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EARLY RETIREMENT INCENTIVE PROGRAMS: ARE THEY LEGAL FOR NORTH CAROLINA PUBLIC EMPLOYERS?

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It is no secret that when it comes to personnel costs, employers prefer younger workers. A younger employee will generally be on a lower salary step and earn less than an older worker in the same position. Pension and 401(k) contributions, as a percentage of salary, are also correspondingly smaller for younger employees. Finally, the greater the number of older workers in an employer's workforce, the higher the cost of group health insurance will be.

Employers may not, however, make hiring and firing decisions based on age. The federal Age Discrimination in Employment Act (29 U.S.C. §§ 621-634) prohibits employers from discriminating against workers age 40 or older. So at first blush, it would seem to follow that employers are prohibited from offering early retirement incentives to older workers. After all, the purpose of most early retirement programs is to bring down the average age of the workforce by "buying out" older and more expensive employees.

This is incorrect. Properly structured early retirement incentive programs do **not** violate the Age Discrimination in Employment Act. An early retirement incentive that complies with the Age Discrimination in Employment Act typically includes the following features:

- eligibility requirements with a minimum age requirement, but no upper age limit;
- incentives whose value is based on something other than age, such as flat-dollar amount bonuses, incentive payments based on length of service or longevity, payments that are a percentage of the employee's final salary, or retiree health insurance incentives; and
- a release of employment-related claims.

Public employers may consider using early retirement incentives with features such as these when the need to reduce personnel costs arises or when a restructuring of the organization makes a reduction-in-force necessary.

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This Bulletin discusses in detail each of the features necessary to make an early retirement incentive program comply with the Age Discrimination in Employment Act. It also discusses why early retirement incentive programs do not violate the North Carolina Constitution's public purpose doctrine, which prohibits public entities from compensating anyone beyond what is due them for public services actually conferred, and it answers some frequently asked questions about early retirement incentives.

Early Retirement Incentive Programs: A Definition

An early retirement incentive program (ERIP) is *any* employer-sponsored plan that provides a special benefit or incentive to an employee in return for a voluntary decision to retire sooner than the employee otherwise planned. For example, an employer may offer a flat-dollar amount bonus – say, $10,000 – to employees who retire within the current calendar year. This is an example of an early retirement incentive plan.

Although ERIPs are typically offered to employees nearing retirement age, there is no minimum age requirement. Employers frequently adopt ERIPs to induce workers at the top of the pay scale to retire sooner so that the employer's workforce will have a greater proportion of workers who have less seniority and earn smaller salaries. That is by no means the only reason for considering such a plan, however. Sometimes an employer adopts ERIPs to avoid or reduce the number of involuntary terminations that it must make when financial circumstances dictate that it carry fewer employees or when a reorganization results in redundancies. ERIPs may be offered organization-wide, or to a limited class of employees, such as those in a single department or all those in a certain position.

Which Units of Government Have the Authority to Adopt an Early Retirement Incentive Program?

In the private sector, an individual company can decide to increase the monthly retirement allowance paid under its pension plan to employees electing early retirement. That is not the case for individual North Carolina public employers. Decisions affecting the retirement benefits offered through the state retirement systems — Local Government Employee Retirement System (LGERS), Teachers' and State Employees' Retirement System (TSERS), the Consolidated Judicial Retirement System (CJRS), and the Legislative Retirement System (LRS) — may be made only by the North Carolina General Assembly. Thus, to the extent that an early retirement incentive program were to offer enhanced benefits through the retirement systems, neither state agencies, local governments, public school systems or community colleges could authorize them on their own.

When it comes to other forms of incentive — for example, a $10,000 flat-dollar amount bonus or a bonus based on years of service — the powers of state agencies and local governments diverge. State agencies have no authority to offer benefits such as early retirement incentive plans to their employees independent of the General Assembly. For an individual agency to implement such a plan, it would first have to seek enabling legislation from the General Assembly.

By contrast, for North Carolina local governments, the General Statutes grant the authority to offer employee benefits to the city council and the county board of commissioners. G.S. § 160A-162(a) grants the authority to "fix or approve the schedule of pay, expense allowances and other compensation for all city employees . . . . " to the city council, while subsection (b) gives the council authority to "purchase life, health, and any other forms of insurance for the benefits of all or any class of city employees and their dependents." G.S. § 160A-163(a) authorizes the city council to enroll city employees in the Local Government Employees' Retirement System (LGERS) *and to supplement benefits provided by LGERS through use of local funds*. G.S. §§ 153A-92(a) and (d) and 153A-93 grant similar authority to county boards of commissioners with respect to county employees. Thus, ERIPs that feature either retirement bonuses or increases in the benefits provided under supplemental retirement programs may be enacted by the city council or county board of commissioners.

Public school systems and community colleges fall somewhere in between state agencies and local governments in their ability to offer early retirement incentives. Employees of both participate in TSERS. Both public school salaries and community college salaries are funded through state appropriations, although the board of county commissioners may appropriate local funds to supplement state funds. Thus, for a public school system or community college to fund an early retirement incentive, it would have to look to the board of county commissioners for funding.

The Age Discrimination in Employment Act and Early Retirement Incentive Programs

The Age Discrimination in Employment Act (the ADEA) prohibits employers from refusing to hire or from firing someone because that person is 40 years of age or older. It also prohibits employers from discriminating against a worker age 40 or older "with respect to his compensation, terms, conditions or privileges of employment, because of such individual's age." The ADEA applies to all North Carolina public employers regardless of size.[1]

Retirement May Not Be Required or Encouraged Based on Age

The ADEA expressly prohibits employers from requiring workers to retire simply because they have reached a certain age[2] (note, however, that there is an exception allowing for mandatory retirement of law enforcement officers and firefighters[3]). The ADEA also prohibits employers from structuring employee benefit plans in such a way that employees lose benefits unless they retire by a certain age: such terms have the practical effect of forcing employees into retirement earlier than they would otherwise choose.[4]

Here is an example of an early retirement incentive that violates the ADEA because it is based on age: imagine that the city of Paradise, North Carolina, offers an incentive to employees between the ages of 58 and 61. Employees retiring upon reaching age 58 receive 48 months of additional retirement benefits, those retiring at age 59 receive 36 months of additional benefits, those retiring at age 60 receive 24 months of benefits, and those retiring in the last year of eligibility, age 61, receive only 12 months of benefits. Employees retiring at age 62 or older receive nothing in the way of additional retirement benefits. Under this program, employees retiring between the ages of 58 and 61 receive increasingly lower early retirement benefits for each year that they delay retiring: the program defines "early retirement" and the benefits afforded those taking "early retirement" solely in terms of age. It does not take into account other factors, such as years of service, pension assets, health or employee need or desire to work.

