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Tenth Circuit Puts One More Nail in the Coffin for Cash Balance Plan Litigation

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Cash balance pension plans have been the subject of legal controversy for nearly 20 years. In the 1990s, when many employers were converting their traditional ''final average pay'' plans to cash balance plans, older workers went on the offensive and filed a number of class actions claiming that cash balance plans violated laws prohibiting age discrimination and asserting a host of other technical violations.

On Aug. 11, 2011, the U.S. Court of Appeals for the Tenth Circuit became the most recent federal appellate court to put a nail in the coffin of cash balance plan litigation. In *Tomlinson v. El Paso Corp.*,[1] the Tenth Circuit held that a cash balance pension plan did not violate the Age Discrimination in Employment Act,[2] or the Employee Retirement Income Security Act.[3]

The court's decision highlights the importance of ensuring that any plan amendment is accompanied by straightforward, honest disclosures to plan participants. Specifically, the *El Paso* decision emphasizes that employers and plan administrators must carefully comply with the notice requirements in effect at the time of a plan amendment, because failure to do so can cause the amendment to be ineffective (thereby undoing the intended plan changes).

Background

In 1997, El Paso converted its traditional ''final average pay'' plan to a cash balance plan. At that time, existing employees were given cash balance accounts that were actuarially equivalent to their existing benefits under the old plan. However, rather than immediately transitioning to the cash balance plan, El Paso offered a five-year transition period during which existing employees accrued benefits under both the old formula and the new cash balance formula. After five years, benefits under the old formula were frozen, while cash balance benefits continued to accrue. Upon retirement, an employee received whichever formula had produced the greater amount at that time.

In 2004, three employees filed a class action lawsuit against El Paso in the U.S. District Court for the District of Colorado. Like many plaintiffs in cash balance plan lawsuits, the El Paso plaintiffs argued that the plan conversion discriminated against older workers. Their theory was that once the five-year transition period ended, older workers' frozen final average pay benefits

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[1] No. 10-1385 (10th Cir. Aug. 11, 2011) (156 PBD, 8/12/11; 38 BPR 1505, 8/16/11).

[2] 29 U.S.C. § 621, *et seq.*

[3] 29 U.S.C. § 1001, *et seq.*

were typically higher than their cash balance benefits. Because of that gap, they alleged that older workers did not earn any additional retirement benefits until their cash balance benefit caught up to and exceeded their frozen benefit. This period, during which the cash balance benefit grows and ''wears away'' at the gap between the two benefits, is referred to as a ''wear-away period.''[4]

The plaintiffs argued that the wear-away period violated the ADEA because it disproportionately affected older workers, as those were the individuals who had the highest benefits under the old final average pay formula at the end of the transition period. They also contended that the wear-away period violated ERISA's anti-backloading rules, which require that a future accrual rate cannot be markedly higher than an earlier accrual rate. The plaintiffs also alleged that El Paso's communications to its employees about the plan conversion violated ERISA's notice requirements.

Over the course of six years, the district court dismissed each of the plaintiffs' claims in a series of orders.[5] The plaintiffs then appealed to the Tenth Circuit.

El Paso Complied With ERISA's Disclosure Requirements

In rejecting the plaintiffs' claims that El Paso's notices and summary plan description were inadequate, the Tenth Circuit emphasized that courts should closely scrutinize the communications that an employer distributes to employees in connection with plan changes. With respect to the ERISA Section 204(h) notice that El Paso distributed, the court rejected the plaintiffs' argument that El Paso was required to provide an explicit warning of the wear-away effect, and, in any event, found that there was enough detail in El Paso's notice to let participants know how the pension plan changed and how those changes could affect them.[6]

The Tenth Circuit also made significant findings with respect to what employers are required to include in SPDs—and what they are not required to include—when they amend their pension plans. The plaintiffs argued that El Paso's SPD improperly failed to notify participants about the wear-away period and also did not adequately compare the old plan to the new plan.

The Tenth Circuit rejected the plaintiffs' arguments that El Paso was required to include such information in its SPD, holding instead that ''[a]bsent a finding of deceit on the part of the employer or a failure on the part of the employer to explain how benefits are calculated, we will not invalidate an SPD that neglects to inform employees of a wear-away period.'' Because the plaintiffs had not presented any evidence that the El Paso's SPD was deceitful or failed to explain the manner of the plan conversion, the Tenth Circuit affirmed the dismissal of the plaintiffs' SPD claim.

In light of the court's holding on the SPD claim—which signals that courts will continue to closely analyze the nature of the communications that employees receive regarding plan amendments—employers and plan administrators should take care to ensure that their communications to employees are honest and straightforward.

