

March 3, 2008

MEMORANDUM TO CLIENTS

RE: Federal Courts Appear to Disagree on Whether ERISA Preempts State and Local "Fair Share" / "Play-or-Pay" Health Reform Laws

In the past year, federal courts have addressed challenges to three different state and local "fair share" (or "pay-or-play") laws. The laws, passed in San Francisco, Suffolk County (New York), and Maryland, require employers to contribute certain minimum amounts toward the health care coverage of their employees. The district courts in all three cases held that the Employee Retirement Income Security Act of 1974 ("ERISA") preempted each law. But, a split appears to be emerging among some federal appellate courts.

On January 17, 2007, the United States Court of Appeals for the Fourth Circuit upheld a district court decision holding that ERISA preempted the Maryland Fair Share Health Care Fund Act. *Retail Indus. Leaders Ass'n v. Fielder*, 475 F.3d 180 (4th Cir. 2007) (*Fielder II*). Almost six months later, on July 14, 2007, the United States District Court for the Eastern District of New York shot down a similar "fair share" health reform law, the Suffolk County Fair Share for Health Care Act. *Retail Indus. Leaders Ass'n v. Suffolk County et al.*, 497 F.Supp.2d 403 (E.D.N.Y. 2007) (*Suffolk County*). In *Suffolk County*, the Court relied heavily on the Fourth Circuit's analysis in *Fielder II*. Then, on December 26, 2007, the United States District Court for the Northern District of California held that ERISA preempted the San Francisco Health Care Security Ordinance. *Golden Gate Rest. Ass'n v. City and County of San Francisco*, No. C 06-06997 JSW, 2007 WL 4570521 (N.D. Cal. Dec. 26, 2007) (*Golden Gate I*). But, the City and County of San Francisco appealed the district court's decision, and filed a motion for an emergency stay of the decision pending appeal. On January 9, 2008, the United States Court of Appeals for the Ninth Circuit granted that motion, and in doing so strongly suggested that the case was likely to be reversed on appeal. *Golden Gate Rest. Ass'n v. City and County of San Francisco*, No. 07-17370 (9th Cir. Jan. 9, 2008) (*Golden Gate II*). With this latest ruling, the San Francisco Health Care Security Ordinance, which had an effective date of January 1, 2008 for employers with 50 or more employees, is now in effect. On February 8, 2008, the Golden Gate Restaurant Association filed an application with the Supreme Court of the United States, asking it to vacate the Ninth Circuit's order granting the stay. On February 21, 2008, Supreme Court Justice Anthony M. Kennedy, in his capacity as the Circuit Justice for the Ninth Circuit, denied Golden Gate Restaurant Association's application.

This memorandum discusses the "fair share" laws at issue in these cases, summarizes the various court rulings addressing those laws, provides a status of each case, and discusses the possible implications of those decisions.

I. Maryland Fair Share Health Care Fund Act**A. The Maryland Act**

In 2006, Maryland passed the Maryland Fair Share Health Care Fund Act (the "Maryland Act"). MD. CODE ANN., LAB. & EMPL. § 8.5-101 *et seq.* The Maryland Act requires employers with 10,000 or more Maryland employees to pay the State the difference between 8% of the employer's payroll (6% for nonprofit employers) and the amount the employer spent on employee health care coverage. Only four

Maryland employers have more than 10,000 employees. Of those four employers, only Wal-Mart was subject to the Maryland Act's payment provision. The State Treasury holds and the State Comptroller accounts for the funds the State collects from employers under the Maryland Act. But the funds may only be used to support the Maryland Medical Assistance Program, consisting of the State's Medicaid and children's health programs. MD. CODE ANN., HEALTH-GEN. § 15-142(d), (f), & (g).

B. The Lawsuit

The Retail Industry Leaders Association ("RILA"), a trade association whose membership includes major retail companies, filed suit in the United States District Court for the District of Maryland, arguing that ERISA preempted the Maryland Act because, among other things, the Act interfered with the uniform administration of employee benefits plans. *See Retail Indus. Leaders Ass'n v. Fielder*, 435 F.Supp.2d 481 (D. Md. 2006) (*Fielder I*). The district court agreed. The State appealed the decision to the United States Court of Appeals for the Fourth Circuit.

