File No. 120787 Committee Item No. 3
Board Item No. _____

COMMITTEE/BOARD OF SUPERVISORS

AGENDA PACKET CONTENTS LIST

Committee: Government Audit and Oversight **Date** September 27, 2012

Board of Supervisors Meeting **Date** _____

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☒	☐	**Resolution**
☐	☐	**Ordinance**
☐	☐	**Legislative Digest**
☐	☐	**Budget and Legislative Analyst Report**
☐	☐	**Legislative Analyst Report**
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☐	☐	**Form 126 – Ethics Commission**
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☐	☐	**Application**
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OTHER **(Use back side if additional space is needed)**

☒	☐	"Surcharges and Healthy San Francisco" Civil Grand Jury Report
☒	☐	Response, Mayor's Office
☒	☐	Response, Office of the Treasurer & Tax Collector
☒	☐	Response, Office of Labor Standards Enforcement
☒	☐	Response, Department of Public Health
☒	☐	Response, Office of the District Attorney
☒	☐	Response, Office of City Attorney
☒	☐	Response, State Board of Equalization
☒	☐	Response, Golden Gate Restaurant Association
☐	☐	

Completed by: Alisa Miller **Date** September 21, 2012
Completed by: _____ **Date** _____

An asterisked item represents the cover sheet to a document that exceeds 25 pages.
The complete document can be found in the file.

[Board Response - Civil Grand Jury Report - Surcharges and Healthy San Francisco: Healthy for Whom?]

Resolution responding to the Presiding Judge of the Superior Court on the findings and recommendations contained in the 2011-2012 Civil Grand Jury report entitled "Surcharges and Healthy San Francisco: Healthy for Whom?" and urging the Mayor to cause the implementation of accepted findings and recommendations through his/her department heads and through the development of the annual budget.

WHEREAS, Under California Penal Code Section 933 et seq., the Board of Supervisors must respond, within 90 days of receipt, to the Presiding Judge of the Superior Court on the findings and recommendations contained in Civil Grand Jury Reports; and

WHEREAS, In accordance with Penal Code Section 933.05(c), if a finding or recommendation of the Civil Grand Jury addresses budgetary or personnel matters of a county agency or a department headed by an elected officer, the agency or department head and the Board of Supervisors shall respond if requested by the Civil Grand Jury, but the response of the Board of Supervisors shall address only budgetary or personnel matters over which it has some decision making authority; and

WHEREAS, The 2011-2012 Civil Grand Jury Report entitled "Surcharges and Healthy San Francisco: Healthy for Whom?" is on file with the Clerk of the Board of Supervisors in File No. 120787, which is hereby declared to be a part of this resolution as if set forth fully herein; and

WHEREAS, The Civil Grand Jury has requested that the Board of Supervisors respond to Finding Nos. 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, and 14 as well as Recommendations 1, 2, 3, 4, and 5 contained in the subject Civil Grand Jury report; and

WHEREAS, Finding No. 1 states: "The Jury could not identify any government investigation that reports the number of businesses adding surcharges to pay for Health Care Security Ordinance (HCSO) employee mandates and mandated paid sick days;" and

WHEREAS, Finding No. 2 states: "The City has not investigated health care related surcharges to determine whether or not employers are generating profits from these surcharges;" and

WHEREAS, Finding No. 3 states: "Neither the City nor the state of California, to the Jury's knowledge, has investigated whether sales tax is being added to surcharges;" and

WHEREAS, Finding No. 4 states: "The City has neither a plan nor sufficient staff at the OSLE to audit employers' surcharges in compliance with HCSO regulations;" and

WHEREAS, Finding No. 5 states: "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;" and

WHEREAS, Finding No. 6 states: "Due to the varied wording in describing surcharges on consumers' bills, and the wording of the ordinance, the auditing of surcharges will be difficult;" and

WHEREAS, Finding No. 7 states: "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;" and

WHEREAS, Finding No. 8 states: "Employers with Health Reimbursement Accounts (HRAs) in 2010 allocated $62 million for medical care, reimbursed employees $12 million, and retained up to the remaining $50 million;" and

WHEREAS, Finding No. 9 states: "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;" and

WHEREAS, Finding No. 10 states: "Significant numbers of restaurants utilizing HRAs in 2010 paid out no medical expenses for their employees;" and

