No. 06-___

In the Supreme Court of the United States

XEROX CORPORATION RETIREMENT INCOME GUARANTEE PLAN, ET AL., PETITIONERS,

v.

WALDAMAR MILLER, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

To ensure that an employee receives a minimum level of retirement income, many pension plans coordinate the benefits they provide at retirement with benefits available to the employee from other sources. Coordination typically is accomplished by offsetting the employee's pension benefit by the benefits from the other sources, including benefits the employee receives from the other sources before retirement. The question presented is:

Whether ERISA permits a pension plan, when calculating an employee's accrued pension benefit at retirement, to apply an offset for the benefits the employee receives before retirement from other sources by valuing those benefits in the same way as benefits due at retirement, thus ensuring that employees who receive distributions before retirement from other sources are treated no better than employees who do not receive such distributions.

The Second Circuit has said yes, and the Ninth Circuit has said no, in two cases involving the same nationwide pension plan.

PARTIES TO THE PROCEEDING

The Xerox Corporation Retirement Income Guarantee Plan; Xerox Corporation; and Lawrence M. Becker, as incumbent Plan Administrator of the Xerox Corporation Retirement Income Guarantee Plan, are the petitioners in this Court and were the appellees in the court of appeals.[†]

Waldamar Miller; Thomas H. Sudduth, Jr.; and J. Denton Allen are the respondents in this Court and were the appellants in the court of appeals.

RULE 29.6 STATEMENT

Xerox Corporation has no corporate parent. No publicly held company owns 10 percent or more of Xerox Corporation's stock.

[†] Patricia Nazemetz, former Plan Administrator of the Xerox Corporation Retirement Income Guarantee Plan, appeared as a defendant and appellee in the proceedings in the district court and court of appeals.

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The amended opinion of the court of appeals (App. 1a) is reported at 464 F.3d 871 (9th Cir. 2006). The original opinion of the court of appeals (App. 13a) is reported at 447 F.3d 728 (9th Cir. 2006). The district court's opinion (App. 25a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on May 8, 2006. A petition for rehearing was denied on September 16, 2006. (App. 40a.) The court of appeals' amended judgment was entered on September 13, 2006. On December 4, 2006, Justice Kennedy extended the time within which to file a petition for a writ of certiorari to and including January 11, 2007. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Sections 3(19), 3(22), 3(23), 3(34), 3(35), 203, and 204 of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. §§ 1002(19), 1002(22), 1002(23), 1002(24), 1002(34), 1002(35), 1053, and 1054, are reproduced in the separate appendix to this petition.

STATEMENT

The petition should be granted to resolve a circuit conflict on an important question of ERISA law affecting pension plans nationwide: Does ERISA require an offset for a prior distribution of retirement benefits to be calculated using interest and other assumptions in effect at the time the prior distribution was made to the exclusion of all other methods? Offsets for prior distributions permeate the pension system, and most pension plans, including the Xerox Retirement Income Guarantee Plan ("the Xerox Plan" or "the Plan"), do not calculate the offsets in this way. For example, the Xerox Plan calculates the offset taking into account subsequent changes in investment returns and interest rates to ensure that employees who receive benefits before retirement are treated the same as employees who receive their benefits at retirement. The Second Circuit has held that ERISA permits the Xerox Plan to calculate the offset for prior distributions in this manner. *Frommert* v. *Conkright*, 433 F.3d 254 (2d Cir. 2006). In this case, the Ninth Circuit has held that ERISA does *not* permit the Xerox Plan to calculate the offset in this manner. As a result, a nationwide pension plan covering 40,000 employees and retirees is lawful in one circuit and unlawful in another, and the lawfulness of numerous other pension plans is called into question. Such a conflict is intolerable, and only this Court can resolve it.

1. Many pension plans coordinate the benefits they provide with benefits available to the employee from other employer-funded sources, such as the employer-funded portion of Social Security, see, *e.g.*, *Alessi* v. *Raybestos-Manhattan, Inc.*, 451 U.S. 504, 514-15 (1981), or another ERISA plan sponsored by the same or a related employer, see, *e.g.*, *Williams* v. *Caterpillar, Inc.*, 944 F.2d 658, 661-66 (9th Cir. 1991). Coordinating benefits guarantees that the employee receives a minimum level of retirement income when that income is derived from more than one source. Coordination typically is accomplished by applying an offset, so that the formula for determining the employee's accrued pension benefit includes a reduction, or "offset," for the benefit available from the other source.

When the employee has received a benefit distribution from the other source *before* retirement, the offset in the pension plan almost always takes into account the prior distribution and adjusts it to reflect its value at the time of retirement. Otherwise, employees who receive prior distributions would enjoy a benefit from the other source but not have it reflected in the offset to their pension benefit. If this were permitted, employees who receive benefit distributions before retirement would enjoy greater total benefits than employees who receive all their benefit distributions at retirement. For this reason, pension plans commonly include offsets for prior distributions and, for some purposes, are required to do so.[1]

One common way to coordinate benefits is through a "floor-offset" arrangement. Under a floor-offset arrangement, an employee's pension benefit is coordinated with the benefit provided by a separate defined contribution account funded by the employer. A defined contribution account provides an employee with a retirement benefit based solely on the contributions and forfeitures allocated to the account and the investment returns on those amounts. ERISA § 3(34) & (23)(B), 29 U.S.C. § 1002(34) & (23)(B). Because investment returns are subject to market fluctuation, a defined contribution account cannot guarantee a minimum level of retirement income. A defined benefit pension, by contrast, can guarantee a retirement benefit that is specified by the terms of the plan. ERISA § 3(35) & (23)(A), 29 U.S.C. § 1002(35) & (23)(A). By coordinating an employee's pension benefit with the benefit provided by a defined contribution account, floor-offset arrangements offer employees the best of both worlds—the upside investment potential of a defined contribution account *and* a minimum level of retirement income guaranteed by the defined benefit pension.

In a floor-offset arrangement, the employee's accrued pension benefit is defined as the minimum benefit guaranteed under the arrangement (usually expressed as a function of the employee's pay and service) offset by the benefit provided by the employee's defined contribution account (including the benefit that would have been pro-

[1] See, *e.g.,* Rev. Rul. 76-259, 1976-2 C.B. 111 (App. 96a-98a) (offset for benefits provided under another ERISA plan required to include offset for prior distributions from the other plan); see also, *e.g.*, 26 C.F.R. § 1.401(a)(4)-3(f)(7) (requiring prior distributions to be taken into account in testing pension benefits for tax-qualification purposes); Prop. Treas. Reg. § 1.415(b)-2, 70 Fed. Reg. 31,213 (May 31, 2005) (same).

vided by any prior distributions from the account). Under the arrangement, an employee always receives the balance remaining in the account at retirement. If the balance, together with any prior distributions from the account, are sufficient to provide the guaranteed minimum benefit, the employee receives no benefit from the defined benefit pension side of the arrangement. If the balance and any prior distributions are not sufficient, the defined benefit pension steps in and makes up the difference.

Floor-offset arrangements use a variety of actuarial methods to calculate the benefit that would have been provided at retirement by any prior distributions from the account. Some do so by assuming the prior distribution remained in the account until retirement earning the same investment return as the accounts of other employees who wait until retirement to receive their distributions, and by then converting the accumulated balance at retirement into an actuarially equivalent pension benefit. Other arrangements skip this intermediate step and convert the prior distribution directly into an actuarially equivalent pension benefit. To determine actuarial equivalence, different floor-offset arrangements use different interest and mortality assumptions. For example, some use fixed interest and mortality assumptions, while others use variable assumptions in effect at differing times, such as when the employee's pension benefit begins, when the employee attains retirement age, or when the prior distribution occurred. The variety of methods used by floor-offset arrangements to calculate offsets for prior distributions parallels the variety of methods used for the same purpose by other plans that coordinate pension benefits with other sources of retirement income.

The IRS approved floor-offset arrangements in Revenue Ruling 76-259, 1976-2 C.B. 111 (App. 96a-98a). See *Lunn* v. *Montgomery Ward & Co.*, 166 F.3d 880, 881 (7th Cir. 1999). Because the revenue ruling applies for both tax-qualification and ERISA-compliance purposes, see *id.*, floor-offset arrangements have been structured to comply with the ruling ever since. Under the ruling, an employee's accrued pension benefit must include an offset for the benefit provided by the employee's defined contribution account, including the benefit that would have been provided by any prior distributions from the account. While the plan must state the actuarial basis it will use to calculate the benefit that would have been provided by any such prior distributions, the ruling does not prescribe any specific method for making that calculation.

2. The Xerox Retirement Income Guarantee Plan is a floor-offset arrangement. Under the arrangement, the employee always receives the balance in his or her defined contribution account. If the balance and any prior distributions from the account fall short of providing the Plan's guaranteed minimum benefit, the employee's defined benefit pension steps in and makes up the shortfall. Consistent with Revenue Ruling 76-259, the employee's accrued pension benefit is determined by applying an offset that includes the benefit that would have been provided by any prior distributions the employee received from the account. To calculate the offset, the Plan uses the first method described above, that is, it (1) assumes that the prior distribution remained in the account until retirement earning the same investment return as the accounts of other employees who wait until retirement to receive their distributions, and then (2) converts the accumulated balance at retirement into an actuarially equivalent pension benefit. To determine actuarial equivalence, the Plan uses variable interest and mortality assumptions in effect at the time the employee's pension benefit begins.

3. Each Respondent is a current or former employee of Xerox and a current or former participant in the Plan. Each left his job at Xerox in 1983, received a distribution of his entire retirement benefit at that time, and later resumed his employment with Xerox. The distribution each Respondent received when he left Xerox in 1983 was paid from his defined contribution account. In each case, the

benefit provided by the defined contribution account exceeded the minimum retirement benefit guaranteed to the Respondent based on his pay and service at that time. As a result, none of the Respondents received any payment from the defined benefit pension side of the Xerox floor-offset arrangement.

Each Respondent was rehired by Xerox between 1987 and 1989. Upon rehire, each Respondent received credit for his prior pay and service with Xerox for purposes of calculating the minimum benefit guaranteed under the Plan. Thereafter, each Respondent's guaranteed minimum benefit grew as he accumulated additional pay and service with Xerox. When Xerox was asked to calculate the benefit to which each Respondent was entitled under the Plan in 1998, the plan administrator first calculated the Respondent's guaranteed minimum benefit based on all pay and service with Xerox – including pay and service before 1983. The plan administrator then applied an offset that included the benefit that would have been provided by the prior distribution the Respondent received from his defined contribution account in 1983. This time, the minimum retirement benefit slightly exceeded the benefit provided by each Respondent's defined contribution account (including the benefit attributable to the prior distribution). Each Respondent was informed that he would receive a benefit from the defined benefit pension side of the Xerox floor-offset arrangement, but that the benefit would be relatively small.

4. Contending that the Plan's method for calculating the offset for prior distributions short-changed them, Respondents brought this action in the United States District Court for Central District of California under 29 U.S.C. § 1132. Respondents claimed, *inter alia*, that the Plan's method of calculating the offset for prior distributions results in a forfeiture of their accrued pension benefits in violation of ERISA § 203(a), 29 U.S.C. § 1053(a); that Revenue Ruling 76-259 is inconsistent with ERISA to the extent it purports to authorize the Plan's floor-offset

arrangement; and that the Plan's disclosure of the offset had been inadequate. In a detailed opinion, the district court rejected Respondents' claims. (App. 33a-38a.)

5. The Ninth Circuit reversed, holding that the Plan's method of calculating the offset for prior distributions violates "the substantive requirements of ERISA." (App. 17a.) In the court's view, ERISA prohibits the offset for prior distributions in a floor-offset arrangement from exceeding the minimum benefit guaranteed the employee at the time of the prior distribution, even if the prior distribution would have provided the employee a larger benefit at retirement. (App. 19a-23a.) Under the court's opinion, the only way to calculate the offset for prior distributions in a floor-offset arrangement is to set the offset equal to the lesser of (1) the minimum benefit guaranteed the employee at the time of the prior distribution, or (2) the benefit the prior distribution would have provided the employee at retirement.

Petitioners sought rehearing, contending that the court's decision conflicted with its own previous decision in another case rejecting an identical challenge to the Xerox Plan, *Hammond* v. *Xerox Corp. Ret. Income Guar. Plan*, 225 F.3d 662 (9th Cir. 2000) (mem.), with this Court's decision in *Alessi,* and with decisions of other courts of appeal, and effectively invalidated all floor-offset arrangements nationwide. The court denied rehearing but issued an amended opinion.

In contrast to its original opinion, the amended opinion held that ERISA permits the offset for prior distributions in a floor-offset arrangement to equal the benefit the prior distribution would have provided the employee at retirement. (App. 8a.) However, the court still found that the Plan's method of calculating the offset violates ERISA. (App. 5a.) The court reached this conclusion because it found that ERISA requires a defined benefit pension plan to calculate an offset for a prior distribution as the "actuarial equivalent" of the prior distribution using solely interest, mortality, and other assumptions in effect at the time the prior distribution was paid. (App. 8a-10a.) Any other method using any other assumptions does not yield an actuarially equivalent result and therefore violates ERISA. (*Id.*) The court found that this requirement applies to all defined benefit pension plans, whether they are part of a floor-offset arrangement or not. (App. 10a.) In the court's view, the Xerox Plan failed this requirement because it calculated the offset "based on later developments," including investment returns and other factors in effect after the prior distribution was paid. (App. 10a.)

REASONS FOR GRANTING THE WRIT

Review should be granted because the Ninth Circuit's decision directly conflicts with the decision of the Second Circuit in *Frommert* v. *Conkright*, 433 F.3d 254 (2d Cir. 2006), placing the Xerox Plan in an untenable position – lawful in one circuit, unlawful in another, frustrating Congress's goal of "uniform national treatment of pension benefits." *Patterson* v. *Shumate*, 504 U.S. 753, 765 (1992). Review should also be granted because the Ninth Circuit's decision poses a question of national importance: Offsets for prior distributions permeate the pension system, and most pension plans do not calculate the offsets in the manner prescribed by the Ninth Circuit. Thus, numerous other pension plans nationwide will be placed in the same untenable position as the Xerox Plan. Finally, review should be granted because the decision below is based on an unfounded interpretation of ERISA.

1. Review should be granted to resolve the conflict between the Ninth Circuit and the Second Circuit with respect to the lawfulness of the Xerox Plan's offset for prior distributions. That conflict places Petitioners and the sponsors of numerous other pension plans in an untenable position with regard to plan administration that only this Court can resolve.

In *Frommert*, the Second Circuit held that ERISA permits the method of determining the offset for prior distributions that the Ninth Circuit has held ERISA prohibits. The *Frommert* plaintiffs were another group of Xerox employees who, like Respondents, left the company and later were rehired. Those plaintiffs claimed, *inter alia*, that the Xerox Plan had not properly disclosed the offset for prior distributions and that the offset caused a forfeiture in violation of ERISA § 203(a)(2), 29 U.S.C. § 1053(a)(2). The district court rejected both claims, granted summary judgment in favor of Xerox, and dismissed the action. *Frommert* v. *Conkright*, 328 F. Supp. 2d 420, 429, 432-37, 438 (W.D.N.Y. 2004). Citing *Alessi* and another district court decision rejecting essentially the same challenge to the offset, *Hammond* v. *Xerox Corp. Retirement Income Guaranty Plan*, No. CV 2:97-8349, 1999 WL 33915859 (C.D. Cal. Apr. 8, 1999), *aff'd*, 225 F.3d 662 (9th Cir. 2000) (mem.), the district court stated:

> This claim is little more than a restatement of plaintiffs' other claims, inasmuch as it, too, is premised on plaintiffs' allegation that defendants wrongfully applied the [so-called] phantom account offset when calculating plaintiffs' benefits. As explained, this did not reduce plaintiffs' accrued benefits, and no forfeiture occurred. See *Alessi* v. *Raybestos-Manhattan, Inc.*, 451 U.S. 504, 512-17 (1981) (ERISA's nonforfeiture provisions did not prohibit offset of pension benefits by workers' compensation awards; "the statutory definition of 'nonforfeitable' assures that an employee's claim to the protected benefit is legally enforceable, but it does not guarantee a particular amount or a method for calculating the benefit"); *Hammond*, [1999 WL 33915859, at *14] ("Although *Alessi* dealt with the question of whether benefits derived from sources external to the pension plan could be offset against amounts owed under the plan, its basic observations are even more compelling where previously distributed benefits under the plan itself are offset"). The purpose, and effect, of the offset is not to take away an earned

> benefit, but only to prevent a windfall to participants, which is exactly what would happen if prior distributions were ignored. *Hammond*, [*id.* at *11].

Frommert, 328 F. Supp. 2d at 438.

On appeal, the Second Circuit vacated the district court's judgments, "except as to the anti-forfeiture claim under § 203(a)(2) and an injunction under § 502(a)(3), which we affirm." 433 F.3d at 273. Although the court held that Xerox had not sufficiently disclosed the offset to pre-1998 rehires, *id.* at 266-68, and therefore could not lawfully apply the offset to those rehires, *id.* at 268, the court also held that the offset "may permissibly be applied" to employees rehired after adequate disclosure was made, *id.* at 263, 269, because "these rehired employees, unlike their predecessors who lacked such information, had the opportunity to make an informed decision about the terms of the deal offered to them under the Plan," *id.* at 269.

Thus, the Second Circuit has ruled that ERISA permits the Xerox Plan, with proper disclosure, to apply the offset for a prior distribution calculated as if that distribution had not been made until retirement – just what the Ninth Circuit held ERISA forbids. This conflict places the Xerox Plan Admininistrator, and the administrators of other pension plans that also apply offsets for prior distrbutions, in an impossible position. Under ERISA § 404(a)(1), 29 U.S.C. § 1104(a)(1), the Xerox Plan Administrator must apply the Plan's offset if the Second Circuit's ruling is correct; but the Plan Administrator may *not* apply the Plan's offset if the Ninth Circuit's ruling is correct. Only this Court can resolve the conflict.

2. Review should also be granted because the Ninth Circuit's decision has far-reaching implications for the nation's pension system. The court's decision is not limited to the calculation of benefits in floor-offset arrangements but reflects the court's view of what ERISA re-

quries of any defined benefit pension when it calculates an offset for a prior distribution. (App. 10a.) Thus, the Ninth Circuit's decision affects the calculation of accrued pension benefits under a myriad of pension offset arrangements, such as plans that apply offsets for Social Security benefits, benefits provided by another pension plan, workers' compensation payments, commissions paid after retirement, and severance benefits, along with simple offsets for prior distributions from the same plan. (See pp. 14-15, *infra.*) Indeed, a regulation recently proposed by the Treasury Department would require *all* defined benefit pension plans to calculate offsets for prior distributions in a manner that cannot be reconciled with the Ninth Circuit's ruling. (See note 3, *infra.*)

Nor is the effect of the Ninth Circuit's decision limited to the Ninth Circuit. An employer cannot create a separate plan for each federal judicial circuit; in an economy with a workforce as mobile as ours, such a system is unworkable. Even if employers could create a separate plan tailored to the law of each circuit, such a result would frustrate Congress's goal of "uniform national treatment of pension benefits," *Patterson*, 504 U.S. at 765. Either way, the Ninth Circuit's decision affects pension plans nationwide.

3. Finally, review should be granted because the Ninth Circuit's decision is wrong. First, there is no basis in ERISA or its implementing regulations for the court's holding that offsets for prior distributions may be calculated only in the manner presecribed by the court. Second, the court's holding that ERISA permits offsets to be calculated only in the manner prescribed by the court is inconsistent with the broad latitude that this Court has recognized ERISA affords plan sponsors, and on which plan sponsors have relied, to design their pension plans. Third, the Ninth Circuit's decision invalidates sound methods for calculating offsets and irrationally discriminates among employees based on when they receive retirement benefits.

a. The Ninth Circuit's construction of ERISA finds no support in the text of the statute or its implementing regulations.

