

Seventh Circuit Decides Cash Balance Case in Favor of IBM

In a decision that is highly favorable to cash balance plan sponsors, the Seventh Circuit Court of Appeals yesterday ruled that the IBM cash balance formula is not age discriminatory. The Seventh Circuit is the first appeals court to deal with this important issue and as such the decision is likely to influence decisions in similar cases in other circuits.

The decision rejects plaintiffs' claims and reverses the lower court's opinion in *Cooper v. IBM*. The Seventh Circuit responded to the plaintiffs' claim that it is generally age discriminatory for a younger employee to receive more years of hypothetical interest before age 65 than an older employee by raising this question: "...if the ...interest formula is non-discriminatory when used in a defined-contribution plan, why should it become unlawful because the account balances are book entries rather than cash?" The court noted that plaintiffs' view that reflecting the time value of money constitutes age discrimination is a view that is neither sensible nor required by statute.

The court ruled that the term "benefit accrual" under the age discrimination rules is not the same as the defined term "accrued benefit" under other provisions of the law, and that the former term is most naturally interpreted as a reference to plan inputs (i.e., amounts credited under the plan's benefit formula) rather than outputs (benefits at retirement). Under that view, it found that all terms of IBM's cash balance formula (including the "always cash balance formula" used in determining opening balances) are age-neutral.

The decision considered the proposed Treasury regulations (since withdrawn) to be relevant and an indication that the regulators did not believe cash balance plans were inherently age discriminatory. The court observed that traditional defined benefit plan designs favor older workers and that replacing a plan that discriminates against the young with one that is age-neutral does not discriminate against the old.

The decision concludes with an interesting discussion of the negative impact that litigation of this kind can have on society. It points to IBM's decision to eliminate its cash balance plan for future employees after the lower court ruling in this case. The court noted that its decision frees employers to again make decisions on their plan designs by private choice rather than legal constraint.

This decision, coupled with the generally helpful cash balance and other hybrid plan provisions of the Pension Protection Act of 2006 recently passed by Congress, makes the continuation of hybrid plans and the adoption of new ones a much more viable path now than it seemed only a few days ago. The Seventh Circuit decision should be particularly welcomed by plan sponsors of existing cash balance plans in view of the fact that the Pension Protection Act of 2006 provides clarity on the age discrimination issue only prospectively.

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