IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF SOUTH CAROLINA
ANDERSON DIVISION

KENNETH WALTON GEORGE, *et al.*	)	
	)	
Plaintiffs,	)	**C/A No.: 8:06-CV-373-RBH**
	)	
vs.	)	
	)	
DUKE ENERGY RETIREMENT CASH BALANCE PLAN, *et al.*,	)	
	)	
Defendants.	)	
	)	

PLAINTIFFS' MEMORANDUM IN OPPOSITION TO DEFENDANTS' MOTION FOR JUDGMENT ON THE PLEADINGS

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I. SUMMARY OF ARGUMENT.

Plaintiffs contend that the Duke cash balance plan violates the Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1001, et seq. ("ERISA") by decreasing the rate of benefit accrual based on an employee's age. (Complaint Count One). Plaintiffs contend that the plan likewise violates the Age Discrimination in Employment Act, 29 U.S.C. § 621, *et seq.* ("ADEA"). (Complaint Count Two).

Plaintiffs will further demonstrate that Duke improperly calculated lump sum distributions and interest amounts (Complaint Counts Three and Four), and has violated ERISA's "back loading" and fiduciary duty provisions. (Counts Five and Six).

Plaintiffs bring this case as a putative class action for the period January 1, 1997 to present, on behalf of themselves and all others whose pension benefits are likewise based on the cash balance formula. Duke has moved for judgment on the pleadings as to all claims.

Duke grounds its motion as to Count One on arguments that have been rejected by the better-reasoned cases discussed below. In summary, four major flaws permeate Duke's effort to establish that its plan does not violate ERISA's age-based accrual standards: (1) Duke ignores the statute's plain meaning; (2) it misconstrues the holding of *Lockheed Corp. v. Spink*; (3) it misstates the relevance of time value of money; and (4) it relies on a policy argument belied by ERISA's own plain language. Critically, the statute provides:

> [A] defined benefit plan shall be treated as not satisfying the requirements of this paragraph if, under the plan, an employee's benefit accrual is ceased, or ***the rate of an employee's benefit accrual is reduced, because of the attainment of any age***.

ERISA § 204(b)(1)(H)(i), 29 U.S.C. § 1054(b)(1)(H)(i) (emphasis added). Thus, for a defined-benefit plan such as Duke's cash balance plan, ERISA prohibits the reduction of the rate of an employee's benefit accrual on account of age. The issue is whether the phrase "rate of an employee's benefit accrual" refers

to the employer's contributions to the plan (inputs), or the employees' retirement benefits (outputs). In all cash balance lawsuits reported on this issue, defendants argue for the former interpretation, while the plaintiffs argue for the latter. (*See* Def. Br. p. 17, making the "input" argument). However, as discussed below, the relevant "benefit" is what an employee receives from the hypothetical account in the form of a retirement benefit. "Benefit" is the key term here and the meaning of the law is plain and unambiguous. It can be fairly read no other way than to prohibit Duke's practices.

As discussed below, Duke also relies on one sentence of dicta in *Spink* which gives no guidance at all as to whether the "accrual rate in the formula," the phrase it quotes, means the present value of allocations, or allocations valued as of normal retirement age.

Duke's "time value of money" argument must also fail because Plaintiffs' accounts are hypothetical accounts and the "interest credits" are mere bookkeeping entries.

Duke recites common policy rationales for cash balance plans, i.e., that they are portable between employers and more suited to a younger workforce. In fact, as alleged in the Complaint, the real reason Duke adopted the plan was to free up funds and gut older workers' benefits. More fundamentally, nothing in ERISA prevents a traditional pension plan from being designed to accomplish these effects without reducing the benefits older workers would have accrued going forward under the former plan. Furthermore, under new law Congress has now stated a procedure by which any company can ensure that its cash balance plan is lawful and non-discriminatory.[1]

Plaintiffs' miscalculation claims, found at Counts Three and Four and based on how Duke performs certain calculations, are well-founded as discussed below and further are not appropriate for disposition on a motion for judgment on the pleadings. Likewise, Counts Five and Six are well-founded

[1] The Pension Protection Act of 2006 ("PPA"), signed into law on August 17, 2006 and effective back to June 29, 2005. Pub. L. No. 109-280, 120 Stat. 780.

on the law and facts of this case. Accordingly, and as shown more specifically below, Duke's Motion for Judgment on the Pleadings should be denied.

II. FACTUAL BACKGROUND.

Duke originally adopted a pension plan for employees in 1943. The plan was periodically amended in subsequent years. Prior to 1997, the plan was a traditional defined benefit plan. It provided for a retirement benefit after the participant had engaged in sufficient years of creditable service. Benefits were calculated using a formula based on factors including years of participation in the plan, and the employee's annual pay. (Complaint ¶ 34).

Duke made representations to employees over the years preceding the conversion to the cash balance plan that they would receive a substantial pension benefit when they retired. For example, it periodically provided employees with statements purporting to show "your hidden paycheck" which employees understood to include accumulated retirement benefits. (*Id.* ¶ 35).

During the 1990s, Duke sought to engage in a course of acquisitions and expansions and made changes in the pension plan to fund that effort. By the mid-1990s, it had retained an actuarial firm to design the new cash balance plan. (*Id.* ¶ 36-37). A "cash balance plan," although deceptively named, remains a type of defined benefit plan subject to the same rules and restrictions.

Companies with older workforces, such as Duke Energy, convert to cash balance plans as a way to reduce their future pension obligations, particularly to their older employees. Complaint ¶¶ 47-55; *see also*, Edward A. Zelinsky, "The Cash Balance Controversy," 19 Va. Tax Law Rev. 683, 713-14 (2000), attached as Ex. A. As a result of Duke Energy's conversion to the cash balance plan, Duke Energy paid in no funds at all to its cash balance plan for a period of six (6) years (1997-2002) following the cash balance conversion, after having paid more than $54 million each year for pre-conversion years

1995 and 1996. Complaint ¶¶ 47-48;

A cash balance plan attempts to mimic the attributes of a 401(k) plan – yet it remains a traditional defined benefit plan. In a cash balance plan, an employee's hypothetical account balance is credited with hypothetical allocations and hypothetical earnings determined under a formula selected by the employer. Cash balance plans often specify that hypothetical earnings are determined using a rate of return on specified Treasury securities. (*See* I.R.S. Notice 96-8). [2]

Under a cash balance plan, as in all defined benefit plans, the employer guarantees an employee ***a benefit upon retirement***, so the employer bears the risk that its investments meet the rate of return needed to produce the required benefit (and pockets the gains when such investments exceed the required return). In contrast, under defined contribution plans, such as 401(k) plans, the employer does not guarantee a retirement benefit to the employee. The employee bears the risk of (and reaps the reward of) any investment.

The Duke cash balance formula consists of a compensation or pay credit and an interest credit. *See, e.g.*, Summary Plan Description ("SPD") dated Jan. 1997, pp. 3-6 (Ex. C); SPD dated Jan. 1, 2003, pp. 3-5 (Ex. D).[3] The pay credits end when a participant ends employment; however, the interest credits continue until the participant withdraws his benefit, or in the case of the Duke plan reaches a stated age. (Plan, as amended Jan. 1, 1999, §§ 5.04(a) & 6.03(b)) (Ex. F). The benefit promised is the benefit upon retirement, not the account credits, which are mere bookkeeping entries. Duke's cash balance plan is unquestionably a defined benefit plan, not a defined contribution plan, under ERISA.[4]

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[2] Attached along with IRS Notice 96-8 and IRS Doc. No. 6390 (Rev. 12-98) as Exhibit B.

[3] Excerpts from plan documents are attached as Exhibit C through F.

[4] Duke has conceded that their plan is a "defined benefit plan." (Duke Br. p. 1). This should be contrasted with the position taken in their Answer where, apparently realizing the danger of admitting

Benefits are calculated under the cash balance formula using hypothetical accounts. The hypothetical account is merely a bookkeeping entry for record keeping purposes and tracks benefit accumulation based on periodic application of pay and "interest credits." *Id.* ¶¶ 44-45, 60; *see* 1997 Plan §§ 1.12, 3.6 (Ex. E); 1997 SPD, p. 3 (Ex. C). The pay credit is a percentage of the individual's monthly pay. 1997 Plan § 3.8 (Ex. E.); 1997 SPD p. 3 (Ex. C). As years of service accumulate, the percentage increases. 1997 Plan § 3.8(b)(1) (Ex. E); 1997 SPD, p. 3 (Ex. C). "Interest credits" are based on a variable interest rate tied to an outside index. 1997 Plan, § 3.9 (Ex. E). Once an employee leaves the company, pay credits no longer accumulate. 1997 SPD, p. 4 (Ex. C). Interest credits, however, continue until the employee begins receiving the benefit. Complaint ¶¶ 60, 89; 1997 SPD p. 6 (Ex. C).

Once an employee has vested in the plan through five years of participation, he can elect to receive his retirement benefit in a lump sum payment or in an annuity. 1997 Plan § 4.1 (Ex. E); 1997 SPD pp. 6-8 (Ex. C). The employee's hypothetical account must be converted into a dollar benefit based on actuarial assumptions stated in the plan before the benefit is paid over to him. Complaint ¶ 97; 1997 Plan § 4.1 (Ex. E); 1997 SPD p. 8 (Ex. C). Accordingly, an employee's retirement benefit is determined by but not equal to the value of the interest credits and pay credits in the hypothetical account.

Duke's transition to the cash balance plan is known as a plan conversion. IRS regulations create a disincentive for outright pension plan terminations through severe tax penalties. Plan conversion is the vehicle by which companies like Duke seek to avoid imposition of the tax penalty, but at the cost of prejudicing older workers as well as incurring the risk of miscalculations due to the exceptional complexity of the cash balance transition formula. Complaint ¶¶ 39, 85-87.

Preceding the plan conversion in 1996, Duke made representations to employees to the effect that

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their plan was a defined-benefit plan, Duke denied the allegation of ¶ 22 of Plaintiffs' Complaint that "Duke Energy converted its defined benefit plan to a cash balance plan" (Answer ¶ 22; Complaint ¶ 22.).

the new plan would not impair employee expectations, and would not greatly change the old plan. The language of the formal plan documents is not readily understandable to laypersons and Duke's descriptive materials touted that the plan would benefit workers. Plaintiffs allege these representations misinformed the employees. (*Id.* ¶¶ 41-42).

A. Effect of the Cash Balance Plan Conversion on Older Employees.

The conversion was effective as of January 1, 1997. Under the new plan formula, each employee was assigned a cash balance account, with an initial opening balance. This was a hypothetical account as opposed to an actual account, such as one would find in a defined contribution plan. (Complaint ¶ 44).

Following the conversion, plan participants started out with the greater of (1) the accumulated pension benefit they had accrued under the old plan, or (2) the hypothetical account balance under the cash balance plan. For most workers, particularly those over 40, the accumulated figure under the old plan was greater than the figure under the new plan. Because of this discrepancy, Plaintiffs' accrued pension amounts remained frozen as the final balance under the old plan, until the new cash balance hypothetical figure caught up. This is known in pension parlance as "wear away." Workers had to wait a period of years for the difference between the account balances to wear away or vanish. During that wear away period, affected workers accrued no increase in their pension amounts – the balances remained frozen as what they had accumulated under the old plan. Thus, the practical effect of the plan conversion was that older workers had no increase to their pension balances during their final years of employment. Under the old plan, it was precisely during those final years that the largest accruals were to have occurred. Further, since these workers were older, they did not have the ability to switch jobs or careers as easily as when they were younger. (Complaint ¶¶ 49-56).

Duke had promoted a latter years benefit "bulge" under its old plan to encourage employees to

work for the company upwards of 20 to 30 years. Workers believed that after they put in a full career of loyal work, they would get a substantial pension. Many planned for early retirement based on these expectations. These same workers, because of the conversion, suffered the greatest set back. Starting figures after the conversion were up to 50% less than the frozen benefit under the old plan. When Duke chose the cash balance conversion it was well aware of this outcome, but they did not fully or properly warn its employees. (*Id.* ¶¶ 45-57).

