Employee Benefits Advisory: Ninth Circuit Upholds San Francisco Health Care Ordinance

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In a much anticipated opinion with far-reaching consequences, the Ninth Circuit recently sided with the City and County of San Francisco (the “City”) in a dispute with a restaurant trade association involving the extent to which the Employee Retirement Income Security Act (ERISA) preempts, or renders unenforceable, a municipal health care ordinance requiring employers either to pay a certain hourly rate toward health care for employees or to pay a like amount into a City-funded health care plan. The case is *Golden Gate Restaurant Association v. City and County of San Francisco*, and it is at the epicenter of the debate over the extent to which states and local governments can finance health care by requiring payments from employers under so-called “pay-or-play” or “fair-share” laws. This advisory examines the Ninth Circuit’s decision.

Background

The Ordinance

In 2006, the City adopted an ordinance (the “Ordinance”) that, among other things, required private employers with more than 20 employees to make certain hourly expenditures toward the health care costs of their employees. The required expenditures could be earmarked for various health-related costs for the benefit of covered employees. Payments could also be made to the City to fund a “Health Access Program,” which would provide health coverage to uninsured residents regardless of their employment status.

The Ordinance mandates that covered employers make health care expenditures at a rate of $1.17 per hour or $1.76 per hour for each covered employee, depending on the size and status (for-profit or tax-exempt) of the employer. A “covered employer” is one doing business in the City with an average of at least 20 employees working in the City. The Ordinance provides a nonexclusive list of “qualifying” health care expenditures, such as contributions to health savings accounts, direct reimbursement to employees for health care services, payments to third parties that provide health care services, or costs incurred for the direct delivery of health care services. If an employer chooses not to make required health care expenditures on behalf of its employees, it can fulfill its spending requirement by making payments directly to the City.

The Golden Gate Restaurant Association challenged the Ordinance in federal district court, claiming that it was preempted by ERISA. The District Court for the Northern District of California found in favor of the plaintiffs and issued an injunction against the application of the Ordinance. The City appealed to the Ninth Circuit Court of Appeals, seeking permission for the ordinance to go into effect pending an appeal. The Ninth Circuit agreed and stayed the lower court’s order pending the outcome of an appeal. This most recent case is the Ninth Circuit’s decision on the merits.

State Fair-Share Laws

The Ordinance is a variant of an approach to the financing of health care reform that is sometimes loosely referred to as “pay-or-play” or “fair-share.” These terms have no legal significance. They instead refer and have generally been applied to state and local laws that furnish employers with a choice between providing health insurance coverage to employees or paying some sort of assessment, fee, or tax. Amounts paid to state or local governments are generally used to purchase health coverage or to defray other health-related costs. Pay-or-play/fair-share approaches are a response to rapidly increasing costs of Medicaid and state-funded free care.

ERISA

In ERISA, Congress sought to unify, simplify, and make consistent the judicial and regulatory environment within which employee benefit plans operate. To that end, ERISA was designed to supplant all state laws regulating employee benefit plans with a uniform federal system of regulation. Under ERISA, the regulation of benefit plans is, with few exceptions, an exclusively federal matter.

ERISA provides that ERISA “shall supersede any and all state laws insofar as they may now or hereafter *relate to* any employee benefit plan.” (Emphasis added.) This provision makes ERISA the sole source of rules governing the maintenance and operation of employee benefit plans by preempting, or rendering inoperative, all state laws relating to these plans. But this rule is not absolute. There is an exception, referred to as the “saving clause” or the “insurance saving clause,” under which the states retain the right to regulate insurance, banking and securities. It is because of the insurance saving clause that state medical benefit mandates may be imposed on insured group health plans.

In determining whether a state law “relates to” an employee benefit plan (and is therefore preempted), the Supreme Court started out construing “relates to” expansively. In a 1983 case, *Shaw v. Delta Air Lines*, the Court said that the phrase “relates to” should be given its broad common-sense meaning, such that a state law “relates to” an employee benefit plan if it has “connection with” or “reference to” such a plan. The only laws that relate to employee benefit plans that are not preempted are those whose connection is too “tenuous, remote or peripheral.” But in 1995, in *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Insurance Co.*, the Supreme Court pulled back from its earlier expansive reading of “relates to” in a case involving a New York statute that required hospitals to collect surcharges on hospital bills from patients or payers on their behalf. (The revenue from the surcharges was used to subsidize the state’s uncompensated care programs.)

Shortly after *Travelers*, the Supreme Court revisited the issue of the reach of ERISA preemption in two other important cases, *California Division of Labor Standards Enforcement v. Dillingham Construction*, and *De Buono v. NYSA-ILA Medical & Clinic Services Fund*. As a result of these cases—which are referred to collectively along with *Travelers* as the “*Travelers* trilogy”—a state law is preempted under *Shaw’s* “connection with” prong if it affects plan “structure or administration” but not if it has only an indirect economic influence on plan administrators.

The ERISA Analysis

It is clear that states are free to impose an across-the-board tax on employers for the purpose of defraying health care costs. It is equally clear that states cannot require employers to establish a group health plan or pay a particular level or amount of premiums. But what is less than clear is whether a state can require employers to *either* provide health coverage *or* pay a fee, assessment, or tax. The same question can be restated to ask whether a state could impose a tax but provide a credit for amounts paid toward medical coverage for employees.

