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Can a State Mandate an Employee to Act Voluntarily?—The Saga of State-Mandated Payroll Deduction IRA Programs

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For small employers who wish to establish payroll-deduction, non-ERISA retirement savings plans with "opt-out" provisions for employees, there is much at stake in how courts will define "voluntary."

When a doctor taps your knee with a rubber hammer and your foot "kicks," it is clear that you are not acting voluntarily; it's merely a reflex. Likewise, when an army drill sergeant tells his troops, "I need two volunteers, you and you," the recipient soldiers have been volunteered and did not act voluntarily. Even subtler is when Katniss volunteers as tribute to save her sister Prim in *The*

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Hunger Games. Did she really act voluntarily? Likewise, if state law requires your employer to automatically enroll you into a state-run IRA program, withhold a percentage of your pay, and contribute it to your IRA under the program unless and until you opt out, have you acted voluntarily?

One of the definitions of "voluntary," according to the Merriam Webster Dictionary, is "acting or done of one's own free will without valuable consideration or legal obligation." [*www.merriam-webster.com/dictionary/voluntary*]

In 2016, the United States Department of Labor (DOL) reported that approximately 39 million employees in the United States did not have access to a retirement savings plan through their employer. [Fed. Reg., Vol. 81, No. 168, p. 59464, citing National Compensation Survey, Bureau of Labor Statistics, July 2016] California reports that 7.5 million Californians work for employers that do not offer a retirement plan. [CalSavers Fact Sheet, *www.treasurer.ca.gov/scib/*] Oregon reports that 1 million workers do not have the option to save for retirement at work, which is over half of the workers in Oregon. [OregonSaves website, *www.oregonsaves.com/home/overview/html*] In the past few years, state governments have attempted to help this poor status of retirement savings among employees in their jurisdictions by passing laws mandating that employers who don't otherwise offer employees the opportunity to save for retirement at work through an employer-sponsored retirement plan deduct certain amounts from their employees' pay and contribute them to a government-operated Individual Retirement Account (IRA) program. In particular, the states of California and Oregon have led the way in enacting legislation mandating that employers of a certain size automatically enroll employees into the state-run program and permit the employees to opt out if they so desire.

Whether these state-mandated plans are employee benefit plans subject to Employee Retirement Income Security Act (ERISA) or the laws themselves are preempted by ERISA has been recognized as an issue from the beginning. This article will examine: (1) the ERISA issues, (2) the regulatory history of mandated payroll deduction laws, (3) the history of the Oregon and California automatic enrollment mandatory payroll deduction IRA programs, and (4) recent litigation challenging these laws.

In the Beginning…

Shortly after ERISA became effective, the Department of Labor (DOL) issued guidance on whether a procedure whereby an employer deducted amounts from an employee's pay, and sent such amounts to the custodian of the employee's IRA at the request of the employee, was the establishment of an employee benefit plan by the employer under ERISA's definition of an employee pension benefit plan. [ERISA § 3(2)] Under regulations issued in 1975, the DOL provided an exception to the definition of employee pension benefit plan under ERISA for arrangements involving payroll deduction IRAs where: (1) there are no employer contributions to the plan; (2) the only employer involvement is publicizing the program without endorsing it, collecting employee contributions through payroll deductions, and remitting those contributions to the IRA sponsor; (3) employee participation is "completely voluntary"; and (4) the employer receives no compensation from the IRA sponsor (1975 Safe Harbor). [DOL Reg § 2510.3-2(d)]

In 1999, the DOL supplemented the 1975 Safe Harbor with an Interpretive Bulletin that summarized several advisory opinions issued since the 1975 Safe Harbor was issued in an effort to encourage employee savings through IRAs (the Interpretive Bulletin). [Interpretive Bulletin 99-1, Fed. Reg., Vol. 64, No. 117, p. 33000] The DOL noted that, according to the 1993 Current Population Survey, over half of the private wage and salary workforce did not have employment-based retirement coverage; approximately 82 percent of private wage and salary workers employed by employers with 100 or more employees had access to coverage, but only 18 percent of employers of fewer than 25 employees and 45 percent of employers with 25 to 99 employees sponsored retirement plans. [*Id*.] This meant that, at that time, about 30 million employees of small business did not have access to employment-based retirement coverage. [*Id*.] Additionally, only about 12 percent of these employees contributed to an IRA. [*Id*.]