B. Tying Accrual of Benefits to Age.

As noted, each plan participant receives a contribution or pay credit and a putative "interest credit." This hypothetical "interest credit" imitates interest accumulating on the hypothetical account balance. These "interest credits" continue until retirement age. (*Id.* ¶¶ 59-60).

As discussed below, this manner of crediting the hypothetical account balance means that a participant's benefit accruals (expressed as an annuity at age 65) decrease as the participant ages. Accordingly, the cash balance formula reduces a participant's accrued benefit solely based on increases in age. The rate of a participant's benefit accrual decreases based on age. (*Id.* ¶¶ 61-63).

C. Miscalculation Errors.

The plan includes provisions describing how the interest factor will be calculated. This language has changed over time. The first amendment changed the measurement date for the interest rate by three months. The second amendment changed the date by a week. If these terms are applied over the pertinent times, the result is that the company understated benefits. (Complaint ¶¶ 66-71). On information and belief, Duke was aware of this discrepancy between how the plan specified that interest credits should be calculated, and how it actually was calculated. This awareness is evidenced by the company's twice amending the plan in an effort to resolve the problem However, while the company

amended the plan, it never corrected the understatement or provided refunds or credits to affected employees. (*Id.* ¶¶ 72-75).

Further, Duke used an incorrect discount rate in calculating lump sum distributions. It failed to use the 4% discount rate required by the plan, but instead employed a higher rate more favorable to Duke. For Plaintiff Kenneth George, Duke calculated a lump sum payout of $448,000, but the payment, if properly calculated, would have been $484,000. (*Id.* ¶¶ 77-84).

III. LEGAL STANDARD.

The standard for a motion for judgment on the pleadings under Rule 12(c) is the same as for a motion to dismiss under Rule 12(b)(6). *Burbach Broadcasting Co. v. Elkins Radio Corp.*, 278 F.3d 401, 405-06 (4th Cir. 2002); *Edwards v. City of Goldsboro*, 178 F.3d 231, 244 (4th Cir. 1999). Accordingly, the Court should assume all facts alleged in the Complaint to be true, and draw all reasonable inferences in favor of the Plaintiffs. *Elkins Radio*, 278 F.3d at 406.

IV. ARGUMENT.

A. Count One States a Claim.

Count One states a claim under ERISA that the plan improperly factors age into the calculation of benefits. Defendants' core argument against this Count is that treating "the time value of money" as age discrimination is not sensible. However, as shown below, it is even less sensible to impute the concept of time value of money to mere bookkeeping entries, in violation of ERISA's plain language. As discussed below, the statute's plain language and the better-reasoned cases support the conclusion Duke's cash balance plan violates both the spirit and letter of ERISA.

Further, now that Congress has passed a statute specifically providing a "safe harbor" for cash balance plans, Duke's policy argument that holding for Plaintiffs would threaten pension plans

nationwide is simply wrong.

1. The Duke Plan is a Defined-Benefit Plan.

ERISA provides for two types of pension plans: (a) "defined-contribution plans," and (b) "defined-benefit plans." The categorization of a plan as either a defined-contribution plan or a defined-benefit plan triggers different critical requirements under ERISA.

In a defined-contribution plan, the employer periodically contributes a certain amount of money into the pension account for the employee. 29 U.S.C. § 1002(34). It is "[a] pension plan which provided for an individual account for each participant and for benefits based solely upon ***the amount contributed*** to the participant's account, and any income, expenses, gains, and losses." *Id.* (emphasis added).[5] Under a defined-contribution plan, the employer does not guarantee a retirement benefit to the employee. Defined-benefit plans under ERISA include all plans that do not meet the definition of a defined-contribution plan. 29 U.S.C. § 1002(35). A cash balance plan is a defined-benefit plan.[6] This categorization is crucial because "[t]he categorization of a retirement plan as either a defined-contribution plan or a defined-benefit plan is critical because the plans are subject to different requirements under ERISA." *In re J.P. Morgan Chase Cash Balance Litig., supra,* 460 F.Supp.2d 479, 481 (S.D.N.Y.

[5] Under the Duke plan, because it is a defined-benefit plan, there is no actual account and there is no gain that can properly be credited to the employee. While cash balance parlance speaks in terms of hypothetical interest credits, these are contributions, not gains.

[6] *Esden v. Bank of Boston*, 229 F.3d 154, 158 (2nd Cir. 2000) ("However, notwithstanding that cash balance plans are designed to imitate some features of defined contribution plans, they are nonetheless defined benefit plans under ERISA."); *Berger v. Xerox*, 338 F.3d 755, 757-58 (7th Cir. 2003) (noting "a 'cash balance' plan . . . is a defined benefit plan rather than a defined contribution plan"); *Lyons v. Georgia-Pacific Corp.*, 221 F.3d 1235, 1237-38 (11th Cir. 2000) (*accord*); *In re Citigroup Pension Plan ERISA Litig.*, 470 F. Supp. 2d 323, 332 (S.D.N.Y. 2006) ("Although cash balance plans mimic some of the same features of defined contribution plans, in this Circuit they are treated as defined benefit plans."); *In re J.P. Morgan Chase Cash Balance Litig.,* 460 F. Supp. 2d 479, 481 (S.D.N.Y. 2006) ("[C]ash balance plans fall under the defined-benefit plan umbrella."); *Richards v. FleetBoston Fin. Corp.*, 427 F. Supp. 2d 150 (D. Conn. 2006) (same).

2006).[7] Specifically, under ERISA:

> However 'hybrid' in design a cash balance plan may be, it remains subject to a regulatory framework that is in many regards ***rigidly binary***. Because the individual accounts, and the employer contributions and the interest credits to those accounts, are all hypothetical under a cash balance plan, it is classified as a defined-benefit plan.

Esden, 229 F.3d 158, n. 6 (emphasis added).

The key statutory language and practical differences between defined benefit and defined contribution plans are as follows:

	Defined Benefit Plan (i.e., pension plan)	**Defined Contribution Plan (i.e., 401(k) plan)**
Accrued benefit	The individual's accrued benefit expressed in the form of an annual benefit commencing at normal retirement age (age 65). ERISA § 3 (23)(A).	The balance of an individual's account. ERISA § 23(B).
What the plan sponsor guarantees participants	Actuarial equivalent of age-65 annuity, or "outputs."	Contributions, or "inputs."
Age discrimination test	Unlawful if "***the rate of an employee's benefit accrual*** is reduced, because of the attainment of any age." ERISA § 204(b)(1)(H)(i).	Unlawful if "***the rate at which amounts are allocated*** to the employee's account [is] reduced, because of the attainment of any age." ERISA § 204(b)(2)(A).

2. The Plan Must Meet ERISA's Age Discrimination Standard for Defined-Benefit Plans.

ERISA's anti-age discrimination provisions are meant to protect employees and plan participants from unjustifiable harm to older workers. The test for age discrimination is different for a defined-benefit

[7] [It]t is essential to recognize the difference between defined contribution plans and defined benefit plans . . . . A defined contribution plan is one where employees and employers may contribute to the plan, and " 'the employer's contribution is fixed and the employee receives whatever level of benefits the amount contributed on his behalf will provide. A defined contribution plan "provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account.". . . . A defined benefit plan, on the other hand, consists of a general pool of assets rather than individual dedicated accounts. *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432 (1999) internal citations omitted.

than it is for a defined-contribution plan.

For a defined-benefit plan:

> [A] defined benefit plan shall be treated as not satisfying the requirements of this paragraph if, under the plan, an employee's benefit accrual is ceased, or ***the rate of an employee's benefit accrual*** is reduced, because of the attainment of any age.

29 U.S.C. § 1054(b)(1)(H)(i) (emphasis added).

For a defined-contribution plan:

> A defined contribution plan satisfies the requirements of this paragraph if, under the plan, allocations to the employee's account are not ceased, and the rate at which ***amounts are allocated to the employee's account*** is not reduced, because of the attainment of any age.

Id. § 1054(b)(2)(A) (emphasis added).

These two standards are facially and substantively different. The former uses the key language, "rate of an employee's benefit accrual." The latter uses the key language, "allocations to the employee's account." Because Duke's plan is a defined benefit plan, it must meet the requirements of the former provision for defined-benefit plans.

3. The Plan Violates ERISA's Age Discrimination Standard for Defined-Benefit Plans.

Participants in a defined benefit plan are promised ***a benefit upon retirement***, not yearly credits in a hypothetical account. The plan requires use of a participant's age to calculate his retirement benefit, which is an age 65 annuity. Under Duke's plan, the rate of benefit accrual is reduced for the older employee. Age discrimination arises because older workers accrue their retirement benefits at a slower rate than similarly situated younger workers.

The plan allocates "interest credits" to the hypothetical account through normal retirement age. This means that younger workers have more years to receive "interest credits" in their hypothetical

accounts, making their pay and interest credits more valuable. A worker's age is required to convert the hypothetical account balance into an age 65 annuity and this conversion results in a smaller retirement benefit for older workers because they have fewer years in which to earn their interest credits.

> [In] other words, for similarly situated workers (same salary and work history), the older worker, by definition, will receive a smaller retirement benefit simply because they are older, and thus closer to age 65. Interest credits will accrue to their account for fewer years as compared to the similarly situated younger worker.
>
> Further, the older worker will accrue benefits at a slower rate than the younger worker even though both employees receive the same interest and continue to accrue interest in that account until normal retirement age (age 65). This is simply the result of compound interest. The extra years the younger worker has to earn interest on his retirement benefit grows his money at a faster rate and produces a larger sum when it is converted to an annuity at age 65.

J.P. Morgan Chase, 460 F. Supp. 2d at 487.

Duke contends that the phrase "attainment of any age" relates to attainment of a "specified" age, thereby prohibiting only those plans "that specify a particular age at which benefit accruals cease or are reduced." (Def. Br. p. 24.) First, the language of the statute is clear. The statute does not mention specified age but "any" age. There is no room for statutory interpretation or resort to legislative history.

In addition, Duke's interpretation flies in the face of interpretations by the Department of the Treasury regarding 2002 proposed regulations concerning the identical § 411 language:

> A plan provides for a reduction in the rate of benefit accrual that is directly because of the attainment of any age if, during a plan year, under the terms of the plan, any participant's rate of benefit accrual for the plan year would be higher if the participant were younger. ***Thus, a plan fails to comply with section 411(b)(1)(H) if, under the terms of the plan, the rate of benefit accrual for any individual who is or could be a participant under the plan would be lower solely as a result of such individual being older.***

67 FR 76123-24 (emphasis added).

Duke argues the phrase "rate of an employee's benefit accrual," refers to the employer's

contributions to the plan (inputs), not the employee's benefits (outputs). This argument fails because under ERISA's plain language this is a defined benefit plan and Duke's attempt to have this Court instead consider contributions flies in the face of that critical distinction. Nonetheless, Duke argues that "rate of benefit accrual" means the rate of contributions not benefits. Under ERISA's plain language, the relevant "benefit" is what an employee receives from the hypothetical account in the form of a retirement ***benefit*** and the statutory language, "rate of ***benefit*** accrual," refers to the ***benefit***, i.e., the output, from the plan.

(a) The Phrase "Rate of Employee's Benefit Accrual" is Not Ambiguous.

In a defined benefit plan, employees are promised an output: retirement benefits. Under a defined contribution plan, employees are only promised an input: employer contribution to an account. A cash balance plan is a defined benefit plan, not a defined contribution plan.

Under Duke's incorrect "input" theory, as long as the rate at which payments (i.e., pay credits and interest credits) made to the employee's account does not decrease from one year to the next, no violation occurs. Under its view, the employer's contributions to the account are the relevant "benefit."

"Employee's benefit" is, however, the key term, just as it is for the definitional distinction between a defined-contribution plan and a defined-benefit plan. "Employee's benefit" refers in a defined benefit plan to what an employee receives from the hypothetical account in the form of a retirement benefit – what an employee is promised in a defined benefit plan.

