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*Legal Issues Relating to State Health Care Regulation:
ERISA Preemption and Fair Share Laws*

Jon O. Shimabukuro and Jennifer Staman, American Law Division

October 24, 2008

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Summary

In the absence of comprehensive federal health care reform, states and localities have undertaken certain initiatives in an effort to expand the provision of health care to residents. One type of measure has been the fair share law, which generally requires employers to choose between paying a certain amount towards health expenditures or coverage for their employees, or contributing to a state or locality to offset the cost of medical expenses for uninsured residents. Questions have been raised as to whether fair share laws can be preempted by the Employee Retirement Income Security Act (ERISA). This report provides an overview of ERISA preemption, discusses legal challenges to fair share laws, and analyzes the fair share requirements included as part of the Massachusetts Health Care Reform Act.

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Introduction

In response to an increasing number of uninsured individuals, the declining number of employers offering insurance to their employees, and the absence of federal action, states and localities have experimented with certain measures to address the problems of health care financing and access. One approach has been to enact fair share laws, also referred to as “pay or play” statutes, which generally require employers to choose between paying a certain amount for health expenditures or coverage for their employees, or contributing to the state or locality to offset the cost of medical expenses for their uninsured residents. Recently, questions have been raised as to whether the Employee Retirement Income Security Act’s (ERISA’s) express preemption provision, Section 514, prevents the application of fair share laws. There have been legal challenges to fair share laws enacted in Maryland, San Francisco, and Suffolk County, New York, with courts reaching varying conclusions. In addition, the state of Massachusetts, which has received a great deal of attention for enacting comprehensive health care reform, maintains a fair share requirement as part of its health care reform package. This report provides an overview of ERISA preemption, discusses legal challenges that have been brought against fair share laws, and discusses the fair share requirements of the Massachusetts Health Care Reform Act.

ERISA Preemption

ERISA provides a comprehensive federal scheme for the regulation of employee pension plans, and a somewhat less detailed scheme for regulating welfare benefit plans, offered by private employers. An “employee welfare benefit plan” is defined, in relevant part, as

any plan, fund, or program ... established or maintained by an employer ... for the purpose of providing for its participants or their beneficiaries, medical, surgical, or hospital care or benefits, or benefits in the event of sickness, accident, disability, death or unemployment ...¹

Although ERISA does not require an employer to offer pension or welfare benefits, it does mandate compliance with its provisions if such benefits are offered.

Congress enacted ERISA to eliminate the conflicting and inconsistent regulation of pension and employee welfare benefit plans by state laws. Accordingly, Section 514(a) of ERISA expressly preempts “any and all State laws insofar as they may now or hereafter relate to any employee benefit plan ...”² The U.S. Supreme Court has interpreted this language as applying to any state law that “has a connection with or reference to such a plan.”³ The Court has explained that to determine whether a state law has a connection with an ERISA plan, a court must consider the objectives of ERISA as a guide to the scope of the statute that Congress understood would survive, as well as the nature of the effect of the state law on ERISA plans.⁴ A state law has a

¹ 29 U.S.C. § 1002(1). *See* 29 U.S.C. § 1002(7) (defining the term “participant” as “any employee or former employee of an employer, or any member or former member of an employee organization, who is or may become eligible to receive a benefit of any type from an employee benefit plan which covers employees of such employer or members of such organization, or whose beneficiaries may be eligible to receive any such benefit.”); 29 U.S.C. § 1002(8) (defining the term “beneficiary” as “a person designated by a participant, or by the terms of an employee benefit plan, who is or may become entitled to a benefit thereunder.”).

² 29 U.S.C. § 1144(a). ERISA does exempt from preemption certain laws, including generally applicable criminal laws, the Hawaii Prepaid Health Care Act, and state insurance laws regulating multiple employer welfare arrangements.

³ *See* *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85, 97 (1982).

⁴ *See* *California Div. of Lab. Standards Enforcement v. Dillingham Construction*, 519 U.S. 316 (1997).

reference to an ERISA plan if it acts “immediately and exclusively” on ERISA plans or if the existence of such a plan is essential to the law’s operations.⁵

A state law that “relates to” an ERISA plan may avoid preemption if it regulates insurance within the meaning of ERISA’s “saving clause.” Section 514(b)(2)(A) “saves” from preemption “any law of any State which regulates insurance, banking, or securities.”⁶ However, an additional clause serves as an exception to ERISA’s saving clause. Section 514(b)(2)(B), ERISA’s “deemer clause,” indicates that a state law that “purport[s] to regulate insurance” cannot deem an employee benefit plan to be an insurance company for purposes of regulation.⁷

Until 1995, the Court’s decisions on ERISA preemption suggested generally that the application of Section 514(a) was limitless. However, with its decision in *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, the Court began to show a greater willingness to uphold various state laws.⁸

