
Deana Saxinger
CASH BALANCE PLANS: THEY WORK FOR EMPLOYERS BUT DO THEY WORK FOR EMPLOYEES?

DEANA SAXINGER*

INTRODUCTION

Imagine you are a thirty-five-year-old employee of a Fortune 100 company. You are attending a meeting in which your employer is describing the company’s new pension plan: a “cash balance plan.” Your employer currently has a traditional pension plan, which requires you to remain with the company for several years in order to earn substantial benefits. Because you do not expect to remain with the company until retirement, you do not expect to accrue much benefit under the current plan.

* J.D. Candidate, January 2001.

1. Each year, FORTUNE compiles a list of the 100 best companies to work for in the United States based on various factors such as compensation, benefits and training. Shelly Branch, The 100 Best Companies to Work for in America, FORTUNE, Jan. 11, 1999, at 118.


3. Howard Shapiro & Robert Rachal, Litigation Issues in Cash Balance Plans, in CASH BALANCE PENSION PLANS 187, 190 (Glasser Legal Works 2d ed. 1999). Under traditional defined benefit pension plans, which pay an employee a monthly benefit upon retirement, benefits accrue primarily during the employee's final years of service because the plans tie benefits to years of service. Id. Also, many plans use “final career average pay” formulas, which in effect tie the benefit to the employee’s earnings in the final five to ten years of service, when an employee’s earnings are most likely to be at their peak. Id. Because of this pattern of late-career accrual, traditional pension plans are described as “backloaded.” Id. See also Richard A. Oppel, Jr., IRS Memo Appears to Oppose a Type of Pension Conversion, N.Y. TIMES, Sept. 2, 1999, at C5 (discussing release of IRS memorandum that expresses concern about whether one company's cash balance plan violates age discrimination laws).

4. Shapiro & Rachal, supra note 3, at 190.
The cash balance plan your employer is now proposing, however, does not require you to work for the company for several years before accruing substantial benefits, and you would not forfeit these benefits by quitting your job. The plan is similar to your 401(k) plan, but your employer does not take money away from your salary to establish your account; it contributes its own money to your account. Furthermore, your employer will bear the risk of investment. If, in a given year, the investment actually earns less than your employer promised you, your employer will bear the loss.

The advantages of this plan for an employee in your situation are immediately obvious. You have not accrued substantial benefits under the current traditional pension plan because you are young and have not been with the company very long. But under the new plan, you will accrue substantial benefits earlier in your career, and you may take the benefits with you if you leave the company before you retire.

Now imagine that you are a fifty-five-year-old employee who has worked for the same company for twenty years. You have accrued substantial benefits under the traditional pension plan.

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5. See infra graph at note 52 (illustrating the accrual patterns of cash balance plans versus traditional defined benefit plans).

6. Gerald Cole, Cash Balance Plans, in CASH BALANCE PENSION PLANS, 39, 43 (2d ed. 1999). Participants who terminate their employment may choose to either take their entire account balance as a lump-sum or keep it invested in the plan. Id. If they choose to remain in the plan, the account continues to accumulate according to the particular plan's provisions and is paid either as a lump-sum or as an annuity upon retirement. Id. An annuity is "a right to receive fixed, periodic payments, either for life or for a term of years." BLACK'S LAW DICTIONARY 90 (6th ed. 1990). It is a contractual right that people buy to ensure that they will have adequate funds upon retirement. JOSEPH BANKMAN ET AL., FEDERAL INCOME TAX 77 (Richard A. Epstein et al. eds., 2d ed. 1998).

7. A 401(k) is a type of retirement plan through which employees save and invest their own money. Fidelity: The Basics of 401(k) Retirement Plans (visited Nov. 7, 1999) <http://www.401k.com/401k/about/basics.htm#1>. An employee authorizes her employer to deduct a specified amount from her paycheck before taxes are calculated and invest the money in a fund(s) of her choice. Id. The employee does not pay income taxes on the money until she withdraws it. Id.

8. Cole, supra note 6, at 42. See also Oppel, supra note 3, at C5 (discussing release of IRS memorandum that expresses concern about whether one company's cash balance plan violates age discrimination laws).

9. Cole, supra note 6, at 45. Although the employer bears the risk of investment, typically, the plan actually costs the employer less than the specified pay credits. Id. See also infra note 25 and accompanying text (illustrating how a plan providing for 5% pay credit actually costs employer only 3.5% of payroll).

10. Id. at 45. If the assets earn more interest than the rate the employer guaranteed to participants, the employer retains the extra earnings. Id. However, if the assets earn less interest than that guaranteed to participants, the employer bears the loss. Id.
and you expect to retire in the next five to ten years. If your employer adopts the new plan, you may lose the benefits you worked so long to earn. Furthermore, you will not benefit substantially from the compounding of interest on a cash balance account because your account will only have a few years to accrue interest.

You are angry that your employer would consider such a plan. The contrast between your situation and that of your younger colleague is now painfully obvious to you. Does the new plan discriminate based on age? Is there any recourse for all your

11. *Id.* Much of the criticism of cash balance plans arises from the switch from a traditional pension plan to a cash balance plan. *Id.* The result of the switch is referred to as a "wearaway" or a "plateau." Shapiro & Rachal, *supra* note 3, at 195; *see also* 145 CONG. REC. S7819, S7821 (daily ed. June 29, 1999) (including the statement of Senator Harkin regarding the Older Workers Pension Protection Act) [hereinafter Harkin]. "Wearaway" occurs when the beginning account balance in the cash balance plan is set below the accrued benefit under the prior traditional pension plan. Shapiro & Rachal, *supra* note 3, at 195. For example, an actuary for two Chase Manhattan banking executives calculated that the executives' future pensions fell 45% as a result of the bank's switch from a traditional pension plan to a cash balance plan. Harkin, *supra* note 11, at S7822. One of the executives said he would have to work about 10 more years to simply break even. *Id.* Generally, employers include transition rules in the new plan to protect older, longer service employees. Cole, *supra* note 6, at 45. *See also infra* pp. 29-32 and accompanying notes (discussing transition methods that prevent the "wearaway" problem). In addition, U.S. Supreme Court cases such as *Lockheed Corp. v. Spink*, which gives an employer broad authority in designing plan terms, have deterred litigation of "wearaway" issues. Shapiro & Rachal, *supra* note 3, at 197 (citing *Lockheed Corp. v. Spink*, 517 U.S. 882, 890 (1996)).

12. Cole, *supra* note 6, at 40. The more time the account has to accrue interest, the greater the benefit upon retirement. *Id.* Because of the effects of compounding interest, younger employees accrue benefits over a greater period of time. *Id.* Compound interest is "interest that is paid not only on the principal, but also on any interest earned but not withdrawn during earlier periods." BLACK'S LAW DICTIONARY 286 (6th ed. 1990). In other words, it is "interest upon interest." *Id.*

13. According to Senator Harkin, author of the Older Workers Pension Protection Act, there is discrimination when employees switch from traditional pension plans to cash balance plans, thereby accruing significant benefits under the traditional plan. Harkin, *supra* note 11, at S7822. Senator Harkin's rationale is that newer, younger employees would, in effect, receive greater pay (in the form of money put into their pensions) for the same type of work older employees do. *Id.* However, he bases his statement on the assumption that an older employee would suffer a "plateau" period where the employer would stop contributing to the employee's pension until the value of the new plan reaches the value of the old plan. *Id.* But if an employer does not sponsor a traditional defined benefit plan already, sponsoring a cash balance plan will not likely give rise to this kind of negative response. Cole, *supra* note 6, at 45. Older employees who have not accrued substantial benefits under an existing plan will have nothing to lose. *Id.*

14. Litigation to date includes *Corcoran v. Bell Atlantic*, 159 F.3d 1350 (3d Cir. 1998) (discussing issues of setting the opening account balance and age
years of hard work?

This Comment explores whether this new pension plan, known as the cash balance plan, complies with age-discrimination laws under the Age Discrimination in Employment Act (ADEA). Part I discusses why employers find cash balance plans attractive; it contrasts the basic features of cash balance plans and traditional defined benefit pension plans. Part II addresses whether the cash balance plan formula inherently violates the ADEA, which provides that the pension may not reduce "the rate of an employee's benefit accrual, because of age." Finally, Part III reveals that, unfortunately for older, long-service employees, the new cash balance plans do not inherently violate the ADEA. However, this Comment proposes extra-judicial sources of relief for these employees and briefly explores whether litigation, under a disparate impact theory of liability, is a viable alternative. Ultimately, this Comment establishes that older, long-service employees should not be hopeless and that cash balance plans can benefit both employers and employees.

discrimination in the rate of accrual); Goldman v. First Nat. Bank of Boston, 985 F.2d 1113 (1st Cir. 1993) (rejecting a claim that a bank's adoption of a cash balance plan constituted general evidence of age discrimination, and noting no reasonable inference of discrimination was possible since plaintiff failed to produce any evidence that the cash balance plan disadvantaged older workers); Management Employees of AT&T v. AT&T, No. 98-3660, 1999 U.S. Dist. LEXIS 6260 (D.N.J. 1999) (dismissing age discrimination claims under ADEA and state law because federal ADEA disparate impact claim not a recognized theory of liability for ADEA and state age discrimination claims preempted by ADEA).

15. See 29 U.S.C. § 623(i)(1)(A) (1994) (stating that it "shall be unlawful for an employer... to establish or maintain an employee pension benefit plan which requires or permits... the cessation of an employee's benefit accrual, or the reduction of the rate of an employee's benefit accrual, because of age."). Similarly, the Internal Revenue Code (IRC) and the Employee Retirement Income Security Act (ERISA) have parallel age discrimination provisions that also prohibit a decrease in the rate of benefit accruals based on age. Shapiro & Rachal, supra note 3, at 3 nn.5&6. See IRC § 411(b)(1)(H) and ERISA § 204(b)(1)(H)(i) (codified as 29 U.S.C. § 1054(b)(1)(H)(i) (1994)).


[C]laims that stress 'disparate impact' [by contrast] involve employment practices that are facially neutral in their treatment of different groups but that in fact fall more harshly on one group than another and cannot be justified by business necessity. Proof of discriminatory motive... is not required under a disparate-impact theory.

