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# Employment Law Outlook

Summer 2012

## THE SUPREME COURT RULES ON THE AFFORDABLE CARE ACT

**Cher E. Wynkoop and Corina V. San-Marina**

In a landmark decision, the Supreme Court upheld the most important, and at the same time the most controversial, of the Affordable Care Act Provisions, namely the individual mandate that requires most Americans to maintain "minimum essential health coverage." The Court rejected the government's argument that the individual mandate is a valid exercise of Congress' power under the Commerce Clause and the Necessary and Proper Clause, and upheld the mandate as within Congress' power under the Taxing Clause. In reaching its conclusion, the Court held that labeling the "shared responsibility payment" as a "penalty" not a "tax," is not a controlling factor in determining whether the mandate is constitutional, as one must look at its application and substance.

The other provision of the Affordable Care Act that was before the Court, the Medicare expansion, was found to "violate the Constitution by threatening existing Medicaid funding." The Court found that Congress simply has "no authority to order the States to regulate according to its instructions. States must have a genuine choice whether to accept the offer."

The Court utilized a significant portion of its opinion to explain its duty to keep as much of the Act intact as possible and to find constitutionality where possible. For instance, the Court's explanation of the "penalty" versus "tax" seemed to reflect a last resort to find constitutionality. Finally, the Court at several points in the opinion emphasized that its duty was not policy making and it was not expressing "any opinion on the wisdom" of the Act. The Court noted that "it is not our job to protect the people from the consequences of their political decisions."

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## EEOC GUIDANCE ON CRIMINAL BACKGROUND CHECKS

**William E. Rachels, Jr.**

On April 25, 2012, the EEOC released its updated Enforcement Guidance on the use of arrest and conviction records in employment decisions under Title VII. It reaffirms the Agency's prior position with some additional protocol.

As a refresher, there are two types of potential discrimination under Title VII:

1. "Disparate discrimination" occurs when an employer treats job applicants with the same criminal record differently because of their protected status under Title VII. Such is *intentional* discrimination.

2. "Disparate impact discrimination" occurs when an employer uniformly applies criminal record exclusions, but they operate to disproportionately and unjustifiably exclude individuals of a particular race or national origin. Such is *unintentional* discrimination. There the employer has to show that the exclusion is "job-related and consistent with business necessity" for the job in question in order to avoid violation of Title VII, according to the EEOC.

The EEOC and various courts take into consideration the following three factors: the nature of the offense, the time

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**What the Ruling Means For Employers and Plan Sponsors**

Even though the individual mandate is not effective until 2014, there are certain provisions of the Affordable Care Act that are already in effect and with which employers and plan sponsors must continue to comply and other provisions that will become effective in the very near future. Some of those provisions are:

- Form W-2 reporting requirement on the value of health coverage for the 2012 tax year;
- Summary of Benefits and Coverage for open enrollment periods starting on or after September 23, 2012;
- $2,500 limit on employee contributions to health flexible spending accounts for plan years beginning in 2013;
- Requirement for employers to notify employees of the availability of health insurance exchanges (March 2013);
- Expansion of Medicare to include an additional 3.8% tax on the unearned income of high earners for the 2013 tax year;
- 0.9% Medicare payroll tax increase on higher-income earners for the 2013 tax year; and
- The patient-centered outcomes trust fund fees for plan years ending on or after October 1, 2012, and before October 1, 2019.

Additional provisions of the Affordable Care Act that become effective in 2014 include:

- The "play or pay" employer mandate;
- Employer certification to the U.S. Department of Health and Human Services regarding whether its group health plan provides "minimum essential coverage";
- Detailed reporting to the IRS of health coverage availability and cost to full time employees;
- Increase in permitted wellness incentives from 20% to 30%;
- For large employers (more than 200 employees), automatic enrollment of new employees in a group health plan (effective date unknown);
- 90-day limit on waiting periods;
- Coverage under non-grandfathered plans for certain approved clinical trials;
- Initial phase of the Medicare Part D "donut hole" fix, which will completely eliminate the Medicare Part D coverage gap by 2020;
- Guaranteed availability and renewability of insured group health plans;
- Complete prohibition on pre-existing condition exclusions for enrollees aged 19 or older (prohibition has already taken effect for enrollees under age 19); and
- Complete prohibition on annual dollar limits.

