SURCHARGES AND HEALTHY SAN FRANCISCO:

Healthy for Whom?

June 2012
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THE CIVIL GRAND JURY

California state law requires that all 58 counties impanel a Grand Jury to serve during each fiscal year (Cal. Const., Art. I, § 23; Cal. Penal Code, § 905). In San Francisco, the presiding judge of the Superior Court impanels two grand juries. The Indictment Grand Jury has sole and exclusive jurisdiction to return criminal indictments. The Civil Grand Jury scrutinizes the conduct of public business of county government.

The function of the Civil Grand Jury is to investigate the operations of the various officers, departments and agencies of the government of the City and County of San Francisco. Each civil grand jury determines which officers, departments and agencies it will investigate during its term of office. To accomplish this task the grand jury is divided into committees which are assigned to the respective departments or areas which are being investigated. These committees visit government facilities, meet with public officials, and develop recommendations for improving City and County operations.

The 19 members of the Civil Grand Jury serve for a period of one year from July 1 through June 30 the following year, and are selected at random from a pool of 30 prospective grand jurors. During that period of time it is estimated that a minimum of approximately 500 hours will be required for grand jury service. By state law, a person is eligible if a citizen of the United States, 18 years of age or older, of ordinary intelligence and good character, and has a working knowledge of the English language.

Applications to serve on the Civil Grand Jury are available by contacting the Civil Grand Jury office:
- by phone (415) 551-3605 (weekdays 8:00 a.m. - 4:30 p.m.).
- in person at the Grand Jury Office, 400 McAllister St., Room 008, San Francisco, CA 94102.
- by completing an online application (available at http://www.sfsuperiorcourt.org/index.aspx?page=312), and mailing it to the above address.
CITY AND COUNTY OF SAN FRANCISCO
CIVIL GRAND JURORS
2011-2012
(AS OF DATE OF PUBLICATION)

Umung Varma, Foreperson

Helen Blohm
Mark Busse
Mario Choi
Matthew Cohen
Kay Evans
Allegra Fortunati

Sharon Gadberry
Ossie Gomez
Arlene Helfand
Lewis Hurwitz
Todd Lloyd
Jean Ninos

Mort Raphael
Jack Saroyan
Earl Shaddix
Jack Twomey
Gregory Winters
Sharon Yow

WITNESSES

With regard to witnesses who provide testimony to the Civil Grand Jury to aid it in its investigation, California Penal Code § 929 provides that:

As to any matter not subject to privilege, with the approval of the presiding judge of the superior court or the judge appointed by the presiding judge to supervise the grand jury, a grand jury may make available to the public part or all of the evidentiary material, findings, and other information relied upon by, or presented to, a grand jury for its final report in any civil grand jury investigation provided that the name of any person, or facts that lead to the identity of any person who provided information to the grand jury, shall not be released. Prior to granting approval pursuant to this section, a judge may require the redaction or masking of any part of the evidentiary material, findings, or other information to be released to the public including, but not limited to, the identity of witnesses and any testimony or materials of a defamatory or libelous nature.

The intention of the California State Legislature in enacting Penal Code § 929 is to encourage full candor in testimony in Civil Grand Jury investigations by protecting the privacy and confidentiality of those who participate in an investigation of the Civil Grand Jury.
REQUIRED RESPONSES

California Penal Code § 933(c) provides deadlines for responding to this report:

No later than 90 days after the grand jury submits a final report on the operations of any public agency . . . the governing body of the public agency shall comment to the presiding judge of the superior court on the findings and recommendations pertaining to matters under the control of the governing body, and every elected county officer or agency head for which the grand jury has responsibility . . . shall comment within 60 days to the presiding judge of the superior court . . . on the findings and recommendations pertaining to matters under the control of that county officer or agency head and any agency or agencies which that officer or agency head supervises or controls. In any city and county, the mayor shall also comment on the findings and recommendations. All of these comments and reports shall forthwith be submitted to the presiding judge of the superior court who impaneled the grand jury.

California Penal Code § 933.05 provides for the manner in which responses to this report are to be made:

(a) For purposes . . . as to each grand jury finding, the responding person or entity shall indicate one of the following:
   (1) The respondent agrees with the finding.
   (2) The respondent disagrees wholly or partially with the finding, in which case the response shall specify the portion of the finding that is disputed and shall include an explanation of the reasons therefor.

(b) For purposes . . . as to each grand jury recommendation, the responding person or entity shall report one of the following actions:
   (1) The recommendation has been implemented, with a summary regarding the implemented action.
   (2) The recommendation has not yet been implemented, but will be implemented in the future, with a timeframe for implementation.
   (3) The recommendation requires further analysis, with an explanation and the scope and parameters of an analysis or study, and a timeframe for the matter to be prepared for discussion by the officer or head of the agency or department being investigated or reviewed, including the governing body of the public agency when applicable. This timeframe shall not exceed six months from the date of publication of the grand jury report.
   (4) The recommendation will not be implemented because it is not warranted or is not reasonable, with an explanation therefor.
EXECUTIVE SUMMARY

In 2008, the City and County of San Francisco initiated its historic universal health care program for all residents of San Francisco regardless of immigration status. This legislation mandates that most San Francisco employers spend a minimum dollar amount per employee on health care. This unique program should not be confused with similar programs in other parts of the country like Massachusetts and Hawaii, because those states are providing or mandating health insurance. This San Francisco program provides direct health care to the uninsured by utilizing existing health clinics, government hospitals, and partnerships with local health care providers. The employer mandate offers businesses several options as to the method of compliance with the Employee Spending Requirement. However, the most popular option by far is providing third-party health insurance.