Id. (citing Teamsters v. United States, 431 U.S. 324, 335-36, n.15 (1977)).
I. Basic Features of Cash Balance Plans and Traditional Pension Plans

A. Why Some Employers Have Switched From Traditional Pension Plans to Cash Balance Plans

Since the Internal Revenue Service (IRS) approved the first cash balance plan in 1985, an estimated 400 to 600 mid-sized and large companies have adopted cash balance plans, covering about seven million people. The trend toward switching from traditional pension plans to cash balance plans has evolved into one of the most complex and controversial pension-related issues of the late 1990s. Cash balance plans have caught the attention of the public because they appear to shift money from long-service employees, who are typically older, to short-service employees, who are typically younger. Accordingly, the cash balance plan formula may reduce the future benefit accruals of older employees.

Young employees, who are most likely to switch jobs during their careers, tend to support cash balance plans because the plans have a more frontloaded accrual pattern. This allows younger

18. The first cash balance plan was designed by Kwasha Lipton (now part of Price Waterhouse Coopers, LLP) for Bank of America. Colleen T. Congel, Cash Balance Plans Draw Both Praise, Criticism, 26 BNA PENSION & BENEFITS REP. 656 (1999) [hereinafter Congel, Praise, Criticism].
19. Id.
20. Id. Ironically, one of the advantages of cash balance plans, its flexibility in plan design, also makes the plans controversial because of lack of IRS guidance. Id. The IRS has not promulgated official rules regarding how cash balance plans should address accrued interest, nor has it announced its official position on whether cash balance plans inherently violate the ADEA. Id. As long as employers meet certain requirements, such as defining actuarial assumptions, adhering to minimum funding requirements, and using Pension Benefit Guaranty Corporation (PBGC) premiums, employers may design their plans according to their goals of cost, benefit delivery and workforce management. Id. According to cash balance plan advocates, cash balance plans, when designed properly, meet defined benefit plan requirements and provide meaningful benefits sooner and more evenly over an employee's career than traditional pension plans. Id. However, pending judicial, legislative, and regulatory action leaves the legality of cash balance plans uncertain. Congel, Praise, Criticism, supra note 18, at 656.
22. Id.
23. “Frontloaded” refers to how the plan credits interest to the account. Shapiro & Rachal, supra note 3, at 191. In a frontloaded plan, the employer guarantees interest and credits the future compounding of the interest in the year in which the employee earns the interest credit. Id. As a result, the interest accrual rate decreases over time. Id. at 193. With a backloaded plan, however, the employer credits the interest each year as earned, and the interest credit rises yearly as the account balance increases from prior accruals. Id. at 191. The interest accrual rate increases depending on the rate of interest. Id. at 193.
employees to earn benefits at a faster pace than they would under a traditional plan. Moreover, many employers see cash balance plans as a way to reduce costs and more equitably distribute pension dollars. Older, long-service employees, however, contend that companies simply profit more from cash balance plans at their expense, and, moreover, that these companies are violating age discrimination laws. As a result, many older, longer-service employees have protested the switch and have lobbied politicians and the IRS for support in their fight to terminate the trend toward cash balance plans. Older employees claim that "[i]f the rate of accrual goes down as workers get older, then the plan violates the law." The debate is strong and has caught the attention of the IRS.

24. Congel, Praise, Criticism, supra note 18, at 656.

25. Cole, supra note 6, at 45. Typically, the cash balance plan costs less than pay credits. Id. For example, if the plan provides a pay credit of 5% and an interest credit of 6%, the plan may actually cost only 3.5% of payroll, rather than the 5% of pay credit. Id. Kevin Wagner, a senior retirement consultant from Watson Wyatt Worldwide, a consulting firm with a benefits consulting group, contends that the "vast majority of companies have not made changes with the object to save money," and "many of them pay more money." Congel, Praise, Criticism, supra note 18, at 656. According to Wagner, employers do not want to act in a paternalistic manner regarding employee pensions, but instead want employees to take control over their own work and their own pensions. Id. Cash balance plans, according to Wagner, "create an atmosphere of empowerment and responsibility" for employees. Id. Similarly, Larry J. Sher, a principal at KWASHA/HR Solutions Price Waterhouse Coopers, claims that companies have foregone their defined benefit plans altogether in favor of defined contribution plans, such as 401(k) plans, that require employees to take money out of their own earnings to fund retirement investments. Id.

26. Midcareer employees at IBM sued that company when they discovered that the company stood to gain $200 million from the switch of its traditional pension plan to a cash balance plan; $200 million that seemed to come from the reduced benefits of the employees. Learning From IBM, PENSIONS & INVESTMENTS, Oct. 4, 1999, at 12. The employees successfully demonstrated that IBM's position (that it needed to switch plans for competitive reasons) was not credible, and their efforts forced IBM to give all employees 40-years-old or older with at least 10 years of service the option of staying in the old plan or joining the new cash balance plan. Id. See also Mike Barry, Who Gets the Surplus? No One. Legislation, Litigation Keep Cash Balance From Being the Answer, in PENSIONS & INVESTMENTS, Oct. 4, 1999, at 16 (citing study by Bear Stearns & Co. which found that 1998 pension income (earnings from the assets in a pension plan in excess of liabilities under the plan) accounted for 3% of corporate income for companies in the Standard & Poor's 500 index).

27. Oppel, supra note 3, at C5.

28. Id. (quoting Representative Bernard Sanders, a Vermont Independent and critic of cash balance plans, who released the September 1998 IRS memorandum, which suggested that a company's cash balance plan may not comply with age discrimination rules).

29. See infra Section II. A. and accompanying notes (discussing how the IRS is evaluating its position on cash balance plans).
B. Features of Traditional Defined Benefit Pension Plans

A defined benefit pension plan pays participant-employees a certain amount each month when the participants retire. The plan is called a “defined benefit” because the plan is defined by the administrator’s prediction of the amount an employer must contribute to produce a specific benefit at normal retirement age. Administrators do so by assuming certain factors, such as the participant’s final career average pay and the interest earned on the funds.

Under traditional defined benefit pension plans, participants typically earn most of their benefits late in their careers for two primary reasons: 1) the plans generally tie benefits to years of service so that participants must work for the employer for a significant number of years before they begin to earn substantial benefits; and 2) plans typically use participants’ “final career average pay” to calculate their monthly benefits upon retirement. Since most participants earn their highest salaries in their last years of service, the formula in effect ties benefits received at

31. Shapiro & Rachal, supra note 3, at 190. Section 414(j) of the Internal Revenue Code of 1986 “defines a defined benefit (DB) plan as any plan which is not a defined contribution plan.” TODD NEWMAN ET AL., 1997 IRS EMPLOYEE PLANS CPE TECHNICAL TOPICS EMPLOYEE PLANS AND EXEMPT ORGANIZATIONS, § 2-3 (1997). Defined benefit plans usually express the benefit as an annual annuity beginning at normal retirement age. Shapiro & Rachal, supra note 3, at 190.

“Normal retirement age,” for purposes of defined benefit plan regulations, generally means age 65. Hugh Forcier & Jan Steinhour, Outline, Application of Certain “Qualification” Provisions of the Federal Tax Laws (and Parallel Provisions of ERISA and ADEA), CASH BALANCE PLANS CONFERENCE, July 16, 1999, at 6. Some plans, however, set retirement age at an age earlier than 65. Id. If so, “normal retirement age” is the age designated by the plan. Id.

“Final average pay” means, in effect, that the plan calculates a participant’s benefit upon retirement on the pay earned in the last five to 10 years of service. Shapiro & Rachal, supra note 3, at 190.

Defined benefit plans may be contrasted to defined contribution plans, such as 401(k) plans. Cole, supra note 6, at 41. Section 414(i) of the 1986 Internal Revenue Code “defines a defined contribution (DC) plan as a plan which provides an individual account for each participant” and provides “benefits based solely on the amount contributed to the . . . account” plus any income, expense, gain, or loss. NEWMAN, supra note 31, at § 2-3. Also, any forfeiture of benefits from participants who left the plan may be added to the remaining participants’ accounts. Id.

Unlike defined benefit plans, defined contribution plans do not define the value of the benefit at normal retirement age; the plans only promise the participant the amount in the account. Cole, supra note 6, at 40. The plans involve only setting up a separate account for each participant and defining only the exact contribution from the employer each year. Id. Thus, unlike traditional defined benefit plans, a participant can easily determine what her current benefit is by simply looking up the account balance; it is more difficult, however, for her to determine what her retirement benefits will be. Id.

32. Shapiro & Rachal, supra note 3, at 190.
retirement to the last five to ten years of employment.\textsuperscript{33} Thus, traditional pension plans are described as "backloaded" because participants earn most of their benefits late in their careers.\textsuperscript{34} Older and long-service employees, therefore, benefit most from these plans.\textsuperscript{35}

Several negative features are inherent in the traditional pension plan formula. Only those few employees who stay with one company for a long time will earn a substantial benefit.\textsuperscript{36} Until employees reach an age (typically late-forties to mid-fifties) close to the age required to qualify for substantial benefits, the benefits are difficult to calculate and, therefore, may not mean much to employees.\textsuperscript{37} Early in their careers, employees know that they have earned little or no benefits, so for them, benefits under the traditional plan are only ephemeral. Moreover, employees near to qualifying for substantial benefits may find themselves "in 'pension jail' because they cannot change employers without" losing substantial benefits.\textsuperscript{38}

