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Cash Balance Emergency Preparedness Kit: This Is Not a Test

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The IBM cash balance decision has thrown an already uncertain area of law into utter turmoil. The Treasury Department has abdicated leadership on the issue and has left it to Congress to decide the fate of these plans. Plan sponsors must consider how best to protect their plans against legal challenge pending any Congressional action. Trying to keep a low profile is not an effective strategy. Instead, this article spells out a series of defensive steps that plan sponsors should consider to ward off potential lawsuits.

Cash balance plans are hunkering down for a long *siege* in the wake of the recent decision in *Cooper v. The IBM Personal Pension Plan*, which held that cash balance plans violate federal age discrimination laws.[1] While *IBM* is important as the first case to hold that cash balance plans are intrinsically illegal, the case has stirred up an anti-cash balance political furor that reaches beyond its immediate legal impact. Under an appropriations bill, Congress has blocked the Treasury Department's ability to publish regulations interpreting the age discrimination requirement of Internal Revenue Code (IRC) Section 411(b)(1)(H) through September 2004. Congressional action was mostly symbolic since the Treasury Department had decided to

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move to the sidelines even before the legislation passed. In mid-October, Assistant Secretary Olson announced that the Treasury Department would not be issuing any further cash balance plan guidance and, instead, would turn the matter over to Congress. So, attention now turns to Congress—which appears overtly hostile to cash balance plans—to decide the fate of cash balance plans in an election year.

Until recently, the betting was that Congress would eventually conclude that cash balance plans should not be outlawed, in return for highly protective transition rules. Now this outcome seems less than preordained. Cash balance critics appear especially emboldened after the *IBM* decision, and some members of Congress who formerly attacked only cash balance transitions now seem to be taking aim at cash balance plans generally. Moreover, if there were a Congressional compromise, questions over its retroactive application could prove especially difficult. Even if Congress decided to clarify that cash balance plans are not inherently age discriminatory, it is possible that Congress could leave unaddressed the entire topic of past years and let the courts decide what the law was in prior years.

As a result, cash balance plan sponsors face a growing threat from the possibility of lawsuits challenging the legality of cash balance plans under the age discrimination laws, with no help from Treasury or Congress in sight. In this article, we outline eight steps plan sponsors can take to reduce their exposure to cash balance lawsuits. These range from the simple (amend the plan to add venue restrictions and a statute of limitations), to the seemingly radical (obtain waivers from plan participants). But given the likelihood of cash balance litigation—and the absence of clarification of the law any time soon—sponsors should consider adopting worst-case-scenario protection of the kind we suggest here.

WHAT EMPLOYERS SHOULD KNOW

The *IBM* decision held that the IBM cash balance plan violates federal age discrimination law. Only one other court has decided on cash balance plans under age discrimination law, with opposite results—*Eaton v. Onan Corporation,* 117 F. Supp. 2d 812 (S.D. Ind. 2000). So for now, the judicial score is evenly split—one for and one against cash balance plans. Some commentaries have cited other cases as pro-cash balance, but this scoring is optimistic. Two courts have suggested favorable cash balance views, but only in non-binding dicta.[2] Except for *IBM* and *Eaton*, no court has decided the question in a published opinion.

Plan sponsors should not expect the Seventh Circuit to come to the rescue by overturning the *IBM* decision any time soon. We say this not because we believe that the Seventh Circuit will side with the lower court on the age discrimination issue, but rather because it appears that the *IBM* case will not be ripe for Seventh Circuit review for quite a while. The appeal of the case will be delayed for as much as a year or more, because the lower court still has an issue in the *IBM* case that has not yet been decided.

Until the *IBM* loss, most employers did not focus on the cost of losing an age discrimination suit. They should, however, because of the magnitude of the possible windfall gains to older participants. Here is why: if a cash balance plan loses an age discrimination suit, the court must decide how it will rewrite the plan to satisfy ERISA's requirement that the "rate of benefit accrual" for older people not be less than that for younger people. One possible and troubling solution is to "top up" accrual rates for older people.

To illustrate the enormous windfall cost of a top-up solution, consider a 5 percent pay credit for three participants: an 18-year-old, a 40-year-old, and a 55-year-old. When the annual pay credit of each is converted to an age 65 annuity—as the *IBM* court said it must be for purposes of testing for age discrimination—we see the size of the problem: the 18-year-old has an age 65 accrual rate of 6 percent of pay, the 40-year-old, 2 percent of pay, and the 55-year-old, about 1 percent of pay. If the benefits of the 40-year-old and 55-year-old are topped up to equal the accrual rate of the 18-year-old, *the benefit of the 40-year-old triples, and that of the 55-year-old grows by a factor of 6.* That is, the top-up remedy for older participants is many multiples of their benefit under the plan—and vastly exceeds any benefit they could reasonably have expected from an alternative plan formula such as a final average pay or career average plan. Our illustration assumes an interest rate of 5 percent. Higher interest rates (which give the younger participant a bigger age 65 rate of accrual) produce larger windfalls for older participants. Actuaries informally say that a top-up cure for successful age discrimination claims could *multiply total plan liabilities by between four and ten times.*

How the district court will fashion a remedy in the *IBM* case remains to be seen. The IBM plan, of course, can be expected to argue for a more rational plan redesign to solve the age discrimination problem, perhaps arguing for some kind of a career average benefit formula or the reinstitution of the pre-cash balance plan formula. Given the very hostile light in which some district courts—the courts where plaintiffs are likely to sue—seem to hold cash balance plans, there is a concern that a court might not impose a "reasonableness" limit on windfall damages merely because participants got everything the plan promised.

