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Executive & Director Compensation Reference Guide

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Introduction —

The Employee Retirement Income Security Act's ("ERISA") preemption mechanism "has been aptly termed the most sweeping federal preemption statute ever enacted by Congress."[1] At the same time, it is one of the most confusing areas of law.

[1] *California Hosp. Ass'n v. Henning*, 569 F. Supp. 1544, 1546 (C.D. Cal. 1983), *rev'd on other grounds*, 770 F.2d 856 (9th Cir. 1985), *as amended on other grounds*, 783 F.2d 946 (9th Cir. 1986).

The primary goal of the enactment of ERISA was to establish uniform federal protections for participants in employee benefit plans. Thus, an essential feature of ERISA is its preemption of any state laws that might endanger or erode the desired uniformity with respect to the implementation and application of ERISA across the country. To that end, ERISA contains an expansive preemption mechanism that not only preempts any state law causes of action that duplicate or supplant ERISA's enforcement mechanisms[2] but also any state laws that "relate to" ERISA.[3]

[2] ERISA § 502(a).

[3] ERISA § 514(a).

Since its passage, courts have struggled with defining the scope of ERISA's preemption protections, especially the broad, vague mandate of ERISA § 514(a), for the simple fact that, "as many a curbstone philosopher has observed, everything is related to everything else."[4] This chapter focuses on outlining ERISA's distinct and often complicated preemption provisions and examining how they have been interpreted and applied by the courts since ERISA's implementation.

[4] *California Div. of Labor Standards Enf't v. Dillingham Const., N.A., Inc.*, 519 U.S. 316, 335, 117 S. Ct. 832, 843, 136 L. Ed. 2d 791 (1997) (Scalia J., concurring).

Historical Background —

ERISA was passed in 1974 with the express purpose to "promote the interests of employees and their beneficiaries in employment benefit plans." At the time, the number of pension plans, and the number of employees covered under those plans, had grown exponentially over the previous decades, and as so many people began to depend on the funds in those new plans, there was growing concern regarding the proper management of those funds. Those concerns came to a head in 1963 when the Studebaker-Packard Corporation terminated its plan at a time when it was significantly underfunded and thousands of employees lost their pensions. The result - Congress began looking at legislation to protect other employees from a similar fate. The Studebaker-Packard failure prompted calls for legislation to protect employees' promised pensions, and in March 1974, roughly 10 years later, ERISA was passed. While ERISA's primary goal is to regulate and provide oversight as to how plans are managed, a key component is found in the provision designed to ensure that ERISA is uniformly applied, without interference from the states.

In enacting ERISA and thereby federalizing employee benefits law throughout the country, Congress sought to (1) ensure that employee benefits law was governed by a uniform body of federal laws, and (2) replace the piecemeal edifice of common law jurisprudence that had developed in the state courts. The differences in substantive and procedural law from state to state were outmoded and inappropriate in an increasingly national economy where many employers conducted business in all parts of the country.

Consequently, ERISA was predicated on the broadest federal preemption clause ever utilized in national legislation. The goal was to federalize the law of employee benefits in the private sector so as to create a uniform body of law consistently applicable throughout the 50 states. The result was Section 502(a), ERISA's express preemption of any state law that conflicts with ERISA's civil enforcement mechanism, and Section 514 of ERISA, which has become what is perhaps the single most powerful provision of the ERISA, but also one with which the courts have struggled to consistently interpret and apply in keeping with that purpose.

Section 502(a): Complete Preemption of Any State Laws Conflicting With, Duplicating, or Superseding ERISA's Remedies. —

The first way that ERISA seeks to ensure uniform implementation on a federal level is through its civil enforcement provision found in Section 502(a), which sets forth who may bring a cause of action under ERISA and under what circumstances. Under Section 502(a), a plan participant or a beneficiary may bring a claim to recover benefits, enforce rights, or clarify rights to future benefits under the terms of the plan.[5] A participant or beneficiary, as well as the Secretary of Labor, may also bring a claim for breach of fiduciary duty against any fiduciary of the plan who breaches his or her responsibilities, obligations, or duties to the plan.[6]

[5] ERISA § 502(a)(1)(B).

[6] ERISA § 502(a)(2).

ERISA also proscribes the remedies available to plan participants and beneficiaries. For example, if a participant or beneficiary prevails in a denial of benefits claim under Section 502(a)(1)(B), he or she may recover the benefits owed under the terms of the plan. For breach of fiduciary duties claims, the plaintiff may recover losses incurred by the plan as a result of the breach of fiduciary duty, including holding fiduciaries personally liable for such breaches. In addition, ERISA also allows for the award of attorney's fees in a breach of fiduciary duties case.

