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"Employers nationwide need to understand what is happening in Massachusetts."

THE MASSACHUSETTS HEALTH CARE REFORM ACT: WHAT MUST EMPLOYERS DO?

by
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Employers nationwide need to understand what is happening in Massachusetts. The Commonwealth of Massachusetts has set into motion a plan for providing health insurance to virtually all its citizens. And it is requiring employers with even minimal operations in the state to play their part.

Massachusetts seems to be leading the way in this regard. Vermont has, for example, enacted legislation to provide universal coverage that includes a role for employers. California appears to be headed in the same direction. A host of other states are studying approaches similar to that adopted by Massachusetts.

Massachusetts' new scheme includes a "pay or play" obligation for employers. That is, employers must either make a "fair and reasonable contribution" for employees to their own health plans or pay an amount per employee to the state. The state has substantially improved the odds that its program is not preempted by ERISA by keeping the pay portion low – at most, $295 per employee per year. This does not mean the Massachusetts law will survive the inevitable preemption legal challenge, but it puts it in a better position to defend its program than was Maryland, whose "Maryland Fair Share Act" was recently struck down on ERISA preemption grounds. The Maryland law was preempted in part because the employer pay option was a hefty 8% of payroll and because the law was narrowly applicable only to "jumbo employers" (and, apparently, was specifically targeted at Wal-mart). The Massachusetts law does not suffer either of these deficiencies. It is broadly applicable to all but the smallest employers and, as noted, the "pay" alternative is relatively inexpensive.

Legislative Background

Like most states, Massachusetts has struggled in recent years with the burden of uninsured medical costs. Providing care for uninsured individuals stresses both health care providers and the state. Massachusetts hospitals, for example, are usually required to provide care for individuals who cannot pay for it. As the cost of care for uninsured citizens rises, so does the state's cost of providing Medicaid to its low income residents lacking insurance.

With these concerns in mind, Massachusetts began consideration of a sweeping new health care insurance system. Additional pressure for health care reform came when federal authorities informed the state that it would risk losing millions in Federal Medicaid dollars unless its number of uninsured individuals was reduced.

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The result was a 2006 Massachusetts health care reform act ("the Act"), which imposes a host of requirements on Massachusetts residents and employers, as well as on insurance companies doing business in Massachusetts. In short, all residents are required to purchase health insurance by July 1, 2007, and employers are required to offer or facilitate access to health insurance. Fairly rigid requirements are imposed on health care insurance carriers doing business in Massachusetts, which will indirectly affect employers. The Act also establishes the Commonwealth Health Insurance Connector ("the Connector"), which is the state entity charged with the task of implementing many aspects of the new law.

Which Employers Must Comply?

The Act imposes three main requirements. These requirements apply to employers that employ 11 or more full-time equivalent employees at Massachusetts locations. Only employees who have been employed for at least one month are taken into account for this purpose.

Employer Requirements:

1. **Fair Share Employer Contribution Employers with 11 or more full-time equivalent employees employed at Massachusetts locations must offer a group health care plan (within the meaning of Tax Code Section 5000(b)(1)) to which the employer makes a "fair and reasonable contribution" *or* pay an annual "Fair Share Employer Contribution," not to exceed $295 per employee, into the newly established Commonwealth Care Trust Fund.**

   - **Who is a full-time equivalent employee? Neither the Act nor the regulations explicitly state how to determine how many full-time equivalent employees an employer has for the purpose of determining whether the employer must comply with the "fair share contribution" requirement. The only available guidance on the issue is from the second and third employer requirements (discussed later), where an employer is determined to have 11 or more full-time equivalent employees if "the sum of total payroll hours for all employees . . . divided by 2,000 is greater than or equal to 11." A worker from a "temporary agency" is not considered an employee of the client company.**

   - **How is a "fair and reasonable contribution" determined? If an employer meets either of two tests, the employer is exempt from having to pay into the Commonwealth Care Trust Fund.**

     Primary Test: If 25% or more of an employer's full-time Massachusetts employees are enrolled in the employer's group health plan, the employer is deemed to make a "fair and reasonable contribution." The employees taken into account include all full-time employees (working at least 35 hours a week) who are employed at Massachusetts locations, whether or not they are Massachusetts residents. Full-time employees do not include independent contractors, seasonal employees, or temporary employees.

