Age Discrimination in Pension Plans – The Latest

By Jeremy P. Blumenfeld and Matthew A. Russell

Introduction

A recent appellate decision should put employers on notice that pension plans distinguishing between employees expressly based on age – even if economically reasonable or lacking in ill motive – could be deemed age-discriminatory and unlawful. In *EEOC v. Baltimore County*,[1] the United States Court of Appeals for the Fourth Circuit held that Baltimore County's pension plan violated the Age Discrimination in Employment Act ("ADEA") because it required older employees to contribute a greater percentage of their salary than similarly situated younger employees. In light of the ruling, employers should proceed with caution in distinguishing plan participants on the basis of age – something that many plans do – to make sure that the age-based distinctions would still be considered lawful in light of *Baltimore County*.

Background – Age Discrimination With Respect To Pension Plans

The ADEA prohibits an employer from discriminating against any person who is at least 40 years of age "because of" that person's age.[2] This prohibition applies to discrimination with respect to an employee's "compensation, terms, conditions, or privileges of employment," which the ADEA expressly defines as encompassing "all employee benefits, including such benefits provided pursuant to a bona fide employee benefit plan."[3] Thus, an employer generally may not establish a retirement plan that treats older employees differently than younger employees, unless that distinction "is based on reasonable factors other than age."[4]

An employer can violate the ADEA in two ways: (1) relying on "a formal, facially discriminatory policy requiring adverse treatment of employees"; or (2) by acting on an "ad hoc, informal basis" motivated by the employee's age.[5] With respect to retirement benefits, however a pension plan may lawfully differentiate between employees based on a factor closely correlated with age, so long as that factor is not used as a "proxy for age."

When a plaintiff argues that a policy is discriminatory on its face, it is not necessary to prove that the employer acted with a discriminatory animus, as the Supreme Court explained just a few years ago.[6] In fact, the parties in *Baltimore County* agreed that there was no evidence to suggest that the County subjectively intended to treat older workers less favorably than younger employees.[7] Nevertheless, the EEOC argued that the Baltimore County plan was unlawful because age was a "but for" cause of the purportedly less favorable treatment of older employees under the plan.[8]

The Baltimore County Plan

Baltimore County, in conjunction with various labor groups, established a mandatory retirement plan in 1945. At that time, employees were eligible to retire and receive pension benefits at age 65, regardless of how long they worked for the County. To fund the plan, the County required employees to contribute a certain percentage of their annual pay at rates established by the plan's actuaries. In an effort to make these rates fair while providing all employees with a similar level of benefit, the plan set the rates based on the number of years an employee had left before becoming eligible to retire, i.e., before reaching age 65. That is, the County determined that employees joining the plan at an older age would pay a higher percentage of their salaries, as their contributions would not be in the plan for as long and thus would earn lower returns before the benefit became due at age 65. Consequently, the plan expressly provided that "[t]he rate of contribution of the employee shall be determined by the employee's age at the time the employee actually joins" the plan.[9]

The County amended the plan several times over the ensuing years. In 1973, the County added an alternative eligibility provision, allowing employees to become eligible to retire after 30 years of service regardless of age. The County also later amended the plan to permit

1 2014 U.S. App. LEXIS 5902 (4th Cir. Mar. 31, 2014).

2 29 U.S.C. §§ 623(a)(1), 631(a).

3 29 U.S.C. §§ 623(a)(1), 630(l).

4 29 U.S.C. §§ 623(f)(1).

5 Hazen Paper Co. v. Biggins, 507 U.S. 604, 609 (1993).

6 *See* Ky. Ret. Sys.v. EEOC, 554 U.S. 135, 147-48 (2008).

7 Baltimore County, 2014 U.S. App. LEXIS 5209, at *12 n.6.

8 *See* 2014 U.S. App. LEXIS 5209, at *13 (citing Gross v. FBL Fin. Servs., 557 U.S. 167, 177-78 (2009)).

9 2014 U.S. App. LEXIS 5209, at *5.

correctional officers to become eligible to retire after only 20 years of service, regardless of age, or at age 65 with five years of service. In other words, the County provided an early retirement option, allowing eligible employees to retire at the earlier of age 65 or the service-based minimum. However, the County did not alter its age-dependant contribution rates, although it did reduce the rates for older employees in 1977.

