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UNINTENDED CONSEQUENCES: RESOLVING THE DILEMMA OF THE INADVERTENT CREATION OF MULTIPLE EMPLOYER WELFARE ARRANGEMENTS DURING BUSINESS TRANSFERS

Eric Eller^{*}

INTRODUCTION

A “Business Transfer” is a common corporate transaction—one company (the “Buyer”) purchases assets of a second company (the “Seller”).¹ This transaction often brings with it the employees who work with those assets. For example, if an asset is a factory, the Buyer normally becomes the employer of the employees at the factory.

A Multiple Employer Welfare Arrangement (a “MEWA”) is a welfare plan that provides health insurance, or other welfare benefits to the employees of multiple employers, excluding such plans established by a collective bargaining agreement.² When employees come with the purchased assets, there is a risk that a MEWA will be inadvertently created. This can happen if the Seller maintains a self-insured welfare plan (such as a health benefit plan, which is the most important type of welfare plan) that includes the employees who cease employment with the Seller and begin employment with the Buyer as of the date the Business Transfer is effective (the “Closing Date”). This risk can create costs for both the Buyer and the

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1. Asset Purchase vs. Stock Purchase: Advantages and Disadvantages, <http://smallbusiness.findlaw.com/starting-business/starting-business-more-topics/starting-business-buying-asset-stock.html> (last visited Oct. 6, 2006) (explaining that an asset purchase (i.e., a Business Transfer) occurs when one company enters an agreement to purchase “facilities, vehicles, equipment, and stock or inventory” from another company, distinguished from a stock purchase agreement, where one company buys stock in another company).

2. 29 U.S.C. § 1002(40) (2000).

Seller. Despite this risk, inadvertent MEWA creation and its associated costs are relatively unexamined subjects.³

MEWAs are governed by the Employee Retirement Income Security Act (ERISA).⁴ They “provide health . . . benefits to [nonunion] employees of [multiple,] unrelated employers.”⁵ They are also “a source of regulatory confusion, enforcement problems, and . . . fraud.”⁶ The regulatory and enforcement problems occur because MEWAs are only partly covered by ERISA preemption.⁷ Fraud occurs when a purported insurance company collects premiums, fails to provide coverage, and attempts to use ERISA as a shield against the defrauded participants.⁸ The uncertain status of MEWAs lends itself to these problems.

Most legitimate MEWAs are created for groups of small employers.⁹ There is little record of academic or litigation focus having been placed on

3. See generally *EMPLOYEE BENEFITS LAW* 415-23 (Jane Kheel Stanley et al. eds., BNA Books 2nd ed. Supp. 2006) (providing a summary of recent case law concerning MEWAs, but including no new information concerning the creation of MEWAs).

4. U.S. DEP’T OF LABOR, *EMPLOYEE BENEFITS SEC. ADMIN., MEWAs: MULTIPLE EMPLOYER WELFARE ARRANGEMENTS UNDER THE EMPLOYEE RET. INCOME SEC. ACT (ERISA); A GUIDE TO FED. AND STATE REGULATION 5* (2004) [hereinafter *MEWA GUIDE*] (“[T]hose MEWAs that constitute “employee welfare benefit plans” are subject to ERISA’s provisions governing employee benefit plans.”).

5. Roy F. Harmon III, *A Short Course in MEWA’s (Unit 1): Overview* (Sept. 4, 2006), <http://healthplanlaw.com/?p=67> [hereinafter *Harmon Unit 1*] (“MEWA’s provide health and welfare benefits to employees of two or more unrelated employers who are not parties to bona fide collective bargaining agreements. A good example of a MEWA is a plan sponsored by a trade association for its members.”).

6. GENERAL ACCOUNTING OFFICE, *EMPLOYEE BENEFITS: STATES NEED LABOR’S HELP REGULATING MULTIPLE EMPLOYER WELFARE ARRANGEMENTS*, GAO/HRD-92-40 6 (1992).

7. 29 U.S.C. § 1144(b)(6) (2000).

8. See U.S. Dep’t of Labor, *Employee Benefits Sec. Admin., MEWA Enforcement* (2002), <http://www.dol.gov/ebsa/newsroom/fsmewa0902.html> (providing examples of fraudulent insurance schemes and the prosecution thereof by the Dep’t of Labor).

9. See *EMPLOYEE BENEFITS LAW*, 532 (Steven J. Sacher et al. eds., BNA Books 2nd ed. 2000).

the inadvertent creation of MEWAs through Business Transfers.¹⁰ If an inadvertent MEWA is created, new costs could be imposed on the Seller (and possibly on the Buyer).¹¹ This can happen because ERISA, which preempts state regulation of many other health plans, does not preempt state regulation of MEWAs.¹² State regulation of health plans can add to the Seller's costs, depending on factors such as mandatory licensing, benefits, fees, or funding requirements.¹³ The Seller and Buyer's efforts to avoid possible inadvertent MEWA creation can also increase the cost of a Business Transfer.¹⁴

This comment examines inadvertent MEWAs, their creation and potential costs, and possible solutions to eliminate those costs. Part I introduces MEWAs and the effect of ERISA preemption on them. Part II discusses how a MEWA can be created inadvertently. Part III analyzes five possible options to reduce (or eliminate) the potential costs of dealing with inadvertent MEWAs in a Business Transfer. Part IV recommends one option, an ERISA carve-out, which would provide the greatest potential benefit at the lowest relative cost.

I. BACKGROUND

A. MEWAs are Commonly Established as Health Plans for Nonunion Employees of Multiple Employers

A MEWA is "an employee welfare benefit plan . . . which is established or maintained [to provide medical or other welfare benefits] to the

10. See generally EMPLOYEE BENEFITS LAW, *supra* note 3, at 415-23 (summarizing historic and recent case law concerning MEWAs, none of which covers MEWAs created through a Business Transfer).

11. See discussion *infra* Part II.A for further details on possible costs.

12. 29 U.S.C. § 1144(b)(6).

13. See generally Roy F. Harmon III, MEWA Page, http://healthplanlaw.com/?page_id=123 (last visited Aug. 18, 2007) [hereinafter MEWA Page] (providing some examples of state regulatory requirements, or limitations, on MEWAs).

14. Interview with John Forgach, Senior Benefits Counsel, W. R. Grace & Co., in Columbia, Md. (Dec. 14, 2006) [hereinafter Forgach Dec. Interview]. For a discussion in greater detail of what constitutes (and does not constitute) a MEWA, see MEWA GUIDE, *supra* note 4, at 19-22.

employees of two or more employers.”¹⁵ For a MEWA to exist, “[t]he employers that participate in a [MEWA] must . . . exercise control over the program, both in form and substance.”¹⁶ MEWAs are one method used by small employers to reduce the cost of providing health insurance to their employees.¹⁷ Unique to ERISA-governed health plans, MEWAs are not covered by full ERISA preemption.¹⁸ The Supreme Court defines ERISA preemption to mean that self-insured single-employer health plans are “exempt[ed] . . . from state laws that [govern] insurance within the meaning of the saving clause” in ERISA.¹⁹

MEWAs cover nonunion workers.²⁰ They are similar to, but distinct from, Taft-Hartley plans.²¹ Unlike MEWAs, Taft-Hartley plans are covered

15. 29 U.S.C. § 1002(40) (2000).

16. U.S. Dep’t of Labor Advisory Op. 2005-20A, 4 (Aug. 31, 2005).

17. For information on efforts to use MEWAs to expand health insurance coverage, see GENERAL ACCOUNTING OFFICE, SMALL EMPLOYER PURCHASING COOPERATIVES, GAO/HEHS-00-49 9 (2000); see also U.S. Dep’t of Labor, Employee Benefits Sec. Admin., MEWA Enforcement (July 2007) <http://www.dol.gov/ebsa/Newsroom/fsMEWAenforcement.html> (“MEWAs are designed to give small employers access to low cost health coverage on terms similar to those available to large employers. For certain employers they represent the only available option for providing employees with health care.”).

18. Nat’l Bus. Ass’n Trust v. Morgan, 770 F. Supp. 1169, 1177 (W.D. Ky 1991) (“Congress intended to authorize states to apply their insurance laws to MEWAs to the extent such laws are not inconsistent with ERISA.”).

