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ERISA Preemption and State Health Care Reform (Part 1)

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As the 2008 presidential election approaches, health care reform again has become a topic of national debate.[1] Statistics show that the cost of health insurance and health services continues to outpace the growth in workers' earnings and the rate of inflation.[2] National health care spending reached 16 percent of gross domestic product (GDP) in 2006 and is expected to reach 19.5 percent of GDP by 2017.[3]

The rising cost of health coverage has strained our employer-provided health care system. Since 2000, the percentage of private employers offering health coverage to their employees has fallen from 69 to 60 percent.[4] The population under age 65 without any form of health coverage increased from 15.6 percent in 2000 to 17.9 percent in 2006.[5] This increase in the non-covered population may be attributed to a 6 percent decline in the number of under-65 individuals with employment-based coverage—from 68.4 to 62.2 percent.[6] Indeed, this increase might have been even greater during this period had it not been for increases in the percentage of non-elderly individuals with some form of public or individually-purchased coverage.[7]

In an effort to expand health coverage for their citizens, many states have attempted to experiment with health care reform. Recognizing that these efforts may be susceptible to challenge as preempted by the Employee

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Retirement Income Security Act of 1974 (ERISA), many health care reform advocates have urged a narrowing of the scope of ERISA preemption, either by court interpretation or by congressional amendment. This article summarizes the history and purpose of ERISA preemption, explains the preservation of state authority to regulate insurance, discusses the application of ERISA preemption in the welfare plan arena, and explores the current controversy over whether ERISA preempts state "pay or play" laws.

History and Purpose of ERISA Preemption

ERISA's primary goal is to protect the interests of participants and beneficiaries and to make sure that plans deliver on their benefit commitments. It establishes minimum standards of participation, vesting, and funding for pension plans. For both pension and welfare plans, it also establishes reporting and disclosure rules, fiduciary standards, and a civil enforcement scheme that provides ready access to the federal courts.

But Congress also had an additional goal when it enacted ERISA, one that is often at odds with the goal of protecting employees' interests. That goal was to preserve, protect, and expand the private, employer-sponsored system for providing pension and welfare benefits.[8] A key feature of the employer-sponsored system is that it is purely *voluntary*.[9] Employers are not required to establish employee benefit plans.[10] When employers do establish plans, decisions regarding the benefits to be provided, including the type and amount of benefits, are left largely to the employers' discretion.[11] Congress recognized that over-regulation of employee benefit plans could encourage "employers to respond . . . by decreasing benefits under existing plans or slowing the rate of formation of new plans."[12] It thus sought to minimize the costs and burdens of maintaining employee benefit plans in order to promote their growth.[13]

ERISA's broad preemption provision is a major component of the statutory scheme. Indeed, without this preemption provision, ERISA might never have been passed.[14] With narrow exceptions, ERISA § 514(a) expressly preempts "any and all State laws insofar as they may now or hereafter relate to any employee benefit plan described in § 4(a) and not exempt under § 4(b)." The plans described in section 4(a) include both pension and welfare plans established or maintained by an employer, employee organization, or both. Exempted plans include governmental plans, church plans, and plans "maintained solely for the purpose of complying with applicable workmen's compensation laws or unemployment compensation or disability insurance laws."[15] Significantly, plans that must be maintained to comply with state health insurance laws are *not* exempted under section 4(b).[16]

ERISA preempts "any and all" state laws.

ERISA's preemption clause is referred to in the legislative history as the statute's "crowning achievement."[17] It was "intended to preempt the field for Federal regulations, thus eliminating the threat of conflicting or inconsistent State and local regulation of employee benefit plans."[18] As the Supreme Court has explained, section 514(a) "indicates Congress's intent to establish the regulation of employee benefit plans 'as exclusively a federal concern.'"[19] "A patchwork scheme of regulation would introduce considerable inefficiencies in benefit program operation, which might lead those employers with existing plans to reduce benefits, and those without such plans to refrain from adopting them."[20] ERISA's preemption provision is intended to ensure that "plans and plan sponsors [will] be subject to a uniform body of benefits law; the goal [is] to minimize the administrative and financial burden of complying with conflicting directives" and to avoid "requiring the tailoring of plans and employer conduct to the peculiarities of the law of each jurisdiction."[21]

