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Transcript[1] of

Seyfarth Shaw Teleconference on Cash Balance Plans

August 6, 2003

Jim Gehring: Good afternoon everybody, or good morning for those you joining us from the West Coast. My name is Jim Gehring. I'm with the Employee Benefits Practice Group of Seyfarth Shaw here in Chicago and this is the conference call on Cash Balance Plans and, more specifically, the recent federal court decisions affecting cash balance plans. I'm going to be one of the two moderators of this call. Joining me as the other moderator is Fred Singerman, also with the Employee Benefits Practice Group in our Washington, DC office.

In addition, we have some other people with us who can add something to the call. From our ERISA Litigation Department here in Chicago, Allegra Rich is joining us and Brian Stolzenbach, who can answer specifically any litigation-related issues. And because cash balance plans are such an intensely actuarial-type field, we also have some folks from Aon Consulting to answer questions or contribute what they can regarding the actuarial aspects of this. I know we've got Brad Klinck. Brad, is there anyone else there with you?

Scott Macey: This isn't Brad, this is Scott Macey, and we have Raymond Thomas, Bev Rose and Larry Golden here in my office.

Okay, and you're all with Aon Consulting?

Scott Macey: Yes.

Jim Gehring: Okay. A couple of housekeeping things. Number one is that we were asked if we could have a transcript of this available later, because on such short notice a lot of people couldn't fit this into their schedule. So, we are recording this. I am told by my attorneys we're obligated to inform you that we are recording this. And we will either do a transcript or just a summary and circulate it to everyone who's on the sign-up list.

As far as our format today, we are going to talk about these two specific cases. This is not intended to be a primer on cash balance plans. We're assuming that everybody is at least basically familiar with what these are. What we are going to talk about specifically are the two cases that were decided last week – the *IBM* and *Xerox* decisions – what they mean, what we think they mean, what they mean to people who either have adopted these types of plans or are planning on doing so sometime in the future. So that's the format.

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[1] This document is a transcript of a teleconference hosted by Seyfarth Shaw on August 6, 2003. It has been edited for content and grammar.

The way we are going to do this is Fred is first going to talk about the *IBM* case, then I'm going to talk about the *Xerox* case. We're not going to talk at you any more than we have to. We figure we'll just take a few minutes on each of those cases, ask the folks from Aon or from our ERISA group to comment, as well, with anything they want to add. And then open it up for questions.

[Housekeeping omitted.]

Fred Singerman: Okay. I just want to add one thing to what Jim said. When it comes time to start asking questions, keep in mind that this conversation is not privileged because there are a lot of different people on the phone, and so you can identify who you are. If you don't want to say what company you're with, that's okay, but do keep in mind this is not a privileged discussion.

My case is *Cooper v. IBM*, which comes out of the Southern District of Illinois which I'm told is not a good jurisdiction for corporate defendants, and it's evident in this case. IBM had a traditional defined benefit pension plan. It converted to a pension equity plan in 1995 and then it amended its plan another time to convert to a cash balance plan in 1999.

I want to briefly describe what a pension equity plan is just in case people are unfamiliar with them. Basically, it's similar to a cash balance plan in that it's a defined benefit pension plan with essentially a hypothetical account balance. Your retirement benefit is based on a lump sum. The way it differs from a cash balance plan is that, rather than crediting dollars to the account each year and then crediting interest, a pension equity plan computes the lump sum, usually as a function of final average pay. So, for example, an employee may earn some percentage or some number of points for each of year of service, and then when he retires he would be entitled to a lump sum equal to the percentage or point conversion multiplied by final average pay. And then that, in turn, would be converted to an annuity. This difference between a pension equity plan and a cash balance plan is important for some aspects of the decision.

What these retirees or former employees were claiming is that both the pension equity plan and the cash balance plan violated an age discrimination rule in what's called the Older Workers Benefit Protection Act. That's part of ERISA. This claim is different from some of the earlier cash balance litigation that attacked the conversion [from a traditional pension plan] as having an anti-age animus, or an intent to discriminate based on age. It's more of a technical requirement in ERISA that says you can't reduce benefits on account of age and you cannot reduce the rate of benefit accrual on account of increases in age.

