THE WALL STREET JOURNAL.
WSJ.com

Pension-Plan Controversy Escalates As IBM Gives In to Employee Anger

By ELLEN E. SCHULTZ, JON G. AUERBACH and GLENN BURKINS | Staff Reporters of THE WALL STREET JOURNAL

Chalk it up as a victory for aging baby boomers.

On Friday, International Business Machines Corp. gave in to the protests of middle-aged employees and significantly revised its plan to switch to cash-balance pensions, a controversial new type of pension system that has been criticized for benefiting young workers at the expense of older ones. IBM said anyone 40 or older with at least 10 years of service could remain in the old plan, more than doubling the number of employees who have a choice.

IBM said its retreat was driven entirely by employees, who barraged the company with e-mails and other correspondence, and used the Internet to stoke their collective anger. "We heard from enough of them to make the changes," says a company spokesman, John Bukovinsky.

But the controversy stirred by the cash-balance phenomenon, which stayed under the radar for several years, goes well beyond IBM. One reason is that the computer company's disgruntled employees reinforced their message by getting Congress into the act. Republican Sen. James M. Jeffords of Vermont, one of several legislators who got involved, eventually wrote to IBM's chairman, Louis V. Gerstner Jr., asking him to reconsider. The Senate Health, Education, Labor and Pensions Committee, which Mr. Jeffords heads, is holding a hearing Tuesday to look into cash-balance pension plans.

IRS Tells Field Offices to Hold Off on Clearing 'Cash Balance' Plans (Sept. 17)

Cash-Balance Pension Plans Studied by Equal Employment Commission (Sept. 15)

IBM Settles Pension Dispute; Deal May Have Wide Impact (Sept. 14)

Riled IBM Computer Workers Consider Organizing a Union (July 26)

IBM Will Adopt 'Cash-Balance' Plan for U.S. Employees' Pension Program (May 4)

The Internal Revenue Service is trying to figure out whether the plans qualify for favorable tax treatment. Although it has approved favorable tax treatment for several hundred plans in the past, the IRS last week put a moratorium on the approval of any more of them until it sorts out the complex issues.

Perhaps most important is the issue of possible age discrimination. Some IBM employees were preparing to sue the computer company alleging age bias because of the way the new plan treated older workers. The Equal Employment Opportunity Commission had begun an investigation into IBM's pension change.

IBM's backtracking is certain to give pause to other companies that are considering cash-balance pension plans. Indeed, a few other companies, such as New York utility Niagara Mohawk Power , have already revamped plans in the face of employee resistance, and the move by high-profile IBM is likely to send chills through many others of the 300 or so companies that have adopted such plans.

The computer giant says it is confident its proposed changes were legal, even without the Friday revision. But its retreat will only reinforce the arguments of those who say the plans violate pension and age-discrimination laws. It could strengthen the hand, for instance, of the employees who have brought a class-action suit against AT&T Corp. following its cash-balance conversion last year. AT&T says its plan isn't discriminatory.

Cash-balance pension plans, which were devised in the late 1980s and began really catching on in the mid-1990s, are promoted as a way to "modernize" a company's pension plan for today's highly mobile work force. Traditional "defined benefit" pension plans are structured so employees earn as much as half their ultimate benefits in their last five to 10 years on the job. But under cash-balance plans, employees accrue benefits at a steady rate throughout their years of employment. The company sets aside a hypothetical sum -- say, 3% to 7% of salary -- each year for each employee. This theoretical "cash balance" grows at a specific rate, perhaps 5%. If the employee leaves, he or she can usually take the accumulated benefits along. This may be a better system for younger workers who switch jobs before reaching peak pension-earning years.

But many older workers have discovered that when their employer switches to a cash-balance plan, they can lose anywhere from 20% to 50% -- in extreme cases -- of the value of their pensions. Not only do they miss out on the chance to fatten the pension in the late years, but also, in many cases, older workers have found that the opening balance in their cash-balance accounts was significantly lower than the value of their old benefits.

The reason for this is that companies have flexibility in deciding what assumptions they use to calculate the opening balance. The overall result: Some older employees find they would have to work for five or more years just to earn their way back to their old level of benefits -- a phenomenon variously known as "pension plateau" or "wearaway."

Employers sometimes sweeten the cash-balance option for some of their oldest employees, and give some of them the option of staying in the old plan. But typically, many workers who just miss the cutoff are left worse off.

For companies, on the other hand, the switch to cash balance has financial rewards. Because they reduce future pension liabilities, companies don't need to put as much into their pension plans.

And even when a company has a huge pension surplus, and thus doesn't need to contribute to the pension plan at all, it can benefit by converting to a cash-balance plan. That is because companies can take a credit on their income statements when pension income exceeds current liabilities. Cutting benefit obligations through conversion to a cash-balance plan reduces liabilities, fattens the surplus and thus can boost the earnings still more.

IBM Figures

IBM has an overfunded pension plan, and hasn't had to make new contributions in recent years. In 1998, its plan's surpluses provided IBM with about a $450 million credit to earnings. By converting most employees to a cash-balance plan, it was hoping to add to those surpluses and be able to report about a $650 million credit. IBM's Mr. Bukovinsky says that the company, anticipating a boost to its income statement from the pension change, has spent about $200 million to increase compensation and expand a stock-option program. He says there is a possibility that Friday's pension revision could affect the company's bottom line, but says it's too early to say by how much. The cost to IBM "won't be insignificant," Mr. Bukovinsky says.

Whether these plans run afoul of age-discrimination law is a matter yet to be decided. The primary relevant statute is the Age Discrimination in Employment Act of 1967, which protects workers age 40 and older. To win under it, a complainant must prove an employer used age considerations when determining any term, condition or privilege of employment, including hiring, firing, promotion, layoff, compensation, benefits, job assignment and training.

