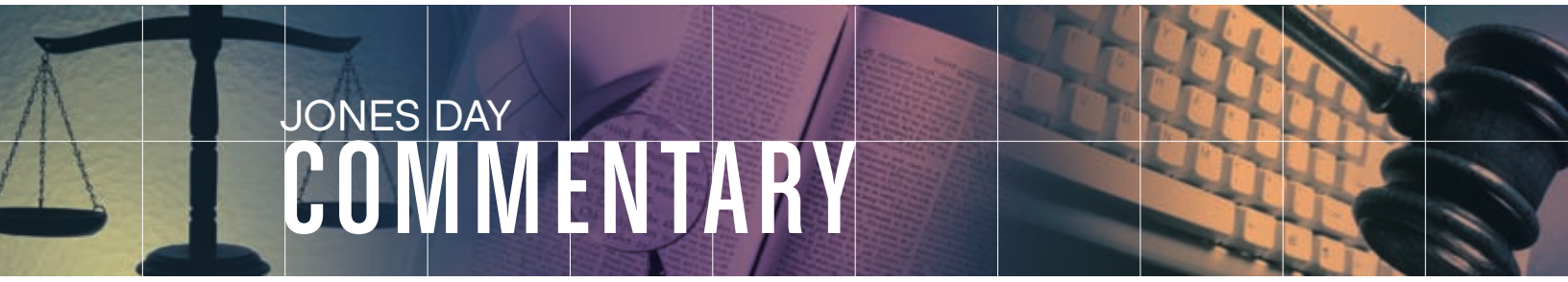
JONES DAY

JUNE 2007



IS COORDINATING MEDICARE-BASED BENEFITS WITH RETIREE MEDICAL-PLAN BENEFITS A FORM OF AGE DISCRIMINATION?

It turns out the short answer is, "no." After 10 years of litigation, three district court decisions, two circuit court of appeals decisions, and a reversal of course by the Equal Employment Opportunity Commission ("EEOC"), this commonsense answer emerged.[1] The Third Circuit Court of Appeals recently ruled that the EEOC has the statutory authority to establish an exemption from the Age Discrimination in Employment Act ("ADEA")[2] for retiree medical plans that coordinate benefits with medical and prescription drug programs such as Medicare. In its June 4, 2007 ruling in *American Association of Retired Persons ("AARP") v. Equal Employment Opportunity Commission*,[3] the Third Circuit upheld the validity of a proposed EEOC regulation that allows employers to reduce or eliminate employer-provided health benefits to retirees who become eligible for Medicare or similar state-sponsored benefit programs.[4] Although the court did not expressly overrule its prior decision in *Erie County Retirees Association v. County of Erie*,[5] which held that such modifications may violate the ADEA, the court's validation of the proposed EEOC regulation relieves employers from the

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1. In a June 2005 Jones Day *Commentary* titled "ERISA Litigation: The Law of Unintended Consequences," we described the district-court decision giving rise to this appeal.
2. 29 U.S.C. §§ 621 *et seq.*
3. No. 05-4594, 2007 WL 1584385 (3d Cir. June 4, 2007).
4. Age Discrimination in Employment Act; Retiree Health Benefits, 68 Fed. Reg. 41,542 (EEOC July 14, 2003) (Notice of Proposed Rulemaking).
5. 220 F.3d 193 (3d Cir. 2000).

adverse effects of *Erie County*. The new decision provides much-needed clarity to employers in drafting, amending, and administering retiree health benefit plans.

THE INTERSECTION OF RETIREE MEDICAL BENEFIT PLANS WITH THE ADEA

Many retiree medical plans coordinate their benefits with government programs such as Medicare in order to avoid duplication of benefits and control medical costs. As a result of such practices, many retiree medical programs provide a lower level of benefits to retirees who are eligible for Medicare or comparable state health-care programs because these government-sponsored programs pay for a significant portion of the cost of retirees' medical services.