ERISA § 203(a) forbids the forfeiture of accrued benefits, and ERISA § 204(c)(3) requires that, when an accrued benefit is paid in a form other than a normal retirement annuity, the payment must be actuarially equivalent to the employee's normal retirement annuity. 29 U.S.C. §§ 1053(a), 1054(c)(3). This requirement ensures that an employee is not short-changed when receiving the benefit that the employee has accrued in a form that is different than the form in which the benefit has been promised. But neither of these rules requires a plan to provide a particular level of benefits or to calculate benefits in a specific way. As the Court stated in *Alessi*, the statute "does not guarantee a particular amount or a method for calculating the benefit" that an employee may accrue. 451 U.S. at 511-12; *see also* ERISA § 3(23)(A), 29 U.S.C. § 1002(23) (App. 42a-43a) (defining "accrued benefit" in a defined benefit plan as "the individual's accrued benefit *determined under the plan*") (emphasis added).

The Ninth Circuit, however, imposed a three-step limitation on the use of offsets in determining accrued benefits: (1) In a defined benefit plan that coordinates benefits with the benefits provided from other sources, an employee's "accrued benefit" must be the minimum guaranteed benefit, as though there were no benefits paid from another source; (2) the offset for benefits from another source therefore results in a forfeiture of an employee's accrued benefit, unless the offset satisfies the actuarial equivalence rule; and (3) the actuarial equivalence rule is satisfied only if the offset is equal to the actuarial equivalent of the benefit provided by the other source, determined based on interest rates and other assumptions in effect at the time the other benefits are paid. (App. 7a-9a.)

To reach this result, the Ninth Circuit relied on a Treasury regulation, which permits a plan to apply an offset for prior distributions from the same plan, but does not specify how that offset should be calculated. (App. 7a (citing 26 C.F.R. § 1.411(a)-7(d)(6).[2]) Furthermore, the same regulation allows pension plans to value a prior distribution for a related purpose in a different way. When an employee leaves and receives a distribution of a portion of his or her benefit but is later rehired, a pension plan may condition credit for prior service on repayment of the value of the prior distribution. The regulation permits the plan to determine the value of the prior distribution using interest rates in effect at the time of the repayment, rather than the time of the prior distribution. See *id.* § 1.411(a)-7(d)(2)(ii)(B) & (d)(4)(iv)(C) (App. 85a, 91a). The Treasury Department therefore permits a method for valuing a prior distribution that the Ninth Circuit concluded would not be actuarially equivalent and thus forbidden *by the same regulation*.[3]

b. Absent a statutory limitation on the calculation of offsets for benefits from other sources, the general rule for

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[2] 26 C.F.R. § 1.411(a)-7(d) ("Rules relating to certain distributions and cash-outs of accrued benefits") (App. 84a-95a). It is doubtful this regulation even applies to Respondents' situation. The regulation addresses the forfeiture of the portion of an employee's accrued benefit that remains in a plan when an employee terminates employment, receives less than the entire accrued benefit, and later returns to employment. *See* 26 C.F.R. § 1.411(a)-7(d)(4)(iv)(A)(1) (App. 90a). No portion of any Respondents' accrued benefit remained in the Xerox Plan after they first left Xerox.

[3] See also Prop. Treas. Reg. 1.415(b)-2(b)(1)(ii)(B)(2), 70 Fed. Reg. 31,213, 31,238 (May 31, 2005) (proposed regulation implementing limit in 26 U.S.C. § 415(b) on defined benefit plan benefit would require consideration of participant's prior defined contribution account distributions, calculated in ways inconsistent with the Ninth Circuit's decision).

determining accrued benefits under ERISA applies. In *Alessi*, the Court construed ERISA to give employers wide latitude regarding offsets in accrued benefit calculations. The Court rejected a claim by retirees that a plan's offset for workers' compensation benefits resulted in an unlawful forfeiture of an accrued benefit. The Court explained that the "accrued benefit" under the plan was an amount remaining after – not before – the offset was taken into account; the offset did not result in a forfeiture because the offset was part of the formula used to calculate the accrued benefit in the first instance. 451 U.S. at 511-12.

> [W]hat defines the content of the benefit that, once vested, cannot be forfeited? ERISA leaves this question largely to the private parties creating the plan. That the private parties, not the Government, control the level of benefits is clear from the statutory language defining nonforfeitable rights as well as from other portions of ERISA.

Id.

Thus, ERISA sets some explicit "outer bounds on permissible accrual practices," *id.* at 512 – none of which apply in this case – but otherwise affords pension plans wide latitute in defining how the accrued benefit will be calculated. Although the Ninth Circuit acknowledged that offsets are permitted by ERISA after *Alessi*, its decision straightjackets plans when it comes to calculating the offsets. Since *Alessi*, other courts of appeals have found no such limitations on offsets. See*, e.g.*, *Brengettsy* v. *LTV Steel (Republic) Hourly Pension Pla*n, 241 F.3d 609, 610-12 (7th Cir. 2001) (addressing offset in floor-offset arrangement); *PPG Indus. Pension Plan A* v. *Crews*, 902 F.2d 1148, 1150-51 (4th Cir. 1990) (offset for workers' compensation benefits); *Bonovich* v. *Knights of Columbus*, 146 F.3d 57, 61-62 (2d Cir. 1998) (offset for sales agents' renewal commissions); *Vintilla* v. *U.S. Steel Corp. Plan for Employee Pension Benefits*, 606 F. Supp. 640, 642-44

(W.D. Pa. 1985) (offset for severance benefits), *aff'd mem.*, 782 F.2d 1033 (3d Cir. 1986) (table).

Discussion of one of those cases will illustrate that other courts of appeals have not imposed limits on offsets akin to the limitation imposed by the Ninth Circuit. In *Brengettsy*, the plaintiff argued that the offset for a distribution from his defined contribution account must be based upon the interest rate in effect at the time he received that distribution – a position consistent with the Ninth Circuit's rule. Citing *Alessi*, the Seventh Circuit rejected this argument, allowing the offset to be determined using interest rates in effect at another time. 241 F.3d at 610-12.

c. The Ninth Circuit's decision requires a method of calculating offsets for prior distributions that irrationally prohibits a plan from treating employees who receive benefits before retirement the same as employees who do not. When the IRS approved floor-offset arrangements in Revenue Ruling 76-259, the agency required that such plans must provide an offset for prior distributions. *See* 1976-2 C.B. 111 (App. 96a). The IRS did so to protect the integrity of the floor-offset arrangement. Otherwise, the size of an employee's benefit would vary depending on whether the employee received a distribution before retirement.[4]

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[4] The IRS ruling also states that the floor-offset plan "must specify the time as of which such determination [of the benefit that the prior distribution would have provided at retirement] is made (the determination date) in a manner which precludes discretion on the employer." Rev. Rul. 76-259 (App. 97a). The IRS does not require the plan to determine the offset as of any particular time; it merely requires that the "determination date" be specified so that the plan sponsor may not change it after benefits have been earned. The Ninth Circuit, on the other hand, ruled that ERISA requires that what is, in effect, the "de-

Under the Xerox Plan, the offset for a prior distribution is calculated by determining the value of the benefit that the distributed funds would have provided if they had remained in the employee's defined contribution account and were invested as the other employees' accounts were invested. Consistent with the IRS's goals, this method achieves equal treatment between participants who receive prior distributions and participants whose funds remain in the Plan until retirement.

The Ninth Circuit's decision requires a different result. Under its approach, the offset is determined using different actuarial factors, depending on when the employee receives a distribution from the other source of benefits. It is impossible to know, at the time a plan is designed, whether the Ninth Circuit's method or the Xerox method will favor or disfavor employees; the outcome depends on later events. What is known, however, is that the Xerox method places employees in the same position regardless of when they receive the distribution from the defined contribuiton account. In this case, economic circumstances since 1983 have allowed securities and other investments of the defined contribution plan to outpace 1983 interest rates, so valuing the offset by the benefit the distributed funds would have provided through such investment generates a larger offset (and thus a smaller defined benefit plan benefit at retirement) than the Ninth Circuit method.[5] If, however, economic circumstances between the times of a given employee's distribution and retirement are such that later investments lag initial interest rates, the Ninth

termination date" must always be the date of the prior distribution.

[5] It is because the outcome of the Xerox Plan's method is known, years after the prior distribution, to create a larger offset, that the Respondents have challenged it as creating a forfeiture.

Circuit method would increase offsets and lower retirement benefits. Indeed, although the Ninth Circuit seemed to conclude that only its method would ensure actual equivalence between the prior distribution and the benefit that would result at retirement, actual equivalence would occur only in the extremely unlikely situation in which the defined contribution plan's later investments exactly matched interest rates at the time of distribution.

Under ERISA, as construed by the Second Circuit, other courts, and the IRS, Xerox's method of calculating an offset would be among the permissible methods. The Ninth Circuit's decision that *only* a different method is permitted by ERISA creates a inter-circuit conflict that stymies the uniform application of this statute and hinders the operation of nationwide pension plans such as the Xerox Plan.

CONCLUSION

The petition should be granted.

Respectfully submitted,

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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

Nos. 04-55582, 04-55583

WALDAMAR MILLER; THOMAS H. SUDDUTH, JR.; J. DENTON ALLEN, INDIVIDUALS, PLAINTIFFS-APPELLANTS,

v.

XEROX CORPORATION RETIREMENT INCOME GUARANTEE PLAN, AN EMPLOYEE PENSION BENEFIT PLAN; XEROX CORPORATION, A NEW YORK CORPORATION; PATRICIA NAZEMETZ, AS PLAN ADMINISTRATOR OF THE XEROX CORPORATION RETIREMENT INCOME GUARANTEE PLAN, DEFENDANTS-APPELLEES.

Argued and Submitted: Dec. 9, 2005
Filed: May 8, 2006
Amended: Sept. 13, 2006

Appeal from the United States District Court for the Central District of California William Matthew Byrne, Senior Judge, Presiding. D.C. No. CV-98-10389-WMB, D.C. No. CV-99-02589-WMB.

Before: PREGERSON, NOONAN, and THOMAS, Circuit Judges.

AMENDED OPINION

THOMAS, Circuit Judge:

This appeal presents the question of whether a procedure used by Xerox Corporation ("Xerox") to reduce pension benefits at final retirement to account for earlier benefit distributions violates the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. § 1001 *et seq*. We conclude that Xerox's method violates ERISA, because it impermissibly reduces pension benefits by more than the accrued pension benefit attributable to the earlier distributions.

I

The facts of the case are undisputed. Plaintiffs Waldamar Miller, Thomas H. Sudduth, Jr., and J. Denton Allen ("the Employees"), all worked for Xerox for many years, received lump sum pension payouts when they left employment in 1983, and returned to work at the company several years later.

During their initial employment with Xerox, the Employees participated in two company retirement plans: the Xerox Retirement Income Guarantee Plan and the Xerox Profit Sharing Plan. The Income Guarantee Plan, a traditional defined benefit pension plan, provided participants with a certain percent of their salary in retirement for each year of service at Xerox, according to a specified formula ("Income Guarantee Plan formula benefit"). Under the Profit Sharing Plan, a defined contribution plan, each participant had an individual Retirement Account. The company made contributions to each employee's account, and the accounts were included in a fund invested and managed by the plan's trustees.

The two plans were linked in a "floor-offset" arrangement, under which the Income Guarantee Plan formula benefit served as the "floor" value of a retiree's pension benefits: each retiree would receive the value of his Retirement Account benefit, supplemented by the value of the Income Guarantee Plan formula benefit to the extent that it exceeded the Retirement Account benefit.

When each Employee left Xerox in 1983, he received a lump-sum payment from his Retirement Account. Because the distribution from the Retirement Account in each case exceeded the lump-sum present value of the Employee's accrued benefit under the Income Guarantee Plan formula benefit, no payment was made from the Income Guarantee Plan itself. Although each Employee returned to work at Xerox sometime between 1987 and 1989, none of the Employees has repaid any portion of his Retirement Account distribution into any Xerox plan, nor do the plans require or permit such a repayment.

In 1989, Xerox restated and consolidated the Income Guarantee Plan and the Profit Sharing Plan. The restatement amended the Income Guarantee Plan formula, eliminated the Profit Sharing Plan, and replaced the Profit Sharing Plan with two new accounts within the Income Guarantee Plan: the Cash Balance Retirement Account and the Transitional Retirement Account. The new Income Guarantee Plan formula was based on the participant's highest average pay multiplied by 1.4% and the member's years of service up to 30 years. The Cash Balance Retirement Account, a "cash balance" plan, used the participant's existing Retirement Account balance as the initial balance, and received annual credits from Xerox of 5% of the participant's salary, plus interest at a fixed annual rate equal to the twelve-month Treasury Bill rate plus 1%. The Transitional Retirement Account consisted of the Retirement Account balance alone, and received no further contributions, but could grow or shrink according to the investment performance of the funds in which the accounts were invested. Upon retirement, a participant received the largest of the three benefits – Income Guarantee Plan formula benefit, Cash Pension Retirement Account balance, or Transitional Retirement Account balance – in the form of an annuity.

For employees who had already received a distribution of pension benefits on a prior departure from the company, Xerox reduced final retirement benefits to account for the earlier distribution by using so-called "phantom accounts." Phantom accounts were calculated for the Cash Balance Retirement Account and the

Transitional Retirement Account, consisting of the actual distribution amount at the time of departure plus the increase or decrease that the distribution would have earned had it remained in each plan. Thus, for the Cash Balance Retirement Account, the phantom account was equal to the distribution amount plus interest at the rate specified in the plan. For the Transitional Retirement Account, the phantom account was the distribution amount plus the investment returns (or losses) of the fund in which that amount had been invested at distribution.

Under the amended Income Guarantee Plan, the relevant phantom account was added to the amount of each participant's benefit before the three benefit choices were compared. The participant was given the benefit that yielded the highest monthly payment (with the phantom accounts included), and the phantom account was then subtracted out to yield the actual benefit amount. If the Income Guarantee Plan benefit was the largest, the Transitional Retirement Account phantom account was subtracted.

In 1997 and 1998, each of the Employees requested a statement of the benefits that would be payable upon his retirement. Each of the statements Xerox provided applied the phantom account offset described above, to drastic effect: Sudduth's monthly benefit fell from \$1,679.23 to \$83.16, Allen's monthly benefit fell from \$2,059.44 to \$262.69, and 11225 Miller's monthly benefit fell from \$2,878.40 to \$554.51. The Employees challenged the phantom account offset, pursuing two levels of administrative appeals. Xerox rejected Miller and Sudduth's appeals by letter dated September 9, 1998, and rejected Allen's appeal by letter dated March 8, 1998.

Miller and Sudduth filed a complaint in the United States District Court for the Central District of California on December 23, 1998. Allen filed his complaint on March 12, 1999. The two cases were stayed in June 1999 pending resolution of the appeal in *Hammond* v. *Xerox Corp.*

Retirement Income Guarantee Plan, No. 97-8349, 1999 WL 33915859 (C.D. Cal. April 8, 1999), which raised different challenges to the 1989 plan amendments at issue here. After *Hammond* was affirmed in an unpublished decision, the Employees filed amended complaints in both actions. The parties then filed stipulated facts and exhibits. The two cases were formally consolidated on January 4, 2002, and a trial consisting of closing arguments was held on April 3, 2002.

The district court granted judgment for Xerox, holding that the "phantom account" mechanism did not violate ERISA. The court also found that Xerox's disclosure of the method had been inadequate in documents issued in 1993, but that the Employees were not entitled to any remedy for that deficient disclosure because they had neither relied on that disclosure nor been prejudiced by it. The Employees timely filed this appeal. Because this appeal presents only questions of law, our review is *de novo. Michael* v. *Riverside Cement Co. Pension Plan,* 266 F.3d 1023, 1026 (9th Cir. 2001).

II

Xerox's method of accounting for prior distributions in calculating the Employees' final retirement benefits violates the substantive requirements of ERISA. The Income Guarantee Plan phantom offset violates ERISA by overestimating the value of distributions made upon a previous separation from employment, and the corresponding reduction in benefits at retirement. ERISA requires actuarial equivalence between the actual distribution and the accrued benefit it replaces.

As a hybrid defined benefit plan with some features of a defined contribution plan,[1] the Income Guarantee Plan

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[1] ERISA defines a "defined benefit plan" as "a pension plan other than an individual account plan," but also permits hybrid plans. 29 U.S.C. § 1002(35). The Profit Sharing Plan was a de-

(both before and after amendment, and including the Cash Balance Retirement Account component) must satisfy the actuarial rules ERISA applies to defined benefit plans.[2] 29 U.S.C. § 1002(35). It is well settled that ERISA allows so-called "floor-offset" plans, in which the participant takes the greater of a defined benefit or a defined contribution benefit amount.[3] However, the defined benefit and defined contribution portions of a combined floor-offset plan must satisfy the ERISA requirements applicable to the respective types of plans.

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fined contribution plan, which ERISA defines as "a pension plan which provides 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, and any forfeitures of accounts of other participants which may be allocated to such participant's account." 29 U.S.C. § 1002(34).

[2] This statutory requirement is explicit, and reads as follows:

> [A] pension plan which is not an individual account plan and which provides a benefit derived from employer contributions which is based partly on the balance of the separate account of a participant – . . .
>
> (B) for the purposes of paragraph (23) of this section [defining accrued benefit] and section 1054 of this title[regulating benefit accrual], shall be treated as an individual account plan to the extent benefits are based upon the separate account of a participant and as a defined benefit plan with respect to the remaining portion of benefits under the plan.

29 U.S.C. § 1002(35).

[3] A pension plan participant's "accrued benefit" is, "in the case of a defined benefit plan, the individual's accrued benefit determined under the plan and, except as provided in [29 U.S.C. § 1054(c)(3)], expressed in the form of an annual benefit commencing at normal retirement age." 29 U.S.C. § 1002(23)(A). The normal form of this benefit is a joint and survivor annuity. 29 U.S.C. § 1055(a)(1). "[I]n the case of a plan which is an individual account plan," the accrued benefit is simply "the balance of the individual's account." 29 U.S.C. § 1002(23)(B).

Here, the distributions made to the Employees in 1983 were intended to satisfy Xerox's obligations under both the Profit Sharing Plan and the Income Guarantee Plan, although they were made solely from the Profit Sharing Plan, because the Profit Sharing Plan account balance exceeded the value of the Income Guarantee Plan formula. When the distributions are viewed as a free-standing defined contribution plan benefit, they cause no difficulty: the Employees received the full amount of their individual account balances, and the rules for defined contribution pension plans require no more.

The trouble arises in integrating the distributions with Xerox's obligations under the defined benefit portion of its pension plans. The Income Guarantee Plan guaranteed the Employees a minimum total retirement benefit, and provided benefits to the extent the Profit Sharing Plan failed to satisfy that minimum. The Income Guarantee Plan's promise of a defined benefit amount triggered ERISA's defined benefit plan rules, which require that any lump-sum substitute for an accrued pension benefit be the actuarial equivalent of that benefit. 29 U.S.C. § 1054(c)(3). Some reduction of future pension benefits to account for the prior distributions is appropriate, but only to the extent that the future benefit is "attributable to the distribution."[4] 26 C.F.R. § 1.411(a)-7(d)(6).