C. Features of Cash Balance Plans

Like traditional defined benefit pension plans, cash balance plans are a type of defined benefit plan.\textsuperscript{39} However, cash balance

\begin{itemize}
  \item Proponents of traditional defined benefit plans refute the myth that employees struggle to understand their benefits under a traditional plan. Learning From IBM, PENSIONS & INVESTMENTS, Oct. 4, 1999, at 12. When IBM switched to a cash balance plan, the strong protest of employees 40 and over showed that they paid attention to their retirement benefits. Id. With the help of the Internet, a computer-literate workforce can find key information quickly, easily share the information with colleagues nationwide, build a network of supporters, and communicate with members of Congress and the media, often without the employer's awareness of the activity. Id.
  \item Cash balance plans mimic the features of both defined benefit plans and defined contribution plans, "but they remain defined benefit plans for regulatory purposes." Forcier & Steinhour, supra note 31, at 2. Like defined benefit plans, cash balance plans define the accrued benefit as an annuity beginning at normal retirement age. Id. at 6. Cash balance plans calculate the amount of money in the annuity by projecting the account balance forward (at a certain interest rate) to normal retirement age and converting that projection to its current value. Id. Like defined contribution plans, cash balance plans establish an individual account that accumulates for each employee. Congel, Praise, Criticism, supra note 18, at 656. The individual accounts, however, are not genuine accounts. Id. They are nominal accounts used for record keeping purposes, and the actual assets of the cash balance plan essentially are the sum of the individual accounts. Id. In a defined contribution plan, the account balances must equal the plan assets. Id. A cash balance plan, however, does not credit the hypothetical account with the gains or losses that the plan's assets actually experience. NEWMAN, supra
\end{itemize}
plans use a different pension formula. The cash balance plan establishes a “hypothetical account” consisting of two components: a work credit (e.g., 3% of compensation) and an interest credit (e.g., 6% per year). The work credit is the employer’s contribution to the employee’s hypothetical account and is defined as a specific percentage of the employee’s annual compensation. The interest on the hypothetical account compounds like the interest on a 401(k) account or any other interest-bearing account, such as a personal savings account held at a bank. Because of the compounding interest, participants begin earning substantial benefits early in their careers with the employer; this is why cash balance plans are called “frontloaded.” Cash balance plans most benefit those young employees who participate in the plans early in their careers and allow their accounts to grow over a long period of time.

The following charts contrast the accrual patterns of a backloaded plan and a frontloaded plan.

**Backloaded Plan: Interest Earned Each Year**

<table>
<thead>
<tr>
<th>Age</th>
<th>Pay credit</th>
<th>Interest credit</th>
<th>Account Balance</th>
<th>Benefit Accrual</th>
<th>Rate of Benefit Accrual</th>
</tr>
</thead>
<tbody>
<tr>
<td>40</td>
<td>$1000</td>
<td>0</td>
<td>$1000</td>
<td>$100</td>
<td>0.50%</td>
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<tr>
<td>41</td>
<td>$1000</td>
<td>$60</td>
<td>$2060</td>
<td>$106</td>
<td>0.53%</td>
</tr>
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</table>

Note that the rate of benefit accrual increases as the participant’s age increases.
Frontloaded Plan: Interest Earned Each Year

<table>
<thead>
<tr>
<th>Age</th>
<th>Pay credit</th>
<th>Earned and Projected Interest Credit</th>
<th>Projected Account Balance</th>
<th>Benefit Accrual</th>
<th>Rate of Benefit Accrual</th>
</tr>
</thead>
<tbody>
<tr>
<td>40</td>
<td>$1000</td>
<td>$3292</td>
<td>$4292</td>
<td>$429</td>
<td>2.15%</td>
</tr>
<tr>
<td>41</td>
<td>$1000</td>
<td>$3049</td>
<td>$8341</td>
<td>$404</td>
<td>2.02%</td>
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<td>$1000</td>
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<td>$12,161</td>
<td>$382</td>
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<td>$1000</td>
<td>$2604</td>
<td>$15,765</td>
<td>$360</td>
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<td>$1000</td>
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<td>$340</td>
<td>1.70%</td>
</tr>
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<td>$1000</td>
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<td>$1000</td>
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<tr>
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<td>$1396</td>
<td>$35,880</td>
<td>$240</td>
<td>1.20%</td>
</tr>
</tbody>
</table>

Note that in the backloaded plan, as the participant's age increases, so does the rate of benefit accrual. In the frontloaded plan, as the participant's age increases the rate of benefit accrual decreases.

In addition, the following graph illustrates how both traditional defined benefit pension plans and cash balance plans can provide substantial benefits to employees upon retirement.

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47. *Id.* These figures are based on "$20,000 pay, 5% pay credit, 6% interest credit, annuity factor of 10, and normal retirement age of 65." *Id.* Note that the rate of benefit accrual decreases as the participant's age increases. *Id.*

48. Cole, *supra* note 6, at 43. The graph assumes the employee began employment at age 25, and the plan vested after five years of service, at age 30. *Id.* Notice that younger employees would find the cash balance plan more attractive than the traditional plan because they will be able to take a greater lump-sum upon termination than under the traditional plan. *Id.*
Notice that if the employee terminates employment at age 35, he will not have earned any benefit under the traditional pension plan, but he will have earned $50,000 under the cash balance plan—money he could either keep in the plan or take out as a lump-sum. However, if he does not start investing in the cash balance plan until age forty-five, he will not earn nearly the same benefits as he would if he started at age twenty-five because his account has twenty fewer years to accrue principle and interest.

Traditional plans and cash balance plans provide comparable final benefits to retirement-age employees. However, the two plans differ in how the benefits accrue and whether employees

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49. Id.
50. Id. at 41–42.
51. Id. at 41.
52. Plan administrators calculate the rate of benefit accrual by projecting forward to normal retirement age the total benefit for each particular year, and dividing the total benefit for each year by the participant's current compensation. Forcier & Steinhour, supra note 31, at 6. The calculation expresses the accrual rate as a percentage of the participant's compensation. Id.
Assuming the participant earns the same salary, same pay credit, and same interest credit each year, the same amount of money would be credited to the participant's hypothetical account each year, and one would expect the rate of benefit accrual to be the same for each year. Id. However, because the benefit earned in a particular year has one less year to accrue interest as the employee approaches retirement, the rate of accrual decreases as a participant's age increases in a cash balance plan. Shapiro & Rachal, supra note 3, at 193. The rate of accrual on a traditional defined benefit pension plan, however, increases as the participant approaches retirement age because traditional plans are designed to provide larger pay and interest credits as the participant approaches retirement age. Id. Even if the participant earns the same salary throughout her career, the pay and interest credits are not the same throughout the participant's career; traditional plans tie benefits to
forfeit their benefits when they terminate their employment before retirement.\(^5\) The difference between the cash-out value of the cash balance plan and the cash-out value of the traditional pension plan illustrates the different allocation of resources between long-service employees and short-service employees.\(^5\) Under the cash balance plan, the employer contributes money to the employees' hypothetical accounts earlier in their careers—money that the employer would not have to contribute until far later in their careers under a traditional plan.\(^5\) The employer may design the plan so that the accrual pattern better approximates a traditional defined benefit plan, but doing so would shift the balance of accruals more toward long-service employees.\(^5\) Accordingly, this would defeat the employer's goal of distributing benefits more equitably.\(^5\)

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years of service and the final career average pay. \textit{Id.} at 190, 193.

53. \textit{See generally} Cole, \textit{supra} note 6, at 43 (discussing employee-participants' options under a cash balance plan upon termination). The following chart summarizes the similarities and differences between traditional pension plans and cash balance plans:

<table>
<thead>
<tr>
<th>Characteristic:</th>
<th>Traditional Plan</th>
<th>Cash Balance Plan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee appreciation</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Investment risk/profit</td>
<td>Employer</td>
<td>Employer</td>
</tr>
<tr>
<td>Portability</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Usual payment form</td>
<td>Annuity</td>
<td>Lump sum or annuity</td>
</tr>
<tr>
<td>Ability to grant past service</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Ability to grant post-retirement increases</td>
<td>Yes</td>
<td>Yes if annuity</td>
</tr>
<tr>
<td>Ability to provide early retirement subsidies, retiree medical and other ancillary benefits</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Funding Flexibility</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Shapiro & Rachal, \textit{supra} note 3, at 190.

54. Cole, \textit{supra} note 6, at 43.

55. \textit{Id.} "Different allocation of resources" does not mean that the employer takes away money already earned by older employees and gives it to younger employees. \textit{Id.} It refers to the long-term effect of switching to a cash balance plan. \textit{Id.} Under a cash balance plan, the employer spreads its total pension resources more evenly than under a traditional defined benefit plan by allocating more money for employees earlier in their careers rather than later in their careers. \textit{Id.}

56. \textit{Id.}

57. Congel, \textit{Praise, Criticism, supra} note 18, at 656.
II. DO CASH BALANCE PLANS INHERENTLY VIOLATE THE AGE DISCRIMINATION IN EMPLOYMENT ACT?

A. Agency Regulations

A major concern of cash balance plans is whether the method used to calculate the rate of benefit accrual on such a plan, a method currently promulgated by the IRS, renders cash balance plans inherently age-discriminatory. The claim that cash balance plans inherently violate age discrimination laws hinges primarily on how the plans handle the compounding of interest credits. Like all defined benefit plans, cash balance plans must satisfy one of the accrual rules of the Internal Revenue Code (IRC) § 411(b)(1). Cash balance plans generally can only satisfy the 133-1/3% rule. Traditional defined benefit pension plans and cash

60. Shapiro & Rachal, supra note 3, at 191.
61. NEWMAN, supra note 31, at § 2-5. Section 411(b)(1) of the Code prevents excessive backloading of benefits in a defined benefit plan. Forcier & Steinhour, supra note 31, at 5. For a defined benefit plan to meet this requirement, it must satisfy one of three accrual methods: 1) the 3% method, Code § 411(b)(1)(A); 2) the 133-1/3% method, Code § 411(b)(1)(B); or 3) the fractional rule, Code § 411(b)(1)(C). Id.
62. NEWMAN, supra note 31, at §2-5. The 3% method requires that, in each plan year, the accrued benefit at normal retirement age equals the standard retirement benefit defined by the plan. Id. Most importantly, the rate of benefit accrual for any particular participant for any particular year must not be more than 1/3 greater than the rate of benefit accrual for any previous year. Forcier & Steinhour, supra note 31, at 5.
A defined benefit plan satisfies the fractional rule if the accrued benefit earned by any participant is not less than the “fractional rule benefit” multiplied by a certain fraction (the numerator equals the number of years of participation in the plan, and the denominator equals the total number of years the participant would have participated in the plan if he terminated employment at the normal retirement age under the plan). NEWMAN, supra note 31, at §2-5. The “fractional rule benefit” is the annual benefit beginning at normal retirement age that the participant would get if he continued to earn annually, until retirement, the same rate of compensation that the plan currently uses to compute “normal retirement benefit.” Id. Because cash balance plans generally can only satisfy the 133-1/3% rule, the scope and text of this Comment will focus primarily on this IRC accrual rule.
balance plans do not specify the rate of accrual for each year. They express the accrual as an annual benefit beginning at normal retirement age, so they must calculate the rate of accrual according to the 133-1/3% rule.\textsuperscript{63} This rule requires that the rate of benefit accrual for any particular year must not be more than one-third greater than the rate of benefit accrual for any previous year.\textsuperscript{64}