History of the Litigation

In 1999 and 2000, two County correctional officers filed charges with the EEOC, alleging that the County's pension plan discriminated against them based on age by requiring them to pay a greater percentage of their salaries to receive the same retirement benefit as a younger employee commencing participation in the plan on the same date. After an investigation and attempts at reconciliation, the EEOC filed a class action in 2007 on behalf of all County employees who were 40 years old or older when they enrolled in the plan, seeking injunctive relief and reimbursement of the excess age-discriminatory contributions for affected employees.

The County responded by denying that its plan was age-discriminatory, moving for summary judgment on the grounds that the employee contribution rates were motivated by financial considerations and the number of years remaining until an employee reached retirement age, not age itself. Stated another way, the County argued that the motivating factor of the disparate rates was "the time value of money," because older new employees would have less time to accrue earnings on their contributions than similarly situated younger employees, and the County intended to make "relatively equal contributions on behalf of all plan members" over the entire expected time until retirement at age 65.[10]

In 2009, the district court agreed with the County and granted summary judgment in its favor.[11] The Fourth Circuit, however, vacated that judgment, finding that the district court considered only the age-based retirement eligibility requirement but neglected the plan's alternative service-based eligibility provisions.[12] The court thus remanded, instructing the district court to consider "whether the disparate rates were supported by 'permissible financial considerations.' "[13] After additional discovery and new cross-motions for summary judgment, the district court found in favor of the EEOC, ruling that age was the "but-for" cause of the plan's disparate treatment.[14]

Fourth Circuit's Opinion

Question Presented

The Fourth Circuit noted its prior decision, in which it directed the district court to consider what it deemed:

> a critical component of the plan regarding retirement eligibility, namely, that an employee's years of service could qualify the employee to retire irrespective of the employee's age.[15]

Thus, the question on appeal was whether the age-based contribution rates were justified by a reasonable factor other than age, in light of the age- or service-based retirement benefits provided under the plan.

Distinguishing Supreme Court's Decision in *Kentucky Retirement Systems v. EEOC*

Before turning to the County's primary substantive arguments, the Fourth Circuit rejected the County's reliance on the Supreme Court's framework in *Kentucky Retirement Systems v. EEOC*.[16] There, Kentucky's retirement plan for employees working in "hazardous positions" provided that if an employee became disabled before qualifying for normal retirement benefits (which could be based on years of service or age), the plan would impute enough years of service to allow the employee to retire immediately and also include those years in the calculation of the amount of the benefits. However, when an employee became disabled *after* qualifying for normal retirement benefits, the plan did not impute any additional years of service.[17] The EEOC thus challenged the plan as treating younger disabled employees more generously than it treats employees who are disabled only after becoming eligible for retirement based upon their age. The state argued that the distinction was drawn according to employees' "pension status," not their age. The Supreme Court

[10] 2014 U.S. App. LEXIS 5902, at *8 (quotations omitted).

[11] EEOC v. Baltimore County, 593 F. Supp. 2d 797 (D. Md. 2009).

[12] EEOC v. Baltimore County, 385 F. App'x 322, 325 (4th Cir. 2010).

[13] 385 F. App'x at 325.

[14] EEOC v. Baltimore County, 2012 U.S. App. LEXIS 149812, at *2 (D. Md. Oct. 17, 2012).

[15] Baltimore County, 2014 U.S. App. LEXIS 5902, at *2.

[16] 554 U.S. 135 (2008).

[17] 554 U.S. at 139-140. The Kentucky plan limited the number of imputed years to an equal amount of the years the employee has previously worked. For example, an employee with eight years of service would not receive more than eight imputed years for purposes of the plan. 554 U.S. at 140.

considered a variety of factors, focusing primarily on whether drawing lines according to an employee's "pension status" constituted an unlawful "proxy for age."[18] The Court ultimately ruled that although the two factors are undoubtedly related, the plan did not violate the ADEA because the disparate treatment was not "actually motivated" by an employee's age, but rather their pension eligibility status.[19]