19. FMC Corp. v. Holliday, 498 U.S. 52, 61 (1990); see also 29 U.S.C. § 1144(a) (2000) (explaining that ERISA “shall supersede any and all State laws insofar as they may now or hereafter relate to any employee . . . [health] plan” covered by ERISA); see also COLLEEN E. MEDILL, INTRODUCTION TO EMPLOYEE BENEFITS LAW: POLICY AND PRACTICE 603 (Thomson West 2004) (explaining that ERISA’s savings clause exempts “from ERISA preemption state laws that regulate insurance, banking, or securities”).

20. 29 U.S.C. § 1002(40)(A)(i) (2000) (excluding benefit plans “established or maintained under or pursuant to one or more . . . collective bargaining agreements”).

21. MEDILL, *supra* note 19, at 32.

by full ERISA preemption.²² As with Taft-Hartley plans, MEWAs can cover many employers or only a single employer.²³ Further, the employer can have no connection to the MEWA beyond having some of its employees as participants.²⁴ Unlike Taft-Hartley plans, MEWAs can be entirely outside of ERISA's reach.²⁵

ERISA formally incorporated provisions regarding MEWAs in 1983.²⁶ A review of the development of the original ERISA legislation does not show a focus placed on MEWAs.²⁷ Problems where state law interacted with MEWAs appeared after ERISA went into effect.²⁸ Unfortunately, ERISA

22. 29 U.S.C. § 1002(37)(A) (2000) (defining multi-employer plans [i.e., Taft-Hartley plans] for the purposes of Title I of ERISA); 29 U.S.C. § 1003 (2000) (defining the scope of Title I of ERISA to include coverage of multi-employer plans).

23. MEWA GUIDE, *supra* note 4, at 8.

24. *Id.* at 25 (noting that an employer's only link to a MEWA can be through the participation of its employees in the MEWA – the employer need not have any administrative role in the MEWA).

25. *Chao v. Crouse*, 346 F. Supp. 2d 975, 982 (2004) (citing *Hall v. Maine Mun. Employees Health Trust*, 93 F. Supp. 2d 73, 77 (D. Me. 2000)) (“A MEWA is not necessarily [an employee welfare benefit plan] covered by ERISA.”).

26. An Act to Amend the Internal Revenue Code of 1954 with Respect to the Treatment of Periodic Payments for Damages Received on Account of Personal Injuries or Sickness, and for other Purposes, Pub. L. No. 97-473, § 302, 96 Stat. 2605, 2612 (1983).

27. See generally JAMES A. WOOTEN, *THE EMPLOYEE RETIREMENT INCOME SEC. ACT OF 1974: A POLITICAL HISTORY* (Univ. of Cal. Press 2004) (providing a detailed discussion of the particulars of the original ERISA legislation, and how and why it was developed).

28. State regulation of MEWAs before 1983 was fraught with difficulties.

Prior to 1983, a number of states attempted to subject MEWAs to State insurance law requirements, but were frustrated in their regulatory and enforcement efforts by MEWA-promoter claims of ERISA-plan status and Federal preemption. In many instances MEWAs, while operating as insurers, had the appearance of an ERISA-covered plan—they provided the same benefits as ERISA-covered plans, benefits were typically paid out of the same type of tax-exempt trust used by ERISA-covered plans, and, in some cases, filings of ERISA-required documents were made to further enhance the appearance of ERISA-

sets the stage for this type of fraud to exist.²⁹ Preemption of state laws, as provided in section 514(a) of ERISA, creates the circumstances.³⁰ By preempting state law, ERISA shields health plans from state regulation and thus blocks plan participants from seeking recourse under state law for any fraudulent activities. The changes in 1983 helped to mitigate this problem. The original purpose of the 1983 provisions was to confront abuse by purported insurance providers who “marketed insurance products . . . claiming [they were] ERISA covered plans” and used ERISA preemption as a shield when defrauded participants pursued claims under state insurance law.³¹

plan status. MEWA-promoter claims of ERISA-plan status and claims of ERISA preemption, coupled with the attributes of an ERISA plan, too often served to impede State efforts to obtain compliance by MEWAs with State insurance laws.

MEWA GUIDE, *supra* note 4, at 5.

29. An unfortunate side effect of the law governing MEWAs is that self-styled insurance providers attempt to manipulate ERISA to find ways to defraud unwitting participants.

Although MEWAs can be provided through legitimate organizations, they are sometimes marketed using attractive but actuarially unsound premium structures that generate large administrative fees for the promoters. In addition, certain promoters will set up arrangements that they claim are established pursuant to a collective bargaining agreement and, therefore, are not MEWAs but legitimate benefit plans free from state insurance regulations. Often, however, these collective bargaining agreements are nothing more than shams designed to avoid state insurance regulation.

U.S. Dep’t of Labor, Employee Benefits Sec. Admin., MEWA Enforcement (July 2007), www.dol.gov/ebsa/newsroom/fsMEWAenforcement.html.

30. 29 U.S.C. § 1144(a) (2000) (“[T]he provisions of [Title I of ERISA] shall supersede any and all State laws insofar as they may now or hereafter relate to an employee benefit plan” that is covered by ERISA. If a welfare plan is governed by ERISA, then ERISA preempts any state laws that would otherwise regulate the welfare plan.).

31. N.Y. State Ins. Dep’t, Employee Retirement Income Security Act (ERISA), Multiple Employer Welfare Arrangement (MEWA) (Jan. 4, 2006), <http://www.ins.state.ny.us.ogco2006/rg060108.htm> (quoting Activity Report of Pension Task Force, 94th Cong. 2 (1977) (statement of Rep. Erlenborn, member, House Comm. on Educ. and Labor)).

B. Companies Can Create MEWAs Inadvertently Through a Business Transfer

In a Business Transfer, two companies enter into an agreement where a Buyer purchases a portion of a Seller's assets. For example, a Business Transfer can be for a physical asset (such as a factory) or the stock of a Seller subsidiary. The Buyer often retains the Seller's former employees who worked at the purchased asset.³² In this situation, the Business Transfer agreement may include provisions to manage the transfer of responsibility for employee benefits.³³ If the divested employees remain covered by the Seller's self-insured health plan,³⁴ this plan could be inadvertently converted into a MEWA.³⁵ This MEWA can exist through the end of the current plan year, which can mean until the end of the calendar year after the Closing Date.³⁶ And this MEWA conversion would strip away some ERISA preemption.³⁷ The freshly minted MEWA is left subject to state insurance laws.³⁸

32. Interview with John Forgach, Senior Benefits Counsel, W. R. Grace & Co., in Columbia, Md. (Sept. 20, 2006) [hereinafter Forgach Sept. Interview].

33. W. R. Grace & Co., Employee Benefits and Comp. Agreement between W. R. Grace & Co., Nat'l Med. Care, Inc., and W. R. Grace & Co.-Conn., 14–16, 20–21 (Sept. 27, 1996) [hereinafter Nat'l Med. Care] (on file with author).

34. *Id.* at 20–21.

35. 29 U.S.C. § 1002(40) (2000) (A MEWA is “an employee welfare benefit plan . . . which is established or maintained [to offer or provide medical or other welfare benefits] to the employees of two or more employers.”).

36. The MEWA would only exist so long as there are employees from more than one employer as participants in the plan. Nat'l Med. Care, *supra* note 33, at 20–21.

37. Fuller v. Norton, 86 F.3d 1016, 1024 (10th Cir. 1996) (“[T]he MEWA clause is a limited exception to the deemer clause.”).

38. *Id.*, citing Atl. Healthcare Benefits Trust v. Googins, 2 F.3d 1, 5 (2d Cir. 1993) (“The Second Circuit has held that the MEWA clause ‘authorizes states to regulate MEWAs as insurance companies.’ . . . Congress obviously viewed self funded arrangements by multiple employers to be different, and less deserving of federal preemption from state insurance regulators.”); *see also* Meredith v. Times Ins. Co., 980 F.2d 352, 354 (5th Cir. 1993) (“[T]he existence of a MEWA . . . is not dispositive of preemptive status.”).

As noted above, a MEWA can be created based solely on whether the defining criteria are met; the definition provided in the ERISA statute does not include intent.³⁹ A MEWA can also exist even if the company administering the MEWA is not an employer of any participants in the MEWA, and if the actual employers do not administer or maintain the MEWA.⁴⁰ Accordingly, even if the Seller can argue that it no longer has any connection to its former employees, the health plan can still be found to be a MEWA.⁴¹

C. ERISA Preempts State Regulation of Self-Funded Health Plans

Any company can self-insure its health plan rather than purchase insurance.⁴² ERISA preempts state insurance laws from regulating such self-insured plans.⁴³ Because state laws that, for example, mandate certain benefits (and thus their associated costs) do not apply to self-insured health plans, ERISA preemption of state law is a benefit to the company sponsoring the health plan.⁴⁴ The Supreme Court provided guidelines for applying

39. 29 U.S.C. § 1002(40).