     Secondary Test: Even if an employer cannot meet the primary test, if the employer offers to pay at least 33% of the premium cost of any group health plan it offers to its full-time employees that were employed at least 90 days during the period from October 11, 2006, through September 20, 2007, then the

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employer is deemed to make a "fair and reasonable contribution." Again, it appears that only full-time employees employed at Massachusetts locations are taken into account. Full-time employees do not include independent contractors, seasonal employees, or temporary employees.

§ **What about Multi-state employers? Multi-state employers can be subject to the fair share contribution requirement. For a multi-state employer with Massachusetts locations, the Primary Test percentage is calculated by taking into account all full-time employees at all Massachusetts locations. The same appears to be true for the Secondary Test as well.**

§ **When does the requirement become effective? July 1, 2007.**

2. **Section 125 Cafeteria Plan Employers with 11 or more full-time equivalent employees at a Massachusetts location are required to adopt and maintain a cafeteria plan that satisfies both Section 125 of the Tax Code and the Connector's rules and regulations.[1] An employer must also file a copy of the Section 125 plan with the Connector. Independent contractors who provide services in Massachusetts are not employees for purposes of the cafeteria plan requirement.**

So long as an employer provides medical coverage to all of its Massachusetts location employees (including, but not limited to, full-time, part-time, seasonal, and temporary employees) and pays the full monthly cost of that medical coverage for all such employees, the employer is exempt from the Section 125 plan requirement. A Free Rider Surcharge will be assessed when an employer with 11 or more full-time employees at Massachusetts locations fails to adopt and maintain a Section 125 plan *and* has any "state-funded employees" *and* its state-funded employees use a total of $50,000 of state-funded health services for themselves or their dependents during a fiscal year (running from October 1 through September 30).

§ **How does an employer know if it has 11 or more employees at a Massachusetts location? An employer has 11 or more employees for purposes of this requirement if the employees on the employer's payroll work a total of 22,000 hours or more (that is, if the sum of total payroll hours for all employees during the applicable determination period divided by 2,000, is greater than or equal to 11). If an employee has more than 2,000 payroll hours, the employer is to count only 2,000 hours for that individual. Only payroll hours of employees working at Massachusetts locations are counted in determining the number of employees.**

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[1] **The actual text of the Act, and 956 CMR 4.00, state that an employer with 11 or more *employees* must adopt and maintain a Section 125 plan. The regulation makes clear that for purposes of determining which employers are subject to the cafeteria plan requirement, employees include, but are not limited to, full-time employees, part-time employees, temporary employees, and seasonal employees. An employer has 11 or more employees if "the sum of total payroll hours for all employees . . . divided by 2,000 is greater than or equal to 11." Thus, the Connector has interpreted the cafeteria plan requirement to apply to employers with 11 or more *full-time equivalent* employees working in Massachusetts. Similarly, under the text of the Act, the free rider surcharge (noted later in this newsletter) is assessed on employers who employ 11 or more full-time equivalent employees, and who fail to adopt and maintain a Section 125 Cafeteria Plan.**

"[E]mployers with 11 or more full-time equivalent employees at a Massachusetts location are required to adopt and maintain a cafeteria plan."

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§ **Who is a state-funded employee? A "state-funded employee" is an employee or dependent of an employee (a) with more than three "state-funded admissions" or visits during a fiscal year (running from October 1 through September 30), or (b) of an employer whose employees or dependents have five or more "state-funded admissions" or visits during a fiscal year.**

§ **What about multi-state employers? A multi-state employer with Massachusetts locations must count all employees employed at all Massachusetts locations when calculating total payroll hours for the purpose of determining whether the requirement applies.**

