MAY 2008

SAN FRANCISCO ALL OVER?

With the passage of the Employee Retirement Income Security Act ("ERISA") in 1974, employers came to believe that a balkanized system of state and local rules governing group health plans would never develop because this federal law mandated uniform national regulation of employee benefit plans. The State of Maryland and Suffolk County, New York, recently enacted group health plan mandates. When those mandates were challenged, the federal courts ruled that they were invalid because ERISA gave exclusive power to the federal government to regulate employee benefit plans (discussed below). The City of San Francisco (the "City") also adopted its own group health plan mandate, in the form of an ordinance that became effective on January 1, 2008. The new health plan law, officially titled the "San Francisco Health Care Security Ordinance" (the "Ordinance"), is also referred to as "Healthy San Francisco." An employer group challenged the Ordinance in 2007, and the San Francisco federal court, citing the cases involving the Maryland and Suffolk County group health plan mandates, ruled on December 26, 2007, that the Ordinance was invalid. However, on January 9, 2008, the Ninth Circuit Court of Appeals ruled that the Ordinance can be enforced while its legality is being challenged in court. As a result, municipal regulation of group health plans has become a reality that employers with 20 or more employees in San Francisco must now consider.

The Ordinance requires all "covered employers" to make special "health care expenditures" on behalf of all "covered employees." For-profit companies having 20 or more employees must comply.[1] "Covered employees" include any person working in San Francisco who has been employed by the employer for 90 days and who works 10 or more hours per week in San Francisco (the 10-hour requirement drops to eight hours in 2009). A "large" employer (employing 100 or more employees) must provide at least $1.76 per hour in health care expenditures for each covered employee. "Medium" employers, which have 50 to 99 employees, must provide $1.17 per hour in health

1. Nonprofits with fewer than 50 employees are exempt from the Ordinance.

care expenditures for each covered employee. As of April 1, 2008, employers that have 20 to 49 employees must also provide $1.17 per hour in health care expenditures for each covered employee. All of a company's employees nationwide are counted in determining the size of the employer (not just the employees working in San Francisco). To fulfill the health care expenditure requirement, covered employers may make payments to health insurers, reimburse employees for their actual health care expenditures, establish health savings accounts or flexible spending arrangements, or make payments directly to the Healthy San Francisco program. The Ordinance further requires all covered employers to maintain certain records, provide certain notices to employees, and submit compliance reports to the City.

LEGAL BACKGROUND

Although two different federal district courts in the East, a federal district court in San Francisco, and the Fourth Circuit Court of Appeals have all ruled that "pay or play" health coverage mandates enacted by state and local governments are invalid (as they encroach on an area of exclusive federal regulation under ERISA), the Ninth Circuit sees things differently. On December 26, 2007, the federal district court in San Francisco ruled that the Ordinance was invalid. The very next day, San Francisco filed an emergency motion with the Ninth Circuit to stay the district court's judgment pending a decision on the merits of its appeal. The Ninth Circuit Court of Appeals, on January 9, 2008, issued a published decision in *Golden Gate Rest. Ass'n v. City of San Francisco*, 512 F.3d 1112 (9th Cir. 2008), granting the City's request to stay enforcement of Judge White's decision. According to the Ninth Circuit, the City of San Francisco was simply exercising its traditional "police powers" in requiring most San Francisco employers to provide every San Francisco employee with up to $1.76 per hour in health care benefits or pay the difference to a City-operated health fund. *Golden Gate Rest. Ass'n v. City of San Francisco*, 512 F.3d 1112, 1120 (9th Cir. 2008).

Prior to San Francisco's foray into mandating health plan benefits, the State of Maryland and Suffolk County, New York, each enacted laws requiring employers to provide employees with a minimum amount of medical plan coverage or pay the difference into government coffers. Employers immediately filed challenges to each of these new laws in federal court, and each federal district court ruled in response that local government health plan mandates were invalid. *Retail Indus. Leaders Ass'n v. Fielder*, 435 F. Supp. 2d 481, 495 (D. Md. 2006), *aff'd*, 475 F.3d 180 (4th Cir. 2007).

Both the Suffolk County Fair Share Act and the Maryland Fair Share Act in the *Fielder* case are called "pay or play" laws. Each law requires employers to "play" by paying a minimum amount of payroll for employee health care coverage or "pay" by paying the difference into a government-administered fund. On January 17, 2007, the Fourth Circuit Court of Appeals, in affirming the district court's decision, ruled that the Maryland Fair Share Act "effectively required employers in Maryland covered by the Act to restructure their employee health insurance plans," and as a result, "it conflicts with ERISA's goal of permitting uniform nationwide administration of these plans." *Retail Indus. Leaders Ass'n v. Fielder*, 475 F.3d 180, 183 (4th Cir. 2007). On July 16, 2007, Suffolk County's so-called fair share law was also found to be preempted by ERISA. *Retail Indus. Leaders Ass'n v. Suffolk County,* 497 F. Supp. 2d 403 (E.D.N.Y. 2007).