The magnitude of possible damages for winning plaintiffs in an age discrimination suit means that the *IBM* holding could affect all cash balance plan designs. A plan might not escape just because it gives participants the "better of" a cash balance formula and some other formula. A "better of" formula did not save the Xerox cash balance plan from having to provide costly "whipsaw" benefit adjustments to retired participants in a recent case. Some cash balance plans offer participants an election between a cash balance formula and some other formula.[3] These plans also may be at risk. If the cash balance formula is massively rewritten to incorporate a top-up formula, the court could well decide that participants' "elections" were invalid, and provide costly remedies to all plan participants, including those who chose the non-cash balance plan design.

WHAT EMPLOYERS CAN DO

It is doubtful that the age discrimination issue will be resolved soon. Most of the cash balance plan cases have been instigated by a handful of lawyers, but copycat lawsuits are likely to proliferate in light of the magnitude of the possible recoveries. With these expected challenges, what can employers do?

The only real solution is regulations and legislation clarifying that cash balance plans are not age discriminatory. But that help may be a long time in coming. In the meantime, there are a number of measures an employer should consider adopting immediately.

Hold Off Adopting New Cash Balance Plans

Treasury guidance, if any, will be delayed until after 2004. Any reversal of the *IBM* decision will occur no sooner. It is virtually inconceivable that Congress will act to clarify the legality of cash balance plans in an election year. A company considering the possibility of converting to or adopting a new cash balance plan should consider delaying the move until the law is clarified.

Freeze Existing Cash Balance Plans

An employer who already sponsors a cash balance plan might consider freezing the formula. A benefit freeze will not protect against a legal challenge to prior benefit accruals, but would reduce the scope of any potential liability.

A benefit freeze requires advance notification to participants under the Employee Retirement Income Security Act (ERISA) Section 204(h), and raises obvious participant morale questions. It also raises tax and accounting issues, including questions of whether it is a "partial termination" for vesting purposes and a "curtailment" for accounting purposes. The consequences of a freeze depend on the funded status of the plan. Although the "partial termination" doctrine is not well developed, one court has held that the likelihood of a reversion is based on current asset and liabilities value, rather than by making future projections.[4] As the partial termination issue is less likely to be a problem if the plan is underfunded, the freeze solution may be relatively attractive in the current climate of depressed financial asset values.

Add a Statute of Limitations on Benefit Claims

As we discussed in a previous article, ERISA does not have a statute of limitations on benefit claims.[5] Courts have thus upheld plans' own internal statute of limitations. For example, courts have upheld plan provisions that limit claims to *one year* from the date the course of action accrued. *See*, for example, *Koonan v. Blue Cross Blue Shield of Virginia*[6] and *Payne v. Blue Cross Blue Shield of Virginia*.[7] Employers should consider amending their plans to include a one-year statute of limitations on benefit claims.

Add a Restrictive Venue Provision

Many cash balance cases are brought in district courts that plaintiffs' attorneys believe will be particularly unfriendly to defendants. To keep from being sued in these unfriendly district courts, some cash balance plan sponsors have added a venue provision to their plans intended to prevent any legal challenge from being brought there. For example, the plan might be amended to provide that actions may be brought only in the district where the plan administrator resides. Forum selection provisions routinely are upheld in non-ERISA contract cases.[8] According to the Supreme Court, a forum selection provision in a contract action should be followed unless it can be shown by the resisting party to be unreasonable under the circumstances.[9] To date, there is limited authority on the efficacy of a forum selection clause in an ERISA setting, but that authority is favorable. In *Frontier Airlines, Inc. Retirement Plan v. Security Pacific National Bank*,[10] a forum selection clause in a trust agreement was upheld where a plan sued the trustee/custodian for various fiduciary breaches.

Amend the Plan to Cap Plaintiffs' Attorney Fees

A major incentive to class action ERISA lawsuits is the lure of contingent attorney fees paid out of any settlement awarded to plaintiffs. For example, consider a $300 million settlement award. Attorneys paid a 33 percent contingency fee—well in the range routinely approved by judges in ERISA class action settlements—take $100 million off the top; participants get the other $200 million. A sponsor can amend its plans to stop the availability of these huge contingency fees, making its plan a less attractive target.

The amendment strategy should work because there are two alternative ways that plaintiffs' lawyers get paid if they win. First, they can be paid by contingent fees taken out of plaintiffs' settlement awards, as in the above example, under the "common fund" doctrine. Alternatively, they can be awarded fees by the court under ERISA Section 502(g), which allows the court to award fees to either party. ERISA Section 502(g) fees would be paid by the plan on top of plaintiffs' settlement award, rather than taken out of it. But because they are capped at an hourly rate, in a large class action ERISA Section 502(g) fees tend to be much smaller than contingent common fund fees. For example, the plaintiffs' attorneys in the above example worked a total of 20,000 hours (roughly 10 lawyer-years), at an average rate of $400 per hour. Attorney fees under ERISA Section 502(g) would be $8 million—a long shot from the $100 million contingency fee.

Under ERISA and federal common law, the plan amendment should successfully forestall attorneys' ability to take fees from the plan on a contingency basis, and confine their fee to an amount based on hourly rates times hours worked under ERISA Section 502(g). Of course, the plan would pay the ERISA Section 502(g) fee in addition to plaintiffs' settlement, rather than out of it. In the above example, by paying the ERISA Section 502(g) fee, the plan would be out $308 million, rather than only $300 million. But the plan is less attractive to plaintiffs' lawyers, and a less likely target of *IBM* suits. The rest of this section explains these ideas in somewhat more depth.