The Interpretive Bulletin expanded what employers could do with respect to a payroll deduction IRA without it being considered an ERISA plan. It stated that, provided the employer's involvement remained limited to facilitating employee contributions through payroll deductions, it could: (1) answer inquiries about the mechanics of the payroll deduction program and refer other inquiries to the appropriate IRA sponsor; (2) provide informational materials written by the IRA sponsor, as long as the employer remained neutral with respect to the IRA sponsor and its products; (3) request that the IRA sponsor prepare informational materials and review the materials for appropriateness and completeness; and (4) display the employer's name or logo in the informational materials in connection with describing the payroll deduction program. [*Id*.]

Preemption

One of the goals of Congress in passing ERISA was to establish a single unified statutory administrative scheme for employee benefit plans. [New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645 (1995)] To do this, ERISA section 514 provides that it supersedes (*i.e.*, "preempts") all state laws that relate to employee benefit plans that are covered by Title I of ERISA, unless otherwise excepted. [29 USC § 1144] Thus, if a state law requires employers to offer a payroll deduction IRA program to their employees and a payroll deduction IRA program is an ERISA plan, such state law should be preempted by ERISA. The 1975 Safe Harbor and Interpretive Bulletin only address payroll deduction IRA programs voluntarily adopted by employers in which an employee's participation was voluntary and required the employee's affirmative action to enroll.

During the Obama administration, certain states began proposing that they be allowed to pass laws mandating that employers offer employees the opportunity to have payroll deductions made and contributed to IRAs for them. Between 2012 and the middle of 2016, over half of the states had introduced some type of legislation regarding such programs. ["How States Are Working to Address the Retirement Savings Challenge - An analysis of state-sponsored initiatives to help private sector workers save," A Report from The Pew Charitable Trust, June 2016]

In 2015, President Obama directed the DOL to publish guidance to support state efforts to promote broader access to workplace retirement savings opportunities for employees at the Whitehouse Conference on Aging. [Preamble to Final Rule 2510-3.2(h), 81 FR 59464] On November 18, 2015, the DOL proposed a new safe harbor regulation regarding such programs and finalized it on August 30, 2016, to be effective October 1 (the 2016 Safe Harbor). In the preamble to the final 2016 Safe Harbor, the DOL stated it was issuing the 2016 Safe Harbor to "provide guidance for states in designing such programs so as to reduce the risk of ERISA preemption of the relevant state laws." [*Id*.] The DOL stated that the 2016 Safe Harbor was necessary because the 1975 Safe Harbor would not cover a program using automatic enrollment. The DOL reasoned that, under the 1975 Safe Harbor, it intended the requirement that the employee's participation be completely voluntary to mean that the employee's enrollment in the program was employee-initiated. Because automatic enrollment means the employer is enrolling the employee, it would not be covered by the 1975 Safe Harbor. The DOL stated, "If the employer automatically enrolls employees in a benefit program, the employees' participation would not be 'completely voluntary' and the employer's actions would constitute the 'establishment' of a pension plan, within the meaning of ERISA section 3(2). [*Id*.] This is true even if the employee can affirmatively opt out of the program." [*Id.*] Therefore, such programs would fall outside of the 1975 Safe Harbor. [*Id.*].

A New Sheriff…

Of course, in November 2016, Donald Trump was elected President and the Republican Party took control of both houses of Congress. Shortly thereafter, the Republican Congress repealed the 2016 Safe Harbor under the Congressional Review Act. The Act gives Congress a simplified procedure to pass a disapproval resolution to repeal recently issued regulations and prevent federal agencies from reissuing new rules that are substantially the same. The House passed a disapproving resolution, H.J. Res. 66, in February 2017, and the Senate followed suit in May. On May 17, President Trump signed the measure, making it effective. [Pub. L. No. 115-35, 131 Stat. 848, May 17, 2018] The resolution provides that the 2016 Safe Harbor shall have "no force or effect." [H.J. Res 66, 115th Cong. (2017)] This meant the status of the law reverted back to the 1975 Safe Harbor and Interpretive Bulletin.

States Sail Legislation Through Rough Water—Without Safe Harbor

Meanwhile, California and Oregon continued to implement their programs despite the repeal of the 2016 Safe Harbor.

California

California first passed legislation in 2012 to create the Secure Choice Retirement Board (Board) and authorized the Board to conduct a detailed market analysis to make recommendations for a payroll deduction IRA program. Based on the Board's recommendation, legislation was enacted in 2016 to establish the

Secure Choice Program. [S.B. 1234] However, the law provided that implementation of the program was contingent upon the Board reporting to the Governor and State legislature that the DOL had issued a safe harbor regulation stating that state-run mandated employer payroll deduction IRA plans were not subject to ERISA and that the Secure Choice Program met such safe harbor's requirements. As mentioned above, in August 2016, the DOL issued the 2016 Safe Harbor, but it was repealed in May 2017.

