Case No. 06-4757

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

STEPHANIE HIRT, BARBARA SEAY, ANN NUSSBAUM, SUSAN CHWAST and LORETTA RONZCA,
Plaintiffs-Appellants,

v.

THE EQUITABLE RETIREMENT PLAN FOR EMPLOYEES, MANAGERS AND AGENTS and THE OFFICERS COMMITTEE ON BENEFIT PLANS, as Plan Administrator,
Defendants-Appellees.

Appeal from the Order of the
United States District Court for the Southern District of New York

BRIEF *AMICI CURIAE* OF

American Benefits Council
AT&T Corp.
Business Roundtable
BP America Inc.
El Paso Corporation
Honeywell International Inc.
Mercer Human Resource Consulting, Inc.
Watson Wyatt Worldwide
Xerox Corporation

IN SUPPORT OF APPELLEES URGING AFFIRMANCE

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STATEMENT REGARDING CONSENT TO FILE *AMICI* BRIEF

Counsel for Appellees and counsel for Appellants have consented to the filing of this *amici* brief.

____
Kent A. Mason Date

CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 26.1, the following disclosures are made:

1) Davis and Harman LLP (1455 Pennsylvania Avenue, N.W., Washington, D.C. 20004) is the sole law firm appearing for the *Amici*.

2) American Benefits Council (the "Council") and Business Roundtable ("Roundtable") are associations and have no parent corporations. No publicly held corporation owns any part of the Council or Roundtable.

3) AT&T Corp. ("AT&T") is a wholly owned subsidiary of AT&T Inc. To the best of our knowledge, no publicly held corporation owns 10 percent or more of AT&T Inc. However, Capital Research and Management Group, an institutional investor, owns approximately 13 percent of the shares of AT&T Inc.

4) BP America Inc. is a wholly owned subsidiary of BP plc. To the best of our knowledge, no publicly held corporation owns 10 percent or more of BP plc.

5) El Paso Corporation does not have a parent corporation and, to the best of our knowledge, no publicly held corporation owns 10 percent or more of El Paso Corporation.

6) Honeywell International Inc. ("Honeywell") does not have a parent corporation and, to the best of our knowledge, no publicly held corporation owns 10 percent or more of Honeywell.

7) Mercer Human Resource Consulting, Inc. is a wholly owned subsidiary of Mercer Human Resource Consulting LLC, which is wholly owned by Mercer Inc. Mercer Inc. is a wholly owned subsidiary of March & McLennan Companies. To the best of our knowledge, no publicly held corporation owns more than 10 percent of Marsh & McLennan Companies.

8) Watson Wyatt Worldwide is a trade name for Watson Wyatt & Company. It is a subsidiary of Watson Wyatt & Company Holdings. To the best of our knowledge, no publicly held corporation owns 10 percent or more of Watson Wyatt & Company Holdings.

9) Xerox Corporation ("Xerox") does not have a parent corporation and, to the best of our knowledge, no publicly held corporation owns 10 percent or more of Xerox.

10) *Amici* are unaware of any publicly held corporation that is not a party to the proceeding before this Court having a financial interest in the outcome of the proceeding.

11) This is not a bankruptcy appeal.

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Kent A. Mason Date

TABLE OF CONTENTS

STATEMENT REGARDING CONSENT TO FILE *AMICI* BRIEF i

CORPORATE DISCLOSURE STATEMENT ii

TABLE OF AUTHORITIES v

STATEMENT OF INTEREST 1

ARGUMENT 7

I. CASH BALANCE PLANS ARE NOT INHERENTLY AGE DISCRIMINATORY 9

   A. The district court's decision is supported by the overwhelming weight of authority, the statutory language, and the legislative history.......... 9

   B. Any other interpretation would cast doubt on common pension plan designs that Congress was aware of when it enacted section 204(b)(1)(H) 17

   C. Adoption of Appellants' theory would have staggering financial consequences that Congress could not possibly have intended 20

II. CASH BALANCE PLANS REPRESENT SOUND RETIREMENT POLICY 24

CONCLUSION 30

CERTIFICATE OF COMPLIANCE WITH TYPE-VOLUME LIMITATION, TYPEFACE REQUIREMENTS, AND TYPE STYLE REQUIREMENTS 31

ANTI-VIRUS CERTIFICATION 32

CERTIFICATE OF SERVICE 33

TABLE OF AUTHORITIES

CASES

Am. Tobacco Co. v. Patterson, 456 U.S. 63 (1982) 20

Bryerton v. Verizon Communications, Inc., No. 1:06-cv-06672, 2007 WL 1120290 (S.D.N.Y., April 17, 2007) 9

Chevron U.S.A., Inc. v. NRDC, Inc., 467 U.S. 837 (1984)....................................12

In re Citigroup Pension Plan ERISA Litigation, No. 05-cv-05296 slip. op. (S.D.N.Y. Dec. 12, 2006) 10

Cooper v. IBM Pers. Pension Plan, 457 F.3d 636 (7th Cir. 2006), *cert. denied* No. 06-760, 2007 WL 91579 (Jan. 16, 2007) 9

Curtiss-Wright Corp. v. Schoonejongen, 514 U.S. 73 (1995) 20

Eaton v. Onan Corp., 117 F. Supp. 2d 812 (S.D. Ind. 2000) 10, 20

Engers v. AT&T Corp., No. 98-3660, 2001 U.S. Dist. LEXIS 25889 (D. N.J. June 6, 2001)..10

Esden v. Bank of Boston, 229 F.3d 154 (2nd Cir. 2000) 12, 15

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Tomlinson v. El Paso Corp., No. 1:04-cv-02686, 2007 WL 891378 (D. Colo. March 22, 2007) 9

Tootle v. ARINC, Inc., 222 F.R.D. 88 (D. Md. 2004) 10

Varity Corp. v. Howe, 516 U.S. 489 (1996) 20

Wheeler v. Pension Value Plan for Employees of Boeing Co., No. 06-cv-500-DRH, 2007 WL 781908 (S.D. Ill. Mar. 13, 2007) 9