An ERIP like that offered by the city of Paradise violates the ADEA, as the case *Solon v. Gary Community School Corp.* makes clear.[5] The early retirement plan offered to Gary, Indiana, school teachers in this case was identical to the hypothetical plan offered by the city of Paradise. In the *Solon* case, the court found that the terms of the plan established a *prima facie* case of age discrimination: Take one employee who may have begun working for the Gary schools at age 28 and would qualify for a full 30-year service retirement at age 58. Take another who started employment at age 31 and would qualify for full service retirement at age 61. If they were both to apply for the early retirement incentive in the same calendar year, they would be treated differently -- one entitled to 48 months of payments, the other to 12 months -- for no other reason than because of their respective ages.[6]

What if the Paradise ERIP contained an upper-age limit of 65 instead of 62, on the grounds that most Americans retire by age 65? An early retirement incentive plan that sets a maximum age-requirement for participation on the assumption that employees over a certain age "would be retiring anyway" also violates the ADEA. Why? Because employees over the upper age-limit are being excluded from the plan on the basis of age.[7] Early retirement incentive plans may, however, have *minimum* age requirements and may provide greater benefits to older workers than younger workers eligible for participation in the plan.[8]

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[1] *See* 29 U.S.C. §§ 623(a)(1) and 630(b)(2).

[2] *See* 29 U.S.C. §§ 623(f)(2).

[3] *See* 29 U.S.C. §§ 623(j).

[4] See 29 U.S.C. § 623(f)(2)(B).

[5] 180 F.3d 844 (7th Cir. 1999).

[6] *See Solon*, 180 F.3d at 853.

[7] *See* Jankovitz v. Des Moines Independent Community School District, 421 F.3d 649, 655 (8th Cir. 2005) (school district's limitation of ERIP to those under age 65 violates the ADEA); *Solon*, 180 F.3d at 846-50; E.E.O.C. v. Crown Point Community School Corp., 1997 WL 54747 (N.D.Ind. 1997) at **6 (early retirement plan that provided that teachers who retired between ages of 61 and 65 received increasingly lower early retirement benefits for each year that they delayed retirement, ceasing entirely at "normal" retirement age of 65, violated ADEA). *See also* Karlen v. City Colleges of Chicago, 837 F.2d 314 (7th Cir.), *cert. denied*, 486 U.S. 1044 (1988) (plaintiffs demonstrated *prima facie* case of age discrimination where early retirement program reduced accumulated sick leave benefits and eliminated insurance benefits for those who failed to retire by age 64).

[8] *See* 29 U.S.C. § 623(l)(1)(A). For an example of an early retirement plan that disadvantages younger beneficiaries but is not illegal, *See* General Dynamic Land Systems, Inc., v. Cline, 540 U.S. 581 (2004)) (no ADEA

The Paradise plan violates the ADEA because the value of the benefit is based solely on age. It is possible, however, to structure early retirement incentive plans that do *not* violate the ADEA, as the following sections show.

Retirement May Be Encouraged Based on Factors Other Than Age

Early retirement incentive programs have the inevitable result of reducing the average age of an employer's workforce, because older employees are the ones approaching retirement eligibility. But the ADEA only prohibits actions that are actually taken on the basis of age. An employer may act on the basis of other considerations, such as employee pension status (it is not, for example, a violation of the ADEA to fire an employee because they are about to vest in a pension plan), seniority or salary cost. Although these factors are correlated with age, an employer violates the ADEA only when it makes a decision *because of age*. The mere fact that an employer looks favorably upon the resulting reduction in average age does not make the program unlawful.[9]

There are a number of ways to structure an ERIP that will not violate the ADEA, such as offering flat-dollar amount bonuses, length-of-service or longevity bonuses, bonuses based on percentage of final salary, or retiree health insurance where the employer pays all or some percentage of the premium. The courts have held that each of these incentives is legally permissible under the ADEA *because the value of the incentive is not determined on the basis of age*. This is by no means an exhaustive list. Other forms of early retirement incentive benefits may be allowable under the ADEA, but their legality must be determined on a case-by-case basis.[10]

violation where employer eliminated retiree health benefits for workers under 50, but retained it for workers 50 and over: ADEA does not prohibit favoring the older worker over the younger); Hamilton v. Caterpillar, Inc., 966 F.2d 1226 (7th Cir. 1992) (ADEA does not provide remedy for reverse age discrimination).

[9]*See* Lyon v. Ohio Education Assoc., 53 F.3d 135, 137-38 (6th Cir. 1995), *citing* Hazen Paper Co. v. Biggins, 507 U.S. 604, 611 (1993) (age, not pension status, must be motivating status for there to be violation of ADEA); Anderson v. Baxter Healthcare Corp., 13 F.3d 1120, 1125-26 (7th Cir. 1994) (no ADEA violation to fire employee for sole purpose of reducing salary costs).

[10]*See* SENATE COMM. ON LABOR AND HUMAN RESOURCES, OLDER WORKERS BENEFIT PROTECTION ACT, S. REP. NO. 263, 101st Cong., 2nd Sess. 28 (1990), reprinted in 1990 U.S.C.C.A.N. 1509, 1553. *See also* Rebecca Stith and William Kohlburn, *Early Retirement Incentive Plans after the Passage of the Older Workers Benefit Protection Act*, 11 St. Louis U. Pub. L. Rev. 263, 270 (1992); Terry Mumford and Mary Beth Braitman, *Everything You Wanted to Know about ADEA and Early Retirement Plans – But Were Afraid to Ask*, Employee Retirement and Welfare Plans of Tax-Exempt and Governmental Employers, SD18 ALI-ABA 675, 683 (Sept. 10, 1998).

