employees but not to older employees. *Pls. Br.* 50.

This argument confuses the adoption of an age-neutral benefit floor with discrimination against older employees. The ACBF established a benefit floor that applied equally to all employees. *Lunn* makes clear that providing such a "benefits floor" is a "legitimate purpose" of a benefit formula. *Lunn*, 166 F.3d at 883. To the extent that the benefit floor established by the ACBF had the effect of increasing the benefits of younger employees more than those of older employees, that is only because the prior benefit formulas were so generous to older employees that the benefits of many of those employees were already above the floor. (A 448-59.) This plainly is not age discrimination. In *Finnegan v. Trans World Airlines, Inc.*, 967 F.2d 1161, 1165 (7th Cir. 1992), this Court rejected a similar claim asserted under the ADEA – a claim that the adoption of an age-neutral ceiling on

vacation benefits often had the effect of reducing the vacation benefits of older employees but not of younger ones.

This analysis is unchanged by plaintiffs' reference to an e-mail by a plan actuary. The e-mail merely recognizes that “[d]ue to the nature of the [prior benefit formulas]” – which favored older employees over younger employees – the age-neutral benefit floor established by the ACBF will often have the effect of increasing the benefits of younger employees but not of older employees. (SA 87.) This is wholly unremarkable; a similar e-mail could have been written about the age-neutral ceiling on vacation benefits upheld in *Finnegan*. The actuary's e-mail does not change the fact that the ACBF established an age-neutral benefit floor that applied to *all* transition employees for the legitimate purpose of protecting them from potential harm in the transition between benefit formulas. (A 421-23, 447-48.)

Plaintiffs' one-time increase argument is also flawed because it artificially focuses on a single day – the day a new plan amendment takes effect – rather than the period of service actually considered by a benefit formula. Here, the ACBF did not confer an opening account balance based on an employee's service on a *single day*; it did so based on all of the service an employee had provided up to the transition date. (A 454-55.) When accruals are measured over *this* period of service rather than the single day that plaintiffs isolate, it is undisputed that older employees earned their benefits at a rate greater than or equal to that of younger employees. (*Id.* at 454-55, 460.)

Plaintiffs' one-time increase theory *cannot* be right because it would strike down accepted types of defined benefit plans and accepted transition

formulas. For example, under this theory, any plan that converted to a cash balance plan using the “safe harbor” method set out in the Treasury Department’s nondiscrimination regulations, *see* 26 C.F.R. § 1.401(a)(4)-13(f)(2)(iii)(B), would violate § 204(b)(1)(H). This is because, under this method, transition employees must be credited with at least the opening account balance they would have had if the cash balance formula had always been in effect, resulting in precisely the kind of “one-time increase” that occurs under the ACBF. (A 457-58.) Furthermore, plaintiffs’ theory would strike down many plans that *favor* older employees by, for example, providing them with accelerated benefit accruals. (A 455-57 & n.9.)

CONCLUSION

The district court judgment should be reversed.

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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)(ii).

1. Exclusive of the exempted portions of the brief, as provided in Fed. R. App. P. 32(a)(7)(B)(iii), this brief includes 6,991 words.

2. This brief has been prepared in proportionately-spaced typeface using Microsoft Word in 12 point Century Schoolbook font. As permitted by Fed. R. App. P. 32(a)(7)(C), the undersigned has relied upon the word count of this word-processing system in preparing this certificate.

Jeffrey G. Huvelle

CIRCUIT RULE 30(d) STATEMENT

Pursuant to Circuit Rule 30(d), counsel certifies that all materials required by Circuit Rule 30 are included in the Appendix.

Jeffrey G. Huvelle

CIRCUIT RULE 31(e) CERTIFICATION

Pursuant to Seventh Circuit Rule of Appellate Procedure 31(e)(1), the undersigned counsel hereby certifies that the appendix materials required by Circuit Rule 30(b) included in Appellants' Circuit Rule 30(b) Appendix Volume III are not all available in searchable digital format. Those materials available digitally have been provided on the accompanying diskette. Counsel further certifies that the diskette on which the electronic documents are being produced is virus-free.

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CERTIFICATE OF SERVICE

I hereby certify that on December 20, 2005, two true and correct copies of the foregoing **REPLY BRIEF OF APPELLANTS, along with an electronic version of the brief on a virus-free diskette**, were served via First Class United States Mail, postage prepaid, upon the following:

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