In the pension equity plan, what the plaintiffs claimed is that the plan actually reduced benefits on account of age -- not just it reduced the rate of benefit accrual -- but that it actually reduced benefits. The logic of it was this: employees were earning points each year. In fact, in the IBM plan, they were earning more points

each year as they got older, so IBM was actually thinking about age discrimination or at least thinking about backloading benefits and trying to come up with a formula that took age into account. But the other thing that was happening is in converting the lump sum to an annuity, the conversion rates were higher the older you got. So the basic logic is, if an individual was credited with $1,000 at age 45, that converts to a significantly higher annuity than the same $1,000 credited to an age 55 employee. That's just basic time value of money. Money in your hand today is worth more than money in your hands ten years from now. The court gets very hung up by this.

From the court's point of view, when you measure if the plan has reduced benefits on account of attainment of age, you are required to look at the age 65 annuity benefits. You have to look at that. So, as employees get older or enter the plan at an older age, they will necessarily be able to earn a lower age 65 annuity benefit assuming that they have the same service and compensation and that the only difference is age. That's the same … the court's going to come back to that point when it talks about "rate of benefit accrual."

On the pension equity plan, in particular, IBM had a cap on the number of points an employee could earn. They capped it at something like 435 points, and I'm sure this is based on some maximum service requirement that existed under the traditional plan and they just carried it over to a pension equity plan. But the court makes the point that for workers who reach this cap, those workers will continue in service, and while it's true that their lump sum dollar amount isn't going to go down, their age 65 annuity value actually decreases as they get older, because as you get older the same lump sum buys a lower annuity because it has less time to accrue earnings. And in that respect, I think the court makes what may be its only valid point -- which is that if you've got a pension equity plan that doesn't credit interest and employees are not accruing service, that age 65 benefit does indeed go down. And that might be problematic. I don't think there's any other authority out there on that point, but it suggests that in a pension equity plan design, if people terminate, you may end up having to give them the age 65 annuity benefit at the time they leave, if they elect to defer taking the funds.

Interestingly, IBM makes the point that no one was actually injured by this, which suggests to me that everyone took a lump sum when they left or that no one was at the cap at the time. The court said that's all very well and good, but that really goes to damages and not liability.

Now, I want to move over to the point that the plaintiffs raised: That both the pension equity plan and the cash balance plan violate the Older Workers Benefit Protection Act because there's a reduction in the *rate* of benefit accrual as a result of attaining a greater age. You're not allowed to reduce the rate of benefit accrual as a result of attaining any age. Here, again, the court said this is a defined benefit plan. ERISA defines the term "accrued benefits" to mean the participant's benefit expressed as an annuity commencing at age 65. When the court looked back at the words "rate of benefit accrual" on the same page and in the next subsection, it

concluded that the "rate of benefit accrual" must mean the rate at which the accrued benefit at age 65 grows.

Again, because of the time value of money in a cash balance plan, as in a pension equity plan, if you credit someone $1,000 at age 45, it's worth more at age 65 than if you credit the same $1,000 at a later age. And, therefore, [the court reasoned] by definition, this plan reduces a participant's rate of benefit accrual simply because they get older. And, therefore, plaintiffs win because the plan violates the Older Workers Benefit Protection Act.

This is an amazing case because the court does not feel the need to address or cite any contrary authorities. It just lays it out and says that it's perfectly clear to the court and there's no other possible argument. The defendant, IBM, pointed out that the words "rate of benefit accrual" are different from "accrued benefit." And the court says, "well, that's because Congress has good grammar!" Here's what the court actually said:

> "Consider the word 'popcorn.' Popcorn is a word used to describe the product created by exposing corn kernels to extreme heat. If asked to draft a phrase related to the speed of the process, one would not say 'rate of popcorn.' Rather, to be grammatically correct, one would say 'the rate corn pops.'"

It's nonsense. It is an entirely invalid analysis, I think, for two reasons. The first reason is that, even if you assume that Congress meant to tie it into accrued benefits, the phrase "rate of benefit accrual" does not say anything about whether Congress meant to preclude measuring the rate of benefit accrual based on an actuarially equivalent value of the accrued benefit. It doesn't tell you anything about timing of the determination. The second reason it's invalid is the court simply leaps to the conclusion that this is *not* an ambiguous expression. It literally says that "the best interpretation" of this language, "rate of benefit accrual," is that it refers to the accrued benefit in the next provision. But that's different from saying that the statute is ambiguous or unambiguous. And if the statute is ambiguous, you have to look at intent. You have to look at whether your analysis makes any sense.