The enforcement mechanisms set forth in Section 502(a) completely preempt “any state law cause of action that that duplicates, supplements, or supplants the ERISA enforcement remedy.”[7] The Supreme Court explained that, through the passage of ERISA, Congress intended to create a uniform federal system that would exclusively protect employee benefits plans; thus, ERISA completely preempts any state laws in conflict with its enforcement mechanisms.[8]

[7] *Aetna Health Ins. V. Davila*, 542 U.S. 200, 208 (2004).

[8] *Ingersol-Rand. v. McClendon*, 498 U.S. 133, 144 (1990).

Section 514: ERISA's Conflict Preemption Provision —

The more sweeping preemption protects in ERISA are found in Section 514. ERISA's Section 514, has three distinct parts. First, under Section 514(a), ERISA preempts “any and all State laws insofar as they may now or hereafter relate to any employee benefit plan....” Determining the meaning of the inherently vague phrase “relate to” is frequently a key issue in ERISA litigation.

Second, Section 514(b) includes a “savings clause,” which allows states to enforce any “law ... which regulates insurance, banking, or securities.” The issue of which state laws “regulate insurance” under Section 514(b) has received extensive attention and interpretation.

Third, Section 514(b) also includes a “deemer clause,” which provides that an employee benefit plan governed by ERISA shall not be “deemed” an insurer, bank, trust company, investment company, or a company engaged in the insurance or banking business in order to be subject to state law.

Section 514's “relate to” Language —

The broadest preemption protection set forth in Section 514 of ERISA is the broad “relate to” language found in Section 514(a). Generally, Section 514(a) of ERISA, 29 U.S.C. § 1144(a), preempts any state laws that “relate to” ERISA plans.[9] The section provides that “[ERISA] shall supersede any and all State laws insofar as they may now or hereafter *relate to* any employee benefit plan . . . .”[10] It is unsurprising that this enigmatic phrase has produced the most litigation, as parties and the courts have wrestled with determining the precise scope of Section 514(a)'s “relate to” preemption protections.

[9] *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85, 91-92 (1983).

[10] ERISA § 514(a) (emphasis added).

Preemption of laws with a "connection with" or "reference to" ERISA. —

ERISA's preemption of state law is more obvious when the state law at issue contains a specific "reference to" ERISA or specifically depends on the existence of ERISA plans. As such, any state law that imposes requirements or seeks to regulate ERISA plans will be preempted under Section 514(a).[11]

[11] *District of Columbia v. Greater Wash. Bd. of Trade*, 506 U.S. 125 (1992) (preemption applied to regulations applied to health insurance programs regulated by ERISA).

A greater challenge for the courts, however, has been determining when a state law that does not specifically reference or depend upon ERISA plans may have a sufficient "connection with" ERISA to, nonetheless, bring them under the scope of Section 514(a). To determine whether a state law has a "connection with" ERISA plans, courts are to look both to ERISA's objectives as a guide to the scope of the state law that Congress understood would survive, and to the nature of the law's effect on ERISA plans.[12] Finding the proper application of that "test," however, has changed over time and remains a challenge for courts to this day.

[12] *California Div. of Labor Standards Enf't v. Dillingham Const., N.A., Inc.*, 519 U.S. 316, 325 (1997).

In the early years after ERISA's passage, the Supreme Court sought to effectuate the legislative goal of unifying employee benefits law and eliminating the threat of conflicting and inconsistent state rules. To do so, the Supreme Court tended to interpret the words "relate to" broadly. Consistent with this approach, in *Alessi v. Raybestos-Manhattan, Inc.* the Supreme Court stated that ERISA makes clear that even indirect state action bearing on private pensions may encroach upon the area of exclusive federal concern.[13]

[13] *Alessi v. Raybestos-Manhattan, Inc.*, 451 U.S. 504, 525, 101 S. Ct. 1895, 1907, 68 L. Ed. 2d 402 (1981) ("It is of no moment that New Jersey intrudes indirectly, through a workers' compensation law, rather than directly, through a statute called "pension regulation." ERISA makes clear that even indirect state action bearing on private pensions may encroach upon the area of exclusive federal concern.").

A few years later, in *Shaw v. Delta Air Lines, Inc.*, the Supreme Court sought to provide slightly more clarity to Section 514(a)'s confusing "relate to" standard. It explained that a law "relates to" an employee benefit plan if it has "a connection with"[14] or "reference to"[15] such a benefits plan.[16] And as the Court later explained in *Ingersoll-Rand v. McClendon* "'a state law may 'relate to' a benefit plan, and thereby be pre-empted, even if the law is not specifically designed to affect such plans, or the effect is only indirect."[17] Thus, the form of a particular state law is irrelevant to whether it "relates to" ERISA.

