ASPEN PUBLISHERS VOL. 20, NO. 4 WINTER 2007

BENEFITS LAW JOURNAL

Litigation

Fairy Tale Ending? The EEOC Takes a Second Look at the ADEA and Retiree Medical Benefits

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Lawyers are sometimes driven by the strange necessity of championing the literal interpretation of laws. Unintended consequences frequently follow as textual literalism can befuddle the judiciary. The supposed beneficiaries of legislative good intentions soon discover that judicial application of the new law does them more harm than good. The beneficiaries object and litigation ensues. Every so often besieged regulators sprinkle common sense on the law through an interpretative regulation and broker a happy ending. A fairy tale ending of just this sort occurred on June 4, 2007, when the Third Circuit Court of Appeals upheld the EEOC's change of heart about how retiree medical laws should work. In *American Association of Retired Persons (AARP) v. Equal Employment Opportunity Commission (EEOC)*,[1] the Third Circuit upheld the validity of a proposed EEOC interpretive 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.[2] Although

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the court did not expressly overrule its prior decision in *Erie County Retirees Association v. County of Erie*,[3] which held that reducing retiree medical benefits by offsetting Medicare-provided benefits may violate the Age Discrimination in Employment Act (ADEA),[4] the Third Circuit's validation of the proposed EEOC interpretive regulation in *AARP v. EEOC* effectively overrules *Erie County.* This new decision ends a decade-long debate by answering "no" to the question of whether it is a form of age discrimination for a retiree medical plan sponsor to integrate retiree medical plan benefits with Medicare benefits.

The Intersection of the ADEA and Retiree Medical Benefit Plans

No law compels an employer to provide retiree medical benefits. However, once retiree medical benefits are offered, an employer must comply with various laws. For example, different laws regulate basic questions such as, can an employer change its retiree medical benefit offering? Or, if business is bad, can retiree medical benefits be terminated?

Just 33 years ago, life was simpler—there were no federal laws regulating retiree medical benefits, and the cost of providing these benefits was reasonable. Things changed. On the legal side, Congress, reacting to a series of employer abuses that wiped out the retirement benefits of thousands of workers, enacted the Employee Retirement Income Security Act (ERISA). Its primary purpose was "to prescribe a uniform set of requirements for employers in the voluntary delivery of such benefits."[5] Additional federal laws were soon added to the mix, including COBRA, HIPAA, and others that directly affect the operation and design of employer-provided medical benefits. As the years passed, medicine improved, and so did life expectancies. Unfortunately, the mathematics of longer-living retirees and more expensive medicine has generated medical costs that are ravaging many employers' budgets.

Further complicating the law of retiree medical benefits is "employment law creep." For 30 years, the ADEA 29 U.S.C. Section 621, *et seq.*, was understood to be an employment discrimination law. The ADEA was not thought to regulate retiree medical benefits because it did not address employee benefits. For example, in 1989, the Supreme Court ruled that the ADEA did not prohibit discrimination in employee benefits. *Public Employees Retirement System of Ohio v. Betts*, 492 U.S. 158, 109 S. Ct. 256 (1989). However, in response to the Supreme Court's decision, Congress passed the Older Workers Benefit Protection Act of 1990 (OWBPA), which amended the ADEA to include employee benefits.[6] Most employee benefit lawyers continued to believe that life after OWBPA would not be very different. One

thing seemed certain: Employer-provided retiree medical benefits would not be affected because OWBPA's legislative history indicated that the prior employer practices of eliminating, reducing, or altering retiree medical benefits would remain lawful.[7] This analysis turned out to be wrong.

As judges like to point out, lawyers are often confused by the words used in statutes. Our confusion about whether the ADEA applied to retiree medical benefits was justifiable because the ADEA states that its purpose is to protect the wages, hours, and working conditions of older workers. The words "retiree" or "retiree medical benefits" are not used. Instead, according to the ADEA, any worker who is age 40 or older is subject to its protection.[8] The OWBPA amendments to the ADEA prohibited employers from providing fewer or less valuable employee benefits to older workers because of age.

Because lawyers believed the ADEA didn't apply to retirees, many retiree medical plans coordinated 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 provided 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.