Common Fund Versus Statutory Fees

Fee awards taken from ERISA class action settlements are awarded by a court under the common fund doctrine. Very generally, the common fund doctrine is invoked when a successful attorney or plaintiff produces a "fund"—a pool of assets or other value—that benefits persons other than himself or his client. When this happens, the successful litigant or attorney is entitled to "fees from the fund as a whole."[11]

For example, in the typical ERISA class action, the named plaintiff alone has contracted with the attorney to pay a contingent fee. If the attorney secures a successful settlement, all class members benefit but have assumed no obligation to pay the bill. Applying the common fund doctrine, the court may award the attorney a fee which is deducted from the settlement fund.[12]

Common fund fees are awarded under the court's "equitable" powers—that is, not by statute, but by the court's general discretionary power to effect justice or fairness. The common fund doctrine has been described under the equitable doctrines of the prevention of the "unjust enrichment" of the benefited class members, and of the attorney's equitable right to recover in *quantum meruit* the value of his or her services from those who benefited from them.[13]

However it is labeled, the doctrine is based on the general idea that "no one plaintiff, but all those who have benefited from litigation should share its costs."[14] Because in theory all plaintiffs are enjoined to share the cost of the fee, in practice the fee is deducted from the settlement award payable to plaintiffs as a class.

As a theoretical matter, courts can determine the amount of the common fund fee deducted from plaintiffs' settlement using several factors, including the risk of litigation, uncertainty of the law, and time spent. In practice, many courts benchmark the fee as a percentage of the settlement award. Data on ERISA attorney fee awards is hard to collect, because ERISA class actions tend to settle, even after successful litigation. But fee awards in the 30 percent range would seem not uncommon.[15]

In the alternative, ERISA Section 502(g) allows the court to order one party to pay the attorney fees of the other party. ERISA Section 502(g) fees are typically—but not necessarily—awarded from a losing defendant to the prevailing plaintiff. ERISA Section 502(g) is one instance of a "fee shifting" statute, so called because it is an exception to the "American rule" that each party pays its own lawyer's bills and allows the court instead to "shift" the fee to the other party.

Unlike common fund fees, an ERISA Section 502(g) fee would be paid in theory and practice by the defendant plan, that is, paid by the plan in addition to the plaintiffs' award, rather than deducted from the award. Unlike common fund fee awards, statutory fees are capped at hours worked times a reasonable hourly rate, however, according to the Supreme Court's decision in *City of Burlington v. Dague*, 505 U.S. 557 (1992). Following *Dague*, federal courts have agreed that ERISA Section 502(g) fees are capped at hourly rates times hours worked, without an enhancement for risk and contingency.[16] For one example of a cash balance plan ordered to pay an ERISA Section 502(g) fee in addition to an award in a "whipsaw" case litigated to judgment, see *Crosby v. Bowater Inc. Retirement Plan for Salaried Employees of Great N. Paper, Inc.*[17]

Even though Congress enacted ERISA Section 502(g), however, courts to date have agreed that they are permitted to ignore the availability of ERISA Section 502(g) fees in ERISA class actions, and instead award attorney fees out of plaintiffs' settlement fund under the common fund doctrine, including an enhancement for risk and contingency.[18]

In short, upon settlement of an ERISA class action lawsuit, plaintiffs' attorneys can be paid out of the settlement fund under the common fund doctrine, or in addition to the settlement fund, under ERISA Section 502(g). If the fees are awarded on a common fund basis, the plan can reasonably expect that they will be in the neighborhood of 30 percent of the settlement amount. As an award in the context of a large class action under an *IBM* theory might be in the range of hundreds of millions of dollars, the common fund fee will almost certainly be more attractive to plaintiffs' attorney than the statutory fee based on actual time spent.

One detail to note: we discuss common fund fees only in terms of class action *settlements*. This is because some uncertainty exists about the propriety of common fund fees in the context of an ERISA case litigated to judgment, rather than settled. First, there is some question whether common fund fees may be awarded from cases brought to judgment under a statute with a "fee shifting" provision (in this instance, ERISA Section 502(g)). Second, there is some uncertainty about whether ERISA's prohibition against alienation and assignment would block such an award. We therefore couch our common fee discussion solely in terms of ERISA settlements.

Plan Amendment Restricting Fees

A plan sponsor may wish to amend its plan to prohibit payment of common fund fees out of plaintiffs' class action awards. Any such amendment should likely trump the common fund doctrine. Plaintiffs' attorneys will be confined to taking statutory fees under ERISA Section 502(g). Thus, their fees will be capped at hours worked times hourly rates.

The amendment should work because generally, common fund fees are expenses incident to administration of the plan and trust.[19] The "reasonable expenses" of plan administration may be paid from plan assets, including payment of reasonable attorney fees.[20] Attorney fees do not fail to be reasonable merely because paid on a contingency basis.[21] As with any plan expenses, however, they generally may be paid from plan assets only if permitted by the plan and may not be paid from plan assets if the plan does not permit. Thus, under ERISA, an amendment should be effective to stop payments of contingent attorney fees.

While there is no authority precisely on point, courts have recognized that the express provisions of an ERISA plan trump federal common law—*including* the federal common fund doctrine. As a general matter, in *Singer v. Black & Decker Corporation,* the Fourth Circuit held that application of federal common law is "inappropriate" if it would "threaten to override the explicit terms of an established ERISA benefit plan."[22] Citing *Singer*, the Seventh Circuit held in its recent *Varco* decision that the express terms of an ERISA plan prevail over the federal common fund doctrine. Thus, the *Varco* court concluded, common fund attorney fees were not payable from the plan where the plan expressly prohibited their payment.[23] Under the *Singer* and *Varco* doctrine, a plan amendment should be effective to stop payment of common fund attorney fees from a settlement paid by the plan.