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[4] IRS regulations that also apply to the parallel ERISA provisions, *see* ERISA § 3002(c), 29 U.S.C. § 1202(c), permit such reductions as follows:

> [T]he fact that a plan cannot disregard an accrued benefit attributable to service for which an employee has received a distribution because the plan does not satisfy the cash-out requirements of [ERISA's buyback rules] does not mean that the employee's accrued benefit (computed by taking into account such service) cannot be offset by *the accrued benefit attributable to the distribution.*

26 C.F.R. § 1.411(a)-7(d)(6) (emphasis added).

An accrued benefit under a defined benefit plan is ordinarily expressed as an annuity commencing at normal retirement age. *See* 29 U.S.C. § 1002(23)(A), 29 U.S.C. § 1002. Thus, the "accrued benefit attributable to the distribution" for each Employee should be expressed as an annuity. When the Employees first left Xerox, they received Profit Sharing Plan distributions because their Profit Sharing Plan account balances exceeded the benefit which they were guaranteed under the Income Guarantee Plan formula. These distributions can, of course, be offset from the benefits guaranteed under the Income Guarantee Plan formula. However, because ERISA requires actuarial equivalence for any reduction in benefits based on prior distributions, Xerox's method of *calculating* the offset is impermissible. The benefit properly attributable to the Profit Sharing Plan distributions is simply the Income Guarantee Plan annuity amount that those distributions would have provided. Any later change in the value of the distribution should not affect the amount of the benefit under the Income Guarantee Plan defined benefit formula that was attributable to the distribution when it was made. Although floor-offset plans are permissible, the offset permitted is not one increased post hoc by Xerox, but one based on the actual actuarial equivalent of the distribution.[5] In short, Xerox may not use a projected-to-

[5] The actuarial equivalence requirement applies indirectly here: the promised benefit at issue is the amount by which the Income Guarantee Plan formula benefit exceeds the value of the Profit Sharing Plan account balance. The phantom account device distorts the value of the Profit Sharing Plan account, not the Income Guarantee Plan formula itself. However, ERISA's actuarial equivalence requirement would be meaningless – which, even in this indirect, floor-offset context, it cannot be – if Xerox could simply redefine at will the Profit Sharing Plan balance actually distributed, thereby reducing its Income Guarantee Plan obligations. We do not consider here nor disapprove the use of benefit offsets in general, which the courts have

the-present value generated from a phantom account as a proxy for the actual distribution amount.

The logic of this is more readily apparent when one compares this situation to one in which a participant receives a lump-sum distribution from a straight defined benefit plan (i.e., one without a floor-offset arrangement), and then resumes employment under the same plan. If the participant worked for 10 years, left the company, and received a lump-sum distribution actuarially equivalent to a \$300/month annuity (say 1.5% of a \$2000/month salary for each year), the plan could subtract the \$300/month "accrued benefit" represented by that distribution from a later calculation of benefits after the participant resumed employment and worked another 20 years.[6] Nothing in the regulations or the statute,

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plainly sanctioned, or the Profit Sharing Plan offset itself, but only the actuarial sleight of hand behind the phantom account offset. We note, also, that the benefit offsets previously sanctioned have involved not phantom benefit enhancements imagined by an employer, but more mundane creatures such as Social Security or workers compensation benefits, or complementary pension benefits from other plans, which workers actually receive. *See, e.g., Alessi* v. *Raybestos-Manhattan, Inc.,* 451 U.S. 504 (1981).

[6] Because pensions depend on a participant's salary at the end or highest point of his career as well as on his years of service, subtracting the \$300/month would cause a less drastic reduction than simply disregarding the prior years of service completely (which would require the plan to comply with ERISA's "buyback" rules): the participant would be entitled to a percentage of the higher salary earned during the second period of employment not only for the years of the second period, but also for the initial period. Based on a final salary of \$4000/month, for example, the participant would receive a final benefit (not including the \$300/month equivalent already distributed) of \$1500/month under this system (1.5% of \$4000/month times 30 years, minus \$300/month), instead of \$1200/month (1.5% of \$4000/month times 20 years) if the first period of employment were excluded entirely. The employee would thus accrue some additional benefit – over the benefit already paid – for the initial years of employment.

however, would permit the company to subtract more than that $300/month "accrued benefit attributable to the distribution."

Here, Xerox essentially seeks instead to recalculate the "accrued benefit" satisfied by the initial distribution based on later developments, namely investment performance of the funds in which the money would have been held, had it not been distributed. The rate of return on Xerox's funds is not actuarially relevant to the accrued benefit that the distribution satisfied. Xerox's approach is the equivalent, in the above example, of the company seeking to subtract more than the initial $300/month accrued benefit from the final benefit payment, on the grounds that the participant could purchase a larger annuity with the prior distribution amount at the time of final benefit calculation due to his shorter life expectancy or changed discount rate assumptions, or assumed investment returns on the distribution amount. Nothing in the statute or in logic permits this revisionist approach to already-distributed accrued benefits, nor is it more permissible in the context of a floor-offset plan, since such a plan must still satisfy the rules for ordinary defined benefit plans.

Although no court appears to have addressed the precise claim presented here, our approach is consistent with that of other courts of appeals. In *Berger* v. *Xerox Corp. Retirement Income Guarantee Plan,* 338 F.3d 755 (7th Cir. 2003), for example, the Seventh Circuit found that Xerox's method of calculating lump-sum distributions under the Cash Balance Retirement Account component of the Income Guarantee Plan violated ERISA's requirement of actuarial equivalency.[7] Although

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[7] More recently, the Second Circuit held in *Frommert* v. *Conkright,* 433 F.3d 254 (2d Cir. 2006), that Xerox's phantom account mechanism was not properly added to the plan until 1998, and that it would constitute an impermissible reduction

the case is not strictly analogous, because it addressed only the proper calculation of lump sum distributions under the Cash Balance Retirement Account (not the "phantom accounting" for prior distributions that the Employees challenge), our approach is compatible with *Berger's* discussion of the nature of actuarial equivalence, and its application of ERISA's defined benefit plan rules to somewhat murky "hybrid" plans. *Id.* at 759-60. The same is true of *Esden* v. *Bank of Boston,* 229 F.3d 154 (2d Cir. 2000), in which the Second Circuit reached the same conclusion as *Berger* in considering a similar plan.

Xerox argues that, because participants in the Profit Sharing Plan/Transitional Retirement Account received investment growth as part of their benefit, it is proper to project that growth forward to retirement when determining the actuarial equivalent benefit, just as was done with the Cash Balance Retirement Account interest credits under that plan in *Berger*. However, the Cash Balance Retirement Account interest credits are defined benefit entitlements specified by the plan terms, and are not analogous to the investment growth of a defined contribution plan. Unlike the Cash Balance Retirement Account benefits, defined contribution benefits under the Profit Sharing Plan came with no guarantees, and did not depend in any way on projected value at retirement; rather, the plan simply provided participants with the account balance, whatever it might be. Xerox clearly realized the difference: although Xerox projected each

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of benefits if applied to employees rehired by Xerox prior to 1998. *Id.* at 256-57. The *Frommert* court also required the district court to reconsider the plaintiffs' claims of fiduciary breach based on Xerox's alleged misrepresentations of the amended plan's terms. *Id.* at 257. Although this case presents different issues, and we do not reach the Employees' disclosure-related claims, *Frommert*'s analysis of the Xerox plan's broader defects reinforces our own conclusion that Xerox's phantom account mechanism falls short of ERISA's requirements.

retiree's Cash Balance Retirement Account balance forward to retirement and then discounted the projected amount to express it as a present-day lump sum (using too high a discount rate, according to *Berger*), the company made no such projections for the Profit Sharing Plan. Instead, Xerox simply distributed each participant's Profit Sharing Plan account balance if – as in the case of the Employees – it exceeded the lump-sum value of the Income Guarantee Plan formula benefit.

The applicable regulations permit a plan to subtract from a final defined benefit only the "accrued benefit attributable to the [prior] distribution." Xerox's "phantom account" offset exaggerates the amount of "accrued benefit" under the Income Guarantee Plan attributable to the Employees' Profit Sharing Plan distributions, in violation of those regulations, by deducting from the Employees' benefits the distribution's hypothetical value at final retirement, rather than the benefit attributable to the distribution itself. The Employees – and all other plan participants subject to similar benefit adjustments – are entitled to a calculation of benefits that subtracts from their final Income Guarantee Plan benefit only the benefit actually attributable to the Profit Sharing Plan distributions.

III

Because Xerox improperly overstated the benefit attributable to the Profit Sharing Plan distributions the Employees received in 1983, we reverse the judgment of the district court and remand for further proceedings consistent with this opinion.

REVERSED AND REMANDED.

APPENDIX B

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Before: PREGERSON, NOONAN, and THOMAS, Circuit Judges.

OPINION

THOMAS, Circuit Judge:

This appeal presents the question of whether a procedure used by Xerox Corporation ("Xerox") to reduce pension benefits at final retirement to account for earlier benefit distributions violates the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. § 1000 *et seq.* We conclude that Xerox's method violates ERISA, because it impermissibly reduces pension benefits by more than the accrued pension benefit attributable to the earlier distributions.

I

The facts of the case are undisputed. Plaintiffs Waldamar Miller, Thomas H. Sudduth, Jr., and J. Denton Allen ("the Employees"), all worked for Xerox for many years, received lump sum pension payouts when they left employment in 1983, and returned to work at the company several years later.

During their initial employment with Xerox, the Employees participated in two company retirement plans: the Xerox Retirement Income Guarantee Plan and the Xerox Profit Sharing Plan. The Income Guarantee Plan, a traditional defined benefit pension plan, provided participants with a certain percent of their salary in retirement for each year of service at Xerox, according to a specified formula ("Income Guarantee Plan formula benefit"). Under the Profit Sharing Plan, a defined contribution plan, each participant had an individual Retirement Account. The company made contributions to each employee's account, and the accounts were included in a fund invested and managed by the plan's trustees.

The two plans were linked in a "floor-offset" arrangement, under which the Income Guarantee Plan formula benefit served as the "floor" value of a retiree's pension benefits: each retiree would receive the value of his Retirement Account benefit, supplemented by the value of the Income Guarantee Plan formula benefit to the extent that it exceeded the Retirement Account benefit.

When each Employee left Xerox in 1983, he received a lump sum payment from his Retirement Account. Because the distribution from the Retirement Account in each case exceeded the lump-sum present value of the Employee's accrued benefit under the Income Guarantee Plan formula benefit, no payment was made from the Income

Guarantee Plan itself. Although each Employee returned to work at Xerox sometime between 1987 and 1989, none of the Employees has repaid any portion of his Retirement Account distribution into any Xerox plan, nor do the plans require or permit such a repayment.

In 1989, Xerox restated and consolidated the Income Guarantee Plan and the Profit Sharing Plan. The restatement amended the Income Guarantee Plan formula, eliminated the Profit Sharing Plan, and replaced the Profit Sharing Plan with two new accounts within the Income Guarantee Plan: the Cash Balance Retirement Account and the Transitional Retirement Account. The new Income Guarantee Plan formula was based on the participant's highest average pay multiplied by 1.4% and the member's years of service up to 30 years. The Cash Balance Retirement Account, a "cash balance" plan, used the participant's existing Retirement Account balance as the initial balance, and received annual credits from Xerox of 5% of the participant's salary, plus interest at a fixed annual rate equal to the twelve-month Treasury Bill rate plus 1%. The Transitional Retirement Account consisted of the Retirement Account balance alone, and received no further contributions, but could grow or shrink according to the investment performance of the funds in which the accounts were invested. Upon retirement, a participant received the largest of the three benefits – Income Guarantee Plan formula benefit, Cash Pension Retirement Account balance, or Transitional Retirement Account balance – in the form of an annuity.

For employees who had already received a distribution of pension benefits on a prior departure from the company, Xerox reduced final retirement benefits to account for the earlier distribution by using so-called "phantom accounts." Phantom accounts were calculated for the Cash Balance Retirement Account and the Transitional Retirement Account, consisting of the actual distribution amount at the time of departure plus the increase or decrease that the distribution would have earned had it remained in each plan. Thus, for the Cash Balance Retirement Account, the phantom account was equal to the distribution amount plus interest at the rate specified in the plan. For the Transitional Retirement Account, the phantom account was the distribution amount plus the investment returns (or losses) of the fund in which that amount had been invested at distribution.

Under the amended Income Guarantee Plan, the relevant phantom account was added to the amount of each participant's benefit before the three benefit choices were compared. The participant was given the benefit that yielded the highest monthly payment (with the phantom accounts included), and the phantom account was then subtracted out to yield the actual benefit amount. If the Income Guarantee Plan benefit was the largest, the Transitional Retirement Account phantom account was subtracted.

In 1997 and 1998, each of the Employees requested a statement of the benefits that would be payable upon his retirement. Each of the statements Xerox provided applied the phantom account offset described above, to drastic effect: Sudduth's monthly benefit fell from $1,679.23 to $83.16, Allen's monthly benefit fell from $2,059.44 to $262.69, and Miller's monthly benefit fell from $2,878.40 to $554.51. The Employees challenged the phantom account offset, pursuing two levels of administrative appeals. Xerox rejected Miller and Sudduth's appeals by letter dated September 9, 1998, and rejected Allen's appeal by letter dated March 8, 1998.

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After *Hammond* was affirmed in an unpublished decision, the Employees filed amended complaints in both actions. The parties then filed stipulated facts and exhibits. The two cases were formally consolidated on January 4, 2002, and a trial consisting of closing arguments was held on April 3, 2002.

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II

Xerox's method of accounting for prior distributions in calculating the Employees' final retirement benefits violates the substantive requirements of ERISA. The Income Guarantee Plan phantom offset violates ERISA by overestimating the value of distributions made upon a previous separation from employment, and the corresponding reduction in benefits at retirement. ERISA requires actuarial equivalence between the actual distribution and the accrued benefit it replaces.

As a hybrid defined benefit plan with some features of a defined contribution plan,[1] the Income Guarantee Plan

[1] ERISA defines a "defined benefit plan" as "a pension plan other than an individual account plan," but also permits hybrid plans. 29 U.S.C. § 1002(35). The Profit Sharing Plan was a defined contribution plan, which ERISA defines as "a pension plan which provides 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

(both before and after amendment, and including the Cash Balance Retirement Account component) must satisfy the actuarial rules ERISA applies to defined benefit plans.[2] 29 U.S.C. § 1002(35). It is well settled that ERISA allows so-called "floor-offset" plans, in which the participant takes the greater of a defined benefit or a defined contribution benefit amount.[3] However, the defined benefit and defined contribution portions of a combined floor-offset plan must satisfy the ERISA requirements applicable to the respective types of plans.

Here, the distributions made to the Employees in 1983 were intended to satisfy Xerox's obligations under both the Profit Sharing Plan and the Income Guarantee Plan, although they were made solely from the Profit Sharing Plan, because the Profit Sharing Plan account balance

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and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account." 29 U.S.C. § 1002(34).

2 This statutory requirement is explicit, and reads as follows:

> [A] pension plan which is not an individual account plan and which provides a benefit derived from employer contributions which is based partly on the balance of the separate account of a participant – . . .
>
> (B) for the purposes of paragraph (23) of this section [defining accrued benefit] and section 1054 of this title[regulating benefit accrual], shall be treated as an individual account plan to the extent benefits are based upon the separate account of a participant and as a defined benefit plan with respect to the remaining portion of benefits under the plan.

Id. 29 U.S.C. § 1002(35).

3 A pension plan participant's "accrued benefit" is, "in the case of a defined benefit plan, the individual's accrued benefit determined under the plan and, except as provided in [29 U.S.C. § 1054(c)(3)], expressed in the form of an annual benefit commencing at normal retirement age." 29 U.S.C. § 1002(23)(A). The normal form of this benefit is a joint and survivor annuity. 29 U.S.C. § 1055(a)(1). "[I]n the case of a plan which is an individual account plan," the accrued benefit is simply "the balance of the individual's account." 29 U.S.C. § 1002(23)(B).

exceeded the value of the Income Guarantee Plan benefit. When the distributions are viewed as a free-standing defined contribution plan benefit, they cause no difficulty: the Employees received the full amount of their individual account balances, and the rules for defined contribution pension plans require no more.

The trouble arises in integrating the distributions with Xerox's obligations under the defined benefit portion of its pension plans. Here, for the lump-sum distributions to satisfy any portion of the Employees' vested Income Guarantee Plan benefits, the lump sum must be actuarially equivalent to those benefits. ERISA requires that any lump-sum substitute for an accrued pension benefit be the actuarial equivalent of that benefit. 29 U.S.C. § 1054(c)(3). Some reduction of future pension benefits to account for the prior distributions is appropriate, but only to the extent that the future accrued benefit is "attributable to the distribution."[4] 26 C.F.R. § 1.411(a)7(d)(6).

An accrued benefit under a defined benefit plan is ordinarily expressed as an annuity commencing at normal retirement age. *See* 29 U.S.C. § 1002(23)(A). Thus, the "accrued benefit attributable to the distribution" for each Employee should be expressed as an annuity. When the Employees first left Xerox, they received Profit Sharing Plan distributions because their Profit Sharing Plan

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[4] IRS regulations that also apply to the parallel ERISA provisions, *see* ERISA § 3002(c), 29 U.S.C. § 1202(c), permit such reductions as follows:

> [T]he fact that a plan cannot disregard an accrued benefit attributable to service for which an employee has received a distribution because the plan does not satisfy the cash-out requirements of [ERISA's buyback rules] does not mean that the employee's accrued benefit (computed by taking into account such service) cannot be offset by *the accrued benefit attributable to the distribution.*

26 C.F.R. § 1.411(a)-7(d)(6) (emphasis added).

account balances exceeded the accrued benefit which they were guaranteed under the Income Guarantee Plan formula. Essentially, the Profit Sharing Plan distributions substituted for the lump-sum equivalent of the Income Guarantee Plan formula benefit, because the Profit Sharing Plan accounts could have purchased a larger annuity. The accrued benefit attributable to the Profit Sharing Plan distributions is simply the Income Guarantee Plan annuity amount that those distributions replaced. The portion of the Profit Sharing Plan distributions that exceeded the lump-sum value of the Income Guarantee Plan annuity benefit represented a payment from an individual, defined contribution account, not any portion of an "accrued benefit" under the Income Guarantee Plan defined benefit formula. That excess distribution, and any change in the value of the distribution, should not affect the amount of the "accrued benefit" – under the Income Guarantee Plan defined benefit formula – that was attributable to the distribution when it was made. In short, Xerox may not use a projected-to-the-present value generated from a phantom account as a proxy for the actual distribution amount.

The logic of this is more readily apparent when one compares this situation to one in which a participant receives a lump-sum distribution from a straight defined benefit plan (i.e., one without a floor-offset arrangement), and then resumes employment under the same plan. If the participant worked for 10 years, left the company, and received a lump-sum distribution actuarially equivalent to a $300/month annuity (say 1.5% of a $2000/month salary for each year), the plan could subtract the $300/month "accrued benefit" represented by that distribution from a later calculation of benefits after the participant resumed employment and worked another 20 years.[5] Nothing in the regulations or the statute, however, would permit the company to subtract more than that $300/month "accrued benefit attributable to the distribution."

Here, Xerox essentially seeks instead to recalculate the "accrued benefit" satisfied by the initial distribution based on later developments, namely investment performance of the funds in which the money would have been held, had it not been distributed. The rate of return on Xerox's funds is not actuarially relevant to the accrued benefit that the distribution satisfied. Xerox's approach is the equivalent, in the above example, of the company seeking to subtract more than the initial $300/month accrued benefit from the final benefit payment, on the grounds that the participant could purchase a larger annuity with the prior distribution amount at the time of final benefit calculation due to his shorter life expectancy or changed discount rate assumptions, or assumed investment returns on the distribution amount. Nothing in the statute or in logic permits this revisionist approach to already-distributed accrued benefits, nor is it more permissible in the context of a floor offset plan, since such

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[5] Because pensions depend on a participant's salary at the end or highest point of his career as well as on his years of service, subtracting the $300/ month would cause a less drastic reduction than simply disregarding the prior years of service completely (which would require the plan to comply with ERISA's "buyback" rules): the participant would be entitled to a percentage of the higher salary earned during the second period of employment not only for the years of the second period, but also for the initial period. Based on a final salary of $4000/month, for example, the participant would receive a final benefit (not including the $300/month equivalent already distributed) of $1500/month under this system (1.5% of $4000/month times 30 years, minus $300/month), instead of $1200/month (1.5% of $4000/month times 20 years) if the first period of employment were excluded entirely. The employee would thus accrue some additional benefit – over the benefit already paid – for the initial years of employment.

a plan must still satisfy the rules for ordinary defined benefit plans.