In *Travelers*, several commercial insurers challenged a state law that required them, but not Blue Cross and Blue Shield, to pay surcharges on hospital services. The commercial insurers argued that the law was preempted by ERISA because it “relate[d] to” employer-sponsored health insurance plans. In addressing the application of ERISA’s preemption clause, the Court first noted that there is a “presumption that Congress does not intend to supplant state law.”⁹ The Court then considered whether Congress intended to preempt state law by looking to “the structure and purpose” of ERISA.¹⁰ The Court concluded that “nothing in the language of the Act or the context of its passage indicates that Congress chose to displace general health care regulation, which historically has been a matter of local concern.”¹¹

Although the Court continued to uphold several other state laws following *Travelers*,¹² it nevertheless concluded in 2001 that a Washington state law was preempted by ERISA despite the fact that it gave plans an option for avoiding its requirements. The Washington law at issue in *Egelhoff v. Egelhoff* provided that the designation of a spouse as the beneficiary of a nonprobate asset would be revoked automatically upon divorce.¹³ Under the law, plan administrators were required to alter the terms of a plan to indicate that the plan would not follow the law. It was argued that the law not only avoided the regulation of plan administration, but also did not apply so long as the plan documents expressly provided otherwise.

⁵ *Id.* at 325.

⁶ 29 U.S.C. § 1144(b)(2)(A).

⁷ 29 U.S.C. § 1144(b)(2)(B). *See* *Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724, 733 (1984) (discussing ERISA’s “saving clause” and “deemer clause”).

⁸ 514 U.S. 645 (1995).

⁹ *Id.* at 654.

¹⁰ *Id.* at 655.

¹¹ *Id.* at 661. In analyzing whether the state surcharges violated ERISA’s preemption provision, the Court stated, “In *Shaw*, we explained that ‘a law ‘relates to’ an employee benefit plan, in the normal sense of the phrase, if it has a connection with or reference to such a plan.’ The latter alternative, at least, can be ruled out ... [T]he surcharge statutes cannot be said to make ‘reference to’ ERISA plans in any manner.” *Id.* at 656 (citations omitted).

¹² *See, e.g.*, *De Buono v. NYSA-ILSA Medical and Clinical Services Fund*, 520 U.S. 806 (1997) (state tax on gross receipts of health care facilities not preempted by ERISA); *California Div. of Labor Standards Enforcement v. Dillingham Constr.*, 519 U.S. 316 (1997) (California’s prevailing wage law not preempted by ERISA).

¹³ 532 U.S. 141 (2001).

The Court determined that the Washington law had an impermissible connection with ERISA plans because it interfered with nationally uniform plan administration. The Court explained that one of the principal goals of ERISA is to enable employers to establish a uniform administrative scheme that provides standard procedures for the processing of claims and disbursement of benefits. The Court maintained that uniformity is impossible if plans are subject to different legal obligations in different states. Moreover, the Court declined to find the law saved from preemption because of its “opt out” option:

It is not enough for plan administrators to opt out of this particular statute. Instead, they must maintain a familiarity with the laws of all 50 States so that they can update their plans as necessary to satisfy the opt-out requirements of other, similar statutes ... This ‘tailoring of plans and employer conduct to the peculiarities of the law of each jurisdiction’ is exactly the burden ERISA seeks to eliminate.¹⁴

The fair share laws discussed in this report present similar questions about preemption and the impact of a plan or plan sponsor’s ability to choose from various compliance options.

Fair Share Laws and ERISA

Courts have evaluated fair share laws enacted in Maryland, Suffolk County, New York, and San Francisco, with varying results.

Maryland

In January 2006, Maryland became the first state to adopt legislation that would have required for-profit employers with 10,000 or more employees in the state to either spend at least 8% of their total payroll costs on employee health insurance costs, or pay to the state the amount their spending fell short of that percentage.¹⁵ Shortly after the Fair Share Health Care Fund Act (Fair Share Act) was enacted, the Retail Industry Leaders Association (RILA), a retail trade association that includes Wal-Mart as a member, challenged the measure on the grounds that it was preempted by ERISA.¹⁶ In January 2007, the U.S. Court of Appeals for the Fourth Circuit affirmed the decision of a federal district court that found the Fair Share Act to be preempted by ERISA.¹⁷

Prior to enactment of the Fair Share Act, the Maryland General Assembly heard extensive testimony about the rising costs of the Maryland Medical Assistance Program, which provides access to health care services for the state’s low-income residents.¹⁸ The General Assembly also received information concerning Wal-Mart’s failure to provide adequate health benefits to its

¹⁴ *Id.* at 151 (quoting *Ingersoll-Rand v. McClendon*, 498 U.S. 133, 142 (1990)).

¹⁵ 2006 Md. Laws 1.