C. The Fourth Circuit Decision

On January 14, 2007, the Fourth Circuit Court of Appeals issued an opinion, concluding that, if subject to the Maryland Act, any rational employer would increase the amount it spent on health insurance for its employees, rather than pay the State. The court reasoned that health benefits are a form of compensation. By increasing the compensation an employer offers to its employees, the employer would benefit through improved retention, improved performance of current employees, and the ability to attract more and better employees. In contrast, the court concluded that an employer would gain no benefit by paying the State. *See Fielder II*, 475 F.3d at 193.

The court of appeals stated that a principal goal of ERISA is to enable employers to establish a uniform administrative scheme that provides a set of standard procedures to guide processing of claims and disbursement of benefits. To that end, ERISA preempts "any and all State laws insofar as they may now or hereafter relate to any employee benefit plan" covered by ERISA. The court concluded that the Maryland Act required companies to structure their ERISA health care benefit plans in a way that satisfied the minimum spending requirements under the Maryland Act. For this reason, the court struck down the Maryland Act as impermissibly seeking to mandate the structure of ERISA plans. *See Fielder II*, 475 F.3d at 191-94.

Further, the court also expressed concern regarding employers who currently administer employee benefits on a nationwide scale do not track the amount of money they spend in any one state. The court concluded that the Maryland Act could potentially disrupt the uniform administration of benefits because other states might also impose laws similar to the Maryland Act. If such laws were passed, the court explained that employers would have to tailor their health benefit plans to each state where they maintain operations. The court concluded that this was "precisely the regulatory Balkanization that Congress sought to avoid by enacting ERISA's preemption provision." *Fielder II*, 475 F.3d at 194.

The court of appeals concluded that ERISA preempted the Maryland Act and rejected the State's argument that the Act was simply a revenue statute. Although the Maryland Act required the amounts paid to the State be used to support State sponsored medical programs, the Court said that the legislative record made it clear that the law was intended to force employers to increase their health care benefits spending rather than to raise revenue to pay for medical care under the Maryland Medical Assistance Program. *See Fielder II*, 475 F.3d at 194.

D. The Dissent

In a dissenting opinion, Circuit Judge M. Blane Michael concluded that the Maryland Act did not compel an employer to establish or maintain an ERISA plan to comply with its terms. Judge Michael said the Maryland Act gave employers a choice between either paying into the State's fund or increasing their benefits expenditures; the Act did not express a preference for either option. Because the Maryland Act gives employers the choice to pay a regulatory fee to the State, the dissent concluded that the Act was a permissible way to address the problem of rising Medicaid costs.

E. Status of the Case

The State of Maryland (James D. Fielder was sued in his official capacity as the Maryland Secretary of State) did not file a petition for certiorari with the United States Supreme Court, and the time period for doing so expired on April 17, 2007. Therefore, this case is final.

II. Suffolk County Fair Share for Health Care Act

A. The Suffolk County Act

The Suffolk County Fair Share for Health Care Act (the "Suffolk County Act") was originally enacted in October 2005. When it was first passed, large retailers selling groceries were required to spend at least \$3.00 per employee hour worked on health care expenditures for their Suffolk County employees. Employers subject to the law that failed to make the required expenditures had to pay the shortfall, and were subject to an additional civil money penalty. Further, the law required employers to file annual reports that documented their health care expenditures, and certain employee information, including the number of hours worked. Employees that were covered by a collective bargaining agreement were exempt from the law.

In April 2006, the Suffolk County Act was amended. The new law no longer required the \$3.00 per hour health care expenditure, but rather required employers to pay a "public health cost rate" for each employee that an employer had in Suffolk County. Under the amended law, non-compliant employers were no longer required to pay a shortfall, but rather were only subject to a civil money penalty.

B. The Lawsuit

In 2006, RILA filed a law suit in the District Court for the Eastern District of New York challenging the enforceability of the Suffolk County Act. *See Suffolk County*, 497 F.Supp.2d 403.

