March 31, 2006

Hon. Mark W. Everson  
Commissioner  
Internal Revenue Service  
1111 Constitution Avenue, N.W.  
Washington, DC 20224

Re: Proposed Regulations under Section 411(d)(6)

Dear Commissioner Everson:

Enclosed are comments under Internal Revenue Code Section 411(d)(6) Proposed Regulations. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association and should not be construed as representing the policy of the American Bar Association.

Sincerely,

Dennis B. Drapkin  
Chair, Section of Taxation
COMMENTS REGARDING THE PROPOSED REGULATIONS UNDER SECTION 411(d)(6)

The following comments are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, the Comments should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these comments was exercised by Joni L. Andrioff and Kurt Lawson. Substantive contributions were made by Elizabeth Drigotas, Robert Miller, David Levine and Mark S. Dray. The comments were reviewed by Greta Cowart and James R. Raborn, Vice Chair and Chair (respectively) of the Employee Benefits Committee of the Tax Section of the American Bar Association. The comments were further reviewed by T. David Cowart of the Section’s Committee on Government Submissions and by Thomas A. Jorgensen, as Council Director for the Employee Benefits Committee.

Although many of the members of the Section of Taxation who participated in preparing these comments have clients who would be affected by the federal tax principles addressed by these comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these comments.

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I. Executive Summary

The following comments (the “Comments”) are submitted in response to the request for comments made by the Internal Revenue Service (the “Service”) in the Notice of Proposed Rulemaking regarding Treas. Reg. § 1.411(d)-3 (the “Proposed Regulations”) that was published in the Federal Register on August 12, 2005. See 70 Fed. Reg. 47155 (Aug. 12, 2005).

Provisions substantially identical to those found in section 411\(^1\) are found in Part 2 (sections 201 et seq.) of Title I of ERISA.\(^2\) Section 411(d)(6) is substantially identical to section 204(g) of ERISA. Section 3002(c) of ERISA provides that regulations prescribed by the Treasury under section 411 also apply to its counterparts under ERISA. Section 101 of Reorganization Plan No. 4 of 1978, 43 Fed. Reg. 47713 (Oct. 17, 1978), transferred exclusive jurisdiction to the Treasury to interpret both sets of provisions. The preamble to the Proposed Regulations states that they “apply as well for purposes of section 204(g) of ERISA.”

We commend the Service and the Treasury for the extensive and well-considered final regulations (the “Final Regulations”), published at the same time as the Proposed Regulations, which address many difficult issues. We also appreciate the clarifications and guidance that the Final Regulations and the Proposed Regulations provide with respect to protected benefits under section 411(d)(6).

The Proposed Regulations raise concerns with respect to the implementation of the Supreme Court’s decision in Central Laborers’ Pension Fund v. Heinz, 541 U.S. 739 (2004), which addressed whether a plan could apply changes to its suspension-of-benefits provisions to benefits that were already accrued and in pay status, and the test for determining whether an optional form has not been “utilized” and therefore can be eliminated if certain requirements are satisfied. These concerns are that the implementation of Heinz is unnecessarily expansive and the test for determining utilization is too limited.

Therefore we recommend that the Regulations, as finalized:

1. Either not adopt the holding in Heinz, or adopt only its specific holding and not a broader reading of the decision.

2. (a) To the extent they adopt the holding in Heinz, provide relief from suits under Title I of ERISA (similar to the relief that the Service provided from disqualification in Revenue Procedure 2005-23, 2005-18 I.R.B. 991) for amendments to a plan’s suspension-of-benefits provisions made before June 6, 2004, if they complied with section 203(a)(3)(B) of ERISA (the counterpart to section 411(a)(3)(B)), and (b) to the extent they adopt a broader reading of Heinz that extends to other vesting provisions, provide relief both from disqualification and

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\(^1\) All references to sections herein shall be references to sections in the Internal Revenue Code of 1986, as amended (the “Code”) unless otherwise expressly stated.

\(^2\) The Employee Retirement Income Security Act of 1974, as amended (“ERISA”).
from suits under Title I of ERISA for amendments to a plan’s other vesting provisions made before June 6, 2004, if they complied with the applicable vesting rules, such as section 411(a)(10)(B) and section 203(c)(1)(B) of ERISA in the case of changes in a plan’s vesting schedule.

3. (a) Change the 100-participant distribution minimum in the utilization test to the lesser of (i) 100 or (ii) 5% of the number of plan participants at the beginning of the two-year look-back period, and (b) provide an alternative that does not require a participant to have elected some other optional form during the look-back period in order to be counted towards the minimum.