Much of the controversy surrounding cash balance plans stems from different opinions regarding how to calculate the rate of accrual,\textsuperscript{65} and, in particular, whether it should be calculated using a frontloaded or backloaded approach.\textsuperscript{66} The ERISA (Employee Retirement Income Security Act)\textsuperscript{67} plaintiffs bar and other pro-participant advocates argue for a frontloaded approach where the rate of benefit accrual for each year is calculated as an annuity beginning at normal retirement age and the rate is expressed as a percent of an employee's current compensation.\textsuperscript{68} Under this method, the pay and interest credits for each year produce a successively smaller deferred annuity as the participant's age increases.\textsuperscript{69} The pay and interest credit for a particular year will have one year less to earn compound interest than the pay and interest credit for a previous year.\textsuperscript{70} As a result, the rate of accrual decreases each year. Both the IRS and experienced cash balance practitioners use this method to test the 133-1/3% anti-backloading rule.\textsuperscript{71} To attain a level accrual pattern under this method, the employer would have to contribute an additional pay credit to older employees each year to compensate for the one less year the pay and interest credit will have to earn

\textsuperscript{63} Id.
\textsuperscript{64} See supra note 61 (discussing the three accrual rules).
\textsuperscript{65} Forcier & Steinhour, supra note 31, at 9.
\textsuperscript{66} IRS Notice 96-8, 1996-1 C.B. 359. Backloaded interest credit plans generally do not satisfy the accrual rules of IRC § 411(b)(1)(A), (B), or (C) because the plans do not credit the interest that will be earned in a particular year to the hypothetical account until the employee actually serves the employer. Id.; see also graph of accrual patterns, supra note 52 (illustrating the sharp increase of accrued benefits during a participant's later years of service in a backloaded plan—the 133-1/3% rule prevents too sharp of an increase in accrued benefits in the later years of service). The issue regarding rate of accrual, then, refers to the rate of accrual on a frontloaded cash balance plan. IRS Notice 96-8, 1996-1 C.B. 359. A frontloaded plan considers the interest credit to have accrued when the employer makes the underlying pay credit regardless of whether the participant actually served the employer for that year. Forcier & Steinhour, supra note 31, at 9.
\textsuperscript{68} Forcier & Steinhour, supra note 31, at 9.
\textsuperscript{69} Id.
\textsuperscript{70} Id.
\textsuperscript{71} Id.
compound interest.\textsuperscript{72}

Employers, however, argue for a current value approach.\textsuperscript{73} Employers want to define each year's rate of benefit accrual as the current value of the pay credit, expressed as a percentage of the participant's current compensation, rather than the value projected as an annuity at normal retirement age.\textsuperscript{74} Employers advocate this approach because under this method, the rate of benefit accrual does not decrease as the participant's age increases. It either remains level or increases depending on the amount of a participant's compensation.\textsuperscript{75}

Although the Treasury/IRS has commented about benefit accruals under cash balance plans and whether they violate age discrimination laws, the IRS has yet to promulgate official guidance on the issue.\textsuperscript{76} Prior to 1991, Senior IRS staffers were concerned that the frontloaded cash balance plans would violate the age-discriminatory accrual prohibition.\textsuperscript{77} However, in the September, 1991, Preamble to Treasury Regulation \textsection 1.401(a)(4),\textsuperscript{8} the IRS stated that frontloaded cash balance plans would not violate laws which prohibit age-discriminatory accruals.\textsuperscript{79}

\begin{quote}
[T]he interest adjustments through normal retirement age must be
\end{quote}

\textsuperscript{72} Id. Another possible correction is to weigh pay credits based on years of service rather than a specific age. \textit{Id.}

\textsuperscript{73} Forcier & Steinhour, \textit{supra} note 31, at 9.

\textsuperscript{74} Id. This method is also used for application of the Code \textsection 401(a)(4) "general test" under the nondiscrimination rules, Treas. Reg. \textsection 1.401(a)(4)-3(c). \textit{Id.}

\textsuperscript{75} Id.

\textsuperscript{76} Id. at 10.

\textsuperscript{77} Id. The representatives of the IRS and Treasury who questioned the legality of cash balance plans argued that if employees accrue benefits based on the same hypothetical contribution regardless of age, the contribution results in a smaller benefit for older employees than for younger employees. Forcier & Steinhour, \textit{supra} note 31, at Attachment I (citing letter from William M. Mercer, Ltd., an international consulting firm, dated July 9, 1991). The effect would be age related, so cash balance plans arguably violate the prohibition against age-discriminatory accruals. \textit{Id.} The Mercer letter, in turn, contended that nothing in the legislative history of Code section 411(b)(1)(H) (the Code provision analogous to the ADEA's prohibition against age discriminatory accruals) precludes interpreting "accrued benefit" as a level, indexed formula and does not require a comparison of the value of benefits at normal retirement age. \textit{Id.} The Mercer letter also noted that interpreting section 411(b)(1)(H) to require a projection of the future value of benefit accruals would render automatic post-retirement COLAs (Cost of Living Adjustments) impermissible. \textit{Id.} The value of the COLA decreases after normal retirement age, presumably because there will be fewer years over which the COLA might apply. \textit{Id.} There is no indication that Congress ever intended to invalidate automatic COLAs. Accordingly, the IRS should not construe section 411(b)(1)(H) to invalidate cash balance plans either. \textit{Id.}


\textsuperscript{79} Id. at 47,528.
accrued under the plan in the year the hypothetical allocation in which they relate is accrued . . . . The fact that interest adjustments through normal retirement age are accrued in the year of the related hypothetical allocation will not cause a cash balance plan to fail to satisfy the requirements of section 411(b)(1)(H), relating to age-based reductions in the rate at which benefits accrue under a plan. 80

Because the Preamble did not explain the basis for the statement, some commentators have argued that courts should give little or no weight to the statement. 81 Obviously, employers supported the statement while the ERISA plaintiff's bar criticized it. 82 Lee A. Sheppard 83 commented:

What were the drafters of the preamble sentence thinking . . . [t]hey had concluded that cash balance plans should be tested for age discrimination the same way they were tested for discrimination in favor of the highly paid—as though the plans were defined contribution plans. Thus the accrued benefit should be evaluated on a present value basis rather than on a projected benefit basis. The drafters of the preamble just did not bother to state any of this reasoning in a binding official document, nor have their successors bothered to confirm the conclusion. 84

The IRS's previous guidance before the 1991 Preamble, however, supports the statement. 85 In the IRS temporary regulations issued in April 1988, 86 the IRS noted that 1) a defined benefit plan does not cease or reduce the rate of accrual due to age "solely because of a positive correlation between increased age and a reduction or discontinuance in benefit accruals;" 87 and 2) plans may specify benefit accrual reductions that will merely correlate to age, e.g., provide for 2% credit the first fifteen years of service and 1% thereafter. 88 Conversely, the temporary regulations also state that "any limitation on the amount of benefits a participant may accrue . . . may not be based, directly or indirectly, on the attainment of any age," 89 and "whether a limitation is indirectly based on age is determined with reference to all the facts and

80. Id.
81. Shapiro & Rachal, supra note 3, at 194.
82. Forcier & Steinhour, supra note 31, at 10.
83. Lee A. Sheppard, The Down-Aging of Pension Plans, TAX NOTES TODAY, Jan. 11, 1999, at 6-6. Lee A. Sheppard is a contributing editor for TAX NOTES TODAY, a daily and weekly publication covering a variety of issues related to IRS activities.
84. Id.
85. Shapiro & Rachal, supra note 3, at 194.
87. Id. § 1.411(b)-(2)(a)
88. Id. § 1.411(b)-(2)(b)(3)(i).
89. Id. § 1.411(b)-(2)(b)(2)(ii).
circumstances. For example, if a plan provision, for benefit accrual purposes, disregards a participant's years of service after the participant becomes eligible for social security, the provision is a direct limitation based on age. In 1999, the IRS indicated that it may reconsider its guidance. Carol Gold, Director of the IRS Employee Plans Division, stated after a March 1999 conference that the IRS should reexamine whether cash balance plans reduce the rate of benefit accruals based on age. Furthermore Ms. Gold said, "I think we need to take another look at the issue," although the IRS said the plans were not a problem in previously published documents meant as guidance.

In an October 19, 1999 notice, the IRS solicited comments from employees, employers, and their representatives on issues regarding cash balance plans. The issues included the rate of accruals, the protection of accrued benefits, and the prohibitions against reduction of benefit accruals because of age. In addition to the IRS, the Labor Department and the Equal Employment Opportunity Commission (EEOC) are researching the issues as well. Thus, the IRS is taking a close look at the issue, and both sides anxiously await its guidance.