¹⁶ RILA also alleged that the Fair Share Act violated the Equal Protection Clause of the U.S. Constitution. *See* *Retail Industry Leaders Association v. Fielder*, 435 F.Supp.2d 481 (D. Md. 2006).

¹⁷ *RILA v. Fielder*, 475 F.3d 180 (4th Cir. 2007). In November 2006, the U.S. Dept. of Labor filed an amicus brief in support of RILA and the preemption of the Fair Share Act. *See* Brief of the Secretary of Labor as Amicus Curiae Supporting Plaintiff-Appellee and Requesting Affirmance, *RILA v. Fielder*, 475 F.3d 180 (4th Cir. 2007) (No. 06-1840, 06-1901).

¹⁸ *Fielder*, 475 F.3d at 183.

employees, and Wal-Mart employees and dependents enrolling in Medicaid and the state children's health insurance program.¹⁹

Wal-Mart would have been the only for-profit employer in Maryland to be subject to the Fair Share Act.²⁰ Other for-profit employers with at least 10,000 employees in Maryland either satisfied the Fair Share Act's 8% threshold or were exempted from the measure.²¹

James D. Fielder Jr., Maryland's Secretary of Labor, Licensing, and Regulation and the defendant in the case, made two arguments in favor of upholding the Fair Share Act. First, the Secretary contended that the Fair Share Act was a revenue statute of general application and not one that involved an employer's provision of health care benefits. He asserted that the revenue from the "payroll tax" imposed under the Fair Share Act would fund the Fair Share Health Care Fund established under the measure, which would be used to offset the costs of the Maryland Medical Assistance Program.²²

Second, the Secretary argued that the Fair Share Act did not have a connection with employee benefit plans because an employer could act in ways that did not involve such plans.²³ For example, an employer could increase health care spending by establishing on-site medical clinics or by contributing more money to employees' health savings accounts. An employer could also refuse to increase benefits under an ERISA plan and simply pay the amount by which its spending fell short of the measure's 8% threshold.²⁴

The Fourth Circuit rejected both of the Secretary's arguments. Acknowledging the legislative history of the Fair Share Act and what the Maryland General Assembly knew at the time of its consideration, the court indicated that the measure "could hardly be intended to function as a revenue act of general application."²⁵ The court stated,

[L]egislators and interested parties uniformly understood the Act as requiring Wal-Mart to increase its healthcare spending. If this is not the Act's effect, one would have to conclude, which we do not, that the Maryland legislature misunderstood the nature of the bill that it carefully drafted and debated. For these reasons, the amount that the Act prescribes for payment to the State is actually a fee or a penalty that gives the employer an irresistible incentive to provide its employees with a greater level of health benefits.²⁶

In response to the Secretary's second argument, the Fourth Circuit distinguished the Fair Share Act from state laws that were found to not be preempted by ERISA. Citing *Travelers*, the court noted that the Supreme Court upheld the state law in that case because it did not act directly upon employers or their plans, but merely created "an indirect economic influence" on plans.²⁷ In

¹⁹ *Id.* at 184.

²⁰ *Id.* at 185.

²¹ *Id.*

²² *Id.* at 190.

²³ *Id.* at 194-95.

²⁴ *Id.* at 195.

²⁵ *Id.* at 194.

²⁶ *Id.*

²⁷ *Id.* at 195 (citing *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645, 659 (1995)).

contrast, the Fourth Circuit found that the Fair Share Act “directly regulates employers’ structuring of their employee health benefit plans.”²⁸ The court indicated that “the only rational choice employers have” is to structure their ERISA health care benefit plans so as to meet the minimum spending threshold.²⁹

The availability of alternatives to increase health care spending without affecting an ERISA plan did not persuade the Fourth Circuit. The court noted that from an employer’s perspective, the categories of ERISA and non-ERISA health care spending would not be isolated, unrelated costs: “Decisions regarding one would affect the other and thereby violate ERISA’s preemption provision.”³⁰

The dissent maintained that the Fair Share Act was not preempted by ERISA because it offered a means of compliance that does not impact ERISA plans.³¹ The dissent explained that an employer could comply with the measure by paying an assessment or increasing spending on employee health insurance. By not expressing a preference for one method over the other, the dissent concluded that the act is not preempted.³² The dissent suggested that preemption would be more likely if the Fair Share Act dictated a plan’s system for processing claims, paying benefits, or determining beneficiaries.³³ However, any burden imposed on ERISA plans by the Fair Share Act was “simply too slight to trigger ERISA preemption.”³⁴

On April 16, 2007, the Maryland Attorney General announced that his office would not seek review of the Fourth Circuit’s decision by the Supreme Court.³⁵

Suffolk County

Under the Suffolk County Act, covered employers would have been required to make specified minimum employee health care expenditures. Employers with health care expenditures below the specified level would have been required to pay a penalty equal to the shortfall. The Suffolk County Act defined the term “health care expenditure” to mean any amount paid by a covered employer to its employees or to another party for the purpose of providing health care services or reimbursing the cost of such services for employees or their families, including contributions to health savings accounts and expenditures to operate a workplace health clinic.³⁶

The Suffolk County Act defined a “covered employer” as “any person that operates at least one retail store located in Suffolk County where groceries or other foods are sold for off-site consumption” and that meets one of the following requirements: (1) 25,000 square feet or more of the store’s selling area floor space is used for the sale of groceries or other foods for off-site

²⁸ *Felder*, 475 F.3d at 195.