STATUTES, REGULATIONS AND OTHER ADMINISTRATIVE GUIDANCE

26 U.S.C. § 411(b)(1)(H) 13

29 U.S.C. § 623(i) 18

ERISA § 203(a)(3)(B), 29 U.S.C. § 1053(a)(3)(B) 28

ERISA § 204(b), 29 U.S.C. § 1054(b) .... *passim*

ERISA § 204(c), 29 U.S.C. § 1054(c) 17

ERISA § 205, 29 U.S.C. § 1055 5

42 U.S.C. § 415(a)(1)(B) 20

Pension Protection Act of 2006, Pub. L. No. 109-280, § 701, 120 Stat. 780 16

26 C.F.R. § 1.401(a)(4)-8(c)(3) 11

53 Fed. Reg. 11876 (Apr. 11, 1988) 13

56 Fed. Reg. 47524 (Sept. 19, 1991) 12

56 Fed. Reg. 47528 (Sept. 19, 1991) 12

67 Fed. Reg. 76123 (Dec. 11, 2002) 28

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IRS Notice 96-8, 1996-1 C.B. 359 (Feb. 5, 1996) 11, 12

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APPENDIX

Carol Gold, IRS Internal Memorandum on Pension Plan Conversions to Cash Balance Plans (Sept. 15, 1999)....................Appendix A

STATEMENT OF INTEREST

The American Benefits Council (the "Council") is a broad-based non-profit organization dedicated to protecting and fostering privately-sponsored employee benefit plans. The Council's approximately 250 members include primarily large U.S. employers that provide employee benefits to active and retired workers. The Council's membership also includes organizations that provide services to employers of all sizes regarding their employee benefit programs. Collectively, the Council's members either directly sponsor or provide services to retirement and health benefits plans covering more than 100 million Americans.

Business Roundtable (the "Roundtable") is an association of chief executive officers of leading U.S. companies. Together, those companies have $4.5 trillion in annual revenues and more than 10 million employees. They comprise nearly a third of the total value of the U.S. stock markets; represent over 40 percent of all corporate income taxes paid; and returned $112 billion in dividends to shareholders and the economy in 2005. The Roundtable is committed to advocating public policies that ensure vigorous economic growth, a dynamic global economy, and the well-trained and productive U.S. workforce essential for future competitiveness.

AT&T Corp., BP America Inc., El Paso Corporation, Honeywell International Inc., and Xerox Corporation are all national companies that do business in states across the country. Each of these companies maintains at least

one hybrid defined benefit pension plan that would be directly affected by the decision of this Court and some of these companies are parties to litigation involving their hybrid plans.

Mercer Human Resource Consulting, Inc. and Watson Wyatt Worldwide are human resources consulting firms that provide services in connection with hybrid defined benefit plans. As service providers, these companies have a wealth of experience and expertise with hybrid pension plans.

Under Appellants' argument, virtually all cash balance plans and many other forms of hybrid defined benefit plans as well as other common defined benefit plan designs were unlawful until Congress provided otherwise in the Pension Protection Act of 2006. If this theory is accepted, the cost to American businesses will be astronomical and there is little doubt that many companies will exit the voluntary employer-maintained defined benefit system through plan freezes and terminations, leaving millions of workers with diminished retirement security. As a result, *Amici* have filed this brief to urge the Court to affirm the district court's decision that cash balance plans are <u>not</u> and have never been inherently discriminatory.

Amici are committed to a vital and sustainable defined benefit pension system. Defined benefit plans help millions of Americans achieve retirement security by providing employer-funded retirement income. In the private sector,

employees are not typically required to make any contributions toward their benefits in these plans and the assets in defined benefit plans are managed by investment professionals. Employers, rather than employees, bear the investment risk of ensuring that plan assets are sufficient to pay promised benefits. In addition, insurance from the Pension Benefit Guaranty Corporation ("PBGC") means employees' retirement benefits are largely guaranteed.

As of 2003 (the most recent year for which official Department of Labor statistics have been published), more than 10 million retirees were receiving benefits from defined benefit plans, with over $125 billion in benefits paid out in that year alone.[1] Given that America's personal savings rate remains one of the lowest among industrialized nations[2] and that average balances in 401(k) plans are quite modest,[3] there is no doubt that in the absence of defined benefit pensions fewer Americans would be financially prepared for retirement.

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[1] U.S. Department of Labor, Employee Benefits Security Administration, *Private Pension Plan Bulletin*, Abstract of 2003 Form 5550 Annual Reports (Oct. 2006), *available at* http://www.dol.gov/ebsa/PDF/2003pensionplanbulletin.PDF.

[2] The Organization for Economic Cooperation and Development, Main Economic Indicators (Paris: OECD, January 2004).

[3] Data from the Employee Benefit Research Institute shows that in 2002 the average 401(k) account balance for workers age 21 to 64 was only $33,647 and the median (mid-point) 401(k) account balance was a mere $14,000. EBRI Notes, Vol. 26 No. 1 (January 2005).

Given these statistics, the value of defined benefit plans to many American families is undeniable. Yet our nation has seen an alarming decline in defined benefit plan sponsorship and today is a particularly precarious time for the defined benefit system. Employers are increasingly exiting the system.[4] The total number of PBGC-insured defined benefit plans has decreased from a high of more than 112,000 in 1985 to fewer than 31,000 in 2005.[5] This downward trend is even more sobering if you look solely at the past several years. Not taking into account pension plan freezes (which are also on the rise but not officially tracked by the government),[6] the PBGC reported that the number of defined benefit plans it insures has decreased by 7,000 (or 20%) in just the last five years.[7]

The sole bright spot on the defined benefit landscape has been the hybrid plan. Hybrid plans are defined benefit pensions that incorporate attractive features of defined contribution plans. The most popular hybrid plans are the "cash

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[4] In 2004, the Council released a white paper discussing in detail the multiple threats to the defined benefit system. *See* American Benefits Council, White Paper, *Pensions at the Precipice: The Multiple Threats Facing our Nation's Defined Benefit Pension System* (May 2004), *available at* http://www.americanbenefitscouncil.org/documents/definedbenefits_paper.pdf.

