

**Richard A. Epstein**  
**4824 So. Woodlawn Avenue**  
**Chicago, Illinois 60615**

November 3, 2003

James A. Klein  
President  
American Benefits Council  
1212 New York Ave., NW, Suite 1250  
Washington D.C. 20005

Dear Mr. Klein:

I am writing, as you requested, to explain my deep concern about the substantive and constitutional soundness of Section 742 of the Treasury Appropriations bill (H.R. 2989) as passed by the House and Section 205 to H.R. 2989 as passed by the Senate. I am the James Parker Hall Distinguished Service Professor of Law at the University of Chicago, and the Peter and Kirsten Bedford Senior Fellow at the Hoover Institution. I have taught and worked in areas of constitutional, employment and pension law. I have attached a short curriculum vitae and biographical statement. I have been retained by the American Benefits Council to prepare the evaluation that follows.

Section 742, offered by Representative Sanders, reads as follows:

SEC. 742. None of the funds appropriated by this Act may be used to assist in overturning the judicial ruling contained in the Memorandum and Order of the United States District Court for the Southern District of Illinois entered on July 31, 2003, in the action entitled *Kathi Cooper, Beth Harrington, and Matthew Hillesheim, Individually and on Behalf of All Those Similarly Situated vs. IBM Personal Pension Plan and IBM Corporation* (Civil. No. 99-829-GPM).

Section 205, offered by Senator Harkin, reads as follows:

SEC. 205 None of the funds made available in this Act may be used by the Secretary of the Treasury or his delegate to issue any rule or regulation which implements the proposed amendments to Internal Revenue Service regulations set forth in REG-209500-86 and REG-164464-01, filed December 10, 2002, or any amendments reaching results similar to such proposed amendments.

By its terms, Section 742 aims to single out for special protection the district court's ruling in the *Cooper* case, and Section 205, which does not refer to *Cooper* by name, could easily have the same effect. Both target the same proposed Treasury regulations. Section 742 seeks to achieve its goal by keeping the Treasury Department from taking any action that would assist in overturning the district court's ruling in *Cooper*. Some proponents of Section 742 argue that this includes prohibiting Treasury from issuing the

proposed regulations. By preventing Treasury from issuing the proposed regulations or any amendments reaching “similar” results, Senator Harkin’s amendment could be construed to have the same impact on the *Cooper* decision. In this letter I focus mainly on Section 742 because of its specific reference to that decision. But at times I refer to Section 205 because the arguments made in its favor track those made on behalf of Section 742, and , thus, Section 205 raises similar concerns.

Section 742 raises concerns that go both to the unsoundness of *Cooper* and the manner in which Section 742 seeks to protect that ruling. The defense of the ruling offered by the proponents of Section 742 in the House does not withstand scrutiny, and Section 742 itself is contrary to the constitutional principle of separation of powers. The provision prevents the President from faithfully executing the laws and manipulates the appellate process to deny the judiciary access to the views of the Treasury Department, which normally receives deference in interpreting complex statutory provisions. See *Chevron, U.S.A, Inc. v. NRDC*, 467 U.S. 837 (1984). Section 205 for its part seeks to block the issuance of the regulations because the proponents believe that in their present form the regulations will at least in part help bolster the employer’s position. Neither the Senate nor the House provisions address the legal merits of the underlying dispute in *Cooper* and similar cases, to which I now turn.

## **1. THE COOPER DECISION IS UNSOUND.**

*Cooper* addressed the impact of ERISA on the “cash balance formula” (CBF) pension plans in use by IBM and many other employers, both large and small. These defined benefit plans<sup>1</sup> are intended to protect the time-value of money for all employees by allowing them to earn interest on their pension credits during the period that they have to wait before collecting retirement benefits. The district court has disrupted the operation of these CBF plans by ruling that they unlawfully discriminate on the basis of age unless they award every employee the same amount of accumulated interest upon reaching retirement age, regardless of how long the employee must wait to begin collecting retirement benefits.