If the plan is amended to prohibit payment of common fund fees, of course, prevailing plaintiffs' attorneys will not be denied a reasonable fee. Rather, they still will be able to petition the court to award fees from the defendant plan under ERISA Section 502(g). Even if it wanted to, the plan sponsor could probably not amend the plan to prevent payment of ERISA Section 502(g) fees. This is because the fees are authorized by statute, and ERISA's express statutory provisions typically trump the terms of an ERISA plan. Thus, the logic of *Singer* and *Varco* (common law doctrines, including common law attorney fees provisions, do not prevail over terms of ERISA plan) would not apply and would not prevent payment of ERISA Section 502(g) fees. Of course, under *City of Burlington v. Dague*, 505 U.S. 557 (1992), and its progeny, the ERISA Section 502(g) fee would be capped at an amount equal to hours worked times hourly rates.

Redefine the "Accrued Benefit" Under the Plan

For technical reasons, any supposed age discrimination problems arise only when the participant's "rate of benefit accrual" is measured in terms of the age 65 annuity, rather than the account balance. Many cash balance plans define the "accrued benefit" as the age 65 annuity that is the actuarial equivalent of the account balance. This age 65 definition makes it easier for plaintiffs to argue that the "rate of benefit accrual" is age discriminatory.

Any cash balance plan that makes the account available as a lump sum should consider redefining the "accrued benefit" as the account balance rather than the age 65 annuity. While this approach has not been tested by case law, the amended definition of "accrued benefit" is supported by IRC Section 411(c)(3), ERISA Section 204(c)(3), and regulations thereunder, which allow the plan to define the accrued benefit in any way it chooses.

Plans have not adopted this approach because Internal Revenue Service agents typically insist that a plan define the "accrued benefit" as the age 65 annuity as a condition of receiving a determination letter. The IRS has suspended issuance of all cash balance determination letters, however, at least when a plan is converted to a cash balance plan. The Treasury's recent announcement that it will issue no cash balance guidance until Congress acts shows that the logjam will not be broken soon. Since the Treasury has taken itself out of the picture, plans should target their concerns on plaintiffs and federal courts for the foreseeable future.

Redefine Normal Retirement Date as Five Years of Service

A plan sponsor might consider protecting future plan accruals by changing the plan's definition of "normal retirement date" from age 65 to the age of completion of five years of service. With a service-based definition, it can be argued that any supposed reduction in the accrual rate from year to year stems from the employee's years of service and not because of the participant's increasing age.

To someone unfamiliar with the peculiarities of ERISA and age discrimination law, using a service-based normal retirement date to avoid the age discrimination problem may seem like a transparent dodge that is unlikely to survive scrutiny. But the proposed regulations issued under IRC Section 411(b)(1)(H) clarify that the age discrimination provision is not violated merely because of a service-based plan provision.[24] Thus, rather than being a dodge, modifying the plan's normal retirement age as a service-based definition seems to fit the cash balance formula under a form permitted by Treasury guidance.

An added bonus of redefining the normal retirement age in this way is that it reduces the magnitude of the so-called "whipsaw" problem that arises in some plans when the cash balance account is distributed as a lump sum before normal retirement age. The "whipsaw" problem stems from the IRS position set forth in Notice 96-8 requiring that in a cash balance plan, the age 65 annuity—which is the "accrued benefit" in IRS thinking—must be calculated by projecting forward until the normal retirement date the plan's interest crediting rate (usually referred to as the projection rate). If the lump sum discount rate is less than the projection forward rate you have the "whipsaw" problem. The scope of the "whipsaw" problem is a function of two things—the difference between the projection and the discount rate and the length of the projection period. A five-years-of-service "normal retirement date" does not eliminate the "whipsaw" problem altogether, but it reduces the extent of the problem because the interest crediting rate would be projected only for five years and not until age 65. The lower "normal retirement age" provides relief because the minimum lump sum rules only require the projection of interest credits to normal retirement age, and there is no longer the need to project the interest crediting rate into the future once a participant attains "normal retirement age."

There have been informal indications that the IRS might attempt to outlaw the five-years-of-service "normal retirement date," but it is not clear whether the IRS has the statutory authority to do so.[25] IRC Section 411(a)(8) defines "normal retirement age" as the earlier of (1) the time a plan participant attains the normal retirement age under the plan, and (2) the later of either age 65 or the fifth anniversary of plan participation. The first part of the statutory definition permits a plan to define the normal retirement age as low as it pleases. This reading of the statute is supported by Revenue Ruling 78-120.[26] This ruling states that the use of a low normal retirement date is unrestricted under ERISA.

In any event, the IRS to date has taken no action to thwart the use of low normal retirement date even if they oppose the concept. Indeed, in our own experience the IRS has issued favorable determination letters to plans containing such provisions. From the literature on cash balance plans, it appears that a low normal retirement age is a feature found in a number of prominent cash balance plans, including the Nationsbank (now Bank of America) and PricewaterhouseCoopers plans.

Amending a plan to change the "normal retirement age" from age 65 to five years of service will not limit a plan's exposure to "whipsaw" or "age discrimination" claims for prior years. Any such amendment also may increase the actuarial cost since benefits payable to terminated employees will commence sooner. Whether an earlier payment involves an added actuarial cost depends on the extent of the death benefit payable under the plan, and other plan-specific factors.