[14] The following decisions held that ERISA § 514(a) preempts state laws because they have a connection with ERISA benefit plans: *Egelhoff v. Egelhoff*, 532 U.S. 141, 142 (2001) (the Court found that a Washington state statute providing that designation of a spouse as beneficiary of a non-probate asset is automatically revoked upon divorce was preempted by ERISA because it implicated an area of core ERISA concern); *Boggs v. Boggs*, 520 U.S. 833, 836 (1997) (ERISA preempts a state law allowing a non-participant spouse to transfer an interest in undistributed pension plan benefits through a testamentary trust).

[15] The following decisions held that ERISA § 514(a) preempts state laws because they refer to ERISA benefit plans: *UNUM Life Ins. Co. v. Ward*, 526 U.S. 358, 363 (1999) (holding that ERISA does not apply), *overruled in part on other grounds by Ky. Ass'n of Health Plans, Inc. v. Miller*, 538 U.S. 329 (2003) (California's agency law was preempted by ERISA to the extent that it referred to ERISA plans); *District of Columbia v. Greater Wash. Bd. of Trade*, 506 U.S. 125, 129-30 (1992) (Statute that regulated both ERISA and ERISA-exempt benefit plans was preempted. The employer-sponsored health insurance programs referred to in the statute were subject to ERISA regulation, and any state

law imposing requirements by reference to ERISA plans is preempted).

[16] *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85, 97, 103 S. Ct. 2890, 2900, 77 L. Ed. 2d 490 (1983).

[17] *Ingersoll-Rand v. McClendon*, 498 U.S. 133, 139 (1990).

As courts continue to struggle with the application of Section 514(a)'s "relate to" language, and the equally enigmatic "connection with" test, the Supreme Court has sought to offer additional guidance, and to circumscribe the reach of ERISA preemption.

In *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Insurance Co.*, the Supreme Court interpreted the Act's "relate to" language more restrictively holding that a New York state surcharge on a hospital maintained by an ERISA plan had only an indirect relationship to the plan and was consequently not "related to" the plan within the meaning of § 514(a). [18] In so holding, the Court identified three areas where a state law can have "a connection with" or "reference to" employee benefit plans: when it (1) mandates employee benefit structures or their administration, (2) binds employers or plan administrators to particular choices or precludes uniform administrative practice, or (3) provides an alternative enforcement mechanism to ERISA. [19]

[18] *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Insurance Co.*, 514 U.S. 645, 115 S. Ct. 1671, 131 L. Ed. 2d 695 (1995).

[19] *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Insurance Co.*, 514 U.S. 645, 115 S. Ct. 1671, 131 L. Ed. 2d 695 (1995).

Federal Circuit Courts develop their own "relates to" tests —

Various circuit court decisions have also sought to further elaborate on what constitutes "relate to" for the purposes of ERISA preemption. For instance, the Eighth Circuit, in finding that an Arkansas assignment statute was preempted because it "relates to" an ERISA plan, articulated several detailed factors to consider when evaluating whether ERISA preemption applies. [20] Those factors are:

[20] *St. Francis Regional Medical Center v. Blue Cross and Blue Shield of Kansas, Inc.*, 49 F.3d 1460 (10th Cir. 1995).

- the statute negates a proper plan provision;
- the statute has an effect on the relationship of primary ERISA entities because the statute takes control over who should receive payment from the plan fiduciary and gives it to plan participants;
- the statute impacts plan administration because claims administrators are burdened with the determination of whether and to whom assignments were made;
- the statute could have a detrimental administrative effect on plans because multi-state plans could be subject to conflicting laws;
- the statute eliminates healthcare providers' incentive to enter into participation agreements with health insurers or claims administrators, thus adversely affecting a plan's ability to reduce costs; and

• the statute is inconsistent with the notion that ERISA parties are free to negotiate plan provisions governing the right to assign benefits. [21]

[21] *Arkansas Blue Cross and Blue Shield v. St. Mary's Hosp., Inc.*, 947 F.2d 1341, 1349-50 (8th Cir.1991), *cert. denied*, 504 U.S. 957, 1992).