The San Francisco Civil Grand Jury’s investigation found that a small but growing segment of employers, primarily in the restaurant industry, are profiting from the practice of adding a surcharge to the bill of every customer. By using private reimbursement plans instead of the City’s medical reimbursement account, these same employers are legally able to reclaim the majority amount of funds intended for employee health care, thus increasing their profits even more. This blatant capture of funds is at the expense of employees who are not receiving funds earmarked for health care, and customers who are paying the surcharge for what they believed was for employee health care.

While we have no issue with restaurateurs raising menu prices to subsidize the cost of employee health care, this Jury cannot condone the unequivocal fact that a significant number of restaurant owners are benefiting financially from the addition of surcharges that are represented to customers as paying for employee health care. We, the Jury, therefore recommend that the City and County of San Francisco end the practice of allowing businesses to add surcharges to recover the cost of employer mandates. Further, the Jury recommends elimination of private reimbursement plans in favor of the City’s medical reimbursement account.

Implementation of these recommendations will provide uniformity of benefits to employees, eliminate the need for disclosure of employee medical conditions to employers, and reduce complications by employees working for more than one employer. Most importantly, these recommendations will end the fraud being perpetrated on many unwilling patrons of San Francisco restaurants every single day.
BACKGROUND

San Francisco’s Health Care Security Ordinance (HCSO), often referred to as “Healthy San Francisco,” or “Healthy SF,” became effective January 9, 2008. There are two components to this program. The first component provides health care to uninsured residents of San Francisco (the City), and the second component requires employers to make health care expenditures for their employees. The Employee Spending Requirement (ESR) mandates that certain employers spend a minimum amount of money on health care for each of their covered employees. The ESR has come to be known as the “employer mandate.”

In the last few years, a growing number of businesses have made the conscious decision to add surcharges to customer’s purchases. This trend started with restaurants and has spread to beauty salons, caterers, event planners, and other retail businesses. Our analysis shows that these surcharges range from a low of 50 cents per person to a high of 16.8% of the total bill. The most common rate observed is 3-4%. The San Francisco Chronicle Sunday Magazine for April 2012 listed the top 100 restaurants in the Bay Area, 66 of which are in San Francisco, and reported that 31 (47%) add surcharges. The media continues to question whether the surcharges are just another profit center for business owners.

Now that the HCSO program has been in force in San Francisco for four years, the Civil Grand Jury (the Jury) decided to investigate several issues surrounding this program:

- What happens to the surcharge for Healthy SF added to a customer’s bill? Where does the money go?
- Is profiting from health care surcharges a form of consumer fraud?
- How much of the ESR is actually spent on employees’ health care?
- Should HRA guidelines be uniform among employers?

In 2007 the employer mandate provision of the HCSO resulted in a lawsuit against the City. The lawsuit was instigated by the Golden Gate Restaurant Association (GGRA), which argued that employer mandates violate a federal law known as the Employee Retirement Income Security Act (ERISA). The City lost the lawsuit in Federal District Court and appealed the decision to the U.S. Court of Appeals for the Ninth Circuit. In a 2-to-1 decision the Court of Appeals reversed the lower court ruling. The GGRA then filed a writ requesting that the U.S. Supreme Court hear the case but the High Court declined to review it.

While care was taken in the drafting of the HCSO to avoid running afoul of ERISA and its regulations which prohibit public entities from either requiring types of third party insurance plans or “micromanaging” health benefits. The 9th Circuit’s decision held that a public entity like the City could in fact, as an option to an ERISA plan, require employers to contribute a certain amount to employees’ health care.
The City Attorney’s Office, the Office of Labor Standards Enforcement (OLSE), the Board of Supervisors (BOS), and the Department of Public Health (DPH) staff explained to the Jury that the legal issue with respect to ERISA is the extent to which local governments can “micromanage” health benefits for businesses within their jurisdiction. For instance, the City cannot micromanage the type of health insurance a business can offer. The City can however, require businesses to spend a minimum amount on health care for their employees.

Additionally, everyone we interviewed agreed that profiting from surcharges could be considered consumer fraud. In Mayor Ed Lee’s letter of October 25, 2011 to the Board of Supervisors in which he communicates his veto of Supervisor Campos’ amendment to the HCSO, states, “we must aggressively pursue cases of consumer fraud by businesses that charge a so-called ‘Healthy SF Fee’ but do not provide these funds to their employees.”

HCSO requires employers with 20 or more employees (50 for non-profits) to spend a minimum dollar amount on each employee who works in San Francisco. The health care expenditure rate depends on the number of total employees in the business, no matter where they work, as long as at least one employee works in San Francisco. For instance, an employer in Fresno with 100 full-time employees, only one of whom works in the City is subject to the HCSO as to the one employee who works in the City.