WHEREAS, Finding No. 11 states: "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;" and

WHEREAS, Finding No. 12 states: "HRAs may not be an allowable option in meeting the federal requirements under the Affordable Care Act;" and

WHEREAS, Finding No. 13 states: "The financial incentive to retain unspent HRA funds could be a motivating force for employers to restrict employee access to these funds;" and

WHEREAS, Finding No. 14 states: "By submitting personal medical invoices directly to their employers, employees are forced to reveal their medical history and current health conditions to their employers;" and

WHEREAS, the Recommendation No. 1 states: "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;" and

WHEREAS, the Recommendation No. 2 states: "The Office of the Treasurer and Tax Collector investigate the under-reporting of sales taxes on surcharges;" and

WHEREAS, the Recommendation No. 3 states: "The District Attorney open an investigation to review the Jury's survey findings for possible consumer fraud;" and

WHEREAS, the Recommendation No. 4 states: "Disallow the use of the employer HRA option;" and

WHEREAS, the Recommendation No. 5 states: "Eliminate time limits for employees to use their MRA funds;" and

WHEREAS, in accordance with Penal Code Section 933.05(c), the Board of Supervisors must respond, within 90 days of receipt, to the Presiding Judge of the Superior Court on Finding Nos. 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, and 14 as well as Recommendations 1, 2, 3, 4, and 5 contained in the subject Civil Grand Jury report; now, therefore, be it

RESOLVED, That the Board of Supervisors reports to the Presiding Judge of the Superior Court that it {agrees/disagrees} 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, and 14, for reasons as follows_____; and, be it

FURTHER RESOLVED, That the Board of Supervisors reports that it {agrees/disagrees} Recommendations 1, 2, 3, 4, and 5, for reasons as follows_____; and, be it

FURTHER RESOLVED, That the Board of Supervisors urges the Mayor to cause the implementation of accepted findings and the recommendation through his/her department heads and through the development of the annual budget.

City and County of San Francisco
Civil Grand Jury 2011-2012

SURCHARGES AND HEALTHY SAN FRANCISCO:

Healthy for Whom?

June 2012

Superior Court of California, County of San Francisco
Civic Center Courthouse
400 McAllister Street, Room 008
San Francisco, CA 94102
(415) 551-3605

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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	Sharon Gadberry	Mort Raphael
Mark Busse	Ossie Gomez	Jack Saroyan
Mario Choi	Arlene Helfand	Earl Shaddix
Matthew Cohen	Lewis Hurwitz	Jack Twomey
Kay Evans	Todd Lloyd	Gregory Winters
Allegra Fortunati	Jean Ninos	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.[1] 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."[2]

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 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, makes 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.

Number of Employees	Hourly Rate	Yearly Cap for a Full-time Employee
1-19	$0	$0
20-99	$1.46	$3,013
>100	$2.06	$4,541

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.

Percent of Restaurants Adding surcharges	Total Surcharges
27%	$30.8M[5]
50%	$57.0M
75%	$85.5M

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.[6] 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.

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

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.[7] 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[8] 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 difficultly 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.[10] 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).

Lives in City	Has Existing Insurance	Options
Yes	Yes	City MRA
Yes	No	Enroll in Healthy SF with 75% discount
No	Doesn't matter	City MRA

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.[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.[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.[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.[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.[15]

Mayor Lee, President of the Board of Supervisors Chiu, and Supervisor Cohen subsequently introduced their own amendment to the HCSO in November 2011.[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.[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.[18] 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 $123,659 and retained up to $1,916,481 at the end of the year. This represents a miniscule 6% reimbursement rate compared to the City's MRA reimbursement rate of 50%.

Type	# of Restaurants	# of Employees	HRA Funds Earmarked	Paid to Employees	Reimbursement Rate	Retained by Employers
Fine Dining	4	190	$306,844	$36,016	11.74%	$270,828
Neighborhood Favorites	16	1,083	1,225,583	65,856	5.37%	1,159,727
Convenient / Fast Food	2	289	507,713	21,740	4.28%	485,973
Total	22	1,562	$2,040,140	$123,612	6.06%	$1,916,528

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,[19] 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.[20]

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."[21]

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.

[3] Carrie H. Colla, William H. Dow, and Arindrajit Dube, "The Labor Market Impact of Employer Health Benefit Mandates: Evidence from San Francisco's Health Care Security Ordinance." Working Paper Series, National Bureau of Economic Research, July 2011.

