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Legal News

Cash Balance Plans

Court Dismisses ERISA Age Bias Claim But Refuses to Dismiss Workers' ADEA Claim

The U.S. District Court for the District of Colorado joined with the majority of federal courts March 22 in ruling that a cash balance plan does not discriminate against older workers in violation of the Employee Retirement Income Security Act (*Tomlinson v. El Paso Corp.*, D. Colo., No. 04-cv-02686-WDM-MEH, 3/22/07).

In dismissing claims that El Paso Corp.'s cash balance pension plan discriminated against older workers in violation of ERISA, Judge Walker D. Miller said he agreed with the majority of federal courts that have ruled the "rate of benefit accrual" in ERISA's age discrimination provision should be measured by looking at what an employer puts into a participant's plan account.

The court refused, however, to dismiss claims that El Paso violated the Age Discrimination in Employment Act when it converted to a cash balance plan and allegedly set the initial cash balance accounts for older, longer-service employees at levels significantly below the value of their accumulated annuities under the company's former traditional defined benefit plan.

The Plan Conversion

El Paso converted its traditional defined benefit plan to a cash balance plan in 1997. Each participating employee was given a hypothetical account and each quarter the employee earned "pay credits" based on a percentage of their salary and "interest credits" based on the yield of a five-year U.S. Treasury bond, according to the court.

During a transition period between Jan. 1, 1997, and Dec. 31, 2001, participant employees accrued benefits under both the new cash balance plan and the old defined benefit plan and retiring employees could elect whichever option benefited them the most, the court said. Once the transition period expired retirees still could choose either option but the old plan was "frozen" at whatever benefits the employee had earned as of Dec. 31, 2001, the court added.

A group of El Paso employees brought a lawsuit alleging the company violated the ADEA because El Paso set the initial cash balance accounts for older, longer-service employees at levels significantly below the value of their accumulated annuities under the old plan. The employees also alleged that the cash balance plan violated ERISA's age discrimination rules.

ADEA Claim Survives Dismissal

The district court rejected El Paso's claim that the employees' ADEA claim should be dismissed because of their failure to file a charge of age discrimination with the Equal Employment Opportunity Commission within 300 days of Jan. 1, 1997, when the plan was converted to a cash balance plan. The court said it disagreed with El Paso's argument that the employees' ADEA claim accrued on Jan. 1, 1997.

According to the court, it was not clear whether the employees knew or should have known on Jan. 1, 1997, that they had an ADEA claim because while the employees received a brochure on that date explaining that the plan was being converted, the employees claimed the brochure said nothing about a freeze in accruals under the old plan.

"At this stage of the case, I cannot conclude that there exists no set of facts where it would be reasonable to receive such a brochure and not inquire further. Therefore, dismissal of Plaintiffs' ADEA claim based upon time limitations would be inappropriate," the court said.

Bona Fide Plan Exception

In addition, the court rejected El Paso's argument that the ADEA claim was barred because the cash balance plan was exempt as a bona fide plan under 29 U.S.C. §623(f). According to the court, Section 623(f) makes it permissible for employers to observe the terms of a bona fide employee benefit plan "where, for each benefit or benefit package, the actual amount of payment made or cost incurred on behalf of an older worker is no less than that made or incurred on behalf of a younger worker."

El Paso argued that the employees' complaint established that the cash balance plan met the "cost incurred" prong of Section 623(f) because the complaint "clearly indicates the older workers actually receive higher pay credits than younger employees do." The court said El Paso did not cite any case law indicating that a cash balance formula like the one implemented by El Paso was immune from legal action as a bona fide plan.

"[I]t is far from clear that the hypothetical payments made to older employees' cash balance accounts (or 'pay credits' attributed to these accounts) should qualify as a 'cost incurred' under §623(f), especially if the company knows that the vast majority of older workers will never cash in these 'payments' but will rather elect the (now-frozen) benefits they had earned under the old plan," the court said.


No Violation of ERISA

The court went on to dismiss the employees' claim that the cash balance plan violated ERISA Section 204(b)(1)(H) by discriminating against older workers. The employees alleged that the plan violated Section 204(b)(1)(H) because, if a younger worker is given the same amount of interest credits as an older worker, the younger worker will, by the time he or she reaches normal retirement age, have realized a greater benefit from his or her interest credits than the older worker did by the time he or she reached normal retirement age.

The district court said it agreed with the majority of courts that recently have ruled that the words "rate of benefit accrual" in ERISA Section 204(b)(1)(H) is measured by what an employer puts into a participant's account rather than what a participant takes out of the account at retirement. The court noted that the minority of courts have treated the "rate of benefit accrual" as the equivalent of "accrued benefit," which is defined in ERISA as an amount expressed in the form of an annual benefit commencing at normal retirement age.

The minority interpretation of Section 204(b)(1)(H) "results in an untenable discrepancy, making it permissible for a younger employee in a defined-contribution plan to benefit from the time-value of money, while making it illegal for a younger employee in a cash balance plan to do the same," the district court said.

The employees were represented by Stephen R. Bruce of Stephen R. Bruce Law Offices, Washington, D.C., and Barry Douglas Roseman of Roseman & Kazmierski, Denver. El Paso was represented by Christopher James Rillo of Groom Law Group, Washington, D.C., and Raymond W. Martin of Wheeler Trigg Kennedy, Denver.

The full text of the opinion can be found at <http://pub.bna.com/pbd/04cv02686.pdf>. 

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