Incentives Permissible under the ADEA

Almost any incentive may be offered to induce employees nearing retirement age to step out a little earlier, so long as the amount of the incentive that an individual employee will receive is not based on age. Legally permissible incentives include:

- Flat-dollar amount bonuses (for example, $10,000 to all employees electing early retirement);
- One-time termination bonuses based on salary percentages (for example, twenty-five percent of final salary);
- Length-of-service benefits (for example, $1,000 multiplied by the employee's years of service**;**
- Creation of a separation allowance modeled along the law enforcement separation allowance;
- Dollar or percentage increase in the monthly benefits an employee is to receive under a retirement plan;
- Purchase of service credit in the retirement system;
- Imputing years of service under a retirement plan; and
- Retiree health insurance where the employer pays all or some percentage of the premium.

Bonuses

Flat-Dollar Amount Bonuses. Employers frequently offer cash bonuses to employees willing to take early retirement. The simplest form of cash bonus incentive is one that pays the *same flat-dollar amount to all employees* electing to participate in the early retirement program. For smaller public employers with limited resources, the money available to pay a cash bonus may be relatively modest, $5,000 per participating employee, for example. For public employers with greater resources, payments might go as high as $15,000 to $20,000 per employee. There is no legal limit on the amount an employer may offer as an incentive. As a practical matter, however, the jurisdiction's or agency's budget and the savings it projects as a result of reducing its workforce will dictate the limits on what it may offer.

Percentage of Final Salary. One drawback to flat-dollar amount bonuses is that they may have lesser appeal to higher-paid employees -- the very people that the employer typically seeks to eliminate from its payroll through an early retirement program. An alternative form of cash bonus is one based on a *percentage of final salary*. Imagine that an employer offers a bonus of twenty percent of final salary as a retirement incentive. A department head earning $65,000 per year would receive $13,000, a significantly greater bonus than the $6,000 that a semi-skilled worker earning $30,000 per year would get.

Years of Service. Another option is to *base the bonus payment on years of service* because workers who have been with the employer for most of their careers are likely to earn more than those in similar positions who have joined the organization more recently. Thus, an employer might offer $1,000 for every year of service that an employee has with the organization. This incentive may be offered with or without a maximum limit depending on resources and workforce demographics. Although service-based incentives may reward employees for longevity, they may not be an effective way to induce more recent hires with higher salaries to consider retirement. Employers might therefore consider a formula based on a combination of years of service and percentage of final salary if its primary objective in offering an ERIP is to reduce salary costs.

Other Options. Other ways an employer might make a bonus incentive more attractive are to 1) increase the amount of money it offers, but make the bonus payable over time ($20,000 over five years, for example) and/or 2) pay the bonus into employees' 401(k) accounts, if available, so that incentive payment is taxed only upon withdrawal.

Each of these variations on the cash bonus incentive – flat-dollar amount, percentage of final salary and length of service – is legal under the ADEA because the employee's age is not a factor in determining the incentive. Although employees with a relatively high salary or relatively greater length of service are likely to be among the older employees offered the opportunity to take early retirement, the correlation is not exact. Extensive research for this Bulletin has not revealed any reported cases in which challenges to percentage of salary and length of service ERIPs as violative of the ADEA have been successful.

Creation of a Special Separation Allowance

Nothing prohibits local governments, public school systems and community colleges from creating a special separation allowance -- along the model of the special separation allowance for law enforcement officers -- as an early retirement incentive. State agencies may also offer such an incentive, but only if it is approved by the General Assembly.

An example of a special separation allowance is found in Article 12D of Chapter 143 of the North Carolina General Statutes. It provides that every state and local government law enforcement officer shall receive an annual separation allowance equal to .85% of an officer's annualized base rate of compensation applicable at the time of retirement multiplied by the number of years of creditable service. To be eligible for the allowance, officers must either have 30 years of creditable service under the retirement system or be at least 55 years old and have 5 years of creditable service.[11] Eligibility for the allowance ceases when the officer reaches age 62 or becomes re-employed in certain government positions.[12]

Public employers who wish to offer a special separation allowance form of early retirement incentive must first determine whether they intend to offer the annual allowance until the participant's death *or* only until the participant becomes eligible to receive social security benefits. Normally, the ADEA would prohibit an employer from instituting an upper-age limit on eligibility to receive early retirement benefits, as in the *Solon* case discussed above. But when the benefit is styled as a "social security supplement" that (1) begins *before* the age at which participants are eligible to receive either reduced or unreduced social security benefits, and (2) ceases at the age of social security eligibility, the age limit will not violate the ADEA. Currently, retirees are eligible for reduced social security benefits at age 62 and for full benefits at age 65. The law enforcement special separation allowance, which is payable to otherwise eligible retirees from age 55 to age 62 is an example of a social security supplement. To discontinue the allowance at age 60, 70, 80 or any age in between other than 62 or 65 would violate the ADEA.

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[11] There are other requirements not relevant here: for example, the officer must also have 5 years of continuous service as a law enforcement officer immediately preceding retirement. *See* N.C.G.S. §§ 143-166.41 and 143-166.42.

[12] *See* N.C.G.S. §§ 143-166.41(c) and 143-166.42. Payments also cease upon death.

For an ERIP separation allowance to qualify for the social security supplement exception, the amount of the allowance cannot be greater than the anticipated amount of the participant's primary social security benefit as defined in the federal Social Security Act.[13] Take the case of an employee born on January 15, 1950. He earns $40,000 annually and would like to take advantage of an early retirement incentive open to workers 55 and older. The Social Security Online Benefit Calculator estimates that if he retires at 62 years of age in 2012, his monthly benefit amount will be $1,114.[14] This means that his employer cannot offer him an early retirement incentive benefit in excess of that amount.

Other employees, of course, may have social security benefit estimates in excess of $1,100 per month. For others, the estimate may be less. For an ERIP separation allowance to be legal, the employer must undertake an analysis of when its employees actually choose to begin receiving social security payments and/or the specific dollar amounts such employees might expect to receive from the Social Security Administration. An employer could structure the ERIP allowance so that it offers the lowest social security benefit estimate among the eligible pool to all employees. This has the benefit of simplicity. Alternatively, it could offer different ERIP allowances to eligible employees based upon their individual social security benefit estimates. As is the case with the law enforcement special separation allowance, an employer may set the allowance as a percentage of final salary payable on a monthly basis. It must, however, choose the applicable percentage so that it will keep all payments to eligible employees at or below the estimated amount of their individual social security benefits.