²⁹ *Id.* at 193.

³⁰ *Id.* at 197.

³¹ *Id.* at 198.

³² *Id.* at 201.

³³ *Id.* at 202.

³⁴ *Id.*

³⁵ *Maryland Attorney General Will Not Seek Supreme Court Review of “Fair Share” Law*, Daily Lab. Rep. (BNA) No. 73 (Apr. 17, 2007).

³⁶ *See RILA v. Suffolk County*, 497 F.Supp.2d 403, 407 (E.D.N.Y. 2007).

consumption; (2) 3% or more of the store's selling area floor space is used for the sale of groceries or other foods for off-site consumption and the store contains at least 100,000 square feet of selling area floor space; or (3) the retail store had total annual revenues of \$1 billion or more in the most recent calendar year and the sale of groceries comprises more than 20% of the company's revenue.³⁷ The definition for "covered employer" appeared to reflect the Suffolk County Act's express legislative intent to protect small retailers from large employers that did not provide health care for employees.³⁸

RILA contended that the Suffolk County Act was preempted by ERISA because it mandated a certain level of health care benefits for employers, interfered with the uniform national administration of benefit plans, and imposed reporting requirements beyond those prescribed by ERISA. To bolster its position, RILA cited *Fielder* and asserted that the Suffolk County Act should be found similarly preempted.

Although the court noted that it was not bound by the Fourth Circuit's decision, it nevertheless indicated that the Suffolk County Act was "substantially similar" to the Fair Share Act, and that it was "in accord with the Fourth Circuit's well reasoned and comprehensive analysis."³⁹ The court rejected the county's claim that a state law is not preempted by ERISA where the existence of a plan is not necessary to be in compliance with the state law. The county had argued that the Suffolk County Act did not require the establishment or modification of an ERISA plan, and that a company had various options for complying with the law.

Quoting *Fielder*, the court maintained that the only rational choice for covered employers under the Suffolk County Act was "to structure their ERISA health care benefit plans to meet the minimum spending threshold."⁴⁰ Because covered employers would have been forced to change how their employee benefit plans would be structured, the court concluded that the Suffolk County Act had an "obvious connection with employee benefit plans" and thus, was preempted by ERISA.⁴¹

San Francisco

Like the Suffolk County Act, the San Francisco Health Care Security Ordinance requires covered employers to make minimum health care expenditures on behalf of covered employees. "Covered employers" are defined by the Ordinance as employers engaged in business within the city that have an average of at least 20 employees performing work for compensation during a quarter.⁴² The term also applies to nonprofit corporations with an average of at least 50 employees performing work for compensation during a quarter.⁴³ A "covered employee" under the Ordinance is defined as any individual who works in the city and county of San Francisco, works at least 10

³⁷ Suffolk County Reg. Local Law § 325-2.

³⁸ *Suffolk County*, 497 F.Supp.2d at 408.

³⁹ *Id.* at 416.

⁴⁰ *Id.* at 417 (internal quotation marks omitted).

⁴¹ *Id.* at 418 (internal quotation marks omitted).

⁴² See *Golden Gate Restaurant Ass'n v. City and County of San Francisco*, Nos. 07-17370, 07-17372, 2008 WL 4401387, at *2 (9th Cir. Sept. 30, 2008).

⁴³ *Id.*

hours per week, has worked for his employer for at least 90 days, and is not excluded from coverage by other provisions of the Ordinance.⁴⁴

The San Francisco Ordinance identifies various qualifying health care expenditures, including contributions to health savings accounts and payments to a third party for the purpose of providing health care services for covered employees. Covered employers may also satisfy the Ordinance's spending requirement by making payments directly to the city. Regulations that implement the Ordinance confirm that a covered employer has discretion with regard to the type of health care expenditure it chooses to make for its covered employees.⁴⁵

In *Golden Gate Restaurant Association v. City and County of San Francisco*, a California federal district court concluded that the San Francisco Ordinance was preempted by ERISA because it related to employee benefit plans.⁴⁶ The court determined that the Ordinance had an impermissible connection with employee welfare benefit plans and made unlawful reference to such plans. The court observed,

By mandating employee health benefit structures and administration, [the health care expenditure] requirements interfere with preserving employer autonomy over whether and how to provide employee health coverage and ensuring uniform national regulation of such coverage.⁴⁷

The court maintained that the San Francisco Ordinance had an impermissible connection with employee benefit plans not only because it required a certain level of benefits typically provided by ERISA plans, but because it affected the structure of existing plans.⁴⁸ Employers were required to either modify the administration of existing plans or make additional payments with reference to the amounts paid under such plans to comply with the Ordinance.