There is nothing accidental about the application of this preemption provision to health plans and other types of welfare benefit plans. Earlier versions of the bill would have preempted only "state laws relating to specific subject matters covered by ERISA."[22] Congress rejected such a narrow preemption provision, opting instead to broadly preempt all state laws that "relate to any employee benefit plan."[23] Senator Jacob Javits, one of the bill's principal sponsors, explained the rationale in terms that specifically referenced the need to provide broader preemption for *both* welfare and pension plans: "[The earlier] formulation raised the possibility of endless litigation over the validity of State action that might impinge on Federal legislation, as well as opening the door to multiple and potentially conflicting State laws hastily contrived to deal with some particular aspect of *private welfare or pension benefit plans* not clearly connected to the Federal regulatory scheme."[24]

ERISA, as enacted, imposed virtually no substantive requirements on welfare plans.[25] As a result, the scope of preemption in the welfare plan arena would have been significantly narrowed if the earlier versions

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of the preemption provision had been enacted. One of the concerns in the welfare plan context that led to the enactment of the more expansive preemption provision was "a fear that 'state professional associations' would otherwise hinder the development of such employee-benefit programs as 'pre-paid legal service programs.'"[26] Some labor unions had established collectively bargained pre-paid legal services plans, which led to a dispute between the American Bar Association and the AFL-CIO over "whether the panel of lawyers available to provide services under these plans should be open or closed."[27] The AFL-CIO favored closed panels and wanted to ensure that ERISA's preemption clause was broad enough to encompass state laws that might prohibit closed-panel legal services plans.[28]

Another concern in the welfare plan area was that Hawaii had just enacted the Hawaii Prepaid Health Care Act,[29] which required employers to provide Hawaii employees with a comprehensive health care plan. Although ERISA's legislative history does not refer to the Hawaii law, Michael Gordon, then minority counsel to Senator Javits, wrote in March 1993 that the Hawaii law had been brought to the conferees' attention through "intense lobbying."[30] According to Gordon, "[w]hile Hawaii's labor unions had supported the Hawaii health law, the AFL-CIO feared (as did big business) that a series of state laws with varying health plan requirements would impose impossible compliance burdens on large multistate plans."[31]

The Ninth Circuit later held that the Hawaii law was preempted by ERISA § 514(a).[32] The Court rejected arguments that Congress intended to exempt plans mandated by state law from ERISA's coverage, that the Hawaii law was exempt as a "disability insurance law" under ERISA § 4(b)(3), and that ERISA § 514(a) was "not intended to prevent the operation of laws like the Hawaii Act pertaining principally to benefits rather than administration."[33]

At the time of the Ninth Circuit's decision, a bill was pending in Congress that would have amended ERISA to exempt the Hawaii law and "*any other State law* which is determined by the Secretary of Labor to (i) be substantially identical to such Hawaii law on such date, and (ii) require benefits which are substantially identical in type and amount to those required or permitted under such Hawaii law on such date" from preemption.[34] This proposal failed.

Congress finally amended ERISA in 1983 to provide a limited exception to preemption for the Hawaii law. The amendment saves from preemption the substantive provisions of the Hawaii law that were in effect on the date of ERISA's enactment, except to the extent that they address matters governed by the reporting, disclosure, and fiduciary responsibility provisions of ERISA.[35] Unlike the 1979 proposal, the 1983 amendment did not authorize the secretary of labor to approve any other state's health care law. Instead, in language that was not made part of ERISA itself, the amendment made clear that "[t]he amendment made by this section shall not be considered a precedent with respect to extending such amendment to any other State law."[36]

ERISA's Preservation of State Authority to Regulate Insurance

In enacting ERISA, Congress carved out an exception to preemption for "any law of any State which regulates insurance."[37] This exception to preemption is commonly referred to as the insurance "saving clause." As interpreted by the U.S. Supreme Court, the insurance saving clause allows states to regulate not only insurance companies, HMOs, and other insurance organizations, but also the substantive terms of any contracts issued by such organizations.[38] The Supreme Court recently clarified the scope of the exception, holding that it saves a state law if it (1) is "specifically directed toward the insurance industry," and (2) "substantially affects the risk pooling arrangement between the insurer and the insured."[39]

