



IDEAS THAT WORK: Expanding Health Coverage for Workers

Guarding against Legal and Ballot Challenges

Employer expansion laws are potentially subject to at least three types of challenge: 1) a legal challenge based on the federal Employee Retirement Income Security Act of 1974 (ERISA), 2) a legal challenge based on the requirement that the state legislature pass a new tax with a supermajority vote, and 3) a ballot referendum. As you design an employer expansion plan for your state, keep these potential roadblocks in mind.



How to Guard against an ERISA Challenge

Congress enacted ERISA in 1974 primarily to address the mismanagement of employer pension plans, but it also applies to employee benefits such as health insurance. Under ERISA, states are prohibited from directly requiring employers to provide health insurance coverage for their workers. Because of this prohibition, Hawaii obtained a special congressional exemption from ERISA in 1983 that allowed Prepaid to stand. Unfortunately, a state today would be unlikely to get Congress to pass a similar exemption.⁶

One of ERISA's purposes was to provide comprehensive federal standards that would safeguard employee *pension* programs. In order to minimize state-to-state variation in pension standards, ERISA contains a broad preemption clause that stipulates that ERISA supercedes state laws that "relate to" employee benefit plans sponsored by private-sector employers or unions, including health insurance plans.⁷

However, because of an exception in ERISA called the "savings clause," states may regulate "the business of insurance."⁸ It is through this exception that states can mandate benefits for plans in which employers *fully insure* the plans (i.e., purchase insurance from an insurance company or other underwriter that assumes financial risk for medical expenses). However, there is an important limit to the savings clause called the "deemer clause." The deemer clause specifically prohibits states from regulating plans in which employers *self-insure* (i.e., plans in which employers bear the financial risk of insuring their workers, paying medical claims from the employer's own resources).⁹

In addition, there is some room for states to create employer expansion plans by working around the constraints of ERISA (see bullets below). To help states steer clear of potential conflicts, ERISA expert Patricia Butler has developed a checklist of features that can help states

design employer expansion plans that potentially could withstand ERISA challenges.¹⁰ *Remember, because ERISA is a complex area of law, it is important to consult an expert when planning an expansion and drafting this type of legislation.*

- **Do not require employers to offer health coverage to their workers.** A direct mandate that employers must provide coverage mirrors Hawaii's Prepaid and is likely to be invalidated because of the legal precedent in the Hawaii case.¹¹
- **Establish a universal coverage program that is funded in part with employer taxes.** Any expansion plan should be funded at least in part by fees or taxes levied on employers. The law and its sponsors should avoid having the explicit goal of assuring that employers offer insurance coverage to their workers (note the potential conflict with supermajority legal issues in some states as discussed below).
- **Do not refer to ERISA plans.** State laws should be imposed on *employers*, not on employer-sponsored plans. State laws can easily be invalidated if they refer specifically to private-sector, employer-sponsored health plans.
- **Remain neutral regarding whether employers should offer health coverage or pay a fee to the state for such coverage.** The justification for a tax credit might be to permit employers to cover workers, but the law and its sponsors should not express a preference for either option (i.e., providing coverage directly or paying the fee).
- **Beware of imposing conditions on employer coverage that employers must meet to qualify for a tax credit.** You will probably have valid concerns about the workers' share of premium costs, adequacy of benefits, cost-sharing, and deductibles, but these are some of the trickiest elements to address. A court may rule that by providing incentives for employers to meet these requirements, SB 2 affects ERISA plan benefits and structure, thereby raising preemption problems.¹² Ultimately, SB 2's "credit against the fee" design may withstand a challenge, but it is untested at this point. An alternative design—one in which employers pay a payroll tax to the state and receive a credit for the actual costs of any employer-sponsored plan they choose to offer—may be a safer bet. (On the down side, this choice could lead an employer to create a program that required unaffordable out-of-pocket costs for low-wage workers, lacked coverage for critical services, and/or included a complicated wraparound benefit.)
- **Minimize administrative effects on ERISA plans.** Again, states cannot directly tax or charge a fee to ERISA plans; the fee must be imposed on the *employer*.

ERISA: Examples from Hawaii and California

Hawaii: After federal courts ruled that ERISA preempted Hawaii's Prepaid Health Care Act of 1974, Hawaii obtained a special exemption from ERISA in 1983 that allowed Prepaid to stand.¹ This means that Prepaid is essentially frozen in time.² The federal exemption prohibits Hawaii from making any substantive changes to Prepaid or ERISA's preemptive clause will take effect and render Prepaid null and void. It is unlikely that another state would be able to get a similar exemption from Congress today.