Although no court appears to have addressed the precise claim presented here, our approach is consistent with that of other courts of appeals. In *Berger* v. *Xerox Corp. Retirement Income Guarantee Plan,* 338 F.3d 755 (7th Cir. 2003), for example, the Seventh Circuit found that Xerox's method of calculating lump-sum distributions under the Cash Balance Retirement Account component of the Income Guarantee Plan violated ERISA's requirement of actuarial equivalency.[6] Although the case is not strictly analogous, because it addressed only the proper calculation of lump sum distributions under the Cash Balance Retirement Account (not the "phantom accounting" for prior distributions that the Employees challenge), our approach is compatible with *Berger's* discussion of the nature of actuarial equivalence, and its application of ERISA's defined benefit plan rules to somewhat murky "hybrid" plans. *Id.* at 759-60. The same is true of *Esden* v. *Bank of Boston,* 229 F.3d 154 (2d Cir. 2000), in which the Second Circuit reached the same conclusion as *Berger* in considering a similar plan.

Xerox argues that, because participants in the Profit Sharing Plan/Transitional Retirement Account received

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[6] More recently, the Second Circuit held in *Frommert* v. *Conkright,* 433 F.3d 254 (2d Cir. 2006), that Xerox's phantom account mechanism was not properly added to the plan until 1998, and that it would constitute an impermissible reduction of benefits if applied to employees rehired by Xerox prior to 1998. *Id.* at 256-57. The *Frommert* court also required the district court to reconsider the plaintiffs' claims of fiduciary breach based on Xerox's alleged misrepresentations of the amended plan's terms. *Id.* at 257. Although this case presents different issues, and we do not reach the Employees' disclosure-related claims, *Frommert*'s analysis of the Xerox plan's broader defects reinforces our own conclusion that Xerox's phantom account mechanism falls short of ERISA's requirements.

investment growth as part of their benefit, it is proper to project that growth forward to retirement when determining the actuarial equivalent benefit, just as was done with the Cash Balance Retirement Account interest credits under that plan in *Berger*. However, the Cash Balance Retirement Account interest credits are defined benefit entitlements specified by the plan terms, and are not analogous to the investment growth of a defined contribution plan. Unlike the Cash Balance Retirement Account benefits, defined contribution benefits under the Profit Sharing Plan came with no guarantees, and did not depend in any way on projected value at retirement; rather, the plan simply provided participants with the account balance, whatever it might be. Xerox clearly realized the difference: although Xerox projected each retiree's Cash Balance Retirement Account balance forward to retirement and then discounted the projected amount to express it as a present-day lump sum (using too high a discount rate, according to *Berger*), the company made no such projections for the Profit Sharing Plan. Instead, Xerox simply distributed each participant's Profit Sharing Plan account balance if – as in the case of the Employees – it exceeded the lump-sum value of the Income Guarantee Plan formula benefit.

The applicable regulations permit a plan to subtract from a final defined benefit only the "accrued benefit attributable to the [prior] distribution." Xerox's "phantom account" offset exaggerates the amount of "accrued benefit" under the Income Guarantee Plan attributable to the Employees' Profit Sharing Plan distributions, in violation of those regulations, by deducting from the Employees' benefits the "accrued benefit" attributable to the distribution's hypothetical value at final retirement, rather than the benefit attributable to the distribution itself. The Employees – and all other plan participants subject to similar benefit adjustments – are entitled to a calculation of benefits that subtracts from their final

Income Guarantee Plan benefit only the "accrued benefit" attributable to the Profit Sharing Plan distributions.

III

Because Xerox improperly overstated the accrued benefit attributable to the Profit Sharing Plan distributions the Employees received in 1983, we reverse the judgment of the district court and remand for further proceedings consistent with this opinion.

REVERSED AND REMANDED.

APPENDIX C

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

WALDAMAR MILLER, AN INDIVIDUAL; AND THOMAS H. SUDDUTH, JR., AN INDIVIDUAL, PLAINTIFFS,

v.

XEROX CORPORATION RETIREMENT INCOME GUARANTEE PLAN, AN EMPLOYEE PENSION BENEFIT PLAN; XEROX CORPORATION, A NEW YORK CORPORATION, PATRICIA NAZEMETZ, AS PLAN ADMINISTRATOR OF THE XEROX CORPORATION RETIREMENT INCOME GUARANTEE PLAN, DEFENDANTS.

CV 98-10389 WMB (CTx)

J. DENTON ALLEN, AN INDIVIDUAL, PLAINTIFF,

v.

XEROX CORPORATION RETIREMENT INCOME GUARANTEE PLAN, AN EMPLOYEE PENSION BENEFIT PLAN; XEROX CORPORATION, A NEW YORK CORPORATION, PATRICIA NAZEMETZ, AS PLAN ADMINISTRATOR OF THE XEROX CORPORATION RETIREMENT INCOME GUARANTEE PLAN, DEFENDANTS.

CV 99-2589 WMB (CTx)

ORDER GRANTING JUDGMENT FOR DEFENDANTS

Plaintiffs J. Denton Allen, Waldamar Miller, and Thomas H. Sudduth, Jr., bring this action under Sections 502(a)(1)(B) and 502(a)(3) of the Employee Retirement

Income Security Act of 1974 ("ERISA"), 29 U.S.C. §§ 1132(a)(1)(B)-(a)(3), to clarify and recover benefits allegedly due under the Xerox Corporation Retirement Income Guarantee Plan ("RIGP"), a defined benefit pension plan. The parties have filed trial briefs and a comprehensive Joint Stipulation of Facts. The Court held a trial on stipulated facts.

I. Factual Overview

The following factual discussion is based on the parties Joint Stipulation of Facts (JSP).

A. *Plaintiffs*

Plaintiffs Allen, Miller and Sudduth were all members of the RIGP and participants in the Xerox Corporation Profit Sharing Retirement and Savings Plan ("Profit Sharing Plan"). JSP at ¶¶ 1,2,3. Both plans are governed by the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). All three Plaintiffs were employed by Xerox during the 1970's and early 1980's, left the company, and later rejoined Xerox in the late 1980's. Plaintiff Allen was employed by Xerox from 1968 to 1969, from 1973 to 1983, and finally from 1989 to 1997. JSP at ¶¶ 3,10,12. Plaintiff Miller was employed by Xerox from 1966 to 1983, and rejoined the company in 1987. JSP at ¶¶ 1, 8. Plaintiff Sudduth was employed by Xerox from 1962 to 1983, and rejoined the company in 1988. JSP at ¶¶ 2,9. Prior to rejoining Xerox, all of the Plaintiffs received distributions from their retirement accounts due to their initial employment with the company.[1] None of

[1] Plaintiff Allen received a $39,107.14 cash distribution from the Xerox Profit Sharing Plan upon terminating his employment in 1983. JSP at 16. Plaintiffs Miller and Sudduth left Xerox in 1983 and became employees the Loral Corporation as part of an asset sale agreement between Xerox and Loral. Pursuant to the asset sale agreement, the Plaintiffs' retirement account balances were transferred to Loral. When Plaintiffs rejoined Xerox in the late 1980's, they received cash distribu-

the Plaintiffs repaid these distributions upon rejoining Xerox. JSP at ¶¶ 8, 9, 10.

B. *Plan Description*

1. *General Terms and Benefit Calculation*

On July 1945, Xerox established its Profit Sharing Plan as a defined contribution plan. On July 1977, Xerox established the RIGP as a defined benefit pension plan.[2] The benefit for each participant in the Profit Sharing Plan was equal to the balance of the participant's retirement account under that plan. The account was credited with annual contributions equal to a percentage of the participant's pay received in the preceding year. The growth of the account depended upon these annual contributions and the investment performance of the fund in which the Xerox plans were invested. JSP at ¶ 18(a). The benefit for each RIGP member was based upon formula consisting of one and two thirds percent (1 2/3%) of the Member's average monthly salary multiplied by the Member's years of participation (up to 30 years), but reduced by one and two thirds percent (1 2/3%) of the Member's Social Security benefit multiplied by his years of participation (up to 30 years), and offset by the value of an annuity that could be purchased with the balance of the retirement account. JSP at ¶ 18(b).

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tions from the Loral Plan (these distributions consisted of their retirement account balances together with the earning on those balances). JSP at ¶¶ 4, 5, 7, 8, 9.

[2] A defined benefit plan entitles the employee to a pension equal to a specified percentage of his salary in the final year or years of his employment. A defined contribution plan entitles the employee to a pension equal to the value of his retirement account to which contributions have been made. *See Berger* v. *Xerox Corporation Retirement Income Guarantee Plan*, 338 F.3d 755 (7th Cir. 2003) (describing the difference between defined benefit and defined contribution plans).

In 1989, the RIGP and Profit Sharing Plan were restated. The restatement amended the RIGP formula and replaced the Profit Sharing Plan with two new RIGP accounts: the Cash Balance Retirement Account ("CBRA") and the Transitional Retirement Account ("TRA"). JSP at ¶¶ 26(a), 26(b). The new RIGP formula was based on the RIGP member's highest average pay multiplied by 1.4% and the member's years of service (up to 30 years). JSP at ¶ 125. The CBRA was consisted of the Profit Sharing Plan participant's retirement account balance, with annual credits of an amount equal to 5% of the member's annual pay and interest earned at a fixed-annual rate (equal to the twelve month T-bill rate plus 1%). JSP at ¶ 26(a). The TRA would receive no future contributions, and would grow according to the actual investments results of the general fund in which the accounts were invested. JSP at ¶ 26(b). Upon retirement, an RIGP member was entitled to the largest monthly retirement benefit of the RIGP pension formula, the CBRA or the TRA. JSP at ¶ 27.

2. *Phantom Account / Offset Program*

In order to avoid paying double benefits to members that had left and then rejoined the Company, the RIGP plan created a "phantom account" consisting of the amount of any prior distributions plus the increase or decrease in value that the prior distributions would have earned had they remained invested in plan. JSP at ¶¶ 28, 30, 32. This phantom account balance would be subtracted from the RIGP member's monthly benefit prior to distribution. The use of this phantom account offset could substantially decrease an RIGP member's benefits. Plaintiff Sudduth's calculated benefit was $1,679.23, after application of the offset the benefit fell to $83.16. JSP at ¶ 67. Similarly, Plaintiff Allen's benefit decreased from $2,059.44 to $262.69 and Plaintiff Miller's benefit decreased from $2,878.40 to $554.51. JSP at ¶¶ 61, 73.

3. *Disclosure Statements*

In 1993, Xerox issued a Summary Plan Description ("SPD") detailing the three ways to calculate benefits under the RIGP. The SPD also informed members that:

> If you are eligible for benefits from other Xerox retirement plans, including predecessor plans, your retirement income guarantee could be reduced to account for the income you will be receiving from those plans. The amount you receive may also be reduced if you had previously left the Company and received a distribution at that time. . .

JSP at ¶ 42. In 1995, the SPD was updated and included a more detailed notice about the effect of prior distributions:

> It is important to note that if you have received a prior distribution from the plan, this will affect the calculation of your benefit. In calculating your RIGP benefit for the purpose of determining the highest of your TRA, CBRA, or formula benefit, the amount of your prior distribution will be added to your TRA and CBRA accounts, along with hypothetical investment gains and/or losses attributable to the prior distributions, as if the money had been left in your accounts. However, since you already received the prior distribution and there were no actual investment gains and/or losses on this amount, the payment of your RIGP benefit will not include the prior distribution or any hypothetical investment gains and/or losses . . . . Since you were credited with prior years of eligible Xerox service for the purpose of calculating your, benefit accrual under the RIGP, [the above provision ensures] that all participants are treated in the same manner for purposes of calculating RIGP benefits. Your personalized Value Added statement provides more information about your prior distribution and its impact on your retirement benefits.

JSP at ¶ 45. The SPDs were also accompanied by Value Added Statements ("Statements") providing personalized benefit calculations under the three formulas. Prior to 1995, some of these statements contained language indicating that the calculated amounts might be offset by prior distributions, but the personalized benefit calculations did not take into account the offsets. The 1990 statement informed members that:

> Your account balances may contain the value of distributions which you may have already received if you left the company previously and took a distribution from the plan, and were then rehired by the company. Your guarantee may be reduced by benefits payable from other Xerox retirement plans or by distributions you already received.

JSP at ¶ 90. From 1991 to 1993, the statements contained no offset language. JSP at ¶ 90. In 1995, the Value Added Statement was revised to include the following disclaimer:

> This benefit will grow with your service and earnings. It **will be reduced** if you've had a prior distribution, receive amounts before age 65 or from another Xerox plan, or are subject to a court order or a qualified domestic relations order.

JSP at ¶ 90 (emphasis in original). In addition, the 1995 Statement contained a separate page stating:

> In order to calculate the amount of the reduction in your benefit, the amount of the prior distribution will be presumed to have remained in the plan and to have accrued investment gains or losses in the same manner as other funds in the plan." (emphasis in original).

JSP at ¶ 91. From 1996 to 1998, the statement included both a disclaimer with similar language and an actual calculation of the offset, together with a recalculated new RIGP balance for each member. JSP at ¶¶ 93, 94, 95, 96, 98.

C. *Procedural History*

All of the Plaintiffs objected to the manner in which their benefits were calculated and requested a recalculation of benefits. Kathleen Russell, Manager of Total Pay Programs, reviewed the calculations for all three Plaintiffs and concluded that they had been performed correctly. JSP at ¶¶ 75, 77, 79. All of the Plaintiffs appealed the calculation of their benefits. JSP at ¶¶ 76, 78, 80. Patricia Nazemetz, Plan Administrator and Director, reviewed the benefit calculations and concluded that the calculations were correct. This lawsuit followed.

II. Discussion

All Plaintiffs request a clarification of their benefits pursuant to 29 U.S.C 1132(a)(1)(B). Plaintiff Allen has since retired from Xerox, and consequently seeks to recover past benefits and an injunction preventing Xerox from offsetting his future benefits. Plaintiffs Sudduth and Miller are still employed by Xerox, and consequently seek only declaratory relief.

Plaintiffs advance several arguments in support of their claims. First, Plaintiffs argue that the structure of the plan violates ERISA in multiple ways: (1) the RIGP violated ERISA's statutory buyback rules; (2) the offset is in excess of the "reasonable actuarial value" of prior distributions; (3) a prospective benefit may not be offset by the balance of a frozen profit sharing account; and (4) Revenue Ruling 76-259 is inconsistent with ERISA. Second, even if the plan itself does not violate ERISA, Xerox's failure to disclose the impact of the offsets on Plaintiffs' benefits constitutes a breach of fiduciary duty. This order addresses each argument in turn.

A. *Statutory Buyback Rules*

According to Plaintiffs, Section 204(e) of ERISA, 29 U.S.C. 1054(e), requires Xerox to provide employees that leave the firm with an opportunity to repay any prior benefit distribution they received upon rejoining the firm

(Plaintiffs refer to this as allowing a "buyback" into the pension plan). Employees that opt to buyback into the pension plan will receive the same annuity as if they had never received the prior distribution, Employees that decline to buyback will have the prior distribution offset against their future benefits. Plaintiffs argue that since Xerox did not provide a buyback opportunity, it cannot offset future benefits with prior distributions. Pl[s]' Tr. Brief at 8.

The Court disagrees. Section 1054(d) provides that "for purposes of determining the employee's accrued benefit under the plan, the plan may disregard service performed by the employee with respect to which he has received a cash distribution." Only in cases where the plan fails to credit prior service and there has been a prior forfeiture, does Section 1054(e) require a plan to permit former employees to buyback into the plan. *See Frommert* v. *Conkright*, 206 F.Supp.2d 435, 441 (W.D.N.Y. 2002) (interpreting Section 1054(e) to require a buy back opportunity "if the plan fails to credit prior service and there has been a prior forfeiture"). In this case, Plaintiffs do not dispute receiving their prior distributions, nor have they challenged the adequacy of those distributions. As a result, there was no forfeiture in this case, and the buyback provisions of Section 1054(e) do not apply. *See Frommert*, 206 F.Supp.2d at 441 ("Since plaintiffs do not allege that Xerox failed to count their prior service, and since plaintiffs acknowledge receipt of their accrued benefits at the time of their initial separation from Xerox, no forfeiture exited. Plaintiffs, therefore, have no statutory right to buy back into the plan.").

B. *Value of Offset*

Plaintiffs primary argument is that Xerox's valuation of the prior distributions violates ERISA. ERISA regulations require that "Certain rights in an accrued benefit must be non-forfeitable to satisfy the requirements of § 411 (a) . . . . Certain adjustments to plan benefits such as adjustments in excess of reasonable actuarial reductions can result in rights being forfeitable." 26 C.F.R. § 1.411(a)-4(a). According to Plaintiffs, the RIGP's use of a phantom account ignores these regulations and violates ERISA by inflating the actuarial value of prior distribution for the sole purpose of negating a defined benefit. Pl[s]' Tr. Br. at 11. Specifically, Plaintiffs object to Defendant's calculating the value of the prior distributions as if those distributions had remained invested in the CBRA or the TRA, rather than valuing the distributions based on "actuarially equivalent factors."[3]

Plaintiff's rely on *Berger* v. *Nazemetz*, 157 F. Supp. 2d 998 (S.D. Ill. 2001), in support of their argument that the phantom account violates ERISA. According to Plaintiffs, Berger concluded that the Xerox RIGP understated the participant's accrued benefit by projecting the participant's real benefit forward at too low an interest rate. In this case, the RIGP projects the phantom benefits (the offset) forward at too high a rate. Pl[s]' Tr. Br. at 2. Plaintiffs' reliance on *Berger* is misplaced. In *Berger*, the court held that in projecting a CBRA account balance to age 65, the RIGP must use the same interest crediting rate it would have received had it remained in the plan. As the Court of Appeals stated,

> Xerox tells its employees who leave the company before they reach [retirement] age that if they leave their money with the company they will obtain a pension beginning at age 65 that will reflect future interest credits. They are offered the alternative of taking a lump sum now in lieu of a pension later, but the lump sum is not the prescribed actuarial

[3] It should be noted that Plaintiffs do not ever state what "actuarially equivalent factors" should be used, nor do they calculate an appropriate offset using these factors.

> equivalent of the pension that they are invited to surrender by accepting the lump sum because it excludes those credits. They are, in short, being invited to sell their pension entitlement back to the company cheap, and that is a sale that ERISA prohibits.

Berger v. *Nazemetz*, 338 F.3d 755, 761-762 (7th Cir. 2003) *affirming Berger* v. *Nazemetz*, 157 F.Supp.2d 998 (2001). Berger stands for the proposition that a company may not deprive its employees of their accrued pension benefits by reducing their benefits if they accept a lump sum as opposed to waiting until age 65. In *Berger*, the plaintiffs lump sum distributions were lower than what the plaintiffs would have been entitled to had they left their benefits in the fund. It was this loss of appreciated value – the value the benefits would have accrued had they remained in the fund – that lead the District Court and the Court of Appeals to conclude that the plan violated ERISA. In this case, the phantom account is designed to value the participant's past distribution as if it had remained in the fund; exactly what the courts said should have been done in *Berger*.

C. *Defined Benefit vs. Defined Contributions*

While Plaintiffs concede that a participant's retirement annuity may be offset if the participant has already received another payment properly attributable to that annuity, Plaintiffs argue that not every payment an employee receives from his employer is properly attributable to a pension benefit. Specifically, Plaintiffs contend that the payment from a profit sharing benefit plan is not properly attributable to the accrued benefits under a defined benefit plan. Acknowledging that Revenue Ruling 76-259 permits floor-offset plans, Plaintiffs argue that such plans must concurrently maintain their defined benefit and defined contribution plans, and Xerox's freezing of its profit sharing account means that the accounts are not concurrently maintained. Pl[s]' Tr. Br. at 17.