In fact, there are other sources that the court doesn't get to. There is a directly contrary district court opinion called *Eaton v. Onan* (which is also in the Seventh Circuit), that walks through the same language and comes to exactly the opposite conclusion. The court in the *IBM* case says that all cash balance plans and all pension equity plans are illegal. You cannot have a compliant cash balance plan or compliant PEP plan, so the fallout of the case is enormous. The court ignores this in the *IBM* case. But they don't ignore it in *Eaton v. Onan*, which says, "there are hundreds of cash balance plans out there so let's look at what the authority is."

The second piece of contrary authority is the legislative history of the Older Workers Benefit Protection Act. What Congress is trying to do here is protect the accruals once employees reach normal retirement age. You cannot reduce the rate of accrual for an employee reaching the normal retirement age. There is some authority for the position that you don't even apply the age discrimination provisions of the Older Workers Benefit Protection Act before age 65. Now, I don't think that that is the majority view or that its going to prevail. But, assuming that it applies before age 65, you look at Congress' example in the legislative history for guidance. Congress gives an example of an individual who's got a $100 accrued benefit and he's entitled to accrue another $10 per year based on an additional year of service. So the individual, when he turns 66, has an accrued benefit of $110. The court in *Eaton v. Onan* makes a great point. It said, if you really believe that Congress meant by "rate of benefit accrual" to refer to your accrued benefit *at age 65*, then the example in the legislative history doesn't work. Because giving someone a $10 annuity beginning at 66 is worth less than a $10 annuity beginning at age 65. The legislative history basically cuts against interpreting "rate of benefit accrual" as meaning your accrued benefit at age 65.

What struck me as somewhat more persuasive is the fact that it is absolutely inarguable that the Internal Revenue Service thinks these plans work. They used to give determination letters on them. The still give determination letters on new cash balance plans. They slowed up in the determination letter on a process for conversion to cash balance plans, but the IRS has been blessing cash balance plans.

IRS issued a notice in 1996 specifically showing how cash balance plans can be designed to avoid backloading, something Jim is going to talk about a little more. And the IRS issued proposed regulations specifically discussing how cash balance plans can be designed in a given way so as not to be age discriminatory.

So, we've got, on the one hand, the district court in Illinois saying no cash balance plans work; we have a district court case that goes the other way; we have legislative history; and we've got this entire regulatory process. At this point, IBM is appealing the case, and we need to see what the Seventh Circuit is going to do, but I don't think that this is the end of the world; primarily because I think either it gets reversed on appeal or we get sufficient regulatory relief that will permit us to go forward with cash balance plans. What *would be* the end of the world, I think, frankly, is if we start getting announcements from the IRS saying that it's going to back off, or we got an affirmation by the Seventh Circuit. Then its a much, much bigger problem.

Jim, I'm going to turn it back to you.

Jim Gehring: Thank you, Fred. We thought the best way to do this would be to describe both cases and then open it up for discussion rather than try to divide the hour into two

pieces, so I'm going to now briefly summarize the Xerox case and then we will open it up.

The Xerox case, *Berger v. Xerox Corporation Retirement Plan*, is different in many ways. It's a case that was decided by the Seventh Circuit Court of Appeals, which is the court that will hear the appeal from the IBM plan. Because it's a Court of Appeals decision, we have to take it more seriously. It is not going to be appealed; it is not going to be reversed. It's one we're going to have to live with. But it assumes basically that cash balance plans work. It deals with the details of how they work. So, in one sense, it's much less radical than the *IBM* case, but we can't just say it's going to be reversed, so we won't worry about it.

