Federalism and ERISA: A Return to First Principles

*By Michael J. Collins**

The Supreme Court takes federalism seriously. In a series of 5-4 decisions, the current Court has been the first post-New Deal court to attempt to ensure that the federal government does not exceed its enumerated powers or unduly intrude upon state authority. Chief Justice Rehnquist and Justices O'Connor, Scalia, Kennedy and Thomas have, over biting dissents from the Court's four liberals, restricted Congress's authority in ways that were previously unimaginable.

Despite the Court's professed solicitude for federalism, the Court has not yet attempted to apply its reasoning to most federal legislation. In particular, the Court seems not to have even considered whether the application of the broad preemption provisions of the Employee Retirement Income Security Act (ERISA) are a proper exercise of federal power. As described below, there are good arguments that ERISA's preemption clause, as currently interpreted, exceeds Congress's authority under the Commerce Clause.

The Federalism Cases

There are two main currents to the Court's federalism decisions. First, Congress does not have an unlimited right to impose uniform national rules on the states without the states' consent. Second, the Court no longer allows Congress to regulate any area it chooses simply by citing to its authority under the Commerce Clause.

The first glimmer of the Court's potential concern for preserving states' traditional prerogatives was *National League of Cities v. Usery.*[1] In *National League of Cities*, the Court invalidated legislation extending the minimum wage and maximum hour provisions of the Fair Labor Standards Act to the states. Writing for the Court, then-Justice Rehnquist stated that "Congress may not exercise [its Commerce Clause powers] so as to force directly upon the States its choices as to how essential decisions regarding the conduct of integral governmental functions are to be made."[2] However, nine years later, in *Garcia v. San Antonio Metropolitan Transportation Authority,*[3] the Court overruled *National League of Cities* and upheld the application of the FLSA to state and local governments. The Court adopted a "process based" approach, stating that the "Framers chose to rely on a federal system in which special restraints on federal power over the States inhered primarily in the workings of the National Government itself, rather than in discrete limitations on the objects of federal authority."[4]

In later cases, the Court has appeared to return to the concerns expressed in *National League of Cities*, and has shown an increased skepticism to Congress's ability to subject the states to various enactments. In *New York v. United States,*[5] the Court invalidated a federal statute that, among other things, required individual states either to enact legislation regulating low-level radioactive waste generated within their borders or to take title to the waste. The Court held that Congress may not commandeer the legislative processes of the states by compelling them to enact and enforce a federal regulatory program. Similarly, in *Printz v. United States,*[6] the Court struck down the portion of the "Brady Bill" that required state law enforcement officers to conduct background checks on handgun purchasers. The Court held that Congress may not conscript state officers to enforce a federal regulatory program. The holdings from *New York* and *Printz* are commonly referred to as the "anti-commandeering" rule.

In addition to the holdings that Congress lacks the authority to regulate the states qua states in certain cases, the Court has also rolled back its previous holdings, epitomized by *Wickard v. Filburn,*[7] that Congress's right to regulate interstate commerce provides almost unlimited police power authority that is circumscribed only by the Bill of Rights. In *United States v. Lopez,*[8] the Court invalidated the federal Gun Free School Zones Act, which purported to prohibit the possession of guns in and around school grounds, as beyond the reach of Congress's authority under the Commerce Clause. *Lopez* was the first case in almost six decades in which the Court struck down a federal law on that ground. The Court held that the Commerce Clause allows Congress to regulate (1) the use of channels of interstate commerce, (2) instrumentalities of interstate commerce, including persons or things in interstate commerce, and (3) activities that "substantially affect" interstate commerce. *Lopez* signified that Congress no longer has a free pass to regulate what it chooses by virtue of the Commerce Clause.

United States v. Morrison[9] followed up on and clarified *Lopez*. In *Morrison*, the Court invalidated the civil remedies provision of the 1994 Violence against Women Act, which authorized the victims of gender-motivated violence to sue their aggressors for damages in federal court. In the course of holding that neither the Fourteenth Amendment nor the Commerce Clause authorizes Congress to enact that provision, the Court clarified *Lopez* to provide that Congress may not regulate "non-economic" conduct under the Commerce Clause, but otherwise generally left *Lopez* intact.

