

Employers Be Aware: ERISA Preemption Is Under Review

By: John R. Richards* and Howard S. Suskin**

A significant preemption battle is brewing. For the first time, a court of appeals has indicated that it may find that a local ordinance requiring employers to make a certain level of “health care expenditures” is not preempted by the Employee Retirement Income Security Act (“ERISA”). The court’s ultimate ruling may have significant implications for how ERISA preemption is viewed by other courts.

The current battle, being waged in the Ninth Circuit Court of Appeals, stems from a recent ruling in *Golden Gate Restaurant Ass’n v. City and County of San Francisco*¹, where the district court enjoined the implementation of the newly enacted San Francisco Health Care Security Ordinance on preemption grounds. The Ordinance is one of several recently enacted statutes across the country that mandate covered employers to make “required health care expenditures to or on behalf of” certain employees each quarter.² Surprising some observers, the Ninth Circuit stayed the district court’s judgment pending the appeal and allowed the Ordinance to go into effect. The Ninth Circuit in *Golden Gate* concluded that the City has shown not only a “probability” but also a “strong likelihood of success on the merits.”³

At issue on appeal will be whether the Ordinance’s requirement that covered employers make a certain level of “health care expenditures” for their covered employees is preempted by ERISA.⁴ If the Ninth Circuit upholds the Ordinance, as its initial pronouncements suggest that it might, its ruling may have dramatic consequences for how employers administer and fund their ERISA plans.

A. ERISA PREEMPTION

ERISA establishes a comprehensive federal regulation governing employee benefits. It does not require that employers provide specific employee benefits, but leaves them free, “for any reason at any time, to adopt, modify, or terminate welfare plans.”⁵ If an employer chooses to establish ERISA plans, ERISA provides a uniform regulatory regime that sets forth consistent rules regarding reporting, disclosure, and fiduciary responsibilities.⁶ To ensure its goal of uniformity, § 514(a) of ERISA broadly preempts “any and all State laws insofar as they may now or hereafter *relate* to any employee benefit plan” covered by ERISA.⁷ Because of such preemption, employers do not endure the financial and administrative costs of “the tailoring of plans and employer

conduct” to potentially conflicting state directives.⁸ States, however, continue to enjoy wide freedom to regulate healthcare *providers*⁹. ERISA also explicitly exempts state regulations of *insurance companies* from preemption.¹⁰

The Supreme Court has established a two-part inquiry to interpret the scope of what falls within § 514(a) preemption: “A law ‘relate[s] to’ a covered employee benefit plan for purposes of § 514(a) if it [1] has a connection with or [2] reference to such a plan.”¹¹ Under these principles, courts are to assess the extent to which the state law disrupts the ability for an ERISA plan to be administered uniformly nationwide. The Supreme Court has established that ERISA preempts state law that directly regulates or effectively mandates some element of the structure or administration of employers’ ERISA plans. Conversely, a state law is generally not preempted when it creates only indirect economic influences that affect but do not bind an employer to any particular set of rules in regard to its ERISA plans.¹²

B. THE GOLDEN GATE DECISION

In July 2006, the San Francisco Board of Supervisors unanimously passed the Ordinance, and the mayor signed it into law.¹³ The

1 *John R. Richards is a member of Jenner & Block LLP’s Litigation Practice.

2 **Howard S. Suskin is a partner in Jenner & Block LLP’s Chicago office. He is Chair of the firm’s Class Action Litigation Law Practice and Co-Chair of the firm’s Securities Litigation Law Practice.