Covered employees are persons who have been employed for more than 90 days and work eight or more hours per week in San Francisco. Employers with 100 employees or more have a higher hourly health care expenditure rate than those with 20 to 99 employees. The current rate is $2.20 per hour per covered employee for an employer with 100 or more employees and $1.46 per hour for employers with 20 to 99 employees. Total hours subject to this requirement are capped at 2,064 hours per year per employee, making the maximum health care expenditure for a full-time employee $4,541 for large employers and $3,013 per employee for employers with 20-99 employees. Enforcement authority is charged to the OLSE.

<table>
<thead>
<tr>
<th>Number of Employees</th>
<th>Hourly Rate</th>
<th>Yearly Cap for a Full-time Employee</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-19</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>20-99</td>
<td>$1.46</td>
<td>$3,013</td>
</tr>
<tr>
<td>&gt;100</td>
<td>$2.06</td>
<td>$4,541</td>
</tr>
</tbody>
</table>

Table 1. Health Care Expenditure Rates and Caps
METHODOLOGY AND APPROACH

The Jury interviewed employees, managers, and directors of DPH, OLSE, the City Attorney’s Office, and members of the Board of Supervisors. In addition, we interviewed restaurant owners, employees and customers, as well as professionals in the health industry. The Jury reviewed reports from outside consultants and various City departments, media coverage, and articles from professional journals.

The Jury conducted its own survey of 38 San Francisco employers in the retail food industry. Over the course of several months, Jury members collected receipts from restaurants they normally frequent. For reporting purposes, these receipts were grouped into three categories: Fine Dining, Neighborhood Favorites, and Convenient/Fast-Food establishments. In general, these restaurants are long-established, well-known, local favorites, reflecting the make-up of the Jury. The collected receipts detailed the amount of surcharge, if any, and whether or not sales tax was added to the surcharge.

The Jury then obtained the 2010 annual reports filed with the OLSE for those restaurants as required by the HCSO regulations. In the report each employer details the number of covered employees, whether these employees have a third-party health insurance plan, and if so, the cost of that plan. For those covered employees not afforded health insurance, the employer must report the amount of total health care expenditures and whether this was paid to the City for the “City Option” or provided the employee with a Health Reimbursement Account (HRA). The Jury was then able to compare the health care option taken by each restaurant, along with the cost, in order to calculate health care expenses for each business. Information we received from the OLSE is public information and available upon request.

From the Office of the Treasurer and Tax Collector (TTC), we also obtained (for these same 38 restaurants) their annual 2010 Payroll Expense Tax and Business Registration Statements. The Payroll Tax and Business Registration form requires reporting of annual payrolls and gross receipts from all San Francisco sources. Because reported payrolls and gross receipts are not available to the general public, the Jury cannot reveal actual restaurant names. We can only summarize the information we have garnered from the reports. The Jury was able to calculate surcharge income based on reported gross receipts and the surcharge percentage, if any, detailed on the customers’ bills. With this information, we were able to determine whether the surcharges collected were sufficient to cover health care expenses for each restaurant.

It should be noted that the information we received is self-reported by each business, signed and certified to be true under the City’s Business and Tax Code (6.5-1). The City has not verified or validated this information for the requested restaurants.
DISCUSSION

I. Customer Surcharges for Health Care Mandates

An anonymous quote from the blog *Inside Scoop SF* about added surcharges states:

I have been on both sides of the fence as a consumer and a restaurateur. I knew about “pocketing” unused money since 2010 (in fact, a restaurant consultant suggested that I do it), but I personally hated the idea and decided not to charge the fee. Yes, I recognize that it cost more money to do business in SF, but I also know that we often charge more money for dishes than other Bay Area cities. Maybe I am not smart for gaming the system, but I just think it is a disservice to our customers, our employees, and our beautiful city.³

The City has other ordinances besides the HCSO, affecting employees that also have a direct cost to the employers. The City has the highest minimum wage in the country, currently at $10.24 per hour. The City also mandates part-time employees receive paid sick-days.

A. Estimate of Restaurants with Surcharges and Surcharge Totals

A study completed by the National Bureau of Economic Research (NBER) in 2010 found that 27% of 217 San Francisco restaurants surveyed imposed customer surcharges, the median being 4% of the bill.⁴ Recently the San Francisco Chronicle reported that 47% of their top restaurants have surcharges. The Jury’s survey found 66% have surcharges. The NBER report concluded that larger businesses were more likely to institute a surcharge. This report also states that the annual sales for 2010 from San Francisco restaurants were estimated at $2.85 billion.

Using the above information the Jury made the assumption that if 27% of total restaurant sales include an average surcharge of 4%, the estimated total of surcharges for the year 2010 would be $30.8 million. Table 2 shows the potential growth in surcharges.