A dictionary definition for "benefit" is: "A ***payment*** or service provided for under an annuity, pension plan, or insurance policy." *J.P. Morgan Chase*, 460 F. Supp. 2d at 486 (quoting Merriam-Webster's Dictionary). A dictionary definition for "accrual" is: "the action or process of accruing." "Accruing" in turn is defined: "to ***accumulate*** or be added periodically." *Id.*; *see also,*

MERRIAM-WEBSTER ONLINE DICTIONARY at *http://www.merriamwebster.com* (last visited 7/6/07). These dictionary definitions should be compared with Duke's argument, found at pp. 16-17 of its Brief, wherein it cites a definition for "accrual," but not for "benefit," the critical term in the age-based accrual provision at issue. (Def. Br. pp. 16-17). Understandably, "benefit" is a term Duke would wish to gloss over because, from a plain language standpoint, the statutory language, "rate of employee's benefit accrual," refers, to the benefit or the "output" an employee receives from the Plan.

The plan itself states that participants do not receive the amounts in the hypothetical account as their retirement benefit.[8] "In truth, 'the employee has no actual account, the employer makes no contributions to an employee account, and so there is no account balance to which interest might be added.'" *Donaldson v. Pharmacia Pension Plan*, 435 F. Supp. 2d 853, 857 (S.D. Ill. 2006) (quoting *Berger v. Xerox*, 338 F.3d 755, 758 (7th Cir. 2003). Instead, the balance in the account must be converted into an accrued benefit before it is paid over. *See* 1999 Plan § 7.01 (Ex. F); *see also* 1997 Plan §3.6 (Ex. E).[9] This actuarial conversion requires "projecting the cash balance forward and then discounting back to present value." *Esden*, 229 F.3d at 159.

Although the *Esden* court was not faced with an age discrimination claim, it recognized and

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[8] The cash balance accounts are "bookkeeping accounts only." Jan. 1, 1997 Plan, § 3.6 (Ex. E). The accounts do not create "a right in any person to receive specific assets of the Plan." (*Id.*). The retirement benefit is not the cash balance account but a life annuity equal to the actuarial value of a participant's accrued benefit. (*Id.* § 4.1(a)).

[9] Section 3.6 of the original 1997 cash balance plan states: "The Cash Balance Accounts shall be bookkeeping accounts only, and neither the maintenance of, nor the crediting of amounts to, such Accounts shall be treated as an allocation of assets of the Plan to, or a segregation of such assets in, any such Account or as otherwise creating a right in any person to receive specific assets of the Plan." (Ex. E). Section 5.01 of the 1999 plan is similar. (Ex. F) While Duke references the defined contribution statute providing that employers may allocate interest at uniform rates, and attempts to apply this language to its defined benefit plan, the fact that the plan itself allows no such allocation or segregation of assets demonstrates the futility of its argument.

applied the conversion concept in the cash balance plan context. The Second Circuit found that because the cash balance plan was a defined benefit plan, any distribution from the plan had to be the actuarial equivalent of the accrued benefit expressed as an annual benefit payable at normal retirement age, i.e., the normal retirement benefit. The court applied this law governing defined benefit plans to a fact pattern where the plaintiff elected to collect a lump sum annuity before she reached age 65 and the lump sum was more than was in the hypothetical account. The employer was required to give the employee the present value of her accrued benefit, not the smaller amount of her cash balance account. *Id*. at 159-165. This followed from ERISA's definition of an "accrued benefit" in a "defined benefit plan" as "the individual's accrued benefit . . . expressed in the form of an annual benefit commencing at normal retirement age." 29 U.S.C. § 1002(23)(A).

Applying the plain language and logic of the statute, rate of benefit accrual refers to the benefit, and thus, the plan is age-discriminatory. As one court put it:

> In light of the great similarity that 'rate of benefit accrual' bears to the statutorily defined term 'accrued benefit,' and the fact that ERISA requires accrued benefit to be measured as an annual benefit commencing at normal retirement age for defined benefit plans, but requires accrued benefit to be measured as the balance of an individual's account for defined contribution plans, in this court's opinion the term 'rate of benefit accrual,' as used in § 204(b)(1)(H)(i), refers to rate measured as a change in the annual benefit commencing at normal retirement age. ***The statute is unambiguous in this respect, and the court need not inquire further into its meaning.***

Parsons v. AT&T Pension Benefit Plan, 2006 WL 3826694 *1 (D. Conn. Dec. 22, 2006) (emphasis added).[10]

Duke essentially argues that, although the cash balance plan is a defined benefit plan, the words "rate of benefit accrual" must be interpreted in accordance with the definition of "accrued benefit"

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[10] Attached along with other unreported authorities as Exhibit G.

applicable to defined ***contribution*** plans, 29 U.S.C. § 1054(23)(B), not defined ***benefit*** plans, § 1054(23)(A). This contention flies in the face of long-standing rules of statutory construction, as well as the "rigidly binary" pension structure established by Congress. The courts are split on whether to follow the above-described statutory analysis, or to deviate from basic rules of statutory construction and accept arguments such as those made by Duke. While Duke Energy can cite to some courts[11] that have accepted its argument, a close reading of those cases reveals that the courts accepted a strained construction of the statute amidst fears that to hold otherwise would create chaos in industry as cash balance plans would all be struck down. However, over the last year the legal landscape has changed drastically. Under the new PPA law, cash balance plans are legal so long as the employer meets the safe harbor requirements and does not use "wear away." Thus, the Plaintiffs respectfully submit that this Court is unimpeded from following the better-reasoned cases, including *Parsons v. AT&T Pension Benefit Plan*, 2006 WL 3826694 (D. Conn. Dec. 22, 2006); *In re Citigroup Pension Plan ERISA Litig.*, 470 F. Supp. 2d 323 (S.D.N.Y. 2006); *In re Citigroup Pension Plan ERISA Litig.*, 241 F.R.D. 172 (S.D.N.Y. 2006) (granting motion for class certification); *In re J.P. Morgan Chase Cash Balance Litig.*, 460 F. Supp. 2d 479 (S.D.N.Y. 2006); *J.P. Morgan Chase Cash Balance Litig*, Opinion and Order filed May 30, 2007, Case No. 1:06-cv-00732 (granting plaintiffs' motion for class certification); *Richards v.*

[11] *Cooper v. IBM Personal Pension Plan*, 457 F.3d 636 (7th Cir. 2006); *Register v. PNC Fin. Servs. Group, Inc.*, 477 F.3d 56 (3d Cir. 2007); *Bryerton v. Verizon Comm., Inc.*, 2007 WL 1120290 (S.D.N.Y. April 17, 2007); *Drutis v. Quebecor World (USA), Inc.*, 459 F. Supp. 2d 580 (E.D. Ky. 2006); *Laurent v. PriceWaterhouseCoopers LLP*, 448 F. Supp. 2d 537 (S.D.N.Y. 2006); *Hirt v. Equitable Ret. Plan*, 441 F. Supp. 2d 516 (S.D.N.Y. 2006); *Eaton v. Onan Corp.*, 117 F. Supp. 2d 812 (S.D. Ind. 2000); *Wheeler v. Pension Value Plan for Employees of Boeing Co.*, 2007 WL 781908 (S.D. Ill. Mar 13, 2007); *Sunder v. U.S. Bank Pension Plan*, 2007 WL 541595 (E.D. Mo. Feb 16, 2007); *Finley v. Dun & Bradstreet Corp.*, 2007 WL 196753 (D.N.J. 2007); *Tomlinson v. El Paso Corp.*, 2007 WL 891378 (D. Colo. Mar 22, 2007); *Campbell v. BankBoston, N.A.*, 206 F. Supp. 2d 70 (D. Mass. 2002), *aff'd on other grounds*, 327 F.3d 1 (1st Cir. 2003). The Fourth Circuit has not decided the issue; one district court has adopted the defense view. *Tootle v. ARINC, Inc.*, 222 F.R.D. 88 (D. Md. 2004).

FleetBoston Fin. Corp., 427 F. Supp. 2d 150 (D. Conn. 2006); and *Wells v. Gannet Ret. Plan*, 385 F. Supp. 2d 1101 (D. Colo. 2005).

As noted, the test for age discrimination for a defined-benefit plan does not mirror the test for a defined-contribution plan. The better-reasoned cases note this difference:

> Congress did not intend that "the rate of an employee's benefit accrual," as used in section 204(b)(1)(H)(i), [would] be measured as "the rate at which amounts are allocated to the employee's account." Congress' use of the latter phrase, which explicitly requires measurements involving an increase in account balances, in ERISA § 204(b)(2) demonstrates that Congress could have used the same phrase in the age discrimination provision governing defined benefit plans had it intended to apply the same measurement rule to defined benefit plans. Instead, it used a completely different phrase, "rate of benefit accrual."

Richards, 427 F. Supp. 2d at 164; *accord, Parsons*, 2006 WL 3826694 at *1.

For purposes of testing compliance with ERISA's ***minimum accrual rules***, what is tested is the rate at which a participant earns the accrued benefit, which is to say, the future value of the benefit payable at the normal retirement age. *See Esden*, 229 F.3d at 167 n.18. When it comes to testing compliance with ERISA's ***age-based accrual standards***, however, Duke argues that what is to be tested is only the rate at which amounts are allocated to the employee's account – the ***present value*** of those hypothetical accounts, rather than their ***value at the normal retirement age***.[12] Duke seeks to divorce the term "accrued benefit" from "rate of benefit accrual" by arguing that the two phrases must have two different interpretations.[13]

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[12] In contradiction, the Plan itself recognizes the principle that there is no real employer allocation of assets by stating "[t]he Cash Balance Accounts shall be bookkeeping accounts only, and neither the maintenance of, nor the crediting of amounts to, such Accounts shall be treated as an allocation of assets of the Plan to, or a segregation of such assets in, any such account . . ." Jan. 1, 1997 Plan, §3.6 (emphasis added) (Ex. E); *see also*, Jan. 1, 1999 Plan, §5.01(Ex. F).

[13] Duke states "[h]ad Congress intended to use this defined term [accrued benefit] in § 204(b)(1)(H)(i) it could and would have done so" and that "[b]edrock canons of statutory construction ***compel*** the conclusion that use of this different term was deliberate, and that it has a different meaning."

If, however, "rate of accrual" means "rate of allocation" or "rate of contribution," as Duke suggests, then the language of the statute is nonsensical when applied to a traditional defined benefit pension plan. Such a plan promises a "defined benefit" at retirement, not a "defined contribution," i.e., periodic allocations to an account. Traditional defined benefit plans were what Congress had in mind when it adopted § 204(b)(1)(H)(i) in 1986. A traditional defined benefit plan could not provide for a rate of accrual of $100 per month at age 20, with the rate reduced by $3 per month each year thereafter, without violating the age discrimination rule. A cash balance plan, however, effects the same result by means of a system of credits, not to be confused with interest, the value of which diminishes with age. The age-based accrual test for a defined benefit plan must apply to the rate at which the participants earn ***the benefit they actually receive***, i.e., the annuity payable at the normal retirement age.

The cash balance formula is not based on actual accounts or contributions and the hypothetical account is not credited with actual investment earnings. *See Berger v. Xerox*, 338 F.3d 755, 758 (7th Cir. 2003). Nevertheless, Duke draws an analogy between the way that the interest credits are assigned to the account and the "time value of money." The cases upon which Duke relies accept this analogy and suggest that the decreasing rates of accrual under cash balance formulas merely reflect the time value of money.[14] Yet a more appropriate question is why a "hybrid" plan should be allowed to provide benefits that diminish with age by the simple expedient of using hypothetical interest credits, i.e., bookkeeping

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(Def. Br. p. 16) (emphasis added). Yet Duke goes on to criticize courts which have found that the plain meaning of the age-based accrual standard for defined benefit plans is not the same as for defined contribution plans, stating: "these court have mistakenly reasoned that, because Congress used a different phrase in § 204(b)(2) – i.e., 'rate at which amounts are allocated to the employee's account' – this phrase must have a different meaning that Congress would have used in § 204(b)(1)(H)(i) 'had it intended to apply the same measurement rule to defined benefit plan.'" (Def. Br. at 20, n. 10) (quoting *Richards v. FleetBoston Fin. Corp.*, 427 F. Supp. 2d 150,164 (D. Conn. 2006)). Duke's own argument, stated above, requires the conclusion that Duke is mistaken.

[14] *E.g., Register*, 477 F.3d at 69; *Cooper*, 457 F.3d at 639.

entries, rather than cash. If this subterfuge were permitted, the sponsor of a traditional defined benefit plan could argue with equal logic that a declining pension for older workers is *per se* proper.