§ **What are the additional requirements for the Section 125 plan promulgated by the Connector? In addition to the need for an employer's cafeteria plan to meet the requirements of Tax Code Section 125, (1) the plan must consist of a written plan document specifically describing its available benefits, its eligibility rules regarding participation, procedures for plan elections, the manner in which employer contributions may be made to the plan, the maximum amount of elective employer contributions available to any plan participant, and the plan year on which the plan operates; (2) the plan must, at a minimum, be a "premium only plan" offering access to at least one medical care coverage option in lieu of cash compensation; (3) an eligible employee must be offered participation in the plan during any applicable election periods, without regard to whether the eligible employee was previously eligible or had previously waived participation; (4) no employer contribution is required; (5) the following employees may be exempt from eligibility to participate in the plan: employees younger than 18, temporary employees, part-time employees (working, on average, less than 64 hours a month), wait staff or service employees who earn, on average, less than $400 in monthly payroll wages, student employees employed as interns, and certain seasonal employees who are international workers.**

§ **What are the filing requirements? An employer must submit a copy of its cafeteria plan to the Connector or its designee on or before the date the employer becomes subject to the cafeteria plan requirement. Each submission must be in the form and manner specified by the Connector and the employer must designate a responsible individual authorized to verify and certify the accuracy of the document being submitted. For employers with 11 or more full-time equivalent employees during the 12 months ending March 31, 2007, the filing deadline is October 1, 2007. For subsequent years, the determination of whether an employer is subject to the requirement will be made based on the 12 months ending June 30, with employers becoming subject to the Section 125 requirement (including the filing requirement) on the immediately following October 1.**

§ **Who is subject to the free rider surcharge and what is it exactly? An employer is subject to the surcharge if it employs 11 or more full-time equivalent employees, fails to meet the Section 125 cafeteria plan requirement, has employees who are state-funded employees, and its state-funded employees receive state-funded health services that total at least $50,000 (the employer is then termed a "non-providing employer"). An employer who is a signatory to or obligated under a bona fide collective bargaining agreement that governs employment conditions of the state-**

"Employers . . . are required to report specific information on an Employer HIRD ("Health Insurance Responsibility Disclosure") Form."

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funded employee is not, however, considered a "non-providing employer." A non-providing employer is subject to a surcharge equal to a portion of the state's cost of providing benefits to the employer's uninsured employees at the end of each fiscal year.

- **When does the requirement become effective? July 1, 2007.**

3. **<u>Health Insurance Responsibility Disclosure</u> Employers with 11 or more full-time equivalent employees at Massachusetts locations ("reporting employers") are required to report specific information on an Employer HIRD ("Health Insurance Responsibility Disclosure") Form. In addition, each reporting employer must provide an Employee HIRD Form for completion and signature by each employee at a Massachusetts location who declines to enroll in employer-sponsored insurance or who declines to use the employer's Section 125 plan.**

   - **How does an employer know if it has 11 or more full-time equivalent employees? An employer has 11 or more full-time equivalent employees if the sum of the total payroll hours for employees at Massachusetts locations divided by 2,000 is equal to or greater than 11 (and, thus, the employer is a "reporting employer"). For employees with more than 2,000 payroll hours, the employer is to count only 2,000 hours.**

   - **What is the required information for the Employer HIRD Form? Each reporting employer is required to report: (1) its legal name; (2) its "DBA" (doing business as) name, if any; (3) its Federal Employer Identification Number; (4) its Massachusetts Division of Unemployment Assistance Account Number; (5) whether the employer adopts and/or maintains a Section 125 plan in accordance to the Connector's requirements; (6) whether the employer contributes to the premium cost of a group health plan; (7) if the employer does contribute to a group health plan, the employer contribution percentage (for each employee category, if the percentage varies); (8) if the employer contributes to a group health plan, the total monthly premium cost for the lowest priced health insurance offered for an individual plan and a family plan; (9) if the employer contributes to a group health plan, the total monthly premium cost for the highest priced health insurance offered for an individual plan and a family plan; and (10) if the employer offers an employer sponsored group health plan, the open enrollment period for each plan.**

   - **When should this form be submitted? An employer must submit its Employer HIRD form using information as of July 1 of each year. The state's Division of Health Care Finance and Policy will announce later the due date for the form.**

   - **What is the required information for the *Employee* HIRD Form? Each employee is required to submit the following information, if the employee works at a Massachusetts location and declines to enroll in employer-sponsored health care insurance or the employer's Section 125 plan; (1) the employee's name; (2) the employer's name; (3) whether the employee was informed about the employer's Section 125 plan; (4) whether the employee declined to use the Section 125 plan to pay for health insurance; (5) whether the employer offered the employee subsidized health insurance; (6) whether the employee declined to enroll in employer subsidized health insurance; (7) if the**

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employee declined employer subsidized health insurance, the dollar amount of the employee's portion of the monthly premium cost of the least expensive individual health plan offered by the employer; (8) whether the employee has alternative insurance coverage; and (9) the date the employee completed and signed the HIRD Form.