Round One: Coordinating Retiree Medical Benefits with Medicare Benefits Is Deemed to Be Age Discrimination

In 1997, Erie County, Pennsylvania tried to control its rapidly rising medical plan costs by changing the benefits it offered under its retiree medical plan. Erie County's retiree medical plan (prior to 1997) provided all retirees with the same health benefits regardless of their Medicare eligibility status. The new plan divided the benefits by placing older Medicare-eligible retirees in an HMO plan that coordinated its benefit payments with Medicare and placing the younger retirees in a hybrid point-of-service plan. The benefits received by the non-Medicare retirees were better than the combined benefits provided by Medicare and the HMO to the Medicare-eligible retirees. In 1999, six Medicare-eligible retirees (the Erie County Six) sued, claiming that Erie County's actions violated the ADEA by providing them with inferior medical benefits because of their age.

The Erie County Six eventually won. The federal district court in *Erie County* first ruled in favor of Erie County, finding that retiree medical plans are not regulated by the ADEA.[9] However, the Third Circuit reversed.[10] In parsing the words of the ADEA statute, the Third Circuit found that its basic provision, Section 4(a), prohibits age discrimination "against any individual" with respect to the terms,

conditions, or privileges of employment. With that, the Third Circuit concluded it was constrained to apply the words of the statute.[11] Thus, the Third Circuit held: (1) the ADEA applies to retirees and to retiree medical plans, and (2) that Erie County's retiree medical plan violated the ADEA, unless Erie County could meet either the equal benefit or the equal cost safe harbor tests under the ADEA.[12] The Third Circuit stated that Erie County could take into account the benefits provided by Medicare for purposes of applying the equal benefit safe harbor. Generally, the safe harbor rule requires a plan either to incur equal or greater costs in providing benefits to older workers, or to provide equal or greater benefits to older workers, when comparing either the costs or benefits to those provided for younger workers. The case was sent back to the District Court for resolution. On rehearing, the District Court found that Erie County's retiree medical plan did not meet the equal benefit or the equal cost safe harbor.[13] Not surprisingly, Erie County eventually decided to reduce benefits for all retirees to comply with the ADEA.

Round Two: The EEOC Reverses Course

The federal government at first embraced and then shunned the *Erie County* decision. Following the Third Circuit's 2000 ruling, in the EEOC implemented a policy in its Compliance Manual requiring retiree medical programs to prove that either (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. The EEOC subsequently announced informally that it would not pursue cases involving retiree medical coverage. 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.

A firestorm of criticism ensued. Employers, employees, and labor groups came to the conclusion that the Third Circuit's *Erie County* decision and the EEOC's new policy would have disastrous consequences for retirees. Instead of protecting retiree medical benefits, the EEOC's new policy would have the effect of reducing health coverage for retirees, as employers revised their plans to lower benefits to the lowest common denominator. In response to these comments, the EEOC rescinded its policy in August 2001 and announced that it was forming a task force to study the issue.

As a result of the task force's recommendations, the EEOC reversed course. On July 14, 2003, the EEOC issued a Notice of Proposed Rulemaking that exempted from the prohibitions of the ADEA the employer practice of coordinating or eliminating employer-sponsored

retiree benefits upon the retiree's reaching the age of eligibility for government-sponsored health benefit programs.[14] 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 only applies 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 new exception created by the EEOC would permit employers to provide retiree medical benefits as they had before the *Erie County* decision. It would be lawful to provide better benefits for non-Medicare- eligible retirees and lesser benefits for older Medicare eligible retirees. In April 2004, the EEOC formally approved the proposed rule.

Round Three: The AARP Sues to Invalidate the EEOC's Proposed Interpretive Regulation

On February 4, 2005, the AARP challenged the proposed EEOC rule in federal court. The AARP filed suit under the ADEA and the Administrative Procedure Act (APA)[15] seeking an injunction to prevent the EEOC from promulgating the proposed regulation (*AARP I*).[16]

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 exempt 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. On March 30, 2005, Judge Anita B. Brody in the District of Pennsylvania ruled she was bound by the Third Circuit's prior ruling in *Erie County* and permanently enjoined the EEOC from promulgating its proposed regulation. Judge Brody explained:

> The Third Circuit has already decided that Congress intended for the provisions of the ADEA to apply when an employer reduces health benefits based on Medicare eligibility…. An administrative agency, including the EEOC, may not issue regulations, rules or exemptions that go against the intent of Congress.[17]

The EEOC was ordered not to exempt employers from the ADEA provisions making it unlawful to provide lesser benefits to retirees who are Medicare eligible.