The RILA Case

The Fourth Circuit, in *Retail Industry Leaders Association v. James D. Fielder, Jr., Maryland Secretary of Labor, Licensing and Regulation*, upheld a decision of the District Court for the District of Maryland, which held that ERISA preempted the Maryland Fair Share Health Care Fund Act (the “Maryland Act”). The Maryland Act required businesses with 10,000 or more employees to spend 8% (6% in the case of nonprofit organizations) of their payroll on employee health care benefits. If an employer’s spending fell short of the mandated amount, the difference was to be paid to a state fund set up for the purpose of defraying state health care costs for the uninsured. Additionally, the Maryland Act included a substantial civil penalty for failure to make the required payments to the state.

Because of its 10,000-employee threshold, the Maryland Act potentially affected only four of the state’s employers (Johns Hopkins University, Northrop Grumman Corp., Giant Food, LLC and Wal-Mart), only one of which—Wal-Mart—would have been required to pay any money. The Retail Industry Leaders Association (RILA), a trade association of which Wal-Mart is a member, challenged the law in federal court. RILA based its challenge principally on ERISA preemption grounds.

The District Court for the District of Maryland sided with RILA, holding that the Maryland fair-share law was preempted by ERISA and therefore unenforceable. The district court cited *Shaw* for the proposition that a state law "relates to an ERISA plan if it has either a 'reference to' or 'connection with' such a plan." Under the "connection with" prong, the court determined that the Maryland Act created health care spending requirements that were not applicable in most other jurisdictions, some of which had conflicting requirements. The court was also concerned that Wal-Mart would have to track separate pools of expenditures for its Maryland employees and structure its contributions (including deductibles and co-pays) "with an eye to how this will affect the Act's 8% spending requirement." The court viewed the law as imposing an obligation on Wal-Mart to increase its contributions to its health benefit plans in violation of federal law. The main objective of ERISA's preemption clause (*i.e.*, "to avoid a multiplicity of regulation in order to permit the nationally uniform administration of employee benefit plans") could not be met, in its view, if the Maryland Act was allowed to stand.

Golden Gate

The Ninth Circuit examined the Ordinance's spending requirement and found that, by allowing employers to make direct payment to the City, the ordinance effectively offered employers a meaningful alternative that did not interfere with their existing ERISA plans. Following the analysis first announced in *Shaw* and developed in *Travelers* and later cases, the court determined the following:

Reference to. The Ordinance makes no "reference to" ERISA. On this prong, the court held that the Ordinance did not act immediately and exclusively on ERISA plans and that it is "fully functional even in the absence of a single ERISA plan."

Connection with. The Ordinance has no "connection with" ERISA plans because it neither mandates the adoption of, nor requires employers to provide any particular benefits under, an ERISA plan. And, in a nod to *Travelers*, the court also concluded that the Ordinance has no direct economic influence on plan administrators that binds them to a particular choice.

As a consequence, the Ordinance does not "relate to" ERISA-covered plans and is not preempted.

The essence of the Ninth Circuit's decision is that the obligation either to provide medical coverage to employees or to pay money to the City to assist the City in providing medical benefits is purely a monetary decision that has only an indirect economic influence. In contrast, the Fourth Circuit was of the view that the net effect of the Maryland Act was to compel employers to adopt plans, because no rational employer would pay money to the government if it had the option of paying a like amount to its employees instead. The Ninth Circuit insists that the Ordinance is unlike the Maryland Act and that, as a result, its decision does not conflict with that of the Fourth Circuit. There are differences, to be sure, between the Ordinance and the Maryland Act, but, at bottom, the differences appear to us to be functionally indistinguishable. In each case the employer must either provide some medical coverage to employees or pay money to the government.

Conclusion

There is a great deal riding on the outcome of the debate over the impact of ERISA in state pay-or-play/fair-share laws. State and local governments have a legitimate concern over the rising costs of Medicaid and uncompensated medical care. And, as the *Travelers* case acknowledges, medical care is a legitimate area of governmental concern. State and local governments have compelling reasons to adopt laws of this type. Employers—multi-state employers in particular—also have a compelling concern: If every city, town, and county adopts its own rules, the administrative burdens and costs could be potentially crushing. For these employers, the preemptive shield of ERISA has left them free to offer uniform benefit programs across multiple jurisdictions.

Discussing ERISA preemption is a little like discussing presidential politics. Each side's analysis is colored by its desired outcome. Both the Fourth and Ninth Circuits provided compelling reasons for the result that it reached. Neither opinion is "nutty"—other than perhaps in the eyes of its detractors. We understand that the Golden Gate Restaurant Association may ask for a rehearing before a full panel of Ninth Circuit judges. Whether the court would agree, and if so whether the result would be any different, is anyone's guess. If this approach fails, and if Golden Gate chooses to pursue an appeal to the Supreme Court, we would fully expect the Supreme Court to accept the case.

Attempting to predict how the Supreme Court will come out in any instance involving ERISA preemption is a fool's errand, and one on which we will not embark. Such a contest would involve policy issues of enormous magnitude. Ideally, these are the kinds of issues that ought to be decided by Congress. But the historical forces in favor of, and in opposition to, ERISA preemption are so large and so evenly balanced that Congress has, with only a few minor exceptions, essentially abdicated its role in this area for more than 30 years. Therefore, the Supreme Court is likely the only forum left in which this dispute may be settled.

If you have any questions concerning the information discussed in this advisory or any other employee benefits topic, please contact one of the attorneys listed below or your primary contact with the firm who can direct you to the right person. We would be delighted to work with you.

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