[5] Pension Benefit Guaranty Corp., *Pension Insurance Data Book 2005*, at 2 & 8 (2006), *available at* http://www.pbgc.gov/docs/2005databook.pdf.

[6] A plan freeze typically means closing the plan to new hires and/or ceasing future accruals for current participants.

[7] PBGC *Pension Insurance Data Book 2005*, *supra* note 5, at 58.

balance" design and the "pension equity" design. In a cash balance plan, employers provide annual "pay credits" to an employee's notional account and "interest credits" on the balance in the account. In a pension equity plan, employers provide credits for each year of service and these credits are multiplied by an employee's final pay to produce a lump sum figure. Hybrid plans offer the security of a traditional defined benefit plan through employer funding, employer assumption of investment risk, federal guarantees and required lifetime and spousal benefits;[8] they also show account balances in a lump sum format, are portable, and provide for a benefit accrual pattern that is more even across a worker's entire career than traditional defined benefit plans.

The positive characteristics of hybrid plans have driven their explosive growth since the cash balance plan first became known by that name in 1985.[9] Approximately one-third of large employers have converted their traditional plans to cash balance or pension equity plans.[10] As of the year 2004 (the most recent year for which official government data is available), 29 percent of all private

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[8] *See* ERISA § 205, 29 U.S.C. § 1055.

[9] *See, e.g.*, Leonard Sloane, *Your Money; Cash Balance Pension Plans*, N.Y. TIMES, section 1, page 36, column 1 (Aug. 17, 1985).

[10] PBGC *Pension Insurance Data Book 2005*, *supra* note 5, at 61.

single-employer defined benefit plan participants were covered by hybrid plans.[11] According to the PBGC, there were more than 1,700 of these plans providing benefits to more than 10 million Americans as of 2004.[12] This represents a nearly 46 percent increase in the number of plans, as well as an increase of more than one million hybrid plan participants since 2001.[13]

If Appellants' theory is accepted, the results would be devastating for hybrid plans and our private pension system. The cost to American businesses would be enormous and there is little question that many employers would lose faith in the private pension system. The result would be plan freezes and terminations, which would have an enormous impact on the retirement security of millions of working Americans and their families. The increased plan liability would also overload the already strained PBGC, which insures defined benefit plans. Taken as a whole, reversal of the district court's well-reasoned opinion would have a devastating effect on employers, employees, the PBGC, and the voluntary employer-maintained defined benefit system.

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[11] *Id.* at 62.

[12] *Id.* at 61-62.

[13] *Id.*

ARGUMENT

The district court correctly held that cash balance plan[14] designs are not inherently age discriminatory under section 204(b)(1)(H), which states:

> [A] defined benefit plan shall be treated as not satisfying the requirements of this paragraph if, under the plan, 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.

Substantially identical provisions appear in the Age Discrimination in Employment Act of 1967 ("ADEA") and the Internal Revenue Code of 1986 (the "Code"). Congress enacted the three provisions as part of the Omnibus Budget Reconciliation Act of 1986 ("OBRA") and Congress intended that the different statutes be interpreted in a consistent manner. *See* H.R. Conf. Rep. No. 99-1012, at 378-79 (1986).

The district court read section 204(b)(1)(H) to mean that the rate of pay and interest credits under a cash balance plan cannot be less for an older worker than a younger worker. The district court reasoned that the phrase "rate of an employee's benefit accrual" refers to the benefits that accrue under the terms of a pension plan and concluded that the cash balance plan at issue was not age discriminatory because it credited pay and interest at the same rates for all covered employees.

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[14] Appellants' theory raises similar issues for other hybrid designs, particularly pension equity plan designs, as well as numerous other forms of defined benefit plans.

Appellants would have this Court define the "rate of an employee's benefit accrual" by reference to the future value of a projected benefit payable at normal retirement age. That theory would mean that any pension plan that provides benefits of equal present value to participants of different ages would be age discriminatory because younger workers have a longer period to reap the advantages of compound interest, thereby receiving a larger benefit at retirement for that year's contribution. Under this interpretation, for example, a cash balance plan that credits all employees with 5 percent pay credits and equal interest credits would be age discriminatory, even though all employees are treated the same regardless of age. In fact, plans that provide greater pay credits to older participants would generally still be considered age discriminatory under Appellants' interpretation. The district court properly rejected this artificial and strained reading of section 204(b)(1)(H), which overlooks the purpose and structure of the statute, the time value of money, and the impact this reading would have on many common defined benefit plan designs and our pension system as a whole. We urge this Court to do the same.

I. CASH BALANCE PLANS ARE NOT INHERENTLY AGE DISCRIMINATORY.

A. The district court's decision is supported by the overwhelming weight of authority, the statutory language, and the legislative history.

Since cash balance plans first became publicly known by that name in 1985,[15] such plans have been repeatedly recognized as valid, non-age discriminatory plans by the courts and by the Treasury Department.

The two appellate courts that have addressed the issue have concluded that there is nothing inherently age discriminatory about cash balance plan designs. *See Register v. PNC Fin. Serv. Group, Inc.*, No. 05-5445, 2007 WL 222019 (3d Cir. Jan. 30, 2007); *Cooper v. IBM Pers. Pension Plan*, 457 F.3d 636 (7th Cir. 2006), *cert. denied* No. 06-760, 2007 WL 91579 (Jan. 16, 2007).

The district court's decision also agrees with the decisions of numerous other district courts that have rejected age discrimination challenges to cash balance plans under section 204(b)(1)(H). *See Bryerton v. Verizon Communications, Inc.*, No. 1:06-cv-06672, 2007 WL 1120290 (S.D.N.Y. April 17, 2007); *Tomlinson v. El Paso Corp.*, No. 1:04-cv-02686, 2007 WL 891378 (D. Colo. March 22, 2007); *Wheeler v. Pension Value Plan for Employees of Boeing Co*., No. 06-cv-500-DRH, 2007 WL 781908 (S.D. Ill. Mar. 13, 2007); *Sunder v.*

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[15] *See, e.g.*, Sloane, *supra* note 9.

