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Retiree Health Care Benefits:

New Rules, New Strategies

by Richard Ostuw

► Two recent court decisions in a retiree health care benefits age discrimination case are likely to bring changes to employer-sponsored retiree health care. After reviewing the cases and how the Equal Employment Opportunity Commission has responded to them, this article discusses employer implications. *Although the court decisions add complexity to retiree health plan design, they also provide employers with the valuable opportunity to analyze the match between their retiree health plans and business needs.* ◀

Employers' health plans have commonly differentiated between retirees eligible for Medicare and younger retirees. Two recent court decisions in a retiree health care benefits age discrimination case and a corresponding change in the U.S. Equal Employment Opportunity Commission's (EEOC) interpretation of the law are likely to change this practice, however. Based on court rulings in *Erie County Retirees Assoc. v. County of Erie Pennsylvania*, many employers will need to consider altering their retiree health care offerings to eliminate provisions that violate the standards of the Age Discrimination in Employment Act (ADEA).

The court decisions add complexity to retiree health plan design, but they also provide employers with valuable opportunities. The rulings will force companies to review their retiree health care offerings to ensure compliance with the decisions. During this review, employers can analyze the match between their retiree health plans and their business needs. Are their retiree health plans furthering business objectives by improving attraction and retention rates? Are they contributing to a positive corporate culture? Do they add to the company's image as a socially responsible employer?

Many employers have long been frustrated by their retiree health plans. Viewing them as high-cost, low-yield programs, a number of employers have chosen to simply discontinue their retiree health benefits altogether. This may not be the best solution given the potentially damaging effect discontinuation has on attraction and retention, public relations, employee relations and litigation risks. Instead, employers should focus on reshaping their programs to better align them with their business needs. The *Erie County* rulings may be just the catalyst needed to get this done.

THE ERIE COUNTY CASE

In *Erie County Retirees Assoc. v. County of Erie Pennsylvania*, the U.S. Court of Appeals for the Third Circuit ruled that ADEA applies to retirees. Shortly afterwards, the U.S. District Court for Western Pennsylvania sided with the plaintiffs in the case, ruling that Erie County violated ADEA by providing a lesser health benefit to Medicare-eligible, post-65 retirees

than to younger retirees who were not eligible for Medicare. While the appellate court decision technically applies only in the Third Circuit, its impact could be felt nationwide—The EEOC has incorporated language from the appellate court decision directly into its compliance manual.

CASE BACKGROUND

Erie County in Pennsylvania had been providing retired employees with health and hospitalization insurance benefits since 1972. The county classified employees and retirees into three main coverage groups—one for current employees, one for Medicare-eligible retirees and one for retirees not eligible for Medicare. Each group had separate, but similar, traditional indemnity coverage.

In 1998, faced with increasing health insurance costs, including an average 48% jump in premiums, the county required all Medicare-eligible retirees (those over 65 years of age or older) to enroll in a health maintenance organization (HMO) called SecurityBlue or lose their coverage. Retirees under the age of 65, ineligible for Medicare, were incorporated into a point-of-service (POS) plan, known as SelectBlue, that combined the features of an HMO with those of a traditional indemnity plan. For pre-65 retirees outside the SelectBlue service area, a traditional indemnity plan was provided.

Retirees put into the SecurityBlue plan subsequently filed suit against the county, alleging that SecurityBlue provided inferior coverage as compared to SelectBlue. They contended that the county was violating ADEA by discriminatorily placing retirees into SecurityBlue on the basis of their age.

THE COURT DECISIONS

The first court to hear the case, the U.S. District Court for Western Pennsylvania, initially dismissed the suit, ruling that ADEA did not apply to retiree health benefits. The plaintiffs appealed to the Third Circuit Court of Appeals, which examined the legislative history of ADEA to determine its intent. In August 2000, the Third Circuit court found that if Congress had intended ADEA to exempt retirees, it would have provided an explicit exception.

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Since no exception was provided, ADEA applies to retirees.

Having decided that ADEA does apply to retiree health benefits, the Third Circuit sent the case back to the district court to determine whether Erie County’s plan was discriminatory. The district court was directed to apply what is known as *the equal cost/equal benefit test*. Employers must either pay a cost for older participants equal to that for younger participants or provide equal benefits. And employers may not require older participants to pay a greater percentage of the premium cost than their younger counterparts.

The court found that because Erie County’s plan required Medicare-eligible retirees to pay the Medicare Part B premium to receive coverage, older retirees paid a higher percentage of the total premium than those enrolled

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in the traditional indemnity plan. In addition, the court said, the absence of an out-of-network benefit for post-65 retirees also was discriminatory as compared with the POS plan.

