

June 13, 2007

**Memorandum to Clients**

**Third Circuit Upholds EEOC Regulation  
Allowing Retiree Medical Plans to Coordinate With Medicare**

Last week, a panel of the United States Court of Appeals for the Third Circuit unanimously upheld an Equal Employment Opportunity Commission ("EEOC") regulation that would exempt Medicare carve-outs for retiree health benefits from the prohibition in the Age Discrimination in Employment Act ("ADEA"). See AARP v. EEOC, --- F.3d ----, 2007 WL 1584385 (3rd Cir, June 04, 2007 ). In doing so, the Third Circuit affirmed the EEOC's authority, granted in ADEA, to make exceptions that are both "reasonable" and "necessary and proper in the public interest."

The ruling allows the EEOC to publish a regulation which permits plan sponsors to provide one package of health benefits to pre-Medicare retirees, but another package to Medicare-eligible retirees. As a result, if the Third Circuit's ruling stands, affected plan sponsors may continue to offer post-employment benefits that take into account the benefits that some retirees receive through Medicare, including reduced or no benefits for Medicare-eligible retirees. Previously, the EEOC had indicated that employers needed to comply with an equal cost or equal benefit standard regardless of Medicare eligibility. If the EEOC had maintained this position, the trend of reducing retiree medical benefits would have accelerated even further.

**A. Background**

The challenged EEOC regulation was issued in response to a controversial decision of the Third Circuit in Erie County Retirees' Association v. County of Erie, 220 F.3d 193 (3rd Cir. 2000). The Court in Erie County held that a plan sponsor would violate ADEA if the sponsor reduced a retiree's health benefits when the retiree became eligible for Medicare. To comply with the ruling, employers would have to increase the level of benefits provided to Medicare-eligible retirees or decrease (or eliminate) health care benefits provided to all retirees.

The EEOC originally expressed an intent to adopt the Erie County decision in enforcing ADEA, but rethought its position when both employers and labor unions pointed out that, under almost all circumstances, employers would decrease or eliminate benefits for all retirees rather than increasing them for Medicare-eligible retirees. After some deliberation, in July 2003, the EEOC published a proposed regulation to "exempt from all prohibitions of [ADEA the] coordination of retiree health benefits with Medicare or a comparable state health benefit." Age Discrimination in Employment Act: Retiree Health Benefits, 68 Fed. Reg. 41,542 (proposed July 14, 2003) (to be codified at 29 C.F.R. pt. 1625 and 1627). The AARP (formerly called the American Association of Retired Persons), which had opposed the regulation from the outset, filed suit in federal court in Philadelphia to block the regulation's enactment.

The AARP challenged the proposed regulation under ADEA and the Administrative Procedure Act ("APA"). See 5 U.S.C. §§ 551. The AARP alleged (i) that the regulation was contrary to ADEA under the Court's decision in Erie County, and (ii) that the regulation was "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law under the APA." See 220 F.3d 193 (3rd Cir. 2000),

In March 2005, District Court Judge Brody, siding with the AARP, entered an order prohibiting the EEOC from finalizing the regulation. AARP v. Equal Employment Opportunity Comm'n, 383 F.3d 705, 708 (E.D. Pa. 2005) ("AARP I").

On June 27, 2005, the Supreme Court decided National Cable and Telecommunications Ass'n. v. Brand X Internet Services, 545 U.S. 967 (2005), which held that prior judicial interpretation of a statute bars subsequent agency interpretations only where the precedent unambiguously forecloses the agency's interpretation, and leaves no further interpretation necessary. The EEOC moved for relief of judgment in the District Court, citing Brand X as an intervening change of law. AARP v. Equal Employment Opportunity Comm'n, 390 F. Supp. 2d 437, 441-42 (E.D. Pa. 2005) ("AARP II"). In September 2005, based on the EEOC petition, Judge Brody reversed her decision on the merits, but permitted the injunction to stand pending the Third Circuit's decision. See AARP v. Equal Employment Opportunity Comm'n, 390 F. Supp.2d 437, 441-42 (E.D. Pa. 2005) ("AARP II").

## **B. The Decision**

The Third Circuit issued key rulings on the scope of the EEOC's exemption authority and compliance with APA procedures.

### **1. The Third Circuit's Decision on EEOC Exemptions to ADEA**

On appeal, the Third Circuit affirmed the District Court's conclusion that the EEOC's regulation was valid under ADEA, but it did not rely on the lower court's reasoning. The Court held that ADEA explicitly authorized the EEOC to promulgate the regulation. Id. ADEA Section 9 states that "any or all provisions" may be subject to exemptions so long as the exemption is "reasonable" and "necessary and proper in the public interest." See 29 U.S.C. § 628. The Third Circuit, applying the plain language of Section 9, avoided the need to examine whether the EEOC's current exception was consistent with the law as interpreted in Erie County. The Court held that even if Erie County presented the only acceptable interpretation of the ADEA section in question, section 9 of ADEA granted the EEOC power to create reasonable exceptions. The Court also found the exemption to be reasonable and necessary citing the EEOC's studies that found that the prior regulation had led to a reduction in retiree health benefits generally, rather than an increase in benefits for those with Medicare.

### **2. Validity Under the APA**

The AARP also challenged the validity of the regulation under the APA. The Third Circuit ruled that the regulation did not violate the APA requirement that agency actions that are

"arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law" should be set aside. See 5 U.S.C. § 706(2)(a). The Court based its ruling on "[t]he EEOC determin[ation] that the proposed exemption would be in the interests of all retirees, permitting employers to provide a valuable benefit to early retirees who otherwise might not be able to afford health insurance coverage and allowing employers to provide valuable supplemental health benefits to retirees who are eligible for Medicare."

The AARP also challenged whether the EEOC met the APA notice and comment requirement in issuing the regulation. The Third Circuit held that the APA only requires general notice of proposed rule making that includes "either the terms or substance of the proposed rule" and "an opportunity to participate in the process through submission of comments" and that the EEOC had met this requirement. Disposing of the AARP's arguments, the Third Circuit lifted the injunction and held that the regulation issuing the exception is a valid exercise of the EEOC's power under ADEA.

### **C. Conclusion**

This ruling brings relief from one of the most controversial consequences of the Erie County decision by permitting the coordination of benefits for Medicare-eligible retirees under ADEA. Both employers and unions favored the current outcome as it is expected to improve the affordability of providing health care benefits to both Pre- Medicare and Medicare-eligible retirees. The EEOC has not yet stated how it will proceed, but the ruling allows the EEOC to move forward and finalize the exemption. The AARP indicated it is contemplating a challenge; however, because the Third Circuit panel was unanimous, it is unlikely the full Third Circuit will agree to hear the case. Further, because there is no split among the circuit courts, this means, the Supreme Court is unlikely to agree to take the case if a petition is filed.

If you have any additional questions or comments about the application of this decision, please contact Lou Mazawey, Jon Breyfogle, Jon Bourgault, or Heather Meade by calling the Groom Law Group at (202) 857-0620 or through our website at <http://www.groom.com>.