The court also explained that the San Francisco Ordinance made unlawful reference to employee benefit plans in two ways. First, it specifically referenced the existence of ERISA plans in its expenditure requirements provisions.⁴⁹ Second, liability under the Ordinance was determined exclusively with reference to employer-sponsored health benefits that were provided mostly under existing ERISA plans.⁵⁰ In other words, to determine liability, the Ordinance required an examination of how much an employer paid for employee health coverage under these existing plans.

In September 2008, the Ninth Circuit reversed the district court's decision and concluded that ERISA does not preempt the San Francisco Ordinance. On appeal, the court addressed two arguments espoused by the Golden Gate Restaurant Association. First, the Association contended that the so-called "city-payment option," which allows covered employers to make payments to

⁴⁴ *Id.*

⁴⁵ *Id.* at *3.

⁴⁶ 535 F.Supp.2d 968 (N.D. Cal. 2007). The court explained that the analysis of whether a state law is preempted by ERISA follows one of two paths—if the law is either found to be connected with or to make reference to an ERISA plan, the law is found to be preempted.

⁴⁷ *Id.* at 975.

⁴⁸ *See id.* (observing that the provisions of the Ordinance cannot operate successfully without the existence of employee welfare benefit plans).

⁴⁹ *Golden Gate Restaurant Ass'n*, 535 F.Supp.2d at 978.

⁵⁰ *Id.*

the city to satisfy the Ordinance's requirements, establishes an ERISA plan. Thus, the Association maintained that the Ordinance impermissibly relates to an ERISA plan. Second, the Association argued that even if the city-payment option does not create an ERISA plan, the Ordinance requires an employer to make health care expenditures that relate to the ERISA plans of covered employers in violation of the statute.

The Association believed that the city-payment option established an ERISA plan because of the administrative obligations that are imposed on employers by the Ordinance. The Ninth Circuit, however, found that the Ordinance imposed only minimal administrative duties on employers that chose the city-payment option. The court observed, "Under the Ordinance, an employer has no responsibility other than to make the required payments for covered employees, and to retain records to show that it has done so."⁵¹

In addition, the Ninth Circuit declined to apply criteria that had been used previously to identify the existence of an ERISA plan based on the notion that plan creation requires only that a reasonable person can ascertain the intended benefits, beneficiaries, source of financing, and procedures for receiving benefits.⁵² The court noted that this criteria has been employed only in cases that involve some type of unwritten or informal promise made by an employer to its employees.⁵³ The court maintained that the criteria has never been used to evaluate arrangements required by state or local law.

The Ninth Circuit evaluated the Association's argument that the San Francisco Ordinance impermissibly relates to the ERISA plans of covered employers by examining whether the Ordinance and its health expenditure requirements have a connection with or reference to such plans. After conducting this two-part inquiry, the court concluded that the Ordinance does not relate to an ERISA plan, and is thus not preempted by the statute.

The Ninth Circuit distinguished the San Francisco Ordinance from other laws that have been found to have a connection with an ERISA plan. Citing *Egelhoff*, for example, the court noted that unlike the Washington law at issue in that case, the Ordinance does not bind plan administrators to a particular choice of rules for determining plan eligibility or entitlement to particular benefits.⁵⁴ The court further explained that the Ordinance does not require employers to structure their employee benefit plans in a particular manner or to provide specific benefits.

The Ninth Circuit also determined that the San Francisco Ordinance does not have an unlawful reference to an ERISA plan. The court found that the Ordinance does not act immediately and exclusively on ERISA plans, and that the existence of ERISA plans is not essential to the operation of the Ordinance. The court observed the following:

[T]he Ordinance can have its full force and effect even if no employer in the City has an ERISA plan. Covered employers without ERISA plans can discharge their obligation under the Ordinance simply by making their required health care expenditures to the City.⁵⁵

⁵¹ *Golden Gate Restaurant Ass'n*, 2008 WL at *9.

⁵² *Id.* at *10-*11.

⁵³ *See id.* (citing *Scott v. Gulf Oil Corp.*, 754 F.2d 1499 (9th Cir. 1985); *Modzelewski v. Resolution Trust Corp.*, 14 F.3d 1374 (9th Cir. 1994); *Winterrowd v. American General Annuity Ins. Co.*, 321 F.3d 933 (9th Cir. 2003)).

⁵⁴ *Golden Gate Restaurant Ass'n*, 2008 WL at *15.