The *Solon* case (discussed above on page 3) is a cautionary tale with respect to calculating the amount of an ERIP separation allowance. In *Solon*, eligibility for the incentive payment ended at age 62. The school system argued that once employees reach the age at which they become eligible for reduced social security benefits (at the time of the litigation, as now, age 62), they no longer need a financial incentive to retire. Thus, the schools' early retirement incentive age limit of 62 was based on reasoning from objective facts, rather than on an arbitrary age stereotype. As such, it claimed, the ERIP did not discriminate on the basis of age.[15]

The court rejected this argument because the record did not reveal any evidence that the upper age limit was in fact keyed to anticipated social security payments – in fact, there was explicit testimony from school system administrators that they never considered the projected amount of social security payments that their retirees would receive.[16] It is therefore imperative for a public employer structuring an ERIP separation allowance to ensure that the payments do not exceed the amount that any given participant is likely to receive in the way of social security benefits. If the incentive is keyed to social security, then it will not violate the ADEA even though it is likely that employees retiring at a younger age will receive greater benefits than do workers retiring at an older age (for example, 48 months at age 58 versus 12 months at age 62).

Increase in Amount of Retirement Plan Benefits

Dollar or Percentage Increase in Monthly Retirement Plan Benefits. This is a popular form of early retirement incentive among private employers with their own pension plans. The organization and funding structure of the North Carolina public employee retirement systems makes this an impractical option for North Carolina government employers, however. As noted earlier, benefits paid under TSERS and LGERS and the other state retirement systems are determined in accordance with formulas set forth in the North Carolina General Statutes. Individual participating state agencies and local government jurisdictions cannot effect any change in retirement benefits offered under these plans. The decision to offer an early retirement incentive program and under what terms and conditions it will be offered can be made only by the General Assembly. While the General Assembly has, on occasion, approved early retirement incentives for state employees and others covered by TSERS, it is unlikely to adopt an ERIP that involves benefit payments under LGERS since it would apply to all local government employers. It is likely that not all jurisdictions would be in favor of such a program, depending on a city or county's individual need to reduce salary costs and on the available labor pool in the immediate geographic area.

[13] *See* 29 U.S.C. § 623(l)(1)(B(ii). *See also* 42 U.S.C. § 402(a) (eligibility); 42 U.S.C. § 415(a) (primary insurance amount); 42 U.S.C. § 416(l) (definition of "retirement age").

[14] Go to http://www.ssa.gov/cgi-bin/benefit6.cgi.

[15] *See Solon*, 180 F.3d at 855.

[16] *See Solon*, 180 F.3d at 854 - 85.

Service Credits. A public employee's retirement allowance is based on his or her "creditable service." Under the Local Government Employee Retirement System (LGERS), "creditable service" is defined as "the total of 'prior service' plus 'membership service' plus service, both noncontributory and purchased, for which credit is allowable as provided in G.S. 128-26" (credit for accrued sick leave is noncontributory credit allowed under § 128-26). "Membership service" is defined as "service as an employee rendered while a member of the Retirement System." The Teachers and State Employees Retirement System (TSERS) has functionally identical definitions for "creditable service" and "membership service."[17] Under LGERS, "prior service" is defined as service rendered for (1) a participating employer before the employer became a member of the retirement system, (2) any other North Carolina public employer, (3) any other U.S. public employer, (4) certain qualifying military service. The definition under TSERS is substantively identical.[18] By definition, creditable service is only service actually rendered and service purchased or imputed in accordance with the terms set out in the General Statutes.

Purchase of Service Credits. Employer-paid purchase of service credits is a popular incentive among public employers nationwide whose retirement plans allow for unrestricted purchase of service credit. Although North Carolina's public retirement plans – LGERS, TSERS, CJRS, and LRS – all provide for the purchase of service credits, they do so only under certain limited circumstances.

Participants in LGERS, for example, may purchase service credit for

- service with an employer before the employer began participating in the retirement system,[19]
- military service entered into while the employee was a participant in the retirement system,[20]
- temporary or part-time service,[21]
- withdrawn service,[22]
- public employment in another state[23] and federal employment,[24]
- approved leaves of absence,[25] and
- service in the North Carolina General Assembly.[26]

These examples are not exhaustive.[27] The restrictions on the purchase of service credits make this form of incentive of limited use to employers because not all ERIP-eligible employees will be eligible for the purchase of service credits.

Imputing Years of Service under the Retirement System. This is theoretically possible, but probably not advisable. Although the North Carolina state retirement systems do not permit individual employers to increase the level of benefits paid to their employees, imputing years of service is an

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[17] *See* G.S. § 128-21(8) and (14) (LGERS); G.S. § 135-1(8) and (14) (TSERS)

[18] *See* G.S. § 128-26(a) (LGERS); G.S. § 135-1(17) (TSERS).

[19] *See* G.S. § 128-26(s).

[20] *See* G.S. § 128-26(j1). TSERS will credit teachers and other state employees for military service entered into while the employee was a TSERS participant. See G.S. 135-4(g). TSERS participants may purchase military service credits for military service entered into before the participant was a member of TSERS under G.S. § 135-4(f)(7). Note that under the Uniformed Services Employment and Reemployment Rights Act of 1993 (USERRA), periods of military leave automatically count as creditable service for which the employer must make its contribution if the employee returns to work with the same employer upon discharge. *See* 29 U.S.C. § 4318(a)(2)(A) and (B).

[21] G.S. § 128-26(p). *See* G.S. § 135-4(p) and (s) for purchase of temporary or part-time service credits under TSERS.

[22] G.S. § 128-26(i). *See* G.S. § 135-4(k) for purchase of withdrawn service credits under TSERS.

[23] G.S. § 128-26(j2). *See* G.S. § 135-4(l)(1) for purchase of service credits under TSERS for public employment in another state.

[24] G.S. § 128-26(h). *See also* G.S. § 135-4(w) (TSERS).

[25] *See* G.S. § 128-26(l) (workers' compensation leave). Under TSERS, *See also* G.S. § 135-4(r) for workers' compensation leave; G.S. § 135-4(z) for purchase of service credits for leave for extended illness.

[26] G.S. § 128-26(h). For TSERS, *See* G.S. § 135-4(j) and (j2).

