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United States Court of Appeals  
For the Seventh Circuit

U.S.C.A. - 7th Circuit  
RECEIVED

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

AUG 21 2006 RJT

GINO J. AGNELLO  
CLERK

v.

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

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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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PLAINTIFFS-APPELLEES' PETITION FOR REHEARING  
AND SUGGESTION FOR REHEARING *EN BANC*

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Steven A. Katz  
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1441 Eighteenth Street  
Denver, Colorado 80202  
303-296-8100

*Counsel for Plaintiffs-Appellees*

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SEP 27 2005 000

CIRCUIT RULE 26.1 DISCLOSURE STATEMENT

GINO J. AGNELLO  
CLERK

Appellate Court No: 05-3588

Short Caption: Cooper, et al. (Plaintiffs/Appellees) v. IBM Corporation (Defendants/Appellants)

To enable the judges to determine whether recusal is necessary or appropriate, an attorney for a non-governmental party or amicus curiae, or a private attorney representing a government party, must furnish a disclosure statement providing the following information in compliance with Circuit Rule 26.1 and Fed. R. App. P. 26.1.

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- (1) The full name of every party that the attorney represents in the case (if the party is a corporation, you must provide the corporate disclosure information required by Fed. R. App. P 26.1 by completing item #3):

Kathi Cooper, Beth Harrington, Matthew Hillesheim, and the certified Plaintiff  
Class of Plan Participants (see attachment for definition of participant)

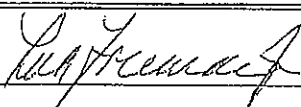
- (2) The names of all law firms whose partners or associates have appeared for the party in the case (including proceedings in the district court or before an administrative agency) or are expected to appear for the party in this court:

Freeman, Freeman & Salzman, P.C.; Hill & Robbins, P.C.;  
Korein Tillery, LLC; and Law Offices of William K. Carr

- (3) If the party or amicus is a corporation:

i) Identify all its parent corporations, if any; and  
N/A

ii) list any publicly held company that owns 10% or more of the party's or amicus' stock:  
N/A

Attorney's Signature:  Date: Sept. 27, 2005

Attorney's Printed Name: Lee A. Freeman, Jr.

Please indicate if you are *Counsel of Record* for the above listed parties pursuant to Circuit Rule 3(d). Yes  No

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E-Mail Address: lfreemanjr@ffspc.com

Attachment to Disclosure Statement

Appellate Court No. 05-3588

Short Caption: Cooper, et al. (Plaintiffs/Appellees) v.  
IBM (Defendants/Appellants)

(1) The Certified Plaintiff Class:

“Participant” means an individual who (a) accrued a benefit under the Plan after December 31, 1994, and before January 1, 2005 (even if liability for payment of such benefit has been transferred to another plan in a transaction subject to Code Section 414(I)); or (b) was, on December 31, 2004, a Regular Employee, a Leave of Absence Employee, or receiving disability benefits under the LTD Plan; or (c) is a Vanity Fair Employee. Notwithstanding the foregoing, an individual is not a Participant if:

- (1) the individual is a “Participant” as defined in the “Class Action Settlement Agreement with respect to Subclass 3,” filed with the District Court on October 26, 2004;
- (2) the individual received benefits under IBM’s MDIP and did not return to active employment as a Regular Employee on or after January 1, 1995, and before January 1, 2005;
- (3) the individual commenced a “no-frills leave of absence” (i.e., a period of leave during which the individual accrues no Benefit Service) on or before January 1, 1995, and did not return to active employment as a Regular Employee on or after January 1, 1995, and before January 1, 2005; or
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For purposes of this definition of “Participant,” the following terms have their respective meanings as provided in the Plan Document: Leave of Absence Employee, LTD Plan, MDIP, and Regular Employee.

CIRCUIT RULE 26.1 DISCLOSURE STATEMENT

Appellate Court No: 05-3588

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Class of Plan Participants (see attachment for definition of participant)

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Korein Tillery, LLC; and Law Offices of William K. Carr

- (3) If the party or amicus is a corporation:

i) Identify all its parent corporations, if any; and

N/A

ii) list any publicly held company that owns 10% or more of the party's or amicus' stock:

N/A

Attorney's Signature:  Date: August 21, 2006

Attorney's Printed Name: James T. Malysiak

Please indicate if you are *Counsel of Record* for the above listed parties pursuant to Circuit Rule 3(d). Yes  No

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Chicago, Illinois 60611-4207

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E-Mail Address: jmalysiak@ffspsc.com

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Appellate Court No. 05-3588

Short Caption: Cooper, et al. (Plaintiffs/Appellees) v.  
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(1) The Certified Plaintiff Class:

“Participant” means an individual who (a) accrued a benefit under the Plan after December 31, 1994, and before January 1, 2005 (even if liability for payment of such benefit has been transferred to another plan in a transaction subject to Code Section 414(I)); or (b) was, on December 31, 2004, a Regular Employee, a Leave of Absence Employee, or receiving disability benefits under the LTD Plan; or (c) is a Vanity Fair Employee. Notwithstanding the foregoing, an individual is not a Participant if:

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For purposes of this definition of “Participant,” the following terms have their respective meanings as provided in the Plan Document: Leave of Absence Employee, LTD Plan, MDIP, and Regular Employee.