The *Xerox* case deals specifically with a phenomenon which is known as "whipsaw." Let me just briefly describe that. Those of you who have cash balance plans are probably somewhat familiar with it. But the notion of whipsaw comes from the fact that the Internal Revenue Code specifies the interest rate that you must use when you're paying out lump sums to someone who has not yet reached age 65. As you know, that's currently the 30-year Treasury bill rate. Congress is currently debating whether to change that to a rate based on corporate bonds but for right now, it's the 30-year T-bill rate. However, most cash balance plans are more generous when they're crediting interest than that, because the 30-year T-bill rate is a pretty cheap rate. So what you have is, when somebody quits or is terminated before they're 65, what the Internal Revenue Code says is you can't just pay them their account balance, which is what you want to do. That's the way a cash balance plan is supposed to work. Instead, what you have to do is take their account balance on the day they quit, project it forward to age 65 using the interest rate that's set in your plan and then discount it back to their current age using the 30-year T-bill rate. And if those two interest rates are different, the result is that you wind up with a benefit that exceeds the amount that's in their hypothetical retirement account. So, they wind up having to get the better of the two amounts and that's what's called whipsaw.

That's exactly what happened to the Xerox Corporation and it cost them several hundred million dollars because of it. The important thing to realize about the *Xerox* case is, although it was a terrible result for them, it's one that's fairly easily avoidable. The IRS has issued guidance on this. As Fred said, the IRS has been assuming all along that cash balance plans do work if you do them right. And what the IRS said is if you use certain specified safe harbor interest rates, you don't have to do the whipsaw calculation. You can simply assume that the discounted value of the age 65 retirement benefit is no greater than the retirement account balance and just pay the employee his retirement account balance. They gave several examples of permissible safe harbor rates, one of which is the 1-year T-bill rate plus 100 basis points. And in fact, the Xerox plan came very close to using that. They used an interest rate which they describe as substantially similar to that rate, and the lesson of the opinion here seems to be substantially similar "ain't good enough." You either have to follow the IRS guidelines or you have to do the whipsaw calculation. You have to project the interest rate forward and

discount it back, which in the Xerox case was a difference of hundreds of millions of dollars to the class of terminated employees.

Xerox tried to argue that whipsaw was not a valid theory, that you didn't have to do the whipsaw calculation, and they really got squelched on that. There are now two or three cases which say very specifically, yes, whipsaw is the law, you do have to do it, and don't even think about trying to avoid it unless you follow the IRS guidelines and use one of these safe harbor interest rates. So, one lesson we get out of this case is if you're going to do a cash balance plan, you have to use one of the safe harbor interest rates or you have to be prepared to calculate the greater of the two benefits, the so-called whipsaw calculation. In a sense, then, although the case was very bad for Xerox, it's got a fairly simple fix for people who are designing new cash balance plans or doing a conversion.

Now there's a second aspect of this case that we wanted to point out because it's kind of a sleeper. Most of the focus in this case has been on the whipsaw effect. But there is also some discussion, some very brief discussion, in this case regarding the use of preretirement mortality assumption. It's an actuarial term and I will do my best to explain it and let the folks from Aon jump in if I say anything too wrong.

You can have a plan which doesn't use one of the safe harbor rates and actually does the whipsaw calculation and gives each employee the greater of the two benefits. In other words, you do the calculation where you project the interest rate forward and then discount it back again.

What Xerox wanted to do, for purposes of paying damages when they discounted that rate back to present value, was to use a preretirement mortality assumption. In other words, if you have somebody who's 45 years old, and you're figuring out what is the present value of his pension benefit at age 65, you don't just take into account interest rates. You also take into account the statistical possibility that he's not going to make it to age 65. He won't live that long and therefore he'll never collect his pension; therefore, that affects and reduces the current present value of his pension. That's a normal component of present value calculations and Xerox wanted to use it when they were paying damages to their employees.

The Seventh Circuit said "no, you can't do that." And the reason you can't do it is because in a cash balance plan somebody always gets paid the benefit. You do not have to live to age 65 in order for one of your heirs to get a death benefit. Somebody will always get that benefit. Therefore, you don't do a preretirement mortality calculation. This is actually a very radical theory, because a standard part of all present value calculations is using a preretirement mortality assumption. And there are various technical reasons why we feel the court was wrong on this. Our best reading of this is just that what they were really talking about was only how you calculate damages in this one particular case. But it is also possible to read this, although we don't think this is the right reading, to say that any cash balance plan when they are doing a present value calculation cannot

use a preretirement mortality assumption because somebody is going to get that benefit, even if the employee dies before age 65. And if that's the case, then there are a lot of cash balance plans that think they're designed properly that are not doing the present value calculations correctly.