[27] Note that TSERS grants some additional credits and allows for the purchase of some additional service credits. *See*, for example, G.S. § 135-4(aa), which allows for the purchase of service credits for time off for parental leave, including time off for pregnancy and childbirth. For the purchase of service credits under CJRS, *See* G.S. §§ 135-56, 135-56.2 and 135-56.3. There is no provision for the purchase of service credits under the Legislative Retirement System.

indirect way in which a public employer theoretically may increase the benefits to which a retiring employee is entitled. The retirement system itself imputes years of service when it credits an employee with one month of service for every 20 days of accrued, unused sick leave that an employee has upon retirement.[28]

A North Carolina government employer could, therefore, offer to credit employees taking early retirement with additional sick-days as an ERIP incentive. This would allow those employees to apply the additional unused sick days to their creditable service and thus to increase the amount of the monthly payments they will receive from the retirement system.[29]

There are a number of problems with this form of incentive, however. First, an employer would have to grant employees taking early retirement an exceedingly large number of sick days to effect a meaningful increase in any given employee's monthly retirement benefit. The retirement systems are structured on the assumption that only actually accrued sick days will be applied to an employee's creditable service. To grant unearned sick days as a retirement incentive would be to attempt to pass on the costs of the incentive from the employer to the retirement system.

In addition, an increase in the number of accrued sick days being certified by a single employer for the brief time that an early retirement incentive program were being offered would probably lead to an audit of the employer's account by the retirement sytem. Any widespread attempt by employers to grant large numbers of additional sick days could lead to legislation prohibiting any rolling over of unused sick days to creditable service.

The retirement systems are not structured in such a way as to allow individual employers to impute creditable service to their employees in any other manner.

[28]*See* G.S. § 135-4(e) (TSERS); G.S. § 128-26(e) (LGERS). Credit for unused sick leave does not apply to CJRS or to LRS.

[29]In both TSERS and LGERS, retirement benefits are generally calculated by multiplying the retiree's number of years of creditable service by a statute-based multiplier of the member's average compensation for the final four years of service. *See*, *e.g.*, G.S. § 128-27(b21)(2)a. (LGERS); G.S. § 135-5(b19)(2)a. (TSERS). Retirement benefits for CJRS and LRS are calculated differently. *See* G.S. § 135-58(CJRS); G.S. § 120-4.21 (LRS).

Retiree Health Insurance

Offering or enhancing retiree health benefits is another ADEA-compliant form of early retirement incentive. Many North Carolina public employers already offer retiree health benefits. The State of North Carolina, for example, provides state employees with employer-paid retiree health insurance through the Teachers' and State Employees' Comprehensive Major Medical Plan ("State Health Plan"); this coverage ceases to be primary once participants are eligible for Medicare, and instead pays those covered charges not paid by Medicare.[30] Many local government employers offer similar coverage to their retirees.

For local government employers who do not provide retiree health insurance, offering to do so may provide a powerful early retirement incentive. But the very reason that the offer is so attractive to employees – namely, the high cost of health insurance, especially for those between the ages of 50 and 65 – may make this incentive less favored among employers. Employers do not necessarily have to provide full retiree coverage until death, however. Under the ADEA, employers must either spend the same amount of money on health benefits for younger and older retirees, or offer equal benefits to younger and older retirees.[31] Employers may, however, take Medicare benefits into account when considering whether the benefits provided to retirees age 65 and older are equal to those provided to retirees younger than 65.[32] This enables employers to do what the State of North Carolina has done with the State Health Plan – namely, become a secondary payor once a retiree reaches the age of Medicare-eligibility – and to reduce its costs accordingly.[33]

[30]*See* generally, Article 3 of Chapter 135 of the General Statutes. G.S. § 125-40.10 addresses coverage upon participant eligibility for Medicare.

[31]*See* 29 C.F.R. § 1625.10(a).

[32]*See* 29 C.F.R. § 1625.10(e).

[33]Note that the Third Circuit's decision in Erie County Retirees Ass'n v. County of Erie, Pa., does not directly affect North Carolina public employers, who are under the jurisdiction of the Fourth Circuit Court of Appeals. In the *Erie County* case, the Third Circuit held that where an employer offered equal coverage for younger and older worker, the practice of providing secondary employer-sponsored coverage to Medicare's primary coverage did not violate the ADEA. Where the employer incurred equal costs for younger and older workers, however, Medicare's costs could not be taken into account. *See* Erie County Retirees Ass'n v. County of Erie, Pa., 220

For employers who already offer retiree health insurance, potential incentives for ERIPs include enhancing the benefit by reducing or eliminating the cost of the retiree premium, or by providing employer-paid spousal coverage.

Other Typical ERIP Provisions

In addition to the incentive itself, early retirement incentive programs usually share the following features, all of which must also be designed with care to avoid inviting claims of age discrimination:

- eligibility requirements;
- dates by which retirement must be effective;
- time frame in which to elect to participate in the plan; and
- a release of employment law claims.

Eligibility Requirements

In structuring early retirement incentive programs, employers may set a *minimum* age for participation. They may **not** set a maximum age.

An Employer Does Not Have to Offer an Early Retirement Incentive to All Employees within the ADEA Protected Class

Retirement benefit plans almost always fix a minimum age as a condition that must be met before a participant may begin drawing retirement income benefits. Nothing in the ADEA requires an employer offering an early retirement incentive program offer it to *all* employees 40 and over.[34]

Imagine that the city of Paradise decides to offer an early retirement incentive program that requires employees to have reached age 55 to participate. The city's police chief is 50 years old and has worked in local government law enforcement for 30 years. He is therefore eligible for a service retirement with full benefits under LGERS. He is angry that the terms of the city's early retirement incentive program do not allow him to take advantage of the $10,000 bonus that the city is offering. "The city is discriminating against me because of my age!" he says. "I'm over 40 years old and I am protected by the Age Discrimination in Employment Act."

Is the police chief correct? The United States Supreme Court says that he is not. In *General Dynamics Land Systems, Inc., v. Cline*, a 2004 case, the Supreme Court held that there was no ADEA violation where an employer eliminated future retiree health benefits for workers under 50, but retained it for workers 50 and over. The ADEA, the court said, does not prohibit favoring the older worker over the relatively younger, even where the younger worker is over 40 and falls within the ADEA's protected class.[35]

Clear Eligibility Date

When an employer announces early retirement incentive eligibility requirements, it should make clear the date against which eligibility will be measured. For example, if the ERIP is open only to employees who are 55 years or older and have at least 25 years of service, then the offer should make clear whether an employee must be 55 and/or have completed the service requirement at the time the offer is accepted *or* by the time the retirement is effective.