EEOC ADOPTS COURT'S VIEW

The EEOC has taken the Third Circuit decision and incorporated it into its compliance manual addressing ADEA. This means the EEOC can now allege employers are in violation of the law, and retirees can sue for retroactive benefits. The fact that the plans were long considered to be in compliance could turn out to be of little consequence.

Unfortunately, the EEOC may have plenty of fodder. Many of today's retiree health plan designs are unlikely to satisfy ADEA based on the *Erie County* ruling and analysis. Medical or dental plans covering only pre-65 retirees would violate ADEA under *Erie County*, for example. Similarly, plans that offer lesser post-65 benefits may not comply. Plans that charge all retirees the same contribution amount may fail the equal percentage contribution test, since the employer's costs drop after employees become eligible for Medicare. In addition, if a retiree's payment of the Medicare Part B premium must be considered as a plan contribution, many employers would fail the equal percentage contribution requirement.

These rulings put employers in a predicament. If new legislation had been passed ex-

tending coverage of ADEA to retirees, it would have carried with it a “comply-by” date some time in the future. Employers would have had a period of time during which they could revise their plans to meet the new requirements. But, since these rulings are interpretations of existing laws, they take effect retroactively.

NEW RULES, NEW STRATEGIES

Given these rulings, employers need to examine their retiree health care plans and implement changes, where appropriate. Compliance issues and the opportunity to realign retiree benefits with business objectives both should be considered.

Employers will need to balance the current risk of litigation against the time and cost involved with modifying the plan. Technically, the appellate court ruling extending coverage to retirees under ADEA applies only in the Third Circuit. It is quite possible that another court could read the EEOC regulations and the legislative history in another way, offering relief to employers in other circuits. Any conflict that emerges in the circuit courts could prompt the Supreme Court to issue a final ruling on the issue. It is also possible—although unlikely—for legislation to emerge from Congress that would clarify its intent related to retirees under ADEA.

Employers also must factor in the potential benefits of restructuring their retiree health plans. Many plans were developed in a different economic environment than today's, and they may not accurately reflect the current business needs of the organization. Good retiree health plans are designed to attract and retain talented people while minimizing the impact of rising health insurance costs, slowing economic growth, proposed changes in Medicare coverage and the swelling of the retiree ranks as the baby boomers age. Although these benefits are not on the radar screen for young employees, midcareer workers are increasingly concerned with access to health benefits.

The first course of action for employers is to consult with their counsel and their benefits team to review their retiree health plans to determine areas of vulnerability and potential im-

Does Your Plan Comply With ADEA?

Want to figure out if your plan meets the requirements of ADEA? Consider the following:

Equal benefits: All plan features should be as favorable for post-65 retirees as for pre-65 retirees. To evaluate whether you meet this requirement, consider the options you offer, including plan eligibility requirements such as age and years of service, the definition of covered services, covered expenses, the level of benefit payable and the conditions for payment, such as use of in-network services. All benefits must be considered, including vision and dental care.

Equal cost: Is the employer's contribution after age 65 equal to or greater than that for coverage before age 65?

Equal percentage contribution: Is the retiree's contribution after age 65 as a percentage of the plan cost no greater than that for coverage before age 65? The answer must consider each service category for service-related contributions and the net retiree contribution where the employer contribution is capped. Under the *Erie County* decision, the Medicare Part B premium must generally be considered a required contribution under the employer program. The EEOC interpretation is silent on this issue.

provement. The pros and cons of immediately addressing the issue can then be evaluated, and information on appropriate remedies can be obtained.

Employers that determine their plans are noncompliant have a number of options. For plans that currently terminate coverage at age 65, for example, possible approaches include:

- Converting to retiree health accounts with funding limited to the account balance
- Extending coverage past 65, but limiting it to, perhaps, eight years from the date of retirement
- Giving retirees a choice of pre-65 coverage only or lifetime coverage with more limited pre- and post-65 benefits.

Ultimately, achieving compliance for an existing plan will involve either improving the terms of post-65 coverage, reducing the terms of pre-65 coverage or a combination of the two.

CONCLUSION

The *Erie County* court decisions could turn out to be a boon for employers. Retention issues, public relations considerations and the potential for litigation should be weighed against the hassles of revamping retiree health plans. Smart employers will use the rulings as the catalyst for restructuring retiree health benefit programs to bring them into alignment with business needs, while ensuring compliance with the requirements of ADEA. ◀