4. Either (a) take single-sum distributions into account in determining whether a participant is counted towards the distribution minimum, or at least (b) take them into account for plans with fewer than a minimum number of participants.

II. Application of Central Laborers’ Pension Fund v. Heinz

A. Summary

1. Heinz was decided on June 7, 2004. In it, the Supreme Court held that a plan amendment violates section 204(g) of ERISA if it expands the categories of post-retirement employment that result in a suspension of early retirement benefits already in pay status as of the effective date of the amendment.

   a. The plaintiffs in Heinz were participants in a multiemployer pension plan who commenced receiving early retirement benefits in 1996 when each was in his late 40s. Thereafter, each obtained jobs as construction supervisors. At that time, the plaintiffs’ early retirement benefits were not suspended by reason of their reemployment because the Plan required a suspension of benefits only if the participant engaged in “disqualifying employment” which did not include employment as a construction supervisor. Two years later, the Plan was amended to change the definition of “disqualifying employment” to include work as a construction supervisor, and the early retirement benefits being paid to the two plaintiffs were suspended. They sued to reinstate the payments, claiming that the amendment was a violation of section 204(g) of ERISA.

   b. The Court, affirming the Seventh Circuit, held for the plaintiffs, determining that the plan amendment violated section 204(g) of ERISA because it “had the effect of ‘eliminating or reducing an early retirement benefit’ that was earned by service before the amendment was passed”. 541 U.S. at 744.

      i. The Court stated that its conclusion was “confirmed” by Treas. Reg. § 1.411(d)-4, Q&A-7, which generally prohibits a plan from imposing new conditions on already-accrued benefits but does not specifically mention vesting conditions. 541 U.S. at 746.

      ii. The Court rejected as “technical” and “irrelevant” the plan’s and the United States’ argument that such an amendment was not prohibited by section 204(g) of ERISA because another provision, section 203(a)(3)(B) of ERISA,
specifically allows a plan to suspend a participant’s benefits while he is employed. It noted that section 203(a)(3)(B) is part of the vesting rules of ERISA, while section 204(g) is part of the accrual rules, and stated that “it would be a non sequitur to conclude that, because an amendment does not constitute a prohibited forfeiture under § 203, it must not be a prohibited reduction under § 204. Just because § 203(a)(3)(B) failed to forbid it would not mean that § 204(g) allowed it.” 541 U.S. at 749.

iii. The Court focused on the narrow question raised by the facts of the case, namely whether section 204(g) of ERISA “prohibits an amendment expanding the categories of postretirement employment that triggers suspension of payment of early retirement benefits already accrued.” 541 U.S. at 741. However, its analysis suggests that it thought that section prohibited a plan from imposing any new condition—whether related to accrual or vesting—on a benefit after it has accrued, and, in the case of a vesting condition, to prohibit it even if the vesting rules of ERISA specifically allowed it.

iv. As the Court did not expressly address the retroactive effect of its decision, the decision creates a risk that any amendment changing or even establishing a suspension of benefits provision may be viewed as a benefit cutback. Indeed, if the decision is broadly interpreted, it creates a risk that any amendment changing any aspect of a plan’s vesting provisions may be viewed as a benefit cutback, even for participants with less than three years of service, as otherwise permitted by section 203(c)(1)(B) of ERISA (the counterpart to section 411(a)(10)(B)).

2. On April 18, 2005, the IRS released Revenue Procedure 2005-23 to provide, under section 7805(b)(8), retroactive relief from plan disqualification based on Heinz because of a plan amendment made on or before June 6, 2004, adding or expanding a provision under which a suspension of benefits occurs, as long as a reforming amendment is made that reverses the effect of the original amendment for periods after June 6, 2004, for benefits that accrued before the original amendment. The Revenue Procedure did not specifically provide relief from Title I actions by participants or other eligible claimants. It also did not specifically provide relief from plan disqualification because of other kinds of changes to a plan’s vesting provisions that could be restricted by a broad reading of Heinz.

3. The Proposed Regulations were published on August 12, 2005.

a. The Proposed Regulations would adopt a broad reading of Heinz. They would amend Treas. Reg. § 1.411(d)-3(a)(3) to provide that the anti-cutback rules in the regulations under section 411(d)(6) “apply to a plan amendment that . . . places greater restrictions or conditions on a participant’s rights to section 411(d)(6) protected benefits, even if the amendment merely adds a restriction or condition that is otherwise permitted under the vesting rules in section 411(a)(3) through (11).”