CIRCUIT RULE 26.1 DISCLOSURE STATEMENT

Appellate Court No: 05-3588

Short Caption: Cooper, et al. (Plaintiffs/Appellees) v. IBM Corp. (Defendants/Appellants)

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- (3) If the party or amicus is a corporation:

i) Identify all its parent corporations, if any; and

n/a

ii) list any publicly held company that owns 10% or more of the party's or amicus' stock:

n/a

7th Circuit RECEIVED DEC 13 2005 NO. 05-3588

Attorney's Signature:

Douglas R. Sprong

Date:

12/1/05

Attorney's Printed Name:

Douglas R. Sprong

Please indicate if you are *Counsel of Record* for the above listed parties pursuant to Circuit Rule 3(d). Yes  No

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Fax Number: (314) 588-7036

E-Mail Address: DSprong@KoreinTillery.com

Attachment to Disclosure Statement

Appellate Court No. 05-3588

Short Caption: Cooper, et al. (Plaintiffs/Appellees) v.  
IBM (Defendants/Appellants)

(1) The Certified Plaintiff Class:

“Participant” means an individual who (a) accrued a benefit under the Plan after December 31, 1994, and before January 1, 2005 (even if liability for payment of such benefit has been transferred to another plan in a transaction subject to Code Section 414(I); or (b) was, on December 31, 2004, a Regular Employee, a Leave of Absence Employee, or receiving disability benefits under the LTD Plan; or (c) is a Vanity Fair Employee. Notwithstanding the foregoing, an individual is not a Participant if:

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CIRCUIT RULE 26.1 DISCLOSURE STATEMENT

Appellate Court No: 05-3588

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Kathi Cooper, Beth Harrington, Matthew Hillesheim, and the certified Plaintiff  
Class of Plan participants

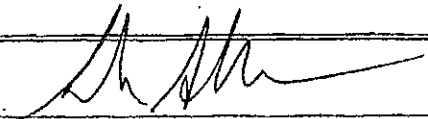
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i) Identify all its parent corporations, if any; and  
N/A

ii) list any publicly held company that owns 10% or more of the party's or amicus' stock:  
N/A

Attorney's Signature:  Date: 8/21/06

Attorney's Printed Name: Steven A. Katz

Please indicate if you are Counsel of Record for the above listed parties pursuant to Circuit Rule 3(d). Yes  No

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Phone Number: (314) 241-4844 Fax Number: (314) 588-7036

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Attachment to Disclosure Statement

Appellate Court No. 05-3588

Short Caption: Cooper, et al. (Plaintiffs/Appellees) v.  
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(1) The Certified Plaintiff Class:

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n/a

USCA 7th CIRCUIT  
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GINO J. AGNELLO  
CLERK

Attorney's Signature: William K. Carr

Date: 12-1-2005

Attorney's Printed Name: William K. Carr

Please indicate if you are *Counsel of Record* for the above listed parties pursuant to Circuit Rule 3(d). Yes  No

Address: 2222 East Tennessee Avenue  
Denver, CO 80209

Phone Number: 303-296-6511 Fax Number: 303-296-6652

E-Mail Address: bill@pension-law.com

Attachment to Disclosure Statement

Appellate Court No. 05-3588

Short Caption: Cooper, et al. (Plaintiffs/Appellees) v. IBM (Defendants/Appellants)

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“Participant” means an individual who (a) accrued a benefit under the Plan after December 31, 1994, and before January 1, 2005 (even if liability for payment of such benefit has been transferred to another plan in a transaction subject to Code Section 414(D)); or (b) was, on December 31, 2004, a Regular Employee, a Leave of Absence Employee, or receiving disability benefits under the LTD Plan; or (c) is a Vanity Fair Employee. Notwithstanding the foregoing, an individual is not a Participant if:

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CIRCUIT RULE 26.1 DISCLOSURE STATEMENT

Appellate Court No: 05-3588

Short Caption: Cooper, et al. (Plaintiffs/Appellees) v. IBM Corp. (Defendants/Appellants)

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n/a

ii) list any publicly held company that owns 10% or more of the party's or amicus' stock:

n/a

USCA - 7th Circuit  
RECEIVED  
DEC 18 2006 000  
CINDY J. AGNELLO  
CLERK

Attorney's Signature:

Date:

12/1/05

Attorney's Printed Name:

Robert F. Hill

Please indicate if you are *Counsel of Record* for the above listed parties pursuant to Circuit Rule 3(d). Yes  No

Address: 100 Blake Street Building, 1441 Eighteenth Street  
Denver, Colorado 80202

Phone Number: 303-296-8100

Fax Number: 303-296-2388

E-Mail Address: roberthill@hillandrobbins.com

Attachment to Disclosure Statement

Appellate Court No. 05-3588

Short Caption: Cooper, et al. (Plaintiffs/Appellees) v.  
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(1) The Certified Plaintiff Class:

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Short Caption: Cooper, et al. (Plaintiffs/Appellees) v. IBM Corporation (Defendants/  
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N/A

ii) list any publicly held company that owns 10% or more of the party's or amicus' stock:

N/A

Attorney's Signature:

John H. Evans

Date: August 21, 2006

Attorney's Printed Name:

John H. Evans

Please indicate if you are *Counsel of Record* for the above listed parties pursuant to Circuit Rule 3(d). Yes      No X

Address: 100 Blake Street Building, 1441 Eighteenth Street, Suite 100

Denver, Colorado 80202

Phone Number: 303-296-8100

Fax Number: 303-296-2388

E-Mail Address: jevans@hillandrobbins.com

Attachment to Disclosure Statement

Appellate Court No. 05-3588

Short Caption: Cooper, et al. (Plaintiffs/Appellees) v.  
IBM (Defendants/Appellants)

(1) The Certified Plaintiff Class:

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**PLAINTIFFS/APPELLEES' PETITION FOR REHEARING  
AND SUGGESTION FOR REHEARING *EN BANC***

**INTRODUCTION**

Rehearing en banc is required because the Panel decided two legal issues of exceptional importance under the Employee Retirement Income Security Act (“ERISA”),<sup>1</sup> and the rulings conflict with prior decisions of this Court: *Berger v. Xerox Corp. Retirement Income Guarantee Plan*, 338 F.3d 755, 758 (7th Cir. 2003), and *Solon v. Gary Community School Corp.*, 180 F.3d 844 (7th Cir. 1999). Therefore, rehearing en banc is necessary to correct the Panel’s errors on issues of great national impact and to secure and maintain uniformity of this Court’s decisions.

