SEYFARTH SHAW
MANAGEMENT ALERT

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The New Massachusetts Health Care Law
Promises, Parallels and Preemption

On April 12, 2006, Governor Mitt Romney signed into law an act providing access to health care for Massachusetts residents (the "Act"). The landmark legislation puts Massachusetts (and Governor Romney) squarely in the health reform spotlight. Although Governor Romney used his line-item veto power to strike eight provisions of the Act, the Massachusetts House voted to override his vetoes and to reinstate those eight provisions. (To date, the Massachusetts Senate has voted to reinstate six of those provisions, including the fair share contribution.) Thirty other states are considering some form of health reform.

The new Massachusetts law enacts a novel "individual mandate" under which those who can afford health insurance must obtain it. The Act establishes the Commonwealth Health Insurance Connector (the "Connector"), an entity designed to connect individuals and small businesses of 50 or fewer employees with health insurance products. In addition, the Act creates Commonwealth Care Health Insurance, a subsidized insurance program for those who earn less than 300% of the Federal Poverty Level and are ineligible for the Massachusetts Medicaid program known as MassHealth.

How will the Act affect Massachusetts employers?

The Act imposes four obligations on Massachusetts employers: completion of a health insurance disclosure form, potential liability for a free rider surcharge, mandatory establishment of a cafeteria plan, and the fair share contribution.

Disclosure Form: Under the Act, every employer and employee "doing business" in Massachusetts must complete and sign (under oath) a "Health Insurance Responsibility Disclosure" form, on which the employer and employee will disclose (i) whether the employer has offered to pay for or arrange for the purchase of health care insurance, (ii) whether the employee has accepted or declined such coverage, and (iii) whether the employee has available an alternative source of health insurance coverage. By signing the disclosure form, employees will agree that if they decline the health coverage offered by their employers, they may be subject to sanctions under the Act's "individual mandate" provisions.

Free Rider Surcharge: The Division of Health Care and Finance (the "Division") will assess "non-providing" employers with a charge equal to a portion of the state's cost of providing health benefits to the employer's uninsured employees if (i) any employee (or dependent of an employee) receives free health services more than three times in a single year or (ii) the employer has five or more instances in a single year of employees (or their dependents) receiving free health services. The Act exempts the following employers from the definition of "non-providing employer," and these employers are thus not subject to the free rider surcharge:

(i) An employer with 10 or fewer employees (with later regulations probably clarifying whether only full-time employees count toward the 10-person limit);

(ii) An employer who participates in the Insurance Partnership Program (offered through the Massachusetts Executive Office of Health and Human Services);

(iii) An employer that is signatory to or obligated under a collective bargaining agreement which governs the employment conditions of the employee receiving free care; and

(iv) An employer that offers to contribute toward, or arrange for the purchase of, health insurance for the employee receiving free care.

It appears that any employee (whether full-time or part-time) not offered health insurance by his employer could expose his employer to the free rider surcharge should he or his dependents seek free care. Thus, employers who do not offer health insurance to all of their employees will need to review the eligibility provisions of their health plans.

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The surcharge assessed by the Division on non-providing employers will range between 10-100% of the state's costs of services provided to the employees or their dependents, after taking into consideration all payments received by the state from other financing sources for such "free care." The first $50,000 of "free care" in any single year will be exempt from the free rider surcharge. Forthcoming regulations will provide some guidance as to how to determine the assessment in the form of factors, including: (i) the number of incidents of free care use; (ii) the number of persons employed by the non-providing employer; and (iii) the proportion of employees for whom the non-providing employer provides health insurance.

Cafeteria Plan: Effective as of January 1, 2007, each Massachusetts employer with more than 10 employees, other than nonprofit entities "that are exclusively staffed by volunteers" and sole proprietors, must adopt and maintain a cafeteria plan that satisfies Section 125 of the Internal Revenue Code of 1986, as amended (the "Code"), and the rules and regulations promulgated by the Connector. Moreover, each employer must file a copy of its cafeteria plan with the Connector.