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3 Section 7805(b)(8) allows the Secretary of the Treasury to “prescribe the extent, if any, to which any ruling (including any judicial decision or any administrative determination other than by regulation) relating to the internal revenue laws shall be applied without retroactive effect.”
b. The Proposed Regulations would add three examples of amendments that would violate this rule (Prop. Treas. Reg. § 1.411(d)-3(a)(4)):

i. The first example concerns a plan with five-year cliff vesting that reinstates pre-break vesting service after an employee has been reemployed for a year. The plan is then amended to provide that pre-break service is not recognized for a participant with five consecutive one-year breaks in service, as permitted by section 411(a)(6)(D). Under the Proposed Regulations, the amendment violates section 411(d)(6) because it imposes greater restrictions or conditions on the ability of participants with less than five years of service to further vest in their pre-break benefit.

ii. The next example concerns a plan that changes from five-year cliff vesting to a seven-year graded vesting schedule. Pursuant to section 411(a)(10)(B), the amendment provides that any participant who has at least three years of service is permitted to elect to have either the five-year cliff or seven-year graded vesting schedule apply. Under the Proposed Regulations, the amendment violates section 411(d)(6) as to a participant with only two years of service because it imposes a restriction on vesting until the end of the seven-year schedule. In the example, the amendment would not violate section 411(d)(6) if it provided a five-year graded schedule.

iii. The third example covers the facts of Heinz regarding suspension of benefits.

c. The portion of the Proposed Regulations dealing with the Heinz issue is proposed to be effective June 7, 2004. As noted already, the preamble to the Proposed Regulations states that they “apply as well for purposes of section 204(g) of ERISA.” However, the Proposed Regulations do not specifically (i) extend the relief provided in Revenue Procedure 2005-23 to include relief from suits brought under section 204(g) of ERISA, or (ii) provide any relief from disqualification under the Code or suits under ERISA for amendments to a plan’s vesting provisions besides those addressed in Revenue Procedure 2005-23, which could be restricted by a broad reading of Heinz, either for any period before Heinz was decided, or for any period after that date and before the Proposed Regulations were published.

B. Recommendations

We recommend that the Regulations, as finalized:

1. Either not adopt the holding in Heinz, or adopt only its specific holding and not a broader reading of the decision.

2. (a) To the extent they adopt the holding in Heinz, provide relief from suits under Title I of ERISA (similar to the relief that the Service provided from disqualification in Revenue Procedure 2005-23) for amendments to a plan’s suspension-of-benefits provisions made before June 6, 2004, if they complied with section 203(a)(3)(B) of ERISA (the counterpart to section 411(a)(3)(B)), and (b) to the extent they adopt a broader reading of Heinz that extends to other vesting provisions, provide relief both from disqualification and from suits under Title I of ERISA for amendments to
a plan’s other vesting provisions made before June 6, 2004, if they complied with the applicable vesting rules, such as section 411(a)(10)(B) and section 203(c)(1)(B) of ERISA in the case of changes in a plan’s vesting schedule.

C. Explanation

1. The Court’s specific holding in Heinz, and even more so the Proposed Regulations’ broad reading of Heinz, are difficult to reconcile with the statutory structure of the Code and ERISA.

   a. The accrual rules (found in section 411(b) and section 204 of ERISA) were added by ERISA as a backstop to the vesting rules (found in section 411(a) and section 203 of ERISA), to make sure the vesting rules work as intended. See H.R. Rep. No. 93-807, at 60 (1974); S. Rep. No. 93-383, at 51 (1974) (“It is necessary to provide a statutory definition of an ‘accrued benefit’ because, unless this is a defined amount, vesting of an ‘accrued benefit’ in whatever form is specified by the plan has little, if any, meaning.”); 120 Cong. Rec. S. 15737 (daily ed. Aug. 22, 1974) (“The vesting provisions apply to whatever benefit an employee has accrued under a plan. It is, therefore, important to assure that a plan’s accrual formula is not inconsistent with the statutory purpose reflected in the bill’s vesting provisions. A basic concern was that a plan not be permitted to use an accrual formula . . . to subvert the statutory intent to provide meaningful vested rights.”).

      i. Restricting amendments to a plan’s vesting provisions that are permitted under the vesting rules for the purpose of providing a backstop to the accrual rules would turn this structure on its head. Although section 411(d)(6) and section 204(g) of ERISA were revised significantly by the Retirement Equity Act of 1984 (“REA”), the legislative history of REA does not suggest that Congress intended such a dramatic reversal. See H.R. Rep. No. 98-655, Pt. 2, at 25-26 (1984) (“the bill codifies present law generally precluding the elimination or reduction of benefits that have already been accrued by employees”); S. Rep. No. 98-575, at 28 (1984) (“the bill clarifies the scope of the prohibition” against decreases in accrued benefits).

      ii. The Court in Heinz noted the distinction between the two sets of rules, but not the deliberate and carefully-considered reason for the distinction, and used the distinction mainly to minimize the relevance of section 203(a)(3)(B) of ERISA (the counterpart of section 411(a)(3)(B)). 541 U.S. at 749.

   b. The Court’s specific holding in Heinz would significantly limit the scope of section 411(a)(3)(B) and section 203(a)(3)(B) of ERISA, by allowing plan provisions implementing those sections to be amended only with respect to benefits that accrue after the effective date of the amendments.