Now, we know that there's at least one case that is presently being briefed in the Sixth Circuit of Appeals that specifically focuses on this issue, not just as part of the damages calculation but as actually the central point of the case. Plaintiffs' attorneys are very aware of this issue, and there can be some very big dollars involved. So, that's the second concern that we have about this case. The whipsaw isn't so bad because you can avoid it, just do like the IRS tells you to. But this other aspect is kind of a sleeper in this case which we're going to be watching very carefully.

That's pretty much what I have to say about Xerox. I think before I throw it open I'll ask Allegra from our Litigation group and the folks at Aon if they want to add anything, and then we'll throw it open to you folks.

Allegra Rich: No, I think you guys pretty much covered it. I think the issues that ERISA litigators are looking at are what type of relief is going to be awarded in these cases and what section of ERISA participants are going to sue under, and it seems, especially in the Seventh Circuit case, that they're all just going to fall under ERISA 502(a)(1)(B), which is the section that allows the participant to recover benefits under the plan. Technically speaking, I don't know that that's the right analysis, because the plan is essentially, in the cash balance cases, being ruled unlawful, so they're not seeking benefits under that plan, but they're sort of seeking for the illegal terms to be stricken and then benefits under the old plan. But we'll have to see how that plays out.

Jim Gehring: One of the things we've talked about is the question of what can we do, other than wait and see what happens, if you have a cash balance plan or thinking about putting one in place. One possibility is amending them so that there's kind of a backup benefit formula in there, so that you don't have the situation we just talked about. We haven't talked all the way through this, but we were discussing this morning with a client that might want to amend its plan to put a backup formula in there so it doesn't have a situation where, if the court throws out the cash balance portion, the only thing they can do is fall back on the old plan, which could be very expensive.

Allegra Rich: Exactly, because presumably, converting to a cash balance saves money to begin with, and that was part of the point in doing it. So to go back to the old plan, your actuarial assumptions are going to be all off and it's going to cost a lot of money.

Jim Gehring: The only real way to protect against this, other than to wait and see what happens, would be to freeze your plan now and stanch the bleeding by not accruing any more benefits of any kind. I think we all agree that's too drastic a reaction to one fairly off-the-wall district court case, but of course it's a possibility.

Brad Klinck: I was just going to add one other point with regard to – this is Brad Klinck – and that is that in addition to these cases, with regard to the *Cooper v. IBM* in the Seventh Circuit you mentioned *Onan* also in the Seventh Circuit, there are a number of other cash balance cases out there that are currently being litigated including those in other circuits. Some of those cases have, with regard to ADEA charges, have different results. So, there is also a possibility when we discuss potentially the next steps that if the different circuits conclude differently, that ultimately this argument may go to the Supreme Court.

Scott Macey: This is Scott Macey from Aon. There's two things. One, on the *Xerox* case, in a way, forgetting the results for a moment, I was gratified at least to see Posner, who wrote the decision, take account of and give recognition to the time value of money concept in the decision, which it seems like if it gets to him or judges that accept that on the Seventh Circuit, same court for IBM on appeal, would be helpful to IBM, because that's the whole issue on the 204(b)(1)(H) issue on the rate of accrual that they're taking account of the time value of money as opposed to just the next effect of the compounding of interest on the normal retirement benefit.

Fred Singerman: I would love to see Posner decide that case.

Scott Macey: I agree. The second issue is, Raymond here, one of our senior actuaries, wants to say something about the mortality assumption.

Raymond Thomas: First of all, we should point out that the benefit we are talking about under 417(e) is the normal retirement benefit, and we are taking the present value of that. You look at what benefits you're taking the present value of – is that the benefit given before retirement or is that the normal retirement benefit. In this case, we are talking about the normal retirement benefit and, therefore, the present value that you look at is the present value of that benefit, not any benefit before that. And it is appropriate, we think, to reflect mortality in arriving at that benefit. Most plans, in fact, do that. That's not uncommon. So, I think there's a significant case in arguing that you should reflect the preretirement mortality.