- **When should this form be submitted? An employer must obtain a signed form from each employee required to submit a form by the earlier of (a) 30 days after the close of the applicable open enrollment period for the employer's health insurance (or cafeteria plan), or (b) September 30 of the reporting year. It appears that reporting years run from July 1 through June 30, although neither the Act nor the regulations explicitly define "reporting year" with regard to the *Employee* HIRD Form. If an employee enrolled in an employer sponsored health insurance plan subsequently terminates participation in the plan, the employee must sign a HIRD Form within 30 days of that termination. An employer must also obtain a signed HIRD Form from newly hired employees (who either decline employer sponsored health insurance or decline to use the employer's Section 125 plan to pay for health insurance) within 30 days of the applicable enrollment period.**

What If an Employee is Not a Massachusetts Resident?

Regulations make it clear that the last two employer requirements (the cafeteria plan requirement and the HIRD disclosure requirement) apply to employees who work at a Massachusetts location even if they are not Massachusetts residents. Thus, a Vermont resident working for an employer at a Massachusetts location is an employee for purposes of employer compliance with these two requirements of the Act. As a result, such an employee would need to be among those offered cafeteria plan coverage (to avoid the employer being subject to the Free Rider Surcharge), and would be subject to HIRD reporting. However, a Massachusetts resident working for an employer at a Vermont location is not considered an employee for these purposes.

The first requirement (the "fair share contribution") does not explicitly mention the issue of residency. However, the Connector's Employer Handbook states that employees who are not Massachusetts residents but who work at Massachusetts locations are included in the number of full-time employees, and therefore would be subject to the Fair Share Employer Contribution requirements.

What If an Employer Has No Facility in Massachusetts?

It is unclear, but seems likely, that an employee must actually work at a physical facility maintained by the employer in Massachusetts to be considered working at a "Massachusetts location." There has, as of yet, been no indication that employees who do not have a regular worksite in Massachusetts, but who regularly make sales calls, or otherwise provide services, in the state are subject to the new rules.

Additional Requirements Under the Act That May Affect Employers:

While the Act imposes only three requirements on employers directly, several requirements imposed upon health care insurance carriers may indirectly affect the underlying plan design of insured group health plans of Massachusetts employers.

1. **Nondiscrimination The Act requires that insurance contracts or policies *delivered in Massachusetts* be offered by the employer to all its full-time**

"[The Act] also prohibits [a Massachusetts] employer [with an insured plan] from contributing a smaller premium percentage for an employee than it contributes for other employees with an equal or greater hourly or annual salary."

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employees (scheduled or expected to work at least the equivalent of an average of 35 hours a week) who live in Massachusetts. It also prohibits an employer from contributing a smaller premium percentage for an employee than it contributes for other employees with an equal or greater hourly or annual salary. These nondiscrimination requirements apply to policies issued, delivered, or renewed in Massachusetts on or after July 1, 2007.

2. **Expanded Dependent Coverage The Act requires carriers with insured health benefit plans that provide dependent coverage to make dependent coverage available until a dependent reaches age 26 or, if earlier, for two years following the individual's loss of dependent status under the Tax Code. This requirement applies to employees whose principal place of employment is within Massachusetts. The new rule is imposed on all insured health plans offered by commercial insurance companies, Blue Cross Blue Shield of Massachusetts, and health maintenance organizations.**

3. **Small Group Insurance Requirements The Act requires "small group policies" sold or offered for sale in Massachusetts to be available to every eligible small business ("any sole proprietorship, firm, corporation, partnership or association actively engaged in business with not more than 50 eligible employees, the majority of whom work in the Commonwealth"). These health benefit plans must generally be "renewable" in accordance with HIPPA requirements. No such policy may include pre-existing condition provisions that exclude coverage for a period beyond 6 months following enrollment. Waiting periods may not exceed 4 months from an eligible employee's or eligible dependent's date of enrollment. Carriers may not exclude any employees or their dependents from a small group plan on the basis of age, occupation, actual or expected health condition, claims experience, and duration of coverage or medical condition.**

Will ERISA Preempt The Act?