[4] Carrie H. Colla, William H. Dow, and Arindrajit Dube. "How Do Employers React to a Pay-or-Pay Mandate? Early Evidence from San Francisco." *Forum for Health Economics and Policy 14*, no. 2 (July 2011).

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

[6] "Frequently Asked Questions 2011 Amendment to the HCSO Administrative Code Chapter 14," updated December 23, 2011.

[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.

[10] Office of Economic Analysis item #110546, "Amendments to the HCSO Economic Impact Report." July 13, 2011.

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

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

[13] *Ibid.*

[14] Administrative Code HCSO, §§ 14.1, 14.3 & 14.4.

[15] October 25, 2011 Veto Letter.

[16] Administrative Code HCSO, §§ 14.4, 14.3, 14.4, amended, § 14.1.5.

[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.

[19] *Forbes Magazine*, September 13, 2001.

[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

	Findings							Recommendations		
Respondent	F1	F2	F3	F4	F5	F6	F7	R1	R2	R3
Mayor's Office	X	X	X	X	X	X	X	X	X	X
Board of Supervisors	X	X	X	X	X	X	X	X	X	X
Office of Labor Standards Enforcement	X			X	X	X				
Department of Public Health	X									
Office of the Treasurer and Tax Collector			X						X	
City Attorney					X	X	X	X		X
District Attorney		X					X			X
Golden Gate Restaurant Association		X	X		X		X	X		
State Board of Equalization			X							

II. Employers Health Reimbursement Accounts

	Findings							Recommendations	
Respondent	F8	F9	F10	F11	F12	F13	F14	R4	R5
Mayor's Office	X	X	X	X	X	X	X	X	X
Board of Supervisors	X	X	X	X	X	X	X	X	X
Office of Labor Standards Enforcement	X		X						
Department of Public Health	X	X		X	X	X	X	X	X
City Attorney					X			X	X
Golden Gate Restaurant Association	X	X	X	X	X	X	X	X	X

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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OFFICE OF THE MAYOR
SAN FRANCISCO

EDWIN M. LEE
MAYOR

September 17, 2012

The Honorable Judge Katherine Feinstein
Presiding Judge
Superior Court of California, County of San Francisco
400 McAllister Street, Room 206
San Francisco, CA 94102

Dear Judge Feinstein,

Please find attached my response to the Civil Grand Jury's July 2012 report: "Surcharges and Healthy San Francisco: Healthy for Whom?" I appreciate the Civil Grand Jury's attention to such an important topic.

The passage of the Health Care Security Ordinance (HCSO) in 2006 was a momentous occasion for San Francisco, supporting a long-held San Francisco value that health care is an important right for our residents and workers and setting an example for federal policy. Implementing a significant new policy is never a simple, one step endeavor, which is why we will continue to shape this law to ensure its ultimate policy goal is met.

In November 2011, I signed into law an amendment to the Health Care Security Ordinance - sponsored by Board President David Chiu and Supervisor Malia Cohen - designed to strengthen the ordinance's policies regarding surcharge collection and the management of reimbursement programs. It is important to note that the changes required by these legislative amendments went into effect in January 2012. Therefore, findings in the recent Civil Grand Jury report and Office of Labor Standards Enforcement 2011 Analysis of HCSO Annual Reporting Forms serve as an important baseline against which we will measure 2012 data.

That being said, I am extremely encouraged by the data found in the 2011 Analysis of HCSO Annual Reporting Forms: 89% of our employers' health care expenditures went towards health insurance for employees. The report also identified areas where we need to do some work. Just as the passage of the HCSO was a consensus-driven process, so is the ongoing review and maintenance of this important law. I appreciate the ongoing outreach and partnerships between the Office of Labor Standards Enforcement, the Department of Public Health, the Office of Small Business, and our business community, to outreach to and educate businesses – small businesses in particular – about how to come into compliance with the new regulations in order to better serve their employees.

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The Mayor's Office response to the Civil Grand Jury's <u>findings</u> is as follows:

Finding 1: "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."

