PEOs Deemed MEWAs Have State and Federal Regulatory Concerns

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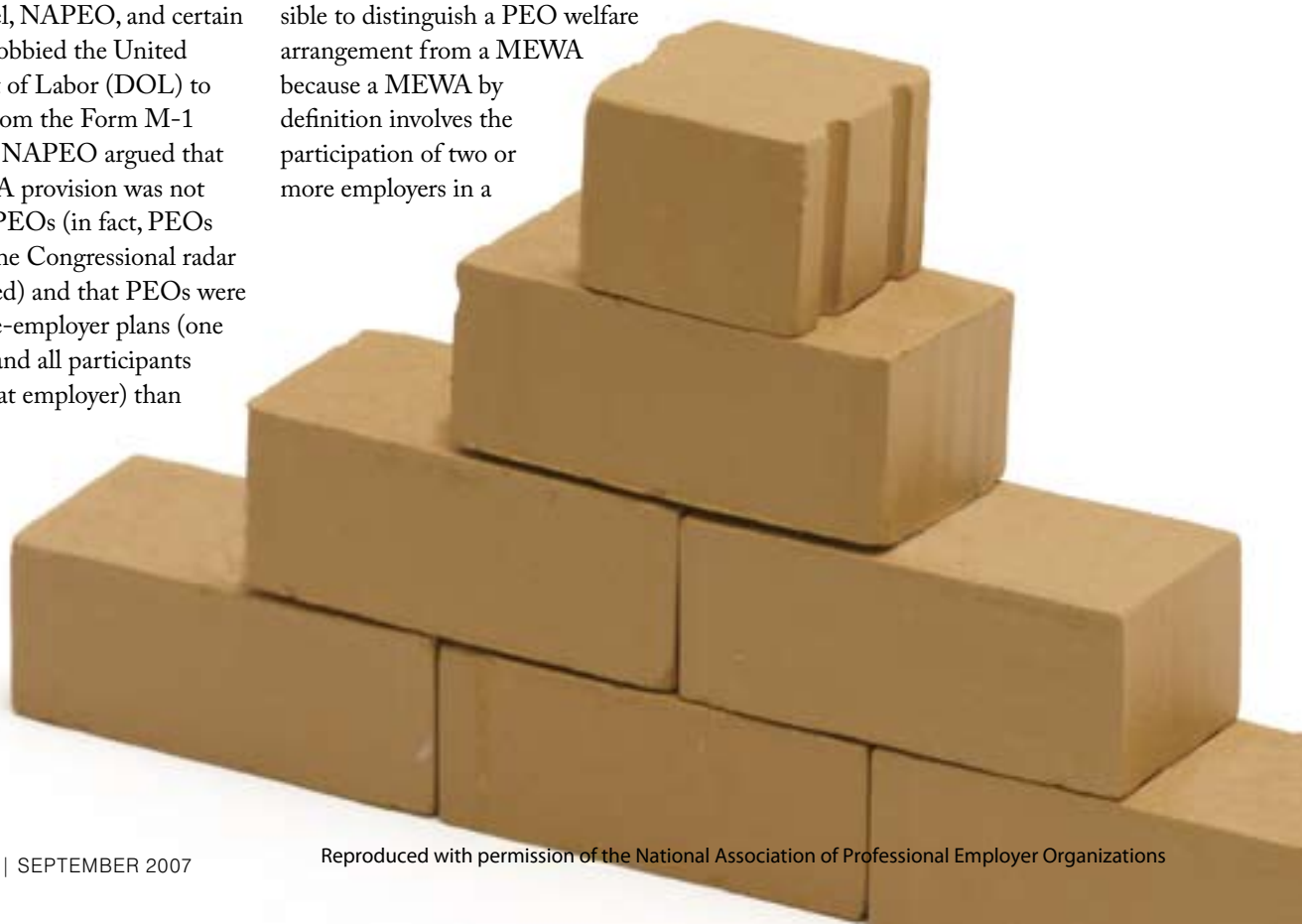
The Employee Retirement Income Security Act of 1974 (ERISA), with exceptions not relevant here, defines a multiple employer welfare arrangement (MEWA) as any group welfare arrangement in which two or more employers participate. ERISA § 3(40), 29 U.S.C. § 1002(40). PEOs have long aspired to have their welfare plans be exempted from MEWA status. NAPEO and others have advanced this regulatory goal at the federal and state levels.

