Executive Signal

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ERISA Preemption: What Is It, and Why Is It Important?

Employee benefit articles often refer to it, and attorneys sometimes mention it – but what exactly is ERISA preemption, and why is it important? In a nutshell, ERISA preemption means that despite state and local attempts to create mandates for employers providing health plans to employees, employers will in the end likely be subject to one set of federal rules.

Preemption

As a general legal doctrine, federal preemption refers to those instances when federal law overrides state law. Generally, that occurs when Congress has specifically provided for federal preemption in the statute, and a state law contradicts federal law directly or indirectly, wholly or in part. If states choose to enact laws that are inconsistent with federal law, the courts have the power to overturn those laws. Regardless of the shortcomings of a federal law or the desirability of a state law, if there is a conflict, the federal law wins.

Preemption language does not have to be included in every federal statute, but some laws (such as ERISA) incorporate very specific preemption provisions. Preemption can be full or partial. How does the legal concept of preemption apply to employer-sponsored benefit plans?

ERISA Preemption

ERISA is the acronym for the *Employee Retirement Income Security Act of 1974*, which broadly applies to employers that offer employee benefit programs (health and welfare benefit programs as well as pension programs).

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Congress enacted ERISA, in part, to regulate employee benefits on a national scale. A fundamental element of the ERISA statute reserves for the federal government the authority to legislate and regulate matters related to employee benefit programs. Congress intended that statutory provision to bring more certainty to employers and their employees in the administration of employee benefit plans. ERISA's

preemption provision has been applied extremely broadly. In fact, on a question examining the breadth of ERISA preemption, the U.S. Supreme Court ruled that a state law relates to a plan "if it has a connection with or reference to such a plan" (*Shaw v. Delta Airlines, Inc.*, 463 U.S. 85 [1983]) and would therefore be preempted by ERISA. Consequently, ERISA preempts most state laws that relate to ERISA-covered employee benefit plans. Important exceptions, however, apply.

In addition to preempting state law, ERISA also preempts civil remedies based on state law from applying to ERISA-covered plans. This means that employees who would like to sue their employer's ERISA plan may not do so in state court. Instead, they must file suit in federal court and even then only after exhausting all ERISA-mandated procedures. At the risk of overgeneralizing, state courts tend to treat plan participants more favorably than do federal courts – and they are usually less predictable as well. Plan sponsors usually prefer to defend themselves in the federal court system.

How Do the Exceptions Work?

As with most rules, there are exceptions, and in several relevant areas, ERISA does not preempt state law. These areas include laws governing insurance, banking, securities and criminal activity. The exception for insurance laws is probably the most familiar and contentious. (In addition, Hawaii has a mandate that requires most employers to provide medical benefits for employees. Although similar state obligations would be preempted (see below) if enacted elsewhere, Hawaii already had that mandate in place when ERISA went into effect. Hawaii then obtained an ERISA exception to continue its mandates.)

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ERISA contains an **insurance savings clause**, which allows states to continue to regulate insurance companies and insurance contracts even if they are used for employee benefit plans. That generally permits states to indirectly regulate the content of insured ERISA plans by dictating the terms and conditions to be included in underlying insurance policies issued within the state. States can therefore mandate that insurance policies contain certain provisions and benefit levels. Employers who choose to buy an insurance contract to fund their benefit plans are therefore indirectly regulated by the state laws governing the programs available in the insurance marketplace.

Exception to the Exception

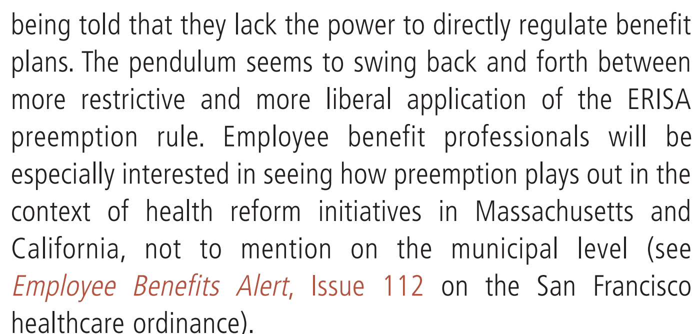
Luckily for employers fearful of government mandates – and the potential for 50 separate mandates from 50 states – ERISA's insurance savings clause includes language known as the "deemer clause." The deemer clause is really an exception to the insurance exception. This ERISA rule *prohibits* states from regulating self-insured plans through insurance laws by "deeming" the self-insured plans as insurance policies that fall under state regulations. Self-insured ERISA plans generally are not considered insurance and therefore not subject to state insurance regulations.