40. *MDPhysicians & Assocs., Inc. v. State Bd. of Ins.*, 957 F.2d 178, 185 (5th Cir. 1992) (holding that a MEWA can exist when none of the participating employers set up the MEWA, and when none of the employers “participate[d] in the day-to-day operation or administration of the plan”).

41. MEWA GUIDE, *supra* note 4, at 25 (“[T]he MEWA status of an arrangement is not affected by the absence of any connection . . . between the arrangement and the employers whose employees are covered.”).

42. Colleen E. Medill, *HIPAA and its Related Legislation: A New Role for ERISA in the Regulation of Private Health Care Plans*, 65 TENN. L. REV. 485, 493 (1998) (explaining that “self-funded plans provide health care benefits to plan participants from a fund comprised of employer or employee contributions, or both, or out of the general assets of the employer”); *FMC Corp. v. Holliday*, 498 U.S. 52, 54 (1990) (distinguishing self-funded plans from the use of an employer-purchased insurance policy to provide health care benefits).

43. *FMC Corp.*, 498 U.S. at 58 (“The saving clause returns to the States the power to enforce those state laws that ‘regulate insurance,’ except as provided in the deemer clause. Under the deemer clause, an . . . [ERISA-governed plan] shall not be ‘deemed’ . . . engaged in the business of insurance for purposes of state laws . . . [regulating] insurance . . .”).

44. Medill, *supra* note 42, at 493 (“ERISA preemption of state insurance laws with respect to self-insured private health care plans gives plan sponsors a strong incentive to

ERISA preemption in *FMC Corp. v. Holliday*, by holding that employers are not insurance companies.⁴⁵ If a company funds all of the benefits provided by its health plan, it is not “deemed” to be an insurance company and is exempt from state laws that regulate insurance.⁴⁶ Laws that “relate to” plans covered by ERISA are also preempted.⁴⁷ In the context of ERISA, a law relates to an ERISA-covered plan “if it has a connection with or reference to such a plan.”⁴⁸ Though the “relate to” doctrine is to be read broadly,⁴⁹ any connection cannot be adhered to in an overly rigid and literal manner; the impact of the law, as well as Congressional intent, must be evaluated.⁵⁰ A policy basis for preemption is to ensure a single, consistent standard set of rules governing company-provided health benefits across the country.⁵¹ Thus, a company can self-insure to save administrative costs and provide uniform benefits to their employees across multiple states.

D. ERISA Does Not Fully Preempt State Law for MEWAs

ERISA specifically limits MEWAs’ preemption protection.⁵² ERISA-covered MEWAs must, besides ERISA requirements, comply with certain

self-insure and thereby avoid benefits mandated by state insurance law for insured plans.”).

45. *FMC Corp.*, 498 U.S. at 61.

46. See generally MEWA GUIDE, *supra* note 4, at 17-19 (discussing ERISA preemption and the “deemer” and “savings” clauses).

47. See *Egelhoff v. Egelhoff*, 532 U.S. 141, 146-52 (2001).

48. *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85, 97 (1983).

49. *Egelhoff*, 532 U.S. at 147.

50. *Cal. Div. of Labor Standards Enforcement v. Dillingham Constr., N.A., Inc.*, 519 U.S. 316, 324 (1997).

51. *Fort Halifax Packing Co. v. Coyne*, 482 U.S. 1, 9 (1987) (noting that a primary ERISA goal is to enable companies to “establish a uniform administrative scheme, which provides a set of standard procedures to guide processing of claims and disbursement of benefits”).

52. 29 U.S.C. § 1144(b)(6)(A) (2001).

state insurance laws.⁵³ Though all MEWAs are not ERISA-covered plans, a determination that a MEWA has been established is sufficient to conclude that ERISA applies to that MEWA.⁵⁴ Even so, “ERISA does not prohibit a state insurance commissioner from regulating [the MEWA] through its insurance laws to the extent such laws are not inconsistent with ERISA.”⁵⁵

E. The Department of Labor Advocates Broad State Authority to Regulate MEWAs

The U.S. Department of Labor, through the Employee Benefits Security Administration (EBSA), has determined that the states have a broad ability to regulate MEWAs.⁵⁶ EBSA focuses enforcement on purported insurance providers who defraud insurance plan participants and do not provide the paid-for benefits.⁵⁷

Several factors determine how state regulation applies to MEWAs.⁵⁸ ERISA does not preempt “state laws that require the maintenance of

53. MEWA GUIDE, *supra* note 4, at 5.

54. See *Nat’l Bus. Ass’n Trust v. Morgan*, 770 F. Supp. 1169, 1175 (W.D.Ky. 1991); see also *Wis. Educ. Ass’n Ins. Trust v. Iowa State Bd. of Pub. Instruction*, 804 F.2d 1059, 1063 (8th Cir. 1986).

55. *Morgan*, 770 F. Supp. at 1170; see also *Atl. Healthcare Benefits Trust v. Googins*, 2 F.3d 1, 5 (2nd Cir. 1993).

56. MEWA GUIDE, *supra* note 4, at 28 (explaining the scope of state authority under 29 U.S.C. §1144(b)(6)(A) – “[w] hile the range of State insurance law permitted under [29 U.S.C. §1144(b)(6)(A)] is subject to certain limitations, the Department of Labor believes that these limitations should have little, if any, practical affect on the ability of States to regulate MEWAs under their insurance laws”).

57. Ann L. Combs, Assistant Sec’y, U.S. Dep’t of Labor, Testimony before the House Comm. on Educ. and Workforce, Subcomm. on Employer-Employee Relations (Sept. 10, 2002) available at <http://www.dol.gov/ebsa/newsroom/ty091002.html> (testifying that “PWBA continues to focus its enforcement efforts on abusive and fraudulent MEWAs created by unscrupulous promoters who sell the promise of inexpensive health benefit insurance, but default on their obligations”).

58. Roy F. Harmon III, *A Short Course in MEWA’s (Unit 3): Regulation of MEWA’s Under State Insurance Laws* (Sept. 10, 2003), <http://healthplanlaw.com/?p=85> [hereinafter Harmon Unit 3] (“[ERISA Section 514(b)(6)(D)] opens up MEWA’s to State insurance laws requiring the maintenance of specific reserves or contributions [and] licensing, registration, certification, financial reporting, examination, audit and any other requirement of State insurance law necessary to ensure compliance with the State

specified levels of reserves and contributions” to fund a MEWA.⁵⁹ Whether a MEWA is fully insured is also a factor. Fully insured MEWAs receive the most protection under ERISA; the limit on state insurance laws’ application to MEWAs that are not fully insured is only that the laws must not be “inconsistent with Title I of ERISA.”⁶⁰ Also, for “a [MEWA] that is not fully insured, [ERISA] exempts from ERISA preemption any state laws that regulate insurance.”⁶¹ Further, self-insured health plans (normally covered by full ERISA preemption) that become MEWAs can be regulated by the states in the same manner by which fully insured plans are regulated.⁶²

States typically regulate MEWAs via specific taxes and fees.⁶³ States can also regulate funding and registration requirements for MEWAs as if they

insurance reserves, contributions and funding requirements.”); *see also* MEWA GUIDE, *supra* note 4, at 30.

59. H.R. REP. NO. 97-984, at 19 (1982), *as reprinted in* 1982 U.S.C.C.A.N. 4598, 4604.

60. MEWA GUIDE, *supra* note 4, at 30-31 (“[I]f a MEWA is not ‘fully insured,’ the only limitation on the applicability of State insurance laws to the MEWA is that the law not be inconsistent with Title I of ERISA.”).

61. H.R. REP. NO. 97-984, at 19.

62. This result has potentially large implications for self-insured plans that inadvertently become MEWAs. ERISA § 514(b)(6)(A)(ii) allows state insurance law to govern self-funded MEWAs.

[T]o the extent not inconsistent with . . . the provisions of Title I of ERISA [a] State insurance law generally is not ‘inconsistent’ with the provisions of Title I simply because it requires . . . MEWAs to: meet more stringent standards of conduct, to provide more or greater protection to plan participants and beneficiaries than required by ERISA, comply with standards requiring the maintenance of specified levels of reserves and . . . of contributions[,] requires a license or certificate of authority as a condition precedent or otherwise to transacting insurance business[, or] subjects persons who fail to comply with State requirements to taxation, fines and other civil penalties . . .