C. The District Court Decision

On July 14, 2007, the district court issued an opinion, finding that the Suffolk County Act was substantially similar to the Maryland Act that the Fourth Circuit ruled was preempted by ERISA. Relying heavily on the Fourth Circuit's preemption analysis in *Fielder II*, and without setting forth an extensive legal analysis, the district court concluded that the Suffolk County Act impacted ERISA plans through which employers typically provide health benefits to their employees. For this reason, the district court found that the law had an "obvious" impermissible connection with employee welfare benefit plans, and therefore was preempted by ERISA. *See Suffolk County*, 497 F.Supp.2d at 416-18.

D. Status of the Case

Suffolk County did not file a petition for appeal with either the district court or the United States Court of Appeals for the Second Circuit. The time period for doing so expired on August 13, 2007. Therefore, this case is also final.

III. The San Francisco Health Care Security Ordinance

A. The Ordinance

In 2006, the City and County of San Francisco (collectively, the "City of San Francisco" or the "City") passed the San Francisco Health Care Security Ordinance (the "Ordinance"), S.F. Admin. Code §§ 14.1-14.8.¹ The Ordinance requires medium-sized and large businesses to make minimum health care expenditures each quarter on behalf of their covered employees, based on a per hour rate for each employee hour worked (the "Employer Spending Requirement"). S.F. Admin. Code § 14.1(b)(8); S.F. Off. of Lab. Stds. Enf. Regs. Impl. Emp'r Spend'g Req't of the Ord. ("S.F. Reg.") § 5.2(A)(1)-(2). The Ordinance provides a non-exclusive list of qualifying health care expenditures that can satisfy the Employer Spending Requirement, including health savings accounts, direct reimbursement to employees for some of the expenses incurred for health care services, payment to third parties for the provision of health care services, the costs incurred for the direct delivery of health care services, and payments to the City of San Francisco for the purpose of being used on behalf of the covered employees. S.F. Admin. Code § 14.1(b)(7).

The Ordinance also establishes the Health Access Program/*Healthy San Francisco*² ("HAP"), a health care program administered by the San Francisco Department of Public Health, and medical reimbursement accounts ("MRAs"). S.F. Admin. Code § 14.2; S.F. Reg. § 4.2. Contributions from employers, individuals,³ and the City's general fund provide funding for HAP. S.F. Admin. Code § 14.2(d). The City may also use contributions from employers to establish and maintain MRAs. S.F. Admin. Code §§ 14.1(b)(7), 14.2(g); S.F. Reg. § 4.2(A)(6). HAP delivers health care services to qualified uninsured San Francisco residents. S.F. Admin. Code §§ 14.2(e), 14.1(b)(6). The HAP program has eligibility requirements, including a San Francisco residency requirement. MRAs provide reimbursement for qualifying health care expenditures to covered employees that do not qualify for HAP regardless the employees' residency. S.F. Admin. Code § 14.1(b)(6); S.F. Reg. § 4.2(A)(6).

The Ordinance requires employers to: (i) maintain accurate records of both health care expenditures and proof of such expenditures, (ii) allow the City to access and inspect those records, (iii) provide an annual report of this information to the City, and (iv) notify employees when a payment has been made to the City on his or her behalf. S.F. Admin. Code § 14.3(b); S.F. Reg. § 7.1 – 7.4. Employers are also prohibited from reducing their workforce to avoid workforce threshold requirements. S.F. Admin. Code § 14.4(c); S.F. Reg. § 7.5. If an employer fails to comply with any these provisions or the Employer Spending Requirement, the employer will be subject to a monetary penalty.

¹ On April 2, 2007, the San Francisco Ordinance was amended. The amended law established that employers with 50 or more employees would be subject to the Ordinance as of January 1, 2008, and employers with between 20 and 49 employees would be subject to the Ordinance as of April 1, 2008.

² The Health Access Program was recently renamed *Healthy San Francisco*, but the program is often still referred to as the Health Access Program or HAP.

³ While § 14.2(d) of the San Francisco Ordinance refers to individual contributions, neither the Ordinance nor the regulations specify how individuals contribute to HAP.

B. The Lawsuit

On November 8, 2006, the Golden Gate Restaurant Association ("GGRA") filed a lawsuit against the City of San Francisco in the United States District Court for the Northern District of California, and asked the Court for declaratory and injunctive relief, claiming that ERISA preempted the Ordinance. On March 1, 2007, the San Francisco Central Labor Council, Service Employees International Union ("SEIU") Local 1021, SEIU United Healthcare Workers-West, and UNITE-HERE! Local 2 (collectively, the "Intervenors") filed a motion to intervene as defendants. The district court granted this motion on April 5, 2007. On July 13, 2007, the parties filed cross motions for summary judgment, with GGRA arguing that ERISA preempted the Ordinance.