Thus, as of May 2017, California law authorized its Secure Choice mandated payroll deduction IRA program, provided that the Secure Choice Board could report to the Governor and legislature that the DOL had issued a safe harbor for state-run IRA programs and that the Secure Choice program met the DOL safe harbor regulation. However, the 2016 Safe Harbor had been repealed and had no force or effect. Therefore, no safe harbor for state-mandated IRA programs existed.

Undaunted, also in May 2017, the Secure Choice Retirement Board obtained a legal opinion from a private law firm (the Opinion), which stated that, despite the repeal of the 2016 Safe Harbor, the Secure Choice program would not create a retirement plan under ERISA under the 1975 Safe Harbor and Interpretive Bulletin. [*See* opinion of K&L Gates, May 16, 2017, at *www.treasurer.ca.gov/scib/background.asp*] The Opinion summarizes the DOL's position in the proposed and final 2016 Safe Harbor that a payroll deduction IRA program of an employer that uses automatic enrollment to nudge employees to enroll would not satisfy the requirement that an employee's enrollment be "completely voluntary." It cited the preamble to the proposed 2016 Safe Harbor, in which the DOL stated that an employer that adopts automatic enrollment of its own volition is establishing a plan under ERISA. [80 Fed. Reg. 72006, 72008 (Nov. 18, 2015)] The Opinion reasoned that where an employer is offering the program because it is required by state law, the employer is not voluntarily acting to establish a plan or coercing employees to participate. Therefore, the employees' participation through automatic enrollment with an opt-out provision should be considered "completely voluntary."

Armed with this Opinion, the California legislature then amended the Secure Choice statute to remove the contingency of a DOL safe harbor and required the Secure Choice Retirement Board to merely report to the Governor and legislature the date on which enrollment would start and self-certify that the program is structured in a manner to keep it from being classified as an employee benefit plan under ERISA. [AB 119, section 10, amending section 100043 of the Government Code] The Governor signed the legislation on June 27, 2017.

The California program, now called CalSavers, requires covered employers of a certain size to automatically enroll employees into CalSavers and contribute a percentage of the employee's pay unless that employee opts out. In the first year of implementation, covered employers are those with 100 or more employees. In the second year, the number drops to 50 or more employees, and in the third year it drops to five or more employees. The Secure Choice Board will decide when the program is ready to be implemented and is anticipating implementation in 2019. Employers that maintain a 401(k) plan, profit sharing, pension, Simplified Employee Pension (SEP), or Savings Incentive Match Plan for Employees (SIMPLE) plan are exempt from having to automatically enroll employees.

Oregon

The Oregon Retirement Savings Plan was enacted on June 23, 2015. It created the Oregon Retirement Savings Board (ORS Board), which is responsible for implementing and maintaining the "OregonSaves" program whereby employers of a certain size must automatically enroll employees into the IRA program. [ORS 178.205(2)(a)] Like California's law, Oregon's statute becomes effective on a rolling basis over three years based on the number of employees an employer employs. It took effect for employers with 100 or more Oregon employees on November 15, 2017. For employers with at least 50 but no more than 99 Oregon employees, it was effective May 15, 2018. For employers of at least 20 but no more than 49 Oregon employees, it is effective December 15, 2018. For employers with at least 10 but no more than 19 employees, the effective date is May 15, 2019. If an employer has at least five but no more than nine Oregon employees, the date is November 15, 2019. And for those with four or fewer Oregon employees, it is effective May 15, 2020. [OAR 170-080-0015(1)(b)]

Under rules of the ORS Board, an employer that already provides its employees with an ERISA-covered qualified retirement plan is exempt from automatically enrolling employees. However, as originally enacted, such employers were required to file a "certificate of exemption" with the state. Failing to file the certificate meant that the employer would be required to register with the state to enroll employees in OregonSaves. [ORS 178.210(1)(b), 178.215(8), OAR 170-080-0015(1)(a), 170-080-0020] The certificate of exemption is good for three years and thereafter must be renewed. [OAR 170-080-0020] As further addressed below, there is a new procedure for the exemption for employers that are members of The ERISA Industry Committee (ERIC) as part of the settlement of a lawsuit challenging the statute as preempted under ERISA.

