CLIENT ALERT

Ninth Circuit Holds that San Francisco Health Care Security Ordinance is Not Preempted by ERISA

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Despite the interest in health care reform expressed by both Presidential candidates in the recent election, federal health care reform is still a long way off. States and local governments have, therefore, begun acting to fill this void. The City of San Francisco entered this arena in July 2006, by adopting its Health Care Security Ordinance (the "Ordinance"). The Ordinance has two major components: First, it establishes a city-administered health care program that prioritizes services for low and moderate income persons within the city limits (persons who live outside of the city may be entitled to establish a medical reimbursement account with the city). Second, it requires all covered employers (those with at least 20 employees or non-profit corporations with at least fifty employees) to make a level of health care expenditures of between $1.17 and $1.76 per hour (depending on several factors) for each covered employee (generally speaking, those individuals who work in the city and who work at least ten hours per week). These health care expenditures can, at the employer's discretion, be made in a number of different ways, including by contributions to health savings accounts, direct reimbursement to employees for health care services, payments to third parties that provide health care services, or via costs incurred for the direct delivery of health care services. If an employer chooses not to make required health care expenditures on behalf of employees in some other way, it can fulfill its spending requirement by making payments directly to the city (the "city-payment option"), with the result being that its covered employees who satisfy certain requirements may either enroll in the city-administered health care program or may be eligible for medical reimbursement accounts with the city.

The Ordinance was challenged in court by the Golden Gate Restaurant Association ("Association"), which argued that the federal Employee Retirement Income Security Act of 1974 ("ERISA") preempts the employer spending requirements of the Ordinance. In December 2007, the U.S. District Court for the Northern District of California agreed with the Association and enjoined the implementation of the employer spending requirements. In January 2008, pending a substantive ruling on the merits of the preemption question, the U.S. Court of Appeals for the Ninth Circuit stayed implementation of the District Court's order, thereby allowing the Ordinance, including the employer spending requirements, to go into effect. In February 2008, Justice Kennedy of the U.S. Supreme Court refused to reverse the Ninth Circuit's stay upon a motion by the Association.

On September 30, 2008, the Ninth Circuit ruled that the Ordinance was not preempted by ERISA. In making its decision, the Ninth Circuit made two primary observations: First, the Court found that the Ordinance does not require employers to establish their own ERISA plans or to make any changes to any existing ERISA plans, in large part because the city-payment option is an alternative available to employers that do not wish to establish or alter ERISA plans. Second, the Court found that the Ordinance is not concerned with the nature of the health care benefits an employer provides its employees, but rather is concerned only with the dollar amount of the payments an employer makes toward the provision of such benefits. Noting that ERISA will preempt a law only where such law refers to or otherwise relates to an employee benefit plan, the Ninth Circuit held that the Ordinance is not preempted by ERISA because (a) the city-payment option does not create an ERISA plan, de facto or otherwise, and (b) the city-payment option does not otherwise "relate to" an employer's ERISA plan because the Ordinance does not regulate benefits or charges for benefits provided by ERISA plans and because the Ordinance can be fully effective even in the total absence of any employer-sponsored ERISA plans within the city.
After holding that ERISA does not preempt the Ordinance, the Court went out of its way to explain its view that this holding is not inconsistent with the holding of the Fourth Circuit in Retail Industry Leaders Association v. Fielder (4th Cir. 2007). Fielder involved a challenge to a Maryland law that required employers with 10,000 or more Maryland employees to spend at least 8% of their total payrolls on employees’ health insurance costs or pay the amount their spending falls short to the State of Maryland. Any amount sent to the State of Maryland would be in the form of a penalty and would not provide any direct benefits to the employer. The only employer in Maryland affected by this law's minimum spending requirement was Wal-Mart, and the Fourth Circuit found that the only rational choice Wal-Mart would have under the Maryland law was to structure their ERISA healthcare benefits so as to meet the minimum spending threshold. As a result, the Fourth Circuit found the Maryland law to be preempted by ERISA. The Ninth Circuit found that, in contrast to the Maryland law in Fielder, the Ordinance provides tangible benefits to employees when their employers choose to pay the city rather than to establish or alter ERISA plans and does not effectively mandate that employers structure their employee healthcare plans to provide a certain level of benefits, as the Maryland law in Fielder did. Therefore, the Ninth Circuit concluded that the Ordinance does not compel employers to establish or to alter ERISA plans.

On October 21, 2008, the Golden Gate Restaurant Association asked the Ninth Circuit for a full-court review of this decision, arguing, among other things, that the Court had interpreted ERISA preemption far too narrowly in this case. A decision on whether full-court review will be granted is expected by the end of 2008, and the distinction between this decision and the Fourth Circuit’s decision in Fielder will likely be the focus of any future proceeding. In the meantime, employers with employees in San Francisco must continue to comply with the Ordinance. Furthermore, if the Ordinance ultimately survives any further court challenges (including any challenge before the U.S. Supreme Court), it could well serve as a model for similar programs by states and other municipalities, which in turn could result in a wide variety of legislation at various levels of state and local government addressing this issue. Indeed, the Ordinance itself appears to be based, at least in part, on recommendations from state coalitions in recent years that have examined how best to design "pay or play" health care reform bills in view of the risk of ERISA preemption. In view of the recent Presidential election, and the similarity of many health reform proposals advanced by the Democrats to the "pay or play" statute adopted in other states, the fate of the San Francisco ordinance may be an important key in the on-going health reform debate.

If you have any further questions about this case or about ERISA issues in general, please contact those listed below.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.