Harmon Unit 3, *supra* note 58.

63. For an example of the application of a state tax on MEWAs, see U.S. Dep’t of Labor Advisory Op. 2005-18A (Aug. 1, 2005) (“Under section 24(2) of the [Washington Sate Self-Funded Multiple Employer Welfare Arrangement Regulation Act], self-funded MEWAs are subject to an annual premium tax equal to two percent of the total premiums

were insurance companies.⁶⁴ States can exert further control over fully funded MEWAs.⁶⁵ For example, “[a] state insurance law will, generally, not be deemed ‘inconsistent’ with . . . ERISA if it requires MEWAs to meet more stringent standards of conduct, or to provide more or greater protections to plan participants and beneficiaries, than required by ERISA.”⁶⁶ This can mean stronger coverage than provided for under ERISA.⁶⁷ Thus, if imposed on an inadvertent MEWA previously protected by ERISA preemption, state-mandated coverage could increase the plan’s costs.⁶⁸

II. ANALYSIS

A. Business Transfers Can Generate New Seller and Buyer Costs by Creating an Inadvertent MEWA

A self-insured health plan covering nonunion employees that is exposed, via a Business Transfer, to state regulation as a MEWA is a potential source of new costs. Any expanded costs caused by state regulation would fall on the plan administrator, who, in the case of self-insured plans, is generally the employer.⁶⁹ Several factors can expand these costs:

and prepayments for health care services received by the MEWA during the preceding calendar year.”).

64. MEWA GUIDE, *supra* note 4, at 30–31.

65. *E.g.*, U.S. Dep’t of Labor Advisory Op. 90-18A (July 2, 1990), *as reprinted in* MEWA GUIDE, *supra* note 4, at 42-44.

66. *Id.* (explaining that there is a “clear intent of Congress to permit states to . . . enforce their insurance laws with respect to ERISA-covered MEWAs” and have the “authority to require and enforce registration, licensing, reporting and similar requirements necessary to establish and monitor compliance with those laws”).

67. U.S. Dep’t of Labor Advisory Op. 2005-18A, *supra* note 63 (citing U.S. Dep’t of Labor Advisory Op. 90-18A (July 2, 1990)).

68. *Id.* (noting that a self-funded MEWA in the state of Washington must pay a 2% tax on “the total premiums and prepayments for health care services received by the MEWA during the preceding calendar year”).

69. *E.g.*, W. R. Grace & Co., W. R. Grace & Co. Grace Group Life, Med. and Dental Plan for Active Employees 112 (2006) [hereinafter Grace Med. Plan] (on file with author).

- state insurance regulations that mandate minimum funding levels, special insurance taxes, or registration fees;⁷⁰
- state-mandated health benefits that add previously uncovered medical procedures or treatments to the health plan;⁷¹
- increased legal costs in preparing the Business Transfer documents;⁷²
- upfront reimbursement by the Buyer of medical expenses to be incurred by the employees going to the Buyer;⁷³ and
- administrative costs for monitoring multiple state insurance regulations if the transaction covers employees in multiple states.⁷⁴

Even if the Business Transfer agreement allocates to the Buyer any new costs for the employees who go with the asset, the inadvertent MEWA would still cover the Seller's employees who remain in the plan. Thus, the Seller would retain the burden of any additional costs related to those plan participants.

70. U.S. Dep't of Labor Advisory Op. 2005-18A, *supra* note 63.

71. Adele Nicholas, *Super-Sized Liabilities*, INSIDECOUNSEL, Sept. 2006, http://www.insidecounsel.com/issues/insidecounsel/15_218/litigation/ ("Georgia, Indiana, Maryland and Virginia, for example, all have laws that require employer benefit plans to include coverage for gastric bypass surgery . . .").

72. Costs associated with resolving potential MEWA problems commonly arise late in the deal, often when the other parts of the deal (which are typically given higher priority) have been resolved and the deal documents are nearly complete. Late changes to the deal document can be much more expensive than changes made earlier. In the worst case, such changes can delay the deal or even provide an excuse to terminate the deal, if one side is having second thoughts. Forgach Dec. Interview, *supra* note 14.

73. *E.g.*, Nat'l Med. Care, *supra* note 33, at 21 ("Grace-Conn. Group shall reimburse NMC, promptly upon receipt of appropriate invoices, for all direct expenses incurred by the NMC Group after the Distribution Date related to the participation of Amicon Employees in NMC Insured Welfare Plans . . .").

74. See Michael H. Bernstein & John T. Seybert, *You Can't Get There From Here - ERISA Preemption Of State Laws Mandating Employer Healthcare Contributions* (Mar. 2007), <http://www.abanet.org/health/esource/Volume3/07/bernstein-seybert.html> (noting that differing state regulations can impose costs on companies to ensure compliance).

If the Seller retains the divested employees within its health plan, the Seller meets the criteria for a MEWA insurance provider.⁷⁵ As noted above, self-insured health plans that become MEWAs can be regulated by the states. And higher benefit standards can be applied.⁷⁶ Also, MEWAs cannot remove actions from state courts to avoid state regulation or legal actions.⁷⁷

Despite the risk of state regulation, the impact of inadvertent MEWA creation may be limited. As noted earlier, there are no cases involving inadvertent MEWAs. Further, the period of time where there is a risk of exposure to MEWA regulation can be short.⁷⁸ This limited period of time, coupled with inadvertent MEWAs' generally low profile, likely limit the chances that a state will try to regulate an inadvertent MEWA. States would only have a brief period of time in which to act, and they would have to be made aware of the MEWA's existence. The most direct way to make a state aware of a MEWA is through form M-1. Form M-1 is the reporting form that MEWAs (barring certain exceptions) must file with the Department of Labor.⁷⁹ However, inadvertent MEWAs are exempted from this requirement.⁸⁰

75. See 29 U.S.C. § 1002(40) (2000).

76. See Harmon Unit 3, *supra* note 58; see also U.S. Dep't of Labor Advisory Op. 90-18A (July 2, 1990), *reprinted in* MEWA GUIDE, *supra* note 4, at 42-44.

77. Roy F. Harmon III, A Short Course in MEWA's (Unit 4): Compliance Requirements (2006) <http://healthplanlaw.com/?cat=6> [hereinafter Harmon Unit 4] ("[E]ntities cited by the State authorities for violating MEWA laws [sic] not be permitted to circumvent State proceedings by resort to federal court [O]nce the compliance issue is raised in State proceedings, the matter will be resolved by the State authorities in most cases.").

78. See Nat'l Med. Care, *supra* note 33, at 15 (illustrating that the transition period where an inadvertent MEWA could exist lasts from the date of the Business Transfer (Sept. 27, 1996 in this agreement) until the last day of the welfare plan year (Dec. 31, 1996 in this agreement)).

79. U.S. Dep't of Labor, Employee Benefits Sec. Admin., 2006 Form M-1 Report for Multiple Employer Welfare Arrangements (MEWAs) and Certain Entities Claiming Exception (ECEs) Instructions § 1.2 (2006) [hereinafter Form M-1].

80. 29 CFR § 2520.101-2(c)(2)(ii)(A) (2003); see also U.S. Dep't of Labor, Employee Benefits Sec. Admin., FAQs On The Form M-1, <http://www.dol.gov/ebsa/faqs/faq-FormM1.html> (last visited Aug. 18, 2007).

It is just as likely that a participant would be unaware of how a MEWA can be created inadvertently. A participant may not be aware that the transaction is taking place until shortly before the Closing Date, and even with that knowledge would be unlikely to be aware of the potential MEWA implications. Without this knowledge, it is unlikely that a participant would attempt to enforce the provision of state-mandated benefits not provided by the health plan in question. However, as discussed below, federal or state law (outside of form M-1) could require an announcement that an inadvertent MEWA exists, putting both the states and the participants on notice.

B. Inadvertent MEWA Recognition is an Undesirable Result for a Business Transfer

1. A State's Recognition of an Inadvertent MEWA Can Increase the Seller's and the Buyer's Costs

When a Seller's health plan becomes an inadvertent MEWA, it faces the likelihood of increased costs because "[s]tates may be able to take immediate action with respect to a MEWA upon determining that the MEWA has failed to comply with licensing, contribution, or reserve requirements under State insurance laws."⁸¹ States do not need EBSA's authorization to act.⁸² Moreover, each state has its own insurance regulations. This means that compliance with multiple state regulatory agencies would likely be an added administrative burden for the plan administrator.