<table>
<thead>
<tr>
<th>Percent of Restaurants Adding surcharges</th>
<th>Total Surcharges</th>
</tr>
</thead>
<tbody>
<tr>
<td>27%</td>
<td>$30.8M⁵</td>
</tr>
<tr>
<td>50%</td>
<td>$57.0M</td>
</tr>
<tr>
<td>75%</td>
<td>$85.5M</td>
</tr>
</tbody>
</table>

Table 2. Total Surcharges (based on $2.85B in sales and a 4% surcharge)

These numbers are only an estimate, as actual figures will not be known until April 2013, when employers are required to start reporting surcharge data to the OLSE.
B. Legislative Response

In response to the practice of adding surcharges, Mayor Ed Lee, President of the Board of Supervisors David Chiu, and Supervisor Malia Cohen sponsored legislation that amended the HCSO and addressed surcharges for the first time. As of January 1, 2012, a surcharge on customers’ bills to cover, in whole or part, the cost of the health care expenditure requirement, must be spent on employee medical expenses. Any excess must be “for the benefit of the employees.” In addition, employers must state in their annual report to the OLSE the amount of money collected from the surcharge and the amount of money spent on employee health care. This legislation gives the City the right to audit employers who add surcharges, regardless of whether or not the surcharges cover health care expenses. The first report requiring this information is due in April 2013. Any surcharges prior to January 1, 2012, do not have to be reported to the City nor reconciled with the ESR. The enforcement of this new compliance requirement falls under the OLSE.

C. The Jury’s Survey Results on Surcharges

The Jury’s survey of 38 restaurants found:

- 25 (66%) add surcharges;
- 16 (42%) did not add sales tax to the surcharge;
- Ten (26%) had not filed a report with the OLSE, reducing our sample size to 28 (of which 19 have surcharges);
- Six of the ten restaurants that failed to file a report with the OLSE have surcharges;
- 16 out of 18 profited from surcharges;
- Only one provided third party health insurance for all its employees;
- One labeled the surcharge “SF City Tax,” when clearly the City has no health sales tax;
- One had a flat rate per customer of $0.50 billed as “bread;”
- 18 surcharged a percentage of the total bill, ranging from 2% to 7.5%;
- The common surcharge rate observed is 4%; and
- The average profit from surcharges is 46%.

Our data also suggests that the practice of adding surcharges has grown rapidly in the past two years. The 2010 report by the NBER reported that 27% of restaurants in the City added a surcharge. More recently, as noted in the San Francisco Chronicle Sunday Magazine report 47% of the top San Francisco restaurants have surcharges. Our observed rate of 66% may be higher since we included more moderate priced neighborhood favorites in our survey.
As detailed in Table 3 below, our survey shows that 18 restaurants collected $2,174,362 in surcharges, of which $1,163,399 was spent on net health care expenses, leaving a surplus of $1,010,963. To our knowledge, this Jury’s study is the first to analyze data filed with the City, comparing surcharge receipts and net health care expenses.

<table>
<thead>
<tr>
<th>Type</th>
<th># of Restaurants</th>
<th># of Employees</th>
<th>Gross Receipts</th>
<th>Total Surcharges</th>
<th>Net Health Care Exp.</th>
<th>Profit / (Loss)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fine Dining</td>
<td>4</td>
<td>189</td>
<td>$19,283,605</td>
<td>$922,133</td>
<td>$699,709</td>
<td>$222,424</td>
</tr>
<tr>
<td>Neighborhood Favorites</td>
<td>12</td>
<td>583</td>
<td>34,990,547</td>
<td>989,676</td>
<td>344,992</td>
<td>644,684</td>
</tr>
<tr>
<td>Convenient / Fast Food</td>
<td>2</td>
<td>163</td>
<td>9,584,545</td>
<td>262,553</td>
<td>118,698</td>
<td>143,855</td>
</tr>
<tr>
<td>Totals</td>
<td>18</td>
<td>935</td>
<td>$63,858,697</td>
<td>$2,174,362</td>
<td>$1,163,399</td>
<td>$1,010,963</td>
</tr>
</tbody>
</table>

Table 3. Restaurants with Surcharge Profit / (Loss)

For the purpose of this report, net health care expenses were calculated by adding third party health insurance costs plus the ESR for the remaining covered employees, minus funds the employer may retain from the HRAs.

D. Surcharges and Sales Tax

Surcharges are subject to the State of California Sales Tax. The Special Notice #L224 states, “When a surcharge is separately added to any taxable sale, the surcharge is also subject to sales tax.” In our survey, 16 out of the 38 restaurants (42 %) did not add sales tax to the surcharge. Under reporting of sales tax is a significant revenue loss to the City as well as the State of California. Based on the total gross receipts in Table 3, and an 8.5% sales tax rate, the amount of lost sales tax is over $77,500/year just for our sample. To our knowledge, the City and the State of California has yet to investigate any under-reporting of sales tax in regard to surcharges.

E. Enforcement of HCSO Regulations

The Jury interviewed many of the City’s administrators who expressed concern regarding the definition of surcharges in the amendment to the HCSO and the difficulty involved in enforcing the new regulations. If an employer imposes a surcharge, but labels it “SF Benefits Offset” rather than “SF HCSO,” would the ordinance still apply? The Jury presented this question to the City Attorney’s Office and received the following response:

The answer is that the language would probably still apply, but it would become much more complicated for the OLSE to enforce this provision. If someone were to complain to the OLSE that an employer is collecting an excessive amount in surcharges, the OLSE would have to investigate whether the amount collected by the employer in surcharges exceeds the amount the employer is required to spend to comply with all the various
employee benefit mandates that the City imposes on employers. This includes the Minimum Wage Ordinance and the Paid Sick Leave Ordinance, in addition to the HCSO. OLSE would then have to figure out what percentage of an employer’s costs to comply with these mandates should be attributed to the HCSO. The OLSE could require the employer to ensure that the percentages of the excess surcharges are dedicated towards employee health care.9

When the landmark HCSO legislation was passed five years ago, it never occurred to City officials that some businesses would financially benefit by adding surcharges and then keeping the surplus funds as profit for themselves. The amendment that passed in November 2011 addressed surplus surcharges requiring the excess, if any, must be “for the benefit of the employees.” It remains to be seen if it effectively curbs this practice.