⁵⁵ *Id.* at *16.

The court further noted that an employer's obligations under the Ordinance are based on the hours worked by its employees, and not on the value or nature of benefits available to ERISA plan participants.

Finally, the Ninth Circuit responded to the Association's concern of a "circuit split" with the Fourth Circuit if it upheld the San Francisco Ordinance. The court emphasized that the Ordinance does not require employers to structure their employee health care plans to provide a certain level of benefits. In contrast, the court maintained, the Maryland Fair Share Act did not provide meaningful alternatives to comply with the law. Covered employers were given an "irresistible incentive" to provide employees with a greater level of health benefits.⁵⁶

Massachusetts's Fair Share Requirement

In 2006, Massachusetts enacted "An Act Providing Access to Affordable, Quality, Accountable Health Care," considered to be the most comprehensive health care reform legislation ever enacted by a state.⁵⁷ The act has received a great deal of attention, in part due to the fact that it is the first state law to require residents to obtain and maintain health care coverage or be subject to adverse tax consequences.⁵⁸ The act establishes a "Connector"⁵⁹ through which individuals and small groups may obtain health coverage, and creates numerous requirements for private insurers as well as employers.⁶⁰ One of the employer requirements is a fair share requirement. There has been speculation over whether this requirement of the Massachusetts Act could be preempted by ERISA.⁶¹

Under the act, employers with more than 11 full-time equivalent employees that do not make a "fair and reasonable" contribution to a group health plan⁶² for their employees' health coverage

⁵⁶ *Id.* at *19. On October 21, 2008, the Golden Gate Restaurant Association filed a petition for rehearing en banc (full court) to the U.S. Court of Appeals for the Ninth Circuit. The Association argues that the decision by the three-judge panel of the Ninth Circuit is inconsistent with ERISA preemption precedent and ignores the purpose of the statute's regulatory regime. For additional information on the petition, see *Restaurant Group Seeks En Banc Review of Ninth Circuit's ERISA Preemption Ruling*, Pens. & Ben. Daily (BNA) (Oct. 23, 2008).

⁵⁷ Anthony Ten Haagen, *Surviving Preemption: The Importance of Chapter 5 in the Context of America's Health Care Crisis*, 33 American Journal of Law and Medicine 663 (2007).

⁵⁸ MASS. GEN. LAWS ch. 111M, § 2 (2008). Under this provision of the act, Massachusetts residents are only required to purchase coverage that is deemed affordable. Thus, Massachusetts residents may be exempted from the individual mandate if they can demonstrate that, based on their income and other factors, they do not meet certain affordability standards. See 956 C.M.R. 600 *et. seq.* (regulations addressing the affordability standards).

⁵⁹ The Commonwealth Health Insurance Connector is one of the most significant parts of the act. The Connector is an independent public entity that facilitates access to private insurance plans for small employers and individuals. The Connector assists individuals who are not offered insurance by a large employer (one with more than 50 employees) that pays part of the premium. See MASS. GEN. LAWS. ch. 176Q.

⁶⁰ For a broader discussion of the act's requirements, see CRS Report RS22447, *The Massachusetts Health Reform Plan: A Brief Overview*, by April Grady.

⁶¹ See, e.g., Amy B. Monahan, *Symposium: The Massachusetts Plan and the Future of Universal Coverage: Regulatory Issues: Pay or Play Laws, ERISA Preemption, and Potential Lessons from Massachusetts*, 55 Kan. L. Rev. 1203 (2007); Marcia S. Wagner and Barry M. Newman, *Will ERISA Preemption Derail Massachusetts Health Care Reform?* 23 Tax Management Financial Planning Journal, No. 6., (June 19, 2007). Edward Zelinsky, *Article: The New Massachusetts Health Law: Preemption and Experimentation*, 49 Wm. and Mary L. Rev. 229, 268 (2007). It is important to note that there may be other provisions of the Massachusetts Act susceptible to an ERISA preemption challenge. See, e.g., *id.* at 268 (2007) (tax expert Edward Zelinsky argues that the requirement for individuals to have coverage is preempted by ERISA). This report only discusses the fair share requirements of the Massachusetts Act.