Obtain Waivers from Participants

Before canceling its guidance-writing altogether, the Treasury Department signaled that any future regulatory relief would not be retroactive. Even if Congress steps in, there may be reluctance to apply any new rules retroactively. Given the possible absence of retroactive relief, one radical solution is to condition future employee benefits on the employees' agreement to waive certain past claims against the plan. The waiver solution has some obvious drawbacks in terms of participant communications. In the current environment, however, it may be preferred to keeping past liabilities exposed indefinitely.

A waiver or release of cash balance claims could be structured in a number of ways. For example, the signing of a legal release by the participant could be a precondition for obtaining future accruals in a cash balance plan. The promise of future accruals could extend for a set time, such as one year. Alternatively, the consideration for signing a legal release could involve something in addition to the normal plan accruals; it could involve a benefit enhancement of some sort. Another variation of the theme would be to condition the continuation of all employee benefits for a set period—welfare benefits as well as pension plan accruals—on the employee's signing of a legal release. The plan sponsor could extend all benefits to the annual enrollment concept typically found with medical plans. As part of the annual benefit plan enrollment, the employee would have to sign a legal release of prior claims as a precondition for any benefit.

The contemplated release could be broad or narrow in scope. It could cover all possible theories of recovery associated with the prior operation of the employee benefit plans or it could be tailored to a particular item, such as age-based or "whipsaw" claims under the cash balance plan.

If a legal release is intended to cover the age discrimination claim represented by the *IBM* case, the release would have to satisfy the requirements of the Age Discrimination in Employment Act (ADEA) as well as ERISA. The ADEA includes a statutory rule on legal waivers, which is found in ADEA Section 626(f). This section sets forth an eight-part general test to determine if the waiver is "knowing and voluntary."[27] Unlike ADEA, however, ERISA does not include specific statutory rules on the permissibility of waivers and releases. Not surprisingly, the law has evolved to allow the voluntary and knowing waivers and releases of all sorts of ERISA claims. The test adopted by the courts under ERISA is quite similar to the statutory test found in ADEA.

As a general rule, an ERISA release is honored if the release is "knowing and voluntary."[28] The courts generally have concluded that ERISA waivers require closer scrutiny by a court than the waiver of general contract claims.[29] When scrutinizing an ERISA release, the courts typically look at six factors to determine if the release was made knowingly and voluntarily. These factors are: (1) the participant's education and business sophistication; (2) the respective roles of the employer and employee in determining the provisions of the waiver; (3) the clarity of the agreement; (4) the time the participant had to study the agreement; (5) whether the participant had independent advice, such as that of counsel; and (6) the consideration for the waiver.[30] As under ADEA, an ERISA waiver is effective only with respect to past wrongs—a participant may not waive unknown, future ERISA wrongs.[31]

The courts generally do not examine the amount of the consideration given in exchange for a waiver in ADEA and ERISA cases. The courts, however, do examine the quality of the consideration. ADEA requires that the consideration must be something "in addition to anything of value to which the individual already is entitled" and the ERISA decisions also require that the consideration be something "extra."[32] Unless obligated by a collective bargaining agreement, employers generally are not required to continue employee benefits in place from year to year, so participants have no "entitlement" to future benefits. This means that future employee benefits are not an "entitlement" and may be used as the carrot to obtain a release of claims.

The Supreme Court blessed the idea of pairing a legal release with a promise of future benefit accruals in *Lockheed Corp. v. Spink*.[33] In this case, the Supreme Court held that it is not an ERISA prohibited transaction to condition additional early retirement benefits on the voluntary waiver of claims against the employer. The Supreme Court explained that if an employer can avoid litigation that might result from laying off an employee by enticing him to retire early, ". . . it stands to reason that the employer can also protect itself from suits arising out of that retirement by asking the employee to release any employment-related claims he may have."[34]

The fact pattern in the *Spink* case is identical to the approach we are suggesting. It involved the trading of new pension plan accruals in consideration of the employee's release of claims. The scope of the particular release in *Spink* was not at issue in the case; indeed, the exact wording of the release never appeared in the text of any of the court opinions. Nonetheless, based on the general description of the release, it appears that the release was quite broad—it was described as extending to all "employment related" claims. Since Spink asserted that he did not sign the Lockheed release because he did not wish to sign away any ERISA rights, it is clear that the broad release extended to ERISA claims, including any claims under the plan that the new benefits were being added to.

As discussed in a previous *Benefits Law Journal* article,[35] some of the pre-*Spink* case law endorses a more narrow acceptance of ERISA waivers. Both the Seventh Circuit and the Tenth Circuit have limited the enforceability of ERISA waivers to cases involving contested claims. In *Lynn v. CSX Transportation, Inc.*, the Seventh Circuit distinguished between "contestable claims," which can be settled or released, and "pension entitlements," which cannot.[36] The Seventh Circuit was concerned that the waiver of a "pension entitlement" amounts to an impermissible "assignment or alienation" of the benefit.[37]

The Tenth Circuit also expressed some reservations on ERISA waivers, focusing mainly on the scope of a waiver. In *Wright v. Southwestern Bell Telephone Company*,[38] an employee whose work record came under scrutiny applied for company disability benefits. The disability benefits were denied, and the employee subsequently was terminated. The terminated employee asserted a claim of racial discrimination against his employer and later settled the discrimination claim. The release settling the discrimination claim involved the release of "all claims" against the employer, and the question was whether the release covered an ERISA claim for disability benefits, which were originally denied before the employee was fired. The Tenth Circuit held that the release did not cover the ERISA claim, which was not asserted in court until after the release was signed. In the Tenth Circuit's thinking, the disability claim could not be waived because the underlying cause of action had not yet accrued.