Hypothetically, the politics of a state where the assets at issue are located could also play a part in increasing the Seller's costs. A state government that has some issue or concern regarding the Business Transfer, if aware of the potential creation of an inadvertent MEWA, could take legislative or regulatory steps to address the MEWA, thus increasing the Seller's costs. For example, the state insurance regulators could require compliance with its insurance laws for funding levels. The state government might act if it wanted to delay, alter, or even kill the deal. A political maneuver of this type could also put other states on notice. Hypothetically, this action could

81. MEWA GUIDE, *supra* note 4, at 16.

82. *Id.* at 35; *but see* U.S. Dep't of Labor Advisory Op. Letter 2007-05A (Aug. 15, 2007), *citing* U.S. Dep't of Labor May 8, 2006 Info. Letter (stating that "whether any given welfare benefit arrangement is a MEWA within the meaning of [ERISA] section 3(4) is a question of federal law" [and] "a state statute . . . would not govern the determination of whether a welfare benefit arrangement . . . is a MEWA).

expand the inadvertent MEWA risk if the Business Transfer involves assets in multiple states.

Each state regulation is a potential new cost for the company administering the health plan—the Seller. Some examples of state regulations (otherwise preempted by ERISA for self-insured single employer health plans) governing MEWAs include:⁸³ annual taxes based on the service provided or premiums charged,⁸⁴ mandatory licensure,⁸⁵ and required cash reserves.⁸⁶ Outside of state-imposed costs (and as noted earlier), the potential risk posed by inadvertent MEWA creation can also increase the legal costs associated with the Business Transfer, create the need for upfront reimbursement of health plan costs for the transferred employees, and add costs due to the need to monitor multiple states' insurance regulations.

EBSA has held that state civil penalties can also be imposed on a company providing insurance if that company violates MEWA-regulating insurance laws.⁸⁷ This is another cost risk for inadvertent MEWAs. Redefining a plan as a MEWA (inadvertently or not) may also subject the plan to additional federal regulations particular to MEWAs.⁸⁸ MEWAs face specific regulations under the Health Insurance Portability and Accountability Act of 1996 (HIPAA).⁸⁹ One of these HIPAA requirements is the annual filing of form M-1.⁹⁰ On the form, a MEWA must list the states where it provides coverage and whether it is a licensed healthcare

83. See generally MEWA Page, *supra* note 13.

84. U.S. Dep't of Labor Advisory Op. 2005-18A, *supra* note 63.

85. N.Y. State Ins. Dep't, *supra* note 31.

86. *Atl. Healthcare Benefits Trust v. Googins*, 2 F.3d 1, 6 (2nd Cir. 1993).

87. MEWA GUIDE, *supra* note 4, at 31.

88. See GRETA E. COWART, *HIPAA Nondiscrimination and Portability Updated and Expanded*, in CURRENT PENSION AND EMPLOYEE BENEFITS LAW AND PRACTICE, at 361; 369-70 (ALI-ABA Course of Study Materials, July 2006); see also MEWA GUIDE, *supra* note 4, at 33; see also Harmon Unit 4, *supra* note 77.

89. *Id.* at 369-70.

90. MEWA GUIDE, *supra* note 4, at 33.

provider.⁹¹ The completed forms are accessible electronically,⁹² providing an easy method for a state to identify MEWAs operating in that state. There are some exceptions to form M-1 filing. One of these form M-1 filing exceptions is for health plans that “provide[] coverage to the employees of two or more employers due to a change in control of businesses (such as a merger or acquisition) that occurs for a purpose other than avoiding form M-1 filing and is temporary in nature” (i.e., inadvertent MEWAs).⁹³ Lacking this filing requirement, there may be no immediate method by which a state would become aware of the MEWA.

2. A Business Transfer Agreement Containing Specific Language to Address the MEWA Issue is Not Necessarily an Effective Shield Against Inadvertent MEWA Creation

Companies can attempt to shield themselves from inadvertent MEWA creation through careful drafting of the Business Transfer agreement. Of course, this act alone entails additional costs for both parties because preparing documents for the Business Transfer is not free.

For example, one approach is to draft the Business Transfer agreement to transfer all liabilities and responsibilities for the divested employees to the Buyer, and then assign to the Seller only the comparable responsibilities for the non-divested employees.⁹⁴ The Business Transfer agreement could state that the Seller “shall take, or cause to be taken, all such action as may be necessary or appropriate to establish the Buyer as the successor to all rights, assets, duties, and [I]liabilities” related to the Buyer’s plan participants after the Closing Date.⁹⁵ The companies could then insert identical language covering the Seller’s responsibilities for the health plan liabilities for its employees.⁹⁶

91. Form M-1, *supra* note 79, at Part III.

92. See Forms, Document Requests and FOIA, http://www.dol.gov/ebsa/forms_requests.html (last visited Sept. 19, 2007) (summarizing information concerning the form M-1 filing process).

93. 29 CFR § 2520.101-2(c)(2)(ii)(A).

94. W. R. Grace & Co.-Conn., Grace Battery Separators Employee Benefits Agreement, § 2.4(b), (e)(ii) (Nov. 18, 1994) (on file with author).

95. Nat’l Med. Care, *supra* note 33, at 14–15.

96. *Id.* at 15. (“[Grace] shall . . . indemnify [National Medical Care] against all Indemnifiable Losses arising with respect to [Grace health plan participants] . . .

The Seller and Buyer could also, if they maintain the divested employees' coverage under the Seller's health plan for some time beyond the Closing Date, insert language to transfer responsibility entirely from the Seller to the Buyer.⁹⁷ For example, the Buyer could agree to fully reimburse the Seller for all expenses stemming from the former employees' participation in the Seller's plan.⁹⁸ The transaction agreement could also include language providing that the Seller is "responsible for, and [indemnifies] . . . all Indemnifiable Losses arising with respect to [Seller participants] relating to or arising under any [Seller health plan], regardless of whether such Indemnifiable Losses arise from, or are related to, events occurring or circumstances existing before, on or after the Closing Date."⁹⁹ The Buyer would likewise indemnify the Seller for any of the Buyer's employees who remain in the health plan, agreeing to reimburse the Seller for any expenses or charges related to those employees.¹⁰⁰ This language should eliminate any liability or responsibility for both the Buyer's and the Seller's employees from the other company.

This approach has a problem. MEWA existence is not governed solely by fiduciary or financial responsibility.¹⁰¹ When a business creates a MEWA, even inadvertently, the act creates a responsibility on the part of the

regardless of whether such Indemnifiable Losses arise from, or are related to, events occurring or circumstances existing before, on or after the [Closing Date].").

97. *Id.* at 21 ("NMC shall administer each Amicon Mirror Self-Insured Welfare Plan in the same manner and with the same degree of care as applicable to the corresponding NMC Self-Insured Welfare Plan.").

98. *Id.* ("The Grace-Conn. Group shall reimburse NMC . . . for all direct expenses incurred by the NMC Group after the Distribution Date related to the participation of Amicon Employees in NMC Insured Welfare Plans." Amicon employees remained employees of the selling company; NMC was the purchasing company.).

99. *Id.* at 15.

100. *Id.* at 15–16, 20–22.

101. *See* 29 U.S.C. § 1002(40)(a) (2000) ("The term 'multiple employer welfare arrangement' means an employee welfare benefit plan, or any other arrangement . . . established or maintained [to offer or provide medical or other welfare benefits] to the employees of two or more employers (including one or more self-employed individuals), or to their beneficiaries . . .").

company that administers the health plan.¹⁰² This administrative responsibility, regardless of whether it is held by the Buyer or the Seller, sustains the MEWA's existence. So long as the Seller administers the health plan and the plan contains some of the Buyer's employees, a MEWA exists. There will be a health plan covering the nonunion employees of two or more companies, with a role for at least one of the employers in the health plan's administration. Negotiating away any liability for the divested employees does not remove the Seller from its role as the plan administrator of its own self-insured plan. Terminating the plan for the divested employees would break this link and preserve full ERISA preemption. Doing so would (by reducing the "multiple" employers to only one employer) return the health plan to its status as a self-insured single-employer plan.

C. The States Have an Incentive to Regulate Inadvertent MEWAs

State governments are motivated to ensure their residents have health care. There are many recent legislative efforts that show the hold this has on state government agendas.¹⁰³ Inadvertent MEWA creation can give a state the opportunity to strengthen health care for some of its residents. Incomplete ERISA preemption for MEWAs makes this possible.