The states' authority to regulate insurance under the saving clause is subject to two significant exceptions. First, states cannot use the insurance saving clause to create alternative state causes of action that have the effect of duplicating, supplementing, or supplanting ERISA's civil enforcement provision. The Supreme Court has made clear that any such alternative state cause of action interferes with Congress's intent that ERISA's civil enforcement provision be "exclusive" and is thus preempted by the Supremacy Clause of the U.S. Constitution.[40] For example, although a state law that regulates the substantive terms of insurance contracts may be saved from preemption, the Supremacy Clause would nonetheless preempt any state cause of action under the law allowing ERISA plan participants to enforce the substantive contract terms.

Second, the insurance saving clause is itself subject to a statutory exception that has been construed to exempt self-funded plans from state laws regulating insurance. By the time ERISA was enacted, the number of self-funded plans had grown dramatically,[41] and states were beginning to regulate them under their insurance laws. For example, a Missouri trial court ruled that Monsanto's self-funded health and disability plan could not pay benefits until it subjected itself to regulation under Missouri's insurance code and met applicable licensing requirements.[42]

Both business and organized labor were afraid that self-funded plans would become impractical if states were permitted to regulate them as insurance companies.[43] The result was an exception to the saving clause, which provides that no employee benefit plan "shall be deemed to be an insurance company or other insurer . . . or to be engaged in the business of insurance . . .

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for purposes of any [State] law purporting to regulate insurance companies [or] insurance contracts."[44] This provision, known as the "deemer clause," exempts "self-funded ERISA plans from state laws that 'regulat[e] insurance' within the meaning of the saving clause."[45] Thus, "if a plan is insured, a State may regulate it indirectly through regulation of its insurer and the insurer's insurance contracts; if the plan is uninsured, the State may not regulate it."[46]

According to recent statistics, approximately 132.8 million individuals received health coverage from ERISA plans (both insured and self-funded) in 2006.[47] Roughly 59.8 million of these individuals were covered by insured plans, leaving about 73 million covered by self-funded plans.[48] Large employers are much more likely to provide coverage through self-funded plans. In 2006, approximately 89 percent of workers employed by firms with 5,000 or more employees were covered by self-funded plans.[49] In contrast, only 13 percent of workers employed by firms with less than 200 employees were covered by self-funded plans.[50]

[*Part 2 of this article, which looks at the application of the ERISA preemption in the welfare plan arena and the impact of the ERISA preemption on state "play or pay" laws, will appear in the summer 2008 issue of* Infrastructure. *Issues of the newsletter are posted online for Section members at http://www.abanet.org/pubutil/home.html and available to nonmembers on LexisNexis.*]

Endnotes

1. *See* Congressional Research Service Report for Congress, *Health Reform and the 110th Congress* at CRS-1 (Feb. 25, 2008).

2. Kaiser Family Foundation, *Employer Health Benefits: 2007 Annual Survey* at 1 (Sept. 2007).

3. S. Keehan et al., *Health Spending Projections Through 2017: The Baby Boom Generation Is Coming to Medicare*, Health Affairs Web Exclusive at W146 (Feb. 26, 2008); *see also* U.S. Department of Health and Human Services, *National Health Expenditure Projections 2006-2016*, at 4, Tab 1 (2005).

4. Kaiser Family Foundation, *Employer Health Benefits: 2007 Annual Survey* at 3.

5. P. Fronstin, *Sources of Health Insurance and Characteristics of the Uninsured: Analysis of the March 2007 Current Population Survey*, EBRI Issue Brief No. 310 at 5 (October 2007).

6. *Id.* at 5, 6.

7. *Id.*

8. Varity Corp. v. Howe, 516 U.S. 489, 497 (1996) (noting Congress's "desire not to create a system that is so complex that administrative costs, or litigation expenses, unduly discourage employers from offering welfare benefit plans in the first place").

