

Analysis of 9th Circuit Decision

The Ninth Circuit Upholds San Francisco Health Care Ordinance Against ERISA Preemption Challenge

By David L. Bacon and Suzanne D'Amato

On September 30, 2008, the Ninth Circuit released its opinion in *Golden Gate Restaurant Association v. City and County of San Francisco*, __F.3d__ (9th Cir. 2008), 2008 U.S. App. LEXIS 20574. The court held that ERISA does not preempt a San Francisco health care security ordinance that requires private employers with 20 or more employees either to pay a specified hourly rate towards health care for their employees or to pay the same amount into a City-sponsored health care program called the Health Access Plan (“HAP”). The HAP provides health care for uninsured San Francisco residents through a network of hospitals and clinics. The goals of the ordinance are of exceptional importance. A restaurant trade association, which had concern that many of its members could not afford either option, challenged the ordinance on the ground of ERISA preemption.

Both sides presented briefing of high quality, and there was a distinguished body of *amicus* briefing. One of California’s preeminent appellate lawyers, Curtis A. Cole, gave oral argument on behalf of the trade association, commenting that “the context of the case is momentous.” The U.S. Department of Labor filed an *amicus* brief asserting that the City-payment option in the ordinance has a prohibited connection with ERISA plans is therefore preempted for two reasons. First, the ordinance requires employers to establish and maintain an ERISA plan. Second, the ordinance’s spending requirements interfere with uniform plan administration. In essence, the Department of Labor contended that the ordinance involved serious interference with ERISA’s statutory framework - state regulation of ERISA plans dressed up in sheep’s clothing. The Ninth Circuit dismissed the argument. As is often the case, the Department of Labor may have the better grip on the scope of ERISA plan coverage and preemption. If the case reaches the Supreme Court, the opinion will face tough challenges both from the economic policy and legal standpoints.

The City ordinance is one variety of what are sometimes called “pay or play” or “fair share” laws. In general, these state or local laws require employers either to provide health care coverage for their employees or to pay a form of tax, fee or assessment that will be used to help pay for medical expenses for uninsured persons. The San Francisco ordinance requires, among other things, that employers adhere to record-keeping and information-providing requirements. Employers may also have to determine whether they are covered as part of a controlled group of employers, and whether their employees are excluded under numerous exceptions. In addition, employers may be required to differentiate hours worked by employees inside and outside the City, calculate the percentage of time attributable to the two different categories, and determine the hours worked and location of telecommuters. As the Department of Labor noted in its *amicus* brief, the ordinance requires employers to do far more simply cut a series of checks.

No one contests the increasing need for state and local assistance in this area. The question focuses on whether ERISA restricts the state or local government from requiring employers to finance either part or all of health care reform. Sales taxes, hotel room charge taxes, and an

almost infinite series of fees and assessments - limited only by the imagination of government officials - can also be used to finance health care reform. So, too, budget cuts - fewer “bridges to nowhere” – or savings from government employee hiring freezes or cost controls on government employee wages and benefit costs, including fleets of cars for government officials, could be used to assist in accomplishing these goals. The universe of options is broad. In practice, the state and local governments focus on private sector employers as the financing source.

States with low-tax, business-friendly environments, such as Texas, tend to do well in a global economy. San Francisco’s placing a heavy financial burden on midsized employers to fund health care reform may act to shutter business establishments and discourage the creation of new ones. It may not be a wise economic policy overall. It calls to mind the 1932 “check tax,” which was a 2-cent tax on all checks (over \$.30 per check in today’s dollars) that was designed to improve economic conditions – and social welfare - at the outset of the Great Depression. One of the results was a severe monetary contraction. See W.D. Lastergres and G. Selvin, “Folly and the Great Monetary Contraction,” *Journal of Economic History* 59(4), Dec. 1997, 859-78. John F. Kennedy said that “a rising tide lifts all boats.” (1963 speech). The Ninth Circuit courtroom sitting on the Bay may have missed the larger picture.

Broadly speaking, ERISA regulates employee benefit plans, not employee benefits. Employee benefit plans include any plan, fund or program through which private sector employers provide health benefits to their employees. 29 U.S.C. § 1002. ERISA preempts state and local regulations that “relate to” ERISA plans. *Id.* at § 1144(a). ERISA preemption turns on whether the state or local regulation mandates employee benefit structures or their administration, or interferes with uniform plan administration. *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645, 658 (1995); *Egelhoff v. Egelhoff*, 532 U.S. 141, 148 (2001). ERISA also preempts state laws directed at plans or plan sponsors that mandate plans, as well as benefits. *Fort Halifax Packing Co. v. Coyne*, 482 U.S. 1, 16 (1987). One of Congress’ overarching goals in enacting ERISA was to establish the regulation of pension and welfare benefit plans as “exclusively a federal concern.” *Travelers*, 514 U.S. at 626 (citation and internal quotations omitted).

