Articles + Publications | February 3, 2021

Supreme Court Reaffirms State Governments May Enact Cost Regulations Without Triggering ERISA Preemption

WRITTEN BY

Andrew Henson | Mary Grace W. Metcalfe

In the recent decision *Rutledge v. Pharmaceutical Care Management Association*, the Supreme Court unanimously affirmed the power of state governments to regulate Prescription Benefit Managers (PBMs) without triggering federal preemption under the Employee Retirement Income Security Act of 1974 (ERISA). In relevant part, the Court's opinion authorized state governments to enact rate regulations, which "merely increase costs or alter incentives for ERISA plans without forcing plans to adopt any particular scheme of coverage," distinguishing such regulations from those which "'govern[] a central matter of plan administration'" and are thus preempted.[1] The decision upends prior precedent from the Eighth Circuit, which had recently embraced an even more expansive interpretation of ERISA's preemptive power that resulted in the invalidation of several state laws regulating PBMs.

While it remains well-settled law that ERISA's preemption clause is one of the most expansive in the federal statutes, this decision reaffirms the tenuous balance the Supreme Court has previously struck in its attempt to reconcile ERISA's broad preemption clause with the courts' reluctance to trammel the historical provinces of state regulation.

ERISA preempts state laws that "relate to" a covered employee benefit plan. Traditionally, this has been a two-part analysis, which looks to whether (1) the state law includes a reference to ERISA plans, or (2) the law has an impermissible connection with ERISA plans. A state law "refers to" an ERISA plan either by its express terms or by acting immediately and exclusively upon ERISA plans, and the existence of ERISA plans is essential to the law's operation. A state law can have an "impermissible connection" with an ERISA plan if the "acute, albeit indirect, economic effects of the state law force and ERISA plan to adopt a certain scheme of substantive coverage."[2]

Eleven of the nation's largest PBMs filed the lawsuit to invalidate Act 900, an Arkansas law passed in 2015. PBMs work as intermediaries between pharmacies and prescription-drug plans that reimburse pharmacies for drugs used by plan beneficiaries. Act 900 required PBMs to reimburse pharmacies at a price no less than the pharmacy's wholesale cost, among other requirements. The law was enacted at the urging of community pharmacies, which had complained that certain PBMs were reimbursing the cost of pharmaceuticals at a rate lower than many pharmacies' wholesale cost, thereby jeopardizing the viability of many community pharmacies. The PBMs argued in part that Act 900 was written broadly enough to encompass ERISA plans, which meant that the law made an "implicit reference" to ERISA, thereby triggering preemption. The PBMs pointed to an Eighth Circuit decision decided in their favor a few years earlier, *Pharmaceutical Care Mgmt. Assn. v. Gerhart*, 852, F.3d

722 (8th Cir. 2017), in which the appellate court had invalidated a similar law passed in Iowa.

The trial court and, subsequently, a panel on the Eighth Circuit each concluded that it was obliged to follow the prior precedent of *Gerhart*, which established that ERISA preempted a state law if it contained an "implicit reference" to an ERISA plan — namely, where the state law was written broadly enough to encompass ERISA plans among other insurance plans not subject to ERISA.

Arkansas petitioned the Supreme Court for review and was joined by 47 attorneys general and the federal government writing amici briefs, collectively urging the Court to reject such an overbroad reading of ERISA's preemption.

The *Rutledge* Court ultimately agreed with the Arkansas petitioners, reaffirming the prior precedent of ERISA preemption and rejecting the emerging string of precedent in the Eighth Circuit. In doing so, the Court distinguished the two groups of cases based upon the focus and scope of the regulation at hand. In particular, the Court reiterated that ERISA preemption is classically triggered where state law requires benefit plans to be structured in particular ways, such as requiring payment of specific benefits,[3] or binding administrators to specific rules.[4] However, where the state law imposes regulations that have an indirect economic effect on ERISA plans,[5] or merely affect cost,[6] the regulation is not impermissibly connected and federal preemption is not triggered.

The Supreme Court noted that Act 900 affected pharmacy rates whether or not the plans fall within ERISA's coverage and that the cost impacts on ERISA plans were not so acute as to require plans to adopt certain schemes of substantive coverage. Accordingly, the Court determined that Act 900 was not preempted by ERISA.

Rutledge is likely to be viewed as the Court's rejection of an untenably expansive interpretation of ERISA emerging from the Eighth Circuit and clarification of the permissible scope of state regulation within the context of employee benefit plans. To the practitioner, in particular, it offers better insight into where the Court draws the line with regard to what rises to an impermissible connection.

---

[1] 2020 WL 7250098, at *4 & 3 (quoting *Gobeille v. Liberty Mut. Ins. Co*., 136 S. Ct. 936, 194 L. Ed. 2d 20 (2016)).

[2] 2020 WL 7250098, at *4.

[3] Citing *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85, 103 S.Ct. 2890, 77 L.Ed.2d 490 (1983).

[4] Citing *Egelhoff v. Egelhoff ex rel. Breiner*, 532 U.S. 141, 121 S. Ct. 1322, 149 L. Ed. 2d 264 (2001).

[5] Citing *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645, 115 S.Ct. 1671, 131 L.Ed.2d 695 (1995).

[6] Citing *De Buono v. NYSA–ILA Medical and Clinical Services Fund,* 520 U.S. 806, 816, 117 S.Ct. 1747, 138

L.Ed.2d 21 (1997).

RELATED INDUSTRIES + PRACTICES

- State Attorneys General