Participants in cash balance plans do not actually earn any interest. Duke could earn a 20% return on its plan's investments and only credit the hypothetical cash balance accounts of its employees with 6% or less. Equating interest credits with the time value of money, however, ignores the hypothetical nature of key aspects of the plan and, more fundamentally, ignores the fact that under ERISA this is a defined-benefit plan. In a defined contribution plan, a participant is entitled to receive "benefits based solely upon the amount contributed to the participant's account, and any income, expenses, gains and losses, and forfeitures of accounts of other participants which may be allocated to such participant's account." 29 U.S.C. § 1002(34). But, interest credits in a cash balance plan do not correspond to the plan's actual investment returns, so the time value of money in such a plan is at best a hypothetical construct.

As noted by the court in *Pharmacia Plan*, "there is no account balance to which interest might be added." 435 F.Supp.2d at 857 In fact, the spread between the investment returns and the amount of the hypothetical interest credits is one of the major reasons why cash balance plans are liked by employers. The plan can offer hypothetical interest credits based on 30-year Treasury bond rates, while actually investing the plan's assets in historically higher-yield stocks and bonds.

The better-reasoned cases reject such arguments based on the time value of money. *Citigroup,* 470 F. Supp. 2d at 343; *Richards*, 427 F. Supp. 2d at 168. Thus, in *Citigroup*, Judge Scheindlin found that,"[b]ecause this actuarial conversion [to the age 65 annuity] requires knowing an individual's age, cash balance plans are not age neutral . . . . [A]s a matter of plain arithmetic, a greater value is added to

a younger employee's account than into an older employee's account." 470 F. Supp. 2d at 343-44.[15]

Nor does *Central Laborers' Pension Fund v. Heinz*, 541 U.S. 739 (2004), dispose of the issue as Duke contends. Again the key provision at issue in the instant case is 29 U.S.C. § 1054(b)(1)(H)(i) ("A defined benefit plan shall be treated as not satisfying the requirements of this paragraph if, under the plan, an employee's benefit accrual is ceased, or the rate of an employee's benefit accrual is reduced, because of the attainment of any age."). The *Heinz* opinion nowhere cites or addresses this statute. Nowhere does the Supreme Court in *Heinz* find, as contended by Duke, that 29 U.S.C. § 1054(b)(1)(H)(i) mandates use of "input" to determine whether a plan is age discriminatory. It is not surprising that the many cases ruling on the precise issue before this Court today do not cite to the *Heinz* decision – it simply does not apply.

***(b) Plain Language of the Statute*.**

Congress established age-based accrual tests for defined benefit and defined contribution plans using distinct language. For the former, the test is based on the "rate of an employee's benefit accrual,"[16] while for the latter it is based on "the rate at which amounts are allocated to the employee's account."

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[15] Many cases state that employers cannot avoid an anti-discrimination statute by explaining discriminatory effects in purportedly neutral economic terms that remain dependent on age, race, or sex. *See, e.g., Arizona Governing Comm. for Tax Deferred Annuity Comp. Plans v. Norris*, 463 U.S. 1073, 1081 (1983) (holding that "one cannot say that an actuarial distinction based entirely on sex is 'based on any other factor than sex.'"); *EEOC v. Jefferson Co. Sheriff's Dept.*, 467 F.3d 571, 572 (6th Cir. 2006) (rejecting argument that the plan merely used age as one of several factors to determine benefits and holding that ADEA is violated when benefits were calculated in such a way that an older employee who is eligible to receive disability benefits receives fewer benefits than a younger disabled employee).

[16] Duke has conveniently ignored the fact that Congress' use of the term "benefit accrual" is also manifest in ERISA § 204(h), 29 U.S.C. § 1054(h), which was enacted only six months before ERISA Section 204(b)(1)(H), and which requires plan administrators to provide advance notice of a significant reduction in "the rate of future benefit accrual." Of greater importance is that, in issuing regulations on this rule, the IRS concluded that "[t]he statutory phrase "rate of future benefit accrual implies, on its face, that section 204(h) is limited to changes in the accrued benefits." 63 F.R. 69678, 68680 (Dec. 14, 1998).

ERISA §204(b)(1)(H)(i) and 204(b)(2)(A). It is well established that "when the legislature uses certain language in one part of the statute and different language in another, the court assumes different meanings were intended." *Sosa v. Alvarez-Machain*, 542 U.S. 692, 712 n. 9 (2004) (citation omitted); *Russello v. U.S.*, 464 U.S. 16, 23 (1983) ("[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposefully in the disparate inclusion or exclusion.") (citation omitted).

(c) Legislative History.

As the "plain language of the statute is unambiguous" legislative history is irrelevant.[17] Nevertheless, even if it is considered it does not change the outcome.

(1) 1991 IRS Preamble.

Duke relies on an IRS statement that appears in a preamble to unrelated regulations. In the *Guide to Cash Balance Plans*, Forcier, Hubert V., p.10-4 (Aspen 2003), the author notes the language appeared in the preamble to Treasury Decision 8360, which issued final regulations dealing with rules under Code Section 401(a)(4) prohibiting discrimination in favor of highly compensated employees. The final regulations were not expressly interpreting Code Section 411(b)(1)(H). The "statement," which thus appears out of the blue in a preamble to unrelated regulations, stated:

> The fact that interest adjustments through normal retirement age are accrued in the year of the related allocation will not cause a cash balance plan to fail to satisfy the requirements of §411(b)(1)(H) relating to age based reductions in the rate at which benefits accrue under the plan.

Forcier, at 10-4.

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[17] *BedRoc Ltd., LLC v. U.S.*, 541 U.S. 176, 183 (2004) ("Thus, our inquiry begins with the statutory text, and ends there as well if the text is unambiguous" (citations omitted); *Hartford Underwriters Ins. Co. v. Union Planters Bank*, 530 U.S. 1, 6 (2000) (same); *Hillman v. IRS.*, 263 F.3d 338, 342 (4th Cir. 2001) (same).

The circumstances under which this sentence appeared in the preamble to unrelated regulations was the subject of an article by Ellen E. Schultz, "Pension Paternity: How a Single Sentence by IRS Paved the Way to Cash Balance Plans, Wall Street Journal," Dec. 28, 1999, at A1 (describing the suspected role of former Treasurer official Richard Shea). The insertion of this sentence in the preamble to the unrelated regulations was deemed sufficiently suspicious to kick off an investigation by the United States Governmental Accounting Office ("GAO"), which issued a report in 2001, concluding that, although no law was violated, the statement should not have been published:

> Treasury should not have opined on whether cash balance plans were age discriminatory in a public manner without having coordinated that position with DOL [Department of Labor] and EEOC [Equal Employment Opportunity Commission]. The preamble sentence may have misled the public and practitioners into believing that the sentence reflected the coordinated views of all three of the responsible agencies.

Forcier, at 10-5 (quoting from GAO report GAO-01-511R).

While Duke attempts to rely on a single unauthorized statement mysteriously added to a preamble to unrelated regulations, it ignores regulations proposed by the IRS in 1988 governing §204(b)(1)(H). These proposed regulations stated that "any differences in the rate of benefit accrual . . . may not be based, directly or indirectly on the attainment of any age." 53 F.R. 11876, 11880 (April 11, 1988). Although those regulations were never finalized, taxpayers were authorized to "rely on these regulations for guidance." *Id.* at 11878; *see also*, 67 F.R. 76123, 76129 (Dec. 11, 2002) ("[T]he reliance provided on the 1988 proposed regulations continues to be available.").

While the IRS has not determined that cash balance plans are inherently discriminatory, it has never given them a green light – even after the passage of the PPA law. To the contrary, IRS Notice 2007-6 expressly announces that the IRS ***will not*** decide that issue for cash balance conversions that occurred ***before*** the effective date of the PPA:

> 3-6/30/05 Conversions. For purposes of processing a determination letter for a moratorium plan, the plan will not be reviewed as to whether the conversion of the plan satisfies the requirements that §411(b)(1)(H) [the analogue of ERISA §204(B)(1)(h)] if the amendment that results in the conversion was adopted prior to June 30, 2005. Therefore, determination letters issued to moratorium plans will not consider, and may not be relied on with respect to whether such a conversion satisfies the requirements of §411(b)(1)(H), as in effect prior to the addition of §411 (b)(5) by PPA.

IRS Notice 2007-6, 2007-3 IRB 272, 2006 WL 3743114, p.6 (Ex. B). Accordingly, Duke's reliance on the IRS preamble is negated by other statements by the IRS itself.

(2) Proposed 2002 IRS Regulations.

Duke also cites proposed 2002 IRS regulations, issued on December 11, 2002, but withdrawn on June 15, 2004, as supportive evidence for their argument. However, withdrawn proposed regulations have no weight.[18]

Further, to the extent the proposed regulations could have any significance, they were proposed to support a "special" rule for cash balance plans, which supports Plaintiffs' argument that the existing statute did not supply such a rule. The preamble to the 2002 proposed regulations summarizes them, as follows:

> These proposed regulations would provide two basic approaches to determining the rate of benefit accrual, based on the way the benefit is expressed in the plan. One approach may be used by all defined benefit plans. A second approach may be used only by an eligible cash balance plan, as defined in these proposed regulations.

67 F.R. 76123-01. By adopting the "second approach," which, in essence, was the approach urged by cash balance proponents, the IRS conceded that a new regulation was needed to bring such plans into compliance with ERISA's age-based accrual standards. Furthermore, the proposed regulations, even if

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[18] *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833, 845 (1986) ("[I]t goes without saying that a proposed regulation does not represent an agency's considered interpretation of its statute and that an agency is entitled to consider alternative interpretations before settling on the view it considers most sound."); *see also, Depenbrock v. Cigna Corp.*, 389 F.3d 78, 85 (3d Cir. 2004) (rejecting reliance on a proposed Treasury regulation to support its interpretation of a cash balance plan).

they had been adopted, could not have been applied retroactively inasmuch as they created standards not previously present in either ERISA or the IRS regulations.

If the IRS believed that the 1991 preamble to unrelated regulations or the 2002 purposed regulations reflected the law, it could have so stated in Notice 2007-6. It did not.

4. Duke Misstates the Import of Lockheed Corp. v. Spink.

Duke argues that a Supreme Court decision, *Lockheed Corp. v. Spink,* 517 U.S. 882 (1996), is dispositive regarding Count One. In *Spink*, the issue was the amount of the benefit due an employee admitted to participation in a plan after ERISA was amended to prohibit the exclusion of employees hired within five years of normal retirement age. The Ninth Circuit held that to deny the employees credit for pre-participation service, "even though that exclusion was lawful at the time . . . reduce[d] the rate of benefits accrual for that employee." 517 U.S. at 897.

The Supreme Court reversed, holding that, quite apart from the fact that the statute did not permit retroactive application, "[a] reduction in total benefits due is not the same thing as a reduction in the rate of benefit accrual; the former is the final outcome of the calculation, whereas the latter is one of the factors in the equation." *Id.*

Duke claims that somehow this dicta makes clear that §204(b)(1)(H)(i) is applied to a plan by considering the increment that was provided each year under the plan's formula, rather than the final benefit at retirement. In addition to being mere *obiter dicta*, the quoted text says nothing about whether the "accrual rate in the formula" means the present value of allocations, or allocations valued as of normal retirement age. Simply put, *Spink's* one sentence of *dicta* does not come close to establishing that the rate of "interest" is the focus of ERISA's age-based accrual requirements for defined benefit plans.

Defendants, very simply, misrepresent the import of *Spink*. The fact that eleven years since it was

decided and many cash balance decisions later, not a single court has ever cited *Spink* for the proposition advanced by Defendants is instructive.

5. Policy Based Arguments Are No Substitute for Statutory Interpretation.

Defendants rely heavily on the decisions of the Third and Seventh Circuits in *Register* and *Cooper*. These cases have little to do with statutory interpretation and everything to do with policy preferences. Those cases gravitate on policy arguments that striking down cash balance plans would have dire effects on pensions.