A similar limitation was applied by the Tenth Circuit in *Hudson v. Aetna Life Insurance Company*.[39] Here, the court held that an ERISA action does not "accrue" until an application for benefits has been denied, and that an earlier general release entered into in connection with the settlement of a wrongful termination lawsuit did not extend to a later claim for ERISA benefits.

The limits expressed in the Seventh and Tenth Circuits do not find universal acceptance. To the contrary, there are many cases—often involving the payment of additional severance benefits granted in exchange for a legal release—that involve broadly worded general releases that cover any and all claims related to the individual's employment, whether the claim was known or unknown at the time the release was signed.[40] Even those cases that limit waivers to matters involving "contested claims" often find that there was a "constructive" contest of the benefit claim. This notion of a "constructive" claim just means that the claim *could have* been contested and resolved at the time the release was entered into.

An example of the "constructive" claim approach is found in *Yablon v. Stroock, Stroock & Lavan Retirement Plan & Trust*.[41] In this case, an employee terminated employment and entered into a separation agreement with the employer waiving all claims against the employer. The employer had previously announced to employees that it was freezing a defined contribution plan, but the employer never adopted a plan provision freezing the plan. When the participant later challenged the employer's failure to amend the plan to formalize the plan freeze, the court held that the participant had already released the claim. The court noted that the participant had been notified of the amount of his plan benefit and also had been notified of the plan freeze. On the basis of this information, the court held that the participant had constructive knowledge of any claims he may have had regarding the benefit calculation. This amounted to a "constructive contest" of the pension benefit that was subject to a valid release.

Whether a court applies the broad case law on ERISA waivers or the more narrow "contested claim" interpretation, it should be possible to shape an ERISA release covering the cash balance plan issues. Given the wide notoriety of age discrimination and "whipsaw" issues affecting cash balance plans, the issues are not hidden and participants may have sufficient constructive knowledge of these issues. Of course, to avoid any doubt about the scope of any release, the agreement should specify that it covers both the "whipsaw" and age discrimination issues. As noted, courts have held that generally worded releases of "all employment-related claims" cover ERISA issues, but an ERISA release is more likely to be honored if it specifically covers certain issues.[42]

CONCLUSION

Cash balance plan sponsors are now involved in a disquieting waiting game—they are waiting to see if, and when, Congress acts and they are waiting to see if they will be sued before any relief arrives. Employers can take steps right now to protect against lawsuit. Some of the steps we suggest may sound extreme. But the *IBM* suit has highlighted the risks and costs of a successful age-discrimination suit against a cash balance plan. Many plan sponsors might agree that the time has come to stop hoping for Treasury and Congress to act as first responders, and instead reach for the ERISA duct tape and plastic sheeting to prepare for the elevated alert level of this new, post-*IBM* world.

NOTES

1. No. Civ. 99-829 GPM, 2003 WL 21767853 (S.D. Ill. July 31, 2003).

2. In *Campbell v. Bank Boston, N.A.*, 2003 WL 834720 (1st Cir. Mar. 7, 2003), for example, the First Circuit suggested in dictum that it would adopt the *Eaton* court holding. In *Engers v. AT&T Corp.*, 2000 U.S. Dist. LEXIS 10937 (June 29, 2001), a New Jersey district court also heard argument on the age discrimination issue, but issued a "no decision" by allowing the issue to proceed beyond a motion to discuss.

3. *Berger v. Xerox Retirement Income Guaranty Plan*, 338 F.3d 755 (7th Cir. 2003).

4. *Gluck v. Unisys*, 1995 US Dist. Lexis 12092 (E.D. Pa. 1995).

5. "The ERISA Common Law and the Limits of Reticulation," *Benefits Law Journal*, Vol. 14, No. 4, at 1 (Winter 2001).

6. 802 F.Supp. 1424 (E.D. Va. 1992).

7. No. 91-00156 (E.D. Va. June 3, 1991).

8. *Himes v. Admiral Insurance Co. Inc.*, 575 F.Supp. 312 (E.D. Ky. 1983); *Intermountain Systems, Inc. v. Edsoll Constr. Co. Inc.*, 575 F.Supp. 1195 (D.Colo. 1983).

9. 407 U.S. (1972).

10. 696 F.Supp. 1403 (D.Co. 1988).

11. *Boeing Co. v. Van Gemert*, 444 U.S. 472, 478 (1980).

12. *See, e.g., In re Unisys Corp. Retiree Med. Benefits ERISA Litig.*, 886 F.Supp. 445, 456 (U.S. Dist. 1995); *Florin v. Nationsbank*, 34 F.3d 560, 564 (7th Cir. 1994).

13. *See, e.g., Boeing Co. v. Van Gemert*, 444 U.S. 472, 478 (1980) ("The doctrine rests on the perception that persons who obtain the benefit of a lawsuit without contributing to its cost are unjustly enriched at the successful litigant's expense."); *Lindy Brothers Builders, Inc. of Philadelphia v. American Radiator & Standard Sanitary Corp.*, 487 F.2d 161, 165 (3d. Cir. 1973) (*Lindy I*) ("The award of fees under the equitable fund doctrine is analogous to an action in quantum meruit: the individual seeking compensation has by his actions benefited another and seeks payment for the value of the service performed."), *appeal following remand*, 540 F.2d 102 (3d Cir. 1976) (*Lindy II*); *Trustees v. Greenough*, 105 U.S. 527, 532 (1882) ("Where one creates value for others out of a trust fund, one is entitled to reimbursement out of the fund itself or by proportional contribution from those who accept the benefit of his effort.").