2. The Proposed Regulations’ broad reading of Heinz is difficult to reconcile with section 411(a)(10)(B) (the counterpart of section 203(c)(1)(B) of ERISA).

   a. The Proposed Regulations would prohibit changes to a vesting schedule that are otherwise expressly permitted by section 411(a)(10)(B). That
section specifically allows amendments to a plan’s vesting schedule to be imposed on already-accrued benefits, even if they are adverse to participants, as long as the current vested percentage of each participant’s accrued benefit is not reduced, and participants with at least three years of vesting service are given a choice to continue to vest under the previous schedule. Any plan amendment that directly or indirectly affects the computation of the nonforfeitable percentage of employees’ rights to their accrued benefits is treated as an amendment to the plan’s vesting schedule for this purpose. See Treas. Reg. § 1.411(a)-8(c). Changes to the vesting schedule itself, and changes to the way in which vesting service is calculated, e.g., from the hours-of-service to the elapsed time method, are expressly included. Id. Changes in the vesting computation period, and changes in the break-in-service rules (within the limitations imposed by the Code), probably are included, as well. Yet the Proposed Regulations would explicitly or implicitly prohibit all of these changes if they reduced the chance that a participant would ultimately vest in and receive any already-accrued benefits. The Court did not explain the relationship between its holding in Heinz and the rule in section 411(a)(10)(B), and may well have been unaware of the conflict.

b. Under accepted rules of statutory construction, the specific language in section 411(a)(10)(B) regarding permitted changes in vesting schedules should override any suggestion in the more general language of section 411(d)(6) that such changes might not be permitted. Furthermore, the Proposed Regulations’ interpretation of section 411(d)(6) to prohibit amendments otherwise allowed in section 411(a)(10)(B) effectively renders section 411(a)(10)(B) meaningless, which is inconsistent with another rule of statutory construction, namely that if possible statutes are to be read together so as to give each one effect.

3. The Proposed Regulations’ broad reading of Heinz could prevent plans from applying many other vesting-related restrictions that are expressly permitted by the vesting rules and not subject to section 411(a)(10)(B) and section 203(c)(1)(B) of ERISA. For example:

a. Taken to an extreme, it could require a terminated plan to continue to allow participants to vest in their accrued benefits, notwithstanding Revenue Ruling 2003-65, 2003-25 I.R.B. 1035, and section 411(a)(4)(C).

b. It could prevent a plan from adding a deemed cash-out provision to disregard service performed by participants who terminate employment with no nonforfeitable benefit, as permitted by section 411(a)(7)(B).

c. It could prevent a plan from charging the accounts of terminated vested participants for expenses related to those accounts as permitted by Revenue Ruling 2004-10, 2004-7 I.R.B. 484, and section 411(a)(11).

4. The Regulations, as finalized, are not required to adopt the Court’s specific holding in Heinz.
a. The Court’s recent decision in National Cable & Telecommunications Association v. Brand X Internet Services, 125 S. Ct. 2688 (2005), would permit Treasury to promulgate regulations inconsistent with Heinz. In Brand X, the Court held that an administrative agency is not prohibited from construing a statute in a manner inconsistent with a federal court’s prior interpretation of such regulations, except where the court determined that the statute in question was unambiguous and therefore not subject to the agency’s discretion in interpreting it.

i. Brand X concerned the Federal Communication Commission’s interpretation of the Telecommunications Act. The FCC classified broadband cable modem services as an “information service”, rather than as a “telecommunications service” for purposes of the statute. The petitioners sought review of the FCC’s decision. On review, the Ninth Circuit struck down the FCC’s interpretation, relying on its prior decision that a cable modem service was a “telecommunications service.”