However, it is simply no longer the case that a finding in this case of age discrimination would have dire repercussions. Specifically, Congress has passed the PPA law effectively insulating companies from suit for plans adjusted to fit the statutory parameters from 2005 forward. Accordingly, companies only have a limited period of exposure.[19]

Further, Duke's policy arguments that cash balance plans accommodate a more mobile workforce and the like ignore the fact that this is a Rule 12 motion and Plaintiffs' allegations are to be taken as true. Plaintiffs have clearly alleged and intend to prove that Duke's intent and motive in adopting this plan had nothing to do with helping workers and everything to do with cutting out a bulge of benefits owed to older workers and reducing the company's pension obligation. The old Duke plan, touted to employees

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[19] In general, the provisions under the Act are effective as early as June 29, 2005. PPA § 701(e). The PPA expressly provides that nothing in it should be construed to infer anything one way or the other regarding whether pre-PPA cash balance plans were age discriminatory. § 701(d). The Act addresses on a prospective basis several issues pertaining to cash balance plans, including the rate of benefit accrual and plan conversions. As to rate of benefit accrual, the PPA makes it clear that cash balance plans will not be treated on a going-forward basis as violating the age discrimination provisions if certain requirements are met. § 701(a)(1) (amending ERISA § 204(b)). As to plan conversions, the PPA prohibits "wear away" going forward. PPA § 701(a)(1). Duke's plan would have violated this provision if the plan conversion had occurred after the PPA's effective date. In this regard, Duke's contention that Congress endorses wear away is incorrect. (Def. Br. p. 7). The PPA prohibits wear away on a prospective basis. It clearly does not endorse it.

when the company underwent expansion in the 1960s and 1970s, promised a bulge in accruals for workers who stayed with the company into their 50s. The new Duke plan cut out that bulge of benefits. The plan did so after many workers had already reached their later years and were no longer in a position to look for better jobs, make investments, or undertake other steps to secure a better retirement. The cash balance plan, as used by Duke and on the particular facts of this case, was neither progressive nor equitable for workers.

6. *The Court Should Not Follow the Seventh Circuit Cooper Decision and its Progeny.*

The Seventh Circuit's decision in the *Cooper* case, that cash balance plans are not age discriminatory is both incorrect and inapplicable to this case. *See Cooper v. IBM*, 457 F.3d 636 (7th Cir. 2006). That Court found that ERISA's age discrimination provisions for defined benefit and defined contribution plans "appear to say the same thing." *Id*. at 638. As discussed above, this is incorrect since the statutory provisions plainly do say different things. Thus better-reasoned decisions have declined to follow this reasoning. *E.g., J.P. Morgan,* 460 F. Supp. 2d at 486.

The court in *Cooper* also found that cash balance plans should be deemed functionally equivalent to defined contribution plans and should not be treated differently even though under ERISA they were defined benefit plans. Thus, the court "treated cash balance plans as defined contribution plans." *J.P. Morgan*, 460 F. Supp. 2d at 488.

This treatment was improper since under the law they are defined benefit plans. *See also* Edward A. Zelinsky, "Cooper v. IBM Pension Plan: A Critique," in Alvin D. Lurie (ed.), New York University Review of Employee Benefits and Executive Compensation (2007). Courts "have no authority to override Congress's policy preference so as to substitute [their] own view, whatever they might be, for those of Congress." *Collier v. Barnhart*, 473 F.3d 444, 449 (2d Cir. 2007). "Whatever temptations the

statesmanship of policy-making might wisely suggest, the judge's job is to construe the statute-not to make it better." Frankfurter, "Some Reflections on the Reading of Statutes," 47 Colum. L. R. 527, 533 (1947); *Jones v. Bock*, __U.S.__, 127 S. Ct. 910, 921 (2007). "The judge 'must not read in by way of creation," but instead abide by the "duty of restraint th[e] humility of function as merely the translator of another's command." *Id.* In short, the *laissez faire* approach advocated by *Cooper* and its progeny would turn the ERISA clock back over 30 years, by totally disregarding the fact that ERISA was enacted precisely to superimpose minimum statutory standards on the discretion afforded pension plan sponsors in the crafting of pension plans. Deferring to plan sponsors over statutory mandates is directly contrary to *Esden*, which held: "[T]the dispute is not over what a "better" regulatory regime, more accommodating to the design objectives of cash balance plans might look like; the dispute is over how to apply the existing regulations to this Plan." *Esden*, 229 F. 3d at 171.

The Court in *Cooper* also presented a hypothetical scenario envisioning a 65-year-old working to age 105 to catch up with interest credits accruing to a 25-year-old working 40 additional years. *Cooper*, 457 F.3d at 640. The hypothetical demonstrates that, factually, the IBM plan is not on all fours with the Duke plan. The current Duke plan provides that "Interest Credits will be added to the cash balance account of each participant who has not commenced receiving Retirement Income." 1999 Plan § 5.04(a) (Ex. F). It also states that "benefits must commence no later than April 1 following the year in which the participant attains 70 ½." *Id.* § 6.03(b). Together, these plan provisions require a cessation of "interest credits" based on the Participant's specified age, effectively barring any employee from receiving an equivalent number of future "interest credits" that a younger employee may be awarded. Thus, even if "'rate of benefit accrual' refers to the inputs to the plan formula for earning benefits," as urged by Duke at Def. Br. p. 17, the Duke plan is age discriminatory since the employer's inputs are

reduced and then ceased directly on account of age.[20]

7. Conclusion.

Duke wants a pension plan regulated under the defined contribution rules of ERISA, but doesn't want to pay the price for such regulation, i.e., actually paying money into employees' accounts. They prefer to retain reserves against this liability and to invest these reserves as they see fit and for their benefit, "crediting" employees with a small "interest" return while they earn market rates. Their position illustrates why different rules apply to defined benefit plans and defined contribution plans, they are fundamentally different forms of retirement plans subject to totally different rules.

B. Count Two States a Claim.

The ADEA prohibits age discrimination in pensions using terminology substantially similar to that found in ERISA and addressed in Count One, discussed above.

Specifically, 29 U.S.C. § 623(i)(1)(A) & (B) provides:

> (1) Except as otherwise provided in this subsection, it shall be unlawful for an employer, an employment agency, a labor organization, or any combination thereof to establish or maintain an employee pension benefit plan which requires or permits–
>
> > (A) ***in the case of a defined benefit plan, the cessation of an employee's benefit accrual, or the reduction of the rate of an employee's benefit accrual, because of age,*** or
> >
> > (B) in the case of a defined contribution plan, the cessation of allocations to an employee's account, or the reduction of the rate at which amounts are allocated

[20] *Cooper* also held it not discriminatory that "younger workers have (statistically) more time left before retirement and, thus, a greater opportunity to earn [imputed] interest in each year's retirement savings." 457 F.3d at 639. Unfortunately this is the same as holding that it is not age discrimination for an employer to reduce retirement benefits based on the number of years before retirement so long as the employee excuses the reductions with an analogy to a neutral economic principle. A table which progressively reduces the accrual rate based on age would be prohibited but, according to Duke, the same table accompanied by a neutral explanation would not be. Discrimination law has long rejected the idea that courts cannot go behind a company's facially non-discriminatory explanation of obviously discriminatory results. *See, e.g., Hazen Paper Co. v. Biggins*, 507 U.S. 604, 608-11 (1993).

> to an employee's account, because of age.

(Emphasis added). As shown above with regard to similar language found under ERISA, Duke violated this provision by the terms of its cash balance plan. This violation gives rise to an ADEA claim both under the "disparate impact" and the "disparate treatment" analysis.

1. Plaintiffs State a Claim for Disparate Impact.

Generally, a plaintiff alleging discrimination under the ADEA may proceed under either of two theories: disparate impact or disparate treatment. To prevail on a disparate impact claim, plaintiffs must prove that a challenged policy or practice, has a disparate impact on certain employees because of their membership in a protected group (i.e., older employees). To establish a *prima facie* case under a disparate impact theory, the plaintiff need not show that the employer was motivated by a discriminatory intent. 14A C.J.S. *Civil Rights* § 264.

Plaintiffs state a claim under the ADEA for disparate impact because Plaintiffs have alleged that the cash balance plan has a prohibited disparate impact on older employees.

Defendants misconstrue the case of *Smith v. City of Jackson, Miss.*, 544 U.S. 228 (2005). In fact, the *Smith* case supports the Plaintiffs' claims. There the Supreme Court specifically found that disparate impact claims were allowed under the ADEA. *Id.* at 240 (finding that "it was error for the Court of Appeals to hold that the disparate-impact theory of liability is categorically unavailable under the ADEA."). The ADEA states:

> It shall be unlawful for an employer:
>
> to limit, segregate, or classify his employees in any way which would deprive or tend to deprive any individual of employment opportunities or otherwise adversely affect his status as an employee, because of such individual's age.

29 U.S.C. § 623(a)(2).

This language "focuses on the effects of the action on the employee rather than the motivation for the action of the employer." *Smith*, 544 U.S. at 236. Here, the undeniable effect of the cash balance plan was to adversely affect older workers because of their age.

Duke attempts to limit Plaintiffs' ADEA claim to 29 U.S.C. § 623(a)(1) rather than (a)(2). (Def. Br. p. 25). The Complaint itself does no such thing. (Complaint ¶¶ 92-95). Rather, the Complaint broadly alleges liability under the ADEA, well within the purview of notice pleading. (*Id.*) Duke's attempts to unilaterally recast the claim should be rejected.

As the Supreme Court notes in *Smith*, "the employee is responsible for isolating and identifying the specific employment practices that are allegedly responsible for any observed statistical disparities." 544 U.S. at 241 (citation omitted). Plaintiffs have done so. Duke's use of the cash balance formula causes a statistical disparity in how benefits accrue for older and younger workers. As discussed above with regard to Count One, when purportedly equal allocations to employees' hypothetical cash balance accounts are translated into their deferred annuity equivalents, those annuities decline with age because there is less time for such allocations to earn interest as the employee ages. The result is that the plan "disproportionately impacted employees over the age of 40." (Complaint ¶ 58). This was a disparate impact on older employees.

2. Plaintiffs State a Claim for Disparate Treatment.

To prevail under a disparate treatment claim, the employee must show a discriminatory motive by the employer that is purposeful or intentional discrimination. Liability depends on whether age actually motivated the employer's decision; that is, the plaintiff's age must have actually played a role in the employer's decision-making process and had a determinative influence on the outcome. 14A C.J.S. *Civil Rights* § 264.

Plaintiffs alternatively state a claim for disparate treatment under the ADEA. Plaintiffs specifically allege that Duke:

- Made changes in its pension plan to facilitate corporate funding and investment. (Complaint ¶ 36).
- Misled workers that the cash balance plan would not greatly change the old plan and that it had to change to a cash balance plan to avoid a hostile takeover. (*Id.* ¶ 41).
- Had an undisclosed goal to use the pension plan conversion to enrich itself. (*Id.* ¶ 47).
- "[K]nowingly and willfully adopted a cash balance plan that discriminated against employees over the age of 40." (*Id.* ¶ 94).
- "[K]new or recklessly disregarded the fact that employees over the age of 40 would disproportionately suffer as a result of the conversion." (*Id.*).
- "[I]mplemented the conversion knowing that it would effectively freeze benefit accruals for most employees over the age of 40." (*Id.*).

These allegations state a claim for disparate treatment. Among other things, Plaintiffs have specifically alleged that Duke knowingly and willfully adopted a cash balance plan that discriminates against older workers. (*Id.* ¶ 94).

Duke's protestations that it adopted its cash balance plan to account for a more mobile workforce, and the like, make no difference. The Complaint plainly alleges that the true reason behind Duke's adoption of the plan was to free up money to engage in investments while cutting benefits to workers and discriminating against those older workers. Thus, Duke acted with an intent to discriminate against older workers, and is liable under the ADEA.

C. Count Three States a Claim.

Count Three alleges that Duke miscalculated benefits by (i) using the incorrect interest rate to calculate lump sum distributions, and (ii) using an improper pre-retirement mortality discount.

(Complaint ¶¶ 96-100).