Many employers operate on a multistate basis. In enacting ERISA, Congress sought to ensure that plans and plan sponsors would “be subject to a *uniform* body of benefit laws” in order to “minimize the administrative and financial burden of complying with conflicting directives among States or between States and the Federal Government .. [and] to prevent the potential for conflict in substantive law.” *Travelers*, 514 U.S. 656 (quotations and indentation omitted).

Business groups who urged ERISA preemption in the *Golden Gate* case expressed concern that an opinion upholding the ordinance would be devastating for small business owners and may force some out of business and discourage others from starting businesses in San Francisco. Concern was also expressed that an opinion upholding the ordinance would encourage *every* state and local government seeking to promote its own version of health care reform, with the results being that large, multistate employers would be faced with a bewildering array of divergent health care regulation rather than the employer’s single set of uniform rules for establishing and maintaining health care plans.

The Ninth Circuit rejected all of the ERISA preemption arguments. The court concluded that the ordinance does not require employers to establish their own ERISA plans or to make any changes to any existing ERISA plans. While employers may want to set up ERISA plans or to modify existing plans to comply with the ordinance, they need not do so. Instead, they may select the City-payment option that allows employers to make payments directly to the City.

The Ninth Circuit rejected the employers' assertion that ERISA preempts the ordinance because it either creates a "plan" within ERISA's scope, or "relates to" employers' ERISA plans within the meaning of the preemption clause. The court concluded that the City payment option did not create an ERISA plan. Among other points, the court noted that the payments were made out of the employer's general assets, in a manner similar to regular wage payments, there was no risk of mismanagement of trust funds or other abuse, no ongoing administrative and discretionary duties were triggered, and the payments were made directly to the City, not to employees.

The court also rejected the Department of Labor's argument that the HAP itself is an ERISA plan. The court concluded that there was no "plan, fund, or program" within the meaning of ERISA's definition of employee benefit plan. The HAP is a government entitlement program available to low- and moderate-income residents of the City, regardless of employment status. Taxpayer dollars are the primary funding source for the HAP, not employer contributions paid under the ordinance. The reasons given carry great force. The court's position is strong and its opinion well-written.

At times, the Ninth Circuit's reading of the ERISA statute has shown breathtaking clarity. *See, e.g., Kanne v. Connecticut General Life Ins. Co.*, 867 F.2d 489 (9th Cir. 1988) (as amended, 1989), *cert. denied*, 492 U.S. 906 (1989) (broad ERISA plan coverage and preemption decision); *Snow v. Standard Ins. Co.*, 87 F.3d 327 (9th Cir. 1996) (ERISA standard of review is "significantly deferential"). At other times, the Supreme Court has struck down the Ninth Circuit's reading of ERISA. *See, e.g., Lockheed Corp. v. Spink*, 517 U.S. 882 (1996). The record is mixed.

There is solid merit to the Department of Labor's position that the HAP is an ERISA-covered plan, notwithstanding its dismissal by the Court of Appeals based on a long list of reasons why the HAP did not resemble one. In the author's view, the Ninth Circuit's reasons –while convincingly presented - do not quite add up. The HAP is an ERISA plan, albeit an odd one. Nor does the ordinance's placing so much economic burden on mid-sized employers appear wise; the end does not justify the means. The situation reminds the author of a brief routine he saw when he moved to California. An actor sat on a bare stage with a Chihuahua that was dressed in a tuxedo, wearing it with great pride. The actor spent five minutes giving convincing explanations why the friend sitting at his side was not a dog: all dogs are descended from wolves; but the Chihuahua is so tiny that it could not have wolf blood; most dogs have coats of hair; the Chihuahua has almost no hair; his friend would not chase a ball, roll over, or bully a cat; and who has ever seen a dog wearing a tuxedo with such pride. Everything was strongly stated; it was all very logical. The act concluded with the Chihuahua giving an approving bark.

The Department of Labor has parsed the ERISA statute in a more refined manner. As the Department noted in its *amicus* brief, the ordinance requires employers "to make reasonable health care expenditures on behalf of their employees," and thus intrudes on a core aspect of

ERISA's regulatory framework. ERISA specifically regulates employee welfare plans and defines them broadly as including "any plan, fund, or program [that is] established by or maintained by an employer" to the extent it is "established or maintained for the purpose of providing for its participants or their beneficiaries, through the purchase of insurance *or otherwise*, medical, surgical, or hospital care or benefits, or benefits in the event of sickness." 29 U.S.C. § 1002(1) (emphasis added). The HAP is an "or otherwise" case. It is an ERISA plan. So too, the Chihuahua, as strange as it looks, is a dog.

The "pay or play" and "fair share" laws, although they may differ in form and substance, raise recurrent issues of central importance to the administration of the nation's employee benefit plan system. The Ninth Circuit is not the first to have wrestled with one such law. *See, e.g., Retail Industry Leaders Association v. Fielder*, 475 F.3d 180 (4th Cir. 2007) (holding Maryland fair share law to be ERISA-preempted). A level of uncertainty has descended upon a mainspring of federal employee benefits law. Swift intervention is required by the Supreme Court to restore the carefully-crafted balance between federal and state law struck by Congress in ERISA and to reestablish the preeminence of the federal statute.

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