Jim Gehring: I think we agree with you on that, and the feeling is that the court just barely touched on this and really kind of brushed off the argument. They had already decided Xerox was guilty and it was just now a question of how much. And that, as a result, they really did kind of short shrift this whole argument. We are hoping and we expect that a court that really focuses on this issue will agree with, as Raymond just said, that using a mortality assumption is such a well-established part of present value calculations that it's just not reasonable to just throw it out.

Raymond Thomas: The only thing I should add, too, is that not every cash balance plan provides the full cash balance benefit preretirement. The retirement benefit could be a joint

and survival benefit or it's not in every case where it is the full cash balance plan and therefore, you can't say, as the judge said here, that you're automatically going to receive a death benefit and so forth.

Jim Gehring: That's true. This would not necessarily affect every cash balance plan.

Raymond Thomas: Exactly.

Jim Gehring: Although many cash balance plans do provide it, because the idea is to make it look as much like an account as possible.

Brad Klinck: I just want to add something to a point Scott made just to make certain that everyone understands it, and that is that if, in fact, the argument that Judge Posner used in the earlier *Onan* case that interest does, in fact, should be reflected with regard to the present value … if, in fact, that argument is accepted ultimately on appeal in the *IBM* case in the Seventh Circuit, then that eliminates the 204(b)(1)(H) issue, which is the issue that was found both in the pension equity and in the cash balance plan to provide discrimination. It would still leave … it would eliminate 204(b)(1)(H) then. It would still leave the 204(b)(1)(G) problem with pension equities; if that argument were removed, then the general statement that a lot of people are making, that this is a death knell for cash balance plans, is eliminated. Because that was the problem specifically with regard to cash balance, and the elimination of that issue then would eliminate the problem with regard to cash balance plans.

Jim Gehring: There could still be problems with the IBM plan, even if, as you say, the death knell isn't sounded for all plans.

Fred Singerman: Why don't we open it up to questions.

Jim Gehring: Yeah. Anybody out there, just kind of jump in and start up by telling us who you are if you would.

Caller: I think we're all confused.

Jim Gehring: I was afraid of that. What can we clear up?

Caller: My question is is there anything in the IBM structure that makes that case particular to IBM? For example, you had mentioned earlier about the cap that they imposed may have exacerbated the discrimination. Is there anything else?

Fred Singerman: The other thing IBM had in the plan that bothered the court was, when they did their conversion and they set up their pension equity plan, the benefit was a function of final average pay averaged over five years. But the plan didn't let you count any pay before the conversion date, so in the first year you were dividing

one year of pay by five years; so you only had 20 percent of your pay taken into account. It was a strange design choice, I think. And another thing that annoyed the court was the amount of earning that pension income contributed to the company's financial report, which I though was unfair because the market value of assets was going up enormously at this point. But the court seemed very hung up on that.

The answer really is that these were only "atmospherics" that contributed to how the court perceived the plan. The bottom line is that the logic of the court's holding would apply to all of these plans, and, if it actually survived, would be a death knell. You've heard why it shouldn't survive, but you can't really distinguish the logic of the case from other cash balance and pension equity plans.

Jim Gehring: Two things that possibly should be avoided or that need to be looked at are the way that the cap worked in the pension equity structure and also the way they phased it in with the strange way of counting final average compensation. And those are both unusual features in this type of plan.

Is there anybody else that we can try to unconfuse?

Caller: Just have two quick questions. The first one is sort of a leading one. First, under the *Xerox* decision is it possible to take even a little bit more comfort in the fact that Posner seems to look with favor on [IRS Notice] 96-8? It seems to me that there was always a little bit of a question about that IRS notice, and the fact that they defer to it to a certain extent gives me a little bit of comfort assuming your plan is within the safe harbor. And then, second, could you review one more time on the IBM side, the use of benefit accrual vs. accrued benefit? I'm still not quite clear on that.