Justice Kennedy filed a dissenting opinion in *Kentucky Retirement Systems*, joined by three other justices. Among other things, the dissent noted that, under Kentucky's plan, a 45-year-old and a 55-year-old, both with 5 years of service, could become disabled in the very same incident, yet the plan would provide the 45-year-old with greater benefits by imputing an additional five years of service (for a total of 10 years, and then multiplying the 10 years of service by the employee's pay to determine the benefit), while the 55-year-old would already be eligible to retire at the time of the incident and thus receive no imputed years of service (and thus receive benefits calculated on only 5 years of service).[20] The dissenting justices considered this to be discrimination and disagreed that a plaintiff must demonstrate something more than a facially age-discriminatory policy to establish a claim under the ADEA, such as the majority's requirement of showing that the differential treatment is "actually motivated" by age.[21]

Here, the Fourth Circuit found *Kentucky Retirement Systems* inapplicable, as the Baltimore County plan expressly provided for different contribution rates *based on employees' ages* at the time they enrolled in the plan. Consequently, the court found that the question was not whether a facially neutral basis for treating employees differently (such as one's "pension status") was a "proxy for age," but rather only whether the admittedly age-based disparity "could be justified on any permissible basis."[22] That is, the County's plan did not draw lines based on an employee's eligibility to retire or the number of years until retirement eligibility. Rather, the County's plan made distinctions *expressly* based on age: older employees entering the plan were required to contribute a higher percentage of pay than younger employees who enrolled at the same time, yet received the same benefit. Thus, the various factors the Supreme Court considered in *Kentucky Retirement Systems* did not apply to its analysis.

Rejection of Baltimore County's Arguments

After distinguishing *Kentucky Retirement Systems*, the court rejected each of the County's proffered reasons for treating older and younger employees differently. The County's primary argument was that establishing age-based contributions rates was lawfully based on the "time value of money" (i.e., the years remaining before reaching retirement age) rather than actually motivated by an employee's age.[23] That is, an older employee who will receive the same retirement benefit has fewer years for his or her contributions to generate earnings and grow, and thus more is required to fund a similar benefit at retirement. The County also highlighted the fact that the age-based contribution rates were established well before the service-based eligibility option was added to the plan, they were calculated in a nondiscriminatory manner and using various actuarial inputs and assumptions, they were adjusted in 1977 *in favor* of older employees, and the service-based eligibility represented a separate, subsidized early retirement option that was a generous benefit at no additional cost to employees.[24]

The Fourth Circuit disagreed with the County, holding that its "justification may have explained the basis for the disparate rates at the plan's inception, when the only possible basis for retirement was reaching retirement age."[25] In that instance, a younger employee would necessarily have to wait longer to receive his or her benefit at age 65 (or an early retirement age, if applicable). Critical to the court's decision, however, was that the County amended the plan to include *service*-based retirement eligibility, yet retained disparate contribution rates based on age. The court illustrated the implications of this design with the following example:

> If a 20-year-old correctional officer and a 40-year-old correctional officer enrolled in the plan at the same time, and both employees chose to retire after 20 years of service, the older employee contributed a larger percentage of his annual salary to the plan, despite receiving the same level of pension benefits as the younger employee.[26]

And because the County's plan required the age-based contribution rates regardless of whether an employee chose to retire at age 65 or after the requisite years of service, the

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[18] 554 U.S. at 142-143.
[19] 554 U.S. at 147.
[20] 554 U.S. at 153.
[21] 554 U.S. at 156.
[22] Baltimore County, 2104 U.S. App. LEXIS 5902, at *15.

[23] 2014 U.S. App. LEXIS 5902, at *16.
[24] *See EEOC v. Baltimore County*, Civ. App. No. 13-1106, Dkt. 16, Appellants' Br. at 7-8, 11-14.
[25] Baltimore County, 2014 U.S. App. LEXIS 5902, at *15-16.
[26] 2014 U.S. App. LEXIS 5902, at *16.

number of years until retirement age could not be the basis for the differing rates.[27] The court therefore concluded that the rates were not motivated by the "time value of money" or any other funding consideration, but rather treated older employees differently strictly because of age.[28]

