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ERISA LITIGATION UPDATE

## **Ninth Circuit Finds San Francisco's Employer Spending Requirement Not Preempted by ERISA**

On September 30, 2008, the U.S. Court of Appeals for the Ninth Circuit ruled that ERISA does not preempt the employer spending requirement of the San Francisco Health Care Security Ordinance. (*Golden Gate Rest. Ass'n v. City & County of San Francisco*, No. 07-17370, slip op. (9th Cir. Sept. 30, 2008).) The unanimous three-judge panel reversed the district court's decision and rejected the arguments of the plaintiff, Golden Gate Restaurant Association (GGRA), and numerous amici, including the Department of Labor (DOL). The Ninth Circuit rejected GGRA's arguments that ERISA preempted the ordinance because it either required the creation of an ERISA plan or related to employers' existing plans, thereby thwarting ERISA's goal of ensuring that plan sponsors are subject to a uniform regulatory regime. Although the Ninth Circuit strained to distinguish its decision from the Fourth Circuit's 2007 ruling that ERISA preempted Maryland's employer spending requirement, *Golden Gate* effectively creates a split in the circuits on the issue of whether ERISA preempts state laws imposing employer health care spending requirements. See *Retail Industry Leaders Ass'n v. Fielder*, 475 F.3d 180 (4th Cir. 2007). Given that conflict and the potential impact of such "pay or play" statutes on multi-state employer plans, it is quite possible that, if petitioned, the U.S. Supreme Court will agree to review the Ninth Circuit's decision, assuming that the Ninth Circuit does not change its position on *en banc* rehearing.

### **BACKGROUND**

In July 2006, San Francisco enacted the San Francisco Health Care Security Ordinance (the "Ordinance"). The Ordinance has two parts: a city-administered health care program called the Health Access Plan (HAP), and the employer spending requirements. GGRA challenged only the employer spending requirements. The employer spending requirements apply to employers with an average of at least 20 employees performing work for compensation during a quarter (50 employees for nonprofit corporations). In general, an individual is an employee for this purpose if he works at least 10 hours per week and has worked for the employer for at least 90 days.

The Ordinance requires a minimum health care expenditure by employers. A health care expenditure is any amount paid for the purpose of providing health care services for covered employees or reimbursing the cost of such services for covered employees. Employers who have between 20 and 99 employees (nonprofit employers with 50 or more employees) must make health care expenditures at a rate of \$1.17 per hour. Employers with 100 or more employees must make expenditures at a rate of \$1.76 per hour. The hourly rate is multiplied by the total number of hours paid for each employee during the quarter. If the employer does not make the required health care expenditure by providing or reimbursing health care services for its employees, it must satisfy the spending requirement by making payments directly to the city. If employers pay the city, employees for whom those payments are made are entitled to receive either discounted enrollment in the HAP or medical reimbursement accounts with the city.

On December 26, 2007, the district court concluded that ERISA preempts the employer spending requirements and granted GGRA's motion for summary judgment. See *Golden Gate Rest. Ass'n*, 535 F. Supp. 2d 968 (N.D. Cal. 2007). On January 9, 2008, the Ninth Circuit granted the city's motion to stay the district court's judgment pending appeal. Since that date, covered employers have been required to make quarterly health care expenditures under the Ordinance.

### **THE NINTH CIRCUIT'S ANALYSIS**

Relying primarily on two Supreme Court cases that support the principle that an employer's obligation to make a one-time payment to an employee, standing alone, does not create an ERISA plan, the Ninth Circuit rejected GGRA and DOL's arguments that the Ordinance either forces employers to create new plans or impermissibly "relates to" employers' ERISA plans. See *Golden Gate Rest. Ass'n*, slip op. at 13929, citing *Massachusetts v. Morash*, 490 U.S. 107 (1987); *Fort Halifax Packing Co. v. Coyne*, 482 U.S. 1 (1987). The Court's reliance on *Fort Halifax* and *Morash* is arguably misplaced. Unlike the facts implicated by *Golden Gate*, both cases questioned whether a one-time lump payment of wages triggered by a single event, *viz.*, plant closing or discharge, respectively, constituted an ERISA plan. It is generally understood that a one-time payment tied to a single event does not create an ERISA plan because generally a one-time, lump-sum payment requires no ongoing administrative scheme, a key distinguishing element of an ERISA plan. See *Fort Halifax*, 482 U.S. at 12. GGRA and its