No Discrimination Against Older Workers

The Tenth Circuit also considered whether the wear-away periods allegedly experienced by older workers constituted age discrimination under that provision. Following the US. Court of Appeals for the Seventh Circuit's reasoning in *Cooper v. IBM Personal Pension Plan*,[7]—which has also been adopted by the U.S. Courts of Appeals for the Second, Third, Sixth, and Ninth Circuits—the Tenth Circuit found that as long as the inputs to the cash balance plan (the pay and interest credits) are as good for older workers as they are for younger workers, then the pension plan complies with the ADEA.

The court found that ''[t]he only input that varies with age, the pay credit, actually increases as an employee gets older.'' In the court's opinion, by focusing on the wear-away feature, the plaintiffs were looking at the ''accrued benefit,'' which is an output of the plan, not an input. Because younger and older employees received credits to their accounts in a nondiscriminatory manner, the Tenth Circuit held that El Paso's plan complied with the ADEA in spite of the wear-away period.

Plan Does Not Improperly Backload Benefits

The El Paso plaintiffs also contended that the cash balance plan violated ERISA's anti-backloading requirements, which prohibit pension plans where employees accrue the bulk of their benefits when they are close to retirement. According to the plaintiffs, because older workers experience zero accrual during the wear-away period, and then experience years of positive accrual when the wear-away ends, El Paso's plan violated the rule that a future accrual rate cannot be more than 133⅓ percent higher than the previous year's accrual rate. Because of the special properties of the number zero, any positive growth is infinitely greater than zero growth.

Following the Second Circuit's holding in *Register v. PNC Financial Services Group Inc.*,[8] the Tenth Circuit rejected the plaintiffs' anti-backloading claim. Specifically, the court relied on the provision of ERISA that provides that once there is a plan amendment, only the

[4] Congress prospectively made wear-away periods unlawful when it passed the Pension Protection Act of 2006.

[5] No. 04-cv-02686, 40 EBC 1787 (D. Colo. March 22, 2007) (57 PBD, 3/26/07; 34 BPR 756, 3/27/07); 245 F.R.D. 474, 42 EBC 1429 (D. Colo. 2007) (173 PBD, 9/7/07; 34 BPR 2117, 9/11/07); No. 04-cv-02686, 43 EBC 1932 (D. Colo. March 19, 2008) (55 PBD, 3/21/08; 35 BPR 672, 3/25/08); No. 04-cv-02686, 45 EBC 2534 (D. Colo. Jan. 21, 2009) (13 PBD, 1/23/09; 36 BPR 181, 1/27/09); No. 04-cv-02686, 48 EBC 1408 (D. Colo. Aug. 28, 2009) (167 PBD, 9/1/09; 36 BPR 2057, 9/8/09); No. 04-cv-02686, 49 EBC 1807 (D. Colo. July 26, 2010) (143 PBD, 7/28/10; 37 BPR 1685, 8/3/10); No. 04-cv-02686, 51 EBC 1407 (D. Colo. March 30, 2011) (64 PBD, 4/4/11; 38 BPR 706, 4/5/11).

[6] In its opinion, the court construed a former, less stringent, version of ERISA's notice requirements, which was in effect at the time of El Paso's transition. Pursuant to a 2001 amendment to ERISA and its implementing regulations, the statute now requires a much more detailed and individualized assessment of the effects of plan changes. The newer regulations lay out specific requirements for transitions from a defined benefit plan to a cash balance plan, and mandate that an employer give a range of examples illustrating the effects of the new plan.

[7] 457 F.3d 636, 638-39, 38 EBC 1801 (7th Cir. 2006) (151 PBD, 8/8/06; 33 BPR 1867, 8/8/06).

[8] 477 F.3d 56, 71, 39 EBC 2409 (3d Cir. 2007) (20 PBD, 1/31/07; 34 BPR 326, 2/6/07).

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new plan formula is relevant for ascertaining whether the plan satisfies the anti-backloading rules.

In the context of a plan that offers the ''greater of'' two different benefits, like El Paso's, a participant's election to retain his or her benefits under the old plan is not relevant to this analysis. Instead, a court must look to whether the new plan formula would violate the 133⅓ percent test if it had been in effect for all years. Because the plaintiffs did not contend—nor could they—that the cash balance formula, standing alone, violated ERISA's anti-backloading rules, the appellate court affirmed the district court's dismissal of that claim.

In reaching its holding, the court found unpersuasive a revenue ruling in which the Internal Revenue Service concluded that a cash balance plan similar to El Paso's would violate ERISA's anti-backloading rules with respect to certain employees who experienced a wear-away period in spite of the plaintiff's urging that the court should defer to the IRS's interpretation.

Conclusion

In conclusion, the Tenth Circuit's decision emphasizes the importance of strictly complying with ERISA's notice requirements and providing truthful, straightforward disclosures to pension plan participants in connection with plan changes. Failure to do so can result in significant consequences, including costly litigation and even invalidation of the plan amendments.