



AMERICAN BENEFITS COUNCIL

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BACKGROUND MEMORANDUM ON STATE LAWS AND ERISA PREEMPTION

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As Congress is considering how to address the problem of the working uninsured, one of the questions being raised is how the Employee Retirement Income Security Act of 1974 ("ERISA") will interact with state initiatives.

This brief memorandum summarizes ERISA preemption and describes how ERISA might impact with some of the more prevalent state initiatives like "pay or play" laws.

I. LEGAL FRAMEWORK

A. Does a Law "Relate To" a Plan

ERISA § 514(a) provides that ERISA preempts "any and all State laws insofar as they . . . relate to any employee benefit plan covered by ERISA." The purpose of ERISA § 514(a) "is to enable employers to establish a uniform administrative scheme, which provides a set of standard procedures to guide processing of claims and disbursement of benefits." Egelhoff v. Egelhoff, 532 U.S. 141, 148 (2001). In determining whether a state law "relates to" a plan, the Supreme Court has looked to whether the state law has a "connection with or reference to" an ERISA-covered plan. Shaw v. Delta Airlines, Inc., 463 U.S. 85, 96-97 (1983).

A state law has a "reference to" an ERISA-covered plan if the law specifically refers to such a plan; "acts immediately and exclusively upon" the plan; or if the plan's existence "is essential to the law's operation." Cal. Div. of Labor Standards Enforcement v. Dillingham Construction, N.A., 519 U.S. 316, 324-25 (1997). State laws that "reference" ERISA plans are preempted *per se*, without regard to whether they are viewed as consistent or inconsistent with the goals of ERISA. Mackey v. Lanier Collection Agency & Service, Inc., 486 U.S. 825, 829 (1988).

A state law that does not "refer to" ERISA plans may still be preempted by § 514(a) if it has a "connection with" such plans. To determine if a state law has a "connection with" an ERISA-covered plan, courts look to "the objectives of the ERISA

statute as a guide to the scope of the state law that Congress understood would survive," as well as to the "nature and effect of the

state law on" an ERISA plan. Dillingham, 519 U.S. at 325. If a state law has a "connection with or reference to" an ERISA-covered plan, it is preempted, unless it is "saved" from preemption as a state law regulating insurance.

Although the Supreme Court initially interpreted § 514(a) broadly to encompass "even indirect state action bearing on" plans, Alessi v. Raybestos-Manhattan, Inc., 451 U.S. 504, 525 (1981), the Court's approach to ERISA preemption has narrowed in the past decade, with the Court expressing greater reluctance to find state laws preempted by ERISA. Indeed, when reviewing a state law against an ERISA preemption challenge, courts start with the presumption that the law is not preempted. N.Y. State. Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645, 654-55 (1995).

In Travelers, the Supreme Court held that a state law assessing a surcharge upon hospital bills paid by commercial insurers—but not assessed upon bills paid by Blue Cross/Blue Shield—had only an "indirect" economic impact upon ERISA-covered plans, and that such an indirect impact was insufficient to "relate to" plans for purposes of ERISA § 514(a). In reaching its conclusion, the Court noted that there is a presumption against finding state laws preempted. To overcome this presumption, a plaintiff generally must establish that the state law expressly "refers to" ERISA-covered plans, or has a "connection with" such plans, by: (1) mandating benefits to be offered by plans; (2) mandating the manner in which plans are administered or binding plan administrators to a particular choices of substantive coverage; or (3) providing a cause of action or form of relief that is not authorized by ERISA § 502(a)'s civil enforcement scheme. Id. at 658-59, 668. Specifically, the Court found that:

An indirect economic influence . . . does not bind plan administrators to any particular choice and thus function as a regulation of an ERISA plan itself; commercial insurers and HMO's may still offer more attractive packages than [Blue Cross and Blue Shield plans]. Nor does the indirect influence of the surcharges preclude uniform administrative practice or the provision of a uniform interstate benefit package if a plan wishes to provide one. It simply bears on the costs of benefits and the relative costs of competing insurance to provide them.

Id. at 659-60.

B. The Savings and Deemer Clauses

ERISA's "savings clause," section 514(b)(2)(A), provides that a state law which "relates to" an employee benefit plan will not be preempted if it is a law that regulates insurance. A state law "regulates insurance" if it is "specifically directed toward entities engaged in insurance," and it "substantially affect[s] the risk pooling arrangement between the insurer and the insured." KY. Ass'n. of Health Plans, Inc. v. Miller, 538 U.S.

329, 342 (2003). It is critical to note, however, that ERISA's "deemer clause," section 514(b)(2)(B), provides that states may not "deem" self-funded plans to be insurers, and thus generally preempts state laws that may otherwise be "saved" from preemption as applied to self-funded plans.

II. ANALYSIS

Numerous state and local initiatives are under consideration that challenge one of the key goals of ERISA, uniformity in the administration of plans by employers. This can be easily seen by considering the implications of employers being required to expend varying amounts on health care from state to state or even city to city. The widely different measures require employers to pay 10% of payroll defined one way in one city versus 8% of payroll defined a different way in another state, \$1.60 per hour for certain employees in one city versus \$3.00 per hour for another group in another jurisdiction.

The most common of the state or local initiatives which are intended to require employers to expend specified amounts on health care are known as "pay or play" laws. Pay or play laws require employers of a certain size to spend a set dollar amount or percentage of payroll (*i.e.*, X% of payroll) for health care or face a penalty. Two of the enacted bills (Maryland and Suffolk County) target only very large employers. The penalty for non-compliance is typically in the form of a tax or a mandatory contribution to state run health care programs. Laws have been enacted in Maryland, San Francisco, and Suffolk County.

The Maryland law requires companies with 10,000 or more employees in Maryland to spend at least 8% of payroll (including part-time employees) on health insurance costs. See Md. Code Ann. Labor & Emp. § 8.5-101 *et seq.* Companies spending less than 8% of their payroll on healthcare costs must make up the difference by paying into a fund dedicated to offsetting the costs of the State's public healthcare programs. A company's failure to pay will result in civil penalties.

In 2006, the Retail Industry Leaders Association ("RILA") challenged the law in federal district court arguing, among other things, that the law is preempted by ERISA. On July 19, 2006, in a decisively worded opinion, District Court Judge Motz found that the law is preempted by ERISA. Retail Industry Leaders Assoc. v. Fielder, 435 F.Supp.2d 481 (D. Md. 2006). The Fourth Circuit accepted an expedited appeal and on January 17, 2007, affirmed the District Court's decision. Retail Industry Leaders Assoc. v. Fielder, --- F.3d ----, 2007 WL 102157 (4th Cir. Jan. 17, 2007). In a 2 to 1 opinion, the three judge panel found that the Maryland law was impermissibly related to ERISA plans and was preempted by ERISA. The State of Maryland announced it will not challenge this decision.

In general, it is likely that many of the state and local requirements that impose arbitrary spending targets (like the Fair Share or pay or play laws) will be preempted by ERISA in that they attempt to directly regulate employer actions and thus "relate to" ERISA plans. Similarly, other elements of state or local laws which would lead to inconsistent administration of an employer's plan – because the administrative requirements on the plan would vary by state or local law -- also raise significant preemption questions. However, state laws that regulate individuals or insurers, likely will not be preempted by ERISA. Naturally, the analysis will be distinct for each bill.