Even if opponents of cash balance plans correctly claim that a cash balance plan's rate of benefit accrual decreases as a participant ages, the decrease itself does not render cash balance plans inherently unlawful under the ADEA. The decrease must occur because of age, not merely a mathematical interpretation of the pension formula. The claim largely rests on the IRS's

90. Id. § 1.411(b)-(2)(b)(2)(ii).
92. Shapiro & Rachal, supra note 3, at 195.
94. Id.
96. Id.
97. Id.
98. See generally Colleen T. Congel, Agency Official Rejects Help From Jeffords; Cash Balance Issues Get Airing at Hearing, 183 DAILY TAX REP. G-6 (1999) (discussing September 21, 1999, hearing of the Senate Committee on Health, Education, Labor and Pensions which primarily concerned how an employer should implement a cash balance plan and how much information an employer must disclose when it announces a pension plan change). Most parties at the hearing, including actuaries, benefit attorneys, company officials, consulting firms, and lobby organizations tended to agree that employers should inform employees of plan changes and agreed that cash balance plans are not inherently defective. Id.
100. Id.
classification of cash balance plans as defined benefit plans and
frontloaded plans rather than specific instances of discriminatory
treatment of older workers. 101 By classifying cash balance plans as
defined benefit plans, the IRS subjects cash balance plans to the
prohibitions against excessive backloading. 102 To avoid excessive
backloading, generally a cash balance plan must be frontloaded. 103
The frontloading, in turn, gives rise to the § 623(i)(1)(A) ADEA104
claim. 106

However, cash balance plans are “a new animal” and should
be treated as such. 106 Although classified as defined benefit plans,
they are not the same as traditional defined benefit plans, so the
rules regulating defined benefit plans should not apply to cash
balance plans. 107 If the IRS devised a separate accounting method

101. Id. Typical claims of age discrimination allege employer bias against
older workers. Id. The plaintiff claims some type of adverse treatment, e.g., he
was wrongfully terminated, not promoted, or paid less, because of his age. Id.
at ¶ 4. He offers either direct or indirect evidence of discriminatory intent. Id.
An employer’s statement that “I don’t like older workers” is an example of
direct evidence. Id. An indirect example is where an employer produces a
nondiscriminatory reason for termination, such as poor performance, but the
employer’s reason was a pretext for age discrimination because the younger
employee who replaced the plaintiff performed at least as poorly. Id.
Plaintiffs claiming that cash balance plans inherently violate the ADEA,
however, base their argument on how the IRS interprets the restrictions on
excessive backloading. Id. at ¶ 1.

102. Id. at ¶ 10. See Notice 96-8, supra note 66 and accompanying text
(discussing Notice 96, which describes how cash balance plans may only avoid
violation of the excessive backloading rule through the 133-1/3 method of
accounting).

103. See Notice 96-8 supra note 66 and accompanying text (discussing how
the rule against excessive backloading generally requires cash balance plans
to be frontloaded).

104. 29 U.S.C. § 623(i)(1)(A) (1994) (quoting the ADEA’s prohibition of
reductions in rates of benefit accruals because of age).


106. Congel, Praise, Criticism, supra note 18, at 656.

107. See supra note 39 and accompanying text for a discussion on how cash
balance plans share some of the features of both defined benefit plans and
defined contribution plans, and for sources which suggest the IRS should
create regulations specifically tailored to cash balance plans. Michael S.
Horne, an attorney with Covington & Burling and member of the ERISA
Industry Committee, finds the classification of cash balance plans as defined
benefit plans illogical. Horne, supra note 99, at ¶ 15. If two employers each
offer the same annual contributions and offer equivalent methods of
calculating interest credits, but one employer calls its plan a cash balance plan
and the other calls its plan a defined contribution plan, the employer with the
cash balance plan risks violating the ADEA while the other does not. Id.
According to Horne, the purposes and policies of the ADEA do not support this
result. Id. Horne notes that section 623(i)(1)(B), which parallels section
623(i)(1)(A), states that defined contribution plans are unlawful if
“contributions to the employee’s account terminate or are reduced on account
of age.” Id. at n.8. Thus, in a defined contribution plan, it is irrelevant that
younger employees will accumulate more earnings than older employees if
specifically for cash balance plans, the ADEA claim would disappear.\textsuperscript{108} Furthermore, Congress specifically sanctioned the frontloading of interest credits prior to 1986 for other defined benefit plans.\textsuperscript{109} Finally, cash balance plans use the frontloaded approach to determine benefit accruals primarily because IRS interpretations of the restrictions against excessive backloading encourage them to do so.\textsuperscript{110} Thus, agency regulations defeat the argument that cash balance plans violate the ADEA.

\textbf{B. Case Law}

Like authoritative regulations, case law does not support the argument that cash balance plans inherently violate the ADEA.\textsuperscript{111} Thus far, no reported case has held that cash balance plans inherently violate the ADEA.\textsuperscript{112}

Only one case applying § 623(i)(1)(A) relates to whether a pension plan inherently violates the ADEA.\textsuperscript{113} In \textit{Atkins v. Northwest Airlines, Inc.},\textsuperscript{114} a group of current and retired pilots claimed that Northwest Airlines' retirement policy violated § 623(i)(1)(A).\textsuperscript{115} The plaintiffs alleged that the rate of benefit accrual for pilots age fifty-five to sixty was higher than the rate of benefit accrual for employees who continued to work past age sixty.\textsuperscript{116} In effect, pilots age fifty-five to sixty accrued benefits at a higher rate than those over age sixty due to a “benefit reduction factor” for early retirement.\textsuperscript{117}

The court affirmed summary judgment for Northwest because it found that the early retirement discounts were not part of both work until normal retirement age as long as the employer's contributions are the same. \textit{Id.}

\textsuperscript{108} Horne, supra note 99, at ¶ 1. \textit{See also} White, supra note 39, at 2047 (noting that the vast majority of litigation regarding cash balance plans derives from their classification as defined benefit plans for tax purposes).

\textsuperscript{109} Horne, supra note 99, at ¶ 14. ERISA section 204(c) and Code section 411(c) require defined benefit pension plans that accept mandatory employee contributions to use a frontloaded method, similar to the method used by cash balance plans to determine the accrual of employee benefits. \textit{Id.} at n.7. Because these sections require the use of a frontloaded approach, they strongly indicate that Congress, when it enacted age discrimination laws, did not intend to prohibit cash balance plans from using a frontloaded approach.

\textit{Id.}

\textsuperscript{110} \textit{Id.} at ¶ 14.

\textsuperscript{111} \textit{Id.} at ¶¶ 24-29.

\textsuperscript{112} \textit{Id.} at ¶ 24. \textit{See supra} note 14 (discussing some of the litigation to date concerning cash balance plans).

\textsuperscript{113} Horne, supra note 99, at ¶ 24.

\textsuperscript{114} 967 F.2d 1197 (8th Cir. 1992).

\textsuperscript{115} \textit{Id.} at 1200-01.

\textsuperscript{116} \textit{Id.}

\textsuperscript{117} \textit{Id.} The “benefit reduction factor” for early retirement was 0.25% per month under age sixty. \textit{Id.}
"accrued benefits." The court found that the plaintiffs were simply arguing for a "late retirement bonus" of 0.25% each month to make the rate of accrual after age sixty the same as the rate of accrual from age fifty-five to sixty. Though the pensions of pilots who worked past age sixty would not increase as if they retired at age sixty, the outcome did not "result from age discrimination. It merely reflected that the early retirement discount is exhausted." While the pilots might have had "a valid argument for the bargaining table," they did not have an argument under ERISA or the ADEA.

Cases dealing with more general ADEA provisions also lead to the conclusion that cash balance plans do not inherently violate the ADEA. In Hazen Paper Co. v. Biggins, the U.S. Supreme Court held that an employer who fired a sixty-two-year-old employee a few weeks before his pension vested did not violate the ADEA. The Court found that the employer acted on the basis of years of service, a factor which is only "empirically correlated" with age. The Court stated that "[b]ecause age and years of service are analytically distinct, an employer can take account of one while ignoring the other, and thus it is incorrect to say that a decision based on years of service is necessarily 'age based.'" Under this reasoning, any decrease in the rate of accrual on a cash balance plan only empirically correlates with age. It does not occur because of age, so cash balance plans do not inherently violate the ADEA.

An earlier case, Dorsch v. L.B. Foster Co., held that a flat monthly supplement offered to encourage employees to retire early does not amount to age discrimination. Although the supplement may be "worth" more to younger employees than older employees based on longer life expectancies, the mathematical distinction does not amount to a violation of the ADEA.

118. Id.
119. Atkins, 967 F.2d at 1201.
120. Id. The court further stated that "[f]ederal law does not forbid early retirement discounts or service caps." Id.
121. Id. at 1200.
124. Id.
125. Id. at 611. The Court clarified its decision by stating that "[w]e do not mean to suggest that an employer lawfully could fire an employee in order to prevent his pension from vesting." Id. at 612. This type of conduct would violate section 510 of ERISA, and the court of appeals correctly entered judgement for the plaintiff under that statute. Id. Furthermore, the Court noted that it would not consider the special case where an employer fires an employee just before his pension benefits were about to vest because of age rather than years of service. Id. at 613.
126. Dorsch v. L.B. Foster Co., 782 F.2d 1421, 1429 (7th Cir. 1986).
127. Id. at 1428. The court concluded that, since the employer's decision to provide equal monthly early retirement benefits rather than equal total early
Likewise, plaintiffs must show more than tangential, mathematical correlation with age. They must show how the formula discriminates because of age.

Similarly, Davidson v. Board of Governors and Tagatz v. Marquette University held that a compensation policy providing larger annual salary increases to employees with the lowest current salaries did not unlawfully discriminate based on age. The court held that this was true although employees with the lowest current salaries generally are younger than higher paid employees performing the same job. Again, age discrimination does not occur unless the plaintiff's complaint arises specifically because of her age. That is, age discrimination does not arise from factors tangentially or stereotypically related to age.

In Quinones v. City of Evanston, the court found that the employer's pension policy violated the ADEA. However, Quinones nevertheless supports the conclusion that cash balance plans do not inherently violate the ADEA. The City of Evanston, retirement benefits serves one of the remedial purposes of the ADEA, (providing financial support to unemployed workers and their families), the employer did not violate the ADEA. Id. at 1429.

128. 920 F.2d 441, 446 (7th Cir. 1990). In Davidson, the plaintiff contended that a compensation scheme that required an existing employee (who was most likely older) to come up with an offer from a second employer in order to get a raise from his current employer, was unlawfully discriminatory because the starting salary of a new employee (who was most likely younger) was not subject to the same limitation. Id. at 444. From the plaintiff's point of view, the defendant's compensation scheme would result in salary inferiority for older workers because of the likelihood that they would not get job offers from other employers while younger workers would receive any salary the defendant would generously offer them. Id.