Retirement Date

In order to minimize disruption to the workplace and confusion among participants and their supervisors, early retirement incentive programs should set a date by which participating employees must retire. Employers will want to take into account any annual or seasonal projects that might be unduly disrupted

F.3d 193 (3d Cir. 2000), *cert. denied*, 532 U.S. 913 (2001). So even under the Third Circuit rule, making the State Health Plan secondary to Medicare once retirees are Medicare-eligible is permissible under the ADEA. Subsequent to the Third Circuit's decision in the Erie County case, the EEOC proposed a final rule that would exempt coordination of retiree health benefits with Medicare eligibility from the ADEA's prohibitions against age-based distinctions in the provision of employment benefits. *See* 68 Fed.Reg. 41542 (July 14, 2003), 2003 WL 21634221. The proposed final rule, however, is the subject of an injunction pending an appeal by the American Association of Retired Persons (AARP) of the EEOC's authority to issue such an exemption to the ADEA. *See* AARP v. E.E.O.C., 390 F.Supp.2d 437 (E.D.Pa. 2005).

[34] *See* 29 U.S.C. § 623(l)(1)(A).

[35] 540 U.S. 581 (2004). As another court explained in an early ERIP case, age discrimination -- like disability discrimination -- differs from race and gender discrimination: "Congress was concerned that older people were being cast aside on the basis of inaccurate stereotypes about their abilities. The young, like the non-handicapped, cannot argue that they are similarly victimized." *See* Dittman v. General Motors Corp – Delco Chassis Division, 941 F.Supp. 284, 287 (D.Conn. 1996), *aff'd*, 116 F.3d 465 (2d Cir. 1997) (early retirement plan available to employees over 50, but not those between 40 and 50 does not violate the ADEA), *quoting Hamilton*, 966 F.2d at 1228.

by retirements and may require actual retirement dates to be set accordingly. For example, state and local government units may not want their department heads to retire while the budget for the next fiscal year is being prepared. For this reason, an early retirement incentive program might specify with respect to department heads that retirement under the plan is to be effective August 1.

Window of Opportunity

An early retirement incentive program should also have a clearly defined timeframe during which employees may consider the offer and decide whether or not to participate. An ERIP, like severance agreements generally, usually requires that employees waive their right to sue under the ADEA and other anti-discrimination statutes as a condition of receiving the benefit.[36] Under the ADEA, employees must be given at least 45 days in which to consider the early retirement offer for such a wavier to be valid.[37] The ERIP's window of opportunity must, therefore, span a minimum of 45 days between (1) the announcement of the program and the distribution of written material explaining the offer, and (2) the date by which employees must tell management whether or not they intend to participate in the program. The date by which employees must decide whether or not to accept the offer is separate and distinct from the date by which retirement is to be effective.

Waiver of Employment Claims

Most early retirement incentive offers require participants to sign a waiver and release of all claims related to their employment as a prerequisite to receiving the incentive benefits. Most employment lawyers routinely recommend that employers make execution of a release a precondition of all severance packages or settlements. Some attorneys, however, counsel employers to evaluate the need for a release on a case-by-case basis. Where the relationship is still cooperative, these attorneys caution, asking for a release may cause employees to wonder whether they are being treated unfairly and to ask whether they are giving away a valuable legal claim. But even attorneys who do not favor asking for releases from all employees, generally advise requiring a release from employees who have already raised the possibility of filing suit or who have retained a lawyer.

Waivers of Age Discrimination Claims

As a general matter, a waiver and release of any employment claims must be knowing and voluntary to be valid.[38] Waivers of age discrimination claims must meet a more stringent standard, however. The ADEA, as amended by the Older Workers Benefit Protection Act of 1990, requires that a waiver given as part of an early retirement incentive program:

- be written in a manner that can be understood by the individual employee or by an average employee;
- specifically refer to a release of claims under the ADEA;
- not apply to claims that may arise after the date the waiver is executed; and
- be given by the employee only in exchange for a benefit that is in addition to those to which the employee is already entitled.[39]

In addition, the employer must:

- advise the employee in writing to consult with an attorney before signing the waiver agreement;
- give the employee at last 45 days within which to consider the ERIP agreement;
- provide in the agreement itself that the employee has at least 7 days from the execution of the agreement in which to revoke his or her acceptance.[40]

The ADEA also requires that the employer provide employees being offered the opportunity to participate in an ERIP certain information ("informational requirements"), namely,

- the class, unit or group of individuals covered by the program (the "decisional unit");

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[36] For a more detailed discussion of waivers of age-discrimination claims, *See below* pp. 10-12.

[37] As amended by the Older Workers Benefit Protection Act of 1990. *See* 29 U.S.C. § 626(f)(1); 29 C.F.R. § 1625.22.

[38] Employers should note that unlike age discrimination claims, claims arising under the Fair Labor Standards Act and the Family and Medical Leave Act may not be waived unless the waiver is part of an overall settlement that involves the U.S. Department of Labor. For the FLSA, *See* D.A. Schulte, Inc. v. Gangi, 328 U.S. 108 (1946). For the FMLA, *See* 29 C.F.R. § 825.220(d) and Taylor v. Progress Energy, Inc., 415 F.3d 364 (4th Cir. 2005).

[39] 29 U.S.C. § 626(f)(1)(A)-(D).

[40] 29 U.S.C. §626(f)(1)(E)-(G).