The FCC appealed, arguing that the Ninth Circuit erred in failing to defer to the FCC’s interpretation under Chevron U.S.A. Inc. v. NRDC, 467 U.S. 837 (1984).

ii. The issue before the Court was whether a federal court’s prior interpretation of a federal statute trumps an agency’s subsequent interpretation. The Court analyzed the issue under a two-step process derived from Chevron. In step one, the Court had to determine whether “the statute’s plain terms directly address[ed] the precise question at issue.” If not, in step two, the Court had to determine whether the agency’s interpretation was a reasonable policy choice. If so, the Court would defer to the agency’s interpretation. The Court determined that the Telecommunications Act did not address the precise question of whether cable modem service is an “information service” or a “telecommunications service.” Further, in step two, the Court determined that the FCC’s interpretation was a reasonable policy choice. Accordingly, the Court held that the FCC’s interpretation was entitled to deference.

iii. According to the Court in Brand X, Chevron requires a federal court to defer to any agency’s construction, even if it differs from what the court believes to be the best interpretation, if the particular statute is within the agency’s jurisdiction to administer, the statute is ambiguous on the point at issue, and the agency’s construction is reasonable.

iv. The Court determined that the Ninth Circuit should have applied Chevron, instead of following its prior precedent in AT&T Corp. v. Portland. According to the Court, a court’s prior construction of a statute trumps an agency construction otherwise entitled to Chevron deference only if the prior court decision holds that its construction follows from the unambiguous terms of the statute and thus leaves no room for agency discretion. Because Portland determined only what the court believed to be the “best” reading of the statute, the Ninth Circuit erred in refusing to apply Chevron. The Court explained that:

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4 See AT&T Corp. v. Portland, 216 F.3d 871 (9th Cir. 2000).
Since *Chevron* teaches that a court’s opinion as to the best reading of an ambiguous statute an agency is charged with administering is not authoritative, the agency’s decision to construe that statute differently from a court does not say that the court’s holding was legally wrong. Instead, the agency may, consistent with the court’s holding, choose a different construction, since the agency remains the authoritative interpreter (within the limits of reason) of such statutes. In all other respects, the court’s prior ruling remains binding law (for example, as to agency interpretations to which *Chevron* is inapplicable). The precedent has not been “reversed” by the agency, any more than a federal court’s interpretation of a State’s law can be said to have been “reversed” by a state court that adopts a conflicting (yet authoritative) interpretation of state law.

125 S. Ct. at 2701.

b. A Treasury regulation that was inconsistent with *Heinz* would still be entitled to *Chevron* deference based on *Brand X* for the following reasons:

i. In *Heinz*, the Court did not hold that section 204(g) of ERISA was unambiguous. The Court conceded that the language of the statute does not address the precise question raised in *Heinz*. In reviewing section 204(g) of ERISA, the Court stated:

Hence the question here: did the 1998 amendment to the Plan have the effect of “eliminating or reducing an early retirement benefit” that was earned by service before the amendment was passed? The statute, admittedly, is not as helpful as it might be in answering this question; *it does not explicitly define early retirement benefit, “and it rather circularly defines “accrued benefit” as “the individual’s accrued benefit determined under the plan . . . .”* Still, it certainly *looks as though* a benefit has suffered under the amendment here, for we agree with the Seventh Circuit that, *as a matter of common sense, “[a] participant’s benefits cannot be understood without reference to the conditions imposed on receiving those benefits, and an amendment placing materially greater restrictions on the receipt of the benefit ‘reduces’ the benefit just as surely as a decrease in the size of the monthly benefit payment.” . . . We simply do not see how, in any practical sense, this change of terms could not be viewed as shrinking the value of Heinz’s pension rights and reducing his promised benefits.*

541 U.S. at 744 (emphasis added).
ii. The Court left the door open for Treasury to promulgate a regulation inconsistent with its holding in *Heinz*.

(A) The Court relied in part on Treas. Reg. § 1.411(d)-4, Q&A-7, viewing the regulation’s prohibition against imposing new conditions on already-accrued benefits as confirmation of its interpretation of section 204(g) of ERISA. It rejected the plan’s and the United States’ argument that retroactive amendments to a plan’s suspension of benefits rules have long been permitted by the Internal Revenue Service and are cited with approval in the Internal Revenue Service’s Manual, because that kind of guidance is less formal and less well-considered than a regulation. According to the Court, “neither an unreasoned statement in the manual nor allegedly longstanding agency practice can trump a formal regulation with the procedural history necessary to take on the force of law.” 541 U.S. at 748. In this statement, the Court seems to acknowledge that the agency could promulgate regulations that would permit retroactive amendment for which the petitioners argued.