ERISA "supersede[s] any and all State laws insofar as they . . . relate to any employee benefit plan," subject to various exceptions and special rules. This is ERISA's "preemption" provision. As a result of this provision, no state can adopt a law that requires employers to offer an employee benefit plan, including health insurance.

As noted, the Massachusetts Act imposes three main requirements on employers with regard to employee group health insurance. At least two of these three raise preemption issues. The first is the requirement that certain employers offer a group health care plan to which the employer makes a "fair and reasonable contribution" *or* pay an annual contribution into the newly established Commonwealth Care Trust Fund. The second requirement that raises a preemption issue is the requirement that covered employers adopt and maintain a cafeteria plan in compliance with Section 125 of the Tax Code (as well as meet other Connector requirements).

It is possible ERISA will preempt the "fair share contribution" requirement of the Act on the theory that the requirement directly regulates employers' plans. Notably, a state law sufficiently "relates to an ERISA plan," so as to be preempted, if the state law "directly regulates or effectively mandates some element of the structure or administration of employers' ERISA plans."[2] As to the Section 125 plan requirement, the fairer argument is probably that the requirement is not preempted. That is because the Act requires only

[2] **Retail Industry Leaders Assoc. v. Fielder, 475 F.3d. 180, 193 (4th Cir. 2007).**

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that employers adopt and maintain a "premium only plan," which offers access to at least one medical care coverage option instead of receiving cash compensation. This required "premium only plan" is probably not an ERISA plan, and, therefore, the requirement to offer such an arrangement would not "relate to" an ERISA plan as required for ERISA preemption.

Although ERISA's preemption provision applies broadly, its application is subject to a number of exceptions. Under one of those exceptions, ERISA does not preempt any state law that regulates insurance. This is known as the "savings clause." The Massachusetts "fair share contribution" requirement is probably not saved from preemption by this exception because the requirement is likely not a state law that "regulates insurance." It is likely not a law that regulates insurance because the "fair share contribution" requirement does not distinguish between employers that provide medical coverage by purchasing insurance and those that instead self-fund coverage. Since the requirement does not apply solely to plans that use insurance, and perhaps more importantly because the requirement is not imposed directly on insurers, the savings clause probably does not save the contribution requirement from preemption.

A recent Fourth Circuit case involving a Maryland statute with many similarities to the Act may offer insight into whether the Massachusetts law is preempted. The Court of Appeals for the Fourth Circuit, in Retail Industry Leaders Assoc. v. Fielder, found that the Maryland Fair Share Health Care Fund Act was preempted by ERISA. The Fair Share Act required employers that were not organized as a nonprofit organization and that employed at least 10,000 Maryland employees to spend 8% or more of total payroll on health insurance costs. If a covered employer did not spend at least 8%, the employer was required to pay the state an "amount equal to 8% of the total wages paid to employees in the State."

Following a strict analytical framework, the court considered the scope of ERISA's preemption provision, and then considered "the nature and effect" of the Maryland Fair Share Act. The court recognized that "the primary objective of ERISA was to 'provide a uniform regulatory regime over employee benefit plans.'" The court relied on the general rule that "a state law has an impermissible 'connection with' an ERISA plan if it directly regulates or effectively mandates some element of the structure or administration of employers' ERISA plans."

The court acknowledged that while states are free to regulate healthcare providers and insurance companies, ERISA preempts state laws "that mandate[ ] employee benefit structures or their administration." The court noted that the Supreme Court has held that where a state law interferes with an employer's ability to administer an ERISA plan uniformly "on a nationwide basis," ERISA preemption applies.

Applying its analysis to the Maryland Fair Share Act, the court concluded that the Maryland Fair Share Act effectively required employers to structure their employee healthcare plans "to provide a certain level of benefits," and thus the Act was sufficiently connected to an ERISA plan for preemption purposes. This was because the Act left the covered employer (Wal-mart) with virtually no choice other than to utilize an ERISA plan or, at a very minimum, to initiate new spending efforts under existing ERISA plans.