F. Findings

F1. The Jury could not identify any government investigation that reports the number of businesses adding surcharges to pay for HCSO employer mandates and mandated paid sick days.

Responses are requested from the Mayor, the Board of Supervisors, Department of Public Health, and Office of Labor Standards Enforcement.

F2. The City has not investigated health care related surcharges to determine whether or not employers are generating profits from these surcharges.

Responses are requested from the Mayor, the Board of Supervisors, District Attorney, and the Golden Gate Restaurant Association.

F3. Neither the City nor the State of California, to the Jury’s knowledge, has investigated whether sales tax is being added to surcharges.

Responses are requested from the Mayor, the Board of Supervisors, Office of the Treasurer and Tax Collector, State Board of Equalization, and the Golden Gate Restaurant Association.

F4. The City has neither a plan nor sufficient staff at the OSLE to audit employers’ surcharges in compliance with HCSO regulations.

Responses are requested from the Mayor, the Board of Supervisors, and Office of Labor Standards Enforcement.
F5. San Francisco businesses that collected surcharges prior to January 1, 2012 have no obligation to report surcharge receipts to the City nor reconcile the surcharges with health care expenses.

Responses are requested from the Mayor, the Board of Supervisors, City Attorney, and Office of Labor Standards Enforcement.

F6. Due to the varied wording in describing surcharges on consumers’ bills, and the wording of the ordinance, the auditing of surcharges will be difficult.

Responses are requested from the Mayor, the Board of Supervisors, City Attorney, Office of Labor Standards Enforcement, and the Golden Gate Restaurant Association.

F7. Consumer fraud is committed if the consumer’s receipt states that a surcharge is being assessed for a stated purpose and is not being used for that purpose.

Responses are requested from the Mayor, the Board of Supervisors, District Attorney, City Attorney, and the Golden Gate Restaurant Association.

G. Recommendations

R1. Disallow employers subject to the Office of Labor Standards Enforcement regulations from adding surcharges on customers’ bill to pay for HCSO employer mandates and mandated paid sick days.

Responses are requested from the Mayor, the Board of Supervisors, City Attorney, and the Golden Gate Restaurant Association.

R2. The Office of the Treasurer and Tax Collector investigate the under-reporting of sales taxes on surcharges.

Responses are requested from the Mayor, the Board of Supervisors, and Office of the Treasurer and Tax Collector.

R3. The District Attorney open an investigation to review the Jury’s survey findings for possible consumer fraud.

Responses are requested from the Mayor, the Board of Supervisors, City Attorney, and District Attorney.
II. Employers Health Reimbursement Accounts (HRAs)

The HCSO calls for an Employee Spending Requirement (ESR) on a per employee basis. This is a minimum dollar amount per covered employee. (See Table 1). An employer may spend a significant amount over the minimum required for their full-time employees by, for example, providing third-party health insurance. In addition, the same employer must still spend the minimum required for covered uninsured employees. Employers have several options as to how they spend the ESR on health care. The most common are:

- Provide traditional third-party health insurance.
- Pay the ERS to the City (the City Option) and the City will either enroll the employee in Healthy SF, or establish a Medical Reimbursement Account (MRA) for the employee.
- The employer can earmark funds to its own HRA for individual employees, which can be administered in-house or by a third party.

According to OLSE, most employers provide health care insurance for their full-time employees, which usually cost more than the ESR. The report states that most businesses employing part-time or temporary employees use the City Option or establish their own HRAs at a cost lower than third-party health insurance. The report concludes that the Accommodation and Food Service industries were, by far, the largest users of the HRA option.

A. The City Option

Employees working for an employer who has selected the City Option have one of two programs available to them, depending on whether or not they live in the City. Employees living in the City who do not have any form of health insurance are enrolled in the Healthy SF program. Employees who live in the City and do have health insurance, other than that provided by their employer (for instance, through a spouse’s employer), the City will set up a MRA. An employee, not living in the City has only one option, which is the City’s MRA (Table 4).

<table>
<thead>
<tr>
<th>Lives in City</th>
<th>Has Existing Insurance</th>
<th>Options</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>Yes</td>
<td>City MRA</td>
</tr>
<tr>
<td>Yes</td>
<td>No</td>
<td>Enroll in Healthy SF with 75% discount</td>
</tr>
<tr>
<td>No</td>
<td>Doesn’t matter</td>
<td>City MRA</td>
</tr>
</tbody>
</table>

Table 4. City Option

The City contracts with a third party specializing in health care spending accounts to administer the employees’ MRA accounts. The funds remain available to the employee for life...
unless there has been a period of inactivity for 18 months. In that case, the City reclaims the unused funds.\footnote{11}

**B. The HRA Option**

The HRA option is becoming increasingly popular with employers for many reasons. Third-party insurance and the City Option require cash payments by the employer, which are non-refundable. By administering their own HRAs, employers earmark the funds and pay out only when actual medical costs are incurred by their employees. Furthermore, after two years, or 90 days after the employee’s termination, employers can retain any unused funds for their own use. Employers may also arbitrarily define what medical expenses qualify for reimbursement under their HRA plan.