Jim Gehring: I'll answer the first question, because it's on the *Xerox* case. Yes, the one thing that the *Xerox* opinion doesn't say is if Xerox had followed Notice 96-8, they would have been fine. We'd love to see that sentence in the opinion; it's not there, but that certainly is the tone of the opinion. They treat it as being definitive when they're using it to beat up on Xerox. They never come right out and say if you follow it, then everything is fine, but there are very approving references to it. Fred, do you want to explain the difference between popcorn and cornpopping again?

Fred Singerman: Absolutely. ERISA defines the term "accrued benefit" to mean annuity benefits beginning at age 65. That is the definition of "accrued benefit." The language under the Older Workers Benefit Protection Act says that you can't have a reduction in the rate of future benefit accrual due to age. So, what the IBM court said was we're going to import that definition of "accrued benefit," meaning the annuity at age 65, into the "rate of future benefit accrual" language and we're going to interpret that to mean that the rate at which your age 65 annuity accrues cannot be reduced on account of age.

Caller: The alternate reading would be, presumably, IBM saying "look, if it was an annuity of $100 payable at age 65, as long as that amount is not reduced, we're fine regardless of whether next year you accrue an additional $10 or $5 or $2." Is that how that works?

Caller: What IBM was saying on that point was their rate of benefit accrual can be measured as an immediate lump sum.

Fred Singerman: Right, and in terms of that, there's another court case out there that says, if the employee is earning $60,000 a year and the IBM plan provides five percent of pay, or another plan does, then it's clear that that employee's account is going to increase by $3,000 a year. As it goes up $3,000 every year until potentially such time as it hits the service cap, then it is not being decreased as a result of age. The benefit accrual continues to go up. So, looking upon that in that manner, and other courts have looked upon it in that manner, you could say that the cash balance plan is not age discriminatory. They looked, and instead of saying that there's an accrual this year, a benefit accrual of $3,000, they said let's look at that age 65 benefit. And, taking a look at how much that benefit accrual went up, looking at that as an annuity benefit, that annuity benefit got smaller and therefore the court in this case decided that that meant that there was in fact a reduction in the rate of benefit accrual.

Jim Gehring: Basically, the $3,000 you get put into your account when you're 40 is maybe worth $10 a month when you're 65 as an annuity. The same $3,000 put into your account when you're 45 is maybe worth $8.00 a month additional annuity. So that the older you get, the slower the growth of the age 65 annuity, and that's what the court said is a reduction in the rate of benefit accrual.

Allegra Rich: It's growing, just not by the …

Jim Gehring: Right, it's growing. The older you get, the slower growth gets. We're all familiar with that process.

[Comments omitted.]

Jim Gehring: Anybody else?

Caller: Do you know if the plaintiffs were represented by an interest group in the *IBM* case? Or was it a law firm on its own?

Fred Singerman: I do know they were represented by a Washington firm, and I actually called over there and chatted about their plans to appeal. I don't know that any interest groups weighed in, and given the judge's decision, I can't imagine it would have helped. What I was told is that it is on appeal, and the Seventh Circuit does not particularly like amicus briefs, but it can't hurt. People have to understand that there are no longer any new traditional defined benefit plans. Companies are not

saying, "gee, do I want to convert my traditional plan into a cash balance plan, or keep my traditional plan going forever." What they're saying is, "do I want to convert my traditional plan into a cash balance plan or terminate it?"

Jim Gehring: I don't know if they were backed by them, but there certainly is a political constituency for the idea that cash balance plans discriminate against older workers. AARP, I know, has that position; organized labor has that position. And as some of you may know, the IRS put out some regulations on cash balance plans late last year which were very controversial. They wound up withdrawing part of them, and the new Secretary of the Treasury, in fact, had to promise to look at them again before he could get himself confirmed.

One thing we don't know, and Scott I'd like to ask you to chime in on this if you've heard anything, is whether the IRS' reaction to this case is likely to be "phew! now we don't have to worry about cash balance plans anymore."

Scott Macey: I haven't heard directly, and I haven't talked to people in the Service or Treasury since last week, but I talked to the trade association and our thinking was they're still working on it and they do have to grapple with it, because otherwise, they're going to be left effectively overturning their prior guidance in proposed regulation and [Notice] 96-8. I mean, 96-8, for the backloading purposes, effectively required the compound interest issue that the IBM court said is unlawful for age-discrimination purposes.