Ordinance mandates that covered employers make “required health care expenditures to or on behalf of” certain employees each quarter.¹⁴ “Covered employers” are employers engaging in business within the City that have an average of at least twenty employees performing work for compensation during a quarter, and non-profit corporations with an average of at least fifty employees performing work for compensation during a quarter.¹⁵ The Ordinance delineates five categories of “covered” employers: those with (1) no ERISA plans; (2) ERISA plans for all employees, and that spend a specified minimum level of expenditures; (3) ERISA plans for some, but not all, employees, and that spend at least a specified minimum level of expenditures; (4) ERISA plans for all employees, but that spend less than the specified threshold; and (5) ERISA plans for some, but not all employees, and that spend less than the specified threshold. “Covered employees” are individuals who (1) work in the City; (2) work at least ten hours per week; (3) have worked for the employer for at least ninety days; and (4) are not excluded from coverage by other provisions of the Ordinance.¹⁶

Under the Ordinance, “[t]he required health care expenditure for a covered employer shall be calculated by multiplying the total number of hours paid for each of its covered employees during the quarter . . . by the applicable health care expenditure rate.”¹⁷ The Ordinance does

not dictate, however, the type of health care expenditure that an employer chooses to make.¹⁸ If an employer does not make required health care expenditures on behalf of employees in some other way, the Ordinance requires that the employer meet its spending obligation by making payments directly to the City.¹⁹

On November 8, 2006, the Golden Gate Restaurant Association filed a complaint against the City in federal district court, seeking a declaration that the Ordinance’s employer spending requirement is preempted by ERISA and also seeking a permanent injunction prohibiting enforcement of the Ordinance’s provisions. In March 2007, several unions successfully moved to intervene as defendants. On April 2, 2007, the City amended the Ordinance to defer implementation of the employer provisions until January 1, 2008, for employers with fifty or more employees, and until April 1, 2008, for employers with twenty to forty-nine employees.

On December 26, 2007, the federal district court entered judgment for the Association, holding that the Ordinance’s employer spending requirements are preempted by ERISA. The district court found that “the Ordinance’s health care expenditure requirements are preempted because they have an impermissible connection with employee welfare benefit plans.” Notably, the district court stated that the Ordinance interfered with an employer’s choice as whether and how to provide employee

health coverage by mandating employee health benefit administration.²⁰ The district court also emphasized that “[e]ven if [options provided by statute] were a meaningful avenue by which [the employer] could incur non-ERISA healthcare spending, we would still conclude that the [statute] had an impermissible ‘connection with’ ERISA plans.”²¹ The district court concluded that any attempt to comply with the statute would directly affect the employer’s funding of its ERISA plans and therefore was preempted.

The following day, the City and the Intervenors appealed to Ninth Circuit, and the City filed emergency motions in the district court and in the Ninth Circuit for a stay of the district court’s judgment pending decision on the merits of the appeal.

In determining whether the Ordinance had a prohibited “connection to” or “reference to” ERISA that would trigger preemption, the Ninth Circuit focused on the non-binding nature of the Ordinance. The Ninth Circuit observed that “the Ordinance does not require employers to establish ERISA plans or to make any changes to any existing ERISA plans.”²² The Ninth Circuit noted, for example, that employers can satisfy the Ordinance by simply making certain levels of health care *payments* to the City or another entity specified in the Ordinance. The Ninth Circuit also observed that because the Ordinance gives the employer such a choice, the Ordinance does not require

that employers provide certain health care *benefits* to their employees, through an ERISA plan or otherwise.²³ Thus, an employer may choose to proceed without an ERISA plan or other health plan and still comply with the Ordinance.²⁴ The Ninth Circuit preliminarily found: “[a]ny employer covered by the Ordinance may fully discharge its expenditure obligations by making the required level of employee health care expenditures, whether those expenditures are made in whole or in part to an ERISA plan, or in whole or in part to the City.” Moreover, the Ninth Circuit preliminarily concluded that the Ordinance does not dictate any particular benefit structure or bind employers to any certain plan choices.²⁵ Accordingly, the Ninth Circuit expressed doubt that the Ordinance would be preempted under ERISA and, consequently, lifted the injunction and ordered that the Ordinance be permitted to be implemented while the appeal on the merits is pending.