California: California's SB 2 could potentially face an ERISA legal challenge as well. However, because SB 2 has yet to be addressed by the courts, the courts would be breaking new ground in analyzing the law, and the outcome of such a challenge is unclear.³ Challengers might focus on several provisions of SB 2. First, they might focus on the fact that the plan is funded by imposing a fee on businesses (while providing a credit for those businesses that provide adequate coverage). However, this is not expected to pose a problem with ERISA because employers can choose between covering workers and paying the fee. Second, opponents might challenge the credit itself because it is conditioned on employer-sponsored plans paying at least 80 percent of the premium and providing a certain benefits package. Even though employers claim this credit voluntarily, it could be argued that the credit "substantially affects the benefits and structure of an ERISA plan." For this reason, if this type of credit arrangement is invalidated, there is also a fallback credit arrangement in SB 2 that allows employers to claim a credit for the cost of benefits they cover that can be deducted from state business income. These benefits must cost at least as much as the lowest level of coverage under Healthy Families or 150 percent of the cost of Medi-Cal coverage.⁴

Although an ERISA challenge is a real threat, a well-established law firm retained by the U.S. Chamber of Commerce in Washington, D.C., concluded that "on balance ... SB 2 is likely to withstand an ERISA preemption challenge."⁵



How to Guard against Supermajority Challenges

There are 11 states that have "supermajority requirements"—laws requiring a two-thirds, three-fourths, or three-fifths majority vote in both chambers of their legislatures before any tax increase or new tax can be passed.¹⁸ Because the way an employer expansion plan is funded may be considered a tax increase,¹⁹ this can be a significant obstacle to passage and can also create the potential for a legal challenge once the law is passed.

States without such a requirement are off the hook when it comes to this particular kind of challenge. However, even if your state does have a supermajority requirement, it may be possible to pass an expansion without a supermajority vote as long as your state law differentiates between a tax and a regulatory fee.²⁰ This is an issue that will vary from state to state, but generally there is a fine line between what is considered a "tax"

and a "fee"—a distinction that has been hotly contested in the courts.

"Fees" vs. "Taxes"

Fees have been defined both as an amount "charged identifiable individuals or entities for a service or good" and as "prices imposed to recover the cost to the federal government of providing special benefits to an identifiable recipient beyond those that accrue to the general public."²¹

In general, taxes are imposed for revenue purposes rather than in return for specific benefits or privileges conferred on taxed individuals,²² and they are compulsory rather than imposed in response to a voluntary decision to seek government services.²³ Some states may consider the purpose of the underlying funding mechanism in determining whether the employer expansion should be considered a tax or a fee.

Supermajority Challenges: California and Hawaii

California: The state's Constitution requires a two-thirds majority vote of both houses in order to enact a tax increase. If opponents of SB 2 raise a supermajority legal challenge, they are likely to argue that the fee imposed on employers to fund the health insurance expansion is actually a tax that requires a two-thirds majority vote of both houses. It was this supermajority requirement that prevented the proponents of SB 2 from proposing a simple payroll tax.

How a challenge against SB 2 would fare in the courts is uncertain because the California Supreme Court has never interpreted a law similar to SB 2. The most similar case is a 1997 decision of the Supreme Court of California, *Sinclair Paint v. State Board of Equalization*,¹³ in which the court ruled that assessments on paint manufacturers and other businesses that contributed to lead contamination were regulatory fees, not taxes. According to an expert, the court's evaluation of whether SB 2 is a tax or a fee will likely center around whether the funds primarily benefit the payer (whether the payer is considered the employer or the employee will have to be determined by the court) and do not produce revenue greater than that needed to support the program it funds.¹⁴

It could be argued that SB 2 benefits employers as payers for a few reasons: 1) Access to health coverage results in healthier and more productive employees. 2) The buying power of the state-wide purchasing pool might lower the cost of health coverage for workers. 3) Some spouses and dependents covered by employers' dependent coverage work for firms that do not offer coverage and that will therefore be covered by the new law, so some employers will actually have to provide less coverage. 4) Access to coverage across all medium- and large-sized employers benefits those companies that have borne the financial burden of providing health coverage and experienced the competitive disadvantage caused by paying for such costs. However, the court may view this evidence as ambiguous.¹⁵

Supporters of SB 2 may also try to argue that the workers are the real payers because their wages are reduced by the value of the fringe benefits. According to this type of reasoning, it is workers who actually bear the cost of the fee but who also directly benefit from access to health insurance. However, the court might decide that under this assertion, the fee should have been characterized as an employee fee imposed directly on employees.¹⁶

A respected law firm retained by the U.S. Chamber of Commerce notes that "the weight of case law authority is in favor of a finding that SB 2 imposes a 'regulatory fee' and not a 'tax'...."¹⁷

Hawaii: Hawaii does not have a supermajority requirement.



Consider Whether You Have the Potential for a Referendum on the Ballot

A popular referendum²⁴—a measure that appears on the ballot as a result of a voter petition drive (which gives voters the opportunity to approve or repeal an act of the legislature)—is allowed in 24 states. These states are as follows: Alaska, Arizona, Arkansas, California, Colorado, Idaho, Kentucky, Maine, Maryland, Massachusetts, Michigan, Missouri, Montana, Nebraska, Nevada, New Mexico, North Dakota, Ohio, Oklahoma, Oregon, South Dakota, Utah, Washington, and Wyoming. State laws typically require a petition drive to take place within 90 days of the law's passage. After signatures are gathered and verified, the law appears on the ballot for a popular vote. The law does not take effect until after the popular vote, and only then if voters approve the law.²⁵ If you are faced with a ballot referendum, you will want to consider how voters might react to a vote to repeal your employer expansion law.