The Fourth Circuit also rejected the County's argument that its service-based retirement option was an "early retirement benefit," such that it fell within a safe-harbor provision of the ADEA that states, in relevant part, that a plan does not violate the statute solely because the plan provides for "payments that constitute the subsidized portion of an early retirement benefit."[29] Specifically, the County pointed out that the service-based retirement eligibility provisions allowed employees to retire early, but *without* any actuarial reduction of their normal benefits.[30] In other words, the County subsidized the additional portion of the benefit that would have otherwise been reduced for early distribution before age 65, such that the service-based retirement benefit therefore was the same as a "normal retirement benefit." Thus, the County's position was that the service-based benefit met the exception to the age-based normal retirement benefit, and the ADEA's safe-harbor provision should apply. The court disagreed, summarily concluding that although the safe harbor provision "permits an employer to subsidize early retirement benefits without violating the ADEA," it "does not address employee contribution rates nor does it permit employers to impose contribution rates that increase with the employee's age at the time of plan enrollment."[31]

Implications of the *Baltimore County* Decision

The Fourth Circuit's decision illustrates the inherent complexities where the ADEA and an employer's pension plan interact, and it should place employers on notice that any express age-based distinction might put a plan (and the plan sponsor) at risk. The decision also highlights the importance of considering any specific benefit plan changes in the context of the overall plan design. Indeed, it appears that the County's plan would have been found lawful when adopted, but that the benefit *enhancements* adopted later – adding service-based retirement eligibility criteria that benefited all employees equally – led the Fourth Circuit to find the contribution rates unlawful.

There may be several legitimate reasons for a retirement plan to treat older and younger employees differently, particularly when a goal is to provide an equivalent level of benefits. But if nothing else, the lesson learned from *Baltimore County* is that a court may deem any express distinction based on age to be facially discriminatory, and, therefore, require the employer to justify such a distinction with reasons other than age. Further, any plan with similar age-based contribution rates that also allows for retirement eligibility based on years of service should consider whether a service-based contribution rate structure (or some other alternative design) can accomplish the same objectives.

The Fourth Circuit's ruling also signals a potential limitation of the Supreme Court's ruling in *Kentucky Retirement Systems*. As highlighted by the dissenting opinion in that case, the majority's decision in *Kentucky Retirement Systems* may have given comfort to plan sponsors, by seeming to raise the bar for establishing an ADEA violation regarding pension plans. The Fourth Circuit's ruling, however, appears to confine *Kentucky Retirement Systems* to its facts – where the distinction at issue was based on "pension status" rather than age directly – and holds that the Supreme Court's multi-factor analysis should not apply to lines drawn based expressly on age. Among other things, this analysis avoids assessing whether age-based contribution rates like those at issue in *Baltimore County* are the type of discriminatory practice rooted in age-related stigmas and prejudices the ADEA was established to combat. In other words, discrimination could be found even where no discrimination, and no animus, was intended.

Finally, the Fourth Circuit's decision arguably could lead to harmful consequences for all County employees. To remedy this result, the plan might have to reduce the pension benefits it provides to older new employees; shift to a service-based system that would result in a similar reduction of older new employee benefits; increase the contribution rates of younger new employees to overcome the funding gap; provide additional funding directly from the County to subsidize older workers' retirement; or make some other adjustment to the plan. Indeed, after the district court ruled against the County in 2012, its Director of Budget and Finance responded strongly in a blog post on the County's website that the decision was "puzzling," could actually be "harmful . . . for hard-working County employees," and warranted the adage "no good deed goes unpunished."[32] The response also noted that the County's

[27] 2014 U.S. App. LEXIS 5902, at *17.

[28] 2014 U.S. App. LEXIS 5902, at *17.

[29] 29 U.S.C. § 623(l)(1)(A)(ii)(I).

[30] *See* Baltimore County, 2014 U.S. App. LEXIS 5902, at *27-28.

[31] 2014 U.S. App. LEXIS 5902, at *18.

[32] *See* Keith Dorsey, *Court's Age Discrimination Ruling is Wrong and Would Force County Employees to Pay More*, Baltimore County NOW, http://www.baltimorecountymd.gov/News/BaltimoreCountyNow/keyword/eeoc (last accessed May 6, 2014).

plan was negotiated by various unions and labor groups, applied sound actuarial principles to determine fair contribution rates, and offered its early retirement option at no cost to the employees by paying the entire early benefit.

At the end of the day, the Fourth Circuit's ruling makes clear that a pension plan that expressly differentiates among employees expressly by age – at least with respect to contribution rates – will draw scrutiny and is potentially unlawful, even without any ill motive or intent. Employers should bear these issues in mind and assess whether their retirement plans are similarly at risk.

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