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DHCFP Issues Emergency Rule Implementing the Massachusetts Health Care Reform Act's "Employer Surcharge for State-Funded Health Costs" (aka the "Free Rider Surcharge")

The Division of Health Care Finance and Policy (DHCFP) of the Massachusetts Executive Office of Health and Human Services recently issued two, long-awaited regulations implementing certain features of the Massachusetts Health Care Reform Act—Chapter 58 of the Acts of 2006, *An Act Providing Access to Affordable, Quality, Accountable Health Care* ("Act")[1]—relating to the Health Insurance Responsibility Disclosure (HIRD) form and the Surcharge for State-Funded Insurance Costs (the so-called "free rider surcharge"). A prior advisory explained the HIRD form emergency rule; this advisory explains the free rider surcharge emergency rule. (Click here to access our *Employers' Guide to the Massachusetts Health Care Reform Act*, which describes all of the Act's employer-related provisions and summarizes the guidance issued to date.)

The Act imposes on "non-providing" employers a charge equal to a portion of the Commonwealth's cost of providing health benefits to employees. On December 22, 2006, the DHCFP issued a final free rider regulation, but the regulation was later withdrawn on or about January 19, 2007. The new emergency rule was issued June 20, 2007.

Background

Early on in the legislative process leading up the Act's adoption, the Employer Surcharge for State-Funded Health Costs was conceived as a separate substantive requirement under which an employer that failed to offer coverage could be liable for medical costs incurred by its uninsured employees. Hence the requirement was colloquially dubbed the "free rider surcharge." This represented a substantial change from pre-Act practice,

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however, and it predictably encountered stiff resistance. As a compromise, the administration and the legislature agreed that it would instead apply to employers that neither offered nor "arranged for" coverage, and an employer was deemed to have "arranged for" coverage if it offered access to other coverage (*e.g.*, through the Connector) with pre-tax dollars under a Section 125 cafeteria plan. When stated this way, the requirement's net effect is to make the free rider surcharge the penalty for failing to comply with the Act's Section 125 cafeteria plan requirement.

The June 20, 2007 Emergency Regulation

The newly minted emergency regulation, 114.5 CMR 17.00, takes effect July 1, 2007, and it imposes a surcharge on non-providing employers (*i.e.*, employers that do not adopt a Section 125 cafeteria plan). The surcharge is assessed for "state-funded health costs" of more than $50,000 incurred during the applicable measuring period by its employees or their dependents that are not offered participation in the employer's Section 125 cafeteria plan. The measuring period is generally the fiscal year beginning October 1st and ending September 30th, but for 2007, the measuring period is July 1, 2007 to December 31, 2007.

State-Funded Health Costs

As the name suggests, "state-funded health costs" are the amounts that are paid by the Commonwealth out of its uncompensated care pool. In assessing the amount of the state-funded health costs, the DHCFP looks to claims for services submitted for payment by hospitals and community health centers, and it will match claims to employers using provider claim and bad-debt information, HIRD forms, Medicaid data, and data from the Department of Revenue and Division of Unemployment Assistance.

State-Funded Employees

A "state-funded employee" is:

- an employee or dependent of an employee with more than three state-funded admissions or visits during a fiscal year; or
- an employee or dependent of an employee of an employer whose employees or dependents make five or more "state-funded admissions" or visits during each October 1st through September 30th of a fiscal year.

Employers Subject to Rule

The free rider surcharge requirement applies to Massachusetts employers with 11 or more full-time equivalent employees. The period for measuring full-time equivalent status is the fiscal period beginning October 1st and ending September 30th (the "determination period"), and "full time" means up to 2,000 hours—*i.e.*, hours in excess of 2,000 worked by a

particular employee are not counted. The mechanics of the calculation work as follows: If "the sum of total payroll hours for all employees" during the determination period divided by 2,000 is equal to or greater than 11, then the employer is subject to the requirement. Payroll hours include all hours for which an employer paid wages including regular, vacation, sick, Family and Medical Leave Act, short-term disability, long-term disability, overtime and holiday hours. Payroll hours of independent contractors are not counted.