The court rejected the argument that the Act was merely a "revenue statute of general application." It did so because, in practice, Wal-mart was the only employer subject to the new law, and "therefore [the Act] could hardly be intended to function as a revenue act of general application." The court found the "core provision" of the Act to require employers to provide medical benefits to its employees. Therefore, the Fair Share Act would "disrupt employers' uniform administration of employee benefit plans on a nationwide basis."

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Although on its face the Maryland statute presented employers with a choice between spending at least 8% of total employee wages on health insurance or paying the state, the court concluded that the alternative of paying the state was, in reality, a meaningless option. This was because the court concluded that no reasonable employer would choose to pay the state "a sum of money that it could instead spend on its employees' healthcare." An employer would potentially "suffer from lower employee morale and increased public condemnation" if it chose to pay the state. Thus, a rational employer would structure its healthcare plans in a way that would satisfy the Fair Share Act's requirements. The court rejected the argument that an employer could satisfy the 8% spending requirement without providing benefits subject to ERISA. Although an employer could maintain on-site medical clinics, the funding of such clinics could not realistically increase healthcare spending enough to comply with the Fair Share Act without the clinic benefit itself becoming a plan subject to ERISA. In addition, the court noted that even if Wal-mart were to "utilize non-ERISA health spending options" to satisfy the Act, it would still need to "coordinate those spending efforts with its existing ERISA plans."

The Massachusetts Health Care Reform Act is similar to the Maryland Fair Share Act in important ways, but also has some very important differences. Among the similarities, both the Massachusetts law and the Maryland Fair Share Act offer employers an alternative of paying an amount to the state rather than funding the employers' own health plans. The Fourth Circuit rejected this alternative under the Maryland Act as a real "choice," since no rational employer would elect to pay the state rather than enjoy the employee good will that would come from providing employees with benefits. Importantly, however, one could argue that for employers subject to the Massachusetts Act, the choice between making a "fair and reasonable contribution" and paying a maximum of $295 per employee is a meaningful choice.

Another difference between the state laws is that under the Massachusetts law, employers that comply with the "fair share contribution" requirement must maintain a "group health plan" within the meaning of Tax Code Section 5000(b)(1). For most employers, this plan will be a plan under ERISA. This is a bit different from the Maryland statute, which did not technically require employers to establish a plan subject to ERISA, although it did require that an employer spend the required amount on its employees' health insurance costs (to avoid paying the state). The requirement under the Massachusetts Act that employers not wanting to pay the state establish a plan that, for most employers, will be subject to ERISA may slightly increase the likelihood of the Act being preempted.

The most obvious difference between the Maryland Fair Share Act and the Massachusetts law is the number of employers affected. The Maryland law effectively applied only to Wal-mart. The Fourth Circuit found that this undermined the state's argument that the law was a "revenue statute of general application." The state of Massachusetts can certainly argue more persuasively that the Act is of general application. Whether this argument will be enough to save the Act from preemption, however, is unclear, particularly since a court could still find that although the Act is of general application it is not a revenue provision at all, but is instead intended to coerce employers to provide health insurance for their employees. The Fourth Circuit, in striking down the Maryland Fair Share Act, found it important that the Maryland law applied to a national employer and, therefore, would "disrupt employers' uniform administration of employee benefit plans on a nationwide basis." The Massachusetts law has the capacity to have the same effect, since multi-state employers with 11 or more full-time employees at Massachusetts locations are subject to its provisions.

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"The better approach may be for employers to comply with the Act unless and until it is found to be preempted."

Conclusion

Given the various arguments concerning preemption, it is not possible to say with confidence whether the fair share contribution requirement or, more broadly, other parts of the Act, will be found to be preempted. The better approach may be for employers to comply with the Act unless and until it is found to be preempted. That is particularly true with respect to the Section 125 plan requirement since that requirement will, for most employers, be minimally burdensome, the requirement is likely not preempted, and noncompliant employers could face heavy consequences under the Free Rider Surcharge.

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