First, the Panel held that ERISA’s requirements for an “employee’s benefit accrual” under defined benefit plans are identical to the requirements for defined contribution plans, a holding directly in conflict with this Court’s holding in *Berger*, 338 F.3d at 758. By ignoring *Berger*’s clear distinction between defined benefit and defined contribution plans, the Panel held that the IBM’s defined benefit plan did not violate ERISA’s prohibition of age discrimination even though a younger worker received a larger pension at retirement age than an older worker with the same salary and service. The Panel justified its result by applying an “equal input” test that finds no age discrimination if the employer made a fictional contribution of the same percentage of salary to each employee’s fictional cash balance account. However, Congress has expressly provided that equal costs are no defense to age discrimination in providing employee pension benefits.

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<sup>1</sup>The amicus briefs filed by the American Association of Retired Persons (“AARP”) and by the American Benefits Council on behalf of a host of large corporations attest to the wide impact and importance of the issues presented by this case.

Second, the Panel held that age discrimination does not occur when younger workers are provided a one-time increase in their pension benefits that is denied to older workers with the same salary and service. IBM accomplished this through a formula known as the Always Cash Balance Enhancement or “ACB.” The Panel ruled that the IBM Plan did not discriminate on the basis of age by giving a pension increase only to younger workers because vested benefits were not taken away from older workers. That holding directly conflicts with this Court's decision in *Solon*, 180 F.3d at 853 (age discrimination results as surely from providing additional benefits to younger workers as taking benefits away from older workers). The Panel ignored the undisputed record that, solely on account of age, younger, but not older, employees were given opening account balances on the first day of the new cash balance plan that were dramatically larger than the value of the accrued benefits they had earned to that date. As IBM Plan's own actuary admitted, “**Young employees get the benefit of the ACB and old participants do not.**” *Id.* at SA-88 (attached as Exhibit 1) (emphasis added).

## ARGUMENT

### **I. THE PANEL CHANGED THE LAW BY HOLDING THERE IS NO DIFFERENCE BETWEEN ERISA'S AGE DISCRIMINATION STANDARDS FOR DEFINED CONTRIBUTION AND DEFINED BENEFIT PLANS.**

#### **A. The Statutory Tests for Age Discrimination in Defined Contribution and Defined Benefit Plans Are Entirely Different.**

Based on its unsupportable assumptions that “there is no statutory difference between the treatment of economically equivalent defined-benefit and defined-contribution plans” (p. 5), the Panel sanctioned a “hybrid” form of defined benefit pension plan—the cash balance plan—by ruling that it should be governed by the age discrimination standards provided in the statute for defined contribution plans. The Panel found equivalence in the two standards of age

discrimination—ERISA § 204(b)(1)(H)(i) for defined benefit plans and § 204(b)(2)(A) for defined contribution plans—by comparing them side-by-side (p. 3). While the Panel without analysis concluded that they “appear to say the same thing,” the two standards are quite different because they reflect the fundamental differences between defined contribution and defined benefit plans as stressed by this Court in *Berger* and the Supreme Court in *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 439-440 & n. 3 (1999) (citations omitted):

A defined contribution plan is one where employees and employers may contribute to the plan, and “the employer’s contribution is fixed and the employee receives whatever level of benefits the amount contributed on his behalf will provide.” . . . A defined contribution plan “provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant’s account.” ERISA § 3(34); 29 U.S.C. § 1002(34). . . .

A defined benefit plan, on the other hand, consists of a general pool of assets rather than individual dedicated accounts. Such a plan, “as its name implies, is one where the employee, upon retirement, is entitled to a fixed periodic payment.” . . . [T]he employer typically bears the entire investment risk and—short of the consequences of plan termination—must cover any underfunding as the result of a shortfall that may occur from the plan’s investments. . . .

. . . [Defined benefit plan] members have a right to a certain defined level of benefits, known as “accrued benefits.” That term, for purposes of a defined benefit plan, is defined as “the individual’s accrued benefit determined under the plan [and ordinarily is] expressed in the form of an annual benefit commencing at normal retirement age.” ERISA § 3(23)(A), 29 U.S.C. § 1002(23)(A). . . .

By contrast, an “accrued benefit” for purposes of defined contribution plans means “the balance of the individual’s account.” ERISA § 3(23)(B); 29 U.S.C. § 1002(23)(B).

ERISA’s distinctly different rules prohibiting age discrimination in defined contribution and defined benefit plans result from fundamental differences in the two types of plans, as reflected in Congress’s use of separate and distinct definitions of “accrued benefit” in defined contribution and defined benefit plans. As *Hughes Aircraft* explained, “accrued benefit” in a defined contribution plan is simply “the balance of the individual’s account.” ERISA § 3(23)(B);

29 U.S.C. § 1002(23)(B). Consequently, age discrimination occurs in defined contribution plans if “the rate at which amounts are allocated to employee’s account is . . . reduced, because of the attainment of any age.” ERISA Section 204(b)(2)(A), 29 U.S.C. § 1054(b)((2)(A).

By contrast, in defined benefit plans the “employee’s accrued benefit” is “expressed in the form of an annual benefit commencing at normal retirement age.” ERISA § 3(23)(A), 29 U.S.C. § 1002(23)(A). Consequently, the test for age discrimination provided in ERISA Section 204(b)(1)(H)(i) is whether “the rate of an employee’s benefit accrual is reduced, because of the attainment of any age.” This test focuses on the amount of benefits the employee will receive beginning at normal retirement age, and there is no testing of the “allocation” or “contributions” because there are none to test. Hence the term “defined *benefit* plan”—the employer makes no allocations to employee accounts but instead funds the pension plan on a group basis, makes the investment decisions, takes the investment risk, and is obligated to pay an amount of benefits at normal retirement age determined by a formula based on compensation and service years.