The OLSE reported in 2010 that 860 out of 4,000 employers used the HRA option.\footnote{12} The total amount allocated to the employees was $62.5 million. However, only $12.4 million was actually spent on employee medical care, allowing their employers to “reclaim” or “retain” up to $50.1 million or 80% of their required expenditures. This compares to DPH records that show a reimbursement rate of 50% for City managed MRAs.\footnote{13} This discrepancy is disturbing, and clearly indicates to the Jury that employees are not receiving the full benefit of health care funds intended by the HCSO.

**C. Legislative Response to HRAs**

There have been legislative attempts to rectify the abuse of HRAs. In the fall of 2011, in response to the OLSE study and intense media scrutiny, Supervisor David Campos introduced an amendment closing many of the loopholes and abuses of the current system.\footnote{14} Supervisor Campos’ amendment defined “expense” as actual funds spent on behalf of the employee, not an earmark that can be “retained” later. This amendment passed the Board of Supervisors; however, Mayor Lee used his first veto to kill the legislation.\footnote{15}

Mayor Lee, President of the Board of Supervisors Chiu, and Supervisor Cohen subsequently introduced their own amendment to the HCSO in November 2011.\footnote{16} This alternative measure passed the Board of Supervisors on November 15, 2011, was signed by the Mayor, and became effective on January 1, 2012.\footnote{17} Under the new law, all funds that remain unspent in an employee’s HRA account at the end of 2011 now roll over into calendar year 2012. Also, HRA expenditure guidelines must now be “reasonably calculated to benefit the employee.” Further, Employer-to-Employee postings and notifications of the program details, rights, and obligations are now required. Employers must provide statements showing the account balance annually and also upon termination of employment. The new legislation still allows businesses to adopt their own guidelines and manage their own HRA plan. This still forces employees to disclose their medical conditions to their employer in order to obtain reimbursement for medical expenditures.
D. HRAs and the Affordable Care Act

New federal laws are also a concern. The Affordable Care Act requires a minimum level of health care coverage. However, HRAs, as currently structured, will not meet the federal guidelines under the new statute. A report published by the Forum for Health Economics and Policy, titled “How Do Employers React to a Pay-or-Play Mandate? Early Evidence from San Francisco,” reveals some interesting information. It reports that the Affordable Care Act will make it more difficult for employers to comply with the San Francisco ordinance because health reimbursement accounts will not be an allowable option under the federal requirements. The Affordable Care Act is now under review by the U.S. Supreme Court and a decision is expected shortly.

E. The Jury’s Survey Results on HRAs

The Jury’s survey of the 28 restaurants that filed with the OLSE (out of the 38 requested by the Jury) for the year 2010 found that:

- 22 (80%) used the HRA option;
- Four (14%) opted for the City Option;
- Two (6%) used third-party health insurance; and
- Five paid zero amounts to their employees.

As detailed below (Table 5), the 22 employers that used the HRA option in 2010 earmarked $2,040,140, but only reimbursed their employees $123,612 and retained up to $1,916,528 at the end of the year. This represents a miniscule 6% reimbursement rate compared to the City’s MRA reimbursement rate of 50%.

<table>
<thead>
<tr>
<th>Type</th>
<th># of Restaurants</th>
<th># of Employees</th>
<th>HRA Funds Earmarked</th>
<th>Paid to Employees</th>
<th>Reimbursement Rate</th>
<th>Retained by Employers</th>
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<tr>
<td>Fine Dining</td>
<td>4</td>
<td>190</td>
<td>$306,844</td>
<td>$36,016</td>
<td>11.74%</td>
<td>$270,828</td>
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<td>Neighborhood Favorites</td>
<td>16</td>
<td>1,083</td>
<td>1,225,583</td>
<td>65,856</td>
<td>5.37%</td>
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<td>Convenient / Fast Food</td>
<td>2</td>
<td>289</td>
<td>507,713</td>
<td>21,740</td>
<td>4.28%</td>
<td>485,973</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>22</strong></td>
<td><strong>1,562</strong></td>
<td><strong>$2,040,140</strong></td>
<td><strong>$123,612</strong></td>
<td><strong>6.06%</strong></td>
<td><strong>$1,916,528</strong></td>
</tr>
</tbody>
</table>

Table 5. Employer HRA Reimbursement Rates

Our survey found that five (23%) of the 22 employers using the HRA option made zero reimbursements to their employees out of the $415,928 these employers earmarked during 2010.
These five restaurants had a total of 206 covered workers in 2010. Even though San Francisco is ranked #6 on Forbes list of the Top 20 Healthiest Cities, the Jury finds it hard to believe that not one of 206 workers had any medical expenses during 2010. It begs the question, did the employers not tell their employees about the program, or did they set the bar for reimbursement too high, or were employees too intimidated to seek reimbursement?