U.S. Bank Pension Plan, No. 4:05-cv-01153, 2007 WL 541595 (E.D.Mo. Feb. 16, 2007); *Finley v. Dun & Bradstreet Corp.*, No. 06-1838, 2007 WL 196753 (D. N.J. Jan. 26, 2007); *Laurent v. PriceWaterhouseCoopers LLP,* 448 F. Supp.2d 537 (S.D.N.Y. Sept. 5, 2006); *Tootle v. ARINC, Inc.,* 222 F.R.D. 88 (D. Md. 2004); *Engers v. AT&T Corp.*, No. 98-3660, 2001 U.S. Dist. LEXIS 25889 (D. N.J. June 6, 2001); *Eaton v. Onan Corp.*, 117 F. Supp. 2d 812, 822-834 (S.D. Ind. 2000); *Godinez v. CBS Corp.*, No. SA CV 01-28-GLT (ANX), 2002 WL 32155542, at *2-3 (C.D. Cal. May 20, 2002), aff'd, 81 Fed. Appx. 949 (9th Cir. Nov. 21, 2003). Only two district courts (the Southern District of New York and the District of Connecticut) have ruled otherwise. *See Parsons v. AT&T Pension Benefit Plan*, No. 3:06-cv-552 (JCH) (D. Conn. Dec. 26, 2006); *In re Citigroup Pension Plan ERISA Litigation,* No. 05-cv-05296 slip. op. (S.D.N.Y. Dec. 12, 2006); *In re J.P. Morgan Chase Cash Balance Litigation,* 460 F. Supp. 2d 479 (S.D.N.Y. Oct. 30, 2006); *Richards v. FleetBoston Fin. Corp.*, Civ. No. 3:04-cv-1638 (JCH) (D. Conn. Mar. 31, 2006).

Moreover, the Internal Revenue Service ("IRS") has consistently indicated that cash balance plans are not inherently age discriminatory. Until 1999, the IRS granted favorable determination letters with respect to cash balance plans, approving them as satisfying the tax-qualification requirements (including the Internal Revenue Code counterpart of section 204(b)(1)(H)). The IRS temporarily

stopped issuing determination letters to cash balance plans in 1999 as a result of questions that were raised about conversions to cash balance plans (which are not at issue in this case). *See* Carol Gold, IRS Internal Memorandum on Pension Plan Conversions to Cash Balance Plans (Sept. 15, 1999). In December 2006, however, the IRS issued a Notice announcing that it was reopening the determination letter process for cash balance plans. IRS Notice 2007-6, 2007-3 I.R.B. 272 (December, 21, 2006). The Notice states that cash balance plans that were covered by the 1999 moratorium on determination letters "will not be treated as failing to satisfy the requirements of [the Internal Revenue Code counterpart to section 204(b)(1)(H)] merely because a moratorium plan that is frontloaded provides that interest credits through normal retirement age are accrued in the year of the related hypothetical allocation."[16] Thus, the Notice reflects the IRS view that cash balance plans were not inherently age discriminatory prior to the Pension Protection Act of 2006, which explicitly validates the cash balance plan design.[17]

The Treasury Department has also issued guidance addressing how various rules apply to cash balance plans, which would make little sense if cash balance plans were inherently age discriminatory. *See, e.g.,* Treas. Reg. § 1.401(a)(4)-

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[16] A front-loaded cash balance plan is a plan that does not condition the crediting of interest on the future performance of services. IRS Notice 96-8, 1996-1 C.B. 359 (Feb. 5, 1996).

[17] The Pension Protection Act of 2006 confirms on a prospective basis that cash balance plans are not inherently age discriminatory. See *infra* page 16.

8(c)(3), 26 C.F.R. § 1.401(a)(4)-8(c)(3); IRS Notice 96-8, 1996-1 C.B. 359 (Feb. 5, 1996). In fact, the Treasury Department explicitly rejected the argument that cash balance plans fail to satisfy the Internal Revenue Code counterpart to section 204(b)(1)(H) in the preamble to 1991 regulations. 56 Fed. Reg. 47524, 47528 (Sept. 19, 1991). While the Treasury Department withdrew proposed regulations that would have squarely recognized the validity of cash balance plans, that withdrawal did not reflect a finding that hybrid plans are age discriminatory, but rather was intended "to provide Congress an opportunity to review and consider a legislative proposal on cash balance plans…." Department of Treasury Press Release, Treasury and IRS Withdraw Proposed Cash Balance Regulations (June 15, 2004); *see also* IRS Announcement 2004-57, 2004-27 I.R.B. 15 (July 6, 2004).

The Treasury Department and the Internal Revenue Service's entirely rational construction of the statute should be given very considerable deference. *Chevron U.S.A., Inc. v. NRDC, Inc.*, 467 U.S. 837 (1984). The mere fact that this construction is not in the format of regulations is not material. "[A] consistent and reasonable interpretation by the responsible agency is entitled to deference, regardless of its form of publication. *See Esden v. Bank of Boston*, 229 F.3d 154 (2nd Cir. 2000) (according substantial deference to an IRS Notice).

As a substantive matter, it should also be clear that cash balance plan designs are permissible. Section 204(b)(1)(H) is undeniably a prohibition against

age discrimination in employment. Appellants argue that section 204(b)(1)(H) requires testing based on the future value of a projected benefit; however, employment discrimination prohibitions properly focus on whether workers are treated differently and there is no question that cash balance plans treat older and younger workers the same both on their face and on an economic basis.