Under *Cooper*, a 64-year-old employee who works for a company for one year before reaching retirement at age 65 must be awarded the same amount of interest upon his retirement as a 24-year-old employee who must wait 41 years to reach retirement age. Thus, if an employer puts \$2,500 into the 24-year-old’s retirement account on January 1, 2003, that sum will earn interest at 5.6% interest, so that on January 1, 2004, \$64 in interest will be added to the employee’s account, bringing its total value to \$2,564. If

---

<sup>1</sup> Under a defined *benefit* plan, the employee does not receive a fixed sum of cash, which then accrues interest, as is the case under a defined *contribution* plan. Rather, certain credits are established for the employee’s account, which the employer can fund as it chooses. If the employer’s return on its benefit funds do not equal the promised rate of interest, then it must make up the difference out of its own revenues. If the employer achieves a higher rate of return, then it can reduce its future contributions to the plan by crediting the excess funds against future contributions. The fixed interest rate under the defined benefit plan leaves the employee in the same position that he or she would have enjoyed if monies were placed in the employee’s account and those monies were then invested in a fixed income security.

interest continues to accrue at that rate for the next 40 years, the employee would be entitled to receive \$25,687 in interest on the original \$2,500 on January 1, 2044. Under *Cooper*, the 64-year-old employee who receives that \$2,500 on January 1, 2003 is entitled to receive that same \$25,687 on January 1, 2004—for an effective interest rate of over 1000%.

The district court reached this astonishing conclusion through an interpretation of ERISA's age-discrimination provision, ERISA § 204(b)(1)(H), 29 USC § 1054(b)(1)(H). That provision specifies that a defined benefit pension plan is age-discriminatory if “an employee's benefit accrual is ceased, or the rate of an employee's benefit accrual is reduced, because of the attainment of any age.” This provision clearly means that the *rate* of interest credited to an individual employee's pension account under a defined benefit plan may not be reduced at 65, or indeed at any other age. The employer cannot reduce the interest rate at 65 (or at any other age) from 5.6% to some lower number, or stop providing interest credits altogether.

The IBM plan and all other CBF plans satisfy ERISA § 204(b)(1)(H) by using the same rate of interest throughout the plan. The district court, however, ruled that the *rate of benefit accrual* referred to in that provision is the same as the employee's *total benefit accrued*, thereby requiring *the same dollar amount of interest* for the 24- and 64-year-old employees in the above example. The district court, in effect, confused velocity with distance. It is as though the court decreed that two people, one 24 and the other 64, running at the same speed, will be deemed to have run at the same speed only if both cover the same distance by the time each reaches age 65, 40 years apart. That, however, is a conceptual muddle and a physical impossibility. Congress clearly did not mandate such a nonsensical result.

The result in *Cooper* cannot be justified on a public policy basis to avoid discrimination against older employees. To the contrary, it effectively mandates *reverse* age-discrimination, on an unprecedented scale. The district court's ruling threatens employers who continue to offer CBF plans with massive future liabilities. A study by two economists at the Federal Reserve Board estimates that cash balance plans, routinely offered by many hundreds of employers nationwide and several hundred of the nation's largest companies, currently account for 40 percent of all assets in defined benefit plans.<sup>2</sup> The prospect of such liabilities is certain to force many employers to abandon the beleaguered pension system altogether.<sup>3</sup>

---

<sup>2</sup> Phillip C. Copeland and Julia Lynn Coronado, CASH BALANCE PLAN CONVERSIONS AND THE NEW ECONOMY, at 20 (April 2002).

<sup>3</sup> Contrary to the district court's ruling, the Seventh Circuit, in *Lunn v. Montgomery Ward*, 166 F.3d 880 (7th Cir. 1999), has emphasized that ERISA does not mandate reverse age discrimination, and in *Eaton v. Onan Corp.* 117 F. Supp.2d 812 (S.D. Ind. 2000), another district court in the Seventh Circuit reached an opposite conclusion from *Cooper* on this issue. If ERISA actually mandated the result reached in *Cooper*, it would be vulnerable to constitutional challenge under both the takings and due process clauses because of its irrationality. See *Eastern Enterprises v. Apfel*, 524 U.S. 498 (1998).

## 2. THE PROPONENTS' DEFENSE OF *COOPER* DOES NOT WITHSTAND SCRUTINY.

In the House floor debate, the proponents of Section 742 portrayed CBF pension plans as a witch's brew of age discrimination, breach of contract, and theft of employee pension assets, which they claimed the *Cooper* decision remedies. Their portrayal of CBF plans and *Cooper* does not withstand scrutiny.