As stated in the Class Certification Reply Brief, Plaintiffs withdraw this claim as to issue (ii). Plaintiffs state a claim as to issue (i) because Duke failed to make proper calculations to determine lump sum benefit payments under the cash balance plan. The Plaintiffs allege that Duke calculated lump sum distributions using the yield on 30-year treasury securities. (*Id.* ¶ 79). Plan section 5.04(c) requires using a lower 4% discount rate which would result in higher lump sum distributions to participants. (*Id.* ¶ 82) (Ex. F). The actuarial intricacies of the claim involve construction and application of technical plan language and are better reserved for factual and expert discovery than disposition on a Rule 12 motion. Below, Plaintiffs detail what they would anticipate their expert testimony would show and what they anticipate factual discovery on plan application would disclose.

1. Lump Sums Generally.

Under ERISA, a participant's accrued benefit (the benefit the participant has earned at any particular point in time) means, for defined benefit plans, an annuity commencing at normal retirement age. 29 U.S.C. § 1002(23)(A). The plan may offer optional forms of payment of the accrued benefit, as an alternative to the annuity, including a lump sum payment as long as the alternative benefit is the actuarial equivalent of the annuity. 29 U.S.C. § 1054(c)(3). The Duke Plan offers such a lump sum optional form of payment.

If a defined benefit plan offers a lump sum, I.R.C.§ 417(e) specifies the maximum interest rate that may be used to determine the actuarial equivalent of the lump sum and defines this interest rate as "the applicable interest rate." 26 U.S.C. § 417(e)(3)(A). Since this interest rate is used to discount the future annuity payments to a present value amount (the lump sum), a ***higher*** interest rate produces a ***lower*** lump sum for any given annuity. Thus, I.R.C. § 417(e), by defining the ***maximum*** interest rate,

mandates the ***minimum*** lump sum distribution that may be made in lieu of a participant's accrued benefit. A plan may, by explicit plan provision, exceed this minimum lump sum distribution by specifying an interest rate that is lower than the 417(e) interest rate. Defendants were required, by the terms of the Duke Plan, to apply an interest rate lower than the "applicable interest rate" mandated by I.R.C.§ 417(e) calculation. January 1, 1999 Plan § 5.04(c) defines the interest rate to be used in the calculation of a lump sum as "the ***lesser*** of 4% or the 'applicable interest rate' specified in Code Section 417(e)." (Ex. F). Instead of using 4%, Defendants used "the 'applicable interest rate' specified in 417(e)," which has been higher than 4% since the Plan's inception.

2. Cash Balance Account Lump Sums.

Duke is required to perform a "whipsaw" calculation in computing the lump sum benefit payment based on a cash balance account. A whipsaw calculation is required wherever the interest rate to project a current account balance to normal retirement date and convert it to an annuity is higher than the interest rate to be used to discount the annuity back to present value. *See* IRS Notice 96-8. (Ex. B). Both the terms of Duke's plan and ERISA mandate a higher interest rate for conversion of the cash balance accounts to an annuity than the interest rate dictated by Duke's plan for discounting an annuity back to a lump sum value. The interest rate used to convert a Duke cash balance account to an annuity under the 1999 Plan is defined in Appendix A as the "[a]nnual yield on 30-year United States Treasury securities for the month of November prior to the beginning of the Plan Year during which the Annuity Starting Date falls."[21] Throughout the Duke Plan's existence, this rate has been greater than 4%.[22] The interest

[21] Also Jan. 1, 1999 Plan § 5.04(b), by reference to plan sections 2.38 and 2.39, defines the monthly interest rate for "interest credits" as the average yield on 30-year United States treasury bonds for the particular month. (Ex. F).

[22] See Exhibit H.

rate for discounting lump sum distributions to present value is the lesser of 4% or I.R.C. § 417(e).[23] *See* Jan. 1, 1999 Plan §5.04(c) (Ex. F). Thus the projection interest rate is higher than the Plan's discount rate.

The whipsaw calculation is a consequence of ERISA's definition of "accrued benefit" in the context of a defined benefit plan as a yearly benefit. A defined benefit plan is not valid unless it offers such a benefit, and any lump sum payout from the plan must be the actuarial equivalent of such a benefit, not the balance of a hypothetical, bookkeeping account.[24]

Duke has thus far claimed to have used two mathematically identical, but legally distinct methods of computing lump sum distributions. The first method is described at Def. Br. p. 31, where Duke claims to have taken the total amount imputed to a participant's cash balance account as of his retirement date as the lump sum payable under his cash balance account. The actual lump sum paid was then the greater of his cash balance account or the actuarial equivalent of his prior plan annuity (albeit calculated in error using the "applicable interest rate" rather than the lower 4% interest rate specified in § 5.04(c), as described above) were it to commence at the participant's current retirement age. This method assumes that Duke was not required to perform a whipsaw calculation because it defined the term "accrued benefit" so as to obviate the need for such calculations.

Duke contends that by Plan § 2.03, it defined a participant's accrued benefit as the amount

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[23] Duke argues that § 5.04(c) allows it to use a 4% interest rate for projecting additional interest credits. But switching from the treasury bond rate under Appendix A and Plan § 5.04(b) to a lower 4% interest rate for the "interest credit" benefit would constitute a forfeiture. *See Berger v. Xerox*, 338 F.3d at 762-63.

[24] The definition of an accrued benefit as the balance of an account is reserved for defined contribution plans. 26 U.S.C. § 411(a)(7)(A)(ii). Duke was, however, free to define a Participant's accrued benefit as ***the value of*** his cash balance account balance. This is the only sensible definition, given that there is no cash in a Participant's cash balance account. Per Defendants' own language, a cash balance account is not actually an account with a cash balance. The account cannot be paid. It has value, but that value is calculated from, not equivalent to, the amount stated as its balance.

reflected as the balance of his cash balance account. (Ex. F). This is not allowed under ERISA. It is improper because (a) a cash balance plan is a defined benefit plan; (b) in a defined benefit plan an accrued benefit is an annual benefit (an annuity) commencing at normal retirement age or its actuarial equivalent;[25] and (c) accordingly, one must go through the complex whipsaw analysis rather than simply defining it away by equating the accrued benefit with the hypothetical cash balance account. In fact, only under a defined contribution plan can this definition of an accrued benefit be given.[26]

The second method is described in Duke's November 30, 2004, letter to Plaintiff's counsel. (See Plaintiffs' Reply Memorandum in Support of Motion for Class Certification filed 6/11/07, Exhibit B). Page 3 of that letter refers to use of a "safe harbor" interest rate guaranteed to produce, via whipsaw calculation, an actuarial value equal to a cash balance account. It is a simple mathematical truth that applying the same rate of return and discount rate over the same future period to a present amount will always yield that present amount. This method reckons that whether Duke performed the calculation or not was irrelevant because it defined the rate of return used to project future interest credits to the cash balance account (from current date to the normal retirement date), and the rate used to convert the projected cash balance account to an annuity, as the 417(e) discount rate. The dual calculations were, thus, according to Duke, set to cancel each other out and result in the notional cash balance account.

Duke contends that IRS Notice 96-8 provides that "where a plan guarantees interest at a rate that is the same as the § 417(e) discount rate, there is no need to perform a whipsaw calculation." (Def. Br. p. 30). The Notice presents, as its example of this scenario, a plan which defines both a rate of return and discount rate in accordance with § 417(e). Section 417(e), however, merely sets a maximum discount

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[25] 26 U.S.C. § 411(a)(7)(A)(i).

[26] 26 U.S.C. § 411(a)(7)(A)(ii).

rate. Duke was free to set a lower discount rate, and it did in Plan § 5.04(c). (Ex. F). Since Duke's declared interest rate is higher than the discount rate, under Notice 96-8, a whipsaw calculation must be performed.

3. Effect of the Interest Rates.

The interest rate used to convert the accrued benefit (an annuity) to a lump sum under 1999 Plan § 5.04(c) – for Participants who elect lump sum distribution prior to their normal retirement date[27] – is "***the lesser of*** 4% or the 'applicable interest rate' specified in § 417(e) and Treasury Regulation 1.417(e)-1T." (Emphasis added) (Ex. F). This means the discount rate used must be 4% when the § 417(e) rate is greater than 4%. In such cases, Duke must project the future interest credits at the greater § 417(e) rate and discount it back at 4%, which results in a benefit calculation greater than the cash balance amount.

Throughout the Duke Plan's existence, the "applicable interest rate" specified in 26 U.S.C. § 417(e) has been higher than 4%. Therefore, the Plan-mandated interest rate to be used in calculating a lump sum distribution of a participant's accrued benefit has always been 4%. Duke, however, calculated actual lump sums paid by the plan using the interest rate specified in I.R.C. § 417(e). Thus, the actual lump sums paid by the Plan were based on an interest rate that was higher than the rate that should have been used and plan participants who elected to receive a lump sum distribution prior to normal retirement did not receive the full value of their accrued benefits.

Duke relies on I.R.S. Notice 96-8, which requires the use of the § 417(e) rate in the analysis. However, the Notice dealt only with whether the Plan must use the § 417(e) discount rate or a ***higher*** rate

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[27] The Plan defines "Normal Retirement Date" as the first day of either the month during which a Participant attains Normal Retirement Age, or the month immediately following. 1999 Plan § 2.46 (Ex. F). The Plan defines Normal Retirement Age as age 65. *Id.* § 2.44.

specified in a cash balance plan. The Notice did not address Plans calling for a rate ***lower*** than the § 417(e) rate. In fact, the Notice states "the employee must be paid ***at least*** the present value, determined in accordance with section 417(e)." Notice 96-8 (emphasis added) (Ex. B). Similarly, I.R.C. § 417(e) states that "the present value shall ***not be less than*** the present value calculated by using . . . the applicable interest rate." 26 U.S.C. § 417(e)(3)(A)(i) (emphasis added). Neither source requires the use of the § 417(e) rate when the plan provides a lower discount rate that would generate a higher present value.

Moreover, the lesser 4% rate addressed in Plan § 5.04(c) could only apply to the discount rate and could not also include the "Monthly Interest Rate" used for interest credits. Section 5.04(b) specifies that the "interest credits" for each month shall be based on the Monthly Interest Rate which is equal to the § 417(e) rate by Plan definition. *See* 1999 Plan §§ 2.38 and 2.39(Ex. F). Interest credits are a vested benefit that cannot be subsequently reduced by the employer under ERISA's anti-reduction rule. *See Berger v. Xerox*, 338 F.3d at 762-63; 29 U.S.C. § 1054(g). Therefore, the only rate Duke could legally reduce in the calculation of the lump sum distribution is the discount rate.

Also, throughout the Plan's existence, the § 417(e) interest rate required to project a current cash balance account balance to normal retirement date and convert such balance to an annuity has been higher than the Plan's 4% interest rate used to convert an annuity to a lump sum. Therefore, a whipsaw calculation is mandated by 26 U.S.C. § 411(a)(7)(A)(i), as interpreted in IRS Notice 96-8 for all participants who have elected to receive their benefit prior to age 65 as a lump sum. A whipsaw calculation was not performed by Defendants, but would have resulted in a higher lump sum than was actually paid in all cases where the annuitized benefit of the projected cash balance account balance exceeded the prior plan's accrued benefit (including cases where there was no prior plan accrued benefit)

payable at normal retirement age.

In conclusion, this issue is technical and factual and will require expert testimony as the case proceeds, as well as factual discovery to disclose how Duke itself applied the plan terms and performed calculations. Disposition under a Rule 12 analysis is premature.

D. Count Four States a Claim.

Count Four claims that under ERISA Duke miscalculated interest credits. (Complaint ¶¶ 101-104). The claim is based on plan provisions describing how the interest factor will be calculated which change over time. Applying this plain language over the pertinent time period, the result is that Duke understated benefits. (*Id.* ¶¶ 65-71).

In Duke's brief, it does not dispute Plaintiffs' reading of this plan language. Rather, it (a) disputes whether the plan document controls and (b) side-steps the issue by claiming failure to exhaust administrative remedies. As to (b), the undersigned respectfully direct the Court to their argument in their reply brief in support of their motion for class certification. As to (a), Duke is incorrect for the reasons stated below.

1. Plan Document Controls Over SPD.

Duke contends that the 1997 SPD tracks the language of the 1999 plan document, and to the extent there is a discrepancy between the 1997 SPD and the 1997 plan documents, the SPD controls. (Def. Br. p. 35).