C. The District Court Decision

On December 26, 2007, the district court granted GGRA's motion and denied the City's motion, concluding that the Ordinance "relates to" ERISA plans, and therefore, is preempted by ERISA. The court indicated that a state law "relates to" ERISA plans if the law either is "connected with" or "makes reference to" an ERISA plan. *See Golden Gate I*, 2007 WL 4570521 at *4. The court then applied the following four-factor test developed by the Ninth Circuit to determine whether the Ordinance is connected with an ERISA plan:

- (1) whether the state law regulates the type of benefits in ERISA plans;
- (2) whether compliance with the state law requires the establishment of a separate employee benefit plan;
- (3) whether the state law imposes reporting, disclosure, funding or vesting requirements for ERISA plans; and
- (4) whether the state law regulates certain ERISA relationships, such as the relationship between an ERISA plan and an employer or the relationship between an employer and an employee (to the extent an employee benefit plan is involved).

See Golden Gate I, 2007 WL 4570521 at *6 (citations omitted).

The District Court drew the following conclusions regarding the four factor test:

- the Ordinance regulates the types of benefits in ERISA plans (*i.e.*, health care coverage) and requires certain mandatory levels of health care coverage for employees;
- the recordkeeping, inspection and reporting requirements of the Ordinance relate to the administration of employers private health care expenditures, creating an impermissible connection with employee welfare benefit plan;
- the Ordinance directly and indirectly affects the structure and administration of ERISA plans because it requires employers to modify the administration of their current employee benefit plans to meet the Ordinance's requirements;

- even if employers incur non-ERISA health care spending, the vast majority of any employer's health care spending is in terms of employee welfare benefit plans, and therefore the Ordinance affects employers' ERISA plans;
- the Ordinance affects the relationship between private employers and the provision of health care coverage to employees, a relationship that ERISA traditionally covers, and requires employers to modify the "core relationship" with their health care beneficiaries; and
- the Ordinance interferes with national uniform plan administration and such interference constitutes a prohibited connection with ERISA plans.

See Golden Gate I, 2007 WL 4570521 at *7-8. Further, the court also concluded that the Ordinance unlawfully refers to ERISA plans because both the Ordinance and the Regulations specifically refer to ERISA plans with regard to employer expenditure requirements.

For these reasons, the district court held that ERISA preempted the Ordinance. The City and the Intervenor filed an appeal with the Ninth Circuit Court of Appeals, and also filed a motion for an emergency stay of the district court's decision pending resolution on the merits of the case on appeal.

D. Ninth Circuit's Decision on the Motion to Stay the District Court Decision

On January 9, 2008, a three-judge panel for the Ninth Circuit Court of Appeals granted the motion filed by the City and the Intervenor, stating that it believed the City and the Intervenor were very likely to succeed on the merits of the appeal. Applying a sliding scale test to determine whether to grant the stay, the court found that the appeal was likely to succeed on the merits and that the balance of the hardships favored the City and the Intervenor over GGRA and the employers it represents. Further, the court considered the affect of the decision on the public interest, and found that public interest also favored granting the stay.

1. Success on the Merits

The court of appeals first found that the City and the Intervenor were likely to succeed on the merits of their appeal. The court found that the Ordinance was neither connected with ERISA plans, nor made impermissible reference to ERISA plans.

The court held that unlike other state laws that have been found to be preempted by ERISA, the Ordinance did not have a connection with ERISA plans because it did not require employers to modify their employee benefit plans. *See Golden Gate II*, slip copy at 17-20 (quoting *Aetna Health Inc. v. Davila*, 542 U.S. 200, 208 (2004)). Therefore, the Ordinance preserved a "uniform regulatory regime over employee benefit plans." *See Golden Gate II*, slip copy at 17-20. The court also stated that the influence that the Ordinance might impose on employers to increase their contributions to their ERISA plans in order to satisfy the Ordinance was "entirely permissible" because employers can choose to either do that or pay the City. *See Golden Gate II*, slip copy at 20-21 (citing *New York State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645 (1995)). Finally, the court of appeals said that while the Ordinance will create administrative burdens with regard to maintaining records, this requirement is not fatal to the Ordinance under ERISA preemption analysis because this burden applies to all covered employers, not just those employers with ERISA plans. *See Golden Gate II*, slip copy at 22.