Similarly, the Second Circuit developed a two-prong test that has been repeatedly applied in that Circuit. Under that test, a state law will "relate to" ERISA, and therefore be preempted, if it either:

• it makes explicit reference to ERISA plans; or

• it would disserve the basic purpose of preemption, namely to avoid a multiplicity of regulation in order to permit the nationally uniform administration of employee benefit plans. [22]

[22] *Romney v. Lin*, 94 F.3d 74 (2d Cir. 1996).

In the wake of Travelers, the Fourth Circuit explained that ERISA was intended to preempt state laws:

• that mandate employee benefits structures or their administration;

• that bind employers or plan administrators to particular choices or preclude uniform administrative practice, thereby functioning as a regulation of an ERISA plan itself; and

• that provide alternate enforcement mechanisms for employees to obtain ERISA benefits. [23]

[23] *Coyne & Delany Co. v. Selman*, 98 F.3d 1457, 1468 (4th Cir. 1996).

The Ninth Circuit has also developed its own four factor test to aid in determining whether a state law is connected with an ERISA benefit plan:

• whether the state law regulates the types of benefits of ERISA employee welfare benefit plans;

• whether the state law requires the establishment of a separate employee benefit plan to comply with the law;

• whether the state law imposes reporting, disclosure, funding, or vesting requirements for ERISA plans; and

• whether the state law regulates certain ERISA relationships, including the relationships between an ERISA plan and employer and, to the extent an employee benefit plan is involved, between the employer and employee.[24]

[24] *BankAmerica Pension Plan v. McMath*, 206 F.3d 821, 829–30 (9th Cir. 2000).

Limits on Section 514(a)'s scope —

While court decisions regarding Section 514(a) are often confusing, both the Supreme Court and the lower courts have generally guarded the intent behind ERISA's preemption provision of protecting the uniform application of ERISA on a national level through their broad application of Section 514(a). That said, when a state law has only a tangential relationship to ERISA, courts have been less inclined to expand Section 514(a)'s reach.

For example, when a state law has only an "indirect economic effect" on a benefit plan, the Supreme Court has held that ERISA preemption does not apply. In *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co*., the Court held that "state actions with indirect economic effects on a plan's cost—such as quality control standards and workplace regulation" fall outside the scope of ERISA's preemption provision.[25] Thus, the Court concluded that New York's insurance surcharges had only "an indirect economic effect on choices made by insurance buyers, including ERISA plans" but did "not bind plan." Hence Section 514(a) did not apply.

[25] *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co*., 514 U.S. 645, 662, 115 S. Ct. 1671, 1680, 131 L. Ed. 2d 695 (1995).

ERISA's Interaction with Laws Regulating Insurance

Section 514(b)'s "savings clause" —

While the "relate to" language contained in Section 514(a) seeks to broaden the net of state laws preempted by ERISA, the "saving clause" in Section 514(b) saves from ERISA preemption "any law of any [s]tate which regulates insurance, banking, or securities."[26] This provision reserves to the states those laws regulating health insurance, with the exception of those that fall under the "deemer clause," as discussed below.

[26] 29 U.S.C. § 1144(b)(2)(A).

In 2003, the Supreme Court articulated a two-part test for determining whether a state law is considered to regulate insurance under the "savings clause." Prior to the Court's calcification on the issue, courts were analyzing whether a law regulated insurance for purposes of ERISA's saving clause by applying the three factors used to determine whether a practice is considered the "business of health insurance" under the McCarran-Ferguson Act, which were whether it: (1) had

the effect of transferring or spreading a policyholder's risk; (2) was an integral part of the policy relationship between the insurer and the insured; and (3) was limited to entities within the insurance industry.[27]

[27] *See, e.g.* , *Metro. Life Ins. Co. v. Mass.*, 471 U.S. 724, 743 (1985).

In *Ky. Ass'n of Health Plans, Inc. v. Miller*, the Supreme Court adopted a new, two-part test which, instead, looks at whether the state law (1) is specifically directed toward entities engaged in insurance; and (2) substantially affects the risk pooling arrangement between an insurer and the insured. Applying its new test, the Supreme Court found that Kentucky's "any willing provider" (AWP) laws, which prohibited insurers from discriminating against a health care provider willing to meet the insurer's criteria for participation in the health plan, was saved from ERISA preemption.[28] In doing so, the Court explained that the savings clause regulates insurance, not only insurers.

[28] *Ky. Ass'n of Health Plans, Inc. v. Miller*, 538 U.S. 329, 331-32, 334-35, 341-42 (2003).