Duke relies on *Aiken v. Policy Mgmt. Sys. Corp.*, 13 F.3d 138, 140-41 (4th Cir. 1993). In *Aiken*, the court stated that the plaintiff, a plan participant trying to enforce terms stated in the SPD, was required either to show significant reliance upon the SPD language or prejudice flowing from the inconsistency between the SPD language and the plan document. In *Aiken*, the SPD language was more favorable to

the employee than the formal plan document. 13 F.3d at 142 (remanding "for further development of the record on the issue of reliance or prejudice."). The court found that "[T]o secure relief, [the claimant] must show some significant reliance upon, or possible prejudice flowing from, the faulty plan description." *Id.* at 141 (quoting *Govoni v. Bricklayers, Masons & Plasterers Int'l Union, Local No. 5 Pension Fund*, 732 F.2d 250 (1st Cir. 1984)); *see also, Hendricks v. Central Reserve Life Ins. Co.*, 39 F.3d 507, 511-12 (4th Cir. 1994); *Porter v. Metropolitan Life Ins. Co*., 17 F. Supp. 2d 500, 504-506 (D.S.C. 1998) (finding that broader standard for "total disability" found in official plan document controlled over narrower standard found in SPD, in absence of showing of reliance or prejudice).

Neither Duke nor Plaintiffs allege they relied on the SPD or were prejudiced. The rule as to conflicting SPDs and formal plan documents was, of course, generated by the Courts as a means to protect employees from inaccurate summary plan descriptions. In the typical case, the SPD contains language more favorable to the employee, and the company claims the formal plan controls. In this case, Duke tries to turn that rule on its head to the detriment of employees, even though the SPD states that the plan controls in cases where the terms of the two documents conflict.

Duke's argument has been rejected by the Fourth Circuit Court of Appeals. In *Glocker v. W.R. Grace & Co.*, 974 F.2d 540, 542 -543 (4th Cir. 1992), the Court held that an employer ***cannot*** rely on the terms of a SPD which are less generous than the formal plan document when the employer has included a statement in the SPD that the plan controls over the SPD. *See also, Benton v. Westinghouse Savannah River Co., LLC*, 2002 U.S. Dist. LEXIS 27807 (D.S.C. September 24, 2002).

The SPDs in Plaintiffs' possession contain language such as that "the SPD . . . is only a summary. The complete provisions are set forth in the Plan documents." Jan. 2003 SPD (Ex. D). More impressively, the January 1997 SPD expressly states "[i]f any conflict arises between this summary and

the official plan documents, the official plan documents will always govern." (Ex. C). Language such as that found in the 1997 SPD is fatal to Duke's argument since a company cannot reply on an SPD where the employer has indicated the formal plan controls.

As the court in *Glocker* noted, "Grace, having represented to its employees that the Plan – not the handbook – governed questions about benefits, cannot now repudiate this representation and rely on statements in the handbook that are less favorable to Mrs. Glocker." 974 F.2d at 542.[28] Applying this Fourth Circuit authority, Duke is not entitled to obtain relief by having the SPD control over the plan document.

E. Count Five States a Claim.

As described above and alleged in the Complaint, after the cash balance conversion, participants would start out with the greater of (1) the accumulated pension benefits which they had under the old plan, or (2) the new hypothetical account balance under the cash balance plan. For workers over 40, the present value of the accumulated figure under the old plan was greater than the opening account balance under the new plan. Thus, the actuarial present value of Plaintiff Henry Miller's vested annuity under the old plan was $258,000 His new account balance under the cash balance plan was only $129,000. Plaintiff Miller, thus, faced no accrual for many years until the cash balance account, set so much lower,

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[28] *See also, Benton v. Westinghouse Savannah River Co., LLC*, 2002 U.S. Dist. LEXIS 27807, *18 at n.12 (D.S.C. Sept. 24, 2002) ("Various cases have allowed plan participants to rely on the more generous of the SPD or Plan language."); *Paulson v. Paul Revere Life Ins. Co.*, 323 F. Supp. 2d 919, 939 (S.D. Iowa 2004) ("Just as the rule allowing enforcement of SPDs helps to ensure that policy summaries are sufficiently accurate and comprehensive to reasonably apprise such participants and beneficiaries of their rights and obligations under the plan, so does a rule requiring that favorable policy terms be enforced over more restrictive terms in an SPD." (Internal quote marks omitted)); *Springs Valley Bank & Trust Co. v. Carpenter*, 885 F. Supp. 1131, 1141-42 (S.D. Ind.1993) (finding that "in cases of conflict between a summary plan description and a policy, the terms which favor the participant will govern"); and *cf. Gable v. Sweetheart Cup Co., Inc.*, 1994 WL 534903, *2 (D. Md. Jan. 14, 1994) ("If ambiguities remain, the Plan should be construed against the drafter." (quoting *Glocker*, supra)).

would finally "catch up" and surpass his frozen amount under the old plan.

This "wear-away" feature of Duke's plan is not a necessary part of a cash balance plan. In fact, under the Pension Protection Act of 2006, wear-away is prohibited for all cash balance plan conversions occurring after June 29, 2005. *See* PPA § 701(a)(1), adding 29 U.S.C. § 1054(b)(5)(B)(ii). Clearly, then, one can have a cash balance plan without "wear-away."

Duke's wear-away period during which a participant's net benefit accruals cease and then pick up again violates ERISA's 133 1/3% accrual rule. This rule requires that the annual rate of benefit accrual payable at a normal retirement age can increase by no more than 133 1/3 % in any later plan year. 29 U.S.C. § 1054(b)(1)(B). If no additional benefits are earned for a period of several plan years, with accruals picking up again in later years, the plan does not comply with the rule against backloading. This is because the rate of benefit accrual after the wear-away period ends is "infinitely" greater than the rate in the years with no additional benefit accruals.

Duke's non-compliance with the 133 1/3 % rule cannot be repaired by drawing on the higher rates of accrual under the plan's old formula. 1997 Treasury regulations make clear that higher accruals in previous years cannot be averaged with lower or non-existent rates in intermediate years to avoid a violation. Instead, the plan's formula must pass the test based on the accruals in each particular plan year. The regulations provide an example in which the plan offers a 2% accrual rate in the first 5 years, then a 1% rate in years 6 through 10, then a 1.5% rate thereafter. The regulations state that the accrual rates in years 6 through 10 must comply with the statutory requirements without resorting to the higher accrual rates in earlier years. As a result, the lower accrual rates in years 6 through 10 violate the law, even though the average accrual rate for years 1 through 10 taken as a whole would not fall below 1.5%. (Treasury Regulation 1.411(b)-1(b)(2)(iii) (Example 3)).

Cases which had dismissed claims for violation of the 133 1/3% rule have not addressed this Treasury Regulation nor how the IRS construes the law. *See Richards*, 427 F. Supp. 2d at 171; *Registe*r, 477 F.3d at 71-72.[29] In those cases, the courts reasoned that, under 29 U.S.C. § 1054(b)(1)(B)(i), only the new plan formula is relevant. However, this reasoning is inconsistent with the Treasury Regulation noted above since three different plan formulas over time are being reviewed. An IRS guideline for minimum vesting standards for defined benefit plans also reflects this analysis at work. In its example, the Guideline describes a plan with a regular benefit formula that offers a benefit of 0.5% of compensation for each year of service. In year X, however, the plan becomes "top-heavy" which requires a minimum accrual of 2% per year. The IRS concluded that if the plan provides that the participant will receive not less than the greater of his accrual under the regular formula or the top-heavy minimum, it violates the 133 1/3% rule. IRS Doc. No. 6390 (Rev. 12-98), p. 12 (Ex. B). The IRS determined that for a participant with 6 years of service, the net increase in the first two years of 0.5% would be exceeded by the 2% accrual rate in future years, by more than 133 1/3%. *Id.*

This approach is also supported by a 1977 Treasury Regulation providing that, when benefits are "determined under more than one plan formula," they "must be aggregated in order to determine whether or not the accrued benefits under the plan for participants satisfy one of the alternative methods." Treasury Regulation 1.411(b)-1(a). It is also supported by the Treasury Department's recognition that

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[29] Duke's reference to 26 C.F.R. §1.401(a)(4) - 13(c)(4)(ii) at Def. Br. p. 7 is not relevant to Plaintiffs' backloading claim under ERISA§ 204 (b)(1)(B). 26 C.F.R. §1.401(a)(4) – 13(c)(4)(ii) addresses the fresh start testing options available for determining whether a frozen plan meets the minimum coverage and participation requirements of I.R.C. §§ 401(a)(4) and 410(b) prohibiting discrimination in favor of highly compensated over non-highly compensated employees. *See* 26 C.F.R. §§ 1.401(a)(4) – 13(c)(1) referencing 1.401(a)(4) – 3, which in turn references 1.401(a)(4) – 1 "Nondiscrimination Requirements of Section 401(a)(4). 26 C.F.R. §§1.401(a)(4) – 13(c)(4)(ii) does not tackle the issue of whether a plan amendment creating wear-away violates the 133 1/3 % backloading rule of 29 U.S.C. § 1054(b)(1)(B).

a minimum benefit provision can affect the rate of future benefit accrual. 60 F.R. 64320, 64322 (Dec. 15, 1995); 63 F.R. 68678, 68681 (Dec. 14, 1998). In this case, the frozen benefit which is used under the "greater of" approach of the plan is such a minimum benefit.

It is clear that both Treasury and the IRS construe the backloading rules differently from how Duke would. In this regard, the Court may also take judicial notice of the fact that Duke is listed as a member of the American Benefits Council.[30] The Council has publicly conceded that the IRS construes the law in the manner Plaintiffs advance herein, stating its opinion that "there is a problem with the way the IRS has been interpreting the backloading rules; in general, the IRS interpretation invalidates 'greater of formulas . . . The IRS has, however, informally insisted that the formulas be tested together, creating a failure of the 133 1/3% rule (which is the one clearly best suited to hybrid plans) because of the accrual rate in the year following the 'crossover' with respect to the participant (i.e., the point in time where one formula ceases to give rise to the larger benefit)."[31]

The courts declining to find violation of the 133 1/3% rule, *Richards* and *Register*, *supra,* reasoned that under 29 U.S.C. § 1054(b)(1)(B)(i), only the new plan formula is relevant. Plainly that section's language regarding plan terms "in effect for the current year" fulfills a different purpose. As explained by the ERISA Conference Report: "[If] a plan provides a one percent rate of accrual for all participants in 1976, and is amended to provide a 2 percent rate of accrual for all participants in 1977, the plan will meet this test, even though 2 is more than 1-1/3 times 1." H. Conf. Rep. 93-1280, at 274, 1974 USCCAN 5038, 5055. The clause is thus meant to allow "across-the-board increases in benefit

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[30] *See* member list available at www.americanbenefitscouncil.org/about/memberlist.cfm.

[31] American Benefits Council, IRS comment letter dated April 16, 2007, pp. 20-21, located at http://www.americanbenefitscouncil.org/documents/irs_notice_2007-6_comments.pdf.

rates made at some future time on behalf of all current employees regardless of past service." *Langman v. Leub*, 328 F.3d 68, 71 (2nd Cir. 2003). The Treasury Regulation regarding aggregation, 1.411(b)-1(a), is no impediment to this intent. This is because a plan amended to provide a 2% benefit accrual in all future plan years complies with the 133 1/3% rule after application of the aggregation regulation - because benefits are not then determined under more than one plan formula.

F. Count Six States a Claim.

Plaintiffs allege that Duke was a fiduciary under ERISA and that it failed to provide accurate and truthful information to plan participants, misled plan participants, and acted negligently. Duke argues that Plaintiffs failed to plead detrimental reliance, which it contends is a necessary element of their claim. (*See* Def. Br. p. 38). Duke misapprehends the import of Plaintiffs' claim.

ERISA § 204(h), 29 U.S.C. § 1054(h), as worded in 1997, mandates under the provision "Notice of significant reduction in benefit accrual:"

> A plan . . . may not be amended so as to provide for a significant reduction in the rate of future benefit accrual, unless, after adoption of the plan amendment and not less that 15 days before the effective date of the plan amendment, the plan administrator provides a written notice, setting forth the plan amendment and its effective date, to (A) each participant in the plan . . .