14. *Florin v. Nationsbank*, 34 F.3d 560, 563 (7th Cir. 1994).

15. *See e.g.*, *Vizcaino v. Microsoft*, 290 F.3d 1043 (9th Cir. 2002) (28 percent award from

$97 million settlement fund); *Tullock v. K-Mart Corporation Employee Pension Plan*, Civil Action No. 99-289-DRM (S.D. Ill. 2002) (29 percent fee from settlement); *Malloy v. Ameritech Pension Plan*, Civil Action No. 98-688-GPM (S.D. Ill 2000) (29 percent fee from $170 million settlement); *Seifert v. The May Department Stores Company Retirement Plan,* Cause No. 96-1028 GPM Class Action (S.D. Ill. 1999) (29 percent fee from $26 million settlement).

16. *See, e.g., Brytus v. Spang & Co.,* 203 F.3d 238, 246-247 (3d Cir. 2000); *Cook v. Niedert*, 142 F.3d 1004, 1014 (7th Cir. 1998) (*dictum*).

17. 262 F.Supp. 2d 804 (W.D. Mich. 2003).

18. *In re Unisys Corp. Retiree Med. Benefits ERISA Litig.,* 886 F. Supp. 445, 456 (1995); *Brytus v. Spang & Co.,* 203 F.3d 238, 246-247 (3d Cir. 2000) (*dictum*); *Cook v. Niedert*, 142 F.3d 1004 (7th Cir. 1998); *Florin v. Nationsbank*, 34 F.3d 560, 564 (7th Cir. 1994). *See also Staton v. Boeing Co*., 327 F.3d 938, 967 (9th Cir. 2003) (common fund fee with risk enhancement permitted despite fee shifting statute in Federal Title VII case).

19. *Trustees v. Greenough* 105 U.S. 527, 532 (1881) (in successful suit against trust, participant bondholder recovered repayment of attorney fees from trust, in part because "it is a general principle that a trust estate must bear the expenses of its administration"); *Lindy Bros. Builders, Inc. of Philadelphia v. American Radiator & Standard Sanitary Corp*. 540 F.2d 102, 112 (3d Cir. 1976) (*Lindy* II) (propriety of attorney fee from common fund "depends on whether the specific services benefited the fund—whether they tended to create, increase, protect or preserve the fund").

20. ERISA §§ 404(a)(1), 408(b)(2).

21. *Kouba v. Joyce*, 1987 U.S. Dist. Lexis 12334, 20-21 (N.D. Ill. 1987).

22. *Singer v. Black & Decker Corporation,* 964 F.2d 1449, 1452 (4th Cir. 1992).

23. *Administrative Committee of the Wal-Mart Stores, Inc. Associates Health and Welfare Plan v. Varco*, 338 F.3d 680 (7th Cir. 2003) (attorney fees could not be deducted from amounts recovered by a plan from a participant, pursuant to the plan's subrogation provision, under the common fund doctrine of *either federal or state common law*, when the plan's provision expressly prohibited such a deduction).

24. Prop. Treas. Reg. § 1.411(b)-2.

25. *See,* Letter from Ira Cohen, PricewaterhouseCooper to Charles Rossotti, Commissioner, IRS, September 30, 1999, reproduced in *Tax Notes Today*, November 18, 1999.

26. 1978-1 C.B. 117; *see also* Rev. Rul. 80-276, 1980-2 C.B. 131 (a profit sharing plan may specify any age for "normal retirement age" and, accordingly, the distribution of benefits).

27. ". . . (f)(1) An individual may not waive any right or claim under this Act unless the waiver is knowing and voluntary. Except as provided in paragraph (2), a waiver may not be considered knowing and voluntary unless at a minimum—

(A) the waiver is part of an agreement between the individual and the employer that is written in a manner calculated to be understood by such individual, or by the average individual eligible to participate;

(B) the waiver specifically refers to rights or claims arising under this Act;

(C) the individual does not waive rights or claims that may arise after the date the waiver is executed;

(D) the individual waives rights or claims only in exchange for consideration in addition to anything of value to which the individual already is entitled;

(E) the individual is advised in writing to consult with an attorney prior to executing the agreement;

(F) (i) the individual is given a period of at least 91 days within which to consider the agreement; or

(ii) if a waiver is requested in connection with an exit incentive or other employment termination program offered to a group or claim of employees, the individual is given a period of at least 45 days within which to consider the agreement;

(G) the agreement provides that for a period of at least 7 days (allowing the execution of such agreement), the individual may revoke the agreement, and the agreement shall not become effective or enforceable until the revocation period has expired . . ."

28. *Morris v. Central Beverage Corporation Union Employees' Supplemental Retirement Plan*, 167 F.3d 709 (1st Cir. 1999); *Finz v. Schlesmger*, 957 F.2d 78 (2d Cir. 1992); *Chaplin v. Nations Credit Corporation and Bank of America*, 307 F.3d 368 (5th Cir. 2002); *Halvorson v. Boy Scouts of America*, 2002 U.S.App. LEXIS 9648 (6th Cir. May 3, 2000); *Lynn v. CSX Transportation, Inc.*, 84 F.3d 970 (7th Cir. 1996); *Leavitt v. Northwestern Bell Telephone Company*, 921 F.2d 160 (6th Cir. 1990); and *Wright v. Southwestern Bell Telephone Co.*, 925 F.2d 1288 (1991).