In addition, states will be required to have their health insurance exchanges up and running by 2014. The rules governing many of these provisions have not yet been drafted by the regulators. Thus, employers and plan sponsors should move carefully when implementing these provisions, and continue to work closely with qualified advisors in order to comply with the applicable law.■

### First Medical Loss Ratio (MLR) rebates for fully insured health plans due August 1, 2012

A provision of the healthcare reform, effective in 2011, requires health insurers to distribute by August 1 of the next year certain annual medical loss ratio ( MLR) rebates to sponsors of insured group health plans. These rebates may be paid in a variety of forms, including cash and credits against future premium payments, but there are strict rules regarding how an employer may deal with these rebates. Generally speaking, an employer <u>may not</u> simply deposit 100% of these MLR rebates into its general assets, but rather must follow specific guidance as to the usage of these rebates. The first rebate is due August 1, 2012.

- Has the plan's insurer notified you of impending MLR rebates?
- Are the MLR rebates "ERISA plan assets?"
- How will the plan sponsor account for or distribute and withhold upon the rebates?
- Did you amend the health plan's terms to account for MLR rebate accounting?

If you have any questions, we can help guide you through this process.

## EEOC GUIDANCE ON CRIMINAL BACKGROUND CHECKS

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period that has elapsed since the offense was committed or the sentence completed, and the relationship to the job at issue.

Under the updated Guidance, an employer can establish the defense in two ways. First, where there is data or analysis about criminal conduct that is related to subsequent work performance or behaviors. Second, where the employer develops a "targeted screen" and then provides the opportunity for an individual assessment to determine whether the policy as applied is job-related and consistent with business necessity.

A targeted screen involves the above three factors. The updated Guidance suggests that an employer should provide the individualized assessment which involves three steps: "(1) inform the applicant that he or she may be excluded based upon the past criminal conduct; (2) provide an opportunity to the individual to establish that the exclusion should not apply; and (3) consider whether the individual assessment shows that the policy should not be applied to the applicant."

The Guidance provides the following examples of "best practices" for employers.

- Eliminate policies or practices that exclude people from employment based on any criminal record.
- Develop a narrowly tailored written policy and procedure for screening applicants and employees for criminal conduct.
- Train managers, hiring officials, and decision makers on how to implement the policy and procedures consistent with Title VII, including its prohibition on employment discrimination.
- Limit criminal record inquiries to records for which exclusion would be job-related for the position in question and consistent with business necessity.
- Keep criminal records confidential. Only use them for the narrow purpose for which they were intended.

Employers should consider how far they need to go in terms of compliance with the updated Guidance. In the absence of disparate treatment, there should not be an issue of adverse impact unless statistics would show that a protected group is treated more adversely because of a criminal record. Employers may also see that the process suggested by the best practices has a ring of fairness about it. It may result in solid hires where application of the factors would establish that the applicant warrants employment rather than being arbitrarily rejected because of criminal history.■

## PERMISSIBLE USES FOR FORFEITURES IN A HEALTH FSA

**Cher E. Wynkoop and Corina V. San-Marina**

Employers sponsoring a cafeteria plan should be aware of requirements imposed by both the IRS Regulations and ERISA on permissible uses of forfeitures in a health FSA. Forfeitures are the result of amounts remaining in a participant account that were not used to pay or reimburse eligible expenses incurred during a plan year, or grace period, if applicable, and that must be forfeited under the IRS use-or-lose rule.