The court of appeals also determined that the Ordinance did not impermissibly refer to ERISA plans. The court held that the Ordinance neither acted immediately and exclusively on ERISA plans nor required the existence of ERISA plans to operate. *See Golden Gate II*, slip copy at 23 (citing *Cal. Div. of Labor Stnds. Enfmt. v. Dillingham Constr., N.A., Inc.*, 519 U.S. 316, 325 (1997)). The court contrasted the Ordinance with laws the Supreme Court determined ERISA preempted, stating that "the Ordinance does not act on ERISA plans at all, let alone immediately and exclusively." *See id.* at 24 (citing *Dillingham*, 519 U.S. at 325; *Mackey v. Lanier Collection Agency & Serv., Inc.*, 486 U.S. 825 (1988)).

The court then contrasted the Ordinance with the laws addressed in two Supreme Court cases to demonstrate that the Ordinance did not impermissibly refer to ERISA plans. *See Golden Gate II*, slip copy at 24-26 (citing *Ingersoll-Rand Co. v. McClendon*, 498 U.S. 133, 140 (1990); *District of Columbia v. Gr. Wash. Bd. of Tr.*, 506 U.S. 125 (1992)). In *Ingersoll-Rand*, ERISA was found to preempt a state law that required a plaintiff to establish the existence of an ERISA plan to bring a claim under the law. *See id.* at 24. The court held that not only does the Ordinance not refer to the ERISA plans, but also the Ordinance will apply to situations where ERISA plans do not exist. In *Greater Washington*, ERISA preempted a District of Columbia law that required employers to provide employees eligible for workers' compensation the same health benefits offered to other employees. Recognizing that the district court in *Golden Gate I* heavily relied on *Greater Washington*, the Ninth Circuit held that a "critical distinction" existed between the Ordinance and the D.C. law – the D.C. law measured employer obligations by referring to the level of *benefits* an employer was required to provide and the Ordinance measures employer obligations by referring to the *payments* an employer is required to make to an ERISA plan or other entity, including the City. Because the Ordinance does not require an employer to provide benefits in any manner, the court held that the Ordinance did not make an impermissible reference to an ERISA plan. *See Golden Gate II*, slip copy at 24-26.

Finally, the Ninth Circuit compared the Ordinance to the California prevailing wage law that the court previously determined ERISA did not preempt. *See Golden Gate II*, slip copy at 26 (citing *WSB Elec., Inc. v. Curry*, 88 F.3d 788 (9th Cir. 1996)). That California law required a minimum amount be paid to workers, which could be comprised of both wages and benefits. The law, however, limited the amount of benefits that could be credited toward meeting the prevailing wage. The *WSB* Court held that ERISA did not preempt the prevailing wage law because the law did not require an employer to provide any particular employee benefit or plan, to alter any existing plan, to provide an ERISA plan or even to provide employee benefits at all. *See Golden Gate II*, slip copy at 27 (citing *WSB*, 88 F.3d at 793-94). The Ninth Circuit held that ERISA did not preempt the Ordinance for the same reason. *See Golden Gate II*, slip copy at 27.

For the foregoing reasons, the court of appeals determined that the City and the Intervenors were likely to succeed on the merits of their appeal.

2. **Balancing of Hardships**

The Ninth Circuit Court of Appeals also found that the balance of the hardships among the parties favored granting the stay. The court determined that uninsured individuals, even those with serious, chronic health conditions, are much more likely not to seek medical care. Based on the City's estimate that 20,000 San Francisco employees would become eligible for health benefits under the Ordinance, the court determined that a denied stay would result in "otherwise avoidable human suffering, illness, and possibly death." The court also determined that a denied stay would cause the City to incur financial costs in the form of emergency treatment provided to uninsured individuals that would be eligible under the Ordinance at City hospitals. The court compared these injuries with the burdens the GGRA employers would encounter if the stay was granted (*i.e.*, satisfying the Employer Spending Requirement and

administrative requirements while the appeal is pending), and determined that preventable human suffering easily outweighed the employers concerns. *See Golden Gate II*, slip copy at 29-30.

