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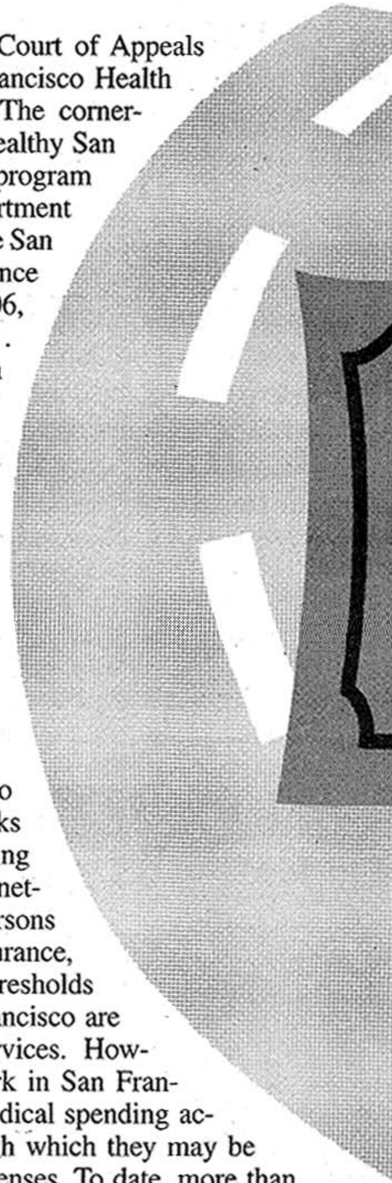
Healthy San Francisco's Tradeoffs

Will the costs of implementing the city's health care ordinance ultimately fall on workers?

By Robert M. Forni Jr.



The Ninth Circuit U.S. Court of Appeals recently upheld the San Francisco Health Care Security Ordinance. The cornerstone of the ordinance is Healthy San Francisco, an entitlement program administered by the Department of Public Health. At the time San Francisco enacted the ordinance in 2006, U.S. health care spending peaked at $2.1 trillion, roughly $7,026 for every person in the nation. Despite the trillions of dollars spent on health care, an estimated 47 million people in this country are uninsured. In San Francisco alone, there are an estimated 73,000 uninsured residents.

Employment Law

Healthy San Francisco promises to reduce the ranks of the uninsured by delivering services to them through a network of care providers. Persons who already have health insurance, exceed maximum income thresholds or who live outside San Francisco are not eligible to receive services. However, nonresidents who work in San Francisco may still establish medical spending accounts with the city, through which they may be reimbursed for medical expenses. To date, more than 30,000 city residents have enrolled in Healthy San Francisco, just half of the approximately 60,000 residents expected to enroll eventually.

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To pay for this program, the city imposes a tax on employers that do not reimburse employee medical expenses or pay medical benefits meeting a certain threshold. Under this "pay or play" system, businesses with 20 or more workers currently provide an estimated $12 million of the program's $200 million annual cost. For the same amount, based on the average cost of premiums for private HMO policies in 2008, the city could pay premiums for such policies covering more than 27,000 individuals or 9,700 families, without incurring additional costs to administer its program.

In November 2006, the Golden Gate Restaurant Association filed suit against the city in the U.S. District Court for the Northern District of California, challenging the ordinance's spending requirements. Last December, the district court granted the association's motion for summary judgment, and enjoined the city from collecting employer contributions, on the grounds that the Employee Retirement Income Security Act of 1974 pre-empted the ordinance's employer spending requirements.

A three-judge panel of the Ninth Circuit reversed the district court on Sept. 30, holding ERISA does not pre-empt the ordinance's spending requirements because the ordinance does not expressly require employers to establish ERISA plans or make any changes to existing ones. The association filed a petition for rehearing *en banc*, to which the court has yet to respond. The ordinance remains in effect in the meantime.

Although the ordinance is similar to the 98 other pay-or-play bills introduced since 2006 in 36 state legislatures in that it increases costs of doing business and imposes administrative burdens, the ordinance is unique in other respects. For instance, the ordinance mandates only that "medium" and "large" businesses, engaging in business within San Francisco, make quarterly

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"health care expenditures" to or on behalf of certain employees. Specifically, a private employer with between 20 and 99 employees and a nonprofit with 50 or more employees must spend $1.17 per hour on behalf of "covered employees." A private employer with 100 or more employees must spend $1.76 per hour on behalf of each covered employee. The required health care expenditure is calculated by multiplying the total number of hours for which each covered employee is paid, or is entitled to be paid, wages for work performed within San Francisco each quarter by the applicable health care expenditure rate. If an employer does not make the required health care expenditures, it must make payments directly to the city.

A "health care expenditure" is defined under the ordinance to mean any amount paid by a covered employer to its employees, or to a third party on behalf of its employees for the purpose of providing health care services to them or reimbursing the cost of such services for its employees. Qualifying expenditures include contributions to health savings accounts, reimbursement to employees for expenses incurred to obtain health care services, payments to third parties for health care services, costs incurred in the direct delivery of health care services, or payments to the city to fund Healthy San Francisco.