Plaintiffs' only support for this argument is *Eaton* v. *Onan Corp*, 117 F. Supp. 812, (S.D. Ind. 2000), where the District Court denied summary judgment to the Defendant pension plan on the issue of whether its use of two different interest rates violated ERISA. In *Eaton*, the Defendant used two different rates in calculating the plaintiffs benefits; the Defendant "inflated" Plaintiffs' benefits by a rate of 7%; but "discounted" the Plaintiffs' benefits by a rate of 9%. *Id*. at 846. The *Eaton* Plaintiffs argued that the use of different interest rates in these calculations resulted in the simultaneous understatement of a participant's opening account balance under the Pension Plan and overstatement of their profit sharing plan offset. In denying summary judgment to the Defendant, the District Court noted that Plaintiffs have produced evidence showing that "defendants used two different interest rates to make what was essentially the same calculation – the present value of a sum or an annuity as of the participant's normal retirement age." *Id*.

Eaton is inapposite to this case. First, the Court in *Eaton* merely denied summary judgment to the defendant. The *Eaton* Court did not rule on whether Defendant's use of two different interest rates actually violated ERISA. Second, and more importantly, the *Eaton* Court were concerned with the use of two different interest rates, not that the profit sharing plan was frozen. It was the use of two different rates for making the same calculation, not the fact that the profit sharing account was frozen, that may have benefitted defendants at the expense of plan participants.

Plaintiffs also argue that to the degree IRS Revenue Ruling 76-259 condones the use of floor offset plans, the Revenue Ruling may be wrong. If the Ruling is incorrect, then Xerox's floor-offset program, while complying with

Revenue Ruling 76-259, still violates ERISA. "[F]loor-offset arrangements are not uncommon." *Berger* v. *Nazemetz*, 157 F.Supp.2d 998, 1007. These arrangements are permitted by Revenue Ruling 76-259, and have been upheld by the courts. *See Id.* n9 (citing cases). Plaintiffs fail to site to any authority for their proposition that the Revenue Rule is wrong, nor do they provide any persuasive analysis. This Court therefore declines to invalidate Revenue Ruling 76-259. Plaintiffs also argue that "unless Revenue Ruling 76-259 is correct and applies," the RIGP violates ERISA's prohibitions against backloading benefit accruals. Given that Revenue Ruling 76-259 is correct and does apply, this Court has no reason to address Plaintiffs allegation that the RIGPs design violates ERISA by backloading accrued benefits.

D. *Failure to Disclose*

Plaintiffs allege that the RIGP failed to comply with ERISA's disclosure requirements and this constituted a breach of their fiduciary duty. Specifically, Plaintiff's contend that Defendant's disclosures failed to provide adequate notice to the Plaintiffs that their retirement benefits would be offset by an appreciated value of prior distributions. This issue is complicated by the fact that there are multiple different disclosures in this case. As noted previously, Xerox amended its SPD in 1993 and 1995, and amended its Statements in 1995 and 1996. Xerox's 1993 SPD informed participants that "the amount you receive may also be reduced if you had previously left the Company and received a distribution at that time." In 1995, the SPD was updated to include a more detailed notice about the effect of the offsets, and referred participants to Statements which provided personalized benefit calculations. The Statements were also modified over time. From 1991 to 1993, the Statements did not include any offset language, nor did they factor in the offset in calculating the participant's benefits. Beginning in 1995, the Statement included an offset disclaimer, and beginning in 1996, the Statements included an actual offset calculation and a recalculated new RIGP balance for each member. Plaintiffs appear to contend that all of Xerox's disclosures have been inadequate.

In *Layaou* v. *Xerox*, 238 F.3d 205 (2d Cir. 2001), the Second Circuit reviewed the 1993 SPD and concluded that it failed to provide adequate notice to the Plaintiff that his retirement formula would be subject to an offset. According to the Court, "Xerox's SPD did not describe the "full import" of the effect of receiving a prior lump-sum distribution on the calculation of future retirement benefits upon rehire . . . . The SPD fails to clearly identify the loss of benefits caused by a prior lump sum distribution . . . . Given the significant reduction in Layaou's monthly benefits . . . one single sentence stating that Layou's benefits may also be reduced if he left the company and received a distribution at that time, is wholly inadequate to provide meaningful notice regarding the loss of benefits." *Id*. at 211. The Plaintiffs in this case received the same notification as Layaou, and suffered similarly significant reductions in benefits. This Court agrees with the Layaou Court that Xerox's 1993 SPD violated the disclosure requirements of ERISA.

While Xerox's 1993 SPD was inadequate, this Court concludes that the 1995 SPD was adequate. In *Layaou*, the Court stated that "SPD could have given sufficient notice, for example, by stating something like, 'Any future benefit will be offset by the appreciated value of any prior distribution assuming that amount remained in the plan,' or by providing an example calculating the benefits of an employee who had received a prior distribution." *Layaou*, 238 F.3d at 211. The 1995 SPD almost mimics the Layaou Court's example by stating, "This benefit . . . will be reduced if you've had a prior distribution . . . . In order to calculate the amount of the reduction in your benefit, the amount of the prior distribution will be presumed to have remained in the plan and to have accrued investment gains or losses in the same manner as other funds in the plan." In addition, from 1996 onward, the Value Added

Statements included with the SPD contained an actual calculation of the offset.

Plaintiffs argue that even if the 1995 SPD constituted adequate disclosure, they are still entitled to recover due to Xerox's inadequate 1993 disclosure. In order to recover for the inadequate 1993 SPD, Plaintiffs must also show that they were actually injured by that inadequate disclosure. The Courts of Appeals are split as to precise standard for demonstrating injury; the Third, Seventh and Eleventh Circuits require a showing of detrimental reliance, while the First, Second, Fourth, Eighth and Tenth Circuits allow recovery upon a showing of either reliance or prejudice. *See Burke* v. *Kodak Retirement Income Plan*, 336 F.3d 103,112 (2nd Cir. 2003) (collecting cases). Under a detrimental reliance standard, the Plaintiff must affirmatively show that "he read the SPD and that but fur the inaccurate description he would have acted differently." *Id*. Under a prejudice standard, the Plaintiff need only show that "a plan participant or beneficiary was likely to have been harmed as a result of a deficient SPD." *Id*. While the Ninth Circuit has not yet ruled on this issue, Plaintiffs argue that the standard of substantial prejudice should apply.

This Court concludes that Plaintiff cannot recover under either standard. While Plaintiffs argue that they would have considered changing employers had they known that their benefits would be offset by prior distributions,[4] the facts of this case indicate otherwise.

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4 All three Plaintiffs have filed declarations stating that "The possibility of leaving Xerox for another employer came up, from time to time, and on occasion I gave consideration to employment with other companies." "If I had not believed that I was accruing significant pension benefits under the RIGP for my services to Xerox, I would have given more serious consideration to other possible employment and may have left Xerox for another position." Plaintiffs' Decl. ¶¶ 6,7 at Jt. Exh. Nos. 41, 42, 43.

Xerox's disclosures from 1993-1995 were inadequate, but Xerox cured this problem with its 1995 disclosure. Plaintiffs were therefore on notice since 1995 that their benefits would be offset. Plaintiff Allen retired from Xerox in 1997, two years after Xerox fully disclosed that his benefits word be offset, and there is no evidence in the record that Allen took any concrete steps to switch his employment during that two year period. As of February 2002, seven years after Xerox disclosed that their benefits would be offset, Plaintiffs Sudduth and Miller continue to be employed by Xerox, and the record contains no evidence that they have sought to switch their employment during this seven year time period. In light of Plaintiffs failure to offer sufficient evidence that they have either detrimentally relied on Xerox's inadequate disclosures or been prejudiced by the disclosures, this Court finds that Plaintiffs have failed to meet their burden.

III. Conclusion

For the foregoing reasons the Court enters judgment in favor of the Defendants. IT IS SO ORDERED.

February 23, 2004

s/ Wm. Matthew Byrne, Jr.
Wm. Matthew Byrne, Jr.
United States District Judge

APPENDIX D

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

Nos. 04-55582, 04-55583

WALDAMAR MILLER; THOMAS H. SUDDUTH, JR.; J. DENTON ALLEN, INDIVIDUALS, PLAINTIFFS-APPELLANTS,

v.

XEROX CORPORATION RETIREMENT INCOME GUARANTEE PLAN, AN EMPLOYEE PENSION BENEFIT PLAN; XEROX CORPORATION, A NEW YORK CORPORATION; PATRICIA NAZEMETZ, AS PLAN ADMINISTRATOR OF THE XEROX CORPORATION RETIREMENT INCOME GUARANTEE PLAN, DEFENDANTS-APPELLEES

Argued and Submitted: Dec. 9, 2005
Filed: May 8, 2006
Amended: Sept. 13, 2006

Appeal from the United States District Court for the Central District of California William Matthew Byrne, Senior Judge, Presiding. D.C. No. CV-98-10389-WMB, D.C. No. CV-99-02589-WMB.

ORDER

Before: PREGERSON, NOONAN, and THOMAS, Circuit Judges.

An amended opinion has been filed concomitantly with this order. With the filing of the amended opinion, the petition for rehearing is DENIED.

The full court has been advised of the Petition for Rehearing En Banc and no judge of the court has requested a vote on whether to rehear the matter en banc.

Fed. R. App. P. 35. The Petition for Rehearing En Banc is DENIED.

No further petitions for rehearing or rehearing en banc may be filed, either as to the original or the amended opinion filed concomitantly herewith.

Filed: Sept. 13, 2006

APPENDIX E

ERISA § 3, 29 U.S.C. § 1002

For purposes of this subchapter:

* * *

(19) The term "nonforfeitable" when used with respect to a pension benefit or right means a claim obtained by a participant or his beneficiary to that part of an immediate or deferred benefit under a pension plan which arises from the participant's service, which is unconditional, and which is legally enforceable against the plan. For purposes of this paragraph, a right to an accrued benefit derived from employer contributions shall not be treated as forfeitable merely because the plan contains a provision described in section 1053(a)(3) of this title.

* * *

(22) The term "normal retirement benefit" means the greater of the early retirement benefit under the plan, or the benefit under the plan commencing at normal retirement age. The normal retirement benefit shall be determined without regard to—

(A) medical benefits, and

(B) disability benefits not in excess of the qualified disability benefit.

For purposes of this paragraph, a qualified disability benefit is a disability benefit provided by a plan which does not exceed the benefit which would be provided for the participant if he separated from the service at normal retirement age. For purposes of this paragraph, the early retirement benefit under a plan shall be determined without regard to any benefit under the plan which the Secretary of the Treasury finds to be a benefit described in section 1054(b)(1)(G) of this title.

(23) The term "accrued benefit" means—

(A) in the case of a defined benefit plan, the individual's accrued benefit determined under the plan and, except as provided in section 1054(c)(3) of this title, expressed in the form of an annual benefit commencing at normal retirement age, or

(B) in the case of a plan which is an individual account plan, the balance of the individual's account.

The accrued benefit of an employee shall not be less than the amount determined under section 1054(c)(2)(B) of this title with respect to the employee's accumulated contribution.

(24) The term "normal retirement age" means the earlier of—

(A) the time a plan participant attains normal retirement age under the plan, or

(B) the later of—

(i) the time a plan participant attains age 65, or

(ii) the 5th anniversary of the time a plan participant commenced participation in the plan.

* * *

(34) The term "individual account plan" or "defined contribution plan" means a pension plan which provides 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, and any forfeitures of accounts of other participants which may be allocated to such participant's account.

(35) The term "defined benefit plan" means a pension plan other than an individual account plan; except that a pension plan which is not an individual account plan and which provides a benefit derived from employer contributions which is based partly on the balance of the separate account of a participant—

(A) for the purposes of section 1052 of this title, shall be treated as an individual account plan, and

(B) for the purposes of paragraph (23) of this section and section 1054 of this title, shall be treated as an individual account plan to the extent benefits are based upon the separate account of a participant and as a defined benefit plan with respect to the remaining portion of benefits under the plan.

ERISA § 203, 29 U.S.C. § 1053

(a) Nonforfeitability requirements

Each pension plan shall provide that an employee's right to his normal retirement benefit is nonforfeitable upon the attainment of normal retirement age and in addition shall satisfy the requirements of paragraphs (1) and (2) of this subsection.

(1) A plan satisfies the requirements of this paragraph if an employee's rights in his accrued benefit derived from his own contributions are nonforfeitable.

(2)(A)(i) In the case of a defined benefit plan, a plan satisfies the requirements of this paragraph if it satisfies the requirements of clause (ii) or (iii).

(ii) A plan satisfies the requirements of this clause if an employee who has completed at least 5 years of service has a nonforfeitable right to 100 percent of the employee's accrued benefit derived from employer contributions.

(iii) A plan satisfies the requirements of this clause if an employee has a nonforfeitable right to a percentage of the employee's accrued benefit derived from employer contributions determined under the following table:

Years of service	The nonforfeitable percentage is:
3	20
4	40
5	60
6	80
7 or more	100

(B)(i) In the case of an individual account plan, a plan satisfies the requirements of this paragraph if it satisfies the requirements of clause (ii) or (iii).

(ii) A plan satisfies the requirements of this clause if an employee who has completed at least 3 years of service has a nonforfeitable right to 100 percent of the employee's accrued benefit derived from employer contributions.

(iii) A plan satisfies the requirements of this clause if an employee has a nonforfeitable right to a percentage of the employee's accrued benefit derived from employer contributions determined under the following table:

Years of service	The nonforfeitable percentage is:
2	20
3	40
4	60
5	80
6 or more	100

(3)(A) A right to an accrued benefit derived from employer contributions shall not be treated as forfeitable solely because the plan provides that it is not payable if the participant dies (except in the case of a survivor annuity which is payable as provided in section 1055 of this title).

(B) A right to an accrued benefit derived from employer contributions shall not be treated as forfeitable solely because the plan provides that the payment of benefits is suspended for such period as the employee is employed, subsequent to the commencement of payment of such benefits

(i) in the case of a plan other than a multiemployer plan, by an employer who maintains the plan under which such benefits were being paid; and

(ii) in the case of a multiemployer plan, in the same industry, in the same trade or craft, and the same geographic area covered by the plan, as when such benefits commenced.

The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subparagraph, including regulations with respect to the meaning of the term “employed”.

(C) A right to an accrued benefit derived from employer contributions shall not be treated as forfeitable solely because plan amendments may be given retroactive application as provided in section 1082(d)(2) of this title.

(D)(i) A right to an accrued benefit derived from employer contributions shall not be treated as forfeitable solely because the plan provides that, in the case of a participant who does not have a nonforfeitable right to at least 50 percent of his accrued benefit derived from employer contributions, such accrued benefit may be forfeited on account of the withdrawal by the participant of any amount attributable to the benefit derived from mandatory contributions (as defined in the last sentence of section 1054(c)(2)(C) of this title) made by such participant.

(ii) Clause (i) shall not apply to a plan unless the plan provides that any accrued benefit forfeited under a plan provision described in such clause shall be restored upon repayment by the participant of the full amount of the withdrawal described in such clause plus, in the case of a defined benefit plan, interest. Such interest shall be computed on such amount at the rate determined for purposes of section 1054(c)(2)(C) of this title (if such subsection applies) on the date of such repayment (computed annually from the date of such withdrawal). The plan provision required under this clause may provide that such repayment must be made (I) in the case of a withdrawal on account of separation from service, before the earlier of 5 years after the first date on which the participant is subsequently reemployed by the employer, or the close of the first period of 5 consecutive 1-year breaks in service commencing after the withdrawal; or (II) in the case of any other withdrawal, 5 years after the date of the withdrawal.

(iii) In the case of accrued benefits derived from employer contributions which accrued before September 2, 1974, a right to such accrued benefit derived from employer contributions shall not be treated as forfeitable solely because the plan provides that an amount of such accrued benefit may be forfeited on account of the withdrawal by the participant of an amount attributable to the benefit derived from mandatory contributions, made by such participant before September 2, 1974, if such amount forfeited is proportional to such amount withdrawn. This clause shall not apply to any plan to which any mandatory contribution is made after September 2, 1974. The Secretary of the Treasury shall prescribe such regulations as may be necessary to carry out the purposes of this clause.

(iv) For purposes of this subparagraph, in the case of any class-year plan, a withdrawal of employee contributions shall be treated as a withdrawal of such contributions on a plan year by plan year basis in succeeding order of time.

(v) Cross reference.

For nonforfeitability where the employee has a nonforfeitable right to at least 50 percent of his accrued benefit, see section 1056(c) of this title.

(E)(i) A right to an accrued benefit derived from employer contributions under a multiemployer plan shall not be treated as forfeitable solely because the plan provides that benefits accrued as a result of service with the participant's employer before the employer had an obligation to contribute under the plan may not be payable if the employer ceases contributions to the multiemployer plan.

(ii) A participant's right to an accrued benefit derived from employer contributions under a multiemployer plan shall not be treated as forfeitable solely because—

(I) the plan is amended to reduce benefits under section 1425 or 1441 of this title, or

(II) benefit payments under the plan may be suspended under section 1426 or 1441 of this title.

(F) A matching contribution (within the meaning of section 401(m) of Title 26) shall not be treated as forfeitable merely because such contribution is forfeitable if the contribution to which the matching contribution relates is treated as an excess contribution under section 401(k)(8)(B) of Title 26, an excess deferral under section 402(g)(2)(A) of Title 26, an erroneous automatic contribution under section 414(w) of Title 26, or an excess aggregate contribution under section 401(m)(6)(B) of Title 26.

(b) Computation of period of service

(1) In computing the period of service under the plan for purposes of determining the nonforfeitable percentage under subsection (a)(2) of this section, all of an employee's years of service with the employer or employers maintaining the plan shall be taken into account, except that the following may be disregarded:

(A) years of service before age 18,[1]

(B) years of service during a period for which the employee declined to contribute to a plan requiring employee contributions,[1]

(C) years of service with an employer during any period for which the employer did not maintain the plan or a predecessor plan, defined by the Secretary of the Treasury;

(D) service not required to be taken into account under paragraph (3);

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[1] So in original. The comma probably should be a semicolon.

(E) years of service before January 1, 1971, unless the employee has had at least 3 years of service after December 31, 1970;

(F) years of service before this part first applies to the plan if such service would have been disregarded under the rules of the plan with regard to breaks in service, as in effect on the applicable date; and

(G) in the case of a multiemployer plan, years of service—

(i) with an employer after—

(I) a complete withdrawal of such employer from the plan (within the meaning of section 1383 of this title), or

(II) to the extent permitted by regulations prescribed by the Secretary of the Treasury, a partial withdrawal described in section 1385(b)(2)(A)(i) of this title in connection with the decertification of the collective bargaining representative; and

(ii) with any employer under the plan after the termination date of the plan under section 1348 of this title.

(2)(A) For purposes of this section, except as provided in subparagraph (C), the term "year of service" means a calendar year, plan year, or other 12-consecutive month period designated by the plan (and not prohibited under regulations prescribed by the Secretary) during which the participant has completed 1,000 hours of service.

(B) For purposes of this section, the term "hour of service" has the meaning provided by section 1052(a)(3)(C) of this title.

(C) In the case of any seasonal industry where the customary period of employment is less than 1,000 hours during a calendar year, the term "year of service" shall be such period as determined under regulations of the Secretary.

(D) For purposes of this section, in the case of any maritime industry, 125 days of service shall be treated as 1,000 hours of service. The Secretary may prescribe regulations to carry out the purposes of this subparagraph.

(3)(A) For purposes of this paragraph, the term "1-year break in service" means a calendar year, plan year, or other 12-consecutive-month period designated by the plan (and not prohibited under regulations prescribed by the Secretary) during which the participant has not completed more than 500 hours of service.