The EEOC timely filed a notice of appeal on May 31, 2005. Less than a month later, the U.S. Supreme Court in *National Cable and Telecommunications Association v. Brand X Internet Services*, 545 U.S. 967, 125 S. Ct. 2688 (2005) ("*Brand X*") granted federal government agencies more discretion to interpret their governing statutes than was previously thought. In *Brand* X the Supreme Court explained:

> Only a judicial precedent holding that the statute unambiguously forecloses the agency's interpretation, and therefore contains no gap for the agency to fill, displaces a conflicting agency construction.[18]

According to the Supreme Court, a government agency may interpret a statute differently from a court unless the court has determined the "only permissible meaning" of the statute. The following day, Judge Brody convened a conference call to invite the parties to address the impact of *Brand X* on the Court's decision in *AARP I*. Recognizing that the decision in *Brand X* might undermine the validity of the Court's permanent injunction, the District Court gave the EEOC leave to file a motion for relief from judgment pursuant to Rule 60(b). Two days later (on June 30, 2005) the EEOC moved for relief from judgment pursuant to Fed. R. Civ. P. 60(b). The Third Circuit remanded the case on July 13, 2005, to the District Court to consider the EEOC's motion for relief.

In its brief to the District Court, the EEOC argued that although the Third Circuit decided in *Erie County* that coordination of retiree medical benefits with Medicare eligibility constitutes age discrimination,

the Third Circuit did not consider whether Section 9 of the ADEA allows the EEOC to issue a regulation exempting that practice.[19] According to the EEOC, the Third Circuit's *Erie County* decision in no way impedes the District Court's consideration of the EEOC's newly promulgated regulation and deferring to it.

The AARP, of course, argued the EEOC had it exactly wrong. To their point of view, the EEOC missed the central point of the Third Circuit's *Erie County* decision. For the AARP, the words of the ADEA statute are not ambiguous because it is clear from the face of the ADEA that Congress intended for its prohibitions against age discrimination to apply to the practice of reducing retiree health benefits when retirees become eligible for Medicare. The AARP argued that because the Circuit Court of Appeals had ruled that the language of the statute is clear, the EEOC's contrary interpretation was foreclosed under *Brand X.*

On September 27, 2005, the District Court reversed its February 4, 2005, order, explaining:

> *Brand X* held that a court's interpretation of a statute only bars an agency from interpreting that statute differently from the court if the court has determined the *only permissible* meaning of the statute. *See Brand X*, 125 S. Ct. at 2701. Because the Third Circuit's *Erie County* decision did not determine the *only permissible* meaning of the relevant provisions of the ADEA, under *Brand X*, I am not bound by *Erie County* in reviewing the EEOC's regulation. *Brand X* also clarified the degree of deference due to agency interpretation under *Chevron*, and made it clear that the EEOC's exemption satisfies *Chevron's* two-step test.[20]

The AARP appealed the District Court's reversal (*AARP III*).[21] The Third Circuit considered "whether the proposed regulation is within the EEOC's authority under the ADEA, and whether the regulation is valid under the APA." The Court first determined that that the EEOC has the statutory authority to issue the proposed regulation under Section 9 of the ADEA. Although the anti-discrimination provision in Section 4 of the ADEA[22] would prohibit 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 the proposed exemption from section 4's anti-discrimination provision was "reasonable." In finding that the EEOC's proposed interpretive regulation was "reasonable," the Third Circuit observed that the EEOC issued the regulation in response to its finding that employer-sponsored retiree health benefits were decreasing. The comments provided to the EEOC showed that many employers were reducing or eliminating retiree medical benefits to avoid ADEA discrimination charges. Thus, as

the Third Circuit saw it, the EEOC's proposed interpretive regulation permitted "employers to offer retiree medical benefits to the greatest extent possible." 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."[23]