9. H.R. Rep. No. 93-533, 93d Cong., 2d Sess., at 1 (1973) ("the committee has been constrained to recognize the voluntary nature of private retirement plans").

10. Hughes Aircraft Co. v. Jacobson, 525 U.S. 432, 443-44 (1999); Lockheed Corp. v. Spink, 517 U.S. 882, 887 (1996).

11. Black & Decker Disability Plan v. Nord, 538 U.S. 822, 833 (2003).

12. H.R. Rep. No. 807, 93d Cong., 2d Sess., at 15 (1974).

13. Rush Prudential HMO, Inc. v. Moran, 536 U.S. 355, 379 (2002) (emphasizing "ERISA's policy of inducing employers to offer benefits by assuring a predictable set of liabilities, under uniform standards of primary conduct and a uniform regime of ultimate remedial orders when a violation has occurred"); Alessi v. Raybestos-Manhattan, Inc., 451 U.S. 504, 515 (1981) ("the House Ways and Means Committee expressly acknowledged the tension between the primary goal of benefiting employees and the subsidiary goal of containing pension costs").

14. J. Wooten, *A Legislative and Political History of ERISA Preemption, Part 1*, J. Pension Benefits, Vol. 14, No. 1 at 35 (2006) ("preemption issues were pivotal to ERISA's enactment because the business community's and the AFL-CIO's strong desire for preemption all but forced them to support federal pension reform"); J. Wooten, *A Legislative and Political History of ERISA Preemption, Part 2*, J. Pension Benefits, Vol. 14, No. 3 at 10 (2007) ("the politics of preemption led Congress to pass a more ambitious slate of reforms than it might otherwise have done").

15. ERISA §§ 4(b)(1), (b)(2) and (b)(3).

16. Standard Oil Co. of Cal. v. Agsalud, 633 F.2d 760, 764 (9th Cir. 1980), *summarily aff'd*, 454 U.S. 801 (1981); *see also* DOL Adv. Op. 75-22 (July 18, 1975) ("the provision of basic health care is fundamentally different and distinguishable from the three listed purposes [in § 4(b)(3)], each of which provides at least partially for income replacement rather than the prevention and treatment of illness").

17. 120 Cong. Rec. 29,197 (1974) (remarks of Rep. Dent).

18. 120 Cong. Rec. 29,933 (1974) (remarks of Sen. Williams).

19. New York State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645, 656 (1995) (citation omitted).

20. Fort Halifax Packing Co. v. Coyne, 482 U.S. 1, 11 (1987).

21. Ingersoll-Rand Co. v. McClendon, 498 U.S. 133, 142 (1990). *See also* Egelhoff v. Egelhoff, 532 U.S. 141 (2001) ("Requiring ERISA administrators to master the relevant laws of the 50 States and to contend with litigation that would undermine the congressional goal of 'minimizing the administrative and financial burdens' on plan administrators—burdens ultimately borne by the beneficiaries."); H.R. Rep. No. 93-533, 93d Cong., 2d Sess., at 12 (1973) ("The uniformity of decision which the Act is designed to foster will help administrators, fiduciaries and participants to predict the legality of proposed actions without the necessity of reference to varying state laws.").

22. *See* Shaw v. Delta Air Lines, 463 U.S. 85, 98 (1983). The House bill provided for preemption of state laws "relat[ing] to the reporting and disclosure responsibilities,

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and fiduciary responsibilities, of persons acting on behalf of any employee benefit plan." H.R. 2, 93d Cong., 2d Sess., § 514(a) (1974). The Senate bill provided that ERISA would supersede state laws "relat[ing] to the subject matters regulated by this Act or the Welfare and Pension Plans Disclosure Act." H.R. 2, 93d Cong., 2d Sess., § 699(a).

23. ERISA § 514(a); *see* New York State Conference of Blue Cross & Blue Shield Plans v. Travelers, 514 U.S. 645, 661 (1995) ("Congress's extension of pre-emption to all 'state laws relating to benefit plans' was meant to sweep more broadly than 'state laws dealing with the subject matters cover by ERISA[,] reporting, disclosure, fiduciary responsibility and the like …") (quoting *Shaw*, 463 U.S. at 98, n.19).