The Court has not yet decided how its federalism cases apply to purely economic conduct. However, it can be persuasively argued that the Commerce Clause does not grant Congress *carte blanche* authority to regulate any area it chooses as long as the area falls within the economic realm. By allowing Congress to regulate any "economic" activity, the Court destroys the ability of the states to experiment with different approaches to regulating medical benefits and other areas in which the states

are precluded from innovating due to ERISA's broad preemptive reach.

ERISA Preemption

After more than ten years of hearings and debate, Congress enacted ERISA in 1974 in response to perceived failures in the private pension system. The most prominent example given for the need for greater regulation of private pensions was the situation involving Studebaker Corporation's employees. In December, 1963, following years of losses, Studebaker decided to close its manufacturing plant in South Bend, Indiana. The plant closing resulted in the dismissal of more than 5,000 workers and the termination of a pension plan covering 11,000 members of the United Automobile Workers (UAW). The assets of the plan were far less than needed to provide the benefits that had vested under the plan. Ultimately, Studebaker and the UAW agreed to allocate the plan's assets in accordance with default priorities specified in the plan. Approximately 3,600 retirees and active workers who had reached age sixty received the full pension promised under the plan, and roughly 4,000 other vested employees received lump-sum distributions of roughly 15% of the value of their accrued benefits. The remaining employees, whose interest had not yet vested in any benefits under the plan, received nothing.

Although the driving force behind ERISA was the desire to more closely regulate private pension plans and prevent recurrences of the issues raised by Studebaker, ERISA also applies to welfare benefit plans, such as medical and disability plans offered by employers. Perhaps the best known part of ERISA that applies to welfare benefit plans is the "COBRA" health continuation coverage rule.

A last-minute addition to ERISA was section 514, ERISA's preemption clause. The addition of the preemption clause was supported by both large employers and labor unions. Employers wanted to avoid a patchwork of state regulation that would require more expensive administration of their plans. Labor unions were concerned that state laws regulating the legal profession would affect collectively-bargained legal services plans. Thus, section 514(a) of ERISA (29 U.S.C. § 1144(a)) provides that, subject to certain limited exceptions, ERISA preempts any state law that "relate[s] to" an ERISA-covered plan. The most important exception to preemption is that state laws regulating insurance are not preempted. For example, state laws regulating health maintenance organizations (HMOs) have been held not to be preempted even when employee benefit plans offer benefits through HMOs because, at base, those laws regulate insurance.

The Court frequently decides ERISA preemption cases; it is a rare term when there is not at least one such case. In recognition of the burdens that conflicting state laws may place on ERISA-covered plans, the Court has held that ERISA preempts any state law that has a "connection with" or "reference to" an ERISA plan, as determined by reference to "'the objectives of the ERISA statute as a guide to the scope of the state law that Congress understood would survive,' as well as to the nature of the effect of the state law on ERISA plans."[10] Not every state law that affects ERISA plans has a connection with an ERISA plan. However, state laws are preempted if they implicate Congress's objective "to avoid a multiplicity of regulation in order to permit the nationally uniform administration of employee benefit plans."[11] Laws that are preempted by ERISA include, *inter alia*, those that regulate "employee benefit structures or their administration."

Before 1995, the Court routinely held that ERISA preempts state laws with even a tenuous connection to an ERISA-covered plan. However, beginning with *Travelers*, the Court has applied a less expansive reading of ERISA preemption. For example, Justice Scalia has suggested that the Court should explicitly recognize that ERISA's preemptive reach is now limited to ordinary field and conflict preemption.[12] However, even with the recent trend toward a somewhat more narrow reading of ERISA preemption, its preemptive scope is still wider than virtually any other federal law.