Those forfeitures are labeled "experience gains." Under ERISA's exclusive benefit rule, experience gains cannot be retained by the employer or used to provide or pay for coverage under a plan other than a health FSA (such as for dependent care).

The following questions and answers summarize some of the most frequent issues encountered in dealing with forfeitures under a cafeteria plan.

**Are employer contributions to a health FSA subject to ERISA's exclusive benefit rule?**

It depends on the type of employer contributions. If an employee has the option to receive the employer contribution as additional compensation, the forfeiture should be subject to ERISA's exclusive benefit rule, and as a result cannot be retained by the employer. If an employee does not have the option to receive the employer contribution as additional compensation, then ERISA's exclusive benefit rule should not apply, and the employer can retain the forfeitures.

**What are permissible uses of forfeitures under a health FSA?**

**1. Defray reasonable administration expenses**

Employers can use the forfeitures to cover "reasonable" administration expenses, and the plan documents should clearly state this. Forfeitures must relate to the health FSA administration (it cannot be an initial expense of establishing the plan) and cannot be applied to another plan, such as a dependant care plan. The forfeitures must be substantiated by adequate records showing the nature, amount and dates the expenses were incurred. In-house administrative expenses do not usually qualify as reasonable administration expenses. With proper documentation certain mailing costs, office supplies and long-distance charges can qualify as direct expenses.

**2. Reduce Required Salary Reductions, Increase Annual Coverage or Cash Refunds**

All three options must comply with two general rules:

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440 Monticello Avenue, Suite 2200
Norfolk, Virginia 23510

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## PERMISSIBLE USES FOR FORFEITURES IN A HEALTH FSA

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experience gains must be allocated among employees on a reasonable and uniform basis and cannot be allocated based (directly or indirectly) on their individual claims experience. There can be no connection between the amount of experience gain returned to an employee and the amount forfeited by that employee, as this would be in violation of the use-or-lose rule.

The most attractive option for employers is to use experience gains to reduce salary reduction amounts ("premium holiday") for the immediately following plan year. The IRS guidance is not clear on the group of employees whose salary reductions can be reduced, but an example in the regulations describes a situation where the only employees eligible for the reduction are the employees who participated in the plan the previous year when the experience gains were generated. Because the amount of experience gains is not known until a couple of months after the end of the plan year, especially for a plan that provides a grace period, an employer most likely would be able to reduce the required salary reductions after the plan year has begun, without violating the irrevocability rule applicable to all cafeteria plans. In this case, employers initiate the salary reductions in order to allocate experience gains, and there is no discretion on the employee's part.

Increasing the annual coverage amount is not an attractive option and may perpetuate forfeitures from year to year, especially for participants who fund their health FSA based on projected expenses and receive an unexpected allocation of experience gains during the plan year.

Using experience gains to provide cash refunds is the least favorite option because of concerns about whether cash refunds may be made only to those employees who had their salary reduced during the year the gain was generated and whether former employees must be tracked down.■

### CONTACTS

**Labor & Employment Law**

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|---|---|
| William M. Furr, Chair | wfurr@wilsav.com |
| Wm. E. Rachels, Jr. | wrachels@wilsav.com |
| Gregory A. Giordano | ggiordano@wilsav.com |
| Samuel J. Webster | swebster@wilsav.com |
| Christopher A. Abel | cabel@wilsav.com |
| Susan R. Blackman | sblackman@wilsav.com |
| David A. Kushner | dkushner@wilsav.com |
| Luba I. Seliavski | lseliavski@wilsav.com |
| Bryan C.R. Skeen | bskeen@wilsav.com |

**Employee Benefits**

| | |
|---|---|
| Cher E. Wynkoop | cwynkoop@wilsav.com |
| David A. Snouffer | dsnouffer@wilsav.com |
| Corina V. San-Marina | csanmarina@wilsav.com |

**Workers' Compensation**

| | |
|---|---|
| Stephen R. Jackson | sjackson@wilsav.com |