(B) For purposes of paragraph (1), in the case of any employee who has any 1- year break in service, years of service before such break shall not be required to be taken into account until he has completed a year of service after his return.

(C) For purposes of paragraph (1), in the case of any participant in an individual account plan or an insured defined benefit plan which satisfies the requirements of subsection 1054(b)(1)(F) of this title who has 5 consecutive 1- year breaks in service, years of service after such 5-year period shall not be required to be taken into account for purposes of determining the nonforfeitable percentage of his accrued benefit derived from employer contributions which accrued before such 5-year period.

(D)(i) For purposes of paragraph (1), in the case of a nonvested participant, years of service with the employer or employers maintaining the plan before any period of consecutive 1-year breaks in service shall not be required to be taken into account if the number of consecutive 1-year breaks in service within such period equals or exceeds the greater of—

(I) 5, or

(II) the aggregate number of years of service before such period.

(ii) If any years of service are not required to be taken into account by reason of a period of breaks in service to which clause (i) applies, such years of service shall not be taken into account in applying clause (i) to a subsequent period of breaks in service.

(iii) For purposes of clause (i), the term "nonvested participant" means a participant who does not have any nonforfeitable right under the plan to an accrued benefit derived from employer contributions.

(E)(i) In the case of each individual who is absent from work for any period—

(I) by reason of the pregnancy of the individual,

(II) by reason of the birth of a child of the individual,

(III) by reason of the placement of a child with the individual in connection with the adoption of such child by such individual, or

(IV) for purposes of caring for such child for a period beginning immediately following such birth or placement,

the plan shall treat as hours of service, solely for purposes of determining under this paragraph whether a 1-year break in service has occurred, the hours described in clause (ii).

(ii) The hours described in this clause are—

(I) the hours of service which otherwise would normally have been credited to such individual but for such absence, or

(II) in any case in which the plan is unable to determine the hours described in subclause (I), 8 hours of service per day of absence,

except that the total number of hours treated as hours of service under this clause by reason of such pregnancy or placement shall not exceed 501 hours.

(iii) The hours described in clause (ii) shall be treated as hours of service as provided in this subparagraph—

(I) only in the year in which the absence from work begins, if a participant would be prevented from incurring a 1-year break in service in such year solely because the period of absence is treated as hours of service as provided in clause (i); or

(II) in any other case, in the immediately following year.

(iv) For purposes of this subparagraph, the term "year" means the period used in computations pursuant to paragraph (2).

(v) A plan may provide that no credit will be given pursuant to this subparagraph unless the individual furnishes to the plan administrator such timely information as the plan may reasonably require to establish—

(I) that the absence from work is for reasons referred to in clause (i), and

(II) the number of days for which there was such an absence.

(4) Cross References

(A) For definitions of "accrued benefit" and "normal retirement age", see sections 1002(23) and (24) of this title.

(B) For effect of certain cash out distributions, see section 1054(d)(1) of this title.

(c) Plan amendments altering vesting schedule

(1)(A) A plan amendment changing any vesting schedule under the plan shall be treated as not satisfying the requirements of subsection (a)(2) of this section if the nonforfeitable percentage of the accrued benefit derived from employer contributions (determined as of the later of the date such amendment is adopted, or the date such amendment becomes effective) of any employee who is a participant in the plan is less than such nonforfeitable percentage computed under the plan without regard to such amendment.

(B) A plan amendment changing any vesting schedule under the plan shall be treated as not satisfying the requirements of subsection (a)(2) of this section unless each participant having not less than 3 years of service is permitted to elect, within a reasonable period after adoption of such amendment, to have his nonforfeitable percentage computed under the plan without regard to such amendment.

(2) Subsection (a) of this section shall not apply to benefits which may not be provided for designated employees in the event of early termination of the plan under provisions of the plan adopted pursuant to regulations prescribed by the Secretary of the Treasury to preclude the discrimination prohibited by section 401(a)(4) of Title 26.

(d) Nonforfeitable benefits after lesser period and in greater amounts than required

A pension plan may allow for nonforfeitable benefits after a lesser period and in greater amounts than are required by this part.

(e) Consent for distribution; present value; covered distributions

(1) If the present value of any nonforfeitable benefit with respect to a participant in a plan exceeds $5,000, the plan shall provide that such benefit may not be immediately distributed without the consent of the participant.

(2) For purposes of paragraph (1), the present value shall be calculated in accordance with section 1055(g)(3) of this title.

(3) This subsection shall not apply to any distribution of dividends to which section 404(k) of Title 26 applies.

(4) A plan shall not fail to meet the requirements of this subsection if, under the terms of the plan, the present value of the nonforfeitable accrued benefit is determined without regard to that portion of such benefit which is attributable to rollover contributions (and earnings allocable thereto). For purposes of this subparagraph, the term “rollover contributions” means any rollover contribution under sections 402(c), 403(a)(4), 403(b)(8), 408(d)(3)(A)(ii), and 457(e)(16) of Title 26.

(f) Special rules for plans computing accrued benefits by reference to hypothetical account balance or equivalent amounts

(1) In general

An applicable defined benefit plan shall not be treated as failing to meet—

(A) subject to paragraph (2), the requirements of subsection (a)(2) of this section, or

(B) the requirements of section 1054(c) or section 1055(g) of this title with respect to contributions other than employee contributions, solely because the present value of the accrued benefit (or any portion thereof) of any participant is, under the terms of the plan, equal to the amount expressed as the balance in the hypothetical account described in paragraph (3) or as an accumulated percentage of the participant’s final average compensation.

(2) 3-year vesting

In the case of an applicable defined benefit plan, such plan shall be treated as meeting the requirements of subsection (a)(2) of this section only if an employee who has completed at least 3 years of service has a nonforfeitable right to 100 percent of the employee’s accrued benefit derived from employer contributions.

(3) Applicable defined benefit plan and related rules

For purposes of this subsection—

(A) In general

The term “applicable defined benefit plan” means a defined benefit plan under which the accrued benefit (or any portion thereof) is calculated as the balance of a hypothetical account maintained for the participant or as an accumulated percentage of the participant's final average compensation.

(B) Regulations to include similar plans

The Secretary of the Treasury shall issue regulations which include in the definition of an applicable defined benefit plan any defined benefit plan (or any portion of such a plan) which has an effect similar to an applicable defined benefit plan.

ERISA § 204, 29 U.S.C. § 1054

(a) Satisfaction of requirements by pension plans

Each pension plan shall satisfy the requirements of subsection (b)(3) of this section, and—

(1) in the case of a defined benefit plan, shall satisfy the requirements of subsection (b)(1) of this section; and

(2) in the case of a defined contribution plan, shall satisfy the requirements of subsection (b)(2) of this section.

(b) Enumeration of plan requirements

(1)(A) A defined benefit plan satisfies the requirements of this paragraph if the accrued benefit to which each participant is entitled upon his separation from the service is not less than—

(i) 3 percent of the normal retirement benefit to which he would be entitled at the normal retirement age if he commenced participation at the earliest possible entry age under the plan and served continuously until the earlier of age 65 or the normal retirement age specified under the plan, multiplied by

(ii) the number of years (not in excess of 33 1/3) of his participation in the plan.

In the case of a plan providing retirement benefits based on compensation during any period, the normal retirement benefit to which a participant would be entitled shall be determined as if he continued to earn annually the average rate of compensation which he earned during consecutive years of service, not in excess of 10, for which his compensation was the highest. For purposes of this subparagraph, social security benefits and all other relevant factors used to compute benefits shall be treated as remaining constant as of the current year for all years after such current year.

(B) A defined benefit plan satisfies the requirements of this paragraph of a particular plan year if under the plan the accrued benefit payable at the normal retirement age is equal to the normal retirement benefit and the annual rate at which any individual who is or could be a participant can accrue the retirement benefits payable at normal retirement age under the plan for any later plan year is not more than 133 1/3 percent of the annual rate at which he can accrue benefits for any plan year beginning on or after such particular plan year and before such later plan year. For purposes of this subparagraph—

(i) any amendment to the plan which is in effect for the current year shall be treated as in effect for all other plan years;

(ii) any change in an accrual rate which does not apply to any individual who is or could be a participant in the current year shall be disregarded;

(iii) the fact that benefits under the plan may be payable to certain employees before normal retirement age shall be disregarded; and

(iv) social security benefits and all other relevant factors used to compute benefits shall be treated as remaining constant as of the current year for all years after the current year.

(C) A defined benefit plan satisfies the requirements of this paragraph if the accrued benefit to which any participant is entitled upon his separation from the service is not less than a fraction of the annual benefit commencing at normal retirement age to which he would be entitled under the plan as in effect on the date of his separation if he continued to earn annually until normal retirement age the same rate of compensation upon which his normal retirement benefit would be computed under the plan, determined as if he had attained normal retirement age on the date any such determination is made (but taking into account no more than the 10 years of service immediately preceding his separation from service). Such fraction shall be a fraction, not exceeding 1, the numerator of which is the total number of his years of participation in the plan (as of the date of his separation from the service) and the denominator of which is the total number of years he would have participated in the plan if he separated from the service at the normal retirement age. For purposes of this subparagraph, social security benefits and all other relevant factors used to compute benefits shall be treated as remaining constant as of the current year for all years after such current year.

(D) Subparagraphs (A), (B), and (C) shall not apply with respect to years of participation before the first plan year to which this section applies but a defined benefit plan satisfies the requirements of this subparagraph with respect to such years of participation only if the accrued benefit of any participant with respect to such years of participation is not less than the greater of—

(i) his accrued benefit determined under the plan, as in effect from time to time prior to September 2, 1974, or

(ii) an accrued benefit which is not less than one-half of the accrued benefit to which such participant would have been entitled if subparagraph (A), (B), or (C) applied with respect to such years of participation.

(E) Notwithstanding subparagraphs (A), (B), and (C) of this paragraph, a plan shall not be treated as not satisfying the requirements of this paragraph solely because the accrual of benefits under the plan does not become effective until the employee has two continuous years of service. For purposes of this subparagraph, the term "year of service" has the meaning provided by section 1052(a)(3)(A) of this title.

(F) Notwithstanding subparagraphs (A), (B), and (C), a defined benefit plan satisfies the requirements of this paragraph if such plan—

(i) is funded exclusively by the purchase of insurance contracts, and

(ii) satisfies the requirements of paragraphs (2) and (3) of section 1081(b) of this title (relating to certain insurance contract plans),

but only if an employee's accrued benefit as of any applicable date is not less than the cash surrender value his insurance contracts would have on such applicable date if the requirements of paragraphs (4), (5), and (6) of section 1081(b) of this title were satisfied.

(G) Notwithstanding the preceding subparagraphs, a defined benefit plan shall be treated as not satisfying the requirements of this paragraph if the participant's accrued benefit is reduced on account of any increase in his age or service. The preceding sentence shall not apply to benefits under the plan commencing before benefits payable under title II of the Social Security Act [42 U.S.C.A. § 401 et seq.] which benefits under the plan—

(i) do not exceed social security benefits, and

(ii) terminate when such social security benefits commence.

(H)(i) Notwithstanding the preceding subparagraphs, 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.

(ii) A plan shall not be treated as failing to meet the requirements of this subparagraph solely because the plan imposes (without regard to age) a limitation on the amount of benefits that the plan provides or a limitation on the number of years of service or years of participation which are taken into account for purposes of determining benefit accrual under the plan.

(iii) In the case of any employee who, as of the end of any plan year under a defined benefit plan, has attained normal retirement age under such plan—

(I) if distribution of benefits under such plan with respect to such employee has commenced as of the end of such plan year, then any requirement of this subparagraph for continued accrual of benefits under such plan with respect to such employee during such plan year shall be treated as satisfied to the extent of the actuarial equivalent of in-service distribution of benefits, and

(II) if distribution of benefits under such plan with respect to such employee has not commenced as of the end of such year in accordance with section 1056(a)(3) of this title, and the payment of benefits under such plan with respect to such employee is not suspended during such plan year pursuant to section 1053(a)(3)(B) of this title, then any requirement of this subparagraph for continued accrual of benefits under such plan with respect to such employee during such plan year shall be treated as satisfied to the extent of any adjustment in the benefit payable under the plan during such plan year attributable to the delay in the distribution of benefits after the attainment of normal retirement age.

The preceding provisions of this clause shall apply in accordance with regulations of the Secretary of the Treasury. Such regulations may provide for the application of the preceding provisions of this clause, in the case of any such employee, with respect to any period of time within a plan year.

(iv) Clause (i) shall not apply with respect to any employee who is a highly compensated employee (within the meaning of section 414(q) of Title 26) to the extent provided in regulations prescribed by the Secretary of the Treasury for purposes of precluding discrimination in favor of highly compensated employees within the meaning of subchapter D of chapter 1 of Title 26.

(v) A plan shall not be treated as failing to meet the requirements of clause (i) solely because the subsidized portion of any early retirement benefit is disregarded in determining benefit accruals.

(vi) Any regulations prescribed by the Secretary of the Treasury pursuant to clause (v) of section 411(b)(1)(H) of Title 26 shall apply with respect to the requirements of this subparagraph in the same manner and to the same extent as such regulations apply with respect to the requirements of such section 411(b)(1)(H).

(2)(A) 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.

(B) A plan shall not be treated as failing to meet the requirements of subparagraph (A) solely because the subsidized portion of any early retirement benefit is disregarded in determining benefit accruals.

(C) Any regulations prescribed by the Secretary of the Treasury pursuant to subparagraphs (B) and (C) of section 411(b)(2) of Title 26 shall apply with respect to the requirements of this paragraph in the same manner and to the same extent as such regulations apply with respect to the requirements of such section 411(b)(2).

(3) A plan satisfies the requirements of this paragraph if—

(A) in the case of a defined benefit plan, the plan requires separate accounting for the portion of each employee's accrued benefit derived from any voluntary employee contributions permitted under the plan; and

(B) in the case of any plan which is not a defined benefit plan, the plan requires separate accounting for each employee's accrued benefit.

(4)(A) For purposes of determining an employee's accrued benefit, the term "year of participation" means a period of service (beginning at the earliest date on which the employee is a participant in the plan and which is included in a period of service required to be taken into account under section 1052(b) of this title, determined without regard to section 1052(b)(5) of this title) as determined under regulations prescribed by the Secretary which provide for the calculation of such period on any reasonable and consistent basis.

(B) For purposes of this paragraph, except as provided in subparagraph (C), in the case of any employee whose customary employment is less than full time, the calculation of such employee's service on any basis which provides less than a ratable portion of the accrued benefit to which he would be entitled under the plan if his customary employment were full time shall not be treated as made on a reasonable and consistent basis.

(C) For purposes of this paragraph, in the case of any employee whose service is less than 1,000 hours during any calendar year, plan year or other 12- consecutive-month period designated by the plan (and not prohibited under regulations prescribed by the Secretary) the calculation of his period of service shall not be treated as not made on a reasonable and consistent basis merely because such service is not taken into account.

(D) In the case of any seasonal industry where the customary period of employment is less than 1,000 hours during a calendar year, the term "year of participation" shall be such period as determined under regulations prescribed by the Secretary.

(E) For purposes of this subsection in the case of any maritime industry, 125 days of service shall be treated as a year of participation. The Secretary may prescribe regulations to carry out the purposes of this subparagraph.

(5) Special rules relating to age

(A) Comparison to similarly situated younger individual

(i) In general

A plan shall not be treated as failing to meet the requirements of paragraph (1)(H)(i) if a participant's accrued benefit, as determined as of any date under the terms of the plan, would be equal to or greater than that of any similarly situated, younger individual who is or could be a participant.

(ii) Similarly situated

For purposes of this subparagraph, a participant is similarly situated to any other individual if such participant is identical to such other individual in every respect (including period of service, compensation, position, date of hire, work history, and any other respect) except for age.

(iii) Disregard of subsidized early retirement benefits

In determining the accrued benefit as of any date for purposes of this clause, the subsidized portion of any early retirement benefit or retirement-type subsidy shall be disregarded.

(iv) Accrued benefit

For purposes of this subparagraph, the accrued benefit may, under the terms of the plan, be expressed as an annuity payable at normal retirement age, the balance of a hypothetical account, or the current value of the accumulated percentage of the employee's final average compensation.

(B) Applicable defined benefit plans

(i) Interest credits

(I) In general

An applicable defined benefit plan shall be treated as failing to meet the requirements of paragraph (1)(H) unless the terms of the plan provide that any interest credit (or an equivalent amount) for any plan year shall be at a rate which is not greater than a market rate of return. A plan shall not be treated as failing to meet the requirements of this subclause merely because the plan provides for a reasonable minimum guaranteed rate of return or for a rate of return that is equal to the greater of a fixed or variable rate of return.

(II) Preservation of capital

An interest credit (or an equivalent amount) of less than zero shall in no event result in the account balance or similar amount being less than the aggregate amount of contributions credited to the account.

(III) Market rate of return

The Secretary of the Treasury may provide by regulation for rules governing the calculation of a market rate of return for purposes of subclause (I) and for permissible methods of crediting interest to the account (including fixed or variable interest rates) resulting in effective rates of return meeting the requirements of subclause (I).

(ii) Special rule for plan conversions

If, after June 29, 2005, an applicable plan amendment is adopted, the plan shall be treated as failing to meet the requirements of paragraph (1)(H) unless the requirements of clause (iii) are met with respect to each individual who was a participant in the plan immediately before the adoption of the amendment.

(iii) Rate of benefit accrual

Subject to clause (iv), the requirements of this clause are met with respect to any participant if the accrued benefit of the participant under the terms of the plan as in effect after the amendment is not less than the sum of—

(I) the participant's accrued benefit for years of service before the effective date of the amendment, determined under the terms of the plan as in effect before the amendment, plus

(II) the participant's accrued benefit for years of service after the effective date of the amendment, determined under the terms of the plan as in effect after the amendment.

(iv) Special rules for early retirement subsidies

For purposes of clause (iii)(I), the plan shall credit the accumulation account or similar amount with the amount of any early retirement benefit or retirement-type subsidy for the plan year in which the participant retires if, as of such time, the participant has met the age, years of service, and other requirements under the plan for entitlement to such benefit or subsidy.

(v) Applicable plan amendment

For purposes of this subparagraph—

(I) In general

The term "applicable plan amendment" means an amendment to a defined benefit plan which has the effect of converting the plan to an applicable defined benefit plan.

(II) Special rule for coordinated benefits

If the benefits of 2 or more defined benefit plans established or maintained by an employer are coordinated in such a manner as to have the effect of the adoption of an amendment described in subclause (I), the sponsor of the defined benefit plan or plans providing for such coordination shall be treated as having adopted such a plan amendment as of the date such coordination begins.

(III) Multiple amendments

The Secretary of the Treasury shall issue regulations to prevent the avoidance of the purposes of this subparagraph through the use of 2 or more plan amendments rather than a single amendment.

(IV) Applicable defined benefit plan

For purposes of this subparagraph, the term "applicable defined benefit plan" has the meaning given such term by section 1053(f)(3) of this title.

(vi) Termination requirements

An applicable defined benefit plan shall not be treated as meeting the requirements of clause (i) unless the plan provides that, upon the termination of the plan—

(I) if the interest credit rate (or an equivalent amount) under the plan is a variable rate, the rate of interest used to determine accrued benefits under the plan shall be equal to the average of the rates of interest used under the plan during the 5-year period ending on the termination date, and

(II) the interest rate and mortality table used to determine the amount of any benefit under the plan payable in the form of an annuity payable at normal retirement age shall be the rate and table specified under the plan for such purpose as of the termination date, except that if such interest rate is a variable rate, the interest rate shall be determined under the rules of subclause (I).

(C) Certain offsets permitted

A plan shall not be treated as failing to meet the requirements of paragraph (1)(H)(i) solely because the plan provides offsets against benefits under the plan to the extent such offsets are allowable in applying the requirements of section 401(a) of Title 26.

