ELLEN F. ROSENBLUM
Attorney General

FREDERICK M. BOSS
Deputy Attorney General

DEPARTMENT OF JUSTICE
GENERAL COUNSEL DIVISION

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MEMORANDUM

DATE: April 19, 2017

TO: Jeannette Taylor
Division of Financial Regulation
Oregon Department of Consumer and Business Services

FROM: Deanna Laidler, Assistant Attorney General
Health and Human Services Section

SUBJECT: Common Law Employee Requirements for Group Health Plan Purchases

In accordance with administrative rules established by the Department of Consumer and Business Services (DCBS), a small employer must have at least one common law employee to be eligible to purchase a group health plan in Oregon. In response to concerns expressed by insurance carriers, the Division of Final Regulation (DFR) raised the following questions:

Question: How does DFR define a "common law employee" for the purposes of its counting methodology?

Short Answer: DFR defines "common law employee" using the definition utilized by the Internal Revenue Service, which considers an individual to be a common law employee if the employer has the authority to direct and control the manner in which the services are performed by the individual.

Question: Can the common law employee referenced above be satisfied by an employee that is not eligible for or enrolled in coverage?

Short Answer: Probably not. Under both state and federal law, an employer that employs at least one employee or one full-time equivalent employee meets the definition of a small employer. However, under both the Small Business Health Options Program and the Employee Retirement Income Security Act, if the employer seeks coverage under the group health plan, at least one common law employee must also be enrolled in the plan.

I. Background

A. DCBS Guidance on Counting Methodology for Determining Small or Large Group

In distinguishing between large and small group health plans, DCBS utilize uses the federal definition of small employer set forth in 42 U.S.C. 18024:

> [A]n employer who employed an average of at least 1 but not more than 50 employees on business days during the preceding calendar year and who employs at least 1 employee on the first day of the plan year.

DCBS defines a large employer as an employer that, during a calendar year, employed more than 50 employees (including full-time equivalent employees).

As authorized by the Insurance Code, DCBS adopted rules implementing a methodology for determining whether an employer is a small employer, as defined in ORS 743B.005. Pursuant to ORS 743B.020, the methodologies used to define small employer must be consistent with the corresponding federal requirements for the Small Business Health Options Program. In accordance with such authority, DCBS adopted Oregon Administrative Rule (OAR) 836-053-0015(4), which directs health insurers to follow guidance set forth in Exhibit 1 to the aforementioned OAR for purposes of determining employer size. In referencing group size, Exhibit 1 provides the following guidance regarding an employer's eligibility to purchase a group health plan:

> The following criteria determine whether an employer is eligible to purchase a group health plan:
>
> 1. If the employer is a sole proprietor, a partner in a partnership, a 2-percent S corporation shareholder, or the spouse of a person who is a sole proprietor, a partner in a partnership or a 2-percent S corporation shareholder, at the beginning of the plan year, the employer employs at least one common law employee, and offers the group health benefit plan to all full time employees.
> 2. At the beginning of the plan year, the group has at least one common law employee.

In referencing the group profile form to be completed by health plans, Exhibit 1further provides that in determining eligibility for group coverage, the employer must have at least one common law employee and offer the health benefit plan to the employee, without a corresponding obligation for the employee to enroll in the plan. If the employer does not have any common law employees, the employer cannot purchase a group health plan.

B. Affordable Care Act

The Patient Protection and Affordable Care Act (ACA) defines a small employer as "an employer who employed an average of at least one but not more than 50 employees on business days during the preceding calendar year and who employs at least one employee on the first day

of the plan year." While "employer" and "employee" are not defined within the ACA, in accordance with Section 1551 of the ACA, the definitions in the Public Health Services Act apply. The Public Health Services Act, in turn, utilizes the definitions of "employee" and "employer" as set forth in the Employee Retirement Income Security Act of 1974 (ERISA). Under ERISA, "employer" is defined, in relevant part, as "any person acting directly as an employer, or indirectly in the interest of an employer, in relation to an employee benefit plan." ERISA defines "employee" as "any individual employed by an employer."

The Small Business Health Options Program (SHOP) is an insurance exchange created by the ACA and is intended to assist small employers in obtaining health coverage for their employees. SHOP utilizes the same definition of small employer as set forth in 42 USC 18024. Employers with 1 to 50 full-time equivalent (FTE) employees may participate in the SHOP marketplace. In order to use the SHOP marketplace, the employer must offer coverage to all of its full-time employees. Self-employed individuals without employees are not eligible to participate in the SHOP marketplace.

C. Employee Retirement Income Security Act

ERISA distinguishes between an employee and a participant, with a participant defined as any employee who is or may become eligible to receive benefits under an employee benefit plan. In defining the construct of plans subject to ERISA, the regulations provide:

> [T]he term 'employee benefit plan' shall not include any plan, fund or program…under which no employees are participants covered under the plan.

In *Yates v. Hendon*, the U.S. Supreme Court addressed the question of whether working owners were participants for purposes of an ERISA pension plan. In *Yates*, the Court ruled that sole owners, partners and company shareholders are entitled to participate in group health, pension and other plan benefits as employees. However, the ERISA plan in which they participate must cover "as participants" one or more common law employee or the plan is not an employee benefit plan for purposes of ERISA. According to the Department of Labor, an individual other than the owner, partner, or spouse of the foregoing must be eligible to participate in the plan for it to meet the ERISA definition of an employee benefit plan.