The function of § 204(h) Notice, as indicated by its title, "Notice of significant reduction in benefit accruals," was to *warn* plan participants of a future reduction in benefits at least fifteen days before it becomes effective. The "full import of the interaction" between an existing plan and an amendment altering the computation of benefits must be explained in an SPD, or else the disclosure does not comply with ERISA. *Chambless v. Masters, Mates & Pilots Pension Plan*, 772 F.2d 1032, 1040 (2d Cir. 1985). ERISA, thus, requires that material modifications, including amendments that reduce benefits, be understandably disclosed to participants. *See* 29 C.F.R. §§ 2520.102-2(b), 2520.102-3(1) and

2520.104b-3. Plaintiffs' Complaint can reasonably be read to allege that Plan Participants were not provided adequate notice pursuant to § 204(h). Other courts have held that Plaintiffs state claims where they allege inadequate disclosure of the detrimental effects of a cash balance conversion. *Richards*, 427 F. Supp. 2d at 172-73 (finding that ERISA required disclosure of the full import of a cash balance conversion, particularly wear-away).

Further, detrimental reliance relating to a faulty plan description is not required under Fourth Circuit authority. In *Aiken v. Policy Management Sys. Corp.*, 13 F.3d 138, 141 (4th Cir. 1993), the Fourth Circuit held that "[t]o secure relief, [the claimant] must show some significant reliance upon, or possible prejudice flowing from, the faulty plan description." (quoting *Govoni*, 732 F.2d at 252 (emphasis added)). The Plaintiffs, thus, need only show reliance ***or*** prejudice.[32]

The Complaint asserts that employees were prejudiced by the plan conversion because they had put in years of work based on the company's promises related to the retirement benefit and then were dealt a benefit cut once they were too old to take corrective action to protect themselves. This allegation of prejudice suffices under notice pleading. (Complaint ¶ 52).

Duke had a fiduciary duty to speak truthfully regarding changes to the benefits, and the Complaint alleges Duke violated this duty. *See Mullins v. Pfizer*, 23 F.3d 663, 668 (2nd Cir. 1994) (noting fiduciary duty "not to affirmatively mislead participants."); *Flanagan v. GE*, 242 F.3d 78, 84-85 (2nd Cir. 2001) ("Communicating information about future plan benefits is indeed a fiduciary obligation."); *Burke v. Kodak Retirement Income Plan*, 336 F.3d 103, 112-13 (2nd Cir. 2003) (finding plan participants state claim without proving individual reliance if they show likely prejudice), *cert den.* 540 U.S. 1104 (2004); *Frommert v. Conkright*, 433 F.3d 254, 266 (2nd Cir. 2006) (finding harm based on material omissions

[32] The Court noted how "the reliance or prejudice test" was a "disjunctive test." *Aiken*, 13 F.3d at 141.

where plan participants were deprived of the opportunity to take timely action in response to the purported amendment such as by seeking injunctive relief, altering retirement investment strategies, or perhaps considering other employment). The failure in a cash balance context to adequately disclose negative effects such as wear away may be "significant enough to establish a presumption of likely prejudice, common to all members of the class." *Richards*, 2006 WL 860674 *4; *see also, In re Citigroup*, 241 F.R.D. 172, 179 (S.D.N.Y. 2006) and *In re Citigroup*, 470 F. Supp. 2d at 335-40 (S.D.N.Y. 2006) (finding Citigroup's ERISA notices insufficient to notify employees of cash balance conversion).

While Duke cites to *Elmore v. Cone Mills*, 23 F.3d 855, 863 n.8 (4th Cir. 1994), relating to detrimental reliance for an ERISA breach of fiduciary duty, the reliance or prejudice standard is the appropriate one to apply under the facts stated herein. Plaintiffs' pleading sufficiently states prejudice; thus, judgment on the pleadings is not proper.

Duke further contends that the claim should be dismissed because it seeks relief that is not available. For a breach of fiduciary duty claim, ERISA allows equitable relief, but not money damages. Plaintiffs have pled that they are entitled to equitable relief as a result of Duke's breach of fiduciary duty. Plaintiffs seek relief in the form of declaratory relief, reformation of the plan, and restitution to plan participants, all of which sound in equity. (Complaint ¶ 117 and *see* Prayer for Relief). The Supreme Court has limited the "other equitable relief" available under Section 502(a)(3) for breach of fiduciary duty claims to forms of relief that were "typically available in equity" in the time of the divided bench, so that legal damages are excluded. *Mertens v. Hewitt Assocs.*, 508 U.S. 248, 256 (1993). The Supreme Court has further explained that in determining whether relief sought is equitable, courts must focus not on "the substance of the relief requested" but on "the conditions that equity attached to its provision."

Great-West Life & Annuity Ins. Co. v. Knudson, 534 U.S. 204, 210 (2002).

Here, the remedies sought by Plaintiffs are typically available in equity. A declaratory judgment is a procedural mechanism by which this Court may properly grant equitable and injunctive relief in due course. Such relief is expressly provided for by ERISA § 502(a)(3), which authorizes a cause of action for injunctive or other appropriate equitable relief. 29 U.S.C. § 1132(a)(3). The relief Plaintiffs seek is, thus, squarely within the relief by Section 502(a)(3).

This case is not on all fours with *Great West Life*, in which the plaintiff sought an injunction compelling the defendant to pay to plaintiff the sum of $411,157.11 under the subrogation clause of an insurance policy. 534 U.S. at 208. The Supreme Court rejected the plaintiff's characterization of this request as one for equitable relief because "an injunction to compel the payment of money past due under a contract, or specific performance of a past due monetary obligation, was not typically available in equity." *Id.* at 210-11. In contrast, Plaintiffs here seek restoration and reformation of their pension benefits to the level which ERISA requires. This is distinct from a simple request for an order to pay money to Plaintiffs.

If Duke's theory were correct, every form of equitable relief that might potentially result in some economic cost would lose its character as an equitable remedy. But Duke's theory is not correct: Congress expressly authorized injunctive relief under Section 502(a)(3). Indeed, "any equitable relief, including those forms explicated by the Court as available under § 502(a)(3), must involve the direct or indirect transfer of money, and we cannot read the statute to proscribe all forms of relief." *Admin. Comm. of Wal-Mart Assocs. Health & Welfare Plan v. Willard*, 393 F.3d 1119, 1125 (10th Cir. 2004). Thus, courts have frequently granted relief analogous to what Plaintiffs seek. *See Howe v. Varity Corp.*, 36 F.3d 746, 754-56 (8th Cir. 1994) (section 502(a)(3) entitled the plaintiffs "to an injunction reinstating them

as members of [their original employer's] Welfare Benefits Plan under the terms of that plan as it existed at the time of retirement.") *aff'd,* 516 U.S. at 489 (1996); *Beck v. Levering*, 947 F.2d 639, 641 (2d Cir. 1991) ("To deny the power in federal courts to issue permanent injunctions [under ERISA] would . . . fly in the face of both precedent, Congressional intent, and common sense.").

Furthermore, the reformation Plaintiffs seek is an "appropriate equitable relief" under Section 502(a)(3). *See Ross v. Rail Car Am. Group Disability Income Plan*, 285 F.3d 735, 741 (8th Cir. 2002) (holding Section 502(a)(3) authorized suit for declaration that plan amendments were not validly adopted; if participant succeeded, invalidation of amendments would create claim for benefits); *Stephen Allen Lynn, P.C. Employee Profit Sharing Plan & Trust v. Stephen Allen Lynn, P.C.*, 25 F.3d 280 (5th Cir. 1994) (holding beneficiary could pursue claim that pension plan amendments prohibiting distributions before normal retirement age were invalid). Plaintiffs' prayer for reformation cannot be characterized as one seeking a remedy at law.

Likewise, Plaintiffs' request for recalculation via an independent auditor – i.e., an accounting – is equitable. An accounting stops unjust enrichment by reaching money owed by a fiduciary or other wrongdoer, including profits produced by property which in equity and good conscience belonged to the plaintiff. Courts have not hesitated to award this remedy. *See Parke v. First Reliance Standard Life Ins. Co.*, 368 F.3d 999 (8th Cir. 2004) (holding interest on delayed benefits available via accounting for profits); *Dunnigan v. Metropolitan Life Ins. Co.*, 214 F.R.D. 125 (S.D.N.Y. 2003) ("Great West has no bearing on the holding [of the Second Circuit in the same case] because the relief Dunnigan seeks – an accounting of MetLife's profits made on withheld disability benefits – is a form of relief typically available in equity . . . and is clearly distinguishable from the legal relief barred by Great West.") (citations omitted).

Duke's reliance on *Rego v. Westvaco Corp.*, 319 F.3d 140 (4th Cir. 2003), is misplaced. In *Rego*, a plan participant sought to recover from his employer about $80,000, as a remedy for an alleged breach of fiduciary duty in connection with a retirement plan. *Id.* at 144-45. Because the participant's losses from the alleged breach totaled only about $24,500, the Fourth Circuit easily concluded that this remedy was not equitable because "it is obvious on the face of the complaint that Rego is not actually trying to make himself whole." *Id*. at 146. In this case, Plaintiffs do not seek any relief other than that necessary to make them whole for Duke's breaches.

Duke further contends that to the extent the breach of fiduciary of duty claim is based upon underlying benefit miscalculations, it requires exhaustion of administrative remedies. To the extent the Court agrees with this contention, the Plaintiffs show the Court that they have adequately exhausted administrative remedies, and in the alternative, exhaustion should be waived, for the reasons stated in their Reply Brief in support of Class Certification.

Duke further contends the Count should be dismissed because it goes toward "settlor" conduct in the designing plan, not subject to ERISA's fiduciary duties. Duke contends the claim relates to Duke's adherence to the plan terms it designed, and an attack on adherence to those terms attacks settlor conduct in designing the plan. However, the allegations are not wholly based on plan design but on lack of adherence to plan terms. For instance, the Complaint alleges the company repeatedly amended the plan to conform with its actual practice in calculating interest, however issued no refunds or credits to accounts to reflect the variant plan language over the period of nonconformity. (Complaint ¶¶ 72-75). The Complaint also describes Duke's actions in calculating lump sum distributions by using improper interest rates in violation of the plan's stated terms. (Complaint ¶ 82). These actions reach further than mere "settlor" conduct. Accordingly the Count is well-pled.

V. CONCLUSION.

Defendants' motion for judgment on the pleadings should be denied.

Respectfully submitted this the 9th day of July, 2007 by:

s/James R. Gilreath
James Robinson Gilreath
William Mitchell Hogan
THE GILREATH LAW FIRM
P.O. Box 2147
Greenville, S.C. 29602
864-242-4727
864-232-4395 (fax)
jim@gilreathlaw.com
bhogan@gilreathlaw.com

Charles W. Whetstone, Jr
Thad Lee Myers
Cheryl F Perkins
J. C. Nicholson, III
WHETSTONE MYERS PERKINS
& YOUNG LLC
601 Devine Street
P. O. Box 8086 (29202)
Columbia, S.C. 29201
803-799-9400
803-799-2017 (fax)
cwhetstone@attorneyssc.com
tmyers@attorneyssc.com
cperkins@attorneyssc.com
jnicholson@attorneyssc.com

Mona Lisa Wallace, Esq.
Attorney for Plaintiffs,
WALLACE AND GRAHAM, P.A.
525 North Main Street
Salisbury, N.C. 28144
(800) 849-5291 (phone)
(704) 633-9424 (fax)
mwallace@wallacegraham.com

Terry Edward Richardson, Jr.
Andrew Hoyt Rowell, III
Thomas Christopher Tuck

Robert S. Wood
RICHARDSON PATRICK WESTBROOK
& BRICKMAN
P.O. Box 1368
Barnwell, S.C. 29812
803-541-7850
803-541-9625 (fax)
trichardson@rpwb.com
hrowell@rpwb.com
ctuck@rpwb.com
bwood@rpwb.com

Wallace K. Lightsey
Carl Frederick Muller
WYCHE BURGESS FREEMAN
& PARHAM
P.O. Box 728
Greenville, S.C. 29602
864-242-8200
864-242-8324 (fax)
wlightsey@wyche.com
cmuller@wyche.com

ATTORNEYS FOR PLAINTIFFS

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Greenville, SC