C. CONCLUSION

The Ninth Circuit’s reasoning has potentially very significant consequences for any employer with ERISA plans. Because the Ordinance effectively operates as a mandate that offers employers no meaningful alternatives by which they can increase their healthcare spending without substantially altering the administration of their ERISA plans, the Ordinance would be subject to preemption under the analysis traditionally

employed by the courts.²⁶ That is particularly so because the Ordinance prevents employers from consistently administering their ERISA plans by requiring them to be informed of local minimum spending prerequisites and tailoring their financial and administrative costs accordingly. Such interference traditionally has been viewed to be contrary to the fundamental purpose of ERISA preemption. If the Ninth Circuit upholds the Ordinance on the merits, following its full review of the appeal, the Court’s ruling would be a significant departure from past precedent and treatment of ERISA preemption.

ENDNOTES

- 1 Nos. 07-17370, 07-17372, 2008 WL 90078, at *1 (9th Cir. Jan. 9, 2008)
- 2 S.F. Admin. Code § 14.3(a) (2007).
- 3 *Golden Gate Restaurant Ass’n*, 2008 WL 90078, at *6.
- 4 *Id.*
- 5 *Retail Indus. Leaders Ass’n v. Fielder*, 475 F.3d 180, 190 (4th Cir. 2007) (quoting *Curtiss-Wright Corp. v. Schoonejongen*, 514 U.S. 73, 78 (1995)).
- 6 *Aetna Health Inc. v. Davila*, 542 U.S. 200, 208 (2004).
- 7 29 U.S.C. § 1144(a) (emphasis added).
- 8 *Ingersoll-Rand Co. v. McClendon*, 498 U.S. 133, 142 (1990).
- 9 See, e.g., *De Buono v. NYSA-ILA Medical and Clinical Services Fund*, 520 U.S. 806, 815 (1997) (upholding a state tax on gross receipts for patient services at hospitals, residential healthcare facilities, and diagnostic and treatment centers); *New York State*

Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 658-59 (upholding a state mandate that hospitals charge certain insurers at higher rates than Blue Cross & Blue Shield).

- 10 See 29 U.S.C. § 1144(b)(2)(A); *Metro. Life Ins. Co. v. Mass.*, 471 U.S. 724, 739-47 (1985).
- 11 *Cal. Div. of Labor Standards Enforcement v. Dillingham Const., N.A., Inc.*, 519 U.S. 316, 324 (1997) (alterations in *Dillingham*) (some internal quotation marks omitted).
- 12 See *Travelers*, 514 U.S. at 658.
- 13 The Ordinance has been codified as City and County of San Francisco Administrative Code, Sections 14.1 to 14.8.
- 14 S.F. Admin. Code § 14.3(a) (2007).
- 15 *Id.* § 14.1(b)(3), (11), (12).
- 16 *Id.* § 14.1(b)(2).
- 17 *Id.* § 14.3(a); see also RIESR Reg. 4.1(A) (“[a] health care expenditure is any amount paid by a covered employer to its covered employees or to a third party on behalf of its covered employees for the purpose of providing health care services for covered employees or reimbursing the cost of such services for its covered employees.”).
- 18 RIESR Reg. 4.2(A).
- 19 S.F. Admin. Code § 14.1(b)(7)(e).
- 20 *Golden Gate Restaurant Ass’n v. City and County of San Francisco*, No. C 06-06997 JSW 2007 WL 4570521, at *6 (N.D. Cal. Dec. 26, 2007).
- 21 *Id.* at *7.
- 22 *Golden Gate Restaurant Ass’n*, 2008 WL 90078, at *6.
- 23 *Id.*
- 24 See RIESR Reg. 4.2(A)(6).
- 25 *Id.* 4.2(A)(1)-(5).
- 26 *Retail Industry Leaders Ass’n*, 475 F.3d at 196 (Maryland Fair Share Act was preempted by ERISA).