The language of section 204(b)(1)(H) and its legislative history also make clear that cash balance plans do not violate the age discrimination rules. First, the legislative history strongly indicates that the age discrimination provisions only apply after a participant attains normal retirement age.[18] Even if section 204(b)(1)(H) is interpreted to apply to accruals prior to normal retirement age, the "rate of an employee's benefit accrual" (the phrase used therein) should not be determined by reference to the employee's annual benefit commencing at normal retirement age. If Congress had meant for section 204(b)(1)(H) to be interpreted in that manner, Congress could easily have used any of several defined terms that

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[18] *See* H.R. CONF. REP. NO. 99-1012, at 376 (1986) (hereinafter "Conference Report") ("The Senate Amendment [which the Conference Report generally follows] amends ADEA, ERISA, and the Code to require a plan to provide for benefit accruals and contributions with respect to an employee's years of plan participation after normal retirement age."); *see also* heading of Internal Revenue Code section 411(b)(1)(H): "Continued Accrual Beyond Normal Retirement Age"; 53 Fed. Reg. 11876 (Apr. 11, 1988) (preamble to first proposed regulations under the Internal Revenue Code counterpart of section 204(b)(1)(H) states: "This document contains proposed regulations relating to the requirement for continued accruals beyond normal retirement age under employee pension benefit plans.").

appear elsewhere in section 204(b). For example, Congress could have referred to an employee's "normal retirement benefit" (used, for instance, in section 204(b)(1)(A)), the "annual rate at which any individual . . . can accrue the retirement benefits payable at normal retirement age" (the words in section 204(b)(1)(B)) or the "annual benefit commencing at normal retirement age" (used in section 204(b)(1)(C)). Similarly, section 204(b)(1)(H)(i) could have been drafted in a manner consistent with section 204(b)(1)(B) to read as follows:

> Notwithstanding the preceding paragraphs, a defined benefit plan shall be treated as not satisfying the requirements of this paragraph if, under the plan, *the rate at which an employee accrues the retirement benefit payable at normal retirement age (or the employee's age if later) is ceased, or such rate is reduced*, because of the attainment of any age. [changed portion in italics]

By purposely not using such other terms and instead using a phrase not defined in the statute or regulations, Congress was leaving but one place to look for the meaning of the phrase, *i.e.,* the plan documents themselves. Indeed, section 204(b)(1)(H) specifically states that a defined benefit plan fails to satisfy section 204 only "if, *under the plan*, 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" (emphasis added). Thus, the determination of whether a plan satisfies section 204(b)(1)(H) should be based on whether the plan's benefit formula reduces or ceases pay credits (or interest credits) because of the attainment of any age, which is the approach taken under the district court's well-reasoned decision. Cash

balance plans would clearly satisfy section 204(b)(1)(H) based on the benefit formulas as set forth in the plan documents; this is so because the contribution credits under the benefit formulas either are provided on an age-neutral basis or actually increase with increased age and/or service.

This view of the pension age discrimination rules is also entirely consistent with the analytic framework for cash balance plans that was adopted by the Second Circuit in *Esden v. Bank of Boston*, 229 F.3d 154. There, the Second Circuit held that lump sum payments under a cash balance plan cannot be less than the present value of each participant's projected benefit payable at age 65 and rejected the notion that cash balance plans may simply pay lump sums equal to account balances in the same manner that defined contribution plans pay lump sums. *Esden*, 229 F.3d at 162-68. Appellants argue that *Esden* stands for the proposition that the pension age discrimination rules establish a binary structure for defined contribution and defined benefit plans and, therefore, that the age discrimination rules for the two plan types must be different. It is true that there are different age discrimination rules for defined benefit and defined contribution plans. The former focuses on benefits; the latter on contributions. However, there is no reason to believe that the age discrimination test for defined benefit plans is based on the future value of projected benefits. It makes infinitely more sense to interpret the statute as the district court did and focus on the benefits provided under the terms

of the plan. To the extent that all workers are credited with the same rates of pay and interest credits, each worker receives a projected benefit of equal present value and that is not age discrimination.

This view of age discrimination is also the approach recently taken by Congress in the Pension Protection Act of 2006 (the "PPA").[19] Section 701 of the PPA makes clear that the "rate of an employee's benefit accrual" may be determined by reference to the benefits expressed under the terms of the plan, rather than by reference to a projected annuity benefit payable at normal retirement age. So long as pay credits and interest credits are the same for older and younger workers, there is no age discrimination. While the PPA has a prospective effective date and indicates that no inference should be drawn regarding the prior status of cash balance plans under section 204(b)(1)(H), the PPA clearly reflects that, as a matter of substance, there is in fact nothing inherently age discriminatory about cash balance pension plans.[20]

In short, the district court's decision, holding that hybrid plan designs are <u>not</u> inherently age discriminatory, is supported, not only by the overwhelming weight of authority and the interpretations of the agency with regulatory authority over the statute, but also by the statutory language and its legislative history.

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[19] Pension Protection Act of 2006, Pub. L. No. 109-280, § 701, 120 Stat. 780.

[20] Pension Protection Act of 2006 § 701(d).

B. Any other interpretation would cast doubt on common pension plan designs that Congress was aware of when it enacted section 204(b)(1)(H).

In the context of age discrimination, it makes little sense to compare the age 65 benefit accrual of a 25-year old with the age 65 benefit accrual of a 64-year old, as Appellants would have this Court do. The 64-year old will receive his or her benefit much sooner and will only have one year as opposed to 40 years to accrue interest (i.e., the "time value" of money must be taken into account). Not only is Appellants' view wrong as a matter of law and a matter of economics, Appellants fail to recognize or acknowledge that if their view on this subject is correct, then a broad range of pension designs viewed as perfectly appropriate under the pension age discrimination prohibition Congress adopted in 1986 would be considered age discriminatory.

For example, if the "rate of an employee's benefit accrual" were to be based on the annual benefit payable at normal retirement age, all or substantially all contributory defined benefit plans would be disqualified. Contributory defined plans are defined benefit plans under which an employee's benefits are conditioned in whole or in part on the employee making certain specified contributions to the plan. The employee contributions required under such a plan must be credited with interest under ERISA section 204(c), 29 U.S.C. § 1054(c), and provide a minimum benefit at normal retirement age. As a result, the portion of the plan

attributable to these contributions closely resembles a cash balance plan in its benefit accrual pattern. In 1986, Congress clearly did not intend to prohibit contributory defined benefit plans, a common type of arrangement both then and now among State and local governments (which are subject to section 4(i) of the Age Discrimination in Employment Act of 1967 ("ADEA"), 29 U.S.C. § 623(i), the ADEA counterpart to ERISA section 204(b)(1)(H)).

