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Employers May Coordinate Retiree Health Care Benefits With Medicare

By Neal Mollen and Frank Kinson

The Third Circuit has just resolved a significant retiree issue regarding application of federal age discrimination law to retiree health coverage by holding that employers may reduce or eliminate that coverage when a covered person becomes eligible for Medicare. According to the Third Circuit, doing so does not violate the Age Discrimination In Employment Act because the Equal Employment Opportunity Commission's exemption permitting that practice is a valid exercise of its statutory exemption authority. *AARP v. EEOC*, No. 05-4595, ___ F.3d ___, 2007 WL 1584385, 40 Employee Benefits. Cas. (BNA) 2287 (3d Cir. June 4, 2007). This decision should come as welcome news for both employers and retirees alike.

COORDINATED HEALTH BENEFIT PLANS FOR RETIREES AS AGE DISCRIMINATION

For years, many employers have coordinated retiree health benefits with Medicare coverage, *i.e.*, they have provided full coverage until the onset of Medicare coverage, at which point employer-provided coverage either has ceased or has been reduced to include only benefits that Medicare would not provide. This made retiree health benefits, which are very costly, significantly less expensive.

In 2000, however, a divided panel of the Third Circuit held that Medicare eligibility was a proxy for age and, thus, that a benefit plan violated the ADEA when it reduced or terminated retiree health benefits based on Medicare eligibility. *Erie County Retirees Ass'n v. County of Erie*, 220 F.3d 193, 213 (3d Cir. 2000). When the EEOC adopted the holding in *Erie* as part of its enforcement guidance, the opinion took on national significance.

The decision ultimately proved detrimental to the older workers whom the EEOC sought to protect. *Erie* forced most employers to a choice: duplicate Medicare benefits, or terminate retiree coverage altogether to avoid that added expense. *Erie* and the EEOC's guidance embracing it thus created a powerful incentive for employers to abandon retiree programs, a profoundly undesirable outcome for those whom the ADEA was intended to protect.

EEOC'S EXEMPTION FOR COORDINATED HEALTH CARE BENEFIT PLANS

Once the EEOC realized that its *Erie* position had created such a perverse incentive, it abandoned that position less than a year after adopting it. *See Rescission of Section IV(B) of EEOC Compliance Manual Chapter on "Employee Benefits,"* EEOC Compl. Man., No. 915.003 (Aug. 20, 2001). In its place, the EEOC proposed an exemption to ADEA liability for "the practice of altering, reducing, or eliminating employer-sponsored retiree health benefits when retirees become eligible for Medicare or a State-sponsored retiree health benefits program." 68 Fed. Reg. 41,542 (notice of proposed rule-making). The proposed rule read:

> (b) Exemption. Some employee benefit plans provide health benefits for retired participants that are altered, reduced or eliminated when the participant is eligible for Medicare health benefits or for health benefits under a comparable State health benefit plan. Pursuant to the authority contained in section 9 of the [ADEA], and in accordance with the procedures provided therein . . . it is hereby found necessary and proper in the public interest to exempt from all prohibitions of the Act such coordination of retiree health benefits with Medicare or a comparable State health benefit plan.

68 Fed. Reg. 41,548-49.

The American Association of Retired Persons challenged the exemption, arguing that it was unlawful for three reasons: (a) the agency had failed to comply with the Administrative Procedure Act (APA) in promulgating the exemption; (b) the exemption was not "necessary [or]

proper in the public interest" — the statutory threshold for exercise of the exemption authority granted by Congress in section 9 of the ADEA; and (c) the exemption authority granted by Congress to the EEOC amounted to an unconstitutional delegation of Congress's non-delegable legislative power. The district court first granted summary judgment to the AARP, but then reversed course, granting summary judgment to the EEOC. *See AARP v. EEOC*, 383 F. Supp. 2d 705, 708 (E.D. Pa. 2005) (*AARP I*); *AARP v. EEOC*, 390 F. Supp. 2d 437, 441-42 (E.D. Pa. 2005) (*AARP II).*

EEOC'S EXEMPTION FOR COORDINATED HEALTH BENEFIT PLANS IS CONSTITUTIONAL AND WITHIN THE SCOPE OF ITS AUTHORITY

The matter was finally resolved by the recent Third Circuit decision cited at the beginning of this client alert. (*AARP III).* The unanimous panel first held that the exemption met the statutory threshold — that the EEOC had shown the exemption to be "reasonable, necessary and proper… as over time it will likely benefit all retirees." *AARP III*, 2007 WL1584385 at *3. The court agreed with the EEOC that "employers are not required to provide any retiree health benefits, or to maintain such plans once they have been established," and thus a construction of the ADEA that made benefit termination more likely was counter-productive. *Id.* at *3. The court also noted the wide support the proposed exemption had garnered from employer associations and labor groups, including the Chamber of Commerce of the United States, which was represented in the case as *amicus curiae* by Paul Hastings. *Id.* at *6 n.9.

The court also concluded that Congress had constitutionally delegated to the EEOC the authority to exempt certain conduct from the broad sweep of the ADEA. When it delegates legislative authority, Congress must provide an "intelligible principle" to guide agency action. The "necessary and proper" language in section 9, the court held, was just such an intelligible principle; *i.e.*, it authorizes only "narrow exemptions tailored to the overall purpose of the ADEA . . . . Here, the EEOC's exercise of its exemption authority through the proposed regulation is narrowly focused to permit a discrete practice pursuant to the purposes of the ADEA." *Id*. n.6. That suffices for constitutional purposes, the court held.

Finally, the court rejected the AARP's contention that the EEOC violated the APA by promulgating the proposed regulation. After studying the EEOC's reasoning and the administrative process involved, the court concluded that the agency had properly considered the objections raised by the AARP and others. The exemption, it held, was narrowly drawn "to respond to the unintended negative effects of [the EEOC's] prior approach; namely, that employers have chosen to terminate retiree benefits rather than adhere to a standard that has proven too costly to sustain." *Id.* at *4.

THE DECISION WILL LIKELY PROVE A WIN-WIN SITUATION FOR ALL CONCERNED

This decision should be viewed as good news for almost all concerned because it will make retiree health benefits more affordable and, therefore, less likely to be terminated or reduced. The AARP has not announced whether it intends to seek further appellate review and, at least for the short term, there is a temporary stay preventing implementation of the proposed exemption. Barring a motion by the EEOC, the stay is likely to remain in effect until the deadline for petitioning the United States Supreme Court expires on September 4, 2007, after which time the Office of Management and Budget may conclude its review of the proposed final rule.

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