29. *Yak v. Bank Brussells Lambert*, 252 F.3d 127 (2d Cir. 2001).

30. *Laniok v. Advisory Comm. of Brainerd Mfg. Co. Pension Plan*, 935 F.2d 1360 (2d Cir. 1991); *Morais v. Central Beverage Corp. Union Employees' Supplemental Retirement Plan*, 167 F.3d 709 (1st Cir. 1999).

31. *Reighard v. Limbach Co.*, 158 F.Supp. 2d 730 (E.D. Va. 2001). The one exception to waivers of future ERISA actions involves waivers of plan participation. In *Laniok v. Advisory Committee of Brainerd Mfg. Co. Pension Plan,* 935 F.2d 1360 (2d Cir. 1991), the Second Circuit upheld the waiver of plan participation, even if such waivers arguably involve a continuing wrong to the employee. There are other cases in which a waiver was also given future effect. In *Fair v. International Flavors and Fragrances*, 905 F.2d 1114 (7th Cir. 1990), there was a question whether a severance award given in return for a general legal release should be counted as "pensionable earnings" under the employer's pension plan. The Seventh Circuit held that the legal release covered the employee's later claim that the severance pay should have been included in his pension benefit calculation. *See also Licciardi v. Koop Forge Division Employees Retirement Plan*, 990 F.2d 979 (7th Cir. 1993).

32. *Laniok v. Advisory Comm. of Brainerd Mfg. Co. Pension Plan,* 935 F.2d 1360 (2d Cir. 1991); *Nicholas DePace v. Matsushita Electric Corporation*, 257 F.Supp. 2d 543 (E.D.N.Y. 2003); *Feret v. First Union Corp*, 1999 U.S. Dist. LEXIS 570 (E.D. Pa. 1999). 29 U.S.C. §626(f)(1)(D).

33. 517 U.S. 882 (1996).

34. *Id.* at 894–895.

35. "Settlements and Waivers Affecting Pension Benefits under ERISA," *Benefits Law Journal*, Vol. 14, No. 4 (Winter 2001).

36. 84 F.3d 970 (7th Cir.) (1996).

37. The idea that an ERISA waiver or release reformulation of the original plan benefit involves an "assignment" of the benefit back to the original payor reflects a very broad interpretation of the "assignment" concept. Typically, we think of an "assignment" as involving the transfer of the pension rights to a third party. The regulations under Code Section 401(a)(13) limit the concept of an "assignment" to cases where a third party is involved. In particular, the regulations describe prohibited assignments in terms of arrangements where the "employer" or some other "party" receives a "right or interest enforceable against the plan." Treas. Reg. §1.401(a)(13)(b)(2). It certainly is an odd concept to find a prohibited "assignment" because a plan obtains an interest enforceable against itself. To the extent the Seventh Circuit's concern in *Lynn* finds any support in the law, it might be found in the provisions in the "assignment or alienation" rule that clarifies that a plan's security interest in a participant's benefit on account of a plan loan does not involve an outlawed assignment. Code Section 401(a)(13)(A). The statutory provision implies that a transaction between a plan and its participant and its plan involves a permissible "assignment," but the provision also could be interpreted as providing that the plan's interest in the participant account is not an "assignment" at all.

In contrast to the Seventh Circuit's broad view, there is a long line of cases holding that it is not a prohibited "assignment or alienation" if a plan imposes a setoff against benefits of participant who is also a fiduciary of that plan, for breaches against the plan. *Reich v. Davidson Lumber Sales Employees Retirement Plan*, 16 EBC 2802 (D. Utah 1993); *Coar v. Kazimir*, 990 F.2d 1413 (3d Cir. 1993) cert denied (1993); *Parker v. Bain*, 68 F.3d 1131, 1140 (9th Cir. 1994); *Crawford v. La Boucherie Bernard Ltd.*, 815 F.2d 117, 122 (D.C. Cir. 1987); contra., *Herberger v. Shanbaum*, 897 F.2d 801, 804 (5th Cir.), cert denied, 498 U.S. 817 (1990).

38. 925 F.2d 1288 (10th Cir. 1991).

39. 1995 U.S.App. LEXIS 25957 (10th Cir. 1995).

40. *Bickings v. Bethlehem Lukens Plate*, 82 F.Supp. 2d 402 (E.D. Pa 2000) ("a release that bars unknown claims will be enforced, even if the party claims that it was unaware of the matter at the time the release was executed"). *Mitchell Energy & Development Corp. v. Fain, et al*, 172 F.Supp. 2d 880 (S.D.Tex. 2001) (waiver barred claims "whether now known or later becoming known"); *Union Life Insurance Company v. Cappello*, 278 F.Supp. 2d 228 (D. R.I. 2003) (the release covered all claims "known, unknown, unanticipated or undisclosed"); *Halvorson v. Boy Scouts of America*, 2002 U.S. App. LEXIS 9468 (6th Cir. 2000) (release covered all claims "whether now known or unknown, and whether or not concealed or hidden"); *Chaplin v. Nations Credit Corporation*, 307 F.3d 368 (5th Cir. 2002) (release covered "all claims . . . arising at any time in the unlimited past and up to and including the date of your execution of the release").

41. 2002 U.S. Dist. LEXIS 10528 (S.D.N.Y. 2002).

42. *Chaplin v. Nationscredit Corporation*, 307 F.3d 368 (5th Cir. 2002); *Halvorson v. Boy Scouts of America,* 2000 U.S.App. LEXIS 9468 (6th Cir. 2000); *Smart v. The Gillette Company Long Term Disability Plan, 70 F.2d 173 (5th Cir.1995).*