(B) Section 203(a)(3)(B) of ERISA and section 411(a)(3)(B) specifically authorize the Secretary of Labor (now the Secretary of the Treasury) to “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.” Similarly, in a concurring opinion, Justice Breyer joins the opinion of the Court, but assumes that the holding will not “foreclose a reading of ERISA that allows the Secretary of Labor, or the Secretary of the Treasury, to issue regulations explicitly allowing plan amendments to enlarge the scope of disqualifying employment with respect to benefits attributable to already-performed services.” 541 U.S. at 751.

iii. Permitting plan amendments to change the suspension of benefit requirements retroactively is a reasonable policy choice.

(A) Although multiemployer plan sponsors may, under section 203(a)(3)(B) of ERISA, implement suspension of benefit rules on the basis of employment in the “same industry” or “same trade or craft” for the purpose of taking plan funding issues into account, a broad reading of *Heinz* would prevent such a sponsor from adjusting these definitions in the plan, regardless of industry conditions or the funded status of the plan, unless the amendment had the effect of narrowing such definitions. Similarly, if a plan amendment broadened a geographical region, the amendment could be construed as running afoul of section 411(d)(6). This seems antithetical to the discretion afforded in the statutory language itself.

(B) Permitting plan amendments to change the suspension of benefit requirements retroactively makes particular sense for amendments before June 7, 2004, when *Heinz* was decided, since before then there was no clear guidance indicating that such changes were prohibited and, indeed, what guidance existed indicated that such changes were allowed. The case is even more compelling for amendments before July 30, 1984, REA’s effective date, since before then section 411(d)(6) and section 204(g) of ERISA did not even apply to early retirement benefits (the kind of benefits at issue in *Heinz*) and for amendments before January 1, 1989, the effective date
of Treas. Reg. § 1.411(d)-4, Q&A-7, which for the first time said that imposing new conditions on already-accrued benefits would be treated the same as reducing those benefits.

(C) As noted already, Revenue Procedure 2005-23 provided retroactive relief from plan disqualification based on Heinz because of a plan amendment adding or expanding a suspension-of-benefits provision, but did not provide relief from actions under section 204(g) of ERISA by participants or other eligible claimants. The portion of the Proposed Regulations dealing with the Heinz issue is proposed to be effective June 7, 2004. Perhaps this is intended to mean that plan amendments before that date did not violate section 204(g) of ERISA. If so, further clarification is needed. Failure to clarify this issue will have the undesirable effect of exposing plan sponsors to litigation under ERISA Title I with respect to an issue thought to be settled for many years. For example, before 1984 and in accordance with the earlier DOL regulations, many plans were amended to define the suspension period in terms of a year in which a retiree had earnings at a specified level (often, the level that could be earned without triggering reductions in Social Security benefits). Additionally, many plans were amended during that time period to provide a definition of the kind or period of reemployment that might prompt a benefit suspension (i.e., an annual suspension for reemployment for a given period during the year).

c. The fact that the Regulations, as finalized, would apply to ERISA as well as the Code, and would affect participants’ rights under ERISA, would not affect these conclusions.

i. The Treasury’s authority under section 3002(c) of ERISA and section 101 of Reorganization Plan No. 4 of 1978 to interpret the accrual and vesting rules of ERISA is just as broad as its authority under section 7805 to interpret the accrual and vesting rules of the Code. Specifically, it has as much authority to issue interpretive regulations that apply to prior periods under the accrual and vesting rules of ERISA as it does under the accrual and vesting rules of the Code. Interpretive regulations by their nature apply to prior as well as future periods. This does not make them impermissibly retroactive, even if they suggest that the regulator does not agree with a position that a regulated party wanted to take. See, e.g., Esden v. Bank of Boston, 229 F.3d 154, 171-72 (2d Cir. 2000), cert. dismissed, 531 U.S. 1061 (2001) (rejecting argument that Notice 96-8 improperly subjected plan to retroactive application of subsequent interpretation of law).

ii. We believe that the Treasury’s authority under section 7805(b)(8) to prescribe the extent, if any, to which any judicial decision will be applied without retroactive effect extends to its authority to interpret the accrual and vesting rules of ERISA. Any other result would create traps for unwary plan administrators who are told they can ignore the retroactive effect of a decision interpreting one of those rules for tax-qualification purposes (as they were about the Heinz decision, with some limitations, in Revenue Procedure 2005-23) only to face lawsuits based on that decision under the exact same rule in ERISA.
5. It is even less clear that the Proposed Regulations are required to adopt a broad reading of *Heinz* that extends to all changes affecting a plan’s vesting schedule (and other vesting provisions) that are applied to already-accrued benefits.

   a. The *Brand X* analysis applies with even more force in this context.

