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February 2, 2009

Congressional Research Service

Report RS21845

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Retiree Health Plans and the Age Discrimination in
Employment Act*

Jody Feder, American Law Division

Updated April 15, 2008

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CRS Report for Congress

Final Equal Employment Opportunity Commission Rules on Retiree Health Plans and the Age Discrimination in Employment Act

Jody Feder
Legislative Attorney
American Law Division

Summary

Under the Age Discrimination in Employment Act (ADEA), the Equal Employment Opportunity Commission (EEOC) has the authority to issue reasonable exemptions the Commission finds to be in the public interest. In 2004, the EEOC approved a narrowly drawn exemption to permit the practice of coordinating employer-provided retiree health coverage with eligibility for Medicare. However, the proposed regulation was challenged in court, and a permanent injunction blocking its implementation remained in effect for several years while the courts considered the issue. Recently, a federal appeals court upheld the EEOC's promulgation of the proposed rule and lifted the injunction, allowing the EEOC to publish the final rule, which became effective in December 2007. The final rule states that it is not a violation of the ADEA to alter, reduce, or eliminate health benefits for retirees when the participant becomes eligible for Medicare or comparable state health benefits. According to the EEOC, if employers were required to provide equal health benefits to both younger and older retirees, employers would be more likely to reduce benefits for younger retirees or eliminate benefits for all retirees than to increase benefits for older, Medicare-eligible retirees. Thus, the ADEA exemption is designed to eliminate any incentive for employers to cut retiree health benefits.

Employers have frequently sought to trim the high cost of providing group health coverage for their workers by reducing retiree benefits or narrowing the group of retirees eligible for coverage. Under one commonly used formula, employers often provide one level of benefits to retirees under age 65 to cover them until they are eligible for Medicare and then reduce or eliminate the benefit when the retiree becomes Medicare eligible. In

Erie County Retirees Ass'n v. County of Erie,¹ however, a federal appeals court ruled that the Age Discrimination in Employment Act (ADEA) applies to retirees and held that the practice of providing different benefits to older and younger retirees based on their eligibility for Medicare constitutes age discrimination in violation of the ADEA because Medicare eligibility is an “explicitly” age-related factor.

In 2000, the Equal Employment Opportunity Commission (EEOC) adopted the court’s reasoning as the agency’s national enforcement policy, but the Commission later rescinded its position to further review the issue. Following two years of study, the EEOC proposed a rule in 2004 that would allow employer-sponsored retiree health plans to reduce or eliminate benefits for Medicare-eligible retirees without violating the ADEA.² According to the EEOC:

Since the ADEA requires only equal treatment, employers threatened to comply with the ADEA not by raising benefits for older retirees, but by reducing benefits to younger retirees or by eliminating all benefits for all retirees. Indeed, the *Erie County* case was settled by requiring younger retirees to pay higher premiums and move into an HMO plan. In light of evidence that employers would ‘equalize’ benefits by reducing them ... the EEOC sought, in essence, to undo the court’s decision in *Erie County* by issuing a rule specifying that the practice of coordinating a retiree’s health benefits would not violate the ADEA.³

Background.

The ADEA prohibits discrimination against workers over 40 years of age in compensation or with respect to employment “terms, conditions, or privileges.”⁴ The act’s legislative history contained a Statement of Managers, which suggested that the practice of coordinating retiree health plans with Medicare was not prohibited.⁵ In *Erie County*, however, the Third Circuit disregarded that evidence of congressional intent when it ruled that providing inferior benefits to Medicare-eligible retirees than to younger retired workers may be illegal age discrimination. It remanded the case for a trial court determination of whether the plan was saved by the equal-benefit or equal-cost provisions

¹ 220 F.3d 193 (3d Cir. 2000).

² See EEOC, Age Discrimination in Employment Act; Retiree Health Benefits (Final Rule), published at [http://www.eeoc.gov/policy/regs/retiree_benefits.html].

³ Advisory Letter from Raymond L. Peeler, Senior Attorney Advisor, Title VII/ADEA/EPA Division, Equal Opportunity Employment Commission (November 9, 2005), [http://www.eeoc.gov/foia/letters/2005/adea_retiree_health.html].

⁴ 29 U.S.C. § 623.

