Benefits Alert
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SF's Mandatory Health Care Ordinance: Important Developments

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In 2006, the City of San Francisco enacted the San Francisco Health Care Security Ordinance which, among other things, mandates that covered employers make minimum health care expenditures on behalf of their employees. The ordinance was scheduled to take effect this year with the first payments due for some employers following the end of the first calendar quarter. The Golden Gate Restaurant Association (GGRA), the well-respected Bay Area restaurant industry trade association, challenged the ordinance in federal court on the basis that the employer mandates are preempted by ERISA.

The Latest Developments

In November 2007, the District Court for the Northern District of California granted the GGRA's motion for summary judgment in a major victory for employers. This decision was entirely consistent with a January 2007 decision from the 4th Circuit in a similar case in Maryland (See the NP Benefits Alert, dated January 22, 2007, on our website for a discussion of that case). If the Northern District's decision is upheld on appeal, the requirements imposed on employers under the ordinance will not be enforceable.

To nobody's surprise, the City did not simply accept the District Court's well-reasoned decision. Instead, the City sought a stay of that decision so that it could move forward and enforce the ordinance while pursuing an appeal. This request was denied by the District Court. The City, however, also sought an emergency stay for the same purpose from the 9th Circuit.

On January 9th, the 9th Circuit, which is not known for being employer-friendly, stayed the District Court's ruling. Given the reputation of the 9th Circuit, employers in San Francisco were not surprised, but were still disappointed by this decision which now creates much uncertainty and confusion about the status of the ordinance. By its actions, the 9th Circuit is allowing the ordinance to take effect, *de facto*, despite the District Court ruling that the employer mandates are preempted by ERISA and are unenforceable. Thus San Francisco employers must now scramble to comply, at least until the Court of Appeals rules on the merits of the case this spring. Whether payments that will be

made by employers in the interim can then ever be recovered assuming the District Court decision is upheld is an open question and may well depend on the specific method chosen by each particular employer to comply with the ordinance.

History and ERISA Preemption of Employer Health Care Mandates

This is not the first time that employers in San Francisco have been faced with the prospect of mandated health care coverage. In November, 2004, the California electorate rejected a similar statewide initiative, "The California Health Insurance Act." That public referendum, known as Proposition 72, may well have saved the state significant legal fees and costs as well as the embarrassment of being chastised by the federal courts for adopting a measure that violated federal law.

Over 30 years ago, the United States Congress enacted the Employee Retirement Income Security Act (ERISA), which prescribes the compliance rules and reporting requirements with which most employee benefits programs, including group health plans, must comply. At the same time, Congress didn't want employers (especially those operating in many locations) to be responsible for complying with a patchwork of state and local laws that simultaneously sought to regulate benefits. As a result, ERISA contains a very strong preemption provision.

ERISA expressly preempts (that is, blocks from enforcement) all state and local laws that "relate" to covered employee benefits programs. An exception to this broad provision exists for laws regulating insurance, a role that has traditionally been reserved to the states. The question of ERISA preemption should be a relatively simple matter, but the scope of ERISA preemption has been the subject of much debate in the courts since the law's enactment in 1974. Early on, the judiciary tended to view the preemption clause as nearly infinite in scope as most any state law that impacted a benefit plan was held to violate the law. In the mid-1990s, however, several decisions, upheld state laws calling for assessments that indirectly affected ERISA-governed plans under certain circumstances.

So where does all this leave the San Francisco ordinance? Despite the stay issued by the 9th Circuit, the reasoning of the District Court appears sound and we believe the employer mandates in the ordinance should be found to be preempted by ERISA. For reasons not unlike those expressed by the 4th Circuit in the case mentioned earlier, we believe the San Francisco ordinance is preempted because it mandates health care expenditures that must necessarily be made to, and under, ERISA-governed plans. Moreover, it imposes reporting and recordkeeping requirements upon group health plan sponsors above and beyond the exclusive requirements of ERISA. To allow such a law to proceed would necessarily thwart the principle of uniformity that underlies the ERISA preemption clause. As just one example, imagine the nightmare a large national employer would face in administering its employee benefits programs were it required to comply with numerous overlapping and conflicting, perhaps even completely irreconcilable, state and local laws.

What's Next?

It remains to be seen how the 9th Circuit will rule on the merits of this case in the coming months. However, if the decision is unfavorable to businesses, the split between the 4th and 9th Circuit would seem destined to put this case before the U.S. Supreme Court. A decision favorable to employers before the 9th Circuit may cause the City to modify the ordinance to eliminate employer mandates,

but the City may also seek Supreme Court review. A change in administration in Washington after the November elections may also result in efforts to modify ERISA, which could change the playing field in different ways. In the meantime, unfortunately, while this battle rages on, employers who have employees in San Francisco must determine if they are covered by the ordinance and if so, determine how they will comply and then begin compliance even knowing the decision declaring the employer mandates unenforceable may well be upheld by either the 9th Circuit or the Supreme Court.

As the ordinance is now in effect, each employer should do the following:

- Determine the extent to which it is covered by the ordinance. The ordinance requires all large- and medium-sized employers (whether located in San Francisco or elsewhere) to make a quarterly health care expenditure on behalf of each of its employees who works in San Francisco, has been employed for at least 90 days and works at least 10 hours each week. For these purposes, a large-sized employer is one with 100 or more employees; a medium-sized employer is one with between 20 and 99 employees. Certain employees are exempt from this requirement, among them those who waive the expenditure because they receive health coverage elsewhere, and certain management and supervisory employees.

- Select a method of compliance. There are essentially five ways to satisfy the health care expenditure requirement of the ordinance: (1) make a contribution on behalf of the employee to a health savings account; (2) reimburse an employee directly for his or her out-of-pocket expenses; (3) purchase health care coverage for an employee through a third party; (4) directly provide health coverage to an employee by means of a self-insured program; or (5) make a payment to the City of San Francisco, which will then, in turn, use the payments to fund a program for all uninsured City residents.

- Determine the timing for compliance. Employers with 50 or more employees are required to begin making health care expenditures for the first calendar quarter of 2008; employers with fewer than 50 employees need not comply until the second calendar quarter. Expenditures must be made within 30 days after the end of a calendar quarter. Hence, expenditures for the first quarter of 2008 for an employer with 50 or more employees must be made on or before April 30th.

- Determine the cost of compliance. The amount of the requisite health care expenditure for large-sized employers is $1.76 per hour paid to each employee during the calendar quarter. For medium-sized employers, the expenditure is $1.17 per hour paid. Note that the term "hour paid" includes both hours for which an employee received compensation as well as hours for which the employee was entitled to pay, even though he or she was not actually working (e.g., on vacation). The applicable rate should be multiplied by the number of hours paid to each employee for the quarter, and that amount compared to actual dollars expended for health care on behalf of the same employees. If the amount actually expended is greater than the required expenditures, the employer need do nothing further. If the amount expended is less than the required expenditures, an additional expenditure must be made under one of the methods described above.

- Develop suitable recordkeeping procedures. The ordinance requires employers to maintain records demonstrating that they have complied with the health care expenditure requirements. No particular format for such records is mandated at this time, so employers will need to develop their own. In addition, employers will need to comply with annual reporting requirements and access requirements.

- Develop policies and employee communications. The ordinance likely adds a layer of complexity to existing employer group health programs. As such, it is imperative that policies and employee communications be prepared that clearly explain who is and who is not covered by the ordinance and what implications, if any, the ordinance has for the existing programs.

For more information on this issue or any other benefits law matter, please contact your regular Nixon Peabody attorney or:

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