The court found that the defendant based its salaries on market factors rather than a discriminatory factor. Id. at 446. To get a raise, a current employee had to present proof of his market value. Id. However, a new employee did not have to present such proof because the defendant could not hope to hire a new employee without paying him more than his current employer was paying him. Id.

129. 861 F.2d 1040, 1045 (7th Cir. 1988). The plaintiff, a professor at Marquette University, argued that "he had received smaller pay raises than colleagues who were either Catholic or under 40 years" old. Id. at 1042. The court rejected his argument because he based his evidence almost entirely on statistics. Id. at 1043. He presented evidence "that young faculty members receive[d] larger annual raises on a percentage basis." Id. at 1045 (emphasis omitted). Although his statistics were accurate, the court considered the hierarchy of the professoriat, which has only a few ranks, and noted that professors usually reach top rank (full professor) relatively early in their careers. Id. Because of this rank structure, a professor's salary tends to rise sharply in the early years of his career then plateaus once he reaches "full professor" status regardless of age. Id.

130. Davidson, 920 F.2d at 446; Tagatz, 861 F.2d at 1045.

131. Id.

132. 58 F.3d 275, 279-80 (7th Cir. 1995).

133. Id. at 278-80.
Illinois, hired Tony Quinones as a paramedic when he was thirty-nine years old. When Evanston offered employment to Quinones, it told him that he was ineligible for a pension because of an Illinois statute prohibiting cities from providing pensions for firefighters hired after thirty-four years of age. At the district court level, Quinones prevailed in his suit to compel the City of Evanston to fund a pension for him when he retired. The appellate court affirmed, stating that the ADEA, which preempts the conflicting state law, does not tolerate age-based pay differences, and a lower pension for the same work is "equivalent to a lower salary."

The problem here, however, was that Evanston refused any pension for Quinones. The court stated that the ADEA allows employers to "distinguish among employees by the years of service, even though years of service are related to age." But if an employer distinguishes among employees with the same number of years of service, as Evanston did here, the employer must justify the distinction with a cost-based reason. Evanston did not offer a cost-based justification. The court explained how a defined benefit plan may cost the employer more for an older, new employee than for a younger, new employee. Further, the court explained that an employer may "reduce the pension of workers hired later in life so that the annual outlay during years of employment is the same for all workers." However, Evanston could not deny Quinones any pension, because paying younger

134. Id. at 267-77.
135. Id. at 276 (citing 40 ILL. COMP. STAT. 5/4-107(b) (West 1993)).
136. 5/4-107(b), cited in Quinones, 58 F.3d at 277.
137. Quinones, 58 F.3d at 277.
138. 29 U.S.C. § 623(a) (1994). This section prohibits employers from "discriminating against any individual with respect to his compensation, terms, conditions, or privileges or employment, because of such individual's age." Id.
139. Quinones, 58 F.3d at 280.
140. Id. at 278.
141. Id. at 279.
142. Id. at 278-79.
143. Id. at 279.
144. Quinones, 58 F.3d at 279.
145. Id. Evanston has a defined benefit plan where the pension is some percentage of the employee's wage at termination, multiplied by the number of years worked. Id. The court offered the example of a firefighter who started work at age 25 and terminated employment at age 45. Id. The average employer contribution for this employee earns interest for 30 years. Id. Conversely, a firefighter who starts at age 45, works 20 years, then retires with immediate pension will cost the employer more money to provide the same pension as the firefighter who started at age 25. Id. The pension contribution for the second employee earns interest for an average of only ten years, so the employer must contribute more each year to produce the same pension for both employees. Id.
146. Id.
employees more than older employees for the same work is disparate treatment under the ADEA.\textsuperscript{147}

Moreover, the court noted that if Evanston offered its employees a defined contribution plan, it would not have violated the ADEA, even though an employee who was hired at age forty-five and worked twenty years would receive a higher annual pension than an employee who was hired at age twenty-five and worked twenty years.\textsuperscript{148} There would be no violation because the employer contributes the same percentage of compensation for both employees.\textsuperscript{149} Thus, if Evanston adjusted its defined benefit plan so it had the same non-discriminatory effect as a defined contribution plan, it would not have violated the ADEA.\textsuperscript{150}

Thus, according to the reasons elicited by the \textit{Quinones} court, an employee who begins participation in a cash balance plan at age forty-five will receive less benefits at retirement than an employee who begins participation at age twenty-five, but the difference would not violate the ADEA.\textsuperscript{151} Like the defined contribution plan the \textit{Quinones} court described, a cash balance plan does not inherently violate the ADEA so long as the employer contributes the same percentage of compensation for all employees. With respect to the interest credit, the discrepancy between the interest accruals of older employees and younger employees results from a factor other than age: years of participation.

In conclusion, neither agency regulations nor case law indicates that cash balance plans inherently discriminate based on age. The reasoning of the \textit{Biggins} Court applies here. Like the firing of a sixty-two-year-old employee weeks before his pension would have vested, the fact that older employees, who have fewer years to participate in a cash balance plan, may accrue less benefits than younger employees merely correlates with age. The difference does not arise because of age. Also, as \textit{Atkins} explained, a mere mathematical correlation between a reduction in the rate of benefit accrual and a participant's age is not enough to prove a violation of \textsection{623(i)(1)(A)}. Just as the reduced rate of benefit accrual in the Northwest plan resulted from a legitimate plan provision, the reduced rate of benefit accruals in a cash balance plan results from a regulatory requirement encouraging the frontloading of cash balance plans.\textsuperscript{152}

\textsuperscript{147} \textit{Id.} at 279. \textit{See also Tax Law Issues, supra} note 95, at G-3 (providing an example of a disparate treatment age discrimination claim).

\textsuperscript{148} \textit{Quinones}, 58 F.3d at 279.

\textsuperscript{149} \textit{Id.}

\textsuperscript{150} \textit{Id.}

\textsuperscript{151} \textit{Id.}

\textsuperscript{152} \textit{Horne}, \textit{supra} note 99, at ¶ 25.
III. HOW TO MAKE CASH BALANCE PLANS WORK FOR BOTH EMPLOYEES AND EMPLOYERS

A. Classify Cash Balance Plans As “Hybrid Plans”

As discussed in section II, part A, cash balance plans are “a new animal.” Although classified as defined benefit plans and similar to defined contribution plans, they are not identical to either classification. The rules regulating defined benefit plans should not apply to cash balance plans. The IRS should devise a separate accounting method specifically for cash balance plans. Treating them as frontloaded plans and using an accounting method specifically designed for cash balance plans would eliminate the ADEA claim without violating the purpose of the ADEA. It is beyond the scope of this Comment to recommend specific provisions for a new accounting method.

B. Use Certain Transition Methods To Avoid a “Wearaway” of Benefits

Even if the IRS does not devise a new accounting method for cash balance plans, there are several transition methods employers may use to avoid a “plateau” or “wearaway” of

153. See supra II. A. and accompanying notes (discussing how cash balance plans are a “new animal” and why it is inappropriate to classify them with traditional defined benefit plans).

154. See supra Part I.C and accompanying notes (discussing how cash balance plans compare and contrast to traditional defined benefit plans and defined contribution plans).

155. See supra note 39 and accompanying text for a discussion on how cash balance plans share some of the features of both defined benefit plans and defined contribution plans and for sources which suggest the IRS should create regulations specifically tailored to cash balance plans. Michael S. Horne, an attorney with Covington & Burling and member of the ERISA Industry Committee, finds the classification of cash balance plans as defined benefit plans illogical. Horne, supra note 99, at ¶ 15. If two employers each offer the same annual contributions and offer equivalent methods of calculating interest credits, but one employer calls its plan a cash balance plan and the other calls its plan a defined contribution plan, the employer with the cash balance plan risks violating the ADEA while the other does not. Id. According to Horne, the purposes and policies of the ADEA do not support this result. Id. Horne notes that section 623(i)(1)(B), which parallels section 623(i)(1)(A), states that defined contribution plans are unlawful if “contributions to the employee’s account terminate or are reduced on account of age.” Id. at n.8. Thus, in a defined contribution plan, it is irrelevant that younger employees will accumulate more earnings than older employees if both work until normal retirement age as long as the employer’s contributions are the same. Id.

156. See supra note 107 and accompanying text (discussing how treating cash balance plans as frontloaded and devising an accounting method specifically tailored for cash balance plans would eliminate the ADEA claim while still conforming with the purpose of the ADEA).
benefits. One method is to allow some of the employees to remain in the current, traditional defined benefit plan. This is referred to as "grandfathering." There are many ways to determine who is eligible for grandfathering. For example, an employer usually picks a certain cut-off age or designates a certain combination of age and years of service. Two methods of grandfathering include providing employees with the better benefit of the two plans and allowing eligible employees to individually choose if they want to switch to the cash balance plan.

A second transition method is to increase the opening hypothetical account balance for older and/or long-service employees. Third, the employer may provide higher pay credits for older and/or long-service employees. Fourth, the employer may provide greater interest credits for older and/or long-service employees. Lastly, an employer may use a combination of one or more of the above transition methods.

For example, IBM used one of these methods to settle a lawsuit brought by its employees when it switched from a traditional defined benefit plan to a cash balance plan. IBM suffered negative publicity because of the lawsuit. It eventually reached a settlement by allowing older employees to choose between the traditional defined benefit plan and the cash balance plan.

While the switch to a cash balance plan wreaked havoc on IBM, other employers have learned from the IBM incident. They are allowing employees to choose between the traditional defined benefit plan and the cash balance plan before implementing the cash balance plan. Wells Fargo reorganized its pension offerings in July 1999, when it merged with Norwest but avoided negative publicity.