3. Public Interest

The Ninth Circuit also briefly addressed the public interest. After addressing the pros and cons of the Ordinance with regard to the citizens of San Francisco, the court ultimately determined that staying the district court decision was in the public interest because the San Francisco Board of Supervisors unanimously passed the Ordinance and it was signed by the mayor. *See Golden Gate II*, slip copy at 32.

For these reasons, the court of appeals granted the stay of the district court's decision pending a resolution to the case on appeal.

E. Status of the Case

1. Appeal of the Order Granting Stay

On February 8, 2008, GGRA filed an application with the Supreme Court of the United States, seeking an Order vacating the Ninth Circuit's Order granting the stay of the district court decision. GGRA filed the application with Justice Anthony M. Kennedy as the Circuit Justice for the Ninth Circuit. On February 21, 2008, Justice Kennedy denied GGRA's request.

2. Appeal on the Merits

This case is currently pending an appeal on the merits in the Ninth Circuit on the issue of whether ERISA preempts the Ordinance. When the court of appeals issued the Order staying the district court's decision, it also put the case on a somewhat expedited briefing schedule, which will conclude on April 11, 2008. Another three-judge panel will hear oral argument on the merits of this case on April 17, 2008. The panel will issue a decision some time after the hearing, most likely within a few months following the hearing, but no official time line exists for when the court will render a decision.

The names of the three-judge panel that will hear oral argument on April 17th will be released to the public on April 7, 2008. Generally, the judges that sit on a panel are selected randomly. But, if a case has been heard by the court on a prior appeal, the same panel may sit on the later appeal. If the panel does not specify that it intends to retain jurisdiction over the later appeal, the parties may file a motion to have the original panel hear the case.

The three-judge panel that granted the stay on January 9, 2008, may be the same panel that presides over the case on the merits. If the same judges do make up the merits panel, one should not presume that the outcome of the case will necessarily follow the court's analysis from the stay decision. The merits of the case were not fully briefed on the stay decision; and the parties did not have a lot of time to fine tune their briefs on the stay issue. Further, the judges are constitutionally required to give a full review to the case when they decide it on the merits. They are not allowed to bring any bias into court. But, one cannot ignore the court's reasoning in *Golden Gate II*, which gave a clear indication of the panel's initial impression of the preemption issue. If the same panel is drawn for the merits panel, it is likely, but not definite, that the panel will follow its previous rationale, reverse the district court decision, and hold that ERISA does not preempt the Ordinance.⁴

⁴ For further information on the selection of the three-judge panel, *see* Local Rules for the United States Court of Appeals for the Ninth Circuit, Introduction: Court Structure and Procedures Pt. E at xxvii.

The Ninth Circuit's ruling on the issue, however, may not be the final resolution to this matter. If the court of appeals holds that ERISA does not preempt the Ordinance, GGRA may file a motion for rehearing *en banc*,⁵ petition the United States Supreme Court to review the merits of the case, or both. Because the issue in this case is one of important public policy, the Ninth Circuit may grant an *en banc* rehearing. Further, if the court holds that ERISA does not preempt the Ordinance, the ruling will effectively create a circuit-split with the Fourth Circuit's ruling in *Fielder II*. The existence of a circuit-split coupled with the important public policy issue would create a strong likelihood that the Supreme Court would grant GGRA's petition and would review the case.

If the court of appeals holds that ERISA does not preempt the Ordinance, and assuming that (1) an *en banc* hearing does not take place because either GGRA does not move for one or the Ninth Circuit denies GGRA's motion for one, and (2) the Supreme Court grants a review of the case, the Supreme Court most likely would not decide the case until its 2009-2010 term. If an *en banc* hearing is granted, however, Supreme Court review probably would not take place until the Court's 2010-2011 term.

IV. Looking Forward

In the time since the Fourth Circuit held that ERISA preempted the Maryland Act in *Fielder II*, practitioners have debated the potential impact of the ruling on similar laws and health care funding programs in other states such as Massachusetts and California. Many experts thought the Fourth Circuit decision put an end to this issue, and that "fair share" laws would not "fare well" under preemption review. The recent *Suffolk County* and *Golden Gate I* decisions lent further support for that position. But, the Ninth Circuit's ruling on the motion to stay the district court decision in *Golden Gate II* has created uncertainty.