To these general rules are some important exceptions:

- employers who are signatories to or obligated under a "negotiated, bona fide collective bargaining agreement that governs the employment conditions of the State-Funded Employee"; or
- employers who participate in the Massachusetts Insurance Partnership.

Also, in the case of an "employee leasing company" arrangement, it is the "client company" that is the employer for purposes of the surcharge with respect to itself and its employees covered by the arrangement. For this purpose, an "employee leasing company" is defined as:

> A sole proprietorship, partnership, corporation or other form of business entity whose business consists largely of leasing Employees to one or more Client Companies under contractual arrangements that retain for such Employee leasing companies a substantial portion of personnel management functions, such as payroll, direction and control of workers, and the right to hire and fire workers provided by the Employee Leasing Company; provided, however, that the leasing arrangement is long term and not an arrangement to provide the Client Company temporary help services during seasonal or unusual conditions.

And the term "client company" is defined as a "person, association, partnership, corporation or other entity that uses workers provided by an Employee Leasing Company pursuant to a contract." This definition is not the same as the definition of "client company" under the fair share premium regulations, which requires a co-employment relationship. Since "co-employment" is a feature of Professional Employer Organizations (PEOs) but is not usually associated with traditional staffing arrangements, these employee leasing company provisions apply to both PEOs and staffing firms.

Determination of Surcharge Amount

The DHCFP determines the amount of the surcharge by taking into account the following information:

- the number of employees of the employer;
- the number of admissions and visits for each state-funded employee;
- the total state-funded health services attributed to the employer's employees; and
- the percentage of employees for whom the employer provides health insurance.

Under the emergency regulation, the percentage of state-funded costs is assessed based on the following categories, which vary by the number of the employer's full-time equivalent employees:

Category 1	11 to 25 employees
Category 2	26 to 50 employees
Category 3	More than 50 employees

Based on the data set out above and the employer's category, an "assessment percentage" is determined based on the following table:

State-Funded Costs	Category 1	Category 2	Category 3
$50,000 to $75,000	20%	50%	80%
$75,001 to $150,000	30%	60%	90%
Over $150,000	40%	70%	100%

The product of the state-funded health costs and the applicable percentage is then reduced, but not by more than 75%, by the percentage of the employees covered by employer-provided health insurance. To determine the percentage of the employees covered by employer-provided health insurance, the emergency regulation refers to the definition of "enrolled employee" under the fair share premium contribution final regulation, which defines the term "enrolled employee" as "an employee who has accepted and is enrolled in the employer's sponsored Group Health Plan."

Example

A Category 2 employer would be assessed 60% of its state-funded costs between $75,001 and $150,000, but the assessment percentage of 60% would be reduced to 30% if it

provided group health insurance to half of its employees. But in establishing the percentage of employees to whom it provides coverage, only employees who have actually accepted and enrolled in the employer's group health plan are counted.

Collection of Surcharge

The DHCFP will notify employers subject to surcharge at the end of each Fiscal Year. Where a state-funded employee is employed by more than one non-providing employer at the time services are rendered, the amount of the surcharge is prorated based on "the best available data." An employer may challenge the determination only if it can establish either that:

- an individual identified as a state-funded employee was not its employee or the dependent of one of its employees; or
- the employer is not a non-providing employer.

Penalties for nonpayment or late payment include an assessment of interest on the unpaid liability at a rate not to exceed an annual rate of 18% and late fees or penalties at a rate not to exceed 5% per month. Where there is a transfer of ownership, the non-providing employer's surcharge liability is assumed by its successor. If an employer fails to file (or files false or misleading) information required by the DHCFP in connection with its enforcement of the free rider surcharge, it is subject to a civil penalty of up to $5,000 for each week during which the failure occurs or continues.

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[1] As amended by Chapter 324 of the Acts of 2006, *An Act Relative to Health Care Access* and Chapter 450 of the Acts of 2006, *An Act Further Regulating Health Care Access*.

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If you have any questions concerning the information discussed in this advisory or any other employee benefits topic, please contact one of the attorneys listed below or your primary contact with the firm who can direct you to the right person. We would be delighted to work with you.

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