The States' Concerns with ERISA Preemption

ERISA imposes few substantive requirements on medical and other "welfare" plans. Given consumer unhappiness with HMOs and other "managed care" arrangements, states have felt pressure to impose ever more regulations on providers of medical benefits. For example, many states have imposed "independent review" requirements on medical decisions and have required HMOs to cover specified procedures such as mastectomies and *in vitro* fertilization.

These laws generally escape ERISA's preemptive reach when they regulate HMOs. However, many employers, especially large employers, "self-insure" their plans, and the exception for laws regulating insurance does not apply in those cases. Thus, employees whose medical benefits are provided through HMOs may have substantially different legal rights than those whose (otherwise identical) benefits are provided directly by their employer.

As another example, the Court held in *Boggs v. Boggs* that ERISA preempts a state community property law that would allow pension benefits to be subject to the will of a deceased spouse of a plan participant. In that case, the Louisiana law allowed an employee's spouse to transfer by will to her children her interest in her husband's undistributed pension plan benefits. The Court found that a state law permitting such a transfer directly conflicted with ERISA and frustrated ERISA's purposes. The Court wrote: "[c]onventional conflict preemption principles require pre-emption 'where compliance with both federal and state regulations is a physical impossibility . . . or where state law stands as an obstacle to

the accomplishment and execution of the full purposes and objectives of Congress.'" Thus, ERISA's preemptive reach has been read to extend even to family law, an area traditionally reserved to the states.

ERISA and Federalism

The wide sweep of ERISA's preemption clause is not self-evident. Section 514 does not have to be read as broadly as it has been. ERISA was enacted in 1974, and the cases that serve as the foundation for the Court's preemption jurisprudence were decided by a Court much more deferential to federal authority than the current Court.

If asked whether the wide sweep of ERISA preemption is consistent with the Court's federalism jurisprudence, the Justices responsible for that jurisprudence would surely reply that it is. They presumably would state that ERISA is within the scope of Congress's delegated authority, and that there is no need to go beyond that surface inquiry. Because ERISA itself is a permissible regulation of commerce, they might argue, interpreting the preemption clause to have a wide sweep is not at all inconsistent with the Court's federalism jurisprudence.

A New ERISA Federalism Jurisprudence

The Court's federalism jurisprudence teaches that Congress should respect the fact that states are separate sovereigns. The Court should keep that in mind when deciding ERISA preemption cases. Is the preemption of a specific state law consistent with the authority delegated to Congress by the Commerce Clause? If not, the law should survive the preemption analysis. For example, it is at best arguable that an interpretation of ERISA that, in effect, prohibits states from requiring health plans to cover mastectomies comports with a proper reading of Congress's power under the Commerce Clause.

Of particular relevance, Congress recognizes the need for systemic changes to the provision of health care. This is best demonstrated by the addition of "health savings accounts" (HSAs) pursuant to the 2003 Medicare prescription drug legislation. HSAs, which are tax-free medical savings accounts that individuals may use in their discretion to pay certain medical expenses, may have the effect of encouraging preventive care and restraining double-digit annual inflation in medical costs.

Unfortunately, as currently interpreted, ERISA's preemption clause precludes similar innovations by the states. To be sure, if left more discretion, states may impose laws that are unpalatable to many who otherwise support federalism. In particular, states may impose mandates that increase the cost of medical coverage for employers and therefore ultimately add to the millions of uninsured in the United States. However, that is a necessary cost of a federal system, and experience has taught that the states as "laboratories of democracy" are more often right than wrong.

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Footnotes

[1] 426 U.S. 833 (1976).
[2] *Id.* at 855.
[3] 469 U.S. 528 (1985).
[4] *Id.* at 552.
[5] 105 U.S. 144 (1992).
[6] 521 U.S. 898 (1997).
[7] 317 U.S. 111 (1942).
[8] 514 U.S. 549 (1995).
[9] 529 U.S. 598 (2000).
[10] California Div. of Labor Standards Enforcement v. Dillingham Constr., N.A., 519 U.S. 316, 325 (1997).
[11] New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645, 657 (1995).
[12] *Dillingham* at 336 (Scalia, J., concurring).