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Benefits Alert
Legal developments affecting employee benefits

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In a decision last week, the Fourth Circuit Court of Appeals reminded states that, when it comes to regulation of employee benefits plans, ERISA reigns supreme.

Although technically binding in only Maryland, North Carolina, South Carolina, Virginia and West Virginia, the Court's decision should stifle the growing desire by states and municipalities across the nation to require employer health care spending through so-called "pay-or-play" schemes. Proposals for such plans (in which an employer must either provide some prescribed modicum of health coverage to its employees or alternatively pay a fee into a general fund) have grown exponentially over the past year, as governments seek ways to deal with the growing number of uninsured people and the high costs of medical coverage. Now, however, the Fourth Circuit has confirmed what many of us have been consistently saying: ERISA preempts these types of mandates.

By way of background, on January 12, 2006, the Maryland General Assembly enacted the Fair Share Health Care Fund Act, requiring employers with 10,000 or more Maryland employees to spend at least 8 percent of their total payrolls (6 percent for covered non-profit employers) on employees' health insurance costs. If an employer did not pay at least that amount on behalf of its own employees, it would have to pay the amount by which its spending fell short of that mandate to the State of Maryland Medicaid fund or incur stiff fines. Additionally, the Act subjected a qualifying employer to yearly filing and reporting requirements on its spending and benefits plans.

Only one for-profit employer, Wal-Mart, ultimately qualified under the Act. Wal-Mart immediately brought suit to declare the Act preempted by ERISA, and Judge Frederick Motz of the federal district court of Maryland did so.

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Last week, the Fourth Circuit affirmed the lower court's decision on appeal. After dispensing with Maryland's arguments about jurisdiction, the Fourth Circuit ruled 2-1 that the Act was preempted because it thwarted ERISA's purpose of ensuring nationwide uniformity of benefit plan administration. The Court explained that ERISA does not require businesses to adopt benefits plans for their employees, but, if a business chooses to do so, ERISA -- rather than local law -- necessarily controls its operations. In the absence of such nationwide uniformity, employers would face the daunting burden of complying with varied and conflicting laws in multiple jurisdictions.

The test for preemption, the Court continued, is dependent on whether the local law in question precludes uniformity of administration. Although the Act offered each employer the option of maintaining its current medical coverage spending levels and paying the State the difference, the Court recognized that any reasonable employer would likely change its plan and raise its benefits spending to the State-mandated level. An employer gains nothing by paying the State. Increasing benefits, even by legislative mandate, can at least boost employee morale. Therefore, the Maryland Fair Share Health Care Fund Act in effect forces a covered employer to change its employee benefits plan to meet required spending levels. Moreover, even if an employer's plans already comply, the Act's reporting provisions still require the employer to set up mechanisms in the State of Maryland that are not required in other states where the employer operates.

Proponents of similar plans will likely seek to limit this ruling to its facts and the unique provisions of the Act. But the decision with its particularly broad test for ERISA preemption should give pause to those states (including, most recently, California) and municipalities that have been exploring various ways to mandate that employers provide health care benefits to their employees. Indeed, these various state and local efforts amplify the Fourth Circuit's primary concern about uniformity. As the Court stated, "This is precisely the regulatory balkanization Congress sought to avoid by enacting ERISA's preemption provision."

Prudent state and local governments should abandon the "pay-or-play" approach as a means of addressing the escalating costs of medical coverage for, when it comes to the administration of employer-group health plans, ERISA continues to govern. Alternatively, it is possible that the Fourth Circuit's decision may lead to a legislative battle over efforts to modify ERISA itself.

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