

# Client Alert

A report  
for clients  
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of the Firm     June 2007

## Third Circuit Upholds EEOC Rule Allowing Employers To Provide Lesser Health Benefits to Medicare-Eligible Retirees

On June 4, 2007, the United States Court of Appeals for the Third Circuit issued a decision in the case of *AARP v. EEOC*, settling an issue that has been lingering for several years. Specifically, the Third Circuit held that the Equal Employment Opportunity Commission (EEOC) has the authority to issue a regulation exempting from the prohibitions of the Age Discrimination in Employment Act (ADEA) employer-sponsored benefit plans that coordinate retiree health benefits with eligibility for Medicare. The EEOC's final rule expressly permits employers to "alter, reduce or eliminate" retiree health benefits for Medicare-eligible retirees.

### Background

This issue was first raised in the Third Circuit in *Erie County Retirees Association v. County of Erie*, 220 F.3d 193 (3d Cir. 2000). In that case, the Third Circuit held that a benefits package that provides lesser health benefit options upon Medicare eligibility will violate the ADEA, unless the employer incurs the same costs on behalf of older and younger retirees. The Third Circuit's decision then prompted the EEOC to adopt the Court's decision as its national enforcement policy, and the EEOC revised its compliance manual to state that "if an employer eliminates health coverage for retirees who are eligible for Medicare—or if it refuses to continue to cover its older retirees for the benefits it provides that are not offered by Medicare—older retirees will get less coverage than younger retirees on the basis of their age. Unless the employer

can meet the equal-cost defense, the law does not permit this age discrimination."

However, the EEOC policy was short-lived. In August 2001, the EEOC rescinded that portion of its compliance manual, announcing that it wished "to study further the relationship between certain employer practices regarding the provision of retiree health benefits and the [ADEA]." One of the EEOC's primary concerns was that its policy was acting as an incentive to employers to eliminate entirely health benefits for retirees so as to avoid an ADEA violation, since employers are not legally required to provide such benefits in the first instance.

After careful consideration and study, in April 2004, the EEOC approved the following final rule permitting employers to reduce or terminate health benefits when a retiree becomes eligible for Medicare (or a comparable State-sponsored program):

*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, whether or not the participant actually enrolls in the other benefit program. Pursuant to the authority contained in section 9 of the [ADEA], and in accordance with the procedures provided therein and in §1625.30(b) of this part, it is hereby found necessary and proper in the public interest to exempt from all prohibitions of the [ADEA] such coordination of retiree health benefits with Medicare or a comparable State health benefit plan.*

However, this issue was still far from resolved. The American Association of Retired Persons (AARP) commenced a lawsuit in the United States District Court in Pennsylvania challenging the EEOC's authority to issue the exemption. *AARP v. EEOC*, 383 F. Supp. 2d 705 (E.D. Pa. 2005). In March 2005, the District Court enjoined the EEOC from issuing its final rule, on the ground that the rule was contrary to

congressional intent and the plain language of the ADEA. ([See our March 2005 Client Alert discussing the District Court's decision.](#))

The EEOC then appealed the District Court's decision to the United States Court of Appeals for the Third Circuit. While the appeal was pending, the District Court vacated its earlier decision and granted summary judgment in favor of the EEOC, based on a new decision of the United States Supreme Court regarding deference to determinations made by administrative agencies. *See National Cable and Telecommunications Ass'n v. Brand X Internet Services*, 545 U.S. 967 (2005). AARP then appealed the District Court's decision to the Third Circuit.

### The Third Circuit's Decision

Last week, the Third Circuit affirmed the District Court's order granting summary judgment in favor of the EEOC. In doing so, the Third Circuit did not rely on the *Brand X* decision (as the District Court had). Instead, the Circuit Court applied the "well-trodden two-step approach to review of an agency regulation," as described in the United States Supreme Court's decision in *Chevron, USA, Inc. v. Natural Res. Def. Council*. 467 U.S. 837 (1984). Utilizing the *Chevron* analysis, the Court concluded that the EEOC had the express authority (found in Section 9 of the ADEA) to issue exemptions that were "reasonable, necessary and proper in the public interest," and found that the EEOC exemption satisfied that criteria. Importantly, the Court acknowledged that the EEOC issued the exemption in response to its finding that employer-sponsored retiree health benefits were decreasing, as some employers were choosing to eliminate retiree health benefits altogether (or reduce them for all retirees) in an effort to avoid an ADEA violation.

The Third Circuit also addressed and rejected AARP's claim that the Court was required to strike down the exemption in accordance with the requirements of the federal Administrative Procedures Act (APA), which states that a reviewing court must "hold unlawful and set aside agency action, findings, and conclusions found to be ... arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. §706(2)(a). The Third Circuit concluded that the EEOC regulation was valid according to the requirements of the APA, reasoning that, among other things, neither the exemption itself, nor the EEOC's actions in adopting the exemption, were arbitrary or capricious.

### Implications for Employers

As a result of the Third Circuit's decision, the current state of the law is that the EEOC exemption is indeed intact. Thus, employers are free to "alter, reduce or eliminate" retiree health benefits when retirees become eligible for Medicare or a

comparable State program. Of course, it is possible that this issue may be subject to future challenges in other jurisdictions (i.e., the Third Circuit's decision technically would not be binding in other judicial circuits). However, at least for the time being, the issue of reducing health benefits upon Medicare eligibility has been clarified.

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**The following individuals serve as contact persons with respect to this Client Alert and would welcome any questions you might have.**

#### Rory Judd Albert

212.969.3005 – [ralbert@proskauer.com](mailto:ralbert@proskauer.com)

#### Roberta K. Chevlowe

212.969.3949 – [rchevlowe@proskauer.com](mailto:rchevlowe@proskauer.com)

#### Marvin M. Goldstein

973.274.3210 – [mmgoldstein@proskauer.com](mailto:mmgoldstein@proskauer.com)

#### Neal S. Schelberg

212.969.3085 – [nschelberg@proskauer.com](mailto:nschelberg@proskauer.com)

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