Federal Status as MEWAs

On the federal level, NAPEO, and certain individual PEOs, lobbied the United States Department of Labor (DOL) to give PEOs relief from the Form M-1 filing requirement. NAPEO argued that the ERISA MEWA provision was not intended to cover PEOs (in fact, PEOs were not even on the Congressional radar when it was adopted) and that PEOs were more akin to single-employer plans (one employer sponsor and all participants W-2 workers of that employer) than the types of plans of concern to Congress. NAPEO suggested that the DOL either not consider PEO health plans MEWAs or, alternatively, develop a separate reporting mechanism only for those PEO plans that were self-funded.

The DOL ultimately declined to give PEOs any relief from the Form M-1 filing. DOL took the position that because the PEO business model is built on co-employer relationships between the PEO and the PEO client by definition, PEOs are groupings of two or more employers. Thus, based on the PEO business model, the DOL found it impossible to distinguish a PEO welfare arrangement from a MEWA because a MEWA by definition involves the participation of two or more employers in a welfare arrangement. Moreover, the DOL was on record stating that staff leasing welfare arrangements were MEWAs, having issued numerous advisory opinions on staff leasing arrangements. The DOL was unable to distinguish staff leasing welfare arrangements from PEO welfare arrangements and was therefore stuck with its previous pronouncements.

In 2006, the DOL for the first time issued a written pronouncement that a PEO welfare arrangement constituted a MEWA. (See, Information Letter to George J. Chanos, Attorney General, Nevada Department of Justice, May



8, 2006). In the Information Letter, the DOL explained that in numerous advisory opinions involving staff leasing companies it had taken the position that, "where the employees participating in the plan of an employee leasing organization include employees of two or more client employers, or employees of the leasing organization and at least one client employer, the plan of the leasing organization would, by definition, constitute a MEWA because the plan would be providing benefits to the employees of two or more employers." The DOL stated that the same analysis applies to PEOs, in essence, the argument the DOL used to reject the pleas of the PEO industry years ago when the industry sought relief from the Form M-1 filing.

State Status as a MEWA

ERISA supersedes "any and all State laws insofar as they may now or hereafter relate to any employee benefit plan." 29 U.S.C. § 1144(a). The breadth of this provision is evident by ERISA's definition of "state laws," which include "[a]ll laws, decisions, rules, regulations, or other state actions having the effect of law, of any state." 29 U.S.C. 1144(c)(2). As a rule, ERISA preempts a state law that "relates to" an employee benefit plan if it has "a connection with or a reference to such plan." ERISA's preemption provision is qualified by the "insurance savings clause," which provides that nothing in ERISA "shall be construed to exempt or relieve any person from any law of any State which regulates insurance. . . ." The "insurance savings clause," however, is qualified by the so-called "deemer clause," which prohibits a state from deeming an employee benefit plan an insurance company for purposes of state insurance regulation.

In 1983, ERISA's preemption provision was amended to expressly provide that MEWAs are subject to state and federal laws, albeit in varying degrees, depending on whether the MEWA is self-funded or fully insured. The purpose of the amendments was to carve MEWAs out from the "deemer clause" so that states could more easily regulate MEWAs.

In 2006, the attorney general of Nevada specifically asked whether or not a state law was preempted by this provision. The DOL replied: "You also asked that we specifically address the Company's contention that the Plan cannot be a MEWA because Nevada state law provides that 'an employee leasing company shall be deemed to be the employer of its leased employees for the purposes of sponsoring and maintaining any benefit plans.' Nev. Rev. Stat. § 616B.691(2) (2005). It is the Department's view that whether an arrangement is a MEWA within the meaning of section 3(40) is a question of federal law." May 8, 2006 letter to Attorney General George Chanos from Robert J. Doyle.