Litigation Challenging the Oregon and California Statutes

On October 12, 2017, ERIC filed a lawsuit against the ORS Board in federal district court, challenging the OregonSaves program's exemption process for employers that offer employees participation in ERISA retirement plans. [Case No. 3:17-cv-01605-YY] ERIC is a nonprofit trade association that represents the interests of large employers that sponsor ERISA plans. The suit maintained that the OregonSaves exemption process requiring that a certificate be filed or the employer is subject to enrolling employees was preempted by ERISA. ERIC maintained that the law regarding the exemption process related to ERISA plans, because it imposed reporting requirements on multi-state plan sponsors operating in Oregon by requiring that they file the certificate to avoid having to register and enroll employees under OregonSaves. Therefore, the argument went, the procedure interferes with the nationally uniform ERISA plan administration by requiring plan sponsors to report to the ORS Board regarding their ERISA activity of providing ERISA plans.

It is important to note that ERIC was not challenging the entire OregonSaves statutory scheme, but only the exemption process, and it asked the court to declare those provisions to be expressly preempted by ERISA and to enjoin the ORS Board from enforcing those provisions. In a press release ERIC stated that OregonSaves fills an important void for individuals who don't have access to an employer-provided retirement plan. ["ERIC Settles Lawsuit Against Oregon Retirement Savings Board, Secures Exemption For ERIC Members", Kelly Broadway, Mar. 28, 2018 *http://www.eric.org/retirement/eric-settles-lawsuit-against-oregon-retirement-savings-board/?zoom_highlight=oregonsaves*]

In March 2018, ERIC settled its lawsuit against the ORS Board, when the Board agreed to a special exemption for ERIC members. Under the terms of the settlement, if Oregon asks an ERIC member about its exempt status, the member may inform the state that it is a member of ERIC and, once verified by Oregon, the member's exemption will be confirmed. As part of the settlement, ERIC dismissed the lawsuit. Therefore, the court did not have the opportunity to decide the preemption issue.

However, a court will likely have the opportunity to decide whether California's CalSavers program is preempted by ERISA. On May 31, 2018, the Howard Jarvis Taxpayer's Association (HJTA) and two of its employees sued CalSavers and the Chair of its Board, State Treasurer John Chiang, in the Federal District Court for the Eastern District of California. [Case No. 2:18-cv-01584, May 31, 2018] The suit maintains that the statute creating CalSavers is void as preempted by ERISA. The suit also seeks to enjoin the State from spending any further money on CalSavers.

The HJTA suit will have to answer the question of whether CalSavers is preempted by ERISA or whether the statute mandating automatic enrollment of employees by employers who don't otherwise offer ERISA plans can meet the 1975 Safe Harbor because the employees' ability to opt out keeps their participation as completely voluntary as the Opinion opines. Thus, the Court will have to decide whether the state can mandate that California employees act voluntarily.

If the HJTA lawsuit is successful, it would likely be the end of the CalSavers Program. Of course, the Secure Choice Retirement Board could appeal any initial adverse decision. And given that other states, such as Oregon, have similar laws, the issue could be litigated in other states and eventually wind up before the U.S. Supreme Court. Of course, this will take time. Additionally, with the recent shake-up on the high court as a result of Justice Kennedy's retirement, one could predict that the Court would be likely to follow the lead of the Trump administration in finding for preemption.

Conclusion

There is no doubt that Americans need to save more for retirement. While state-mandated payroll deduction IRA programs seem to provide an additional tool for employees to do so, these programs may be preempted by ERISA unless there is a regulatory or legislative change. It seems that Congress could develop other mechanisms to encourage employers to adopt ERISA plans that would allow employees to save for retirement at work and give them the protections of ERISA, as well as provide for uniform administration.

The recent reduction in income tax rates under tax reform serves as a disincentive for employers to adopt qualified plans, as deductions for employer contributions are not as valuable because they don't save as much money. Perhaps a larger credit for establishing a plan, or a credit for establishing a payroll deduction IRA under the 1975 Safe Harbor, would help. Or the increase in the amounts that can be contributed to a SIMPLE plan as proposed under the SIMPLE Plan Modernization Act (S. 3197) could encourage employers to adopt plans. See "A Much More SIMPLE Approach to Increase retirement Savings," The Benefit of Benefits Blog, July 20, 2018, *www.thebenefitof-benefits.com/2018/07/much-simple-approach-increase-retirement-savings/*. Congress might even consider some nondiscrimination testing or fiduciary liability relief for small plans to encourage more employers to adopt ERISA plans. ■