However, in a troubling decision for employers, in 2000, the Third Circuit Court of Appeals in *Erie County* held that such coordination of medical benefit plans with government-sponsored programs potentially violated the ADEA. The *Erie County* case arose out of the decision made by the County of Erie, Pennsylvania, to implement a mandatory health maintenance organization ("HMO") for Medicare-eligible retirees in order to reduce its medical costs. Unhappy with the benefits provided by the HMO, a group of Medicare-eligible retirees filed suit under the ADEA, claiming that the implementation of the new plan design violated the Act. In particular, the retirees claimed the HMO medical-plan design implemented by the county was facially discriminatory because Medicare-eligible retirees were treated less favorably than retirees who were not eligible for Medicare benefits. The retirees' ADEA claim was initially rejected by the United States District Court for the Western District of Pennsylvania on a motion for partial summary judgment.[6] However, the Third Circuit reversed, concluding that Medicare status "is a direct proxy for age" and that, by treating Medicare-eligible retirees less favorably than other retirees, the county's retiree medical program violated the ADEA.[7]

Employers, unions, and even other courts expressed frustration and disagreement with the *Erie County* decision. Considering rising health-care costs, the requirement that full benefits be provided to all retirees regardless of eligibility for government-sponsored medical programs raised serious financial concerns for many companies. Faced with the option of having to offer the same coverage for all retirees or no coverage at all, some employers foresaw the day when they would have to choose the latter and either reduce or discontinue retiree benefit plans altogether. Moreover, the implications of the decision were not limited to those companies in the Third Circuit. Rather, many employers outside the Third Circuit were left in limbo, recognizing that the *Erie County* decision could potentially serve as precedent in the courts of their jurisdiction.

THE EEOC CHANGES COURSE WITH RESPECT TO RETIREE MEDICAL PLANS

Based upon the Third Circuit's ruling in *Erie County*, the EEOC initially implemented a policy in its Compliance Manual requiring retiree medical programs to prove either that (1) the benefits available to Medicare-eligible retirees were the same as the benefits provided to retirees not yet eligible for Medicare, or (2) the employer expends the same costs for both groups of retirees in order to comply with the ADEA. After adopting an enforcement policy consistent with the *Erie County* decision, however, the EEOC subsequently announced informally that it would not pursue cases involving retiree medical coverage. But, of course, the EEOC's determination that it would not pursue these cases did nothing to prevent Medicare-eligible retirees from relying on *Erie County* to pursue ADEA cases on their own.

On July 14, 2003, to formalize its position on the issue, the EEOC issued a Notice of Proposed Rulemaking that exempted from the prohibitions of the ADEA the employer

6. 91 F. Supp. 2d 860 (W.D.Pa. 1999).
7. 220 F.3d at 211–13.

practice of coordinating or eliminating employer-sponsored retiree benefits upon the retiree's reaching the age of eligibility for government-sponsored health benefit programs.[8] Through the regulation, the EEOC sought to "ensure that the application of the ADEA does not discourage employers from providing health benefits to their retirees." In an appendix to the proposed regulation, the EEOC answered some anticipated questions about the proposed regulation, explaining that:

- The proposed regulation does not mean that the ADEA no longer applies to retirees. It merely provides an exemption so that employers may coordinate retiree health benefits with Medicare and comparable state programs.

- The proposed regulation allows employers to offer "carve-out plans" that reduce the benefits available under an employee benefit plan by the amount payable by government-sponsored health benefit programs.

- The exemption also applies to dependent and/or spousal health benefits that are included as part of the health benefits provided for retired participants.

- The exemption applies to existing, as well as newly created, employee health benefit plans.

- The exemption does not apply to current employees who are at, or over, the age of eligibility for government-sponsored health benefit programs. It applies only to retirees. Under the laws governing Medicare, employers must offer employees the same health benefits, under the same conditions, regardless of their age or eligibility for government-sponsored programs.

THE AARP CONTESTS THE PROPOSED REGULATION

The AARP objected to the EEOC's proposed rule and filed suit under the ADEA and the Administrative Procedure Act ("APA")[9] in the United States District Court for the Eastern District of Pennsylvania. It sought an injunction to prevent the EEOC from promulgating the proposed regulation ("*AARP I*").[10] Recognizing that the district court was bound by the *Erie County* decision, the EEOC did not dispute the holding in *Erie County*. Instead, the EEOC argued that it has broad statutory authority under the ADEA to issue regulations exempting otherwise prohibited conduct as long as the exemption is "reasonable" and "necessary and proper in the public interest." The district court didn't buy it, however, and enjoined the EEOC from promulgating its proposed regulation.

After the decision in *AARP I*, the U.S. Supreme Court issued its opinion in *National Cable and Telecomm. Ass'n v. Brand X Internet Services*.[11] In *Brand X*, the Court held that a government agency may interpret a statute differently from a court unless the court has determined the "only permissible meaning" of the statute. Based on the *Brand X* decision, the EEOC filed a motion to vacate the district court's decision in *AARP I*, arguing that the *Erie County* decision did not determine the only permissible meaning of the ADEA and that the EEOC had the statutory authority to adopt a different, but reasonable, interpretation of the ADEA ("*AARP II*").[12] The district court agreed, and it vacated its prior order.