While cash balance plans are designed to resemble defined contribution plans, it is well settled that they are governed by the same ERISA provisions as traditional defined benefit plans. This Court in *Berger* rejected “Xerox’s objective of equating the cash balance plan to a defined contribution plan, where the employee’s only entitlement is to the amount in his account when he decides to leave or retire. But a cash balance plan is not a defined contribution plan; it is a defined benefit plan. . . .” 338 F.3d at 761. For that reason, *Berger* held that a participant’s “entitlement” in a cash balance plan is the same as in a traditional defined benefit plan: “specifically an entitlement to the ‘normal retirement benefit’, 29 U.S.C. § 1053(a), defined, so far as applicable to this case, as ‘the benefit under the plan commencing at normal retirement age,’ *id.*, § 1002(25). . . .” 338 F.3d at 758.

In direct conflict with the holding in *Berger*, the Panel treated IBM's cash balance plan as "economically equivalent" to a defined contribution plan and held that the "benefit accrual" in a cash balance plan can be tested in terms of a fictional salary credit each year to the fictional account rather than the employee's entitlement under a cash balance formula, which is the "benefit under the plan commencing at normal retirement age." But the "employee's benefit accrual" in a cash balance plan cannot be a contribution to the account balance, as the Panel held, because "the employee has no actual account, the employer makes no contributions to an employee account, and so there is no account balance to which interest might be added." *Berger*, 338 F.3d at 758. Moreover, this Court's decision in *Berger* also confirms that the "employee's benefit accrual" in a cash balance plan cannot be the employer's annual book entry to the hypothetical account because each pay credit allocated to the account immediately must accrue interest credits through to normal retirement age. 338 F.3d at 760-61.

Having obliterated the carefully crafted statutory differences between defined benefit and defined contribution plans, the Panel expressly approves (p. 7) a plan design that, like IBM's cash balance plan, provides an annual accrual equal to 3% of salary for a 25-year-old participant which steadily declines with age to .4% of salary for an otherwise similarly situated 65-year-old. As IBM admitted (Reply Br. 14), a traditional defined benefit plan that provided such a declining rate of benefit accrual would violate ERISA Section 204(b)(1)(H)(i). Despite that admission, the Panel excuses IBM's cash balance plan—which provides precisely the same declining rate of benefit accrual as the admittedly discriminatory traditional plan—because those accrual rates purportedly result from compounding fictional interest credits to a fictional account. This exalts form over substance. If a traditional defined benefit plan cannot provide such a rate of benefit

accrual, then a cash balance plan cannot be permitted to do so under the guise of something so facile as fictional “interest credits” to a non-existent account.

**B. Disregarding the Statutory Context, the Panel Misconstrued the Term “Employee’s Rate of Benefit Accrual” To Mean “Employer’s Rate of Contribution.”**

The Panel’s opinion (p. 4) suggests that the District Court improperly “went looking for” a definition of “rate of benefit accrual” in Section 204(b)(1)(H)(i) and “found” ERISA’s definition of “accrued benefit” as the annual benefit at normal retirement age. On the contrary, the District Court had no need to search for a definition, because the term “accrued benefit” permeates ERISA’s defined benefit plan requirements. The detailed defined benefit provisions in ERISA Section 204(b) leading up to subparagraph (b)(1)(H)(i)’s standard for age discrimination repeatedly use the term “accrued benefit.” *See* Section 204(b)(1)(A), (B), (C) (D), (E), and (F). Indeed, subparagraph (B) refers to both “accrued benefit” and the “annual *rate* at which any individual . . . can *accrue the retirement benefits payable at normal retirement age.*” (Emphasis added) Subparagraph (G), immediately preceding (H)(i), provides that ERISA is violated “if the participant’s *accrued benefit* is reduced on account of any increase in his age or service.” Thus, when the very next provision, subparagraph (H)(i), refers to “the rate of an employee’s benefit accrual,” the reference unquestionably is to “accrued benefit” at normal retirement age, not a hypothetical allocation to a fictional account. No defined benefit accrual provision in ERISA refers to such an allocation or account.

That the “rate of an employee’s benefit accrual” refers to the employee’s accrued benefit is confirmed by a later provision in Section 204, Paragraph (h), which requires a defined benefit plan to provide notice to participants if a plan amendment will significantly reduce the “rate of future benefit accrual.” In issuing regulations under this provision, the Treasury Department

explained that “[t]he statutory phrase ‘rate of future benefit accrual’ implies, *on its face*, that Section 204(h) is limited to changes in the *accrued benefit*.” 63 F.R. 68678, 68680 (Dec. 14, 1998) (emphasis added). In April 2003, Treasury issued regulations to implement amendments to Section 204(h) which included an example in which a traditional defined benefit plan was converted to one using a cash balance formula. 68 F.R. 17277, 17282-83; 26 C.F.R. § 54.4980F-1, Q&A-6(b) and Q&A-8(b) (Apr. 9, 2003). The notice of a reduction in the accrued benefit resulting from the conversion must be provided in terms of the change in the annuity accruing at normal retirement age. *Id.*, Q&A-11, Ex. 4. This Court reached essentially the same conclusion in *Davidson v. Canteen Corp.*, 957 F.2d 1404, 1407 (7th Cir. 1992). The Panel’s opinion completely ignores Section 204(h) as well as Treasury’s interpretation of its language.

Based on the many carefully crafted statutory connections between “rate of an employee’s benefit accrual” and “accrued benefit,” the Panel’s conclusion that “the phrase ‘benefit accrual’ reads most naturally as a reference to what the employer puts in . . .” (p. 4) cannot be sustained. The actual term used in subparagraph (H)(i) is “an *employee’s* benefit accrual,” not the Panel’s truncated “benefit accrual,” and “an employee’s benefit accrual” by its plain meaning refers to what the employee will receive, not what the employer fictionally contributes. Moreover, if Congress had intended to use the same test for defined contribution and defined benefit plans, it would have used the same terminology, not the completely different terms highlighted by the Panel’s oversimplified side-by-side examination.