C. Common Law Employees

In its simplest terms, a common law employee refers to an employee, rather than an independent contractor, in connection with work performed for an employer. In *Nationwide Mutual Insurance Co. v. Darden*, the Supreme Court set forth certain factors to determine whether an individual is an employee or independent contractor. According to the Court:

> In determining whether a hired party is an employee under the general common law of agency, we consider the hiring party's right to control the manner and means by which the product is accomplished. Among the other factors relevant to this inquiry are the skill required; the source of the instrumentalities and tools; the

> location of the work; the duration of the relationship between the parties; whether the hiring party has the right to assign additional projects to the hired party; the extent of the hired party's discretion over when and how long to work; the method of payment; the hired party's role in hiring and paying assistants; whether the work is part of the regular business of the hiring party; whether the hiring party is in business; the provision of employee benefits; and the tax treatment of the hired party.

The IRS provided additional guidance to employees, both in providing a succinct description of common law employees and establishing a multi-factor test for employers to use in determining whether an individual is a common law employee or contractor. According to the IRS:

> Under common-law rules, anyone who performs services for you is your employee if you can control what will be done and how it will be done. This is so even when you give the employee freedom of action. What matters is that you have the right to control the details of how the services are performed.

Consistent with the decision in *Darden*, the test developed by the IRS includes numerous factors to determine whether an individual is a common law employee and assesses the degree of control exerted by the employer and independence exercised by the individual. The test considers the criteria of agency law and other factors utilized by courts to determine independent contractor status. These factors fall into three general categories: (i) behavioral control (whether the employer or the worker has control over the work performed); (ii) financial control (whether the individual directly benefits from his or her labor) and (iii) specific facts regarding the business relationship. This test requires consideration of the totality of the factors, with no one factor being determinative as to whether the individual is an employee or independent contractor of the employer.

II. Analysis

As noted above, this analysis was generated in response to concerns raised by a health carrier that health insurers were not interpreting the "one common law employee" requirement consistently, with some insurers requiring that the employer simply offer coverage to at least one common law employee eligible, and others requiring that the common law employee be enrolled in the group health plan. The request stems, at least in part, from a carrier communication issued by the Washington Office of the Insurance Commissioner (OIC) in November 2015. In this communication, the OIC addressed the issue of common law employees and small group plans:

> The OIC has determined that the ACA and implementing Federal regulations require that to qualify to purchase group coverage, the employer must have at least one common law employee. This requirement supersedes the language of RCW 48.43.005(33) that permits sole proprietors with no employees and self-employed individuals to purchase small group coverage. This provision is

> inconsistent with the ERISA definition of an 'employee welfare benefit plan' and with the ACA's division between the individual and small group markets. Under these definitions, an employee benefit plan must include at least one common law employee.

The OIC's guidance requires not only that the employer have at least one common law employee, which is consistent with the ACA, but also requires that the employee benefit plan include at least one common law employee as a participant.

Under the ACA, a sole proprietor or self-employed individual cannot purchase a group health plan and must instead purchase an individual plan. By distinguishing between individual and small group plans, it appears that the ACA intended to require at least one employee to enroll in the plan, in addition to any enrollment by the employer.

SHOP guidance provides that the employer must have at least one employee enrolled in the plan if the employer desires coverage under the plan. While DFR is obligated, by statute, to comply with the SHOP regulations defining small employers, it is less clear whether this statutory requirement encompasses guidance provided outside of the regulatory context and which does more than simply define small employer.

The OIC's reference to ERISA is significant. ERISA defines employee benefit plans by explicit reference to employee participation. In its ERISA regulations, the Department of Labor clarified that the term "employee benefit plan" does not include a plan the only participants of which are "[a]n individual and his or her spouse … with respect to a trade of business…which is wholly owned by the individual or by the individual and his or her spouse" or "[a] partner in a partnership and his or her spouse." The regulation further specifies, however, that a plan that covers as participants "one or more common law employees, in addition to the self-employed individuals" will satisfy the definition of employee benefit plan. Therefore, to qualify as a health benefit plan under ERISA, at least one employee must be eligible for and enrolled in the plan, regardless of whether the employer is also enrolled.

III. Conclusion

Under both ERISA and SHOP, if an employer purchases a plan with the intent to obtain coverage for the employer under the plan, the plan must have at least one common law employee enrolled as a participant. Exhibit 1 to the OARs, which provides guidance on determining employer size, contains some provisions that are inconsistent with this guidance. However, this guidance is currently under revision, with the intent to remove this language and thus eliminate the conflict. It may be beneficial to define "common law employee" within the context of the exhibit to lessen the likelihood of confusion in the future.

Please contact me with any follow-up questions that may arise. I can be reached by telephone at (503) 947-4323 or via email at deanna.p.laidler@doj.state.or.us. Pursuant to ORS 180.060(3), persons other than state officers may not rely upon this letter.

Regards,

Deanna
Deanna P. Laidler
Senior Assistant Attorney General