- the eligibility factors for determining who may participate in the ERIP;
- the job titles and ages of all employees eligible for the program and the ages of all employees in the same job classification or organization unit who are not eligible for the program; and
- any time limits applicable to the program.[41]

A waiver that fails to satisfy any one of the ADEA's safeguards will be unenforceable. The fact than an employee has already received a cash bonus or other ERIP incentive in return for the waiver will not act as a bar to that employee's pursuit of an age discrimination claim. Under traditional principles of state contract law, an employee's retention of a benefit acts to ratify an agreement to release claims. The United States Supreme Court, however, has held that the ADEA's requirements for valid waivers of age discrimination claims are valid restrictions that are separate and distinct from contract law. In accordance with contract law, an employer may sue an employee for return of the incentive benefits if that employee files an age discrimination claim, but if the waiver does not meet the ADEA's standards, the employee may nevertheless proceed with his or her age-discrimination claim independent of the employer's claim for the return of the incentive.[42]

Employers must take care in satisfying the ADEA's waiver informational requirements. Even if the form of waiver satisfies the ADEA and the employer scrupulously observes the time periods it is required to give employees to consider the early retirement incentive offer, the waiver will violate the ADEA and employees will be free to pursue age discrimination claims if the employer does not provide the employee with all of the required information.

Crucial to satisfying this requirement is employer understanding of what comprises the so-called "decisional unit," that is, the class, unit or group of individuals covered by the program. EEOC regulations define "decisional unit" as "that portion of the employer's organizational structure from which the employer chose the persons who would be offered consideration for the signing of a waiver and those who would not be offered consideration for the signing of a waiver."[43] In the context of an early retirement incentive program, the "consideration" would be the incentive – bonus, separation allowance, imputing of sick leave, retiree health insurance – to which the employee otherwise would have no right. As the definition itself makes clear, the "decisional unit" includes not only those employees or departments who are actually selected for reduction, but those employees or departments who are considered but not selected, as well. Consider the following alternative ways that Paradise County might determine to which employees it will offer an early retirement incentive:

a. Organization-wide: for example, 10% of the county's workforce will be offered participation in the ERIP;
b. Department-wide: imagine that the county decides that it will offer fifteen of the employees in the Information Technology Department ERIP participation;
c. Division-Wide: for example, one-half of the employees in the Program Management Division of the Information Technology Department will be offered ERIP participation;
d. Reporting: imagine that the county decides that ten percent of the employees who report to the Finance Director will be offered participation in the ERIP;
e. Job Category: for example, the county will offer ten percent of all administrative assistants county-wide the opportunity to participate in the ERIP.

Early retirement incentives programs, like other forms of reductions-in-force (both voluntary and involuntary) are typically structured along lines like these.[44] For each of the examples given above, the decision units for ADEA information purposes would be, respectively,

a. Paradise County government
b. The Information Technology Department
c. The Program Management Division of the Information Technology Department

[41] 29 U.S.C. § 626(f)(1)(H).

[42] *See* Oubre v. Entergy Operations, Inc., 522 U.S. 422, 426-28 (1988). This overrules the Fourth Circuit's holdings in Blistein v. St. John's College, 74 F.3d 1459 (4th Cir. 1996) (employee ratified agreement that did not comply with Older Workers Benefit Protection Act requirements by accepting its benefits) and O'Shea v. Commercial Credit Corp., 930 F.2d 358 (4th Cir. 1991) (even if employee's release of age discrimination claim was not knowing and voluntary, employee ratified agreement by accepting severance pay and other benefits).

[43] *See* 29 C.F.R. § 1625.22(f)(3)(i)(B).

[44] *See* 29 C.F.R. § 1625.22(f)(3)(iii).

d. All employees reporting to the Finance Director
e. All administrative assistants.[45]

A recent case from the Tenth Circuit Court of Appeals illustrates the importance of correctly delineating the decisional unit and the factors considering in determining eligibility. In *Kruchowski v. Weyerhaeuser Co.*, the court held that an employer's failure to give correct information concerning the decisional unit involved in a reduction-in-force and to explain the eligibility factors it used rendered employees' waivers of their age discrimination claims ineffective. The employer had notified employees that the decisional unit was salaried employees working at the company's Valliant Containerboard Mill facility. It later claimed that the decisional unit was smaller, namely, only those salaried employees who reported directly to the facility manager. The difference between the two decisional units was 10 employees, over 10 percent of the total number of positions affected by the reduction-in-force.[46] Similarly, the employer did not include eligibility factors in its group termination notice, maintaining that eligibility factors were program –wide parameters rather than individualized factors. During the course of the litigation, however, the employer disclosed that the eligibility factors that it used in considering each salaried employee reporting to the facility manager for termination were leadership, abilities, technical skills, behavior and whether each employee's skill matched its business needs.[47]

Why is it so important that employees selected for a group early retirement incentive program or reduction-in-force receive this information? Why do the courts invalidate releases that do not contain this required reporting? As a general rule of law, waivers must be knowing and voluntary to be valid. This principle forms the basis of the ADEA's statutory requirements for valid releases of age discrimination claims. Section 626(f) has the subject title "Waiver" and states in subsection (1) "An individual may not waive any right or claim under this Act unless the waiver is knowing and voluntary. . . . a waiver may not be considered knowing and voluntary unless at a minimum-- . . . ." What follow in subsections (A) through (H) are the substantive, procedural and informational requirements that a release must meet to waive an employee's age discrimination claims.

The informational requirements, that is, the age and job title information set forth in section 626(f)(1)(H), would be relevant to an employee's evaluation of any potential age discrimination claim, an analysis that employees need to make if their waiver of such claims is to be "knowing and voluntary." As the Fourth Circuit Court of Appeals explained in *Adams v. Moore Business Forms, Inc.*, a case in which the employer's designation of a reduction-in-force decisional unit was at issue: "In requiring employers to provide this information, Congress intended that employees, when deciding whether to waive discrimination claims, have the information necessary to assess the value of the rights that they would be giving up."[48] For this reason, employers should take care not to short shrift the informational reporting requirements – the courts will scrutinize employer's decisional units and eligibility factors carefully for accuracy to ensure that an employee's waiver of age discrimination claims is one made freely and with knowledge.

No Emoluments Clause

There is one additional reason that a public employer might choose to require a waiver and release as a condition of receiving an early retirement incentive: that waiver is a valuable benefit to government. It also ensures that the ERIP does not run afoul of the public purpose doctrine set forth in Article I, Section 32 of the North Carolina Constitution. Section 32 provides, "No person or set of persons is entitled to exclusive or separate emoluments or privileges from the community but in consideration of public services." Arguably, an early retirement incentive is not a payment or benefit given in return for public services as it is not deferred

[45] *See* 29 C.F.R. § 1625.22(f)(3)(iv).

[46] 446 F.3d 1090 (10th Cir. 2006).