Jim Gehring: So, the IRS, at least as far as we know, is not assuming that cash balance plans are all going to vanish.

Scott Macey: No, I can't imagine that, especially since, as you guys pointed out, they've been upholding them on the new designs, and this really wasn't a conversion issue, it was a basic design issue. And, you know, with the Xerox case, I would assume that … we understood up until the Xerox case that IRS was going to come out with guidance relatively soon on the whipsaw issue. It wouldn't surprise me if that gets delayed a little bit, but we're still hoping that they come up with something that is more favorable to plans than what they previously had that simplifies the whole whipsaw process.

Caller: We were planning to put in a cash balance plan. What's your counsel? Sit tight?

Jim Gehring: I guess the real question is, how far down the road and how committed are you? If you're just thinking about it, I would hold off. If you've been starting group discussions with your employees and have some steam behind it, I'm not sure I would hold off. I may be crawling out on a limb here, so my partners can try and haul me back, but I have to believe that this case is going to get overturned. I just can't believe it's going to be upheld. And I certainly have not been counseling clients to freeze their existing plans or, if they're really far down the road, to stop. On the other hand, if you've just been kind of thinking about it and you haven't announced it yet, it might not be a bad idea to wait a while.

Fred Singerman: Well, the flip side is the traditional plan costs money, as well. And it may also matter what kind of design you're looking at in the transition. If you're doing an election for participants from the traditional plan to the cash balance, or if you're doing a "greater of" type formula, that really will impact damages, it seems to me since participants would have the opportunity at the end of the election to mitigate any potential damages from age discrimination. So the conversion process might matter a fair amount.

Jim Gehring: Yes, there's certainly ways that the conversion process and the plan can be designed to try and minimize the likelihood of attack under these plans, although there's really nothing you can do about IBM, other than to put into a sort of backup benefit formula that says if this formula is ever determined to be unlawful, then we fall back on something that's cheaper than the old plan design. That's something we just started kicking around and it raises some other issues as well. There really isn't a good, simple answer for this case, other than we really hope it's wrong.

Caller: For those of us who have converted to cash balance, is there any strong sense what the timing would be on the IBM appeal?

Jim Gehring: The IBM appeal is what's called an interlocutory appeal. Because it's not a final decision yet, they have to get permission from the court to appeal an interim ruling, so it's not at all certain that they would be allowed to appeal yet. But assuming that they are, what do you guys think, you litigators, a year?

Allegra Rich: If the Seventh Circuit takes it, which is more likely than not. Yeah, the briefing would go on probably a good three or four months, depending on if there's extensions or whatnot and then the Seventh Circuit generally in the three to four … they would set oral arguments another maybe three to six months after that, and then they take about three to four months after that to decide. So probably, about a year … 11 to 14 months, so it is a while. But, I do think that they'll be interested in the case, which tends to move it along a little quicker. I do think you'll see Posner on it, even though I'm not exactly sure how they will do it. But I wouldn't be surprised at all to see him on it.

Caller: Thank you.

Jim Gehring: Anybody else? Anybody still out there?

Caller: A transcript would be great.

Jim Gehring: Okay. We will do that then. It's about seven minutes until 2:00, so does anybody else have anything they'd like to comment on or anything that they're still confused about that they think can be resolved?

Allegra Rich: Actually, I have a question. This is Allegra. Scott, I have a question. Do you if ERIC or any of those groups are going to file amicus briefs?

Scott Macey: Well, you know, IBM is an important member of ERIC and ABC and other trade associations, and I actually know that they had some type of meeting the day after the decision came out and I'm sure, as a board member of ERIC that if IBM asked for a brief and the Seventh Circuit were to accept it, that ERIC would do one.

Allegra Rich: Okay.

Jim Gehring: Okay? I've heard a lot of beeps, so I think people are dropping off. So one more time. Anybody else have anything? We will circulate the transcript on this.

Fred Singerman: … probably post it on our website at www.seyfarth.com

Jim Gehring: We'll post it on the website. And, of course, all of us also are available to talk about this one-on-one if anybody wants to call one of us.

Scott Macey: Well, this was helpful. You guys did a great job of making a complicated subject relatively easy to understand.

Moderators: Thank you.