A. The Ninth Circuit Should Uphold the District Court's Decision on the Merits

When the Ninth Circuit Court of Appeals addresses the merits of the appeal in this case, the court will determine whether ERISA preempts the Ordinance. We hope that the court will revisit the reasoning in *Golden Gate II* and conclude that the Ordinance *is related* to ERISA because it has a connection with ERISA plans. On appeal, we expect the briefing in support of preemption to be more persuasive than the briefing for the stay motion. This briefing should include several amici briefs—including one from the Department of Labor.

We contend that ERISA preempts the Ordinance on two grounds, both of which should be articulated on appeal. First, whether an employer makes additional contributions to its ERISA plan or makes a payment to the City to satisfy the Employer Spending Requirement, the expenditures go towards ERISA plans. Second, the Ordinance creates a penalty—the required payment to the City—if an employer's health care expenditures do not otherwise meet a minimum threshold for employers that do not spend sufficiently (as defined by the Ordinance) on their ERISA plans.

⁵ Generally, an *en banc* hearing is a hearing in front of all the judges of a court, but the Ninth Circuit has exercised its right, under the Act of October 20, 1978, Pub.L. No. 95-486, to limit the number of required judges for an *en banc* hearing to 15. See Local Rules for the United States Court of Appeals for the Ninth Circuit, Circuit Rule 35-3, as amended. In the *Golden Gate* case, if a motion for rehearing *en banc* is filed, the Ninth Circuit will decide whether to grant such a hearing, and if it does at least 15 Ninth Circuit judges will review the case.

1. Funds Paid to City Establish and Maintain ERISA Plans

The City uses funds received from employers under the Ordinance to fund HAP and to establish and maintain MRAs. S.F. Reg. § 4.2(A)(6). Both of these programs provide medical care to the employers' employees. Under ERISA, employee welfare benefit plans include any program that is established or maintained by an employer to the extent such program was established or is maintained for the purpose of providing participants and their beneficiaries with medical care.⁶ ERISA § 3(1).

HAP and MRAs that are created for employees are established and maintained by the employer through payments to the City and the enrolling of employees in the programs. HAP is a health program that provides health care, including "medical services for the prevention, diagnosis, and treatment of medical conditions," to uninsured San Francisco residents. S.F. Admin. Code §§ 14.1(b)(5), 14.2(f). HAP participants may enroll individually or be enrolled *by their employer*. S.F. Admin. Code § 14.1(b)(6). Employers whose health care expenditures otherwise do not meet the health care expenditure requirements can satisfy the requirement by making a payment to the City. *See* S.F. Admin. Code § 14.2(d); S.F. Reg. § 4.2(A)(6). Eligible employees may obtain reimbursement from MRAs for medical expenses, services or goods that qualify as tax deductible medical expenses under Code § 213. *See* S.F. Reg. § 7(g)(i). HAP and MRAs provide the types of benefits that plan must provide to be an ERISA plan. Therefore, the Ordinance relates to ERISA plans because it requires an employer to either amend its own ERISA plan, or to establish and maintain (re: fund) an ERISA plan through the City.

2. The Ordinance Imposes a Penalty Not a Choice

An employer that otherwise fails to meet the Ordinance's Employer Spending Requirement must pay the City the difference between the required expenditures and the expenditures the employer actually made on behalf of each employee. S.F. Reg. § 6.2(C). The vast majority of health care expenditures that any employer makes will be payments to fund ERISA plans. The only acceptable health care expenditures an employer can make under the Ordinance that would not constitute ERISA plan expenditures are the following: (1) contributions to health savings accounts ("HSAs") in limited circumstances and (2) establishing and funding a non-ERISA on-site medical clinic. These exceptions, however, are problematic, unrealistic, or both.

An HSA can only be established and maintained in conjunction with high deductible health plan ("HDHP"). An HDHP that is offered through an employer is an ERISA plan. Thus, any contribution to an HSA where the HDHP is provided through the employer is a contribution that is related to an ERISA plan—the HDHP. But, HDHPs can also be obtained directly by an employee. Of course, an employer must come to an agreement with each employee for whom an HSA is to be established that the employee will obtain and maintain an HDHP. This arrangement between employer and employee is both administratively difficult and rare.