That such laws are subject to ERISA preemption was affirmed in the case of *Employers Resource Management Company v. Department of Insurance, State of Idaho*,

NAPEO Model PEO Act, §8(B):
Protects fully insured PEO health benefit from state MEWA treatment.

"A fully insured welfare benefit plan offered to the Covered Employees of a single PEO shall be considered a single employer welfare benefit plan and shall not be considered a multiple employer welfare arrangement, or 'MEWA.'"

NAPEO Model PEO Act, §7(E):
Protects PEO sales from insurance licensing.

"A PEO under this Act is not engaged in the sale of insurance or in acting as a third party administrator (TPA) by offering, marketing, selling, administering, or providing professional employer services which include services and employee benefit plans for Covered Employees."

NAPEO Model PEO Act, §7(D) 2 & 4:
Limits PEO tort liability.

"A Client shall be solely responsible for directing, supervising, training, and controlling the work of the Covered Employees with respect to the business activities of the Client and solely responsible for the acts, errors, or omissions of the Covered Employees with regard to such activities. …

A PEO shall not be liable for the acts, errors, or omissions of a Client or of any Covered Employee of the Client when such Covered Employee is acting under the express direction and control of the Client."

NAPEO Model PEO Act, §3(C) 2:
Protects PEO from client licensing requirements.

"A PEO shall not be deemed to engage in any occupation, trade, profession, or other activity that is subject to licensing, registration, or certification requirements, or is otherwise regulated by a governmental entity solely by entering into and maintaining a Co-employment Relationship with a Covered Employee who is subject to such requirements or regulation."

NAPEO Model PEO Act, §3(B) 3:
Limits PEO employer liability to worksite employee.

"Nothing in this Act or in any Professional Employer Agreement shall… (c)reate any new or additional enforceable right of a Covered Employee against a PEO that is not specifically provided by the Professional Employer Agreement or this Act."

NAPEO Model PEO Act, §7(D) 1:
Protects PEO from products liability litigation for client products.

"A Client shall be solely responsible for the quality, adequacy, or safety of the goods or services produced or sold in Client's business."

2006 Opinion No. 56 (Idaho S.Ct., May 9, 2006), in which the court flat-out rejected the plaintiff's argument that its welfare arrangement was a single-employer plan because it was a PEO under the Idaho Professional Employer Recognition Act. The court stated that whether an entity is a MEWA or not is a federal question under ERISA, and any state law purporting to decide that question in a manner that conflicts with ERISA would be preempted by ERISA.

NAPEO responded to this situation by promoting and successfully enacting in a number of states a provision in its Model PEO Act that provides as follows: "[a] registered professional employer organization shall be deemed for purposes of state law an employer for purposes of sponsoring welfare benefit plans for its worksite employees. Worksite employees participating in that professional employer organization's fully insured welfare benefit plan or plans shall be considered employees participating in a single-employer welfare benefit plan or plans. A fully insured welfare benefit plan or plans offered by a registered professional employer organization to its employees and/or worksite employees shall not be considered for purposes of state law a multiple employer welfare arrangement."

The crucial phrase in the NAPEO standard provision is: "A fully insured welfare benefit plan or plans offered by a registered professional employer organization to its employees and/or worksite employees shall not be considered *for purposes of state law* a multiple employer welfare arrangement." (*Emphasis added*). This specific provision has not been tested in court, but NAPEO's argument presupposes the DOL position that "… whether an arrangement is a MEWA within the meaning of section 3(40) is a question of federal law." (*Chanos* letter). NAPEO would argue, however, that the only thing the federal provision does is to specifically allow states to regulate MEWAs at one of two levels. It does not require them to do so or to treat all MEWAs the same.

NAPEO argues therefore that a state can elect not to regulate a PEO as a MEWA. While the NAPEO position has not been adjudicated, it is consistent with ERISA. This argument is only available, however, in states where the Model Act has been adopted in a manner to limit its application to state regulation of PEO plans and to reflect a clear legislative decision not to regulate such plans as MEWAs. Moreover, such a decision at the state level would not limit application of federal ERISA requirements themselves.