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*amici* argued that the Ordinance did impose an impermissible administrative scheme on employers to the extent, for example, that it required employers to calculate for each calendar quarter employees' hours worked inside and outside San Francisco and percentages of paid leave attributable to work in San Francisco.

GGRA and its *amici* argued that the city-payment option under the Ordinance forces employers to create an ERISA plan. In rejecting this argument, the Court disregarded a long line of cases, including Ninth Circuit precedent, following the seminal case of *Donovan v. Dillingham*, 688 F.2d 1367 (11th Cir. 1982) (*en banc*), wherein the test for determining whether an ERISA plan has been established was first discussed. Distinguishing the *Dillingham* cases from the facts of *Golden Gate*, the Court stated that those decisions involved some type of unwritten or informal promise made by an employer to its employees and asserted that employers complying with the Ordinance made no such promise. Arguably, however, employers forced to provide benefits under the city payment option do make a promise, albeit involuntarily. The Court also thought important that payments to the city are made from the employer's general assets, not a trust, despite the fact that ERISA imposes no trust requirement on single employer welfare benefit plans and the failure to establish a trust, even when one is required, is generally not persuasive to support an argument that no ERISA plan exists. The Court also, and perhaps most significantly, noted that none of the *Dillingham* line of decisions addressed the question of whether an ERISA plan was established in the preemption context.

In *Dillingham*, the Eleventh Circuit established a two-part test for determining whether an ERISA plan exists in ambiguous situations. First, the court must determine whether a plan, fund or program of benefits exists. Second, the court must find evidence that the employer established and maintained the plan for the benefit of its employees.

Under the first part of the *Dillingham* test, a plan, fund or program of benefits exists if, given the particular circumstances under consideration, a reasonable person could ascertain: (1) the intended benefits, (2) a class of beneficiaries, (3) the source of financing and (4) the procedures for receiving benefits. See *Donovan*, 688 F.2d at 1373. These four criteria are arguably satisfied under the Ordinance. The intended benefits are defined as the city's health program or the funds in the reimbursement account. The beneficiaries are eligible employees. The source of financing is the employer, even though the employees and the city also pay some of the program costs. The procedures for receiving benefits are set forth in the Department of Public Health's regulations. Thus, the facts do support a finding that the employers who choose the city-payment option are forced to create an ERISA plan. As for the second prong of the *Dillingham* test, the evidence also supported a finding that if the first prong was met, then the employer undeniably established and maintained the plan for the benefit of its employees.

A key feature of the ERISA statutory scheme is that employers are not required to establish plans. See *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 443-44 (1999); *Lockheed Corp. v. Spink*, 517 U.S. 882, 887 (1996). When they do elect to establish plans, design issues involving the eligible employees and the type and amount of benefits are left to the sound discretion of the employers. State laws that have required employers to create plans and/or provide state-mandated benefits have been rejected routinely as preempted under ERISA. See *Egelhoff v. Egelhoff*, 532 U.S. 141 (2001) (state law that revokes former spouse beneficiary designation preempted); *Pilot Life Ins. v. Dedeaux*, 481 U.S. 41 (1987) (alternative enforcement mechanism preempted); *Shaw v. Delta Air Lines*, 463 U.S. 85 (1983) (state law mandating employee benefit structure or their administration preempted); *RILA v. Fielder*, 475 F.3d 180 (4th Cir. 2007) (state law requiring employers to spend 8 percent of total wages on health care for its employees or pay fine preempted); *Standard Oil v. Agsalud*, 633 F.2d 760 (9th Cir. 1980) (Hawaii health care law requiring that employers establish a health care plan preempted), *aff'd*, 454 U.S. 801 (1981). The Ninth Circuit ignored the principles underlying this body of law by feebly distinguishing the Ordinance as a program to help poor and moderate income employees and likening the program to one more akin to minimum wage laws than a benefit program raising ERISA preemption concerns.