The AARP appealed ("*AARP III*").[13] The Third Circuit framed the issue on appeal as "whether the proposed regulation is within the EEOC's authority under the ADEA, and whether the regulation is valid under the APA." Significantly, the court initially determined that the EEOC has the statutory authority to issue the proposed regulation under Section 9 of the

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8. Age Discrimination in Employment Act; Retiree Health Benefits, 68 Fed. Reg. 41,542 (EEOC July 14, 2003) (Notice of Proposed Rulemaking).
9. 5 U.S.C. §§ 551 *et seq.*
10. 383 F. Supp. 2d 705 (E.D.Pa. 2005).
11. 545 U.S. 967 (2005).
12. 390 F. Supp. 2d 437 (E.D.Pa. 2005).
13. 2005 WL 1584385 (3d Cir. June 4, 2007).

ADEA.[14] Although the antidiscrimination provision in Section 4 of the ADEA prohibits employers from coordinating their retiree health benefits with eligibility for Medicare and state-sponsored health benefit programs, the court reasoned that the EEOC had established that an exemption from this prohibition was "reasonable" and "necessary and proper in the public interest." In addressing its own *Erie County* decision, the court noted that "even if *Erie County* sets forth the only acceptable view of section 4 of the ADEA, the exemption is nonetheless permitted under section 9."[15]

The court also found that the regulation was properly issued under the APA. It held that the EEOC's actions in promulgating the proposed regulation were not arbitrary and capricious under the APA. Specifically, the court reasoned that the EEOC's actions were specifically authorized by the ADEA, that it had presented a "reasoned analysis" for its change in policy, that it considered all relevant factors in promulgating the proposed regulation, and that it adhered to the notice and comment requirements of the APA. Thereafter, the court upheld the district court's order dissolving its injunction and affirming the validity of the proposed EEOC regulation.

IMPLICATIONS FOR EMPLOYERS

AARP III is major relief to employers in the Third Circuit and beyond. The EEOC now can finalize its proposed regulation, and employers within the Circuit will be able to draft, amend, and administer retiree health benefit plans to account for benefits provided by Medicare and similar state programs, without fear of violating the ADEA. For employers outside the Circuit, the legal uncertainty presented by *Erie County* will be largely nonexistent after the proposed EEOC regulation is finalized. The result in *AARP III* shows how the playing field can be leveled when the employer community acts in unison on a matter of public policy. There can be no doubt that the outcry following *Erie County* was heard by policymakers in Washington, leading to the EEOC's regulation and the Third Circuit's validation in *AARP III*.

Employers should be cautious, however, to ensure that their retiree health benefit plans fit within the exemption granted by the proposed EEOC regulation. The Third Circuit's recent decision and the EEOC itself have stated that the proposed regulation creates only a "narrow" exemption to the ADEA's prohibition on coordinating employer-sponsored retiree benefits with government-sponsored benefit programs. No aspects of ADEA coverage or benefits other than retiree health benefits are affected by the exemption. Further, the AARP is likely to appeal the Third Circuit's decision to the U.S. Supreme Court.

Despite the fact that *AARP III* upholds Medicare-based distinctions in retiree medical programs, employers must exercise care in amending their medical plans to take advantage of the benefits permitted under the EEOC's rule. Although *AARP III* may reduce or eliminate potential exposure under the ADEA, employee benefit plans and retiree benefits in particular continue to be the subject of a substantial amount of litigation under the Employee Retirement Income Security Act, the Labor Management Relations Act, and other laws. In particular, class-action litigation pertaining to retiree medical plans continues to be a source of concern and potential liability for employers, particularly those employers with collectively bargained medical programs.

Our employee benefits and labor law lawyers have already analyzed the implications of the EEOC's exemptive regulation and can assist clients that need to rein in escalating healthcare costs to the extent permitted under the EEOC regulation and otherwise by law. We draft retiree health plans, work with employers to draft materials to communicate health-program changes to retirees, and are experienced at drafting funding vehicles for retiree health plans such as VEBAs. If you have any questions regarding the drafting or administration of your company's retiree health benefit plan or believe you could benefit from our services, please contact one of Jones Day's many professionals with experience in this area.

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14. *See* 29 U.S.C. § 628 ("the Equal Employment Opportunity Commission may issue such rules and regulations as it may consider necessary or appropriate for carrying out this chapter, and may establish such reasonable exemptions to and from any or all provisions of this chapter as it may find necessary and proper in the public interest.").
15. 2005 WL 1584385, at *4 (3d Cir. June 4, 2007).

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