

Fact Sheet: ERISA Implications for State Pay or Play Laws

Patricia A. Butler, J.D., Dr.P.H.
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What is ERISA? The Employee Retirement Income Security Act of 1974 is a federal law governing pension and other employee benefits offered by private sector employers (other than churches) or unions. ERISA's regulation of employee benefits programs, such as health coverage, is much more limited than its regulation of pensions. The federal law does *not* regulate public sector employee programs or state laws governing workers' compensation, unemployment, or disability insurance.

How might ERISA affect state law? ERISA contains a "preemption clause" providing that it supercedes all state laws that "relate to" private-sector employee pension and benefit programs. Its purpose, as articulated by Congress, was to avoid conflicting state regulation of employee benefits plans. Preemption occurs even when there is no direct conflict between state and federal law. State laws that regulate the business of insurance, such as those requiring insurance policies to offer certain benefits, are not preempted by ERISA.

How is ERISA's preemption clause interpreted? Federal courts interpret the meaning and application of ERISA's preemption clause. Over the last 30 years the U.S. Supreme Court has examined state laws in two dozen preemption clause cases to determine whether they regulate areas already addressed by ERISA, refer to private-sector employer-sponsored pension or benefits plans or have a "connection with" such plans because they affect plans' benefits, structure, or administration.

What kinds of state laws have been held preempted? Following Supreme Court guidance, courts have held that states cannot require employers to offer or pay for worker health coverage (i.e., Hawaii's employer coverage mandate, which Congress exempted from preemption in 1983); directly regulate the benefits, cost sharing, or financial arrangements of employer- or union-sponsored plans; or tax ERISA plans themselves.

What limits have courts placed on preemption? In its 1995 *Travelers Insurance* case, the Supreme Court held that ERISA did not preempt New York's hospital rate-setting law that imposed up to 24% higher costs on private-sector employer- or union-sponsored (i.e., ERISA) plans buying insurance coverage from commercial insurers rather than Blue Cross policies. The Court reasoned that despite the breadth of the preemption clause, federal preemption should be construed only broadly enough to carry out congressional intent. Although the hospital surcharges could influence whether an ERISA plan bought commercial or Blue Cross coverage, the Court concluded that the differential costs would not "bind plan administrators to a particular choice" or limit their ability to maintain uniform benefits packages or administrative practices across state boundaries. The Court reaffirmed its *Travelers* decision in two later cases that placed additional limits on the application of ERISA's preemption clause.

Why did courts hold ERISA preempts the Maryland "Fair Share Act?" In 2006 Maryland enacted a law requiring private employers with more than 10,000 workers to either spend at least 8%

of payroll on employee health services or pay the shortfall to the state to help fund its Medicaid program. According to the law's sponsors, only Wal-Mart was subject to the requirement. A federal district court and the 4th Circuit Court of Appeals held that the law was preempted by ERISA because of its "connection with" an employee health benefits program. The courts reasoned that the law was not a generally applicable business tax but rather a mandate that one employer cover its workers. The courts reached this conclusion based on the statements of bill sponsors and the practical effect of the law on only one employer, whose officers indicated they would increase their health benefits rather than pay to the state the difference between their health benefits costs and the 8% threshold. The Court of Appeals noted that the structure of the state law created an irresistible incentive to modify the ERISA health plan and, as a coverage mandate, was inconsistent with two local ordinances in another state that imposed similar employer spending requirements. Following the 4th Circuit's reasoning, a federal court in New York recently held that ERISA preempts a similar ordinance adopted by Suffolk County that required a few large food retailers to spend a minimum amount on employee health care.

What are state "pay or play" laws? Besides Maryland, in 2006 Massachusetts and Vermont enacted laws requiring employers to either pay an assessment to the state or contribute to employee health premiums. In 2007 several states are considering requirements that employers either pay a fee or tax or participate in financing employee health care. For example, California Assembly Bill 8 would require employers to elect either to spend at least 7.5% of payroll on health expenditures or to pay a fee of 7.5% of payroll to a state pool that will provide health insurance to workers.

What are ERISA implications for state pay or play laws? There are conflicting views. Opponents of state pay or play laws would argue that such approaches mandate employers to offer health coverage in violation of ERISA and would be preempted under reasoning in the 4th Circuit Court of Appeals' decision and the 9th Circuit's decision in the Hawaii case.

Proponents would argue such approaches:

- Require employer spending, but not necessarily coverage—providing a choice to plan administrators (to pay or play) consistent with the Supreme Court's preemption guidance;
- Differ from the Maryland, Suffolk County, and Hawaii laws because their objective is not to mandate employers to cover workers but only to pay a fee (which has never been held preempted); and
- Differ from the Maryland and Suffolk County laws because they apply to a large number of employers who face varying types of choices—some would prefer to pay the assessments while others would prefer to spend money on employee health services.

What is the likely outcome of an ERISA preemption challenge to a pay or play law? Until a court (ultimately, the Supreme Court) decides a particular case, it is not possible to predict with certainty whether ERISA preempts a specific state law. Court decisions depend heavily on the interplay between the objectives of the preemption clause and the purpose and effect of the challenged laws.

For further discussion, see Patricia Butler's *ERISA Preemption Manual for State Health Policy Makers*, January 2000 (published by AcademyHealth's State Coverage Initiatives Program and the National Academy for State Health Policy) and annual updates, available from www.statecoverage.net and www.nashp.org.