⁶² For purposes of the Massachusetts statute, a group health plan is defined as "a plan (including a self-insured plan) of, (continued...)"

must pay a “fair-share contribution” into a state trust fund in order to help cover costs of health care provided to uninsured Massachusetts residents.⁶³ Regulations set forth two alternative tests to determine whether an employer has made a fair and reasonable contribution. Under the “primary test,” an employer has made a fair and reasonable contribution if 25% or more of its employees who are employed at Massachusetts locations are enrolled in the employer’s health plan.⁶⁴ Under the “secondary test,” an employer who fails the primary test, but offers to pay at least 33% of the cost of premiums of a group health plan offered to full-time employees employed over a certain time period, meets the contribution requirements.⁶⁵ If the employer cannot meet either of these tests, the employer must make a fair-share contribution, which is required to be calculated annually and takes into account factors such as the cost of the state-funded care used by the employees of non-contributing employers.⁶⁶ However, the fair-share contribution amount cannot exceed \$295 per employee.⁶⁷

Despite speculation that the Massachusetts Act would be subject to a preemption challenge under ERISA, to date, no actions have been brought.⁶⁸ If the fair share provisions were to be challenged, it is likely that a reviewing court would look to the *Travelers* case and its progeny in making its determination. Similar to those cases, a court may evaluate whether the Massachusetts fair share requirements have a “connection with” ERISA plans by looking to ERISA’s objectives (e.g., establishing uniform, nationwide regulation of employee benefit plans) “as a guide to the scope of the state law that Congress understood would survive” preemption.⁶⁹ A reviewing court may also look to the “nature of the law’s effect on ERISA plans” (i.e., whether the Massachusetts fair share requirements mandate the structure or administration of employee benefit plans, or have more of an indirect influence on ERISA plans).⁷⁰ In addition, a reviewing court could examine whether the fair share requirements of the Massachusetts Act have a “reference to” an employee benefit plan. As stated by the Supreme Court, “where a State’s law acts immediately and exclusively upon ERISA plans ... or where the existence of ERISA plans is essential to the law’s operation ... that ‘reference’ will result in pre-emption.”⁷¹ Further, a court could also rely on or distinguish the fair share requirements of the Massachusetts Act from the *Egelhoff* case. As the Court held in *Egelhoff*, a law that regulates the structure or administration of an ERISA plan will not be saved from preemption just because there is a way to opt out of its requirements.

(...continued)

or contributed to by, an employer (including a self-employed person) or employee organization to provide health care ... to the employees, former employees, the employer, others associated or formerly associated with the employer in a business relationship, or their families.” MASS. GEN. LAWS ch. 149, § 188(a) (2008) (*citing* 26 U.S.C. § 5000(b)(1)).

⁶³ MASS. GEN. LAWS ch. 149, § 188 (2008).

⁶⁴ 114.5 MASS CODE REGS 16.03(1)(a) (2008).

⁶⁵ 114.5 MASS CODE REGS 16.03(1)(b) (2008). It should be noted that the Massachusetts Division of Health Care Finance and Policy has adopted regulations that would, among other things, require employers with 51 or more full-time employees to meet *both* the primary and secondary tests, or have at least 75% of their full-time employees enrolled in the health plan. This new requirement will take effect on January 1, 2009. The regulations are available at http://www.mass.gov/Eeohhs2/docs/dhcfp/g/regs/114_5_16.pdf.

⁶⁶ 114.5 MASS CODE REGS 16.04 (2008).

⁶⁷ MASS. GEN. LAWS ch. 149, § 188 (2008).

⁶⁸ See Joan Indiana Rigdon, *Universal Health Care?* Washington Lawyer, Vol. 22, No. 11 at 27-28 (2008) (discussing speculation of why the Massachusetts Act has not been challenged).

⁶⁹ *Dillingham Construction*, 519 U.S. at 325 (quoting *Travelers*, 514 U.S. at 658-59).

⁷⁰ *Id.*

⁷¹ *Id.*

It is also possible that a reviewing court could adopt similar reasoning used by courts in evaluating other fair share laws.⁷² For example, as discussed above, in *Fielder*, the Fourth Circuit found the Maryland Fair Share Act was preempted because it effectively forced employers to restructure their employee health plans, and as such, interfered with ERISA's goal of providing uniform nationwide administration of these plans.⁷³ The *Fielder* court opined that just because an employer had the option not to spend money on health care for their employees, this option was not a "meaningful alternative" and did not protect the law from preemption. A court evaluating the fair share requirements of the Massachusetts Act could make arguments similar to those articulated in the *Fielder* case. Like Maryland's fair share law, the Massachusetts Act provides that employers covered by the act must either make a contribution towards employee health benefits, or contribute to a state trust fund. And, as argued in *Fielder*, any "reasonable employer" would choose not to pay money to a state when it can, in the alternative, reap benefits from spending money on employee health care.⁷⁴

Some commentators have pointed out that compared to the Maryland Fair Share Act, the Massachusetts Act requires a relatively small amount (i.e., no more than \$295 per employee) to be paid to the state, as a "penalty" for not offering health coverage.⁷⁵ It may be argued that since the Massachusetts fair share contribution amount is relatively small, it does not bind the choices of employers, as the court found in *Fielder*.⁷⁶ Still, despite this smaller "penalty," a court may still see the Massachusetts fair share scheme as a means of coercing an employer to offer health coverage and thus, not escape ERISA preemption.

