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# Management Alert

# Divided Fourth Circuit Holds Maryland's Fair Share Act Preempted

Several states and localities have responded to the federal call to reduce escalating Medicaid costs for low-income individuals who lack health care benefits by passing so-called "fair share" statutes. Under these statutes, employers either pay for (or at least arrange for) health care benefits, or they pay an assessment to the state. A prior Management Alert in May 2006 describes the Massachusetts Health Care Reform Act of 2006 and other state "fair share" efforts.

Last Wednesday, in a 2-1 decision, the Fourth Circuit found that the federal Employee Retirement Income Security Act (ERISA) preempts Maryland's Fair Share Health Care Fund Act (Act). *Retail Industry Leaders Association v. Fielder et al.*, Nos. 06-1840 and 06-1901 (4th Cir., January 17, 2007).

## *Maryland's "Fair Share" Act*

In brief, the Act requires employers with 10,000 or more Maryland employees to pay the state the difference between what the employer spends on "health care insurance" (including any costs to provide health care benefits) for its Maryland employees and 8% (for profits) or 6% (for non-profits) of its total Maryland payroll. The Act covered only four employers. Two of these already met the "fair share" requirement under the Act. The Legislature exempted a third employer that primarily employed highly paid employees within Maryland, given the Act's purpose of reducing the State's funding of health care benefits for low-income individuals. Thus, the Act actually affected only one employer.

## *The Divided Federal Appellate Court*

The Retail Industry Leaders Association (RILA) sued in federal court to stop Maryland from enforcing the Act. Among other reasons for opposing enforcement, RILA asked the court to declare that ERISA preempted the Act, because the Act interfered with the uniform administration of nationwide employee benefit plans. The court found the Act preempted under ERISA. On appeal, a sharply divided Fourth Circuit affirmed that decision.

## *The Majority View of ERISA Preemption and Fair Share Statutes*

The Fourth Circuit majority reasoned that the Act "leaves employers no reasonable choice except to change how they structure their benefit plans." The majority believed that no employer would "pay the State a sum of money that it could instead spend on its employees' health care," because providing benefits would improve retention and performance of incumbent employees and would attract "more and better new employees."

The majority also clearly feared that, if it did not find the Maryland Act preempted by federal law, other states and localities would follow Maryland's lead. The resulting patchwork of state rules would interfere with the administration of nationwide benefit plans and would clash with "ERISA's purpose of authorizing [large employers] to provide uniform health benefits to [their] employees on a nationwide basis." Because the Maryland statute conflicted with the federal law's purpose, the Federal Constitution's Supremacy Clause required the court to enforce ERISA: "As sensitive as we are to the right of Maryland and other States to enact laws of their own choosing, we are also bound to enforce ERISA as the 'supreme Law of the Land.'"

The court also rejected Maryland's argument that the Act did not "relate to" or "have a connection with" ERISA-governed employee benefit plans so that it did not trigger ERISA's specific ERISA preemption provision. Maryland argued that the Act avoided preemption because it ostensibly allowed employers either to pay the 8% assessment or to arrange for health care for employees outside of an ERISA plan, such as through on-site medical clinics or health savings accounts.

The majority labeled both options "meaningless." It found the 8% assessment coercive because it felt that rational employers would always change their benefit structure or administration in order to invest in their employees, rather than pay a tax to the State. It also observed that few low-income employees could afford to establish health savings accounts, and that on-site clinics would only offer "simple, circumscribed care that would not involve substantial expenditures [for health care]." Thus, the majority assumed that ERISA plans remained the "primary subjects" of "fair share" statutes, because most employers maintain ERISA plans and would have to coordinate and monitor their efforts to comply with the substantive and procedural elements of such statutes.

## *The Dissent's Preemption Analysis*

The dissent found that the Act did not compel an employer to establish or to maintain an ERISA plan. Rather, the dissent concluded that "[t]he Act offers a compliance option that does not require an employer to maintain an ERISA plan, administer plans according to state-prescribed rules, or offer a certain level of ERISA benefits." The dissent also observed that the Act contained no impermissible reference to ERISA plans (either by explicitly referring to or by relying upon the existence of an ERISA plan) and directed its reporting and disclosure requirements at employers, and not at ERISA plans.

Relying upon the same Supreme Court decisions cited by the majority, the dissent reasoned that a statute that "alters the incentives, but does not dictate the choices, facing ERISA plans" does conflict with ERISA. The dissent also noted that ERISA's preemption provision does not require "cost uniformity." Finally, the dissent commended Maryland for responding to the congressional call for states to address escalating Medicaid costs, and for providing a statute that offers Maryland's large employers real choice. Commenting that the one covered employer "ha[d] not seen fit thus far to use comprehensive health insurance as a means of generating employee goodwill," the dissent questioned the majority's claim that all employers would rather provide healthcare benefits than pay an assessment to the state. The dissent also pointed out that an employer could avoid the 8% regulation without restructuring or altering the administration of its ERISA plans by reducing the number of its Maryland employees to less than 10,000, by reducing Maryland wages to increase the proportion of its Maryland payroll devoted to health care spending, or by leaving Maryland.

## *Lessons Learned From Split Decision*

Maryland may petition for rehearing of the case by the all of the active judges of the Fourth Circuit, and it may appeal to the U.S. Supreme Court. The decision does not reach other "fair share" statutes than Maryland's. As our May 2006 Management Alert indicated, not all "fair share" statutes contain the sizeable penalty assessment found in the Maryland Act (*e.g.*, the Massachusetts and Vermont acts impose an annual penalty assessment of less than $300 and $400 per employee, respectively), and many vary in substance and scope. The Fourth Circuit's sharply divided opinions demonstrate the difficulty of assessing ERISA preemption of "fair share" statutes. Employers with operations in states or localities that have enacted such laws should consult with experienced ERISA litigation counsel and employee benefits counsel before taking any action inconsistent with those laws.

*If you have any questions concerning this Management Alert, please consult the Seyfarth ERISA litigation counsel with whom you work or any other ERISA litigation attorney on the website at www.seyfarth.com.*

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