The ordinance attempts to limit the scope of employees on whose behalf employers must make such payments. Covered employees are individuals who work in the city at least 10 hours per week on average, and have worked for the employer for at least 90 days. However, the following persons are generally not covered employees under the ordinance: (1) persons who are managerial, supervisory, or confidential employees, unless they earn less than $72,450; (2) persons who are eligible to receive benefits under Medicare; (3) persons who are employed by a nonprofit corporation for up to one year as trainees in a bona fide training program; and (4) persons whose employers verify that they are receiving health care services through another employer, and they have voluntarily waived any right to receive benefits under the ordinance.

A covered employer that provides health benefits to its covered employees through a self-insured plan complies with the spending requirement if the preceding year's average expenditure rate per employee meets the applicable expenditure rate for that employer. The average expenditure rate is calculated by dividing the total amount of health care expenses paid to or on behalf of covered employees by the total number of hours for which they have been, or were entitled to be, paid wages for work performed within San Francisco.

However, the ordinance forbids employers from satisfying their spending requirements by averaging health care expenses paid to their employees. Payments to or on behalf of one covered employee that exceed the required expenditure for that employee will not be considered in determining whether an employer has met its total required expenditures for all employees. If, over the course of a year, an employer that provides health coverage to its covered employees through a self-insured plan pays little or no expenses in some quarters, but large amounts in others that exceed the minimum health care expenses required by the ordinance, then the employer may not satisfy its spending requirements even if the average costs paid over the course of the year exceed the required expenses. For each quarter in which its health care expenses falls below the mandatory minimum, the employer would have to satisfy the ordinance by some other means, such as by paying the difference between actual and required health care expenditures to the city. Thus, during some quarters, an employer that provides health coverage to all of its covered employees through a self-insured plan may end up paying as much to the city as an employer that provides no health care benefits at all.

The ordinance attempts to skirt ERISA's pre-emption rule by affording employers discretion in complying with its spending requirements. An employer is exempt from making payments to the city if it

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spends at least $1.17 or $1.76 per hour (depending on the number of employees), and it is partially exempt to the extent that it spends less. An employer may satisfy its spending requirement by, for example, purchasing health insurance for its full-time employees, and paying the city to fund part-time employees' membership in Healthy San Francisco.

Employers that have no health care plan may continue operating without one, but must make their required health care expenditures directly to the city. Alternatively, they may establish a health care plan. If they do so, the ordinance requires that they make the required level of health care expenditures by paying the full amount to fund the plan, or by paying part to fund the plan and part to the city.

Employers that have health care plans that cover some employees, and that spend at least as much as the required health care expenditure for each employee covered by the plan, may choose to maintain their existing plans or amend them to cover any employees excluded from coverage. If they fail do so, employers may comply with the ordinance by making the required health care expenditures to the city for each employee not covered by their plans.

An employer that spends less than the required health care expenditure for each covered employee under a plan may comply with the ordinance by paying the city the difference between the amount that the employer pays in premiums and other health care expenses for covered employees enrolled in the plan and the required health care expenditures under the ordinance. To satisfy its health care expenditures for covered employees not enrolled in their plans, employers may pay to the city the full amount of the required health care expenditures.

Despite its best intentions, the ordinance's spending requirements may adversely affect employment in the city, particularly for low-income workers. Employers may respond to the mandate by passing the cost of health insurance on to workers in the form of reduced wages.

One recent study by the National Bureau of Economic Research found that the average cost of a health insurance plan providing family coverage between 2000 and 2006 was $9,000, or $3.66 per hour for a full-time worker — well above the spending requirements imposed by the ordinance. The study concluded that wages would need to fall by $3 per hour to offset fully the cost of a mandate requiring employers to provide coverage similar to the average plan.

This estimate may be conservative in light of current health care expenses. In 2008, premiums for employer-sponsored health insurance plans rose to an average of $12,680 per family. The average health care cost per person for major companies is currently $8,331, and is expected to increase to $8,863 in 2009.

In the case of workers making the minimum wage, however, employers could not reduce their wages beneath the statutory minimum to offset the cost of medical insurance or mandatory spending. Thus, if workers' total compensation (wages plus insurance or mandated spending) exceeds their productive value, employers may be forced to lay them off, relocate their businesses outside the city, or drop health insurance benefits altogether, leaving employees to fend for themselves in the private insurance market or participate in Healthy San Francisco, if they're eligible.

This is not an idle possibility in the current economy. The number of small employers with 10 to 199 employees offering health insurance has already fallen nationwide from 69 percent in 2001 to 61 percent in 2007, without the threat of employer mandates. With them, the ordinance may force employers to depress wages and decrease employment and health insurance options for its intended beneficiaries, the working poor.

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