Unfortunately for the states, the opportunity to use inadvertent MEWAs to improve health care is limited and the impact could be short-lived. When the current plan year ends, a Buyer would likely fold the affected employees into its own health plan to reduce costs and simplify administrative structures. This would eliminate the inadvertent MEWA. The participants would be left in a self-insured health plan protected from state regulation by full ERISA preemption.

If the inadvertent MEWA ends, there is no barrier to the Buyer cutting back any state-mandated benefits.¹⁰⁴ Since an inadvertent MEWA's existence could be brief, state regulation of inadvertent MEWAs would

102. *Id.* § 1002(16) (defining the terms "administrator" and "plan sponsor" under ERISA); *see also* Roy F. Harmon III, Third Party Administrators (Aug. 21, 2006), <http://healthplanlaw.com/?p=27> ("Since plan administrators are fiduciaries, most [third party administrators] will provide in the administrative agreement that the employer functions as the 'plan administrator.'").

103. Gerald B. Silverman, et al., *Special Report: Health Insurance*, 33 PENSION & BENEFITS REPORT 773, 829 (2006).

104. *Curtiss-Wright Corp. v. Schoonejongen*, 514 U.S. 73, 78 (1995) (holding that "[e]mployers or other plan sponsors are generally free under ERISA, for any reason at any time, to adopt, modify, or terminate welfare plans").

likely produce little lasting gain. As noted above, an inadvertent MEWA can have a short life. Once the inadvertent MEWA's existence ends, the new Buyer employees could be moved into the Buyer's existing self-insured medical plan, which (as discussed earlier) would not be bound by state insurance laws.¹⁰⁵ Further, state regulatory efforts can create disincentives for companies to invest in that state.¹⁰⁶ Worse still, the efforts could reduce employer-sponsored health care; enforcement of inadvertent MEWAs could signal a business-unfriendly climate.¹⁰⁷ Companies may be reluctant to invest in a state that vigorously expands regulation of businesses located in that state.¹⁰⁸

However, from the state's perspective, there is a possible incentive to regulating inadvertent MEWAs—good public relations. Hypothetically, once a state regulates an inadvertent MEWA, it may be politically inexpedient for the Buyer to cut back the benefits in the new plan year. This could be a problem for the Buyer because it could create a negative public image; the new owner would appear to be treating its new employees poorly. The Buyer's public image in a state containing a newly acquired asset may be more important to the Buyer than additional health plan costs. In effect, the cost to the Buyer in public goodwill from cutting benefits could be greater than the cost of maintaining those benefits.

III. SOLUTIONS

Resolving the problems associated with inadvertent MEWA creation produces a clear, immediate benefit: it reduces barriers to a Business Transfer by reducing the work required on document preparation. A resolution would also encourage continuity (from the Seller to the Buyer) of employer-provided health benefits by eliminating any Buyer reluctance to continue their provision due to MEWA concerns. It would also reduce costs

105. *FMC Corp. v. Holliday*, 498 U.S. 52, 58 (1990).

106. In general, a lower level of state regulation is viewed favorably by businesses as a positive reason to locate in a particular state. See Kurt Badenhausen, *The Best States for Business* (July 11, 2007), http://www.forbes.com/2007/07/10/washington-virginia-utah-biz-cz_kb_0711bizstates_print.html.

107. *E.g.*, Kurt Badenhausen, *The Best States for Business* (Aug. 15, 2006), http://www.forbes.com/2006/08/15/best-states-business_cz_kb_0815beststates_print.html (providing a general discussion of why companies should weigh the impact of state regulation and taxation when deciding whether to relocate to a given state).

108. *Id.*

by eliminating uncertainty. The need to address any inadvertent MEWA issues would be removed from the Business Transfer negotiation. The Business Transfer would be simplified because the divested employees would be able to remain in the Seller's health plan (if so negotiated) through the end of the current plan year without additional concerns about the legal implications of such an arrangement. This result would spare them any mid-year changes in health benefits.

A resolution that provides for continued health plan coverage while reducing Business Transfer costs is the ideal solution. It is certainly better than the simplest option, plan cancellation. Plan cancellation would cause problems for the affected employees and potentially damage the Buyer through lower employee morale. Though a Seller could cancel the health plan for only the divested employees, the Seller may then be required to continue benefit provision under the Consolidated Omnibus Budget Reconciliation Act (COBRA).¹⁰⁹ This could also boost employees' out-of-pocket costs,¹¹⁰ if the Buyer does not add the new employees to its health plan, reducing their incentive to remain with the Buyer and thus reducing the asset's value. However, this cost can be avoided in a stock transfer, because in that instance COBRA is not triggered.¹¹¹

A legislative fix (e.g., providing MEWAs with full ERISA preemption) is also possible, but there are drawbacks. Prior attempts to legislate a solution have still led to abuse when ERISA preemption left defrauded participants with no recourse.¹¹² Opponents to bills recently considered by the House of Representatives testified exactly on this point. They cited problems such as reducing the level of health care by blocking state-mandated health

109. Pub. L. No. 99-272, 100 Stat. 222 (1986); U.S. Dep't of Labor, Health Plans and Benefits: Continuation of Coverage — COBRA, <http://www.dol.gov/dol/topic/health-plans/cobra.htm> (last visited Feb. 5, 2007) (COBRA provides “workers and their families who lose their health benefits the right to choose to continue group health benefits provided by their group health plan for limited periods of time under certain circumstances such as voluntary or involuntary job loss.”).

110. U.S. DEP'T OF LABOR, AN EMPLOYEE'S GUIDE TO HEALTH BENEFITS UNDER COBRA 2 (2006) (“Employers may require individuals who elect continuation coverage to pay the full cost of the coverage. . . . The [cost] is often more expensive than [what active employees pay], since the employer usually pays part of the cost” that is now entirely charged to the individual.).

111. EMPLOYEE BENEFITS LAW, *supra* note 3, at 449.

112. For a discussion of the problems that led to the MEWA / ERISA legislation in the early 1980s, see Harmon Unit 1, *supra* note 5.

benefits,¹¹³ as well as shielding MEWAs from regulation meant to protect health plan participants.¹¹⁴

There are several options to resolve the problems that inadvertent MEWAs present:

- the Seller can cancel the health plan for the divested employees, effective on the Closing Date;
- the Seller can ignore the existence of the inadvertent MEWA and assume that the language in the Business Transfer documents protects them (though this can have a negative impact on the Buyer);
- the Seller can draft a separate health plan for the divested employees;
- the government can expand full ERISA preemption to include MEWAs; or
- the government can carve out an exception for inadvertent MEWAs, fully covering them under ERISA preemption.

As discussed below, a carve-out gives the greatest (though incremental) benefit, with the fewest drawbacks.

A. Option I: The Seller Can Cancel the Health Plan for the Divested Employees

ERISA's anti-cutback provisions do not protect self-insured health plans.¹¹⁵ This means that a company can cut benefits or cancel a self-funded health plan at any time. The Seller, if concerned about the cost of maintaining the health benefits of the divested employees (or if the Closing Date is close to the end of the calendar year, when health plan coverage is typically renewed or changed), could simply cancel the health plan as of the

113. H.R. REP. NO. 109-41, at 56 (2005) ("States were forced to enact consumer protections because businesses did not insist on providing comprehensive coverage for their employees.").

114. *Id.* at 57.

115. *Curtiss-Wright Corp. v. Schoonejongen*, 514 U.S. 73, 78 (1995) (holding that "[e]mployers or other plan sponsors are generally free under ERISA, for any reason at any time, to adopt, modify, or terminate welfare plans"); *see also* *Cent. Laborers' Pension Fund v. Heinz*, 541 U.S. 739 (2004) (providing an example of the application of the ERISA anti-cutback rule to accrued benefits under a pension plan).

Closing Date.¹¹⁶ This would eliminate any risk of state law exposure because no MEWA would ever exist.

Though straightforward, this approach presents costs for the Seller.¹¹⁷ Direct financial costs are not the only risk; canceling health coverage can harm employee morale. A company's cancellation of the divested employees' health plan could generate discontent. This could leave the Seller's employees less happy and less productive. They could view the Seller's treatment of the divested employees as a possible fate for current employees. It could also affect the Buyer; they would get a workforce facing the stress of a change in management topped off with an abrupt change in health care. Also, as noted earlier, canceling the health plan might not be politically expedient for the companies involved, if the action harms the company's public image. Moreover, the Buyer might be reluctant to sign off on a Business Transfer that risked an unmotivated and demoralized workforce.