California: SB 2 faces a referendum in November 2004 (Proposition 72) as a result of a petition drive by "Californians Against Government Run Healthcare," an organization comprised of many large employers that are funding the opposition to SB 2.²⁶

Hawaii: Hawaii does not give voters the option of repealing an act of the legislature through a referendum on the ballot.

Endnotes

¹ 29 U.S.C. 1144 §514(b)(5)(A).

² The Attorney General's opinion states that, although substantive amendments are subject to preemption, passing such an amendment would not necessarily jeopardize the original pre-amendment Prepaid provisions. In order to substantively amend Prepaid, therefore, another specific ERISA amendment would be required. See Gwen N. Ouye-Nakama, *Historical Brief DRAFT, Prepaid Health Care Act* (Honolulu: The Hawaii Uninsured Project, 2003).

³ For a more detailed legal analysis of ERISA and SB 2, see Patricia Butler, *Insurance Markets: ERISA Implications for SB 2* (Oakland: California HealthCare Foundation, November 2003), pp. 3-4. Both the complete report and a synopsis are available online at www.chcf.org.

⁴ Act of October 5, 2003, Ch. 673, §6254(bb)(f)(b) (SB 2: Health Care Coverage). This fallback is less vulnerable to an ERISA challenge, but not immune to one.

⁵ Memo to the U.S. Chamber of Commerce from Morgan, Lewis and Bockius, LLP, October 21, 2003, cited May 17, 2004, available online at www.uschamber.com.

⁶ Congress has expressly refused to grant similar exceptions to other states, including Oregon and Washington, that have attempted to enact employer mandates.

⁷ Patricia Butler, *ERISA and State Health Care Access Initiatives: Opportunities and Obstacles* (New York: The Commonwealth Fund, October 2000).

⁸ 29 U.S. C. 1144 §514(b)(2)(A).

⁹ 29 U.S. C. 1144 §514(b)(2)(B). Self-insured plans are plans in which the employer assumes the financial risk of covering its employees and pays medical claims from its own resources. Fifty-two percent of covered employees are in a plan that is completely or partially self-insured. Gary Claxton and Jon Gabel, *Employer Health Benefits, Annual Survey* (Washington: Kaiser Family Foundation and Health Research & Educational Trust, 2003), Exhibit 10.1.

¹⁰ Patricia Butler, *Revisiting Pay or Play: How States Could Expand Employer-Based Coverage Within ERISA Constraints* (Portland, ME: National Academy for State Health Policy, May 2002), pp. 6-8.

¹¹ Although Congress ultimately provided Hawaii with a special exemption from ERISA to alleviate this problem, it has expressly refused to grant similar exceptions to other states, including Oregon and Washington, that have attempted to enact employer mandates.

¹² Patricia Butler, *ERISA Implications for SB 2*, full report (Oakland: California HealthCare Foundation, March 2004), pp. 13-15. SB 2 allows employers that pay the fee to claim a credit if they pay for employee health benefits.

¹³ *Sinclair Paint v. State Board Of Equalization*, 64 Cal.Rptr.23 447 (June 26, 1997).

¹⁴ The court may also focus on whether the fee regulates employer conduct, but SB 2 supporters may not wish to assert this argument because that could create an ERISA problem. Patricia Butler, *California Constitutional Barriers to Implementation of SB 2* (Oakland: California HealthCare Foundation, March 2004).

¹⁵ Patricia Butler, *California Constitutional Barriers to Implementation of SB 2*, op. cit.

¹⁶ *Ibid.*

¹⁷ Memo to the U.S. Chamber of Commerce from Morgan, Lewis and Bockius, LLP, op. cit.

¹⁸ *Supermajority Requirement to Raise Taxes* (Washington: National Conference of State Legislatures, Sept. 18, 2003). The states are Arizona, Arkansas, California, Delaware, Kentucky, Louisiana, Mississippi, Nevada, Oklahoma, Oregon, and South Dakota.

¹⁹ *Ibid.*

²⁰ *Ibid.* See also Max Minzner, "Entrenching Interests: State Supermajority, Requirements to Raise Taxes," *Akron Tax Journal* (Akron: University of Akron, 1999). These states are Arizona, Arkansas, California, Mississippi, Nevada, Oklahoma, South Dakota, and Washington.

²¹ Max Minzner, op. cit.

²² *Ibid.*

²³ *Ibid.*

²⁴ *The Initiative and Referendum States, Updated October 10, 2002* (Washington: National Conference of State Legislatures, October 2002), cited April 1, 2004, available online at www.ncsl.org/programs/legman/elect/irstates.htm.

²⁵ *Initiative, Referendum and Recall* (Washington: National Conference of State Legislatures, 2004), cited April 1, 2004, available online at www.ncsl.org/programs/legman/elect/Initiat.htm.

²⁶ For more information about this organization, visit the group's Web site at www.stopthehealthtax.org. For more information about the supporters of SB 2, visit their Web site at <http://www.saveyourhealthcare.com>.