F. HRAs and Employees Working for Two or More Employers

The ESR applies to full-time and part-time employees not covered by employer-paid health insurance. When choosing the City Option the employer must pay the City the required ESR for each employee. The City then contacts the employee to determine what benefits are available (See Table 4). Employees who are City-residents will be enrolled in Healthy SF if they have no health coverage or in a MRA if they do. Since non-residents cannot enroll in Healthy SF, a MRA will be established for them. The City’s MRAs are administered by a third-party administrator with on-line access for program participants. There is a small monthly fee, currently $2.25, which program participants pay from their accounts.

When an employee works for two or more employers using the HRA option, each employer allocates and administers its own HRA for the employee. Each employer adopts separate specific reimbursement guidelines and reimburses the employees directly. The employee must submit covered medical expenses to one of their employers for reimbursements. Although employers may have differing reimbursement guidelines, they must be “reasonably calculated to benefit the employee.”

It becomes even more complex for an employee working for two or more employers when one takes the City Option and the other(s) takes the HRA option. Now the employee must manage reimbursements between their employer(s) and the City in order to take full advantage of various guidelines and time limits. There is no coordination between plan administrators and there is nothing to prevent an employee from submitting the same invoice to different plans enabling the employee to collect more than once for the same invoice.

Over a period of several years part-time or temporary workers can and often do accumulate several HRAs from different employers and perhaps an MRA from the City. This system makes it difficult for workers to sort out applicable guidelines and time limits when submitting medical expenses.
G. Findings

F8. Employers with HRAs in 2010 allocated $62 million for medical care, reimbursed employees $12 million, and retained up to the remaining $50 million.

Responses are requested from the Mayor, the Board of Supervisors, Department of Public Health, Office of Labor Standards Enforcement, and the Golden Gate Restaurant Association.

F9. Given similar demographics the 20% reimbursement rate for HRAs is well below the City’s 50% reimbursement rate for MRAs due to lack of program notification to employees, stricter HRA guidelines, and employees’ unwillingness to disclose their medical conditions to their employer.

Responses are requested from the Mayor, the Board of Supervisors, Department of Public Health, and the Golden Gate Restaurant Association.

F10. Significant numbers of restaurants utilizing HRAs in 2010 paid out no medical expenses for their employees.

Responses are requested from the Mayor, the Board of Supervisors, Office of Labor Standards Enforcement, and the Golden Gate Restaurant Association.

F11. Employees with two or more employers may have two or more HRAs, likely with differing guidelines for what constitutes medical expenses and with differing time limits.

Responses are requested from the Mayor, the Board of Supervisors, Department of Public Health, and the Golden Gate Restaurant Association.

F12. HRAs may not be an allowable option in meeting the federal requirements under the Affordable Care Act.

Responses are requested from the Mayor, the Board of Supervisors, Department of Public Health, City Attorney, and the Golden Gate Restaurant Association.

F13. The financial incentive to retain unspent HRA funds could be a motivating force for employers to restrict employee access to these funds.

Responses are requested from the Mayor, the Board of Supervisors, Department of Public Health, and the Golden Gate Restaurant Association.
**F14.** By submitting personal medical invoices directly to their employers, employees are forced to reveal their medical history and current health conditions to their employers.

Responses are requested from the Mayor, the Board of Supervisors, Department of Public Health, and the Golden Gate Restaurant Association.

**H. Recommendations**

**R4.** Disallow the use of the employer HRA option.

Responses are requested from the Mayor, the Board of Supervisors, Department of Public Health, City Attorney, and the Golden Gate Restaurant Association.

**R5.** Eliminate time limits for employees to use their MRA funds.

Responses are requested from the Mayor, the Board of Supervisors, Department of Public Health, and the Golden Gate Restaurant Association.

**CONCLUSION**

The City should be commended for enacting this ambitious and inclusive legislation for delivery of health care to the uninsured. Healthy workers are a benefit to consumers, employers and employees. Healthy workers are especially important in the City’s restaurants to prevent the spread of communicable diseases. By all accounts, Healthy San Francisco is a success, and is funded in small part by employer mandates. Historically San Francisco residents have been generous and willing to incur higher costs for various social causes. This is evidenced in the City’s contracts which contain detailed provisions prohibiting the use of redwood products, prohibits transacting business with the Sudan, and requiring adherence to laws meant to reduce the effects of racial, ethnic, gender, age and other forms of discrimination, each of which increases the price the City pays for goods and services. The City’s ban on plastic bags has dramatically reduced the environmental damage caused by plastic products.