Similarly, any pension plan that provides for pre-retirement indexing of benefits would be considered age discriminatory under the Appellants' theory. For example, a variable annuity plan that increases benefits based on asset returns would be impermissible because younger participants would have more years until normal retirement age to reap the benefits of market rates of return. By way of another example, career average pay plans that provide for pre-retirement indexing would also be unlawful. In these plans, accrued benefits are increased based on changes in an index, such as one based on consumer prices or wage increases. However, under Appellants' theory, the mere fact that younger workers would have more years until normal retirement age to benefit from the indexing would cause these plans to be inherently age discriminatory.

Not only would Appellants' theory indicate that many common plan designs are unlawful, it would even outlaw the sole example of a compliant plan cited in the legislative history to section 204(b)(1)(H). *See* H.R. Conf. Rep. No. 99-1012,

at 381 (1986) (example illustrating interaction of section 204(b)(1)(H) and suspension of benefits rules in section 203(a)(3)). Like most traditional defined benefit plans, the plan illustrated in the Conference Report provides an annuity that increases at the same rate with each year of service before and after normal retirement age. Any plan that shares this commonplace pattern of benefit accruals would be age discriminatory under Appellants' theory, which requires normalizing the rate of accrual as of normal retirement age. As a result, the normal retirement age benefit accrual of a 70-year old would be less than the normal retirement age benefit accrual of a 67-year old because the 70-year old's benefit would be discounted over 5 years (assuming an age 65 normal retirement age) while the 67-year old's benefit would be discounted over 2 years. This is simply the mirror of Appellants' approach of normalizing accruals at age 65 for participants who are younger than age 65.[21] Appellants' approach makes little sense for employees working before normal retirement age and makes even less sense for employees working past normal retirement age -- the intended beneficiaries of the legislation.

[21] The example in the legislative history illustrates the interaction of section 204(b)(1)(H) and the suspension of benefits rules in section 203(a)(3). The declining value of post-normal retirement age accruals in the example is not caused by the suspension of benefits rules. Those rules impact the value of previously accrued benefits, not the value of new accruals.

Ironically, although not technically subject to section 204(b)(1)(H), Appellants' analysis would even mean that the U.S. social security system, which provides for pre-retirement indexing, is age discriminatory.[22]

C. Adoption of Appellants' theory would have staggering financial consequences that Congress could not possibly have intended.

Under Appellants' theory, "hundreds of cash balance plans with millions of participants" nationwide would be found to have been in violation of ERISA. *Eaton*, 117 F. Supp. 2d at 823. In this regard, adoption of Appellants' theory would contradict the Supreme Court's command that ERISA should not be interpreted to impose burdens that unduly discourage employers from offering benefit plans in the first place. *Varity Corp. v. Howe*, 516 U.S. 489, 497 (1996). Appellants' interpretation of section 204(b)(1)(H) should therefore be rejected, as "[s]tatutes should be interpreted to avoid untenable distinctions and unreasonable results whenever possible." *Am. Tobacco Co. v. Patterson*, 456 U.S. 63, 71 (1982). Especially in the ERISA context, the Supreme Court has rejected statutory interpretations that would lead to "improbable results," such as the invalidation of procedures "that no one would think violate" ERISA. *Curtiss-Wright Corp. v. Schoonejongen*, 514 U.S. 73, 81 (1995).

[22] 42 U.S.C. § 415(a)(1)(B) (indexing Social Security old-age retirement benefits for increases in average national wages before retirement age).

There are no firm numbers on the cost to American businesses if Appellants' theory is accepted as law but it is safe to say that, at a minimum, the cost would be staggering. In *Cooper v. IBM*, the Plaintiffs' proposed remedy at the district court level would have increased the IBM cash balance plan's liability by approximately $5.7 billion, and would have increased the total liability for all active participants (*i.e.*, participants not in pay status) by 40%.[23] If total liability for all active participants in all private sector cash balance and pension equity plans across the country were to increase by a comparable amounts, the increase would be well over $100 billion, and perhaps far in excess of that sum.

These increased liabilities would have far-reaching effects. First, almost any employer with a cash balance or pension equity plan would have little choice but to completely "freeze" its plan (so that prospectively, no employees would earn any additional benefits) so as to avoid increasing an unmanageable liability any further. Few employers could afford to continue to provide benefits after absorbing anything remotely close to a 40% increase in liabilities. This could mean that well over eight million participants would lose all further benefits. This may not be

[23] *See* Duncan Martell, *Update 2 – IBM Settles Pension Claims, Other Liability Capped*, Reuters News, Sept. 29, 2004; Alvin D. Lurie, *The Balance Shifts: Cash Balance Support from the Hill*, Pension and Benefits Week Newsletter, Jan. 23, 2006, Vol. 12, No. 4, at *3. The 40% figure provided is based on IBM's 2004 Form 5500 report (Annual Return/Report of Employee Benefit Plan), which is publicly available through www.freeerisa.com.

meaningful for the 64-year old who would receive an enormous windfall. However, it would be devastating for all younger generations who would see their benefit program collapse.

Moreover, an increase in active participant liability of anything close to 40% would mean total liability increases of at least hundreds of millions of dollars (and billions in many cases) for many, many companies. That type of additional liability would preclude companies from investing in their business. It would also force some companies to trim compensation in other areas. In an increasingly competitive business landscape, it is inevitable that the costs associated with an adverse decision would not be borne solely by companies but would instead be shared by employees in the form of reduced total compensation. This could easily take the form of curtailments of other benefits (*e.g.*, 401(k) plan contributions), reduced wage growth rates, or even diminished wages.

