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RILA v. Maryland, the Massachusetts Health Care Reform Act, and the Future of State Law "Pay-or-Play" Health Insurance Arrangements

In our Employee Benefits Advisory of July 28, 2006, *Maryland's 'Fair Share' Health Act Invalidated by Federal Court (and the Possible Consequences for Massachusetts Health Care Reform)*, we reported on a successful challenge by an industry group, the Retail Industry Leaders Association (RILA), to a Maryland law that required businesses with 10,000 or more employees to spend 8% (6% in the case of nonprofit organizations) of their payroll on employee health care benefits or pay the shortfall to the state.[1] In an important new development, a federal appeals court recently upheld the lower court's ruling.[2] While this decision affects only one judicial circuit, and while it may yet be appealed to and overturned by the U.S. Supreme Court, the appellate court's decision has important ramifications for state health care reform efforts (including Massachusetts) based on the so-called "pay-or-play" model.

Overview of Pay-or-Play Arrangements

Under a "pay-or-play" health insurance law, employers are required to either offer, and provide a designated level of subsidy toward, employer-sponsored health insurance, or pay a like amount to the state. The Maryland Fair Share law is such a law. In a variation on the pay-or-play concept, instead of paying the difference to the state, the penalty is a fixed dollar amount that is typically adjusted on the basis of full-time equivalents. The employer mandates under the Vermont Health Care Affordability Act, and the fair share premium contribution requirement under Massachusetts law are examples of this latter approach.

Among other reforms, pay-or-play schemes are a response to the rapid rise in the cost of Medicaid and state-funded free care. Although Medicaid programs are funded with both federal and state dollars, the

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states' share of Medicaid liability has grown markedly in recent years, forcing state legislatures to look for alternative ways to raise revenues or expand coverage, or both. The significance of the *RILA v. Maryland* decision is momentous: if other federal appellate courts accept its reasoning, or if the U.S. Supreme Court affirms the case on appeal, then pay-or-play mechanisms would be unavailable as a health care financing option.

The Primacy (and Limits) of Federal Law—ERISA Preemption

As explained in our earlier advisory, in ERISA, Congress sought to simplify and make consistent the judicial and regulatory environment within which employee benefit plans operate. ERISA supplants all state laws that "relate to" employee benefit plans. Therefore, the regulation of employee benefit plans is generally an exclusively federal matter.

Before RILA's challenge to the Maryland fair share law, it was clear that:

- a state could impose a tax on employer-sponsored group health plans in the state; but
- a state could not require employers to establish a group health plan or pay a particular level or amount of premiums.

What was not clear was whether a state could impose on employers a fee, assessment or tax, *and* provide for a waiver, offset or deduction for amounts the employer expended on health care. Is such a requirement more like the imposition of a tax (which is not preempted), or is it really a mandate to provide coverage (in which case it is preempted)? This is the critical ERISA preemption question that *RILA* addressed.

The *RILA* Appeal

The majority opinion in the appeals court decision generally follows and approves of the lower court's holdings with some subtle differences in emphasis. The court agreed that, faced with the choice of providing additional benefits or paying money to the government, no rational employer would choose to pay money to the government. Thus, reasoned the court, employers would be required to revise their health plans to conform to the requirements of the law. To the court, this resulted in an impermissible attempt to *directly* regulate an employee benefit plan in contravention of ERISA rather than a permissible effort to indirectly regulate by, say, imposing a tax.

While the majority opinion in the *RILA* case is well-reasoned and compelling, there is a dissent in the case, which, too, is well-reasoned and compelling. The dissent concludes that all the Maryland law

requires of employers is to pay money; it does not require employers to make any changes to their plans or the manner in which their plans are administered (beyond certain record-keeping and reporting requirements that already pass muster under prior precedent).

The Impact on the Massachusetts Health Care Reform Act

It makes little sense to ask whether the Massachusetts health care reform act is preempted by ERISA, but one can legitimately ask whether any particular provision of the act that impacts employer-sponsored group health plans is preempted. For this purpose, there are at least three provisions of the act that may be affected:

1. The Fair Share Premium Contribution

The fair share premium contribution is explained in our Employee Benefits Advisory of October 13, 2006. The Massachusetts rule differs from the Maryland law in that the penalty is a relatively modest, fixed dollar amount. One of the earliest Supreme Court cases on the subject of the preemption of state laws under ERISA held that a law that relates to an ERISA-covered employee benefit plan might escape the preemption if its impact on the plan is "tenuous, remote, or peripheral." Should the *RILA* case become widely accepted and applied, the fair share premium requirement might survive if its impact was adjudged tenuous, remote or peripheral. Otherwise, it would likely be preempted.

2. The Employer Surcharge for State Funded Health Costs

The Employer Surcharge for State Funded Health Costs (which is referred to colloquially as the "free rider surcharge") is based on the premise that employers that neither offer nor arrange for heath insurance coverage ought to shoulder some responsibility for free care provided to their employees. The requirement on its face does not appear to require the adoption of a plan or otherwise affect plan administration. There is Supreme Court precedent, however, that says where a law's impact is potentially very costly (as is the case with the exposure under the free rider requirement), even a law with an indirect impact might be preempted. (The *RILA* case did not address the issue.)

3. The Cafeteria Plan Requirement

Because the scope of the 125 plan requirements is left up to regulations not yet issued by the Connector, it's too soon to tell whether this requirement will be susceptible to a challenge under ERISA. If the Connector opts for a narrow definition under which the requirement applies only to Connector access, then preemption is unlikely. On the other hand, if the definition includes employer-sponsored plans, then *RILA* could have an impact.

Conclusion

The *RILA* appeal addresses squarely the fundamental questions of the viability of pay-or-play laws in the face of the preemptive force of federal law. The court's analysis struggled with conflicting Supreme Court precedent, Congressional intent, the plight of the states and emerging health care policy issues. The sense one gets from reading both the majority opinion and the dissent is that these are close issues and that the result could have gone either way. But only one view could prevail, and the result does not bode well for pay-or-play arrangements.

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[1] *Retail Industry Leaders Association v. James D. Fielding, Jr., Maryland Secretary of Labor, Licensing and Regulation*, 2006 WL 2007654, 38 EBC 1814 (D. Md. 2006).

[2] *Retail Industry Leaders Association v. James D. Fielding, Jr., Maryland Secretary of Labor, Licensing and Regulation*, No. 06-1840 (4th Cir. July 17, 2007).

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If you have any questions concerning the information discussed in this advisory or any other employee benefits topic, please contact one of the attorneys listed below or your primary contact with the firm who can direct you to the right person. We would be delighted to work with you.

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