**C. The Panel’s “Equal Input” and “Present Value” Age Discrimination Tests Are Identical to the Equal Cost Defense Rejected by Congress and the Courts.**

The Panel’s holding that ERISA’s rule prohibiting age discrimination in defined benefit plans should be tested by employer “inputs” for each participant, not the “outputs” or benefits

promised to employees, means that as long as the employer's costs for providing benefits are the same for similarly situated workers, there is no age discrimination. The Panel admits that it is applying an equal cost analysis; *see, e.g.*, Op. at 6 (benefit accrual and allocation "both refer to the employer's contribution"); *id.* at 9 ("benefit accrual' refers to the annual addition to the pot, not to the final payout.") Applying an equal cost defense is patently erroneous for two reasons.

First, there are no inputs to individual employee accounts, and the employer does not incur costs attributed to individual employees when it funds defined benefits, including those in a cash balance plan. The employer funds these benefits on a group basis. Thus, the Panel's ruling rests on a fundamental misconception and is devoid of any record support. IBM did not even raise an equal cost defense, much less undertake the impossible task of proving one.

Second, even assuming that hypothetical "contributions" to hypothetical "accounts" can be considered costs (and they cannot), the Panel's holding conflicts with Congress's express rejection of an equal cost defense for age discrimination in defined benefit plans. Section 204(b)(1)(H), ERISA's age discrimination standard for defined benefit plans, was adopted as part of the Omnibus Budget Reconciliation Act of 1986, P.L. 99-509, 100 Stat. 1874 ("OBRA 1986"). Virtually identical provisions were enacted into the Age Discrimination in Employment Act ("ADEA"), Section 4(i)(1), 29 U.S.C. § 623(i)(1) and the Internal Revenue Code, 26 U.S.C. § 411(b)(1)(H). Although the ADEA generally provides an equal cost defense to age discrimination claims, Congress expressly eliminated that defense for claims of age discrimination in employee benefit plans. *See* ADEA Section 4(f)(2)(B)(i), 29 U.S.C. § 623(f)(2)(B)(i).<sup>2</sup> These identical provisions in ERISA and ADEA, enacted together in OBRA

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<sup>2</sup>ADEA Section 4(f)(2)(B)(i), quoted in pertinent part below, omits the equal cost defense for Section 4(i):

1986, must be construed in the same manner. *See Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 384 (1992). *See also* EEOC Compliance Manual, Chapter 3, Section V(b)(1) (<http://www.eeoc.gov/policy/docs/benefits.html>): “[A]n employer cannot defend age-based reductions in accruals or contributions on the ground that it has expended an equal amount to purchase the pension benefit for younger and older workers.”

The Panel attempts to support its novel “equal input” test by speculating (p. 5) that Congress did not really intend to base age discrimination on differences in benefit amounts at normal retirement age, but instead intended to incorporate into the defined benefit system a concept of the “time value of money” by testing for age discrimination only with respect to the present value of retirement benefits. But the Supreme Court has held that discrimination in pension benefits cannot be excused by actuarially reducing differing benefits at retirement age to equal present value. In *Arizona v. Norris*, 463 U.S. 1073 (1983), the plan paid higher monthly pension benefits upon retirement to men than women who had made equal contributions. The plan attempted to justify the lower monthly benefit payments to women with the actuarial fact that women live longer than men, which meant that women would receive smaller monthly benefits but for a longer time, resulting in “roughly equal present actuarial value.” *Id.* at 1083. The Court held that present value equivalence was no defense because the payment of lower monthly retirement benefits to women was based solely on sexual difference:

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It shall not be unlawful for an employer . . .

(2) to take any action otherwise prohibited **under subsection (a), (b), (c), or (e)** of this section . . .

(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.** . . . (Emphasis added.)

We have no hesitation in holding . . . that the classification of employees on the basis of sex is no more permissible at the pay-out stage of a retirement plan than at the pay-in stage. We reject petitioners' contention that the Arizona plan does not discriminate on the basis of sex because a woman and a man who defer the same amount of compensation will obtain upon retirement annuity policies having approximately the same present actuarial value. *Id.* at 1081-1082 (footnotes omitted).

Even though the Supreme Court held that equal inputs by men and women did not legitimize higher benefits for men at retirement age, the Panel dismissed *Norris* as irrelevant (p. 10) because it found IBM's cash balance formula to be "age-neutral." In the Panel's view, any benefit differences between older and younger workers can be explained away by reducing the benefits to present value. That is clearly wrong. The difference in retirement benefits between men and women in *Norris* also resulted from the time value of money (women received smaller retirement annuities because they would receive them for a longer time), but the Supreme Court rejected both "equal input" and "present value" defenses and required equality in benefits at retirement age.

Contrary to the Panel's conclusion, IBM's plan is not age-neutral. Given ERISA's benchmark of the "accrued benefit" at "normal retirement age," which is age 65 in IBM's plan, the passage of time from the date a participant earns a benefit until his normal retirement age is strictly a function of his age. If one employee must "wait" 20 years to receive his accrued benefit at age 65 and a second employee must "wait" 30 years, the first is obviously 45 years old and the second 35. The Panel's time factor is not a function, as it suggests, of a non-discriminatory fact such as years of service, but instead is solely and directly a function of age.<sup>3</sup> Thus, the "time

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<sup>3</sup>The cash balance benefit formula explicitly includes an age factor. The rate of benefit accrual is expressed as  $p\%/1.3002 \times (1 + i\%)^{(65-n)}$ , where  $n$  is the employee's age,  $p\%$  is the annual pay credit percentage,  $i$  is the annual interest credit rate, and 1.3002 is the age-65 annuity factor used by IBM to convert the employee's hypothetical account balance to an annuity.

value of money” is a proxy for age, and a plan cannot escape age discrimination by relying on a factor that is “analytically indistinct from age.” *DiBiase v. SmithKline Beecham Corp.*, 48 F.3d 719, 730 n. 12 (3d Cir.), *cert. denied*, 516 U.S. 916 (1995). *See also Arnett v. California Public Employees Retirement System*, 179 F.3d 690, 695 (9th Cir. 1999), *vacated and remanded on other grounds, California Public Employees Retirement System v. Arnett*, 528 U.S. 1111 (2000) (where disability income based on a percentage of pay is multiplied by potential years of service to retirement age, lower benefits are based solely on age). As the EEOC has stated:

Where a benefit plan ties the amount of benefits provided to the number of years it will be before an employee reaches normal retirement age, it is explicitly age-based. This is facial discrimination that does not require additional proof of intent. EEOC Compliance Manual, Chap. 3, Sec. IV(D)(1)(a) at n. 36.