Further complicating the HSA scenario is the annual limit on HSA contributions. Single individuals can contribute up to \$2,900 per year. Rev. Proc. 2007-36, 2007-22 I.R.B. 1335. Under the Ordinance, a large San Francisco employer must contribute more than \$3,600 per year a single salaried employee in 2008.⁷ In order to comply with the Ordinance, the employer would need to contribute an

⁶ Under ERISA § 3(1), medical care includes "medical, surgical, or hospital care or benefits, or benefits in the event of sickness, accident, disability, death or unemployment, or vacation benefits, apprenticeship or other training programs, or day care centers, scholarship funds, or prepaid legal services," as well as certain other benefits not relevant to this discussion.

⁷ Salaried employees are considered to work forty (40) hours per week. S.F. Admin. Code § 14.1(b)(10). Large employers are required to pay \$1.76 per hour worked per employee in 2008. S.F. Admin. Code § 14.1(b)(8).

additional \$700 toward that employee's health care expenditures. Therefore, in many cases contributions to an HSA alone will not satisfy the Employer Spending Requirement.

The creation of a non-ERISA on-site medical clinic would not practically increase employer health care spending. As the Fourth Circuit stated in *Fielder II* "[t]he ERISA regulation . . . defines non-ERISA clinics quite narrowly as 'the maintenance on the premises of an employer of facilities for the treatment of minor injuries or illness or rendering first aid in the case of accidents occurring during working hours.'" *Fielder II*, 475 F.3d at 196 (quoting 29 C.F.R. § 2510.3-1(c)(2)). The regulation does not cover facilities that treat the families of employees or that treat injuries and illness that are more than "minor." See *Fielder II*, 475 F.3d at 196 (citing Labor Dep't Op. No. 83-35A, 1983 WL 22520 (1983)). Such clinics would be required to provide very limited and simple care, and therefore would not involve substantial health care expenditures. See *Fielder II*, 475 F.3d at 196.

These alternatives are trivial, inconvenient and unproductive. The only practical "choice" an employer has to satisfy the Employer Spending Requirement is to increase its ERISA plan spending or make an equivalent payment to the City. We agree with the Fourth Circuit's ruling in *Fielder II*, no reasonable employer would choose to pay the City instead of increasing its contributions to its own ERISA plan because the payment to the City gets the employer *no benefit* in return for the contribution, and possibly subjects it to public scrutiny. An increase in ERISA contributions, however, increases employee morale, attracts better employees, and avoids potential public scrutiny. Thus, an Ordinance-mandated payment to the City should not be construed as anything other than a penalty.

B. If the Ninth Circuit Reverses the District Court on the Merits

If the Ninth Circuit reverses the district court's decision on appeal and holds that ERISA does not preempt the Ordinance, then two very influential courts (*i.e.*, the Fourth Circuit and the Ninth Circuit) will disagree on this very important issue. If this happens, we believe the case would be ripe for Supreme Court review, where we expect the Ordinance will be held to be preempted by ERISA. *Golden Gate II* represents terrible precedent. If the Ninth Circuit agrees with the rationale of the rationale expressed in that decision and overrules the district court, many states will likely take up these pay-or-play laws, including California, which is considering a more comprehensive version now.

* * *

Authors: Jon Breyfogle, Gina Boscarino and Donald Willis

If you have any questions, please contact your regular Groom contact or any of the health team attorneys listed below:

Jon W. Breyfogle	jwb@groom.com	(202) 861-6641
Gina M. Boscarino	gmb@groom.com	(202) 861-6645
Jennifer A. Cromwell	jac@groom.com	(202) 861-6329
Thomas F. Fitzgerald	tff@groom.com	(202) 861-6621
Debbie G. Leung	dgl@groom.com	(202) 861-2601
Christine L. Keller	clk@groom.com	(202) 861-9371
Heather E. Meade	hem@groom.com	(202) 861-0179
Christy A. Tinnes	cat@groom.com	(202) 861-6603
Donald G. Willis	dgw@groom.com	(202) 861-6332