Due to the Ninth Circuit's January 9, 2008, ruling staying enforcement of the district court's decision, the City of San Francisco is implementing its employer group health plan mandate. It may take a number of months for the Ninth Circuit to issue its decision on the merits of the City's appeal of Judge White's decision striking down the ordinance following the April 17, 2008, oral argument and more time still for the full Ninth Circuit to review the case (if it does so at all). It is likely the Ninth Circuit will uphold the validity of the Ordinance, as the oral argument panel was the same three-judge panel that issued the January 9, 2008, published decision upholding the Ordinance's validity. Nine *amicus* briefs were filed with the Ninth Circuit in support of the San Francisco district court's ruling that the Ordinance was ERISA-preempted (including one from the U.S. Department of Labor, the administrative agency charged with enforcing and administering compliance with the ERISA statute). While many believe the U.S. Supreme Court would find the Ordinance to be preempted by ERISA, there is no guarantee that the Supreme Court will even hear the case. A final decision on the validity of the Ordinance will probably not occur until some time in 2009. In the meantime, all employers with 20 or more San Francisco employees

should understand the steps they need to take to comply with this controversial Ordinance, especially given the steep administrative penalties that the City may attempt to impose on employers that fail to comply.

COMPLYING WITH THE "HEALTHY SAN FRANCISCO" ORDINANCE

Compliance with the Ordinance is no easy matter. Any company whose employees regularly visit San Francisco may be covered by the Ordinance if those employees work an average of 10 hours per week during any quarter in San Francisco. If a company has covered employees, it must calculate the health care expenditures required by the Ordinance and compare that with the amount of health care expenditures it already provides to employees. If the company does not meet the health care expenditure amount required by the Ordinance, it must determine how it will meet the required minimum health care expenditure amount. The Ordinance requires companies to maintain records detailing compliance. An annual compliance report is also required. Failure to comply subjects a company to civil penalties as well as revocation of City permits, registrations, and licenses. The following are seven questions every employer must answer to comply with the Ordinance.

Is the Company a "Covered Employer"? "Covered employers" include all for-profit companies with 20 or more employees. If a company has 100 or more employees, it is considered a large employer and must make expenditures at the higher rate of $1.76 per covered employee. The company does not have to be located within San Francisco to be a covered employer for purposes of the Ordinance. If the company has 20 or more employees and any employees who have been employed for 90 days and perform an average of 10 or more hours of work per week within the geographic confines of San Francisco during any quarter, the company will be required to make health care expenditures on behalf of those covered employees. All of the company's employees, even those who do not work in San Francisco, are counted when determining an employer's coverage status. This means that regular, part-time, seasonal, and temporary employees are included in the count.

Which Employees Are "Covered Employees"? A "covered employee" is any employee who has worked for a covered employer for more than 90 calendar days and has performed an average of 10 or more hours of work per week within the geographic confines of San Francisco during any quarter. The regulations provide that

> for an employee who is separated from employment prior to completing the eligibility period, the prior days of employment shall count toward the eligibility period if the employee returns to work within one year of the most recent separation date; and … an employee who is separated from employment after completing the eligibility period shall not be required to complete a new eligibility period, if the employee is rehired within one year of the most recent separation date.

These regulations also state that leaves of absence to which the employee is legally entitled count toward the 90-day eligibility period. Again, whether an employee is seasonal or temporary does not matter for purposes of the Ordinance.[2]

The Ordinance does *not* require health care expenditures for:

a. Employees who waived coverage because they receive health benefits through another employer or the health plan of a spouse, domestic partner, or parent;

b. Managers, supervisors, and confidential employees earning more than $76,851 annually (during 2008);

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2. The regulations state that whether "an employee's status or classification is seasonal, permanent or temporary, full-time or part-time, exempt or nonexempt, salaried or hourly, or contracted (whether employed directly by the employer or through a temporary staffing agency, leasing company, professional employer or organization, or other entity) or commissioned shall not be considered in determining whether that employee is a covered employee." An employer using temporary-agency employees is advised to communicate with the temporary agency to confirm that the temporary agency is complying with federal ordinances to make sure it does not have to make health care expenditures for those temporary-agency employees.

c. Employees who are covered by Medicare or TRICARE/CHAMPUS; and

d. Employees who receive health plan coverage because their employers comply with the City's public contracting laws.

CAN A COVERED EMPLOYEE WAIVE COVERAGE?