24. 120 Cong. Rec. 29,942 (1974) (remarks of Sen. Javits) (emphasis added).

25. For example, ERISA expressly exempts welfare plans from its participation, vesting, and funding provisions. *See* Curtiss-Wright Corp. v. Schoonejongen, 514 U.S. 73, 78 (1995).

26. Metropolitan Life Ins. Co. v. Massachusetts, 471 U.S. 724, 745 n.23 (1985) (quoting legislative history). *See also* J. Wooten, *A Legislative and Political History of ERISA Preemption, Part 2*, J. Pension Benefits, Vol. 14, No. 3 at 10 (2007).

27. M. Gordon, *The History of ERISA's Pre-emption Provision and Its Bearing on the Current Debate over Health Care Reform*, EBRI Issue Brief No. 135 (March 1993).

28. *Id.*

29. The Hawaii Prepaid Health Care Act was enacted in June 1974. ERISA was enacted on September 2, 1974.

30. Gordon, *supra*, note 27.

31. *Id.* As enacted, the Hawaii law did *not* apply to collectively-bargained health plans. Indeed, a later attempt by Hawaii to extend the law to collectively bargained health plans was held preempted, notwithstanding the 1983 amendment to ERISA that created an exception to preemption for the Hawaii law. Council of Hawaii Hotels v. Agsalud, 594 F. Supp. 449 (D. Haw. 1984).

32. Standard Oil Co. of Cal. v. Agsalud, 633 F.2d 760 (9th Cir. 1980), *summarily aff'd*, 454 U.S. 801 (1981).

33. *Id.* at 764, 765-66.

34. The ERISA Improvement Act of 1979, S. 209, 96th Cong., 1st Sess. (1979) (emphasis added); *see Standard Oil Co. of Cal.*, 633 F.2d at 765 n.2.

35. ERISA § 514(b)(5), (b)(5)(B)(ii) and (b)(5)(C).

36. Pub. L. No. 97-473, § 301(b), 96 Stat. 2605, 2612 (1983).

37. ERISA § 514(b)(2)(A).

38. *See, e.g., Metropolitan Life Ins. Co.*, 471 U.S. at 727, 739-47.

39. Kentucky Association of Health Plans, Inc. v. Miller, 538 U.S. 329, 341-42 (2003).

40. Aetna Health Inc. v. Davila, 542 U.S. 200, 217-18 (2004) ("Under ordinary principles of conflict preemption, . . . even a state law that can arguably be characterized as 'regulating insurance' will be pre-empted if it provides a separate vehicle to assert a claim for benefits outside of, or in addition to, ERISA's remedial scheme.").

41. FMC Corp. v. Holliday, 498 U.S. 52, 68 (1990) (Stevens, J., dissenting).

42. Missouri v. Monsanto Co., Case No. 259774 (St. Louis City Cir. Ct. Jan. 4, 1973), *rev'd*, 517 S.W.2d 129 (Mo. 1974). *See also FMC Corp.*, 498 U.S. at 69 (Stevens, J., dissenting) (discussing *Monsanto* case); J. Wooten, *A Legislative and Political History of ERISA Preemption, Part 1*, J. Pension Benefits, Vol. 14, No. 1 at 34 (2006) (discussing *Monsanto* case).

43. J. Wooten, *A Legislative and Political History of ERISA Preemption, Part 2*, J. Pension Benefits, Vol. 14, No. 3 at 10 (2007); Gordon, *supra*, note 27.

44. ERISA § 514(b)(2)(B).

45. *FMC Corp.*, 498 U.S. at 61; *see also id.* at 64 ("We view the language of the deemer clause, however, to be either coextensive with or broader, not narrower, than that of the saving clause.").

46. *Id.* at 64.

47. W. Pierron and P. Fronstin, *ERISA Pre-emption: Implications for Health Reform and Coverage*, EBRI Issue Brief No. 314 at 11 (Feb. 2008). Another 28.9 million individuals were covered by non-ERISA health plans sponsored by government entities. *Id.*

48. *Id.*

49. *Id.*

50. *Id.*

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