As explained above, CBF plans are not age-discriminatory. Their chief feature is to award constant rates of interest, regardless of age, to any sums credited to the defined benefit pension accounts of individual employees. The CBF plans also comport with universal financial accounting in that they increase the employee's benefit package by the ordinary device of compound interest. Two employees of different ages who receive a pension benefit in one year will have identical sums in their account balances at any and all future times. The plan represents as age-neutral a program as it is possible to devise. There is no breach of contract or theft of employee pension assets when an employer converts to a CBF plan, because such conversions do not deprive employees of any benefits they have previously accumulated. Any decline in future benefits does not depend on the fact of a conversion. With or without conversion, all employers expressly and lawfully retain the right to alter their benefit programs to reduce any future accruals. It is, therefore, critical to avoid conflating arguments about permissible discretion that employers retain with respect to future benefits with any specific actions that run afoul of the age discrimination laws. Similarly, it is incorrect for Senator Harkin to argue that these conversions allow employers "to just break their promises at random." Cong. Rec. S 13090, October 23, 2003 (Remarks of Senator Harkin). No one in *Cooper* even hinted that the plaintiff had a viable action for breach of contract.

In urging adoption of Section 742 to protect *Cooper*, the proponents did not acknowledge, much less defend, what *Cooper* actually holds. Instead, they sought to stir unfounded alarm about CBF plans and employer conversions to such plans. Representative Sanders read this excerpt from the *Cooper* decision in the House floor debate:

"In 1999, IBM opted for a 'cash balance formula.' The plan's actuaries projected that this would produce annual savings of almost \$500 million by 2009. These savings would result from reductions of up to 47 percent in future benefits that would be earned by older IBM employees. The 1999 cash balance violates the literal terms of the Employee Retirement Income Security Act, that is, ERISA. IBM's own age discrimination analysis illustrates the problem."

This portion of the district court's ruling typifies its flawed reasoning. There is nothing inherently wrong with an employer's modifying its pension plan to reduce future benefit accruals to achieve savings. The IBM pension plan that its CBF plan replaced heavily favored older employees over younger employees. Under that plan the younger employee who worked for the company for 10 years before leaving for another job would receive lower benefits in real-dollar terms from the company than the older employee who worked for the company for the same length of time and retired at age 65.

Moreover, the significant savings that IBM was projected to realize from its shift in plans (under one, but not all, of the accounting models employed) did not materialize. Shortly after it introduced the CBF plan, IBM responded to employee demand by allowing all employees who were age 40 or over with at least ten years of service, or who were within five years of eligibility for retirement, to choose between the established CBF and the older PCF plan. None of these employees was transitioned to the new plan against his or her will. All were allowed to look at their individual situations and choose the plan that they assumed would promise them the greatest value, just as Senator Harkin had urged. Market forces achieved his desired goal without disruptive legislation. Measured on the basis of applicable ERISA funding assumptions, the result was a small *increase* in IBM's expected future funding obligations for the plan. The district court's statement that savings to IBM from shifting plans "would result from reductions of up to 47 percent in future benefits that would be earned by older IBM employees" is misleading because that statement depended on cherry-picking a single carefully-selected hypothetical employee. The statement ignores numerous other scenarios that left other employees as well or better off under the CBF plan than under the PCF plan, and it ignored the fact that over 60,000 employees were given an unrestrained election between the new and old plan formulas. Senator Kennedy's like remark that under CBF "employees can drop as much as 50 percent after a company converts to a cash balance plan" is similarly unsupported and misleading.