Code Section 125 requires that a cafeteria plan offer employees a choice between cash and at least one "qualified benefit," such as an employer-provided accident or health plan governed by Code Section 106. It is unclear, until further guidance, whether a plan satisfying the exception to the free rider surcharge will qualify as an employer-provided accident or health plan satisfying Section 106. It is also unclear whether the underlying arrangement providing the qualified benefit, for purposes of the Code, must be or will be deemed to be an "employee welfare benefit plan" for purposes of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). As discussed below, ERISA may well preempt a state law mandating that an employer maintain a plan subject to ERISA.

Fair Share Contribution: The Act includes a provision for a fair share contribution (or "pay or play" assessment), effective as of October 1, 2006. In essence, the employer can choose to "pay" the assessment or to "play" by offering a group health care plan to which it makes a "fair share contribution."

The assessment provision applies to every Massachusetts employer with more than 10 "full-time equivalent employees in the commonwealth" that does not offer a group health plan to which the employer makes a "fair and reasonable premium contribution." The Act requires such employers to contribute an annual assessment of up to but no greater than $295 per employee to the new Commonwealth Care Fund.

Have other states adopted similar statutes?

Hawaii's Prepaid Health Care Act Revisited. Hawaii's Prepaid Health Care Act (the "PHCA"), passed in 1974, requires nearly every employer to insure employees who work 20 hours or more a week for at least four consecutive weeks and gross at least 86.67% of the state's minimum hourly wage. Certain employees are not covered by the law (government employees and most unionized workers). Plans must meet the "prevailing plan standards" (the same standards as those offered by the plan with the largest number of subscribers in Hawaii at any given time) and provide certain minimum benefits. Employees contribute either half of the cost of insurance or 1.5% of their monthly wage, whichever is lower, while employers are responsible for paying the balance of the cost of premiums. The penalty for not complying with the PHCA is at least $25 or $1 per employee per day of violation, plus medical costs incurred by workers who should have been covered. In 1983, Hawaii received an exemption from ERISA, which specifically allowed the PHCA to stand as it was originally passed by Hawaii in 1974, prior to the enactment of ERISA.

The Maryland Experience. Maryland's Fair Share Health Care Act (the "FSHCA"), effective on January 1, 2007, creates the Fair Share Health Care Fund (the "Fund"). The Fund is subsidized by a health care payroll assessment on large employers who do not spend a required percentage of their payroll costs on health insurance costs. Specifically, the FSHCA requires employers with at least 10,000 employees in Maryland to spend at least 8% (6% for non-profit entities) of their Maryland payroll (with certain exceptions) on employee health care or pay into the Fund the difference between the amount spent and the applicable percentage. The FSHCA also requires submission of annual reports by employers with 10,000 or more employees in the state to disclose the number of full- and part-time employees in the state, as well as the amount and percentage of payroll spent by the employer on health insurance in the state. Failure to comply with the reporting requirement carries a penalty of $250 per day, and failure to pay into the Fund or spend the minimum on health care carries a $250,000 penalty. A retail trade association has challenged the FSHCA in federal court, seeking a permanent injunction against its enforcement on the grounds that it is preempted under ERISA, violates the Equal Protection Clause of the Fourteenth Amendment in the Federal Constitution, and violates the "special laws" prohibition in the Maryland Constitution.

The New York Experience. In New York, both New York City and Suffolk County recently passed legislation requiring certain employers to commit a minimum level of funding to health care for their employees. New York City's Health Care Security Act (the "HCSA"), scheduled to take effect on July 15, 2006, requires certain grocers with 50 or more employees and other larger retailers who sell food for off-site consumption to provide health care benefits to their

employees. The HCSA specifically exempts retailers whose primary business is the sale of pharmaceuticals. Similarly, Suffolk County's Fair Share for Health Care Act (the "FSHCA") requires grocers with 50 or more employees and other large retailers of food for off-site consumption to make minimum health care expenditures totaling at least $3.00 per hour worked by an employee. Unlike the City's HCSA, the County's FSHCA does not exempt pharmacies. A covered employer who fails to make the required health care expenditures faces civil penalties and potential revocation or suspension of registration certificates, permits or licenses. The same retail trade association challenging the Maryland "fair share" statute has filed suit in federal court in New York, seeking a permanent injunction against the enforcement of the Suffolk County FSHCA on the grounds that it is preempted under ERISA and the National Labor Relations Act, 29 U.S.C. § 151 et seq., violates the Federal and New York Constitutions, and violates Section 1983 of the Civil Rights Act of 1871, 29 U.S.C. § 1983.

