JONES DAY

APRIL 2009

ONLY IN SAN FRANCISCO?

April may turn out to be the "cruelest" month for employee benefit professionals. One obvious cruelty is the looming April 30, 2009, filing deadline for employers ensnared by San Francisco's Health Care Security Ordinance ("HCSO" or "Ordinance").

The question of whether or not the HCSO is legal is not just a San Francisco problem. Employers across the nation should rightly fear that if the San Francisco law is upheld, it will open the floodgates to a patchwork of city-by-city, county-by-county, or state-by-state group health plan mandates. A patchwork system of group health plan regulation will obviously result in higher employer health plan costs and make it impossible for employers to offer a uniform group health plan.

WHY ARE WE IN THIS MESS?

In 2006, the City and County of San Francisco (the "City") adopted a city-wide group health plan mandate. The new law became effective on January 1, 2008, and is officially titled the "San Francisco Health Care Security Ordinance" also referred to as "Healthy San Francisco"). The Golden Gate Restaurant Association ("GGRA") challenged the Ordinance in 2007, asserting that San Francisco could not regulate group health plans because the federal government had reserved that power to itself. A San Francisco federal court, citing cases involving similar group health plan mandates by the state of Maryland and Suffolk County, New York, ruled on December 26, 2007, that the Ordinance was invalid because it encroaches on an area of exclusive federal regulation under ERISA. The Ninth Circuit Court of Appeals, however, has now ruled on three occasions that the Ordinance is valid.

The Ninth Circuit's third ruling, on March 9, 2009, denied GGRA's request for rehearing en banc. GGRA then filed a request for an emergency stay of the Ninth Circuit's decision with the Supreme Court on March 18, which was denied on March 30, 2009. The Ninth Circuit's rationale (which sparked a blistering en banc dissent) is that local governments may impose health plan spending requirements if they allow employers to comply without disrupting their plans.

Healthy San Francisco requires businesses with at least 20 employees to do one of the following:

- Make a minimum per-hour health care expenditure for each covered employee.
- Pay the City for coverage through the Healthy San Francisco Fund.
- Contribute the minimum per-hour health care expenditure to health care accounts for employees.

HOW DOES THE ORDINANCE WORK?

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 eight or more hours per week in San Francisco. A "large" employer (employing 100 or more employees) must provide at least $1.85 per hour in health care expenditures for each covered employee. As of January 1, 2009, employers that have 20 to 99 employees must provide $1.23 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 annual compliance reports to the City.

LEGAL BACKGROUND

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).

WHAT MUST SAN FRANCISCO EMPLOYERS DO NOW?

Due to the Ninth Circuit's three rulings, employers must now comply with the City of San Francisco's employer group health plan mandate. While many believe GGRA will ask the U.S. Supreme Court to find the Ordinance is preempted by ERISA, there is no guarantee the Supreme Court will even hear the case. A final decision on the validity of the Ordinance will probably not occur until sometime in 2010. In the meantime, all employers with 20 or more employees who

1. Nonprofits with fewer than 50 employees are exempt from the Ordinance; larger nonprofits are subject to the Ordinance.

work eight or more hours per week in San Francisco must take steps to comply.

Every covered employer is required to provide information to San Francisco on an annual basis regarding its health care expenditure compliance. April 30, 2009, is the due date for the first Annual Report Form ("ARF"). 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. Please note that only one ARF is to be filed for all entities within the same "group of controlled corporations" (as defined for purposes of income tax filing). 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 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:

- 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.

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

- 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.

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

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

- 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.

- 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.

Again, until a federal court rules otherwise, San Francisco "covered employers" must take steps to comply with the Healthy San Francisco Ordinance.

LAWYER CONTACTS

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

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