The additional liability would also drive numerous companies into bankruptcy, including many non-profit organizations whose communities would suffer accordingly. For example, the Young Women's Christian Association (the "YWCA") maintains a cash balance plan to provide retirement benefits for employees of the 300 community-based YWCAs nationwide that make up the national YWCA. The YWCA (which is referred to as the "Fund") has publicly described the effect of a finding of age discrimination:

> The Fund's liabilities would more than triple and the Fund would become underfunded by approximately $900 million to $1.2 billion. The potential liability is enormous if calculated retroactively, because the Fund, which was established in 1925, has always been a cash balance plan. . . . [U]nder ERISA each YWCA would be jointly and separately liable for all required contributions. No YWCA would have the resources to satisfy the increased obligations. As a result, all or almost all YWCAs would be forced to seek bankruptcy protection and end their charitable services to the communities that they have served for nearly 150 years. This would mean the end of an American institution.[24]

Moreover, as companies are driven into bankruptcy, their plans are often transferred to the Pension Benefit Guaranty Corporation ("PBGC"). The PBGC is a self-funded governmental organization that insures benefits payable under defined benefit plans. If a plan terminates with insufficient assets, the PBGC is required to provide participants with benefits up to a guaranteed level. The PBGC is entitled to recoup its payments from the plan sponsor, but in the case of a bankrupt employer, this right may not have substantial value. The PBGC is already reporting a large deficit.[25] If Appellants' theory is accepted, the PBGC would inherit a large number of additional plans with enormous unfunded liabilities.

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[24] Brief for the Young Women's Christian Association Retirement Fund, Inc. as Amici Curiae, Hirt v. The Equitable Retirement Plan for Employees, Managers and Agents, (SDNY 2004) (No. 1:01-cv-07920-AKH).

[25] Pension Benefit Guaranty Corp., *2005 Annual Report* at 2 (2005) (reporting a $22.8 billion deficit).

In short, Congress could not have intended these results and Appellants' theory should be rejected.

II. CASH BALANCE PLANS REPRESENT SOUND RETIREMENT POLICY.

For all the questions of technical statutory interpretation that this case raises, we should not lose sight of the fact that cash balance plans are fundamentally good plan designs. If policymakers were today working from a clean slate to produce the ideal retirement plan, they would likely develop a hybrid plan. And, in fact, Congress did exactly that in the PPA when it confirmed the validity of hybrid plan designs. However, this confirmation would be quite hollow if the courts find those plans to have violated ERISA in the past, effectively forcing such plans to shut down due to the enormous liabilities.

Employers like hybrid plans primarily because the benefits in the plans are tangible to employees, resulting in greater appreciation of the pension program. Employees are more comfortable with a plan that expresses its benefit as an account balance, rather than as a life annuity. Pension benefits expressed as future annuities are difficult for workers to understand because their value depends on interest rates and anticipated mortality and, for many workers, represent an ephemeral benefit far into the future that they do not relate to. The average worker simply cannot determine the value of a single life annuity of $10,000 per year commencing at age 65. Is it worth $50,000 at age 55? Less? Even individuals

with financial sophistication may find this valuation difficult. In fact, a survey found that the dominant motives for employer conversions to hybrid plans were employee appreciation of the plan, facilitating communication with employees, and the ability to show the benefit amount in a lump sum format.[26]

Employees likewise appreciate hybrid plans because they are more transparent and more portable while also retaining the favorable security features of the defined benefit system. The unique value of hybrid plans in meeting employee retirement plan preferences is demonstrated in a recent survey. The survey reveals that workers prefer two retirement plan attributes above all others – the portability of benefits and benefit guarantees.[27] It is only hybrid plans that can deliver both these advantages. Traditional defined benefit plans typically do not provide for portability, and benefits in 401(k) and other defined contribution plans are not guaranteed. Clearly, preserving hybrid plans as a viable pension design is

[26] Sylvester J. Schieber, et al., Watson Wyatt Worldwide, *The Unfolding of a Predictable Surprise: A Comprehensive Analysis of the Shift from Traditional Pensions to Hybrid Plans*, at 44 (February 2000) (96% of respondents indicated employees' appreciation of the plan was either very important or important in the decision to convert to a hybrid plan; 93% of respondents indicated facilitation of communication and the ability to show the benefit amount in a lump sum format were either very important or important in the decision to convert to a hybrid plan).

[27] Watson Wyatt Worldwide, *Hybrid Pension Conversions Post-1999: Meeting the Needs of a Mobile Workforce,* at 6 (2004).

critical if employers are to maintain retirement programs that meet employee needs and preferences.

Perhaps most important of all, many participants build higher retirement benefits under a hybrid plan than a traditional plan of equal cost.[28] This is because traditional defined benefit plans tend to award disproportionate benefits (often as much as 75% of total benefits under the plan) to very long service employees at the end of their careers. But workforce patterns have changed substantially since traditional defined benefit plans were originally established. It is comparatively unusual for an employee to spend an entire career with a single employer.[29] Hybrid plans were designed to respond to this reality and deliver benefits more equitably to short, medium and longer-service employees than traditional pensions. The advantage of hybrid plans for most workers is confirmed by a recent study that shows that if an employee changes jobs just three times in the course of her or his career, she or he can expect to receive 17% more in retirement benefits from

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[28] Kopp and Scher, *A Benefit Value Comparison of a Cash Balance Plan with a Traditional Average Pay Defined Benefit Plan*, Society of Actuaries, The Pension Forum (Oct. 1998).

[29] Watson Wyatt Worldwide 2004, *supra* note 25, at 6 -7.

participating in cash balance plans than had her or his employers provided traditional plans.[30]

This is particularly important for demographic groups that tend to experience a greater number of job changes during their working careers. In this regard, hybrid plans tend to be significantly better than traditional plans for women who, despite their changing role in the workforce, continue to experience greater job turnover than men do. One study found that more than 75 percent of women do better under a cash balance plan than a traditional plan.[31]

More generally, cash balance plans provide a level benefit accrual pattern that stands in contrast to the accrual patterns in many traditional defined benefit plans. Traditional plans often include subsidized early retirement benefits for long-service employees who satisfy certain age and service conditions, *e.g.*, age 55

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[30] Watson Wyatt Worldwide 2004, *supra* note 25, at 7. The Federal Reserve has likewise reported that "conversions have generally been undertaken in competitive industries that are characterized by tight and highly mobile labor markets. Since mobile workers benefit most from such conversions, we conclude that this trend may have positive implications for the eventual retirement wealth of participants." Julia Lynn Coronado and Phillip C. Copeland, *Cash Balance Pension Plan Conversions and the New Economy*, The Federal Reserve Board: Finance and Economics Discussion Series 2003-63, at 3 (Nov. 2003) *available at* http://www.federalreserve.gov/pubs/feds/2003/200363/200363pap.pdf.

