

# Insurance Markets

## ERISA Implications for Employer Pay or Play Coverage Laws

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MOST INSURED CALIFORNIANS RECEIVE health coverage through the workplace, but 22 percent of the state's workers are uninsured,<sup>1</sup> primarily because one-third of California firms do not offer health insurance.<sup>2</sup> In 2003 the California legislature enacted SB 2, which required large and medium-sized employers to pay a fee<sup>3</sup> to fund a public health coverage program or to cover their workers with specified health benefits. This law was, however, repealed by the voters in November 2004. To inform public discussion of future "pay or play" proposals, this issue brief discusses potential problems for these laws posed by ERISA, a federal employee benefits law that preempts certain types of state laws affecting employer-sponsored health benefits.

### Employer "Pay or Play" Laws

A pay or play law requires public and private sector employers to fund a state-administered health coverage program,<sup>4</sup> but credits against employer assessments the cost of coverage provided to employees and dependents. The purpose of the credit is to acknowledge that, by covering its workers, an employer relieves the state of the responsibility to provide health benefits to these individuals. It allows employers to choose to either pay the assessment or "play" by offering coverage. Massachusetts enacted such

a law in 1988, but it was repealed before implementation.<sup>5</sup> SB 2 used a similar model.

### ERISA

ERISA, the federal Employee Retirement Income Security Act of 1974,<sup>6</sup> may raise problems for state pay or play laws. ERISA was enacted primarily to address fraud and mismanagement of private-sector employer pension plans. Yet the law also applies to other employee benefit plans, including health coverage offered through insurance or other means (such as employer self-insured plans). In contrast to its detailed pension plan standards, ERISA prescribes few federal requirements for employee health plans. It does, however, contain a broad "preemption clause," providing that ERISA supercedes all state laws that, in the words of the statute, "relate to" employee benefit plans sponsored by private-sector employers or unions, even if there is no direct conflict between state and federal law.<sup>7</sup> Congress's purpose in enacting the preemption clause was to minimize the administrative and financial burdens of conflicting state laws facing interstate employers that wished to develop uniform national plans. An important exception to preemption is that states retain the authority to regulate insurance.<sup>8</sup> Yet ERISA prohibits a state from considering a self-insured employer plan to

be an insurer. Read together, these preemption provisions create the distinction between self-insured health coverage plans (that states cannot regulate) and insured plans (that states can affect by regulating insurance products they buy).

### Self-Insurance

Employers can finance employee health coverage by either buying group insurance from HMOs, Blue Cross and Blue Shield plans, or other insurance carriers or self-insuring by paying for employee health care out of the employer's own assets.

## How the Courts Have Interpreted ERISA's Preemption Clause

Because the preemption clause is not particularly clear on its face, courts have been interpreting its implications for state laws for almost 30 years. The U.S. Supreme Court, ultimate arbiter of federal law, has decided more than two dozen preemption cases. During ERISA's first 20 years the Court construed the law broadly to preempt state laws that refer to private-sector, employer-sponsored plans or have any impact on these plans' benefits, structure, or administration. For instance, it affirmed a federal Court of Appeals decision holding that ERISA preempted Hawaii's 1974 employer health insurance mandate, which required all employers to offer certain health coverage to full-time workers.<sup>9</sup> This law was later authorized by Congress as an exception to ERISA preemption.

In *Travelers Insurance*, a 1995 case involving New York's hospital rate-setting law, however, the Supreme Court narrowed the meaning of ERISA preemption.<sup>10</sup> The New York law required commercial insurers to pay a surcharge on hospital bills, but exempted BlueCross/

BlueShield plans from paying this extra cost because of their higher risk case load as the state's insurer of last resort. The Supreme Court held that, despite an economic impact on employer health plans buying commercial insurance coverage, ERISA did not preempt the state law because it was not an explicit mandate on employer health plans. Even though the state law provided an incentive for private-sector employer plans to buy coverage from BlueCross/BlueShield, the law did not compel plan administrators to structure benefits in a particular way or limit a plan's ability to design uniform benefits or administrative practices. The Court noted that nothing in ERISA indicates congressional intent to interfere with traditional types of state authority such as hospital rate-setting. The case did not involve a self-insured employer, but later Supreme Court cases upheld state regulations with a similar indirect impact on self-insured ERISA plans.<sup>11</sup> Although *Travelers* limited the scope of ERISA preemption, the Court has not expressly overruled any of its earlier ERISA preemption cases.