Other State Statutes. Similar legislation is pending in other states. For example, a bill in California's legislature entitled the California Fair Share Health Care Act would require an employer with 10,000 or more employees to spend a specified percentage of the total wages the employer paid to employees in the state on health insurance costs unless the employer elects to contribute a specified amount to a state fund. A bill in the New York State Assembly provides that an employer with 10,000 or more employees must spend at least 8% (6% for non-profit entities) of their total payroll on health care. If an employer does not meet this percentage requirement, it must pay the difference into a state fund.

Is the Massachusetts statute subject to challenge on preemption grounds?

Generally, ERISA preempts state laws that "relate to" or "have a connection with" employee benefit plans, except to the extent that state mandates of employer-sponsored coverage are incorporated into the laws governing insurance policies. Courts generally find that ERISA preempts state laws requiring the establishment of an employee benefit plan or state statutes providing judicial remedies that duplicate, supplement or supplant ERISA's civil enforcement provisions.

No court has yet decided whether ERISA preempts one of the new "fair share" statutes. Twenty-five years ago, the U.S. Supreme Court upheld a determination that ERISA preempted the Hawaii statute explicitly mandating that employers insure their employees, *Standard Oil Co. of California v. Agsalud*, 442 F.Supp. 695 (ND. Cal. 1977), *aff'd.* 633 F.2d 769 (9th Cir. 1980), *aff'd. by memorandum* 454 U.S. 801 (1981); however, Congress overrode the decision by expressly exempting the Hawaii statute from ERISA preemption. As described above, a retail trade association has recently challenged Maryland's FSHCA on ERISA preemption grounds. Conflicting opinions about the statute's viability illustrate the complexity of the preemption issues. The Maryland Chamber of Commerce has obtained a legal opinion that ERISA preempts the Maryland Act, while labor unions supporting the act have obtained a contrary legal opinion. Maryland's attorney general has advised state lawmakers that the statute does not "relate to" an ERISA plan and therefore is not preempted.

Particular provisions of the Act may trigger ERISA preemption issues:

- Section 5 of Chapter 176Q of the Act appears to limit the choice of insurers available to employees and small businesses who use the Connector to those "health insurance plans that have been authorized by the commissioner and underwritten by a carrier." If so, then ERISA may preempt the Act to the extent that it binds plan administrators to a particular choice of insurers.
- Section 42 of the Act requires an employer to establish a Code Section 125 cafeteria plan. If anticipated state regulations interpret the Act as calling for the establishment of an ERISA plan, ERISA may arguably preempt the provision.
- Section 44 of the Act imposes a free rider surcharge on non-providing employers, as discussed above. That section also imposes penalties upon these employers for non-payment or late payment of the free rider surcharge to the Commonwealth Care Trust Fund and for late submission of data reports to the state. It gives the state attorney general authority to sue non-providing employers to enforce the statute. It prohibits an employer from discriminating against any employee who uses free care. A court may deem these provisions an improper attempt to supplement or supplant ERISA's exclusive civil enforcement provisions.
- Section 47 of the Act imposes an assessment on employers who do not contribute their "fair share" of premium contributions to a group health plan. The Act earmarks those contributions for the new Commonwealth Care Trust Fund, designed to replace the former "Health Safety Net Fund" for the uninsured. *See* Chapter 118H of the Act. The preemption issues arising from this section have no easy answers. On the one hand, a court may view this aspect of the Act as a mere payroll tax or assessment that remains neutral regarding whether an employer offers a group plan. On the other hand, a court may determine that the Act directly refers to a group health plan governed under ERISA.

If you have questions about state mandated benefits or "pay or pay laws," please contact the Seyfarth Shaw Employee Benefits Group attorney with whom you work or any Employee Benefits attorney listed on the website at www.seyfarth.com.

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