**D. The Panel Improperly Relied on Withdrawn Treasury Regulations.**

The Panel supports its interpretation of Section 204(b)(1)(H)(i) solely by referring (p. 6) to a quotation from the preamble to proposed Treasury Department regulations that were withdrawn in response to an express Congressional mandate arising from concerns that the regulations might adversely impact the District Court’s decision in this case. *See* Section 205, Consolidated Appropriations Act of 2004, P.L. 108-109. However, even these proposed regulations do not support the Panel’s holding because they provided, in general, that the phrase “rate of benefit accrual” refers to changes in an employee’s accrued benefit at normal retirement age and they carved out, on a prospective-only basis, an exception for qualified cash balance plans that met specific conditions. *See* 67 F.R. 76123 (Dec. 11, 2002). Congress recently revisited this issue when it amended ERISA to prospectively carve out an exception to 204(b)(1)(H) that permits the use of a cash balance formula meeting specific enumerated criteria—criteria that the IBM plan would not meet. *See* Section 701, Pension Protection Act of

2006, P.L. 109-280 (signed by the President on August 17, 2006). By contrast, the Panel opinion created a much broader retroactive exception for all cash balance plans, a dramatic step that Congress deliberately refused to take.

The Panel should instead have been guided by Internal Revenue Service Notice 96-8, 1996-1 C.B. 359 (Feb. 5, 1996), upon which this Court relied in *Berger*, 338 F.3d at 762. The IRS explained that the “accrued benefit” in cash balance plans is not the current account balance, as the Panel held, but the benefit that a participant is entitled to receive at normal retirement age:

Under a cash balance plan, the retirement benefits payable at normal retirement age are determined by reference to the hypothetical account balance as of normal retirement age, including benefits attributable to interest credits to that age. Thus, benefits attributable to interest credits must be taken into account in determining whether the accrual of the retirement benefits under a cash balance plan satisfies one of the rules in section 411(a)(1)(A), (B), or (C) [the identical counterparts to ERISA Section 204(a)(1)(A), (B), and (C)].

The IRS similarly points out that the “accrual” of cash balance benefits must be determined at normal retirement age. It follows that the “rate of an employee’s benefit accrual” in Section 204(b)(1)(H)(i) must also refer to the accrual of the employee’s benefit at normal retirement age.

Notwithstanding Notice 96-8, the Panel declared that “[n]othing in either ERISA or the IBM plan requires 40 years of interest to be credited to the account as soon as the young worker earns wages.” Panel Op. at 8.<sup>4</sup> This flatly contradicts the holding in *Berger* that all interest credits up to normal retirement age accrue immediately when the pay credit is allocated to a participant’s account in a cash balance plan. 338 F.3d at 761.

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<sup>4</sup>The Panel’s opinion attempts to limit *Berger*’s teachings by claiming that “*Berger* described the process [of calculating the lump sums due to cash balance plan participants] as the means to *avoid* age discrimination.” Panel Op. at 8 (emphasis in original). In fact, the *Berger* opinion does not address any age discrimination issue.

## II. IBM'S ONE-TIME INCREASE IN BENEFITS FOR YOUNGER WORKERS VIOLATED ERISA.

The Panel's Opinion distorts the facts and misstates the ERISA age discrimination issue raised by the ACB's overnight increase in benefits for younger workers—but not older workers—when IBM began its cash balance plan. The benefit enhancement provided by the ACB was not “earned” by younger workers. They had already accrued all the benefits to which they were entitled under the prior plan. Based solely on their age, the ACB gave them opening account balances worth far more than the present value of those benefits.

In a discussion limited to a single paragraph, the Panel (p. 11) summarily dismissed plaintiffs' arguments as a “rehash” of their contention that IBM's cash balance plan violated ERISA Section 204(b)(1)(H)(i). That is simply not true. The ACB violates ERISA without regard to “interest credits” or the “time value of money.” In fact, the ACB would unquestionably be illegal under Panel's “equal input” test: IBM made extra contributions—or “inputs”—to the opening account balances for younger workers and none to older workers. As a result of these unearned inputs, the “present value” of younger workers' retirement benefits instantly became larger than under the prior plan, while the present value of older worker's benefits remained unchanged.

The Panel simply ignored the facts regarding the ACB which IBM has never disputed. As part of the conversion to the cash balance formula effective on July 1, 1999, each participant was deemed to have an opening account balance equal to the greater of (a) an amount equal to the present value of their benefits under the prior, traditional defined benefit plan, or (b) the ACB formula. Appendix at A-268-269, A-391. The dramatic results produced by the ACB depended entirely on an employee's age on June 30, 1999. For younger employees, the ACB provided an

instant increase in their account balance—up to twice as much as the present value of their vested benefit. For older employees, the ACB provided no additional benefit solely because of their age. Supplemental Appendix (“Supp. App.” at SA-87, attached as Exhibit 1). IBM management was advised by the Plan’s enrolled actuary that:

Due to the nature of the IBM Retirement Plan vs. the Personal Pension Account, younger employees will benefit the most from this Always Cash Balance enhancement. On average, very young employees (in their 20s), could see their benefit double due to the enhancement, while a person who is in their early 40s might only see a 10% increase due to the Always Cash Balance enhancement. Older employees (over 45) will generally not be covered by the Always Cash Balance enhancement. Supp. App. at SA-87.