ERISA and the parallel provisions in the Age Discrimination in Employment Act prohibit age discrimination. They do not require any employer to continue to maintain a defined benefit plan at the level stated under any past formula, or at any level at all. With IBM, market forces led the employer to allow some of its employees to opt out of the conversion plan. Other firms are, under current law, free to follow its lead or to eliminate these options so long as they do not violate some provision of their contract or some independent substantive limitation of pension law. Stated otherwise, the IBM response was made for valid business reasons not because there is any independent entitlement, express or implied, of individual employees to remain in their prior plan when there is a general conversion to CBF plans. Indeed, IBM or any other company could end its pension program *entirely*, so long as it does not discriminate against older employees on account of age. Ironically, this is the result that *Cooper* invites. IBM never promised to provide lifetime contributions to the plan -- any more than it ever promised all employees lifetime jobs, or lifetime jobs at constant or rising salaries. To be sure, *past* credits to the defined benefit plan are protected from divestment by ERISA's so-called anti-cutback provisions. But not a single cent of protected benefits are taken back in a conversion from the PCF to the CBF plan. Senator Harkin, however may have created the same incorrect impression when he analogized the *Cooper* case to a situation in which an employer reneges after three years on a promise to pay a \$50,000 benefit at the end of five years. Cong. Rec. S. 13090, October 23, 2003 (remarks of Senator Harkin). No one has reneged on any promise with respect to future payments in the conversion to CBF plans. The proponents' suggestions to the contrary are incorrect.

### 3. SECTION 742 THREATENS SEPARATION-OF-POWERS PRINCIPLES.

Section 742 seeks to prevent the Executive Branch from offering its views on the ERISA age-discrimination issue in *Cooper* in order to protect *Cooper*'s prospects of success on appeal to the Seventh Circuit. The apparent aim of this provision is to block the Treasury Department from issuing further regulations on ERISA § 204(b)(1)(H) or from participating in the *Cooper* litigation or other litigation insofar as it wishes to register its disagreement with *Cooper*. Even the requirement that the Department be silent on the entire matter would be deeply troublesome. Even more troublesome is that the agency may be allowed to speak on one side of the issue but not the other (i.e. it may not assist in overturning, but could assist in upholding *Cooper*).

It is a generally accepted principle of constitutional law that the Congress may not through its legislation trample on the prerogatives of the Executive Branch in the discharge of its duty to see that the laws are faithfully executed. The Constitution provides that "The executive Power shall be vested in a President of the United States of America." U.S. Const. Art. II § 1. It further provides that "he shall take care to see that the Laws be faithfully executed." U.S. Const. Art. II § 3. In similar fashion, Article III, § 1, provides that "The judicial Power of the United States shall be vested in One Supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish." These fundamental texts indicate that the Constitution contemplates a division of power among the three branches of government. Its importance is raised in a number of cases that bear at least brief mention. In *Bowsher v. Synar*, 478 U.S. 714 (1986) the Supreme Court cast a critical eye on efforts of Congress to oversee the actions of the executive branch, in that case by the appointment of a Comptroller General who was answerable to them. The Court held that the centerpiece of the Gramm-Rudman-Hollings Act was unconstitutional because of Congress's decision to control the officials charged with executive functions. More recently, in *Plaut v. Spendthrift Farm, Inc.*, 514 U.S. 211, (1995), the Supreme Court held unconstitutional efforts of the Congress to encroach upon the power of the judiciary by passing legislation that purported to reopen final judgments made by the judicial system.

Unlike *Bowsher*, Section 742 does not assert the power of removal over any member of the Executive Branch, but it does seek to commandeer administrative officials in ways that necessarily compromise the independence of the Executive Branch. Unlike *Plaut*, Section 742 does not seek to reopen a final judgment, but it does attempt to usurp the judicial function by ratifying a district court's determination of what an earlier Congress intended. Section 742 similarly calls into question the principle of separation of powers reaffirmed by both cases, *Bowsher*, 478 U.S. at 721-34; *Plaut*, 514 U.S. at 219-225.

First, the precise scope of Section 742 is uncertain, casting a pall over core Executive functions. The provision says that no funds appropriated "may be used to assist in overturning the judicial ruling" in *Cooper*. What would count as providing such assistance? Is the phrase broad enough, as the proponents hope, to prohibit the Treasury Department from issuing final regulations on this question? Does the language allow the Treasury Department to issue regulations addressing proper administration of CBF plans only if those regulations invalidate all CBF plans under ERISA's age-discrimination

provision? Would Section 742 disable the Treasury Department from pressing a position at odds with *Cooper* in related ongoing or future litigation? If *Cooper* reaches the Supreme Court, would the Solicitor General be allowed to respond to an order from the Court inviting the views of the United States, on which Treasury would have to be consulted?