[47] This is reported in the original *Kruchowski* decision, 423 F.3d 1139 (10th Cir. 2005), which was withdrawn and superseded by the decision at cited in footnote 48. In the first decision, the failure to accurately report the eligibility factors was a basis for invalidating the waiver. The court never reached the question of the eligibility factors in the second decision.

[48] *See* Adams v. Moore Business Forms, Inc., 224 F.3d 324, 328 (4th Cir. 2000) (decisional unit included only plant that employer was closing and not other manufacturing plans in the absence of evidence that employer considered layoffs at other plants).

compensation for work done as a government employee. It is an open question whether any severance payments (and an early retirement incentive is a form of severance payment) to public employees is unconstitutional. A 1995 North Carolina Supreme Court case, Leete v. County of Warren, held that Warren County's proposed severance payment to its manager was compensation beyond that due for services rendered and thus unconstitutional.[49] In the Leete case, however, the manager had elected to leave his position of his own accord to take another job and the board of commissioners voted to pay him a severance bonus above and beyond his agreed-upon compensation as a show of appreciation for his work as county manager. The *Leete* case, however, is distinguishable from situations where the General Assembly has authorized severance pay to state employees as part of a reduction-in-force or closing of an institution, or, more generally, where severance pay is negotiated and agreed upon upfront as a condition of a manager or other employee's acceptance of the offer of employment -- as the *Leete* decision itself acknowledges.[50] As the North Carolina Court of Appeals noted in a later case, the Supreme Court has left open the question of whether all severance payments are prohibited by the North Carolina Constitution.[51]

In this context, it is arguable whether a public employee's agreement to retire earlier than he or she might otherwise choose to do actually confers a public service on the government employer given that the employee could simply be terminated as part of a reduction-in-force (even employees who have just cause protection and a property right in employment, such as SPA employees, may be terminated as part of a reduction-in-force). If, however, employees sign a waiver and release of their employment claims, then they have surely conferred a benefit on the employer and thus given consideration for the incentive payment. In these circumstances, the early retirement incentive payment is unlikely to be challenged by a taxpayer under the public policy doctrine.

[49] 341 N.C. 116 (1995).

[50] *See Leete*, 341 N.C. at 122.

[51] *See* Myers v. Town of Plymouth, 135 N.C.App. 707, 712 (1999).

A Few Frequently Asked Questions

A) May an Employer Decide to Institute a Reduction-in-Force After Offering an ERIP?

B) Must an Employer Mention the Possibility of a Reduction-in-Force When Offering an ERIP?

The answers to these questions are "yes" and "no" respectively. Employers may plan a subsequent reduction-in-force prior to offering an early retirement incentive program. They may also decide to institute a reduction-in-force after offering an ERIP, if it determines that not enough employees have retired under the program to meet the employer's financial or reorganization goals. An employer has no affirmative obligation to inform employees about a potential or planned reduction-in-force when it discloses its early retirement incentive offer.

Some employees have argued that notice of an imminent reduction-in-force effectively forced them to elect early retirement, and thus amounted to a constructive discharge. The courts have not been receptive to such claims where the employer did not directly or indirectly indicate who would be laid off in a reduction-in-force.[52]

Even where an employee perceived "as a threat" a supervisor's statement that employees would not receive severance pay if not enough employees accepted early retirement and their positions were eliminated, the court did not find that working conditions had become so intolerable as to force the employee to accept the early retirement offer. The court noted that the employer had not identified those persons whose positions would be eliminated and that the risk of losing their jobs was shared by all of those who chose not to accept the ERIP offer and to remain at work. The early retirement plan actually gave those employees who qualified for it a way to mitigate the risk that was not offered to other employees.[53] In another case, an employee argued simply that he believed that if he did not accept the early retirement incentive, he would be fired. The court held that he had not been forced to retire and thus, constructively discharged.[54]

[52] *See* Bodnar v. Synpol, Inc., 843 F.2d 190, 193-94 (5th Cir.), *cert. denied*, 488 U.S. 908 (1988); Vega v. Kodak Caribbean Ltd., 3 F.3d 476, at 480-81 (1st Cir. 1993) .

[53] *See Bodnar*, 843 F.2d at 193-94.

[54] *See* Duke v. Uniroyal, Inc., 719 F.Supp. 428, 431 (E.D.N.C. 1989).

If, however, an employer explicitly told an employee that if he did not participate in an early retirement incentive program, he would be fired without any additional compensation or benefits, then that employee would be constructively discharged and could have a claim against the employer on that basis.[55]

C) May an Employer Limit the Number of Senior Employees or of Employees in a Particular Department Retiring?

D) May an Employer Deny the Opportunity to Participate in an ERIP to a Particular Employee?

The answer to both of these frequently asked questions is "yes." An employer may limit the number of employees or the individual employees eligible to participate in an early retirement incentive program in any manner it chooses, so long as it does not do so on the basis of race, color, gender, religion, or national origin in violation of Title VII of the Civil Rights Act of 1964, on the basis of disability in violation of the Americans with Disabilities Act, or on the basis of age in violation of the ADEA. An employer may offer an ERIP to any subset of persons over 40; the ADEA only prohibits employers from restricting employees over a certain age from participating on the grounds that they would likely retire soon anyway.

Conclusion

For public employers seeking to reduce personnel costs, early retirement incentive programs are an option that they may have overlooked. There are a variety of incentives that may be offered to employees that will not violate the Age Discrimination in Employment Act – even if one of the driving considerations behind the ERIP is a desire to reduce the average age of the workforce.

The three single most important points for an employer to keep in mind when designing an ERIP are:

1. The ERIP cannot have an upper-age limit (it may, however, require employees to have reached a minimum age to participate);
2. The amount of the incentive cannot be based on age; and
3. The waiver and release of claims must include all of the required elements set forth in the ADEA and must accurately describe both the decisional unit from which persons offered the opportunity to participate have been chose, and the requisite eligibility factors applied in choosing offerees.

Designing an ERIP will be a team effort, requiring participation from the city, county or agency manager, the human resources director and the finance director. To ensure that the early retirement incentive program complies with the ADEA, employers should include their attorney in the ERIP design team.

[55] *See* Rowell v. BellSouth Corp., 433 F.3d 794, 806 (11th Cir. 2005).

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