**As you can see, the excess percentage of the ACB over the basic opening balance is directly related to age. Young employees get the benefit of the ACB and old participants do not.** *Id.* at SA-88 (emphasis added).

Thus, the Panel based its finding (p. 11) that ACB was not age discriminatory on the mistaken and irrelevant factual assertion that “[e]very employee with the same salary and service record receive the same opening account balance.” The relevant fact is that under the ACB a 38-year-old, for example, received an opening account balance substantially larger than the accrued benefit earned to that date, while a 46-year-old with the same salary and service record did not. That difference resulted solely from age.

The only legal justification offered by the Panel (p. 11) for approving IBM’s gratuitous benefit increases for younger workers but not older workers is that “[a]n employer is free to move from one legal plan to another legal plan, provided that it does not diminish vested interests—and this transition did not.” The Panel thus held that it was legal to boost younger workers’ opening account balances as long as older workers’ vested benefits were not diminished. This Court held to the contrary in *Solon v. Gary Community School District*, 180 F.3d at 853.

In *Solon*, the school district offered early retirement incentives to teachers aged 58 to 61. Teachers who chose not to take early retirement claimed that the age-based incentives violated the ADEA. This Court held that providing early retirement benefits on the basis of age discriminated against the older teachers who chose not to take early retirement even though it did not diminish their benefits:

That the disadvantage employees over the age of 58 experience is the withdrawal of a “carrot” rather than the sting of a “stick” . . . makes no difference to the analysis. . . . [E]mployees who retire at a younger age are treated more favorably than those who retire later, based not on years of service or some other nondiscriminatory factor, but solely on their age at retirement. . . . [T]he “carrot” of early retirement incentives cannot be extended based solely on the age of the retiree. *Id.*

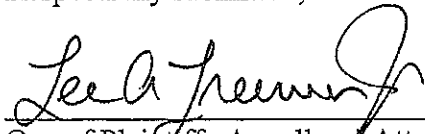
The fact that IBM has agreed that the class is entitled to \$620 million in additional benefits if the ACB violates ERISA Section 204(b)(1)(H)(i) demonstrates the magnitude of the one-time benefits IBM wrongfully gave to younger workers but not older workers.

### CONCLUSION

Plaintiffs-Appellees ask the Court to grant rehearing *en banc*.

Dated: August 21, 2006

Respectfully submitted,



One of Plaintiffs-Appellees' Attorneys

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Counsel for Plaintiffs-Appellees

EXHIBIT  
Speier 64  
9-5-02

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"David Speier" <David\_Speier@watsonwyatt.com> on 05/04/99 07:05:00 PM

To: Andrew Richter/Armonk/IBM@IBMUS, "David Speier at -ww\_washington3" <David\_Speier@watsonwyatt.com>  
cc: Philip Webber/Somers/IBM@IBMUS, Kathleen Roin/Armonk/IBM@IBMUS, Donald H Sauvigne/Mount Pleasant/IBM@IBMUS  
Subject: Re[3]: Comparison Formula Issues

Reply Separator

Subject: Re: Comparison Formula Issues  
Author: David Speier at -ww\_washington3  
Date: 5/4/99 5:28 PM

Andrew,

You asked two questions which I will try to answer. In answering these questions, I will give you my own ideas and suggestions as to an alternative design if IBM decides the windfall issue is significant.

(a) What magnitude of gain (percent and/or dollar) constitutes a windfall in this situation.

First, let us define the original purpose of the Always Cash Balance calculation. My understanding is that this formula was introduced to allow employees who currently work for IBM to be in a starting position on July 1, 1999 no worse than someone who had always been covered by this 3% cash balance plan. The formula  $5\% \times \text{Average Pay} \times \text{Service}$  provides for a rough approximation of this Always Cash Balance amount.

For commissioned employees, does the always cash balance amount as it is currently defined provide a rough approximation of what the employee would have accumulated had the cash balance been in place since the employee's original date of hire? If you believe that the always cash balance account should be based on pay as defined in the old plan, then I would argue the formula accurately represents an approximation of the always cash balance amount. If you believe that the always cash balance account needs to be based on the new definition of pay that caps commissions based on on-target earnings, then there will be a windfall to all employees with pay in excess of on-target earnings.

So let's start with the premise that the always cash balance plan should be based on pay as defined in the old plan, because that is the current definition of pay and it is not being changed until 1/1/2000. Because if you believe this premise, then we can argue there is no windfall.

Due to the nature of the IBM Retirement Plan vs the Personal Pension Account, younger employees will benefit the most from this Always Cash Balance enhancement. On average, very young employees (in their 20s), could see their benefit double due to the enhancement, while a person who is in their early 40s might only see a 10% increase due to the Always Cash Balance enhancement. Older employees (over 45) will generally not be covered by the Always Cash Balance enhancement.

Although the level of pay and service may influence, to some extent, if and how much (on a percentage basis) the Always Cash Balance enhancement is larger than the basic opening balance (accrued pension benefit), it is not the driving reason. It does however determine the dollar amount of the 'excess (windfall)', provided by the Always Cash Balance enhancement. In other words, high pay and long service drive larger benefits, and therefore a large dollar 'excess' over the basic opening balance.

EXHIBIT  
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DEPOSITION EXHIBIT

Amoroso #15  
1-15-04 KFS

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As I review the Tivoli and Sales Representative data, I did not see a pattern that deviates substantially from the general population. In fact, since this group is highly paid, the excess percentage is less than the general population for many of these employees. Therefore, I would conclude that the Always Cash Balance Enhancement is not generating a windfall for these employees. I am sure we could identify a case or two in this population which look unusual, but I can not see a general pattern of windfalls beyond what the Always Cash Balance was intended to provide. To support this claim, I have faxed you two graphs which compare the supposed ACB windfall to the age of the employees. As you can see, the excess percentage of the ACB over the basic opening balance is directly related to age. Young employees get the benefit of the ACB and old employees do not.