The problems with plan cancellation can be mitigated. The Buyer could add the new employees to its health plan immediately, shoring up employee morale by demonstrating the Buyer's dedication to its new employees. Furthermore, the Business Transfer agreement could require that the new plan cover pre-existing conditions as an even greater assurance.¹¹⁸ There might still be some dissatisfaction from changing health plans with no warning in the midst of a plan year, but it would not likely be as great a problem.

Unfortunately, canceling the plan would boost costs for the Seller and the Buyer. If the Seller cancels the health plan and the Buyer adds the affected employees to its plan immediately, the sudden impact of a change in plans could cause problems. Changing health plans for a group of employees during a plan year brings with it administrative costs and potential contract problems with the companies (e.g., Aetna or United Healthcare) contracted

116. *E.g.*, W. R. Grace & Co., Agreement for the Purchase and Sale of the Organic Chem. Div. of W. R. Grace & Co.-Conn. and Related Assets, U.S. Employee Benefits Agreement, 3 (Nov. 25, 1992) [hereinafter Organic Chem. Div.] (on file with the author).

117. *See* EMPLOYEE BENEFITS LAW, *supra* note 3, at 444 (stating that COBRA generally "requires that sponsors of group health plans give former participants and beneficiaries an opportunity to elect continuation coverage when they would otherwise lose coverage on account of 'qualifying events' such as . . . termination of employment").

118. *E.g.*, Organic Chem. Div., *supra* note 116, at 6 ("Any Buyer health care plan providing health care benefits shall cover all pre-existing conditions of Continued Employees existing on the Closing Date.").

to provide the actual health care.¹¹⁹ These problems include participants' doctors not being in the new plan's network, limits on the number of participants or total cost under the new plan, changes in deductibles and other charges, etc.

There is a middle ground where some of the problems associated with this approach can be mitigated. The Seller could cancel the health plan for the divested employees, effective as of the Closing Date, and the Buyer could agree to pay the cost of coverage under COBRA through the end of the plan year. With the new plan year, the affected employees would be eligible for coverage under the Buyer's health plan. This approach would provide continuity of benefits for the affected employees through the end of the plan year. It would also mitigate any potential morale problems, as the Buyer would cover the health plan costs rather than the divested employees. Further, it would give the divested employees time to prepare for a switch to the Buyer's health plan. The downside is the cost to the Buyer to pay for COBRA coverage. While not a perfect solution (canceling health benefits would likely still carry a negative connotation), it does avoid the more extreme problems that could occur if the affected employees had to bear the full cost of COBRA coverage.

B. Option II: The Seller Can Ignore the Inadvertent MEWA

There is a benefit to leaving well enough alone; states do not appear to be regulating health plans in Business Transfers.¹²⁰ One possible explanation for this is that the risk of legal action, mandated benefits, or enforcement of state insurance laws is low.¹²¹ However, the risk of being considered a MEWA is not zero.¹²² Companies recognize this, and they expend effort to avoid creating MEWAs in their Business Transfers.¹²³

119. Interview with John Forgach, Senior Benefits Counsel, W. R. Grace & Co., in Columbia, Md. (Feb. 7, 2007) [hereinafter Forgach Feb. Interview].

120. EMPLOYEE BENEFITS LAW, *supra* note 3, at 415-23 (providing a summary of recent litigation concerning MEWAs, but providing no evidence of state regulation or litigation concerning inadvertent MEWAs).

121. *See generally id.* (summarizing historic and recent case law concerning MEWAs, none of which covers MEWAs created through a Business Transfer).

122. Forgach Sept. Interview, *supra* note 32.

123. Nat'l Med. Care, *supra* note 33, at 14-15, 20-22; *see also* Forgach Sept. Interview, *supra* note 32.

Also, attorneys involved in the Business Transfer potentially face ethical and legal implications if the inadvertent MEWA issue is not addressed. For example, if a Business Transfer involves a publicly traded company, the transaction is subject to the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”).¹²⁴ Under § 307 of Sarbanes-Oxley, attorneys are required to report any violations of the law that they observe.¹²⁵ Therefore, if an attorney involved in a Business Transfer is aware that the agreement would create an inadvertent MEWA, he may be obligated under Sarbanes-Oxley to report any violations of state law that that would regulate the MEWA at the time the inadvertent MEWA is created. This requirement is without taking into account potential issues under the applicable state rules of professional conduct.

Likewise, corporate officers are bound by § 302 of Sarbanes-Oxley to certify that their company is in compliance with the law requiring accuracy and truthfulness in reports on the company’s financial condition and results of operations.¹²⁶ If an inadvertent MEWA is created, choosing to not follow state laws regulating MEWAs could be a violation of Sarbanes-Oxley by a corporate officer, if the decision caused the company to issue annual or quarterly reports that “contain any untrue statement of a material fact or omit to state a material fact.”¹²⁷

Still, one could argue that the impact of Sarbanes-Oxley on inadvertent MEWAs is minor, though one cannot just ignore a violation of the law because it is minor. Violating the law is a serious problem. But knowingly ignoring a violation of the law can have greater consequences than the original violation. The most reasonable conclusion is that a requirement likely exists to make public an inadvertent MEWA and a company’s efforts to paper over it. Ignoring the inadvertent MEWA would not be a viable option.

There are other drawbacks to ignoring the MEWA’s existence. If the required conditions are met, the MEWA exists, regardless of the companies’ efforts to avoid creating a MEWA. As noted earlier, this exposes the

124. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, §§ 301–409, 116 Stat. 745, 775–791 (2002) (describing obligations of publicly-traded companies under the Sarbanes-Oxley Act of 2002).

125. *Id.* § 307(1), 116 Stat. at 777 (requiring that attorneys must “report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company”).

126. *Id.* § 302, 116 Stat. at 777.

127. *Id.*

MEWA to state insurance regulations.¹²⁸ Because of the increased cost that state regulation can bring, the Seller and Buyer would be unwise to neglect taking steps to mitigate this risk. Such steps mean expending time and resources to shield the transaction from state MEWA regulation.¹²⁹ But there is still no guarantee that this will work. Ultimately, the courts could decide whether the Business Transfer agreement really does what its drafters intended. And this issue could be raised in every state in which participants in the inadvertent MEWA are located. The company administering the inadvertent MEWA could face many states' insurance regulations, all converging on the same health plan.

C. Option III: The Seller Can Create a Separate Health Plan for the Divested Employees

A health plan has two components: a document describing the plan's provisions and the funding provided to pay for benefits, and an administrative structure managing billing and costs to provide benefits.¹³⁰ Either the Buyer or the Seller could create a new health plan that duplicates the provisions in their existing health plan (contracting with the same health care provider to handle the administrative structure), but that only covers the divested employees. The company could then update its original health plan to exclude the divested employees. Since the new health plan would cover only the divested employees, they would only have one employer. The plan should not then qualify as a MEWA.

Still, this solution is not airtight. Whether or not a MEWA exists could thus hinge on whether a court determines if the facts and circumstances demonstrate that the new plan exists strictly on paper for the purpose of avoiding the creation of a MEWA. If the two plans were not considered separate, a MEWA would likely be found to exist.¹³¹ The administrative costs for this new plan are a further drawback to the option of creating a new, separate Seller plan. Two plans instead of one means two sets of administrative costs, where there was previously a single plan. Moving employees to a new plan does not eliminate the administrative costs in the old plan. The Buyer would likely consider these costs in its purchase price

128. Nat'l Bus. Ass'n Trust v. Morgan, 770 F. Supp. 1169, 1177 (W.D. Ky. 1991).

129. Forgach Sept. Interview, *supra* note 32.

130. Forgach Feb. Interview, *supra* note 119.

131. 29 U.S.C. § 1002(40)(A) (2000).

estimate, which could add to the cost and possibly make the Business Transfer a less desirable purchase.

D. Option IV: The Government Can Expand ERISA Preemption for MEWAs to Match the Preemption Provided for Self-Insured Health Plans

Government expansion of ERISA preemption to match that provided for self-insured plans provides the clearest set of benefits to the companies involved. The risk that state-mandated benefits could come into effect if a health plan were found to be a MEWA would be eliminated. With an expansion of ERISA preemption, state laws would be preempted from affecting any MEWAs. Option IV also protects the involved companies from the administrative burden of complying with multiple state regulatory schemes and from the cost of state-mandated benefits.¹³² As part of such an expansion, the form M-1 reporting requirement exceptions could be carved out of the MEWA definition itself, as further insurance of a reduction in administrative costs.