⁵ See Older Workers Benefit Protection Act of 1990, P.L. 101-433, 104 Stat. 9780(1990), Final Substitute: Statement of Managers, 136 Cong. Rec. S25353 (September 24, 1990). In addition, the Conference Report for the recently enacted Medicare Prescription Drug Improvement and Modernization Act of 2003, P.L. 108-173, 117 Stat. 2066 (2003) also provides that “the conferees reviewed the ADEA and its legislative history and believe the legislative history clearly articulates the intent of Congress that employers should not be prevented from providing voluntary benefits to retirees only until they become eligible to participate in the Medicare program.” H.R. Conf. Rep. No. 108-391, at 365 (2003).

of the ADEA, which provide a “safe harbor” for employers who provide equal benefits to older and younger workers or who incur equal costs on behalf of each.⁶

In the *Erie County* case, a group of retirees who were over the age of 65 sued the county claiming that their retiree health program was inferior to the program offered to younger retirees. Designed to supplement Medicare benefits, older retirees were offered an HMO plan that coordinated all health care services through a primary care physician. The county provided former employees who were not Medicare-eligible with a “hybrid point of service program” that combined the features of an HMO with a traditional indemnity plan. The district court granted partial summary judgment for the county, holding that the ADEA was not intended to apply to retirees such as plaintiffs, who based their age discrimination claim on disparities in health coverage arising from Medicare eligibility. In its reversal, the Third Circuit found that age discrimination had occurred since the medical benefits for older retirees were based solely on their eligibility for Medicare, and “Medicare eligibility follow[s] ineluctably upon attaining age 65.”⁷

In reviewing the ADEA, the Third Circuit concluded that an age-based disparity in retiree health benefits is only lawful if the program falls within a “safe harbor” established by the “equal benefit/equal cost” standard. Both the legislative history of the ADEA and the “plain language” of the safe harbor provision indicated Congress’s intent that the section apply when an employer reduces health benefits on the basis of Medicare eligibility. In other words, the County of Erie could only prevail if it established that the benefits offered to Medicare-eligible retirees were equal to those provided to younger retirees or that its costs for providing benefits to the two groups were equal. The Third Circuit remanded the case back to the trial court, which ultimately found that the county’s plan was unlawful because: (1) older retirees were required to pay a greater percentage of their overall premium than were younger retirees; and (2) younger retirees were given the option between HMO coverage or indemnity coverage, while older retirees could only elect HMO coverage. For these reasons, the trial court concluded that older retirees were provided inferior benefits in violation of ADEA.⁸

The EEOC had initially supported the position adopted by the Third Circuit in *Erie County*, which the agency then incorporated in its “Compliance Manual” as part of its national enforcement policy on the ADEA. In 2001, however, after consulting various labor and employer groups, the EEOC rescinded its policy regarding employer-sponsored retiree health plans, announcing that it would study the issue further. The EEOC study demonstrated a considerable decline in the number of employers providing retiree health benefits in the decade preceding, due to higher health care coverage costs, the number of employees nearing retirement age, and changes in accounting rules for retiree health benefits.⁹ In addition, it found that “concern about the potential application of the ADEA to employer-sponsored retiree health benefits is adversely affecting the continued provision of this important retirement benefit.” In other words, when faced with the prospect of equalizing benefits, many employers were choosing not to increase benefits

⁶ 29 U.S.C. § 623(f)(2)(B)(i); 29 CFR § 1625.10.

⁷ *Erie County Retirees Ass’n v. County of Erie*, 220 F.3d 193, 211 (3d Cir. 2000).

⁸ *Erie County Retirees Ass’n v. County of Erie*, 140 F. Supp. 2d 466 (D. Pa. 2001).

⁹ 68 FR 42542-49.

for Medicare-eligible retirees, but instead to reduce benefits for younger retirees or to eliminate retiree benefits altogether. Indeed, the *Erie County* case resulted in a settlement in which benefits were reduced for younger retirees. Ultimately, the EEOC concluded that a reversal of policy was required in the “public interest” to protect retiree health coverage as a valuable benefit to older individuals, and, therefore, the agency proposed to amend the EEOC’s ADEA regulations.

The EEOC’s Proposed Rule.

As proposed, the EEOC rule would exempt from ADEA requirements the alteration, reduction, or elimination of employer-sponsored retiree health benefits when retirees become eligible for Medicare or other comparable state retiree health benefits. The EEOC cited § 9 of the ADEA, which permits the EEOC to “establish such reasonable exemptions to and from any or all provision of [the act] as it may find necessary and proper in the public interest,” as its authority for issuing the regulation. Noting that employers are not legally obligated to provide any retiree health benefits and arguing that the safe harbor provisions of the ADEA have become unworkable given the broad diversity of employer health plan options currently available, the EEOC indicated that the exemption provides a “necessary and proper” incentive to employers not to eliminate all retiree health benefits, nor to reduce the benefits of younger retirees to equal those provided to their Medicare-eligible counterparts.

Legal Challenges to the Proposed Rule.

Implementation of the proposed rule, however, was delayed in 2005 by a federal district court in Philadelphia that initially found the rule in conflict with the Third Circuit decision in the *Erie County* case. In *AARP v. EEOC*,¹⁰ the court first ordered a permanent injunction against enforcing the rule, finding that it “is contrary to congressional intent and the plain language of the Age Discrimination in Employment Act.” The EEOC, according to the court,

has the power to issue rules, regulations and exemptions within . . . explicit or implicit gaps that Congress left in the ADEA. In the case of the challenged exemption, however, the Third Circuit held that Congress did not allow for ambiguity with regard to the applicability of the ADEA to retiree health benefits.