      i. It is no less unclear that section 411(d)(6) and section 204(g) of ERISA apply to amendments affecting a plan’s vesting schedule than it is that they apply to amendments changing a plan’s suspension-of-benefits provisions. Even if those sections appeared on their faces to apply to amendments affecting a plan’s vesting schedule, an ambiguity would be created by the fact that section 411(a)(10)(B) and section 203(c)(1)(B) of ERISA specifically allow such changes, even if they are adverse to participants, as long as the current vested percentage of each participant’s accrued benefit is not reduced, and participants with at least three years of vesting service are given a choice to continue to vest under the previous schedule. If section 411(d)(6) and section 204(g) of ERISA prohibit a plan from being amended to adopt changes to its vesting schedule that might adversely impact already-accrued benefits, then section 411(a)(10)(B) and section 203(c)(1)(B) of ERISA become dead letters, a result that Congress is unlikely to have intended.

      ii. Permitting plans to be amended to adopt changes to their vesting schedules that might adversely impact already-accrued benefits, as long as the changes are consistent with section 411(a)(10)(B) and section 203(c)(1)(B) of ERISA, also is a reasonable policy choice.

         (A) It is submitted that the great majority of those changes are adopted in the context of mergers and acquisitions and plan mergers, in the interest of making one plan’s terms consistent with another’s or one plan sponsor’s policies consistent with another’s, or in the context of changes in plan vendors. Often, but not always, participants with three or more years of service are given the benefit of whichever set of provisions is better for them, rather than being given a choice, but it is less common for participants with less than three years of service to get any special treatment. The changes frequently do not involve the vesting schedule itself, but rather changes in the way that vesting service is calculated, changes in the vesting computation period, and similar changes that the regulations under section 411(a)(10)(B) and section 203(c)(1)(B) treat the same as changes in the vesting schedule. Prohibiting plan sponsors from consolidating and fine-tuning their plans’ vesting schedules in this way is likely create enormous administrative burdens. For example, it would require a plan sponsor switching from the hours-of-service-method of calculating vesting service to the elapsed time method to continue to count hours for all participants who worked under the old method, potentially for as long as they continued to be employed. We think this burden is out of proportion to the potential benefits to participants from an expansive reading of *Heinz*.

         (B) All of the policy arguments outlined above for limiting the retroactive effect of the specific holding in *Heinz*, and providing relief for
suits under Title I of ERISA, apply, if anything, even more strongly to limiting a broader reading of *Heinz*. In cases involving changes to a plan’s method for determining vesting service, an added challenge will be re-creating service records with enough detail to determine what a participant would have been entitled to if he had continued to work under the old method.

b. Furthermore, we think that the Court might very well have been influenced in reaching its decision in *Heinz* by the unique character of the suspension-of-benefit rules, which impact participants later in their careers than the other vesting rules, after their benefit expectations are more fully formed, and, as the Court noted, can in theory permit even a “permanent suspension of payments”. We also think that the Court might have been influenced by the fact that the plaintiffs’ early retirement benefits were already in pay status by the time of the 1998 amendment. In the Court’s words, “Heinz worked and accrued retirement benefits under a plan with terms allowing him to supplement retirement income by certain employment, and he was being reasonable if he relied on those terms in planning his retirement. The 1998 amendment undercut any such reliance, paying retirement income only if he accepted a substantial curtailment of his opportunity to do the kind of work he knew.” 541 U.S. at 744-45. Thus, we believe it appropriate for the Regulations, as finalized, to limit changes to changes in a plan’s suspension-of-benefit provisions applicable to benefits in pay status.

III. “Utilization” Test

A. Summary

1. The Final Regulations permit the elimination of optional forms of benefit, early retirement benefits, and retirement-type subsidies. The Final Regulations provide three methods for eliminating optional forms of benefit: (a) one for “redundant” optional forms, one for “non-core” optional forms, and one for optional forms that are not “utilized” under the plan. Treas. Reg. § 1.411(d)-3(c), (d). The Final Regulations define the terms “redundant” and “non-core”, but the definition of “utilization” rule is found in the Proposed Regulations. See Prop. Treas. Reg. § 1.411(d)-3(f). This comment addresses the requirements of the utilization rule.

2. In general, the utilization rule provides that a defined benefit plan may be amended to eliminate a “generalized” optional form of benefit that has not been “utilized” by participants over a look-back period, within the definition provided by the Proposed Regulations.

   a. A “generalized” optional form means “a group of optional forms of benefit that are identical except for differences due to the actuarial factors that are used to determine the amount of the distributions under those optional forms of benefit and the annuity starting dates.” Treas. Reg. § 1.411(d)-3(g)(8).

   b. A “look-back period” can be 2, 3, 4 or 5 years immediately preceding the plan year in which the amendment is effective.