This generosity extends to the City’s health care ordinances. Every day, customers throughout the City pay surcharges they believe go to employees’ health care. When businesses use the health care surcharge to earn large profits, the public trust is violated. It is for this reason the Jury strongly recommends the City bring an end to the gratuitous practice of allowing business owners to add surcharges for employee mandates to their customers’ bills. The intent of the mandates called for in the HCSO is a business expense not a consumer tax. Healthy San Francisco is about providing healthcare for employees, not creating additional profits for businesses.
Additionally, the Jury strongly recommends the City totally eliminate employer HRAs in favor of the City Option since the City cannot effectively police the rampant abuse of HRAs. Eliminating HRAs would not only be permissible under the law, but would more fully meet the intended objectives of the HCSO by:

- Simplifying disclosure and administration of employee benefits;
- Eliminating the multiple employer issue;
- Reducing the burdensome regulations and reporting requirements on employers providing uniform benefits;
- Avoiding the onerous requirement that employees reveal their medical conditions to their employers, a requirement that often discourages employees from seeking reimbursement; and
- Eliminating the concern over the HRA compliance with the Affordable Care Act.

The Cohen-Chiu compromise legislation did not close the loopholes in the HCSO. The new law merely requires employers to wait two years rather than one to “retain” HRA funds. It does increase notification regulations on businesses to their employees.

Unfortunately, there remains a compelling financial incentive for businesses to choose HRAs over the City Option, an alternative that is clearly not in the best interest of employees. The current ordinance, as amended, does not provide a level playing field to those businesses offering health coverage, through either third-party insurance or the City Option, and those they must compete with who work the system. The promise of the HCSO is to provide health care for workers in San Francisco that is easily accessible. HRAs do not fulfill this promise. Though employer-controlled private reimbursement plans may be technically legal, the question looms, are they ethical? The Jury thinks not!
ENDNOTES

1 SF Chronicle Sunday Magazine, April 2012.

2 October 25, 2011 Veto Letter from the Mayor of the City and County of San Francisco to the Board of Supervisors.


5 Calculation Detail: $2.85B total restaurant sales x 4% surcharge x 27% = $30.8M.


7 State Board of Equalization Special Notice #L-224, issued April 2009.

8 $2,174,362 times 42% = $913,232 times 8.5% = $77,624.

9 March 21, 2012 Email from the San Francisco City Attorney Office to the Civil Grand Jury.


11 Agreement between Department of Public Health and SHPS, Inc.

12 Office of Economic Analysis item #110546, July 13, 2011.

13 Ibid.


15 October 25, 2011 Veto Letter.


17 City and County of San Francisco Board of Supervisors, Legislative Digest, File # 111030, November 15, 2011.

18 Volume 14, Issue 2, Article 4, 2011.


20 Agreement between Department of Public Health and SHPS, Inc.

21 Legislative Digest, File # 111030, November 15, 2011, San Francisco Board of Supervisors.
RESPONSE MATRIX

Pursuant to Penal Code § 933.05, the Civil Grand Jury requests responses as follows:

I. Customer Surcharges for Health Care Mandates

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<thead>
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<th>Respondent</th>
<th>Findings</th>
<th>Recommendations</th>
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<tr>
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II. Employers Health Reimbursement Accounts

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Surcharges and Healthy SF
APPENDIX

Glossary of Terms

ACA: Affordable Care Act. The new Federal law expanding health care to the uninsured, mandates employers and individuals to purchase health insurance, and expands Medicaid to those who cannot afford health insurance.

BOS: The Board of Supervisors of San Francisco for the City and County of San Francisco

Covered Employer: A covered employer include businesses and nonprofit organizations that engage in business within San Francisco, are required to obtain a valid San Francisco business certificate, and meet the minimum-size threshold. The minimum-size threshold is 20 or more employees for businesses and 50 or more employees for nonprofit organizations.

Covered Employee: A covered employee has been employed by his or her employer for at least 90 days and works eight or more hours per week in San Francisco. An explanation of the limited exceptions to this definition is available at www.sfgov.org/olse/hcso.

City: The City and County of San Francisco

City Option: One of the options covered employers can use to be in compliance with the HCSO. By taking this option the employer pays to the City its health care expenditure rate for covered employees. The City then determines what programs are available to each employee.

DA: The District Attorney of the City and County of San Francisco.

DPH: The Department of Public Health of the City and County of San Francisco.

ERISA: Employee Retirement Income Security Act, the federal law regulating employee pensions and health benefits.

ESR: Employee Spending Requirement as defined by the OLSE. The health care expenditure rate for the ESR depends on the total amount of employees a covered employer has. (See Table 1).

GGRA: Golden Gate Restaurant Association, The advocacy organization for restaurants in San Francisco and the oldest restaurant association in the country.

HCSO: Health Care Security Ordinance, as amended, that established Healthy SF and the employer mandates.
Healthy SF: The marketing name of HCSO, which includes the delivery program that provides the residents of the City health care and its employer mandates. Normally this term is used to refer to the health care program for the uninsured residents in San Francisco. It is also used as describing the surcharge on customer bills to cover the costs of employer’s health care expenditure requirement.

HRA: Health Reimbursement Accounts (or Arrangements) that covered employers set up for their covered employees. They can be managed in house or by a third party.

Jury: The 2011-2012 Civil Grand Jury for the County of San Francisco.

MRA: Medical Reimbursement Accounts, administered by the City for covered employees who have some form of medical insurance other than from their employer, which prevents the employee from enrolling in the Healthy SF health care program.

OLSE: San Francisco Office of Labor Standards Enforcement for the City and County of San Francisco. It is charged with enforcement of HCSO.

TCC: Office of the Treasurer and Tax Collector for the City and County of San Francisco.
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