Age-discrimination law and related tax and pension laws were amended in 1986 to, among other things, bar employers from using age as a basis for ending or reducing a worker's pension accruals under defined-benefit plans. The change was aimed at companies that, for instance, stopped pension accruals for workers once they reached age 65. Pension law says the rate of accrual can't go down on the basis of age. Now, some are arguing that cash-balance plans run afoul of this provision because the rate of accrual declines with age, something that doesn't happen under traditional pension plans.

IRS Moves

Earlier this month, the office of Rep. Bernard Sanders, Independent of Vermont, leaked to the press a confidential memo in which the IRS district office in Cincinnati said it thought cash-balance plans discriminated against older workers. The IRS Washington office had publicly remained silent on the issue until last week, when it instructed its field offices to stop approving cash-balance plans until further notice.

The issue hasn't yet gotten a clear airing in the courts. The first case against a cash-balance plan was Aull v. Cavalcade Pension Plan, brought against Furr's/Bishop's Cafeterias Inc., one of the first companies to convert to a cash-balance plan, back in 1987. The IRS began an audit of that plan and essentially forced the employer to settle the case in March of this year.

A broader case making its way to trial is a suit by employees of Onan Corp., a subsidiary of Cummins Engine Co. The court has certified the case as a class action under the age-discrimination and pension laws. Set for trial next April, the suit has created shock waves among those who follow benefit issues. The IRS has sided with employees and asked the court to disqualify Onan's pension plan.

At the EEOC, Ida L. Castro, the chairwoman, says, "There is a reason I've taken a very measured approach" on whether cash-balance plans involve age bias. "It's very complicated. It's really difficult to come up with a broad-stroke decision."

Age-discrimination complaints have been on a downtrend, perhaps because of the low-unemployment economy. The EEOC investigated 26,350 such complaints last year, down from 32,000 in 1992. About half of the complaints blame age for a dismissal, and most of the rest allege unfair treatment or failure to be hired because of age. Only about 1.5% of 1998 complaints involved pensions or other benefits.

Case by Case

But with the conversion to cash-balance plans, it is clear that pension-related complaints are on the rise. David Certner, who coordinates economic issues for the AARP, says pension issues may be emerging as the next battleground in the age-discrimination war.

Government officials expect the matter to be dealt with on a case-by-case basis. By allowing long-employed workers 40 and over -- the key age in age-bias law -- to stay in existing plans, companies such as IBM may skirt a lot of liability.

Companies can do things that soften or eliminate the impact on older workers. Eastman Kodak Co. will give all its U.S. workers a choice of remaining in the old pension plan or joining the new one. They have until the end of November to decide. And Boeing Co. has eliminated the "wearaway" problem by keeping the old benefit in one pot and starting the new benefit from zero, so even older workers begin to build a benefit from the start.

One of several bills in Congress addressing cash-balance issues deals with the wearaway problem, and several others require employers to make clearer to workers how a pension conversion would affect them. Employees' confusion about how they were affected was one of the first issues to arise with cash-balance plans.

IBM Pension Switch

At IBM, rumors began to circulate about a switch to cash balance late in 1998. In April, after news leaked that IBM was considering such a move, employees discovered that a "pension calculator" had been removed from the company's internal computer system, making it harder for them to figure the value of their pensions.

On May 3, IBM announced its plan to convert. Two weeks later, IBM employees launched a Web site on Yahoo! (clubs.yahoo.com/clubs/ibmpension) to compare notes and air gripes about the plan. The Yahoo board says it has recorded about 1.7 million page views since May 18. And as people began getting their personal profiles from IBM on the new pension plan in June, many long-service employees realized their pensions would fall.

About this time, IBM's human-resources chief, J. Thomas Bouchard, laid out the cash-balance setup to board members. Although the possibility of a backlash was raised, the company clearly underestimated that reaction.

Workers began to organize in July, forming the IBM Employee Benefits Action Coalition, and joined forces with a group of activist retirees at General Electric Co., which doesn't have a cash-balance plan but has a much-overfunded traditional plan. IBM employees reached out to the EEOC, the IRS and Congress. IBM employees showed up at August town-hall meetings held by numerous members of Congress, making their biggest stand in Vermont, where 800 people jammed into the art center at St. Michael's College in Winooski for a meeting held by Rep. Sanders.

Mr. Gerstner and other top managers were astonished by the reaction, company insiders say, and before long began planning a retreat. On Friday, Mr. Gerstner called Sen. Jeffords to tell him of the change. The senator praised IBM for "understanding what's the right thing to do."

Union Drive at IBM

The reversal hasn't ended the problem for IBM, however. The Communications Workers of America has used the controversy to launch organizing drives at IBM facilities. In Poughkeepsie, N.Y., where IBM has about 10,000 employees, organizers have been collecting signatures and passing out flyers. "The whole union movement is gaining steam," says Bruce Cunningham, a 36-year-old employee.

Some IBMers say the past three months make them feel differently about IBM. Beth Harrington, a programmer in Rochester, N.Y., says she joined the company 10 years ago because of the pension plan and impressive benefits.

Although 45 years old, she missed by just a few weeks the 10-year service cutoff set under Friday's revised IBM plan. Ms. Harrington, who has two children and whose husband is self-employed, says she has $41,000 in her cash-balance retirement account and expects to get 7% of her about $80,000 salary each year, plus interest, under the new plan. "I cannot retire on that," she says, adding that she is considering leaving the company.

The pension-plan flap at a high-profile employer like IBM has sent a distinct message to employers, a reminder to beware of the sentiments of aging workers. It is as if the generation that once rallied around the slogan "Don't trust anyone over 30" now has a new one: Don't mess with anyone over 40.