Certainty: PEO Can Sponsor Benefits

These states have NAPEO provisions that explicitly allow the PEO to sponsor employee benefits:

Louisiana	New York
Nevada	Tennessee
New Hampshire	Vermont

or allow either the client or the PEO to sponsor benefits:

Alabama	Montana	Rhode Island
Arizona	North Carolina	Texas
Indiana	Oklahoma	Utah

Regulation of MEWAs

Thus, in most states, MEWAs are subject to both state and federal regulations.

PEOs that desire to be fully compliant under the current regulatory scheme must be cognizant of how state and federal laws apply to their welfare arrangements.

On the federal level, PEOs must establish procedures that will ensure that they prudently manage the welfare arrangement. To establish prudent procedures, the PEO must, among other things, understand:

- ERISA's test for who is a fiduciary;
- ERISA's fiduciary standards of conduct;
- ERISA's interpretation of when assets become plan assets;
- ERISA's restrictions on the use of plan assets, including ERISA's prohibited transaction and party in interest rules;
- ERISA's reporting and disclosure requirements;
- ERISA's liability provisions for breach of a fiduciary duty; and
- ERISA's Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) and Health Insurance Portability and Accountability Act of 1996 (HIPAA) rules and regulations.

The United States Department of Labor has some very useful publications that can be accessed on its Web site, *www.dol.gov/ebsa/publications/main.html*. The Web page has a category of publications designed to assist health plan managers with compliance issues and includes a publication called "Multiple Employer Welfare Arrangements Under the Employee Retirement Income Security Act: A Guide to Federal and State Regulation," and another publication called "Reporting And Disclosure Guide For Employee Benefit Plans," which provides an excellent summary of those requirements.

State regulations are much more difficult to follow because all states treat MEWAs differently and many have idiosyncratic laws and regulations specifically enacted to regulate MEWAs. Some states have MEWA-specific laws that apply to self-funded and self-insured MEWAs. Some have MEWA-specific laws that apply only to self-funded plans. Some states have outlawed self-funded MEWAs. Some states ignore MEWAs that are fully insured. States where there are no MEWA-specific statutes treat MEWAs as an unauthorized insurance company unless the MEWA is certified as an insurance company and compliant with all laws that regulate insurance companies. Some states have expressly stated that MEWAs are subject to state-mandated benefits. Some states haven't thought that much about it, but if they did, they would likely conclude that state mandates apply to MEWAs.

The NAPEO Web site (*www.napeo.org*) provides helpful information on each state in its regulatory database. In addition, the National Association of Insurance Commissioners (NAIC) Web site has a link to every state's insurance commissioners' office that allows easy access to finding state insurance regulations. That site is located at *www.naic.org/state_web_map.html*. The Web page also has a link that provides contact information for the designated MEWA specialist in every state's insurance commissioners' offices.

Conclusion

PEO welfare arrangements, especially those operating in multiple states, face many challenges to be compliant with all applicable laws. The best advice for those operating in multiple states is to make sure you either have very good in-house counsel or you seek outside counsel assistance. While the DOL does not have a national project that targets PEOs, it does have a national project that targets MEWAs.

Some area offices of the Employee Benefits Security Administration (EBSA), the DOL agency charged with ERISA enforcement, have discovered that PEO plans can offer a plethora of violations, many totally inadvertent, and are aggressively investigating PEO plans. It also does not help that some PEOs have filed for bankruptcy and left behind unpaid health claims or benefit plans missing assets. Bad situations involving PEOs have pushed PEOs generally onto the regulatory radar screen.

On the state side, while states do not typically disturb MEWAs that are paying claims, some states do. Most notably Texas, which has been known to pursue MEWAs paying claims and force them to comply with their state laws. Being caught off guard in this most complicated regulatory area can be costly, time-consuming, and not good for business. Be proactive and understand your risk.●

Certainty: Alternative Registration

These states have PEO provisions to allow alternative registration through certification:

Arizona	Montana	Rhode Island
Arkansas	Ohio	South Carolina
Indiana	North Carolina	Utah

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