In other words, the court found that the EEOC was interpreting too broadly its powers to create exemptions to the ADEA. The EEOC filed an appeal with the Third Circuit.

Meanwhile, the U.S. Supreme Court decided *National Cable and Telecommunications Association v. Brand X Internet Services* in 2005.¹¹ The Justices there ruled that a federal court under the “*Chevron doctrine*”¹² is required to defer to an agency’s interpretation of law — even if it differs from the court’s own views — if the particular statute is within the agency’s administrative authority, if it is ambiguous on the point in contention, and if the agency’s interpretation is “reasonable.” In other words, the

¹⁰ 383 F. Supp. 2d 705 (D. Pa. 2005).

¹¹ 125 S. Ct. 2688 (2005).

¹² See *Chevron U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984).

agency's interpretation of a statute is entitled to deference except where a court finds that the law in question is clear and unambiguous, leaving no gaps for the agency decision to fill. In view of *Brand X*, the EEOC moved the district court to reconsider whether prior judicial precedent foreclosed issuance of the proposed rule on retiree health benefits. Ultimately, the district court reversed its earlier decision, holding that the EEOC does, indeed, have the authority to issue the challenged regulation.¹³

. . . *Brand X* makes it clear that where a court's holding states merely the 'best' interpretation of a statute, not the 'only permissible' interpretation, the court decision does not foreclose a later, differing agency interpretation. . . . Because the Third Circuit's opinion in *Erie County* did not hold that it was the only permissible interpretation of the ADEA, it cannot foreclose a contrary interpretation by the EEOC.¹⁴

Despite the decision to vacate its earlier judgment, the court left in place the injunction preventing implementation of the proposed EEOC rule pending the outcome of appeals that the parties filed with the Third Circuit.

In 2007, the Third Circuit issued its ruling in *AARP v. EEOC*.¹⁵ Although the appellate court affirmed the district court's decision upholding the EEOC's retiree health benefit rule, the Third Circuit reached its decision on different legal grounds. Specifically, the court held that the proposed rule does fall within the EEOC's exemption authority under § 9. According to the court, because "the power to grant exemptions provides an agency with authority to permit certain actions at variance with the express provisions of the statute in question ... Congress made plain its intent to allow limited practices not otherwise permitted under the statute, so long as they are 'reasonable' and 'necessary and proper in the public interest.'"¹⁶ Finding that the retiree health benefit rule was a reasonable, necessary, and proper exercise of the EEOC's exemption authority under the ADEA, the court upheld the rule and lifted the injunction, allowing the final regulations to become effective on December 26, 2007, when the EEOC published them in the *Federal Register*. Although the American Association of Retired Persons (AARP) filed a petition with the Supreme Court requesting review of the Third Circuit's decision, the Court recently declined to review the case.¹⁷

The EEOC's Final Rule.

The EEOC's final rule contains a narrowly drawn exemption from the ADEA to permit the practice of coordinating employer-provided retiree health coverage with eligibility for Medicare.¹⁸ Specifically, employers may, without violating the ADEA, alter, reduce, or eliminate health benefits for retirees when the participant becomes eligible for Medicare or comparable state health benefits. The EEOC emphasizes that the rule is not

¹³ *AARP v. EEOC*, 390 F. Supp. 2d 437 (D. Pa. 2005).

¹⁴ *Id.* at 448.

¹⁵ 489 F.3d 558 (3d Cir. 2007).

¹⁶ *Id.* at 563.

¹⁷ *AARP v. EEOC*, 2008 U.S. LEXIS 2762 (U.S. 2008).

¹⁸ 72 FR 72938.

intended to encourage employers to eliminate any retiree health benefits they may currently provide. The final regulations also include an appendix with questions and answers that provide the following specific guidance:

- The exemption does not mean that the ADEA does not apply to retirees, or that all forms of retiree health coverage are exempted. Only the specific practice of coordinating retiree health benefits with Medicare or a comparable state health plan is exempted from ADEA.
- Employers may offer to retirees “Medicare carve out plans” under which Medicare is primary and the employer plan secondary for retirees, but they may not offer such plans to active employees.
- The exemption also applies to dependent and/or spousal health benefits included as part of retirees’ benefits, although these may be altered, reduced, or eliminated even when the retirees’ are not.
- No other aspects of ADEA coverage or employment benefits other than retiree health benefits are affected by the exemption.
- The exemption applies to existing, as well as newly created, employee health benefit plans.
- The exemption does not apply to active employees over the age of Medicare (or state health plan) eligibility.

Conclusion.

As noted above, the Supreme Court recently denied a request to review the Third Circuit’s decision upholding the EEOC regulation. As a result, the EEOC’s new retiree health benefit rule has survived legal challenge and remains in effect.