As discussed earlier, ERISA normally preempts state laws from being applied to self-insured plans. Since these mandated benefits might not necessarily be part of the company's health plan, full ERISA preemption would eliminate their cost.¹³³ Expanded ERISA preemption would also likely reduce, at least incrementally, the amount of work necessary to prepare the Business Transfer documents.

Unfortunately, this approach has drawbacks. Protecting MEWAs with full ERISA preemption would undermine the original purpose for their partial exclusion from ERISA.¹³⁴ The old problems (fraud by purported insurance providers, companies who then hide behind ERISA preemption to avoid prosecution under state law) could recur.¹³⁵ These incidences of

132. Nicholas, *supra* note 71.

133. *See generally* Grace Med. Plan, *supra* note 69, at 56 (providing coverage of gastric bypass surgery only under certain circumstances – the procedure receives no blanket coverage) (on file with author); *see generally* Northrop Grumman Health Plan, <http://benefits.northgrum.com/spd/Health/Medical-LumenosMedicalPlanOption-CoveredServices/default.aspx?qt=gastic&topicId=1618262673&spdId=Health&IsSearch=true> (last visited Nov. 20, 2007) (limiting coverage of gastric bypass surgery to the morbidly obese under the Lumenos Medical Plan Option).

134. 29 U.S.C. § 1144(a) (2000) (“[Title I of ERISA] shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan” covered by ERISA.); *see also* Shaw v. Delta Air Lines, Inc., 463 U.S. 85, 91 (1983).

135. N.Y. State Ins. Dep't, *supra* note 31.

MEWA abuse still occur, and expanding preemption could expand abuse opportunities.¹³⁶ Expanding preemption to resolve the problem of inadvertent MEWAs, only to risk creating additional opportunities for MEWA abuse by fraudulent insurance providers to steal money from health plan participants, is no real solution.

E. Option V: The Government Can Create an ERISA Exception for Health Plans in Business Transfers

The government can amend ERISA to create a carve-out that exempts health plans (for a limited period of time—six months or less) that would otherwise become MEWAs due to a Business Transfer. As part of the carve-out, the reporting requirements for MEWAs should also be formally excluded for inadvertent MEWAs. Carving out an exception would be a precise solution, addressing only the specific issue at hand. This solution would forestall any inadvertent MEWA risk attendant on a Business Transfer. A carve-out would also obviate any need to cancel the Seller's health plan as it applies to the Buyer's new employees, avoiding possible morale risks. It would also be a better option than the current practice because a carve-out avoids all of the risks that would otherwise remain if the legal situation were not changed.

Lastly, a carve-out would avoid the pitfalls of an overbroad change to the law that could recreate old problems, problems that the changes made to ERISA's rules governing MEWAs were meant to correct. These problems would be avoided through specificity. Creating a specific carve-out would provide for the fewest possible opportunities for abuse, as the conditions to qualify for the carve-out could be narrowly tailored to apply only for a Business Transfer.

The carve-out approach has been suggested for other MEWAs (e.g., association health plans).¹³⁷ Health plans set up to benefit small employers have also been proposed as candidates for protection from state MEWA regulation via the carve-out approach.¹³⁸ A similar approach could be used to preempt state regulation of MEWAs created via a Business Transfer.

136. See Combs, *supra* note 57.

137. Small Business Health Fairness Act of 2005, H.R. 525, 109th Cong. (2005) (carving out association health plans (health plans set up for a group of (often small) employers organized in a professional association) as exceptions to ordinary MEWA regulation).

138. Patients' Health Care Reform Act of 2005, H.R. 2203, 109th Cong. (2005).

Language paralleling that used in either of two bills considered by the House of Representatives in 2005 could be bolted onto 29 U.S.C. § 1144(b)(6), the ERISA provision governing MEWAs.¹³⁹ In other words, 29 U.S.C. § 1144(b)(6) could be modified by adding a new subsection (29 U.S.C. § 1144(b)(6)(E)) that defines a Business Transfer and excludes any MEWAs created via a Business Transfer from regulation under 29 U.S.C. § 1144(b)(6)(A). This would only protect a narrow subset of MEWAs, avoiding the concerns raised by opponents of expanded ERISA carve-outs.¹⁴⁰

However, the carve-out approach has drawbacks. The track record of recent MEWA carve-out bills is illustrative. The association health plan bill, H. R. 525, did pass the House and was referred to the Senate Committee on Health, Education, Labor, and Pensions. But it did not progress in the Senate.¹⁴¹ The small employer bill, H. R. 2203, did not even get out of the House Subcommittee on Employer-Employee Relations.¹⁴²

This poor track record of ERISA carve-outs for MEWAs suggests that the legislative route has a low chance of success. Even so, it is the option with the largest benefit, and smallest downside, in terms of how well the issue would be resolved for the largest number of involved parties. Both Sellers and Buyers would benefit, the states would see little net impact as they currently do not pursue inadvertent MEWAs, and the affected employees would benefit from a smoother transition in health plans.

Unfortunately, setting aside any political resistance to ERISA carve-outs, passing a new law to create a new carve-out does not guarantee that the problem will be solved. Clever and aggressive frauds could still seek out ways to use the carve-out to defraud plan participants with purported “insurance” schemes. The creation of sham transactions to produce a protected MEWA, followed by the use of ERISA as a shield against participants’ lawsuits, is one such possibility. Setting the effective period for such a carve-out in any particular Business Transfer at six months or less could limit the risk of abuse (though there are no guarantees).

139. H.R. 525 § 812(b)(2)(D) (modifying ERISA to specifically override any state laws that govern the provision of health insurance, in so much as such laws create any limitations on companies that provide health insurance for association health plans).

140. H.R. REP. NO. 109-41, at 55-58 (2005).

141. Bill summary and status file, <http://thomas.loc.gov/cgi-bin/bdquery/z?d109:H.R.525>: (last visited July 25, 2007).

142. Bill summary and status file, <http://thomas.loc.gov/cgi-bin/bdquery/z?d109:H.R.2203>: (last visited July 25, 2007).

IV. RECOMMENDATION

Considering the five options discussed, the best choice is to create an ERISA carve-out for inadvertent MEWAs created via Business Transfers. Such a carve-out would exempt health plan arrangements that result from a Business Transfer from state regulation as MEWAs. To avoid abuse, the carve-out should be narrowly tailored. Further, the specific circumstances necessary for a Business Transfer to qualify under the carve-out should be clearly defined. The goal is to make it difficult to abuse the carve-out, precluding, for example, sham transactions designed to create MEWAs for fraudulent purposes. The abuse cited as a risk to other MEWA carve-out ideas would also be less likely; creating the conditions that would activate the carve-out would be more difficult with a carve-out in place than simply establishing a MEWA.

V. CONCLUSION

The creation of an inadvertent MEWA is both a risk and a cost during a Business Transfer. The continuation of health benefits for the Seller's employees who become the Buyer's employees as part of the Business Transfer presents this risk. Costs that could be imposed via inadvertent MEWAs include taxes, fees, and administrative costs, as well as costs from state-mandated health benefits. In addition, costs can be imposed to maintain compliance with the mix of different state laws that could be imposed on one health plan if the Business Transfer includes work locations in multiple states.

The costs arrive through what is essentially an ERISA loophole, because MEWAs stand partly outside of ERISA preemption.¹⁴³ The MEWA amendment to ERISA simply defines MEWAs, without addressing any unusual ways in which they can be formed.¹⁴⁴ For a MEWA, ERISA is the floor upon which state regulation is based, not the ceiling limiting state regulation. Required benefits can then be tacked onto the health plan above anything that ERISA requires.

These costs are a risk to companies contemplating a Business Transfer, but there are several possible solutions. The best of these is an ERISA carve-out for MEWAs created via Business Transfers. A carve-out would obviate the need to worry about inadvertent MEWA creation. In doing so, it would eliminate the associated costs. The major drawback is that the chance

143. *Fuller v. Norton*, 86 F.3d 1016, 1024 (10th Cir. 1996) (explaining that "Congress obviously viewed self funded arrangements by multiple employers to be different, and less deserving of federal preemption from state insurance regulators, than self funded plans by single employers").

144. 29 U.S.C. § 1002(40)(A) (2000).

of success is low, as evidenced by similar legislative efforts. Even so, inadvertent MEWAs are short-lived, and a narrowly crafted statute could minimize any rebirth of old MEWA problems. So the potential downside is small. With little net impact on the states or the affected employees, a carve-out would reduce Business Transfer costs and encourage health care continuity, a net benefit to all.