Were Section 742 to be given any of these readings, it would infringe on the prerogatives of the Executive Branch to see that the law is faithfully executed, and on the power of the judicial branch to give a fair and impartial interpretation of the law. The Executive Branch is effectively handcuffed in its ability to articulate its position in regulations or litigation, and the courts are deprived of an important source of information that allows them to decide an important case. The situation is made worse because any statement that the Executive Branch is still allowed to make by regulation or in litigation is necessarily piecemeal and therefore misleading.

Second, and equally worrisome, Section 742 aims to neutralize the Treasury Department through a legislative device -- a funding prohibition -- that does not require Congress to confront the substance of what it is actually doing. By shielding the *Cooper* ruling on appeal as Section 742 proposes, Congress would be weighing in on a substantive issue of far-reaching significance without careful consideration of the merits of its position. It would take its stand, moreover, on the basis of the flawed presentation of the merits of the *Cooper* ruling and the merits or demerits of CBF plans offered by the proponents of the amendment, and without a full airing of the issue in the committees with substantive jurisdiction.

If Congress had to draft and consider substantive legislation translating *Cooper* into statutory language, the result would be something to this effect: "Providing interest on payments to an employee's pension account will be considered to be age-discriminatory unless all employees accumulate the same amount of interest by the time they reach retirement age, regardless of how long they have to wait until they reach that age." Is it plausible that such language would ever be adopted in light of the economic consequences pointed out above? Section 742 -- a spending limitation that merely incorporates this principle through its reference to *Cooper* -- avoids serious consideration of this question. Section 742 is a stealth attempt to redefine, *post hoc*, the meaning of previously enacted legislation. This is something Congress could not do directly, and it is something Congress cannot do indirectly, through a rider to an appropriations bill, by biasing the work of the executive and judicial branches.

#### **4. SECTION 205 IS SUBJECT TO SIMILAR CONSTITUTIONAL IMPEDIMENTS.**

Section 205 of the Senate bill raises issues similar to those raised by Section 742 of the House bill. On its face the Senate amendment appears only to block the Secretary of Treasury or his delegate from implementing regulations similar to those that the Secretary has proposed to address this particular issue. But the amendment was offered with the belief that the proposed regulations support IBM's position in the *Cooper* case, again without having to explain why the amendment's proponents believe that IBM's position is wrong. The amendment also puts the Department of Treasury in an awkward position

because it now has to decide whether it can litigate the issue once it is barred from issuing the regulations in question. And, like Section 742, the Senate provision could amount to an unconstitutional attempt by a later Congress to determine the meaning of legislation enacted by an earlier Congress, by disabling the Treasury Department from giving ERISA § 204(b)(1)(H) an interpretation different from the one adopted by the district court in *Cooper*. In practice, Section 205 could have the same effect on the Department as Section 742, and should therefore also be considered to be constitutionally suspect.

Congress should not, deliberately or inadvertently, place a check on executive power that would throw the structure of the federal government out of balance. The bulwarks of liberty rest, in part, in structural protections found in our long-standing system of separation of powers. The Legislative Branch makes the law, and, within the modern administrative state, the Executive Branch has responsibility both for issuing regulations that interpret statutes and for representing the government position in litigation that involves the application or interpretation of the statute. This delegation of power to the Executive Branch takes place in full recognition that the technical expertise needed to implement a complex statutory scheme like ERISA cannot rest in a Congress all of whose members are of necessity generalists and who are not engaged in enforcement. There is no sound reason to enact provisions (i.e. both Section 742 and Section 205) of such dubious constitutionality in order to protect a district court ruling that is, itself, so misguided.

For these reasons, I believe that Section 742 of the House version of H.R. 2989 and Section 205 of the Senate version of H.R. 2989 are both substantively and constitutionally unsound.

Sincerely yours,

Richard A. Epstein

## Richard A. Epstein

### I. PERSONAL

Born: April 17, 1943; Age: 60, married Eileen W. Epstein, three children (Melissa, Benjamin, Elliot).