Section 514(b)'s "deemer clause" —

While state laws regulating insurance are not preempted by ERISA, ERISA's deemer clause exempts ERISA plans from regulation as insurance companies. "Neither an employee benefit plan . . . , nor any trust established under such a plan, shall be deemed to be an insurance company or other insurer, . . . or to be engaged in the business of insurance . . . for purposes of any law of any State purporting to regulate insurance companies [or] insurance contracts . . . ."[29] Thus, ERISA's "deemer clause," clarifies that state laws "cannot deem an ERISA plan to be an insurance company" and therefore subject to regulation by state insurance law rather than ERISA.[30]

[29] 29 U.S.C. § 1144(b)(2)(B).

[30] *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 46 (1987); 29 U.S.C. § 1144(b)(2)(B).

The Supreme Court has adopted a broad approach to interpreting the "deemer clause" that precludes state law from regulating employers' self-insured plans.[31] Citing ERISA's legislative history, the Court declined to read the word "purporting" as limiting the scope of the clause.[32]

[31] *FMC Corp. v. Holliday*, 498 U.S. at 52, 61 (1990).

[32] *FMC Corp. v. Holliday*, 498 U.S. 52, 63-64 (1990) ("Indeed, the Conference Report, in describing the deemer clause, omits the word 'purporting,' stating, 'an employee benefit plan is not to be considered as an insurance company, bank, trust company, or investment company (and is not to be considered as engaged in the business of insurance or banking) for purposes of any State law that regulates insurance companies, insurance contracts, banks, trust companies, or investment companies.'").

Under the "deemer clause," Congress created a distinction between employers who purchase plans for their participants and employers who self-insure, leaving the former open to indirect regulation while the latter are not. Consequently, the practical effect of the "deemer clause" is that a state law may indirectly regulate insured ERISA plans, by regulating the insurance policies that the plans purchase,[33] but it may not regulate self-funded plans, which do not purchase insurance and which are "deemed" not to be insurers for purposes of the law.[34]

[33] *See, e.g., America's Health Ins. Plans v. Hudgens*, 915 F. Supp. 2d 1340 (N.D. Ga. 2012), *aff'd*, 742 F.3d 1319 (11th Cir. 2014).

[34] *See, e.g.* , *Scharff v. Raytheon Co. Short Term Disability Plan,* 581 F.3d 899 (9th Cir. 2009).

Anti-subrogation laws —

Some states have adopted anti-subrogation laws preventing insurers from seeking reimbursement from their insureds via subrogation. Circuits have split on whether ERISA completely preempts such laws. For instance, the Third Circuit ruled that ERISA completely preempts state anti-subrogation laws holding that claims to avoid subrogation liens are claims for benefits due under ERISA Section 502(a). [35] By contrast, the Second Circuit held that New York's anti-subrogation laws were not completely preempted by ERISA, holding that the state's anti-subrogation laws gave rise to legal duties independent of ERISA. [36]

[35] *Levine v. United Healthcare Corp.*, 402 F.3d 156, 163 (3d Cir. 2005).

[36] *Wurtz v. Rawlings Co., LLC*, 761 F.3d 232, 236 (2d Cir. 2014).

ERISA's Interaction with Certain Healthcare Laws

Any willing provider laws —

An “any willing provider” law is a law that requires a managed care organization to contract with or accept services from any health care provider who meets the organization's terms and conditions, such as payment levels. The purpose of such laws is to increase access to medical care by preventing managed care organizations from selectively contracting with a limited number of providers.

In *Ky. Ass'n of Health Plans, Inc.*, the Supreme Court determined that the Kentucky's any willing provider” law related to ERISA. [37] However, because the law regulated insurance it was saved from preemption under the “savings clause.”

[37] *Ky. Ass'n of Health Plans, Inc.*, 538 U.S. at 339 (2003).

Assignment of benefits laws —

Circuit courts of appeals are split on whether ERISA preempts state laws requiring health insurers to recognize and honor assignments of benefits by patients to health providers. ERISA does not explicitly deal with this issue, however under Eighth and Tenth Circuit precedent, such laws would be subject to ERISA preemption. [38] On the other hand, the Fifth Circuit has held that ERISA does not preempt state statutes requiring health insurers to honor assignments of benefit claims made by patients to hospitals. [39]

[38] *Ark. Blue Cross & Blue Shield v. St. Mary's Hosp., Inc.*, 947 F.2d 1341, 1343 (8th Cir. 1991); *St. Francis Reg'l v. Blue Cross & Blue Shield of Kan., Inc.*, 49 F.3d 1460, 1464 (10th Cir. 1995)).

[39] *La. Health Serv. & Indem. Co. v. Rapides Healthcare Sys.,* 461 F.3d 529, 541 (5th Cir. 2006).