(D) Permitted disparities in plan contributions or benefits

A plan shall not be treated as failing to meet the requirements of paragraph (1)(H) solely because the plan provides a disparity in contributions or benefits with respect to which the requirements of section 401(l) of Title 26 are met.

(E) Indexing permitted

(i) In general

A plan shall not be treated as failing to meet the requirements of paragraph (1)(H) solely because the plan provides for indexing of accrued benefits under the plan.

(ii) Protection against loss

Except in the case of any benefit provided in the form of a variable annuity, clause (i) shall not apply with respect to any indexing which results in an accrued benefit less than the accrued benefit determined without regard to such indexing.

(iii) Indexing

For purposes of this subparagraph, the term "indexing" means, in connection with an accrued benefit, the periodic adjustment of the accrued benefit by means of the application of a recognized investment index or methodology.

(F) Early retirement benefit or retirement-type subsidy

For purposes of this paragraph, the terms "early retirement benefit" and "retirement-type subsidy" have the meaning given such terms in subsection (g)(2)(A) of this section.

(G) Benefit accrued to date

For purposes of this paragraph, any reference to the accrued benefit shall be a reference to such benefit accrued to date.

(c) Employee's accrued benefits derived from employer and employee contributions

(1) For purposes of this section and section 1053 of this title an employee's accrued benefit derived from employer contributions as of any applicable date is the excess (if any) of the accrued benefit for such employee as of such applicable date over the accrued benefit derived from contributions made by such employee as of such date.

(2)(A) In the case of a plan other than a defined benefit plan, the accrued benefit derived from contributions made by an employee as of any applicable date is—

(i) except as provided in clause (ii), the balance of the employee's separate account consisting only of his contributions and the income, expenses, gains, and losses attributable thereto, or

(ii) if a separate account is not maintained with respect to an employee's contributions under such a plan, the amount which bears the same ratio to his total accrued benefit as the total amount of the employee's contributions (less withdrawals) bears to the sum of such contributions and the contributions made on his behalf by the employer (less withdrawals).

(B) Defined benefit plans.

In the case of a defined benefit plan, the accrued benefit derived from contributions made by an employee as of any applicable date is the amount equal to the employee's accumulated contributions expressed as an annual benefit commencing at normal retirement age, using an interest rate which would be used under the plan under section 1055(g)(3) of this title (as of the determination date).

(C) For purposes of this subsection, the term "accumulated contributions" means the total of—

(i) all mandatory contributions made by the employee,

(ii) interest (if any) under the plan to the end of the last plan year to which section 1053(a)(2) of this title does not apply (by reason of the applicable effective date), and

(iii) interest on the sum of the amounts determined under clauses (i) and (ii) compounded annually—

(I) at the rate of 120 percent of the Federal mid-term rate (as in effect under section 1274 of Title 26 for the 1st month of a plan year for the period beginning with the 1st plan year to which subsection (a)(2) of this section applies by reason of the applicable effective date) and ending with the date on which the determination is being made, and

(II) at the interest rate which would be used under the plan under section 1055(g)(3) of this title (as of the determination date) for the period beginning with the determination date and ending on the date on which the employee attains normal retirement age.

For purposes of this subparagraph, the term "mandatory contributions" means amounts contributed to the plan by the employee which are required as a condition of employment, as a condition of participation in such plan, or as a condition of obtaining benefits under the plan attributable to employer contributions.

(D) The Secretary of the Treasury is authorized to adjust by regulation the conversion factor described in subparagraph (B) from time to time as he may deem necessary. No such adjustment shall be effective for a plan year beginning before the expiration of 1 year after such adjustment is determined and published.

(3) For purposes of this section, in the case of any defined benefit plan, if an employee's accrued benefit is to be determined as an amount other than an annual benefit commencing at normal retirement age, or if the accrued benefit derived from contributions made by an employee is to be determined with respect to a benefit other than an annual benefit in the form of a single life annuity (without ancillary benefits) commencing at normal retirement age, the employee's accrued benefit, or the accrued benefits derived from contributions made by an employee, as the case may be, shall be the actuarial equivalent of such benefit or amount determined under paragraph (1) or (2).

(4) In the case of a defined benefit plan which permits voluntary employee contributions, the portion of an employee's accrued benefit derived from such contributions shall be treated as an accrued benefit derived from employee contributions under a plan other than a defined benefit plan.

(d) Employee service which may be disregarded in determining employee's accrued benefits under plan

Notwithstanding section 1053(b)(1) of this title, for purposes of determining the employee's accrued benefit under the plan, the plan may disregard service performed by the employee with respect to which he has received—

(1) a distribution of the present value of his entire nonforfeitable benefit if such distribution was in an amount (not more than the dollar limit under section 1053(e)(1) of this title) permitted under regulations prescribed by the Secretary of the Treasury, or

(2) a distribution of the present value of his nonforfeitable benefit attributable to such service which he elected to receive.

Paragraph (1) shall apply only if such distribution was made on termination of the employee's participation in the plan. Paragraph (2) shall apply only if such distribution was made on termination of the employee's participation in the plan or under such other circumstances as may be provided under regulations prescribed by the Secretary of the Treasury.

(e) Opportunity to repay full amount of distributions which have been reduced through disregarded employee service

For purposes of determining the employee's accrued benefit, the plan shall not disregard service as provided in subsection (d) of this section unless the plan provides an opportunity for the participant to repay the full amount of a distribution described in subsection (d) of this section with, in the case of a defined benefit plan, interest at the rate determined for purposes of subsection (c)(2)(C) of this section and provides that upon such repayment the employee's accrued benefit shall be recomputed by taking into account service so disregarded. This subsection shall apply only in the case of a participant who—

(1) received such a distribution in any plan year to which this section applies, which distribution was less than the present value of his accrued benefit,

(2) resumes employment covered under the plan, and

(3) repays the full amount of such distribution with, in the case of a defined benefit plan, interest at the rate determined for purposes of subsection (c)(2)(C) of this section.

The plan provision required under this subsection may provide that such repayment must be made (A) in the case of a withdrawal on account of separation from service, before the earlier of 5 years after the first date on which the participant is subsequently re-employed by the employer, or the close of the first period of 5 consecutive 1-year breaks in service commencing after the withdrawal; or (B) in the case of any other withdrawal, 5 years after the date of the withdrawal.

(f) Employer treated as maintaining a plan

For the purposes of this part, an employer shall be treated as maintaining a plan if any employee of such employer accrues benefits under such plan by reason of service with such employer.

(g) Decrease of accrued benefits through amendment of plan

(1) The accrued benefit of a participant under a plan may not be decreased by an amendment of the plan, other than an amendment described in section 1082(d)(2) or 1441 of this title.

(2) For purposes of paragraph (1), a plan amendment which has the effect of—

(A) eliminating or reducing an early retirement benefit or a retirement-type subsidy (as defined in regulations), or

(B) eliminating an optional form of benefit,

with respect to benefits attributable to service before the amendment shall be treated as reducing accrued benefits. In the case of a retirement-type subsidy, the preceding sentence shall apply only with respect to a participant who satisfies (either before or after the amendment) the preamendment conditions for the subsidy. The Secretary of the Treasury shall by regulations provide that this paragraph shall not apply to any plan amendment which reduces or eliminates benefits or subsidies which create significant burdens or complexities for the plan and plan participants, unless such amendment adversely affects the rights of any participant in a more than de minimis manner. The Secretary of the Treasury may by regulations provide that this subparagraph shall not apply to a plan amendment described in subparagraph (B) (other than a plan amendment having an effect described in subparagraph (A)).

(3) For purposes of this subsection, any—

(A) tax credit employee stock ownership plan (as defined in section 409(a) of Title 26), or

(B) employee stock ownership plan (as defined in section 4975(e)(7) of Title 26),

shall not be treated as failing to meet the requirements of this subsection merely because it modifies distribution options in a nondiscriminatory manner.

(4)(A) A defined contribution plan (in this subparagraph referred to as the "transferee plan") shall not be treated as failing to meet the requirements of this subsection merely because the transferee plan does not provide some or all of the forms of distribution previously available under another defined contribution plan (in this subparagraph referred to as the "transferor plan") to the extent that

(i) the forms of distribution previously available under the transferor plan applied to the account of a participant or beneficiary under the transferor plan that was transferred from the transferor plan to the transferee plan pursuant to a direct transfer rather than pursuant to a distribution from the transferor plan;

(ii) the terms of both the transferor plan and the transferee plan authorize the transfer described in clause (i);

(iii) the transfer described in clause (i) was made pursuant to a voluntary election by the participant or beneficiary whose account was transferred to the transferee plan;

(iv) the election described in clause (iii) was made after the participant or beneficiary received a notice describing the consequences of making the election; and

(v) the transferee plan allows the participant or beneficiary described in clause (iii) to receive any distribution to which the participant or beneficiary is entitled under the transferee plan in the form of a single sum distribution.

(B) Subparagraph (A) shall apply to plan mergers and other transactions having the effect of a direct transfer, including consolidations of benefits attributable to different employers within a multiple employer plan.

(5) Except to the extent provided in regulations promulgated by the Secretary of the Treasury, a defined contribution plan shall not be treated as failing to meet the requirements of this subsection merely because of the elimination of a form of distribution previously available thereunder. this paragraph shall not apply to the elimination of a form of distribution with respect to any participant unless

(A) a single sum payment is available to such participant at the same time or times as the form of distribution being eliminated; and

(B) such single sum payment is based on the same or greater portion of the participant's account as the form of distribution being eliminated.

(h) Notice of significant reduction in benefit accruals

(1) An applicable pension plan may not be amended so as to provide for a significant reduction in the rate of future benefit accrual unless the plan administrator provides the notice described in paragraph (2) to each applicable individual (and to each employee organization representing applicable individuals) and to each employer who has an obligation to contribute to the plan.

(2) The notice required by paragraph (1) shall be written in a manner calculated to be understood by the average plan participant and shall provide sufficient information (as determined in accordance with regulations prescribed by the Secretary of the treasury) to allow applicable individuals to understand the effect of the plan amendment. the Secretary of the treasury may provide a simplified form of notice for, or exempt from any notice requirement, a plan

(A) which has fewer than 100 participants who have accrued a benefit under the plan, or

(B) which offers participants the option to choose between the new benefit formula and the old benefit formula.

(3) Except as provided in regulations prescribed by the Secretary of the Treasury, the notice required by paragraph (1) shall be provided within a reasonable time before the effective date of the plan amendment.

(4) Any notice under paragraph (1) may be provided to a person designated, in writing, by the person to which it would otherwise be provided.

(5) A plan shall not be treated as failing to meet the requirements of paragraph (1) merely because notice is provided before the adoption of the plan amendment if no material modification of the amendment occurs before the amendment is adopted.

(6)(A) In the case of any egregious failure to meet any requirement of this subsection with respect to any plan amendment, the provisions of the applicable pension plan shall be applied as if such plan amendment entitled all applicable individuals to the greater of

(i) the benefits to which they would have been entitled without regard to such amendment, or

(ii) the benefits under the plan with regard to such amendment.

(B) For purposes of subparagraph (a), there is an egregious failure to meet the requirements of this subsection if such failure is within the control of the plan sponsor and is

(i) an intentional failure (including any failure to promptly provide the required notice or information after the plan administrator discovers an unintentional failure to meet the requirements of this subsection),

(ii) a failure to provide most of the individuals with most of the information they are entitled to receive under this subsection, or

(iii) a failure which is determined to be egregious under regulations prescribed by the Secretary of the Treasury.

(7) The Secretary of the Treasury may by regulations allow any notice under this subsection to be provided by using new technologies.

(8) For purposes of this subsection—

(A) The term "applicable individual" means, with respect to any plan amendment—

(i) each participant in the plan; and

(ii) any beneficiary who is an alternate payee (within the meaning of section 206(d)(3)(K)) under an applicable qualified domestic relations order (within the meaning of section 206(d)(3)(B)(i)), whose rate of future benefit accrual under the plan may reasonably be expected to be significantly reduced by such plan amendment.

(B) The term "applicable pension plan" means-

(i) any defined benefit plan; or

(ii) an individual account plan which is subject to the funding standards of section 412 of the Internal Revenue Code of 1986.

(9) For purposes of this subsection, a plan amendment which eliminates or reduces any early retirement benefit or retirement-type subsidy (within the meaning of subsection (g)(2)(A)) shall be treated as having the effect of reducing the rate of future benefit accrual.

(i) Prohibition on benefit increases where plan sponsor is in bankruptcy

(1) In the case of a plan described in paragraph (3) which is maintained by an employer that is a debtor in a case under Title 11 or similar Federal or State law, no amendment of the plan which increases the liabilities of the plan by reason of—

(A) any increase in benefits,

(B) any change in the accrual of benefits, or

(C) any change in the rate at which benefits become nonforfeitable under the plan, with respect to employees of the debtor, shall be effective prior to the effective date of such employer's plan of reorganization.

(2) Paragraph (1) shall not apply to any plan amendment that—

(A) the Secretary of the Treasury determines to be reasonable and that provides for only de minimis increases in the liabilities of the plan with respect to employees of the debtor,

(B) only repeals an amendment described in section 1082(d)(2) of this title,

(C) is required as a condition of qualification under part I of subchapter D of chapter 1 of Title 26, or

(D) was adopted prior to, or pursuant to a collective bargaining agreement entered into prior to, the date on which the employer became a debtor in a case under Title 11 or similar Federal or State law.

(3) This subsection shall apply only to plans (other than multiemployer plans) covered under section 1321 of this title for which the funding target attainment percentage (as defined in section 1083(d)(2) of this title) is less than 100 percent after taking into account the effect of the amendment.

(4) For purposes of this subsection, the term "employer" has the meaning set forth in section 1082(b)(1) of this title, without regard to section 1082(b)(2) of this title.

(j) Diversification requirements for certain individual account plans

(1) In general

An applicable individual account plan shall meet the diversification requirements of paragraphs (2), (3), and (4).

(2) Employee contributions and elective deferrals invested in employer securities

In the case of the portion of an applicable individual's account attributable to employee contributions and elective deferrals which is invested in employer securities, a plan meets the requirements of this paragraph if the applicable individual may elect to direct the plan to divest any such securities and to reinvest an equivalent amount in other investment options meeting the requirements of paragraph (4).

(3) Employer contributions invested in employer securities

In the case of the portion of the account attributable to employer contributions other than elective deferrals which is invested in employer securities, a plan meets the requirements of this paragraph if each applicable individual who—

(A) is a participant who has completed at least 3 years of service, or

(B) is a beneficiary of a participant described in subparagraph (A) or of a deceased participant, may elect to direct the plan to divest any such securities and to reinvest an equivalent amount in other investment options meeting the requirements of paragraph (4).

(4) Investment options

(A) In general

The requirements of this paragraph are met if the plan offers not less than 3 investment options, other than employer securities, to which an applicable individual may direct the proceeds from the divestment of employer securities pursuant to this subsection, each of which is diversified and has materially different risk and return characteristics.

(B) Treatment of certain restrictions and conditions

(i) Time for making investment choices

A plan shall not be treated as failing to meet the requirements of this paragraph merely because the plan limits the time for divestment and reinvestment to periodic, reasonable opportunities occurring no less frequently than quarterly.

(ii) Certain restrictions and conditions not allowed

Except as provided in regulations, a plan shall not meet the requirements of this paragraph if the plan imposes restrictions or conditions with respect to the investment of employer securities which are not imposed on the investment of other assets of the plan. This subparagraph shall not apply to any restrictions or conditions imposed by reason of the application of securities laws.

(5) Applicable individual account plan

For purposes of this subsection—

(A) In general

The term "applicable individual account plan" means any individual account plan (as defined in section 1002(34) of this title) which holds any publicly traded employer securities.

(B) Exception for certain ESOPs

Such term does not include an employee stock ownership plan if—

(i) there are no contributions to such plan (or earnings thereunder) which are held within such plan and are subject to subsection (k) or (m) of section 401 of Title 26, and

(ii) such plan is a separate plan (for purposes of section 414(l) of Title 26) with respect to any other defined benefit plan or individual account plan maintained by the same employer or employers.

(C) Exception for one participant plans

Such term shall not include a one-participant retirement plan (as defined in section 1021(i)(8)(B) of this title).

(D) Certain plans treated as holding publicly traded employer securities

(i) In general

Except as provided in regulations or in clause (ii), a plan holding employer securities which are not publicly traded employer securities shall be treated as holding publicly traded employer securities if any employer corporation, or any member of a controlled group of corporations which includes such employer corporation, has issued a class of stock which is a publicly traded employer security.

(ii) Exception for certain controlled groups with publicly traded securities

Clause (i) shall not apply to a plan if—

(I) no employer corporation, or parent corporation of an employer corporation, has issued any publicly traded employer security, and

(II) no employer corporation, or parent corporation of an employer corporation, has issued any special class of stock which grants particular rights to, or bears particular risks for, the holder or issuer with respect to any corporation described in clause (i) which has issued any publicly traded employer security.

(iii) Definitions

For purposes of this subparagraph, the term—

(I) "controlled group of corporations" has the meaning given such term by section 1563(a) of Title 26, except that "50 percent" shall be substituted for "80 percent" each place it appears,

(II) "employer corporation" means a corporation which is an employer maintaining the plan, and

(III) "parent corporation" has the meaning given such term by section 424(e) of Title 26.

(6) Other definitions

For purposes of this paragraph—

(A) Applicable individual

The term "applicable individual" means—

(i) any participant in the plan, and

(ii) any beneficiary who has an account under the plan with respect to which the beneficiary is entitled to exercise the rights of a participant.

(B) Elective deferral

The term "elective deferral" means an employer contribution described in section 402(g) (3)(A) of Title 26.

(C) Employer security

The term “employer security” has the meaning given such term by section 1107(d)(1) of this title.

(D) Employee stock ownership plan

The term “employee stock ownership plan” has the meaning given such term by section 4975(e)(7) of Title 26.

(E) Publicly traded employer securities

The term “publicly traded employer securities” means employer securities which are readily tradable on an established securities market.

(F) Year of service

The term “year of service” has the meaning given such term by section 1053(b)(2) of this title.

(7) Transition rule for securities attributable to employer contributions

(A) Rules phased in over 3 years

(i) In general

In the case of the portion of an account to which paragraph (3) applies and which consists of employer securities acquired in a plan year beginning before January 1, 2007, paragraph (3) shall only apply to the applicable percentage of such securities. This subparagraph shall be applied separately with respect to each class of securities.

(ii) Exception for certain participants aged 55 or over

Clause (i) shall not apply to an applicable individual who is a participant who has attained age 55 and completed at least 3 years of service before the first plan year beginning after December 31, 2005.

(B) Applicable percentage

For purposes of subparagraph (A), the applicable percentage shall be determined as follows:

Plan year to which applicable paragraph (3) applies	The percentage is:
1st	33
2d	66
3d	100

(k) Cross Reference

For special rules relating to plan provisions adopted to preclude discrimination, see section 1053(c)(2) of this title.

APPENDIX F

Treas. Reg. § 1.411(a)-7(d), 26 C.F.R. § 1.411(a)-7(d)(2006).

(d) Rules relating to certain distributions and cash-outs of accrued benefits—

(1) In general. This paragraph sets forth vesting rules applicable to certain distributions from qualified plans and their related trusts (other than class year plans). Subparagraphs (2) and (3) set forth the exceptions to nonforfeitability on account of withdrawal of mandatory contributions provided by section 411(a)(3)(D). When a plan utilizes these exceptions with respect to a given participant's accrued benefit, such accrued benefit is not subject to the cash-out rules or vesting rules of subparagraphs (4) or (5), respectively. Section 411 prescribes certain requirements with respect to accrued benefits under a qualified plan. These requirements would generally not be satisfied if the plan disregarded service in computing accrued benefits even though amounts were distributed on account of such service. Subparagraph (4) of this paragraph sets forth rules under section 411(a)(7)(B) which allow a plan to make distributions and compute accrued benefits without regard to the accrued benefit attributable to the distribution. When a defined contribution plan utilizes this exception with respect to an accrued benefit, the plan is not required to satisfy the rules of subparagraph (5) of this paragraph. Subparagraph (5) of this paragraph sets forth a vesting requirement applicable to certain distributions from defined contribution plans. Subparagraph (6) sets forth other rules which pertain to the distribution rules of this paragraph.