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157. See supra note 11 (explaining the concept of "wearaway" which older, long-service employees may experience when their employers switch from a traditional defined benefit plan to a cash balance plan).
158. Cole, supra note 6, at 51.
159. Id.
160. Id.
161. Id.
162. Id. at 52.
163. Cole, supra note 6, at 52.
164. Id.
165. Id.
166. Id.
167. Learning From IBM, supra note 26, at 12.
168. Id.
169. Id.
170. See Arthur M. Louis, Pension Dissension; Veteran Employees Battle Companies Threatening to Introduce New Benefits Plans, S.F. CHRON., Oct. 5, 1999, at C1 (discussing the IBM settlement and how other companies successfully implemented a cash balance plan).
employee reaction by following IBM's lead. It allowed several thousand employees age forty-five or older to collect either the amount they would have received under the old plan or participate in the new cash balance plan. In addition, Wells Fargo tailored the size of the pay credit to account for age and years of service. The cash balance plan allowed Wells Fargo to contribute as little as four percent of pay to the hypothetical accounts of the youngest employees with the least number of years of service. Conversely, it allowed Wells Fargo to contribute as much as eight percent of pay to the oldest employees with the most years of service. As illustrated by Norwest and Wells Fargo, employers can successfully switch to cash balance plans and avoid litigation by implementing certain transition methods like giving older, long-service employees the choice between the old plan and the new plan. While devising a new accounting method for appropriate cash balance plans is the best long-term solution, the above transition methods allow employers to successfully switch to cash balance plans within current regulations.

C. Lawsuit Based on Disparate Impact Theory

Some older, long-service employees disadvantaged by a switch from a traditional defined benefit plan to a cash balance plan have sued their employer based on a disparate impact theory of liability. While a detailed discussion of disparate impact theory is beyond the scope of this Comment, a brief discussion is necessary to adequately explain all possible sources of relief for employees. Employees should seek this remedy only after exhausting all extra-judicial remedies because the majority of federal appellate courts do not recognize the disparate impact theory of liability for ADEA plaintiffs, and, even if courts did, employees might not prevail.

Disparate impact is a theory of liability that remedies situations where the employer's policy does not discriminate on its

171. Id.
172. Id.
173. Id.
174. Id.
175. Louis, supra note 170, at C1. Similarly, Northern States Power Company allowed employees of all ages to choose individually between the old traditional pension plan and the new cash balance plan to avoid the controversy IBM experienced. Ellen E. Schultz, Utility's Pension Plan Allowing Choice Offers Contrast To the Bitterness At IBM, WALL ST. J., Sept. 23, 1999, at C1. See generally, Pamela Yip, Pensions With Complications; Many Companies Are Offering Workers a Choice Between Traditional and Cash Balance Plans; Employees Should Make Many Comparisons Before Coming To a Decision, SUN-SENTINEL, Oct. 25, 1999, at 2 (discussing factors employees should consider if offered choice between traditional defined benefit plan and cash balance plan).
176. Shapiro & Rachal, supra note 3, at 198.
face, nor has a discriminatory purpose, but in which there remains a discriminatory effect on a particular group.\textsuperscript{177} For employees disadvantaged by their employer's switch to a cash balance plan, disparate impact theory would connect the unfavorable treatment (lesser pension accruals) with the protected class or characteristic (age) and find liability by looking only at the effect of the switch.\textsuperscript{178} Disparate impact theory could lead to employer liability for the unfavorable consequences of a switch without requiring employees to prove that the employer specifically intended to discriminate against older employees in switching to a cash balance plan.\textsuperscript{179}

To sustain a cause of action under a disparate impact theory of liability, the plaintiff/employee must show that the practice in question has a statistically adverse effect on a protected class of people or protected characteristic.\textsuperscript{180} If the plaintiff/employee produces this threshold amount of evidence, the employer has the opportunity to rebut the evidence by explaining why the challenged practice is a "business necessity."\textsuperscript{181} Lastly, the plaintiff/employee may rebut the employer's claim of "business necessity" if she can show the employer refused to adopt another practice which would have been equally effective but with a less adverse impact.\textsuperscript{182} Here, the plaintiff/employee would first have to prove that she would have received a significantly greater benefit under the traditional defined benefit plan than under the cash balance plan.

Assuming she could prove this, she would then have to rebut any claims by the employer of business necessity. She would have to do so by proving that another type of pension plan would be equally effective in meeting the employer's goals and have a less adverse impact on her. Since employers have many valid reasons for switching to a cash balance plan, such as equitably distributing pension resources, they would most likely overcome this hurdle. Thus, even if disparate impact theory is an option for ADEA plaintiffs, it would be difficult for plaintiffs to win.

In addition to the problems with proving a disparate impact claim, most federal appellate courts do not recognize disparate impact claims for ADEA plaintiffs.\textsuperscript{183} Currently, only the Second, Eighth and Ninth Circuits explicitly recognize disparate impact

\textsuperscript{177} Arnett v. California Pub. Employees Retirement Sys., 179 F.3d 690, 697 (9th Cir. 1999).
\textsuperscript{178} Horne, supra note 99, at 11 n.13.
\textsuperscript{179} \textit{id}.
\textsuperscript{180} Shapiro & Rachal, supra note 3, at 198.
\textsuperscript{181} \textit{id}. “Business necessity” refers to “reasonable factors other than age” such as lower costs and providing a benefit more appropriate for a mobile workforce. \textit{id}.
\textsuperscript{182} \textit{id} at 199.
\textsuperscript{183} \textit{id}.
theory for ADEA claims.\textsuperscript{184} Prior to the \textit{Biggins} decision in 1993, federal district and appellate courts assumed that disparate impact theory would be available for ADEA claims\textsuperscript{185} because it was available for Title VII employment discrimination claims.\textsuperscript{186} The United States Supreme Court has never directly ruled on the issue, but its decision in \textit{Biggins} cast doubt on whether disparate impact theory is available under the ADEA.\textsuperscript{187}

\begin{itemize}
\item \textsuperscript{184} \textit{Id.} See \textit{Criley v. Delta Airlines, Inc.}, 119 F.3d 102, 105 (2nd Cir. 1997) (recognizing disparate impact theory and stating that to succeed under disparate impact analysis, a plaintiff must “allege a disparate impact on the entire protected group, i.e., all workers aged 40 and over”); \textit{EEOC v. Local 350, 998 F.2d 641, 648 n.1} (9th Cir. 1993) (stating that “in this circuit a plaintiff may challenge age discrimination under a disparate impact analysis”); \textit{Smith v. City of Des Moines, 99 F.3d 1466, 1470} (8th Cir. 1996) (stating that “plaintiff may base a disparate impact claim on § 623(a)(1) . . . and the Supreme Court has made it clear in the Title VII context that the second subsection can be the basis for such a claim”).

Three circuits (the First, Seventh, and Tenth Circuits) explicitly reject disparate impact theory for ADEA plaintiffs. See \textit{Ellis v. United Airlines, Inc.}, 73 F.3d 999, 1009 (10th Cir. 1996) (holding that “plaintiffs cannot bring a disparate impact claim under the ADEA”); \textit{Mullin v. Raytheon Co.}, 164 F.3d 696, 699-704 (1st Cir. 1999) (discussing the legislative history and case law regarding whether disparate impact theory is available under the ADEA and holding that the “ADEA does not impose liability under a theory of disparate impact”); \textit{Salvato v. Illinois Dep't of Human Rights, 155 F.3d 922, 926} (7th Cir. 1998) (stating that “in this circuit, at least, the ADEA does not permit liability based solely on disparate impact”).

Four other circuits (the Third, Fifth, Sixth, and Eleventh Circuits), in dicta or concurring opinions, express doubt that disparate impact theory under the ADEA is available after \textit{Biggins}. See \textit{DiBiase v. Smith Kline Beecham Corp.}, 48 F.3d 719, 734 (3rd Cir. 1995) (doubting the viability of disparate impact theory for ADEA plaintiffs in light of \textit{Biggins}); \textit{Gantt v. Wilson Sporting Goods Co.}, 143 F.3d 1042, 1048 (6th Cir. 1998) (noting in dicta that after \textit{Biggins}, there is considerable doubt that a plaintiff may base an age discrimination claim on disparate impact theory); \textit{Rhodes v. Guiberson Oil Tools, 75 F.3d 989, 1004} (5th Cir. 1996) (\textit{DeMoss, J., concurring}) (stating that, “[u]nder Hazen Paper, an ADEA plaintiff must demonstrate that ‘age actually motivated the employer’s decision’”); \textit{Turlington v. Atlanta Gas Light Co.}, 135 F.3d 1428, 1436-37 n.17 (11th Cir. 1998) (reserving the issue of whether disparate impact theory is available under the ADEA for a later decision).

\item \textsuperscript{185} Shapiro & Rachel, \textit{supra} note 3, at 199 n.29.

\item \textsuperscript{186} Title VII of the Civil Rights Act of 1964, 42 U.S.C. § 2000e-2(a) (1994), prohibits employment discrimination based on race, color, religion, sex, or national origin. Section 2000e-2(k) specifically authorizes disparate impact claims and sets forth a burden of proof scheme.

\item \textsuperscript{187} Hazen Paper Co. v. \textit{Biggins}, 507 U.S. 604, 610 (1993). According to \textit{Biggins}, Congress enacted the ADEA to prevent employers from depriving older workers of employment based on “inaccurate and stigmatizing stereotypes.” \textit{Id.} Congress found that age discrimination was primarily based on stereotypes unsupported by objective fact while older workers generally were in fact “at least as good as younger workers.” \textit{Id.} Congress enacted the ADEA to require employers to “evaluate [older] employees . . . on their merits and not on their age.” \textit{Id.} Therefore, the type of discrimination Congress originally sought to prevent involves intentional conduct, not employment
Even if the Supreme Court approved disparate impact theory for ADEA claims in general, it may not apply to pension claims.\textsuperscript{185} Employees claiming discrimination in the pension context must remember that an employer is not required to provide any decisions "motivated by factors other than age,... even if the motivating factor is correlated with age." Mullin v. Raytheon Co., 164 F.3d 696, 700 (1st Cir. 1999) (quoting Biggins, 507 U.S. at 611).