Yes. The Ordinance allows employees to waive coverage if they are receiving plan coverage from another employer. To support a waiver, the employee must complete a voluntary waiver form provided by the City of San Francisco. Please note that a waiver is effective for one calendar year only. Employees retain the right to revoke the waiver at any time.

HOW MUCH IS THE EMPLOYER CURRENTLY PAYING FOR HEALTH INSURANCE BENEFITS?

The Ordinance permits employers to meet their health care expenditure obligations by providing coverage that is worth at least $1.76 per hour (for large employers). Each component of the company's employee benefit offerings should be examined to see what it costs per hour. If the company is meeting health care expenditure requirements for covered employees and their dependents, it need not adopt other methods for complying with the Ordinance.

WHAT IS THE MOST EFFICIENT WAY TO COMPLY WITH THE ORDINANCE IF THE COMPANY IS NOT PAYING $1.76 PER HOUR IN HEALTH CARE EXPENDITURES?

An employer can meet the Ordinance's health care expenditure requirements in several ways:

a. It can increase the coverage provided by its existing group health plan (including dental and vision coverage) to covered employees to equal or exceed $1.76 per hour;

b. It can pay the difference between what it pays for health insurance coverage and the $1.76 per hour into a flexible spending account, a medical savings account, or some other health care expense reimbursement arrangement;

c. It can arrange to make cash reimbursements to employees for medical expenses;

d. It can make arrangements with a health care provider to directly pay for services rendered to covered employees; and

e. Self-funded plans may use their COBRA rates to determine if they comply with the minimum health care expenditure requirements.

f. It can pay any additional expenditures owed to the Healthy San Francisco program.

If the employer provides uniform health coverage or health coverage through a self-funded or self-insured plan to a group of covered employees, the employer can satisfy the requirements of the Ordinance as long as the average expenditure meets the spending threshold for the employer. Reg. 6.2(B)(1)–(2). The average expenditure rate is calculated "by dividing the total amount of health care expenditures made for such employees by the total number of hours paid to such employees." *Id.* at (B)(3).

All required expenditures must be made within 30 days of the end of the preceding quarter. Reg. 6.2. Accordingly, all expenditures for the first quarter 2008 were due on April 30, 2008. However, employers that have self-funded or self-insured plans are not required to make their expenditures on a quarterly basis. Reg. 6.2(A)(1).

Employers are free to use multiple methods to satisfy the expenditure requirements. If the required monthly expenditure is $300, the employer could pay $250 toward health insurance premiums and then could pay the remaining $50 to the City or into a health care reimbursement account for the employee. The employer is free to use whatever avenues it chooses to satisfy the spending requirement. Reg. 6.2(C)(D).

Employers that do not wish to change their group health plans through additional payments may make contributions directly to the Healthy San Francisco program. The Ordinance provides that payments made by employers into the Healthy San Francisco program are used to fund a covered employee's participation in the program. However, if a covered employee does not qualify for the program (perhaps because the employee does not live in San Francisco or has health insurance coverage), the program will place the employer's contributions for that employee into a health care reimbursement account. The program will administer these accounts and will provide employees with information on how to access them. Payments to Healthy San Francisco are due within 30 days of the end of each quarter. The first quarterly minimum health care expenditure for employees under Healthy San Francisco was due on April 30.

The Healthy San Francisco program requires all employers that wish to participate to enroll through the online portal found on the program's web site. The program considers itself to be a HIPAA-covered entity and has entered into a business associate agreement with the City to protect the disclosure of any protected health information. However, this agreement does not protect the privacy of the information that employers are required to provide to the program through the online portal. Because HIPAA defines "individually identifiable health information" so broadly, the prudent approach would be for an employer's group plan to secure its own business associate agreement with the program before disclosing employee information.

Employers cannot count payments related to workers' compensation claims or "in lieu of" benefit arrangements. Employee contributions for health plan coverage *cannot* be counted toward the $1.76 per hour.

DOES THE COMPANY HAVE A SYSTEM TO TRACK COMPLIANCE?

The Ordinance requires an employee-by-employee analysis. A large employer must spend $1.76 for each hour a covered employee receives pay, and it must keep records to demonstrate its compliance. The "hours paid" tracked under the Ordinance for purposes of health care expenditures include vacation, paid time off, paid sick leave, and any other form of payment to an employee. The maximum number of hours for which health care expenditures are required is 172 per month and 516 per quarter. For salaried employees, "hours paid" are calculated based on a 40-hour workweek. Health care expenditures of $1.76 per hour are due each quarter for any employee who, after being employed for 90 days, worked an average of 10 hours per week during the quarter, even if that employee was terminated during the quarter.