(2) Withdrawal of mandatory contribution—

(i) General rule. In the case of a participant's right to his employer-derived accrued benefit, a right is not treated as forfeitable merely because all or a portion of such benefit may be forfeited on account of the withdrawal by the participant of any amount attributable to his accrued benefit derived from his mandatory contributions (within the meaning of section 411(c)(2)(C) and § 1.411(c)-1) before he has become a 50 percent vested participant (within the meaning of § 1.401(a)-19(b)(2)). For purposes of determining the vested percentage, the plan may disregard service after the withdrawal. For example, assume that a plan utilizes 1000 hours for computing years of service and that for the computation period employee A had 1000 hours of service. If A was 40 percent vested at the beginning of the period but only had 800 hours at the time of the withdrawal, the plan could treat A as only 40 percent vested because service after the withdrawal can be disregarded. On the other hand, if A had 1000 hours at the time of the withdrawal, he must receive a year of service for the computation period, even though service is not taken into account until the end of such period.

(ii) Plan repayment provision. (A) Subdivision (i) of this subparagraph shall not apply unless, at the time the amount described in such subdivision is withdrawn by the participant, the plan provides the employee with a right to restoration of his employer-derived accrued benefit to the extent forfeited in accordance with such subdivision upon repayment to the plan of the full amount of the withdrawal.

(B) In the case of a defined benefit plan (as defined in section 414(j)) the restoration of the employee's employer-derived accrued benefit may be conditioned upon repayment of interest on the full amount of the distribution. Such interest shall be computed on the amount of the distribution from the date of such distribution to the date of repayment, compounded annually from the date of distribution, at the rate determined under section 411(c)(2)(C) in effect on the date of repayment. A plan may provide for repayment of interest which is less than the amount determined under the preceding sentence.

(C) In the case of both defined benefit plans and defined contribution plans, the plan repayment provision described in this subparagraph may provide that the employee must repay the full amount of the distribution in order to have the forfeited benefit restored. The plan provision may not require that such repayment be made sooner than the time described in paragraph (d)(2)(ii)(D) of this section.

(D)(1) If a distribution is on account of separation from service, the time for repayment may not end before the earlier of—

(i) 5 years after the first day the employee is subsequently employed, or

(ii) The close of the first period of consecutive 1-year breaks in service commencing after the distribution.

If the distribution occurs for any other reason, the time for repayment may not end earlier than 5 years after the date of distribution. Nevertheless, a plan provision may provide for a longer period in which the employee may repay. For example, a plan could allow repayments to be made at any time before normal retirement age.

(2) In the case of a plan utilizing the elapsed time method, described in § 1.410(a)-7, the minimum time for repayment shall be determined as in paragraph (d)(2)(ii)(D)(1) of this section except as provided in this subdivision. The 5 consecutive 1-year break periods shall be determined by substituting the term "1-year period of severance" for the term "1-year break in service". Also, the repayment period both commences and closes in a manner determined by the Commissioner that is consistent with the rules in § 1.410(a)-7 and the substitution in section 411(a)(6)(C) and (D) of a 5-year break-in-service rule for the former 1-year break-in-service rule.

(E) A defined benefit plan using the break-in-service rule described in section 410(a)(5)(D) or a defined contribution plan using the break-in-service rule described in section 411(a)(6)(C) for determining employees' accrued benefits is not required to provide for repayment by an employee whose accrued benefit is disregarded by reason of a plan provision using these rules.

(iii) Computation of benefit. In the case of a defined contribution plan, the employer-derived accrued benefit required to be restored by this subparagraph shall not be less than the amount in the account balance of the employee which was forfeited, unadjusted by any subsequent gains or losses.

(iv) Delayed forfeiture. A defined contribution plan may, in lieu of the forfeiture and restoration described in this subparagraph, provide that the forfeiture does not occur until the expiration of the time for repayment described in subdivision (ii) of this subparagraph provided that the conditions of this subparagraph are satisfied.

(3) Withdrawal of mandatory contributions; accruals before September 2, 1974—

(i) General rule. In the case of a participant's right to the portion of the employer-derived benefit which accrued prior to September 2, 1974, a right is not treated as forfeitable merely because all or part of such portion may be forfeited on account of the withdrawal by the participant of an amount attributable to his benefit derived from mandatory contributions (within the meaning of section 411(c)(2)(C) and § 1.411(c)-1(c)(4)) made by the participant before September 2, 1974, if the amount so subject to forfeiture is no more than proportional to such amounts withdrawn. This subparagraph shall not apply to any plan to which any mandatory contribution (within the meaning of section 411(c)(2)(C) and § 1.411(c)-1(c)(4)) is made after September 2, 1974.

(ii) Defined contribution plan. In the case of a defined contribution plan, the portion of a participant's employer-derived benefit which accrued prior to September 2, 1974, shall be determined on the basis of a separate accounting between benefits accruing before and after such date. Gains, losses, withdrawals, forfeitures, and other credits or charges must be separately allocated to such benefits. Any allocad'tion made on a reasonable and consistent basis prior to September 1, 1977, shall satisfy the requirements of this subdivision.

(iii) Defined benefit plan. In the case of a defined benefit plan, the portion of a participant's employer-derived benefit which accrued prior to September 2, 1974, shall be determined in a manner consistent with the determination of an accrued benefit under section 411(b)(1)(D) (see § 1.411(b)-1(c)). Any method of determining such accrued benefit which the Commissioner finds to be reasonable shall satisfy the requirements of this subdivision.

(4) Certain cash-outs of accrued benefits—

(i) Involuntary cash-outs. For purposes of determining an employee's right to an accrued benefit derived from employer contributions under a plan, the plan may disregard service performed by the employee with respect to which—

(A) The employee receives a distribution of the present value of his entire nonforfeitable benefit at the time of the distribution;

(B) The requirements of section 411(a)(11) are satisfied at the time of the distribution;

(C) The distribution is made due to the termination of the employee's participation in the plan; and

(D) The plan has a repayment provision which satisfies the requirements of paragraph (d)(4)(iv) of this section in effect at the time of the distribution.

(ii) Voluntary cash-outs. For purposes of determining an employee's accrued benefit derived from employer contributions under a plan, the plan may disregard service performed by the employee with respect to which—

(A) The employee receives a distribution of the present value of his nonforfeitable benefit attributable to such service at the time of such distribution,

(B) The employee voluntarily elects to receive such distribution,

(C) The distribution is made on termination of the employee's participation in the plan, and

(D) The plan has a repayment provision in effect at the time of the distribution which satisfies the requirements of subdivision (iv) of this subparagraph.

A distribution shall be deemed to be made on termination of participation in the plan if it is made not later than the close of the second plan year following the plan year in which such termination occurs. For purposes of determining the nonforfeitable benefit, the plan may disregard service after the distribution as illustrated in subparagraph (2)(i) of this subparagraph.

(iii) Disregard of service. Service of an employee permitted to be disregarded under subdivision (i) or (ii) of the subparagraph is not required to be taken into account in computing the employee's accrued benefit under the plan. In the case of a voluntary distribution described in subdivision (ii) of this subparagraph which is less than the present value of the employee's total nonforfeitable benefit immediately prior to the distribution, the accrued benefit not required to be taken into account is such total accrued benefit multiplied by a fraction, the numerator of which is the amount of the distribution and the denominator of which is the present value of his total nonforfeitable benefit immediately prior to such distribution. For example, A who is 50 percent vested in an account balance of $1,000 receives a voluntary distribution of $250. The accrued benefit which can be disregarded equals $1,000 times $250/$500, or $500. However, such service may not by reason of this paragraph be disregarded for purposes of determining an employee's years of service under sections 410(a)(3) and 411(a)(4).

(iv) Plan repayment provision. (A) A plan repayment provision satisfies the requirements of this subdivision if, under the provision, the accrued benefit of an employee that is disregarded by a plan under this subparagraph is restored upon repayment to the plan by the employee of the full amount of the distribution. An accrued benefit is not restored unless all of the optional forms of benefit and subsidies relating to such benefit are also restored. A plan is not required to provide for repayment of an accrued benefit unless the employee—

(1) Received a distribution that is in a plan year to which section 411 applies (see § 1.411(a)-2), which distribution is less than the amount of his accrued benefit determined under the same optional form of benefit as the distribution was made, and

(2) Resumes employment covered under the plan.

(B) Example. Plan A provides a single sum distribution equal to the present value of the normal form of the accrued benefit payable at normal retirement age which is a single life annuity. Plan A also provides a subsidized joint and survivor annuity and a subsidized early retirement annuity benefit. A participant who is fully vested and receives a single sum distribution equal to the present value of the single life annuity normal retirement benefit is not required to be provided the right under the plan to repay the distribution upon subsequent reemployment even though the participant received a distribution that did not reflect the value of the subsidy in the joint and survivor annuity or the value of the early retirement annuity subsidy. This is true whether or not the participant had satisfied at the time of the distribution all of the conditions necessary to receive the subsidies. However, if a participant does not receive his total accrued benefit in the optional form of benefit under which his benefit was distributed, the plan must provide for repayment. If the employee repays the distribution in accordance with section 411(a)(7), the plan must restore the employee's accrued benefit which would include the right to receive the subsidized joint and survivor annuity and the subsidized early retirement annuity benefit.

(C) A plan may impose the same conditions on repayments for the restoration of employer-derived accrued benefits that are allowed as conditions for restoration of employer-derived accrued benefits upon repayment of mandatory contributions under paragraphs (d)(2)(ii) (B), (C), (D) and (E) of this section.

(v) In the case of a defined contribution plan, the employer-derived accrued benefit required to be restored by this subparagraph shall not be less than the amount in the account balance of the employee, both the amount distributed and the amount forfeited, unadjusted by any subsequent gains or losses. Thus, for example, if an employee received a distribution of $250 when he was 25 percent vested in an account balance of $1,000, upon repayment of $250 the account balance may not be less than $1,000 even if, because of plan losses, the account balance, if not distributed, would have been reduced to $500.

(vi) For purposes of paragraph (d)(4)(i) of this section, a distribution shall be deemed to be made due to the termination of an employee's participation in the plan if it is made no later than the close of the second plan year following the plan year in which such termination occurs, or if such distribution would have been made under the plan by the close of such second plan year but for the fact that the present value of the nonforfeitable accrued benefit then exceeded the cash-out limit in effect under § 1.411(a)- 11(c)(3)(ii). For purposes of determining the entire nonforfeitable benefit, the plan may disregard service after the distribution, as illustrated in paragraph (d)(2)(i) of this section.

(vii) Effective date. Paragraphs (d)(4)(i) and (vi) of this section apply to distributions made on or after March 22, 1999. However, an employer is permitted to apply paragraphs (d)(4)(i) and (vi) of this section to plan years beginning on or after August 6, 1997. Otherwise, for distributions prior to March 22, 1999, §§ 1.411(a)-7 and 1.411(a)-7T, in effect prior to October 17, 2000 (as contained in 26 CFR part 1, revised as of April 1, 2000) apply.

(5) Vesting requirement for defined contribution plans—

(i) Application. The requirements of this subparagraph apply to a defined contribution plan which makes distributions to employees from their accounts attributable to employer contributions at a time when—

(A) Employees are less than 100 percent vested in such accounts, and

(B) Under the plan, employees can increase their percentage of vesting in such accounts after the distributions.

(ii) Requirements. In order for a plan, to which this subparagraph applies, to satisfy the vesting requirements of section 411, account balances under the plan (with respect to which percentage vesting can increase) must be computed in a manner which satisfies either subdivision (iii)(A) or (B) of this subparagraph.

(iii) Permissible methods. A plan may provide for either of the following methods, but not both, for computing account balances with respect to which percentage vesting can increase and from which distributions are made:

(A)(1) A separate account is established for the employee's interest in the plan as of the time of the distribution, and

(2) At any relevant time the employee's vested portion of the separate account is not less than an amount ("X") determined by the formula: $X=P(AB+(RxD))-(R\ xD)$. For purposes of applying the formula: P is the vested percentage at the relevant time; AB is the account balance at the relevant time; D is the amount of the distribution; R is the ratio of the account balance at the relevant time to the account balance after distribution; and the relevant time is the time at which, under the plan, the vested percentage in the account cannot increase.

A plan is not required to provide for separate accounts provided that account balances are maintained under a method that has the same effect as under this subdivision.

(B) At any relevant time the employee's vested portion is not less than an amount ("X") determined by the formula: X=P(AB+D)-D. For purposes of applying the formula, the terms have the same meaning as under subdivision (iii)(A)(2) of this subparagraph.

(C) An application of the methods described in subdivisions (iii)(A) and (B) of this subparagraph is illustrated by the following examples:

Example (1). The X defined contribution plan uses the method described in subdivision (iii)(A) of this subparagraph for computing account balances and the break in service rule described in section 411(a)(6)(C) (service after a 1-year break does not increase the vesting percentage in account balances accrued prior to the break). The plan distributes $250 to A when A's account balance prior to the distribution equals $1,000 and he is 25 percent vested. At the time of the distribution, A has not incurred a 1-year break so that his vesting percentage can increase. Six years later, when A is 60 percent vested, he incurs a 1-year break so that his vesting percentage cannot increase. At this time his separate account balance equals $1,500. R=$1,500/$750 or 2. A's separate account must equal 60 percent ($1,500+(2x$250))-(2x$250) or 60 percent ($1,500+$500)-$500, or $1,200-$500 equals $700.

Example (2). The Y defined contribution plan uses the method described in subdivision (iii)(B) of this subparagraph for computing account balances and the break in service rule described in section 411(a)(6)(C). The plan distributes $250 to B when B's account balance prior to the distribution equals $1,000 and he is 25 percent vested. At the time of the distribution, B has not incurred a 1-year break so that his vesting percentage can increase. Six years later, when A is 60 percent vested, he incurs a 1-year break so that his vesting percentage cannot increase. At this time his account balance equals $1,500. B's separate account must equal 60 percent ($1,500+$250)-$250, 60% of $1,750-$250 equals $800.

(6) Other rules—

(i) Distributions on separation or other event. None of the rules of this paragraph preclude distributions to employees upon separation from service or any other event recognized by the plan for commencing distributions. Such a distribution must, of course, satisfy the applicable qualification requirements pertaining to such distributions. For example, a profitsharing plan could pay the vested portion of an account balance to an employee when he separated from service, but in order to satisfy section 411 the plan might not be able to forfeit the nonvested account balance until the employee has a 1-year break in service. Similarly, the fact that a plan cannot disregard an accrued benefit attributable to service for which an employee has received a distribution because the plan does not satisfy the cash-out requirements of subparagraph (4) of this paragraph does not mean that the employee's accrued benefit (computed by taking into account such service) cannot be offset by the accrued benefit attributable to the distribution.

(ii) Joint and survivor requirements. See § 1.401(a)-11(a)(2) (relating to joint and survivor annuities) for special rules applicable to certain distributions described in this paragraph.

(iii) Plan repayments. (A) Under subparagraphs (2) and (4) of this paragraph, a plan may be required to restore accrued benefits in the event of repayment by an employee.

(B) For purposes of applying the limitations of section 415(c) and (e), in the case of a defined contribution plan, the repayment by the employee and the restoration by the employer shall not be treated as annual additions.

(C) In the case of a defined contribution plan, the permissible sources for restoration of the accrued benefit are:

income or gain to the plan, forfeitures, or employer contributions. Notwithstanding the provisions of § 1.401-1(b)(1)(ii), contributions may be made for such an accrued benefit by a profit-sharing plan even though there are no profits. In order for such a plan to be qualified, account balances (accrued benefits) generally must correspond to assets in the plan. Accordingly, there cannot be an unfunded account balance. However, an account balance will not be deemed to be unfunded in the case of a restoration if assets for the restored benefit are provided by the end of the plan year following the plan year in which the repayment occurs.

Rev. Rul. 76-259, 1976-2 C.B. 111

Internal Revenue Service (I.R.S.)

Revenue Ruling

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Qualification; pension plan benefits offset by profit-sharing plan benefits. A defined benefit plan that provides a stated benefit offset by the benefits provided by a concurrently operating profit-sharing plan will not fail to satisfy the requirements of section 401 of the Code after September 2, 1974, merely because of the offset provision. Guidelines are provided for determining whether such a plan satisfies the accrued benefit requirements of section 411(b). Rev. Rul. 69-502 superseded.

The purpose of this Revenue Ruling is to (1) reconsider the position set forth in Rev. Rul. 69-502, 1969-2 C.B. 89, in light of the Employee Retirement Income Security Act of 1974 (ERISA), P.L. 93-406, 1974-3 C.B. 1, and (2) provide guidelines as to how the accrued benefits of a defined benefit plan that are offset by the benefits of a defined a contribution plan should be tested to determine whether the accrued benefit requirements of section 411(b) of the Internal Revenue Code of 1954 are satisfied.

Rev. Rul. 69-502 considers an arrangement whereby the employer establishes a profit-sharing plan intended to be qualified under section 401(a) of the Code and also establishes a defined benefit plan which provides a stated benefit offset by the benefits provided by the profit-sharing plan. Rev. Rul. 69-502 finds, in accordance with section 1.401-1(b)(3) of the Income Tax Regulations, that the profit-sharing plan is not for the exclusive benefit of employees because contributions to such plan relieve the employer of the obligation to contribute to the defined benefit plan. Rev. Rul. 69-502 also finds that the defined benefit plan does not provide definitely determinable benefits within the meaning of section 1.401-1(b)(1) of the regulations because such plan benefits are offset by the benefits provided by the profit-sharing the benefits provided by the profit-sharing

It is the position of the Service that under subchapter D of chapter 1 as amended by ERISA an arrangement described in Rev. Rul. 69-502 does not fail to satisfy the requirements of section 401 of the Code after September 2, 1974, the date of enactment of ERISA, merely because of the type of such arrangement. See section 414(k).

Section 1.401-1(b) of the regulations will be modified to permit such an arrangement.

The defined benefit plan in this arrangement must, however, provide definitely determinable benefits. Such defined benefit plan will not be considered to provide definitely determinable benefits unless the benefit offset by the profit-sharing plan is determined in a manner that precludes discretion on the part of the employer. In particular, the defined benefit plan must provide the actuarial basis that will be employed to determine the benefit deemed to be provided by the profit-sharing plan. Also, the defined benefit plan must specify the time as of which such determination is made (the determination date) in a manner which precludes discretion on the part of the employer.

The defined benefit plan will not fail to provide definitely determinable benefits merely because the profit-sharing plan does not have a definite contribution formula.

A separate issue raised by the arrangement considered in this Revenue Ruling is the method of determining whether the accrued benefit of a defined benefit plan in such an arrangement satisfies the requirements of section 411(b)(1) of the Code. Such accrued benefit will be deemed to satisfy the requirements of section 411(b)(1) of the Code if each of the following two conditions is satisfied:

(1) the accrued benefit under the defined benefit plan determined without regard to the offset derived

from the profit-sharing plan satisfies the requirements of section 411(b)(1) of the Code; and

(2) the offset to the benefit otherwise payable is equal to the amount deemed provided on the determination date by the vested portion of the account balance in the profit-sharing plan (plus the additional amount that would have been provided by any prior distribution from the account balance).

The requirements of the second condition in the preceding sentence will not fail to be satisfied merely because the defined benefit plan states that only a specified portion of the vested account balance will be the offset. Thus, for example, in the case of a contributory profit-sharing plan, the defined benefit plan may specify that the offset is limited to the vested portion of the account balance attributable to employer contributions as determined under the profit-sharing plan.

Rev. Rul. 69-502 is hereby superseded effective September 2, 1974