[31] Kopp and Scher, *supra* note 26; *see also* Nancy M. Pfotenhauer, President of the Independent Women's Forum, *Examining Cash Balance Pension Plans: Separating Myth from Fact*, Testimony before the U.S. House Committee on Education and Workforce, 108th Cong. (July 7, 2004).

with 20 years of service. These subsidies can mean that the economic value of an employee's benefit doubles or even triples once the employee reaches early retirement age. The downside to these subsidies is that employees who otherwise qualify for early retirement benefits but choose to continue working stand to suffer a significant economic loss. In many cases, it may be years before an individual who works past early retirement age earns any additional benefits on an economic basis. To the contrary, cash balance plans provide level benefit accruals to all employees regardless of age or service.

Traditional plans also often suspend benefit payments for employees who work past normal retirement age.[32] As a result, a worker who remains on the job past a traditional plan's normal retirement age foregoes payments for the period of continuing employment. These foregone payments offset the additional benefits that accrue from continuing to work. The net effect is that the value of a traditional plan generally falls steeply after attainment of the plan's normal retirement age.

In contrast, cash balance plans almost invariably provide pay credits as well as interest credits after both normal retirement age so that the value of the plan is

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[32] *See* ERISA §§ 203(a)(3)(B); 204(b)(1)(H); *see also* 67 Fed. Reg. 76123 (Dec. 11, 2002) (discussing interaction of permitted forfeiture rule and requirement that accruals continue past normal retirement age).

retained whether or not an employee remains on the job after a specified age.[33] As a result, cash balance plans do not discourage workers from remaining on the job at older ages. In this regard, employers like cash balance plans in part because they are better able to retain older workers. Correspondingly, older workers value the opportunity to continue working past traditional retirement ages while still retaining the value of their pension benefits.

In its *amicus* brief supporting Appellants, AARP makes much of cash balance conversions and scolds employers for purportedly using conversions as a means of reducing future benefit accruals. The problems with this view are manifold. Perhaps the most basic problem is that cash balance conversions are not an issue in this case. The question presented is whether the basic cash balance plan design is age discriminatory. This issue arises when a new cash balance plan is established and when a traditional plan is converted to a cash balance plan. Further, as a legal matter, ERISA does not require employers to provide any future benefits to employees and whether a conversion increased or reduced future benefits is simply not legally relevant. *See Lockheed Corp. v. Spink*, 517 U.S. 882 (1996). Finally, as discussed above, many participants and demographic groups

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[33] *See* Richard W. Johnson & Eugene Steuerle, *Promoting Work at Older Ages: The Role of Hybrid Pension Plans in an Aging Population*, Pension Research Council, (PRC WP 2003-26) (concluding that the popularity of hybrid plans represents a response to the changing demographics of the labor force).

build higher retirement benefits under a cash balance plan than a traditional plan of equal cost, and there are many reasons for an employer to conclude that the benefit accrual patterns of a cash balance plan make more sense for its workforce.

In short, it is clear that cash balance and other hybrid plans have been, and should continue to be, a key component of our national retirement savings system. Put simply, they are good retirement plans.

CONCLUSION

For the reasons stated above, *Amici* respectfully submit that this Court should affirm the judgment of the district court.

Dated: May __, 2007

Respectfully submitted,

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Kent A. Mason

CERTIFICATE OF COMPLIANCE WITH TYPE-VOLUME LIMITATION, TYPEFACE REQUIREMENTS, AND TYPE STYLE REQUIREMENTS

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 6,984 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word in 14-point Times New Roman font.

Dated: May ___, 2007

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Kent A. Mason

ANTI-VIRUS CERTIFICATION

In accordance with Local Rule 32, I certify that on May 30, 2007, the PDF version of this Brief *Amici Curiae*, which will be submitted as an email attachment to briefs@ca2.uscourts.gov, was scanned for viruses, using Symantec AntiVirus version 10, and that no viruses were detected.

Dated: May __, 2007

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Kent A. Mason

CERTIFICATE OF SERVICE

I certify that on May 30, 2007, I caused two (2) copies of this Brief *Amici Curiae* to be served via Federal Express on the following counsel:

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Dated: May ___, 2007

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APPENDIX A

IRS Memorandum to EP/EO Division Chiefs
From Carol Gold, Dir. of IRS to EP/EO Div. Chiefs
September 15, 1999

INTERNAL REVENUE SERVICE
memorandum

DATE September 15, 1999

TO EP/EO Division Chiefs

FROM Director, Employee Plans Division OP:E:EP
/s/ Carol Gold

SUBJECT Conversions to Cash Balance Plans

A number of important issues may be raised when a plan is amended to convert a traditional defined benefit plan formula into a benefit formula commonly known as a "cash balance" formula. This memorandum instructs you to request technical advice before closing any determination or examination case involving such a plan amendment to convert. For this purpose, a "cash balance" formula is a benefit formula in a defined benefit plan by whatever name (e.g., personal account plan, pension equity plan, life cycle plan, cash account plan, etc.) that, rather than expressing the accrued benefit as a life annuity commencing at normal retirement age, defines benefits for each employee by reference to a single-sum distribution amount, such as 10 percent of final average pay times years of service, or the amount of the employee's hypothetical account balance. An employee's hypothetical account balance is typically credited with hypothetical contributions and hypothetical earnings. These hypothetical contributions and earnings are designed to mimic the allocations of actual contributions and actual earnings to an employee's account that would occur under a defined contribution plan. Notice 96-8, 1996-1 C.B. 359, provides a general description of those cash balance plans that define an employee's hypothetical account.

Please identify any open determination or examination cases for defined benefit plans with plan amendments to convert as described above and review them for all issues as usual, including the conversion. Then request technical advice for these plans using current procedures. However, in lieu of the statement of issues, facts, law and arguments with respect to the conversion, you may substitute a statement that technical advice is requested on the effect on the plan's qualified status of the conversion of a traditional defined benefit plan formula to a cash balance formula. Continue this procedure until further notice.

If you have any questions, call me at (202) 622-6300 or a member of your staff may call Mark O'Donnell at (202) 622-7356.