HAS THE COMPANY ESTABLISHED A RECORD-KEEPING AND NOTICE PROCESS TO COMPLY WITH THE ORDINANCE?

Calculations of health care expenditures must be made and monies expended at least quarterly, within 30 calendar days of the end of the preceding quarter. Employers with 50 or more employees were required to make their first expenditure (based on hours paid to covered employees from January 9, 2008, to March 31, 2008) no later than April 30, 2008. Employers with 20 to 49 employees must make their first expenditure (based on hours paid to covered employees from April 1, 2008, to June 30, 2008) no later than July 30, 2008.

The Ordinance requires employers to retain records for a period of four years, which must include:

a. The covered employee's address, telephone number, and first day of employment;

b. Itemized pay statements showing the total hours worked (unless salaried) with all deductibles and net wages earned;

c. Records of health care expenditures made, including calculations of health care expenditures for each employee and proof documenting that such expenditures were made each quarter of each year;

d. If applicable, signed voluntary waiver forms for every employee for whom a covered employer is claiming an exemption from the health care expenditure requirement; and

e. A copy of all "Employee City Option Deposit Confirmation" forms for employers that choose to make deposits directly into the Healthy San Francisco program. Employers that make payments to the Healthy San Francisco program are required to provide a quarterly notice to each employee on whose behalf payments were made. The only notice requirement in the Ordinance is that employers must notify an employee if they make any payments to the City on behalf of that employee. The regulations state that employers should use a specific City-drafted form in giving that notice. Reg. 7.1.

Every covered employer is also required to provide information to San Francisco on an annual basis regarding its health care expenditure compliance. This information must be reported on the Office of Labor Standards Enforcement's Health Care Security Ordinance mandatory annual reporting form, which will be mailed to all businesses registered to do business in San Francisco. All San Francisco businesses are also subject to investigations and audits by the Office of Labor Standards Enforcement (the "OLSE"). Employers must provide the OLSE with access to workers and other witnesses, as well as employer records, including but not limited to employee time sheets, payroll records, employee paychecks, and other documents described in the regulations. Finally, the Ordinance contains an anti-retaliation provision making it unlawful for an employer to discipline, discharge, demote, suspend, or take any other adverse action against an employee for exercising his or her rights under this law.

Penalties for Failure to Comply With the Ordinance. The OLSE is charged with monitoring and enforcing compliance with the Ordinance. Regulations grant the OLSE the authority to investigate compliance and seek penalties for failures to comply. The OLSE has the right to "engage in random inspections of employment sites; to have access to workers and other witnesses; and to conduct audits of employer records as reasonably deemed necessary to determine compliance." Reg. 8.1(A). The OLSE is authorized to initiate a civil action to recover the penalties imposed by the Ordinance and/or (except as prohibited by state or federal law) to request that City agencies "revoke or suspend any registration certificates, permits, or licenses held or requested by the employer or person until such time as the violation is remedied." Reg. 8.1(B).

If a violation is identified, the OLSE will first order the employer to take corrective action, such as making any required expenditures that the employer has missed. If corrective action is not taken, then the OLSE can impose the following administrative penalties:

a. For failure to make a required expenditure, the administrative penalty is up to one and one-half times the total expenditures owed plus 10 percent interest from the date payment was due. The penalty is capped at $1,000 for each employee for each week that expenditures were not made.

b. For failure to cooperate or for impeding an OLSE investigation, the administrative penalty is $25 for each day that the violation occurs.

c. For failure to allow reasonable access to records establishing health care expenditures, the penalty is $25 for each day that the violation occurs for each employee whose records are at issue.

d. For failure to maintain accurate and complete records or for destruction of relevant evidence, the penalty is $500.

e. For failure to complete the required annual report, the penalty is $500.

f. For reducing the number of employees for an improper purpose to avoid the application of the Ordinance, the penalty is $25 for each day that the violation occurs.

g. For retaliation, harassment, or discrimination in violation of the Ordinance, the employer will be ordered to cease the conduct and may be ordered to reinstate or otherwise compensate the employee whose rights were violated. The administrative penalty for these types of violations is $100 for each person whose rights were violated for each day that the violation occurs. Reg. 9.2(A).

Any employer that fails to pay a penalty imposed by the OLSE will owe the debt to the City. The City can then recover the debt either through a civil action or through the imposition of a lien against any property owned by the employer. Reg. 9.4.

This overview of the ERISA preemption controversy concerning the Ordinance, as well as the compliance guide, is intended for the use of employers that have covered employees in San Francisco. Until a federal court rules otherwise, San Francisco "covered employers" must take steps to comply with the Healthy San Francisco Ordinance.

Special thanks to Dennis Drapkin, Marlene Frank, and Alan Miller for their thoughtful comments.

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