The Ninth Circuit also rejected the argument that the Ordinance is preempted by ERISA because it "relates to" employers' ERISA plans to the extent that the Ordinance requires that employers can choose to alter their plans rather than choose the city-pay option. See ERISA § 514(a). In support of its conclusion, the Court stated that the Ordinance does not **require** an employer to adopt an ERISA plan or other health plan, nor does it **require** an employer to provide any specific benefits under an existing plan. The Court reasoned that although the Ordinance might influence an employer to take certain actions with respect to its plans, financial influence on an employer is permissible. *Golden Gate Rest. Ass'n*, slip op. at 13940-1, citing *New York State Conference of Blue Cross & Blue Shields Plans v. Travelers Ins. Co.*, 514 U.S. 645, 659-60 (1995).

The Ordinance clearly goes beyond a mere "financial influence." Employers must comply with the Ordinance by either adopting an ERISA plan or altering an existing ERISA plan to meet the required minimum expenditures, or by making payments to the city so that its employees may receive benefits through the HAP. In other words, the Ordinance prescribes a minimum level of health benefits that must be provided by an employer, either directly through an ERISA plan or indirectly through mandatory payments to the city. As such, the Ordinance quite plainly "relates to" ERISA plans and thwarts ERISA's intended purpose of providing a uniform regulatory regime over employee benefit plans.

Last, the Court considered whether the Ordinance impermissibly referenced an ERISA plan. A law has a "reference to" an ERISA plan if: (1) the law "acts immediately and exclusively upon ERISA plans," or (2) "the existence of ERISA plans is essential to the law's operation." See *Golden Gate Rest. Ass'n*, slip op. at 13942, citing *Cal. Div. of Labor Standards Enforcement v. Dillingham Constr., N.A., Inc.*, 519 U.S. 316, 325 (1997). The Ninth Circuit held that the Ordinance did not have a "reference to" an ERISA plan, because an employer's required payments are calculated by reference to the number of hours worked by employees, and not by reference to the value or nature of benefits available under an ERISA plan; again, a strained interpretation of existing law.

## RETAIL INDUSTRY LEADERS ASSOCIATION V. FIELDER

The Ninth Circuit attempted to position its ruling as not inconsistent with the Fourth Circuit's decision in *RILA v. Fielder*, which held Maryland's "fair share" employer mandate preempted by ERISA. *Fielder*, also known as the "Wal-Mart case," involved a Maryland law requiring that employers with at least 10,000 Maryland employees spend at least 8 percent of their total payrolls on employees' health benefits. If an employer's spending fell short of 8 percent, the employer was required to pay the difference to the state. Wal-Mart was the only employer in Maryland affected by this minimum spending requirement.

The Ninth Circuit distinguished *Fielder*, stating that employers had no choice but to increase benefits, because an employer that did not meet the spending requirement had to pay the difference to the state and received nothing in return – the quintessential "Hobson's choice." In contrast, the Court opined, the Ordinance offers employers a "meaningful alternative"; instead of increasing benefits, an employer may elect to pay the difference to the city, making its employees eligible for free or discounted enrollment in the HAP, or for medical reimbursement accounts. The Court reiterates that this "realistic alternative" means that the Ordinance does not require employers to offer a certain level of benefits. This distinction may be a legally insufficient difference to shield the circuits from a split in the preemption argument of "pay or play" state laws.

## CONCLUSION

*Golden Gate* is a result-driven opinion that demonstrates the ever-increasing need for federal health care reform. The Ninth Circuit's protests notwithstanding, the decision effectively creates a split with the Fourth Circuit's *Fielder* decision as to whether state health care laws imposing pay or play requirements on employers are preempted by ERISA.

## FOR MORE INFORMATION

If you have questions or would like more information about this topic, please contact any of the team members listed below or your primary Thompson Hine lawyer.

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