Riding the Pendulum

ERISA's insurance savings clause provides that ERISA does *not* preempt properly drafted state insurance laws that *relate to* insured employee benefit plans.

Whether a particular state law falls within the scope of this exemption is a point that the courts are often called upon to decide. (See, for example, Willis' *Employee Benefits Alert*, Issue 74, where we discuss how a federal court overturned Maryland's Wal-Mart law as being preempted by ERISA.)

For more than 30 years the courts have been busy deciding where and when ERISA preemptions apply. Many lawyers have grown rich fighting these battles, because states do not like



being told that they lack the power to directly regulate benefit plans. The pendulum seems to swing back and forth between more restrictive and more liberal application of the ERISA preemption rule. Employee benefit professionals will be especially interested in seeing how preemption plays out in the context of health reform initiatives in Massachusetts and California, not to mention on the municipal level (see *Employee Benefits Alert*, Issue 112 on the San Francisco healthcare ordinance).

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Why Is Preemption Important?

As states wrestle with political pressures to promote healthcare coverage, many are becoming bolder in their efforts to challenge ERISA preemption. Many states are actively lobbying Congress to scale back ERISA preemption itself. A number of bills that would either permit waivers or otherwise weaken ERISA preemption have been introduced in the House and Senate, and employer organizations are working diligently to keep those bills from being passed (for example, S. 2031: *States' Right to Innovate in Health Care Act of 2007*). ERISA and preemption are valuable to employers for several reasons.

- ERISA offers plan sponsors one set of laws to follow, versus 50 (or more if local ordinances are passed).
- ERISA preemption generally protects plan sponsors from frivolous lawsuits because plan participants must follow and exhaust ERISA claims procedures before a court will even agree to review the complaint.
- ERISA guarantees plan sponsors access to the more predictable venue of the federal courts.
- ERISA limits available participant recoveries and remedies.

ERISA preemption is the foundation for the delivery of employer-provided benefits. National employers, in particular, depend on ERISA to guarantee one consistent legal framework for compliance, rather than a hodgepodge of compliance requirements for each state in which the organization operates. Any erosion of ERISA protections would be highly problematic for the employer-based system. Willis is working with the American Benefits Council and other industry colleagues to remind legislators that maintaining a single regulatory scheme is in the public interest as it promotes employer-sponsored benefits.

Key Contacts

US Benefits Office Locations

Atlanta, GA
404 224 5000

Austin, TX
800 861 9851

Baltimore, MD
410 527 1200

Birmingham, AL
205 871 3871

Boston, MA
617 437 6900

Cary, NC
919 459 3000

Charlotte, NC
704 376 9161

Chicago, IL
312 621 4700

Cincinnati, OH
513 762 7855

Cleveland, OH
216 861 9100

Columbus, OH
614 766 8900

Dallas, TX
972 385 9800

Denver, CO
303 218 4020

Detroit, MI
248 735 7580

Farmington, CT
860 284 6147

Florham Park, NJ
973 410 1022

Ft. Worth, TX
817 335 2115

Grand Rapids, MI
616 954 7829

Greenville, SC
864 232 9999

Houston, TX
713 961 3800

Jacksonville, FL
904 355 4600

Knoxville, TN
865 588 8101

Las Vegas, NV
702 432 7100

Long Island, NY
516 941 0260

Los Angeles, CA
213 607 6300

Memphis, TN
901 248 3100

Miami, FL
305 373 8460

Milwaukee, WI
414 271 9800

Minneapolis, MN
763 302 7100

Mobile, AL
251 433 0441

Naples, FL
239 659 4500

Nashville, TN
615 872 3700

New Orleans, LA
504 581 6151

New York, NY
212 915 5422

Omaha, NE
402 391 1044

Orange County, CA
949 885 1200

Orlando, FL
407 805 3005

Philadelphia, PA
610 964 8700

Phoenix, AZ
602 787 6000

Pittsburgh, PA
412 586 1400

Portland, OR
503 224 4155

Roswell, NM
505 317 3397

St. Louis, MO
314 721 8400

San Diego, CA
858 678 2000

San Francisco, CA
415 981 0600

San Jose, CA
408 436 7000

San Juan, PR
787 725 5880

Seattle, WA
206 386 7400

Tampa, FL
813 281 2095

Washington, DC
301 530 5050

Wilmington, DE
302 477 9640

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