In addition, it is possible to argue that the Massachusetts fair share requirements may be more susceptible to preemption than the *Fielder* and *Suffolk County* cases. This is because the Massachusetts Act requires employers to pay the fair and reasonable premium contribution amounts to a group health plan (which is likely regulated by ERISA), in order to avoid making a fair-share contribution to the state. Under Maryland and Suffolk County's fair share laws, employers had some choices as to how an employer could make these expenditures (e.g., under the Maryland's fair share law, expenditures could be made towards an on-site medical clinic). Given that the *Fielder* and *Suffolk County* courts found that requiring an employer to pay these health care expenditures directly affected employers' ERISA plans, it may be argued that requiring employers to contribute to a group health plan (versus contributing money to the state) creates an impermissible "reference to" an employee benefit plan.⁷⁷

⁷² It is important to point out that if the Massachusetts Act was to be challenged on preemptive grounds, it would likely be in the First Circuit. If a preemption challenge was brought in this circuit, a court would not be bound to follow any of the previous fair share cases discussed above, but could still rely on these cases in support of its decision.

⁷³ The Department of Labor, in an Amicus brief, had argued for this result. It was argued that "[b]y setting an aggregate amount (by percentage of payroll) affected employers must spend on employee health benefits, Maryland is taking away employers' fundamental authority over whether, and on what terms, to sponsor a plan, and potentially subjecting employers to the competing demands of a multiplicity of state and local regulatory schemes." Brief of the Secretary of Labor as Amicus Curiae, *supra* note 17.

⁷⁴ These benefits include employee retention and the ability to attract better employees. See *Fielder*, 475 F.3d at 193.

⁷⁵ See, e.g., *Monahan*, 55 Kan. L. Rev. at 1214 ("Because of the modest—or weak—penalty associated with the fair share contribution, it will likely survive an ERISA preemption challenge because it is a mere indirect economic incentive for a plan administrator to make certain choices with respect to its health care plan.")

⁷⁶ See *Golden Gate Restaurant Ass'n*, 2008 WL at *19, where the Ninth Circuit, in upholding the San Francisco Ordinance, distinguished the Ordinance from the Maryland Fair Share Act because the Ordinance offers employers a "realistic alternative" to creating or amending an ERISA plan.

⁷⁷ See *Zelinsky*, 49 Wm and Mary L. Rev. at 257.

Alternatively, if a court were to review the Massachusetts Act, it could sustain the fair share requirements by applying the reasoning used by the Ninth Circuit in *Golden Gate Restaurant Association*. As discussed above, the Ninth Circuit, in explaining why the Ordinance had no “connection with” an ERISA plan, pointed to the fact that the San Francisco Ordinance did not require an employer to adopt an ERISA or other health plan, or provide specific benefits through such plans. Because an employer could discharge its obligations in whole or in part to an ERISA plan, or in whole or in part to the city, the Ordinance preserved ERISA’s uniform regulatory regime and was not preempted.⁷⁸ A similar argument could be made for the Massachusetts fair share requirement, as an employer is not required to establish an ERISA health plan, or provide any health benefits to its employees.⁷⁹ The Ninth Circuit also found that the Ordinance does not make reference to an ERISA plan because, among other things, it “does not act on ERISA plans at all, let alone immediately and exclusively” and is “fully functional” in the absence of an ERISA plan.⁸⁰ Again, it may be argued that the Massachusetts Act does not “solely apply” to ERISA plans, and that the formation of a plan is not essential for meeting the requirements of the Massachusetts Act.⁸¹

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⁷⁸ *Golden Gate Restaurant Ass’n*, 2008 WL at *15.

⁷⁹ It should be noted that Massachusetts does require employers to establish a cafeteria plan. MASS. GEN. LAWS ch. 151F, § 2 (2008). Cafeteria plans are employer-established benefit plans under which employees may choose between receiving cash (typically additional take-home pay) and certain normally nontaxable benefits (such as employer-paid health insurance) without being taxed on the value of the benefits if they select to receive the latter. See 26 U.S.C. § 125. The Department of Labor has taken the position that cafeteria plans are not ERISA plans. See U.S. Dep’t of Labor Advisory Opinion 96-12A (July 17, 1996). See also Edward Zelinsky, *Article: The New Massachusetts Health Law: Preemption and Experimentation*, 49 Wm. and Mary L. Rev. at 264-65 (“...ERISA does not preempt [Massachusetts’s] requirement that employers maintain cafeteria plans qualifying under Code section 125. Such cafeteria plans are not ERISA regulated welfare plans.”)

⁸⁰ *Golden Gate Restaurant Ass’n*, 2008 WL at *16-*18.

⁸¹ See *id.* (quoting *Mackey v. Lanier Collection Agency & Service, Inc.*, 486 U.S. 825, 829-30 (1988)).