The Third Circuit also found that the regulation was properly issued under the APA, which requires that a court "hold unlawful and set aside agency action, findings, and conclusions" that are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[24] It held that the EEOC's actions in promulgating the proposed regulation were not arbitrary and capricious. Specifically, the Court reasoned that the EEOC's actions were specifically authorized by the ADEA, the EEOC had presented a "reasoned analysis" for its change in policy, it had considered all relevant factors in promulgating the proposed regulation, and it had 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

The Third Circuit's decision in *AARP III* is certainly a big relief to employers. Once the EEOC finalizes its proposed regulation, employers within the Third 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 Third Circuit, the *Erie County* precedent largely will be rendered moot after the proposed EEOC regulation is finalized. The result in *AARP III* shows how the positive regulatory changes can be made when the employer community acts in unison on a matter of public policy. The outcry following *Erie County* was heard by policymakers in Washington, leading to the EEOC's adoption of the proposed regulation and the Third Circuit's subsequent validation of the proposed regulation in *AARP III*.

Employers should be cautious, however, to make sure 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 other aspects of ADEA coverage or benefits other than retiree health benefits are affected by the exemption. It also appears likely the AARP will appeal the Third Circuit's decision to the U.S. Supreme Court.

Despite the fact that *AARP III* upholds the offsetting of Medicare benefits in retiree medical programs, employers should exercise care in conforming (through plan amendment) their retiree medical plans to the EEOC's new rule. Although *AARP III* may reduce or eliminate potential exposure to lawsuits under the ADEA, retiree medical benefits remain a magnet for litigation under the Employee Retirement Income Security Act (ERISA), the Labor Management Relations Act (LMRA) and other laws. Retirees faced with fixed incomes and spiraling health costs increasingly turn to the courts when their employer announces reductions to a retiree medical benefit program. Whether the language of a retiree medical plan itself permits those changes is a factually intensive inquiry that often taxes even the best legal minds.

NOTES

1. AARP v. EEOC, 489 F.3d 558, (3d Cir. 2007).

2. Age Discrimination In Employment Act; Retiree Health Benefits, 68 *Fed. Reg.* 41,542 (EEOC July 14, 2003) (notice of proposed rulemaking).

3. 220 F.3d 193 (3d Cir. 2000).

4. 29 U.S.C. §§ 621 *et seq.*

5. 120 Cong. Rec. S29942 (1974) (Statement of Sen. Javits).

6. 29 U.S.C. §§ 621, 623, 626, 629, 630.

7. Final Substitute: Statement of Managers, 136 Cong. Rec. S25353 (09/24/90); 136 Cong. Rec. H27062 (10/02/90).

8. 29 U.S.C. § 631(a) (2000).

9. Erie County Retirees Ass'n v. County of Erie, 91 F. Supp. 2d 860 (W.D. Pa. 1999).

10. Erie County Retirees Ass'n v. County of Erie, 220 F.3d 193 (3d Cir. 2000).

11. *Id.* at 213.

12. *Id.* at 213–214.

13. Erie County Retirees Ass'n v. County of Erie,140 F. Supp. 2d 466, 477 (W.D. Pa. 2001).

14. Age Discrimination In Employment Act; Retiree Health Benefits, 68 *Fed. Reg.* 41,542 (EEOC July 14, 2003) (notice of proposed rulemaking).

15. 5 U.S.C. §§ 551 *et seq.*

16. AARP v. EEOC, 383 F. Supp. 2d 705, (E.D. Pa. 2005) (*AARP I*).

17. 383 F. Supp. 2d 705, 710 (E.D. Pa. 2005).

18. 545 U.S. at 982.

19. Section 9 of the ADEA states that "the Equal Employment Opportunity commission may issue such rules and regulations as it may consider necessary or appropriate

for carrying out this chapter, andmay establish such reasonable exemptions to and from any or all provision of this chapter as it may find necessary and proper in the public interest." 29 U.S.C. § 628.

20. AARP v. EEOC, 390 F. Supp. 2d 437, 442 (E.D. Pa. 2005) (*AARP II*) (emphasis in original).

21. 489 F.3d 558, (3d Cir. 2007).

22. Section 4 of the ADEA states that "[i]t shall be unlawful for an employer…[to] discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's age." 29 U.S.C. § 623(a)(1).

23. 489 F.3d 558, 565 (3d. Cir. 2007).

24. 5 U.S.C. § 706(2)(a)

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