Comparing the purposes of Title VII and the ADEA also leads to the same conclusion. The First Circuit in Mullin v. Raytheon Co. noted that the text and structure and legislative history of the ADEA compel the conclusion that disparate impact theory is not available under the ADEA. Mullin, 164 F.3d at 701-03. First, the text of the ADEA, in section 623(f)(1), provides an exception to its general prohibition of age discrimination. Id. at 702. It allows an employer to discriminate with respect to age as long as the discrimination is "based on... factors other than age." Id. If the exception in section 623(f)(1) is not interpreted to preclude disparate impact liability, it would become a superfluous clause and mean nothing more than, "only age discrimination is age discrimination." Id. Furthermore, such an interpretation would ignore the well-settled rule of statutory interpretation that "all words and provisions of statutes are intended to have meaning and are to be given effect, and no construction should be adopted which would render statutory words or phrases meaningless, redundant or superfluous." Id. (quoting U.S. v. Ven-Fuel, Inc., 758 F.2d 741, 751-52 (1st Cir. 1985)). Reading the text of the ADEA as a whole, the general provision prohibits disparate treatment based on age, and the exception authorizes disparate impact as long as it is based on factors other than age. Mullin, 164 F.3d at 702. The confusion has yet to be resolved, but lends itself to the conclusion that disparate impact is not available for an ADEA claim. Lastly, in 1991, Congress amended Title VII to specifically provide for disparate impact claims. Id. Congress also amended the ADEA in 1991, but did not add a provision authorizing disparate impact claims. Id. at 703. Since Title VII and the ADEA essentially are analogous, statutes that differ structurally only on one point, one may infer that Congress never intended to provide for disparate impact claims under the ADEA. Id.

In conclusion, the Mullin court stated that it agreed with the Sixth Circuit's assessment of the issue that "[t]he ADEA was not intended to protect older workers from the harsh economic realities of common business decisions and the hardships associated with corporate reorganizations, downsizing, plant closings and relocations." Id. (quoting Allen v. Diebold, Inc., 33 F.3d 674, 677 (6th Cir. 1994)). Mullin, therefore, persuasively explains how a comparison of the purposes behind Title VII and the ADEA, the text of the ADEA, the ADEA's legislative history, and the 1991 amendments to Title VII and the ADEA compel the conclusion that disparate impact theory is not available under the ADEA.

Second, the 1965 Secretary of Labor report which led Congress to enact the ADEA entitled, "The Older American Worker: Age Discrimination in Employment," recommended that Congress address discriminatory treatment of older workers through legislation but address facially neutral, institutional discrimination (disparate impact) through educational programs and institutional restructuring. Mullin, 164 F.3d at 703. The Report distinguished between the appropriate remedies for disparate treatment and disparate impact claims in the context of age discrimination. Id. Since Congress enacted the ADEA shortly after evaluating the Report, one may conclude that Congress gave effect to the Report's recommendations by requiring proof of intentional discrimination for ADEA claims. Id.

\textsuperscript{188} Shapiro & Rachal, supra note 3, at 199.
benefits, and the employer may discontinue benefits at any time. An employee's disparate impact claim in the context of a pension plan may be based on the false premise that the employee was entitled to continue accruing benefits under the traditional defined benefit plan.

Furthermore, public policy may not favor allowing older employees to maintain a disparate impact claim based on any unfavorable consequence of an employer's switch to a cash balance plan. Assuming the cash balance plan provides the same pay credit and same interest credit for all employees at the same level of compensation regardless of age and was implemented for a non-discriminatory business purpose, the cash balance plan is age-neutral. The traditional defined benefit plan, however, is not age-neutral. Benefits under a traditional defined benefit plan substantially increase the last few years before an employee reaches retirement age. Employers advocate that legal or public policy would favor allowing a plaintiff to claim that she is entitled to continue accruing benefits under an age-favored plan when her employer switches to a more age-neutral plan.

Therefore, older employees disadvantaged by their employer's switch to a cash balance plan face an uphill battle in claiming ADEA disparate impact under the current law. Extra-judicial remedies offer the greatest prospect for success at the least cost. Employees should first encourage their employer to use a transition method that would eliminate or decrease the possibility of a "wearaway" period. As indicated by the Wells Fargo case, employers could successfully switch to a cash balance plan and avoid a negative reaction from employees by giving eligible older and long-service employees a choice between the old plan and the new cash balance plan.

While disparate impact theory may not be the best option for older employees in fighting the loss they may suffer under a cash balance plan, employees nevertheless have strong arguments why Congress and the Court should authorize disparate impact claims for ADEA plaintiffs. Unfortunately, unless employees have

189. Id. ERISA itself specifically provides that an employer has no obligation to provide benefits and may discontinue benefits at any time, and the United States Supreme Court has repeatedly approved that statement. Id.
190. Id.
191. Id.
192. Id.
193. Shapiro & Rachal, supra note 3, at 199.
194. See supra Section I. B. (discussing the pattern of benefit accrual under a traditional defined benefit plan).
195. Shapiro & Rachal, supra note 3, at 199.
196. Id.
197. Although Congress has enacted no legislation requiring employers to use a transition method such as giving employees already participating in a
strong bargaining power, their chance of persuading their employer to use a transition method is slim; the employer has no incentive to ease the transition for employees other than to avoid negative publicity and possible litigation. IBM employees won their fight because a large number of employees supported their claim, and they generated nation-wide negative publicity. Many employees, however, do not have the bargaining power IBM employees enjoyed. For employees without much bargaining power, a legal claim based on disparate impact theory may be the only option.

Although most federal appellate courts do not allow disparate impact liability for ADEA claims, the United States Supreme Court has not ruled on the issue directly. Plaintiffs/employees should argue that the Court should allow the theory for ADEA claims, particularly in the pension context. Changes in employer-sponsored pension plans since Congress enacted the ADEA warrant allowing disparate impact theory of liability for ADEA claims. The employment conditions on which Congress based its decision to focus on intentional discrimination in enacting the ADEA have changed.¹⁹⁸ Today older employees face more than

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¹⁹⁸ In 1965 when the Department of Labor submitted its Report to Congress, the Report stated that the primary source of age discrimination was explicit, intentional discrimination, or “disparate treatment.” Mullin, 164 F.3d at 703. “Institutional” discrimination, or the type remedied by disparate impact liability, was not as much a concern because many facially neutral employee benefits, such as traditional defined benefit plans, advantaged older
intentional discrimination in the work place; they also face unintentional, institutional discrimination. Particularly in the pension area where new plans such as cash balance plans and 401(k) plans have dramatically changed the way employees accrue pension benefits, older employees face a silent, institutional undermining of their efforts.\textsuperscript{199}

In 1965, Congress could not have foreseen the emergence of cash balance plans and the accompanying legal issues. If Congress knew of the adverse impact of cash balance plans on older, long-service employees when it enacted the ADEA, it may have provided for disparate impact liability. Even in 1991, when Congress amended the ADEA, Congress could not have foreseen the claims arising from cash balance plans because the age discrimination issue surrounding the plans had not yet fully emerged in 1991. The emergence of non-traditional pension plans, such as cash balance plans, therefore, has changed the conditions under which employees work, and consequently, the ADEA stands on an incomplete set of assumptions today.

**CONCLUSION**

Although cash balance plans do not inherently violate the ADEA,\textsuperscript{200} the negative effect of lesser pension accruals on older, long-service employees gives reason to re-examine how the plans should be classified, implemented, and litigated. The IRS should devise and adopt an accounting method specifically tailored for the unique characteristics of cash balance plans. Until the IRS prescribes new regulations, however, employees should first attempt to persuade their employers to use a transition method to prevent a long “wearaway” period. If that fails, employees should bring a legal claim based on disparate impact theory. A strong argument exists for why the Supreme Court should recognize such claims: cash balance plans have substantially changed the conditions under which employees work, and this change has led to an institutional undermining of their efforts and calls for a re-

workers. Traditional defined benefit plans were ideal for the workforce in the 1950s and 1960s since most employees stayed with one employer throughout their careers, and employers wanted to bond employees to their jobs. James H. Smalhout, *The Problem With “Sticky” Pensions*, *L.A. Times*, Oct. 31, 1999, at M2. Today most employees do not stay with the same employer throughout their careers, and they can no longer assume their company-sponsored pension will provide substantial benefits during retirement. \textit{Id.}

\textsuperscript{199} See \textit{supra} note 11 and accompanying text (discussing the “wearaway” issue that arises when an employer switches from a traditional defined pension plan to a cash balance plan).

\textsuperscript{200} See \textit{supra} Part II and accompanying notes for an analysis of agency regulations and case law leading to the conclusion that cash balance plans do not inherently violate the ADEA.
examination of the assumptions behind the ADEA. Even if employers have a legitimate, nondiscriminatory reason for switching to cash balance plans, the unfavorable effect on older long-service employees warrants allowing them to at least bring a legal claim based on disparate impact theory. Thus, all hope is not lost for the fifty-five-year-old employee mentioned earlier. He has weapons he could use both at the bargaining table and in court to defend against the adverse effects of a cash balance plan.

201. Congress described the factual basis for enacting the ADEA and the purpose of the ADEA as follows:

(a) The Congress hereby finds and declares that—

1. in the face of rising productivity and affluence, older workers find themselves disadvantaged in their efforts to retain employment, and especially to regain employment when displaced from jobs;
2. the setting of arbitrary age limits regardless of potential for job performance has become a common practice, and certain otherwise desirable practices may work to the disadvantage of older persons;
3. the incidence of unemployment, especially long-term unemployment with resultant deterioration of skill, morale, and employer acceptability is, relative to the younger ages, high among older workers; their numbers are great and growing; and their employment problems grave;
4. the existence in industries affecting commerce, of arbitrary discrimination in employment because of age, burdens commerce and the free flow of goods in commerce.

(b) It is therefore the purpose of this Act to promote employment of older persons based on their ability rather than age; to prohibit arbitrary age discrimination in employment; to help employers and workers find ways of meeting problems arising from the impact of age on employment.


Although Congress does not specifically mention discrimination in the pension context, it could not have foreseen in 1965 the problems arising from the emergence of non-traditional pension plans. Perhaps if Congress knew in 1965 about the age discrimination issue arising from cash balance plans, it would have explicitly provided for disparate impact liability to help “workers find ways of meeting problems arising from the impact of age on employment.” 29 U.S.C. § 621(b).