The Supreme Court's preemption cases address many types of state laws with varying impacts on ERISA plans. Under principles set out in these cases, state laws are subject to preemption if they refer<sup>12</sup> directly to private sector, employer-sponsored plans or affect plan benefits,<sup>13</sup> administration,<sup>14</sup> or structure.<sup>15</sup> ERISA does not, however, preempt state laws imposing costs (such as the New York rate-setting law) that merely create incentives for ERISA plans to be structured or administered in a particular way.<sup>16</sup> Nor does ERISA preempt laws of general applicability that do not single out ERISA plans for different treatment, even if they raise plan costs to some extent.<sup>17</sup>

## Potential ERISA Preemption Issues in State Pay or Play Laws

No court has decided an ERISA case challenging a state pay or play or similar law. (A lawsuit filed against the Massachusetts law was dropped before going to trial because the law was never implemented.) Based on principles from the Supreme Court's preemption decisions, however, state pay or play laws are vulnerable to an ERISA preemption challenge if they interfere with the administration of private sector, employer-sponsored plans or impose substantial burdens on them.

The potential that ERISA will preempt a state law involving employer coverage can be viewed as a spectrum — an explicit mandate that employers insure their workers (like the Hawaii law) certainly would be preempted. A state program of universal coverage financed by an individual income tax would seem least subject to preemption, even though such a program would eliminate the need for most employer health plans.<sup>18</sup> Whether ERISA preempts state access initiatives for workplace coverage that fall between these models is uncertain.

A court is not likely to hold that ERISA preempts a state health program that assesses employers and covers employees.<sup>19</sup> It is the design of the credit against the assessment that is more vulnerable to an ERISA preemption challenge. Under the rationale of the *Travelers Insurance* case, a pay or play law that offers a credit for the employer's cost of worker and dependent coverage (up to the limit of the assessment) without conditioning the credit on certain features of the coverage plan seems likely to withstand an ERISA challenge. The credit allows an employer to choose between paying the assessment and covering its

workers and therefore does not interfere with multi-state firms' plan benefits design or administration. Some analysts have expressed concern that if the law does not require certain minimum benefits to qualify for the credit, employers may offer inadequate coverage. The concern could be addressed by requiring the employer to pay the difference between the assessment and the actual coverage cost, minimizing the financial advantage of offering limited benefits. The public pool could use these funds to supplement inadequate worker benefits.

SB 2 raised several preemption issues because it conditioned the credit on employer coverage meeting certain benefits and premium sharing standards. Had the law survived the November 2004 referendum, it probably would have been challenged in court. Opponents might have argued that ERISA preempted the credit against the employer fee, both because SB 2 referred to ERISA plans and because conditioning the credit on covering certain health benefits and requiring employers to pay 80 percent of the premium had a significant impact on plan structure and benefits.<sup>20</sup>

A state pay or play law would be most likely to overcome an ERISA preemption challenge if it:

- Does not refer directly to or tax ERISA plans but rather imposes an assessment on employers (preferably both public and private-sector employers) because the Supreme Court has held that ERISA preempts state laws that refer to ERISA plans;
- Is neutral regarding whether an employer offers coverage or pays the assessment (to avoid being characterized as a thinly disguised mandate) because ERISA would preempt a mandate that

employers provide health coverage to their workers; and

- Does not condition the credit on employer coverage meeting benefits, enrollee cost sharing, premium sharing, or other plan design features because ERISA would preempt a state law that affects an ERISA plan's benefits, structure, or administration.

Since no court has yet decided an ERISA case involving a state pay or play law, such a law may face a legal test. It seems likely, however, that a carefully drafted law can withstand such a challenge.