If we then compare this to the general population we see similar results:

Percentage Excess of ACB over Basic Opening Balance

Age	General Pop	Tivoli	Sales Rep
25 to 30	83%	96%	53%
30 to 35	57%	41%	44%
35 to 40	32%	13%	14%
40 to 45	16%	-3%	-1%

Therefore, if you believe that the correct definition of pay was used to calculate the always cash balance amount, there is little or no windfall due to the payment of commissions; only the anticipated excess that the design has always been intended generate. If IBM still believes that an 80% increase in the balance due to the ACB is excessive, it is excessive for everyone. In other words, the ACB is providing a 'rough justice' approximation of what the cash balance would have provided had it always been in place, and this provision tends to provide a substantial excess over the accrued benefit for young employees.

On the other hand, if the ACB was intended to replicate the cash balance plan as if it had always been in place using the new definition of pay (on-target earnings), then it does provide a windfall. Since the future cash balance plan only counts commissions at target the ACB should be defined as:  $5\% \times \text{Final } \$ \text{ with commissions at target} \times \text{Service}$ . In the cases where the ACB governs the calculation, every commissioned employee with pay above target is receiving a windfall, albeit small in many cases. As you can see from the analysis above and from your own analysis, this will reduce the opening balance for young employees. Older employees will be unaffected.

The amount of reduction will depend on the degree to which the actual commissions provide for a level above on-target earnings, that is difficult to analyze based on the data I have. However, as an example, if on-target earnings over 5 years was 20% less than the employees actual earnings over 5 years, then the opening balance is 20% overstated for some of the younger employees. For someone with 10 years of service, age 35 making \$250,000 (with commissions), this \$125,000 opening balance would be reduced by 525,000. This represents 10% of average pay, not insignificant, but not half the account either. (I think if you look at the data you provided me you will find that the maximum overstatement of the opening balance is less than 10% of pay for many of these employees.) For older, and generally longer service employees, changing the ACB calculation should have little or no impact on the opening balance for the reasons we have reviewed earlier (the basic opening balance is larger).

To be more specific, if the intent was an Always Cash Balance on the new pay definition, the windfall can be defined as at most:

$$5\% \times (\text{Final Average Pay full earnings} - \text{Final Average On-Target Earnings}) \times \text{Service}$$

I say "at most" because many of the older employees will be covered by the basic opening balance. In addition, if we know that the maximum percentage excess of the ACB over the basic opening balance is 100% then the balances can not be reduced to less than 1/2.

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How large the impact is and how many employees this affects will depend on the comparison of actual earnings to on-target earnings. But I will say if you change the definition, it will generally affect the younger shorter service employees who generally have the smaller balances (i.e. less than 20 years of service). The analysis you forwarded to me provides some potential maximum reductions

(b) What level of incidence of windfalls constitutes a problem worth solving?

If you believe that when the original design was developed, the always cash balance was intended to replicate what the employees would receive had the cash balance always been in place. And in establishing the always cash balance amount IBM should only consider on-target earnings then you may have a windfall issue. Therefore, I will only address this case when discussing the answer to (b).

First, beyond the level of incidence, if you feel the formula overcompensates the commissioned employees, what does changing it accomplish? Remember, it will only impact the younger employees, not the older employees with the large balances. Older employees can only be affected by adjusting the basic opening balance formula which I assume you do not want to change. If we adjust the ACB formula, we may reduce the value for the young employees somewhat, but have we really addressed the issue? Is the real issue that IBM should never have considered including commissions above target in the IBM Retirement Plan especially for Tivoli? If so, it would be very Draconian to change that retroactively.

Also, for the younger employees, who have most of their career ahead of them, haven't we already reduced the level of their future benefit by changing the formula after 2000. If we assume as in my example above that over 5 years, the average balance is overstated by 20% or in my example the overstatement of the opening balance is worth roughly 10% of pay. What is this worth in terms of retirement dollars? It seems since we have corrected the issue on a go forward basis, the 20% overstatement grows with interest and in retirement replacement income terms it is worth maybe 1% of pay. In the grand scheme of things this does not seem like a large windfall.

Now to directly answer your question, in general all cash balance designs have winners and losers. In general, you try to balance the two. However, no design is perfect, and your plan is fairly close. Some people may benefit more than others and sometimes people get small unintended windfalls. As long as we are not talking about 20% of the population, I think you can argue, at worst, this is a minor glitch in the plan design.

To change the design at this stage would involve a great deal of effort.

- \* We would need to collect additional data on historical on-target earnings to implement the formula I suggested:  $b_4 * \text{Final Average On-Target earnings} * \text{Service}$ . I do not think eliminating the ACB formula altogether is necessarily fair. In fact, it would provide them too small a benefit in relation to other employees.
- \* We would need to recalculate all of the benefits for these employees
- \* The Web tool would need to be adjusted
- \* The feeds to IPAS Apollo would need to be revisited, and the requirement reopened.
- \* The plan specs would also need to be reopened
- \* In addition, there will be CSR and HR manager training issues, as well as communication issues.

I can not see how we could accomplish all of this in the limited time we have left prior to July 1. In fact, I think it would be virtually impossible, and it would compromise all of the other deliverables.

These are my thoughts on the data, and my assessment of the windfall issue. I will most likely call into the conference call number tomorrow since I now need to be in Washington D.C. for other IBM

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meetings.

Sincerely,

David Speier.

E S L T 20 1

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**CERTIFICATE OF SERVICE**

I hereby certify that on August 21, 2006, two true and correct copies of the foregoing  
PLAINTIFFS-APPELLEES' PETITION FOR REHEARING AND SUGGESTION FOR  
REHEARING *EN BANC* were served as follows:

**Via Federal Express**

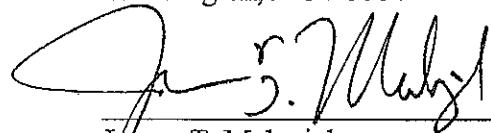
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