3. The Proposed Regulations would provide that:
a. None of the optional forms being eliminated under the utilization rule can be a “core” option (i.e., a straight life annuity generalized optional form, a 75% joint and contingent annuity generalized optional form, a 10-year term certain and life annuity generalized optional form, and the most valuable option for a participant with a short life expectancy).

b. The amendment eliminating the non-utilized form may not be effective sooner than 90 days after the date the amendment is adopted (or whatever the maximum QISA explanation period may be changed to).

c. The optional form must be available to at least 100 participants during the look-back period.

i. A participant is counted as one of the 100 if the participant was eligible to elect to commence payment of an optional form that is part of the generalized option being eliminated with an annuity commencement date within the look-back period.

ii. A participant cannot be counted as one of the 100 if the participant (A) did not elect any optional form with an annuity commencement date during the look-back period, (B) elected an optional form that included a single-sum distribution that applied with respect to at least 25% of the participant’s accrued benefit, (C) elected an optional form that was only available during a limited period of time and contained a retirement-type subsidy which was not extended to the optional form of benefit with the same annuity commencement date that is part of the generalized optional form being eliminated, or (D) elected an optional form of benefit with an annuity commencement date that was more than 10 years before normal retirement age.

d. No participant has elected any optional form that is part of the generalized optional form with an annuity commencement date that is within the look-back period (period of the preceding 2, 3, 4 or 5 years).

B. Recommendations

We recommend that the Regulations, as finalized:

1. (a) Change the 100-participant distribution minimum in the utilization test to the lesser of (i) 100 or (ii) 5% of the number of plan participants at the beginning of the two-year look-back period, and (b) provide an alternative that does not require a participant to have elected some other optional form during the look-back period in order to be counted towards the minimum.

2. Either (a) take single-sum distributions into account in determining whether a participant is counted towards the distribution minimum, or at least (b) take them into account for plans with fewer than a minimum number of participants.
C. Explanation

1. The selection of 100 as the minimum number of distributions necessary to determine whether an optional form of benefit has been “utilized” over a look-back period is rough justice, at best.
   
a. Small plans and plans of small employers will be unable to rely on the rule at all, a categorical exclusion from a favorable rule that the Treasury and the Service have avoided in recent history. We believe that allowing such plans or plan sponsors to rely on the rule if the number of distributions is at least 5% of the number of plan participants at the beginning of the look-back period would address this problem, while still requiring a very substantial sample size (relative to the size of the plan) for the utilization determination.
   
b. Similarly, the ability of larger employers to satisfy the minimum requirement is likely to vary depending on economic and business conditions and demographics. For example, an employer experiencing an extended downsizing might satisfy the minimum, while a healthy business might not. Similarly, an employer with an older workforce or a workforce with more turnover might satisfy the minimum, while an employer with a younger or more stable workforce might not. We recommend that an alternative test be included in the final regulations whereby, if the plan covered at least 1,000 participants at the beginning of the two-year look-back period, and none of them elected the non-utilized option in question, the plan sponsor could eliminate the option. This alternative would give larger employers an alternative that does not require a participant to have elected some other optional form during the look-back period in order to be counted and would address the problem of disparate results for employers with different demographics, while limiting the relief to situations in which the lack of utilization of the particular optional form is likely to be statistically significant.

2. We believe that ignoring single-sum distributions for purposes of the utilization test is unnecessarily restrictive.
   
a. The choice of a single-sum option is still a choice of an optional form. An annuity form that is not utilized because participants would rather elect a single sum is still not utilized. If 100 participants receiving distributions all choose single sums rather than annuity forms of distribution, we believe it is appropriate to allow the plan sponsor to eliminate the form, provided that it is not a core benefit. Moreover, the implementation of the new relative value disclosure rules under section 417(a)(3) is likely to provide participants with sufficient information to allow them to assess the value of the single sum versus the value of an annuity. Thus, we believe it makes sense to include participants receiving single-sum distributions in determining the minimum number of participants receiving a distribution during the relevant look-back period, for purposes of both the 100-participant distribution minimum in the Proposed Regulations and the alternative 5% minimum in our recommendation.
   
b. Excluding single-sum distributions makes it unlikely that many small plans or plans of small employers will be able to rely on the rule, even if they
have more than 100 participants. Thus, even if single-sum distributions are disregarded
generally, we believe it is appropriate to allow plans with fewer than a minimum number
of participants, e.g., 1,000, at the beginning of the two-year look-back period to take them
into account. Again, a uniform rule would be the preferable approach.