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#### ENDNOTES

1. *California's Uninsured 2004*, California Healthcare Foundation, [www.chcf.org/documents/insurance/uninsuredsnapshot2004.pdf](http://www.chcf.org/documents/insurance/uninsuredsnapshot2004.pdf).
2. California Healthcare Foundation and Health Research and Educational Trust, *California Employer Health Benefit Survey 2004*, [www.chcf.org/documents/insurance/HRETEmployerBenefits2004.pdf](http://www.chcf.org/documents/insurance/HRETEmployerBenefits2004.pdf).
3. The assessment was characterized as a “fee” rather than a “tax” in an effort to avoid a challenge under California Constitution Article 13A, section 13; see Butler, Patricia. *California Constitutional Barriers to Implementation of SB 2*, available at [www.chcf.org/topics/SB2/index.cfm?itemID=21739](http://www.chcf.org/topics/SB2/index.cfm?itemID=21739).
4. A state law taxing employers that do not insure their workers, as was proposed in Tennessee in 2000, would not qualify as a “pay or play” program under this definition.
5. Oliver, Thomas. March 2004. *State Employer Health Insurance Mandates: A Brief History*. California Healthcare Foundation, [www.chcf.org/documents/EmployerInsuranceMandates.pdf](http://www.chcf.org/documents/EmployerInsuranceMandates.pdf).
6. 29 U.S.C. 1001 et seq.
7. 29 U.S.C. 1144(a).
8. The Court has upheld several state health insurance laws based on ERISA's preemption exception that allows states to retain the authority to regulate insurance. For example, states can require health insurance to cover certain benefits (*Metropolitan Life Insurance Co. v. Massachusetts*, 471 U.S. 724 (1985)). In a recent insurance case, the Court established two tests for state laws to qualify as insurance regulation and avoid preemption: the law must specifically regulate the insurance industry and also substantially affect risk-spreading between the insurer and insured persons (*Kentucky Association of Health Plans v. Miller*, 123 S. Ct. 1471 (2003)).

9. *Standard Oil Co. of California v. Agsalud*, 442 F. Supp. 695 (N.D. Cal. 1977), *affirmed*, 633 F. 2d 769 (9th Cir. 1980), *affirmed by memorandum*, 454 U.S. 801 (1981).
10. *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Insurance*, 514 U.S. 645 (1995).
11. *DeBuono v. NYSA-ILA Medical and Clinical Services*, 520 U.S. 138 (1997).
12. *Mackey v. Lanier Collection Agency*, 486 U.S. 834 (1988) and *District of Columbia v. Greater Washington Board of Trade*, 506 U.S. 125 (1992).
13. *Metropolitan Life Insurance Co. v. Massachusetts*, 471 U.S. 724 (1985), and *District of Columbia v. Greater Washington Board of Trade*, 506 U.S. 125 (1992).
14. *Alessi v. Raybestos-Manhattan*, 451 U.S. 504 (1981), *Mackey v. Lanier Collection Agency*, 486 U.S. 825, *Ingersoll-Rand v. McClendon*, 498 U.S. 133 (1990), *FMC v. Holliday*, 498 U.S. 52 (1990), and *District of Columbia v. Greater Washington Board of Trade*, 506 U.S. 125 (1992).
15. *Shaw v. Delta Air Lines*, 463 U.S. 85 (1983) and *FMC v. Holliday*, 498 U.S. 52 (1990).
16. *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Insurance*, 514 U.S. 645 (1995) and *California Division of Labor Standards v. Dillingham Construction*, 519 U.S. at 316 (1997).
17. *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Insurance*, 514 U.S. 645 (1995) and *DeBuono v. NYSA-ILA Medical and Clinical Services*, 520 U.S. 138 (1997).
18. The law would be vulnerable because it would make costly and/or complicated the desire of an interstate employer to maintain a uniform national plan, and the opportunity for national uniformity was one congressional objective in enacting ERISA's preemption clause. A state would defend such a law on the ground that it: 1) does not refer to employer plans and 2) although it would obviate the need for most employer coverage, Congress could not have

intended to prohibit a state from implementing a purely publicly financed universal coverage program.

19. See endnote 18. The state could argue that health coverage is an area of traditional state concern, citing health programs that predate Medicaid.
20. For a detailed discussion of these issues, see Patricia Butler, *ERISA Implications for SB 2: Full Report, March 2004*, California HealthCare Foundation, [www.chcf.org/topics/sb2/index.cfm.itemID=21470](http://www.chcf.org/topics/sb2/index.cfm.itemID=21470).

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