Home address: 4824 South Woodlawn Ave.; Chicago, Illinois 60615; Phone: (773) 373-2650;

Business Address: The University of Chicago Law School, 1111 East 60th Street; Chicago, Illinois 60637; Phone: (773) 702-9563; Fax (773) 702-0730; e-mail r-epstein@uchicago.edu

### II. PROFESSIONAL

James Parker Hall Distinguished Service Professor of Law, at University of Chicago, since 1972.

Peter and Kirsten Bedford Senior Fellow, Hoover Institution, since 2000.

Interim Dean, February-June 2001

Member, American Academy of Arts and Sciences, since 1985.

Editor, Journal of Legal Studies, 1981 to 1991; Journal of Law and Economics 1991 to 2001.

Member, California Bar, 1969 to present.

University of Ghent, LL.D, h.c. 2003)

### III. EDUCATION

Yale Law School, LL.B. 1968, cum laude, Order of the Coif.

Oxford University, B.A. (Juris.) 1966, First Class Honors.

Columbia College, B.A. 1964, summa cum laude, phi beta kappa.

### IV. SUBJECTS TAUGHT

Civil Procedure; civil procedure; contracts; communications law; conflicts of law; constitutional law (structure; speech and religion); corporate taxation; corporations; criminal law; estate and gift taxation; future interests; health law; individual income taxation; jurisprudence; land development and finance; land use regulation; legal history; labor law; patents; property; regulated industries; Roman law; torts; workers' compensation.

### V. PUBLICATIONS:

Skepticism and Freedom: A Modern Case for Classical Liberalism (University of Chicago, 2003)

Cases and Materials on the Law of Torts, (Aspen Law & Business, 7th ed. 2000).

Torts (Aspen Law & Business 1999)

Principles for a Free Society: Reconciling Individual Liberty and the Common Good (Perseus 1998).

Mortal Peril: Our Inalienable Right To Health Care? (Addison-Wesley, 1997)

Simple Rules for a Complex World (Harvard University Press, 1995)

Bargaining with the State (Princeton University Press, 1993)

Forbidden Grounds: The Case Against Employment Discrimination Laws, (Harvard University Press 1992)

Takings: Private Property And the Power of Eminent Domain. (Harvard University Press 1985).

Modern Product Liability Law. Westport, CT: (Quorum Books 1980).

Numerous articles and short papers.

## Richard A. Epstein

### Short Biographical Statement

Richard A. Epstein is the James Parker Hall Distinguished Service Professor of Law at the University of Chicago, where he has taught since 1972. He has also been the Peter and Kirstin Senior Fellow at the Hoover Institution since 2000. Prior to joining the University of Chicago Law School faculty, he taught law at the University of Southern California from 1968 to 1972. He served as Interim Dean from February to June, 2001. He received an LL.D., h.c. from the University of Ghent, 2003; He has been a member of the American Academy of Arts and Sciences since 1985 and a Senior Fellow of the Center for Clinical Medical Ethics at the University of Chicago Medical School, also since 1983. He served as editor of the *Journal of Legal Studies* from 1981 to 1991, and of the *Journal of Law and Economics* from 1991-2001, At present he is a director of the John M. Olin Program in Law and Economics. His books include *Skepticism and Freedom: A Modern Case for Classical Liberalism* (University of Chicago, 2003); *Cases and Materials on Torts* (Aspen Law & Business; 7th ed. 2000); *Torts* (Aspen Law & Business 1999); *Principles for a Free Society: Reconciling Individual Liberty with the Common Good* (Perseus Books, 1998); *Mortal Peril: Our Inalienable Rights to Health Care?* (Addison-Wesley, 1997); *Simple Rules for a Complex World* (Harvard, 1995); *Bargaining With the State* (Princeton, 1993); *Forbidden Grounds: The Case Against Employment Discrimination Laws* (Harvard, 1992); *Takings: Private Property and the Power of Eminent Domain* (Harvard, 1985); and *Modern Products Liability Law* (Greenwood Press, 1980). He has written numerous articles on a wide range of legal and interdisciplinary subjects. He has taught courses in civil procedure, communications, constitutional law, contracts, corporations, criminal law, health law and policy, legal history, property, real estate development and finance, jurisprudence, labor law; land use planning, patents,

individual, estate and corporate taxation, Roman Law; torts, and workers' compensation.