Response: Partially Disagree. The Mayor supported and signed legislation amending the Health Care Security Ordinance (HCSO) in November 2011 that directed the Office of Labor Standards Enforcement (OLSE) to begin collecting surcharge data from employers for inclusion in its annual report on employer compliance with the HCSO. This information was required in the 2011 annual reporting forms, distributed to employers in March 2012 by the OLSE.

Finding 2: "The City has not investigated health care related surcharges to determine whether or not employers are generating profits from these surcharges."

Response: Disagree. The Mayor supported and signed legislation amending the HCSO in November 2011 that directed the OLSE to begin collecting data from employers regarding the amount of money collected from surcharges to cover employee health care and the amount of healthcare expenditures made on behalf of employees. In anticipation of new legislative requirements beginning in January 2012 as a result of this amendment, OLSE began collecting this data in 2011, to serve as a baseline. The Mayor's Office also refers to the District Attorney's response.

Finding 3: "Neither the City nor the State of California, to the Jury's knowledge, has investigated whether the sales tax is being added to surcharges."

Response: Disagree. The Mayor's Office refers to the response by the City and County of San Francisco's Treasurer and Tax Collector.

Finding 4: "The City has neither a plan nor sufficient staff at the OSLE to audit employers' surcharges in compliance with HCSO regulations."

Response: Disagree. At the OLSE, there is a process in place to collect, analyze and report on this data, and OLSE has authority under the HCSO to enforce its provisions. The OLSE received an additional staff position in the FY2012-13 budget to focus exclusively on education about and compliance with the HCSO.

Finding 5: "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."

Response: Disagree. In OLSE's 2011 Annual Reporting Form, employers were asked report on both surcharge collections and their expenditures for employee health benefits in 2011. Effective January 2012, as per an amendment to the HCSO signed by the Mayor in November 2011, if the amount of surcharges collected for employee health care exceeds the amount spent on employee health care, the employer must irrevocably pay or designate an amount equal to that difference for health care benefits for its employees.

Finding 6: "Due to the varied wording in describing surcharges on consumers' bills, and the wording of the ordinance, the auditing of surcharges will be difficult."

Response: Partially Disagree. OLSE has a straightforward reporting process in place and the recent amendment to the HCSO clarified expectations for employer practices regarding surcharges. However, education and outreach are important so that employers and employees understand the requirements and benefits of the HCSO. The Mayor's Office is committed to ensuring that stakeholders - in particular small businesses - understand and comply with the HCSO, and appreciates the efforts of OLSE, the Department of Public Health, the Office of Small Business, and the business community for their efforts.

Finding 7: "Consumer fraud is committed if the consumer's receipt states that a surcharge is being assessed for a stated purposes and is not being used for that purpose."

Response: Agree. Consumer fraud is committed if a business collects a surcharge for a stated purpose and then knowingly does not use the resulting receipts for that purpose.

Finding 8: "Employers with HRAs in 2010 allocated $62 million for medical care, reimbursed employees $12 million, and retained up to the remaining $50 million."

Response: Disagree. To clarify, in 2010, employers allocated $62 million to a range of different types of reimbursement programs - not just to Health Reimbursement Accounts (HRA), as this finding states. The data does not report the use of the $50 million that was not reimbursed directly to employees.

Finding 9: "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, strict HRA guidelines and employees' unwillingness to disclose their medical conditions to their employer."

Response: Disagree. The City and County does not know the demographics of employers and employees using Medical Reimbursement Accounts (MRA) versus HRA accounts. Similarly, there is no data stating the reasons behind the differing reimbursement rates. The Mayor's Office believes that the amendment made to the HCSO in November 2011 will increase reimbursement rates for HRA's and other reimbursement programs through increased notification and the requirement that contributions be available for 24 months.

Finding 10: "Significant numbers of restaurants utilizing HRAs in 2010 paid out no medical expenses for their employees."

Response: Partially Disagree. The Mayor's Office refers to the OLSE's response.

Finding 11: "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."

Response: Partially Disagree. While there could be two or more HRA's, time limits are now standardized as per 2011 HCSO amendment.

Finding 12: "HRAs may not be an allowable option in meeting the federal requirements under the Affordable Care Act."

Response: Partially Disagree. No response possible at this time: we will not know what is allowable under the Affordable Care Act until the rules and regulations for employers are released by the federal government.

Finding 13: "The financial incentive to retain unspent HRA funds could be a motivating force for employers to restrict employee access to these funds."

Response: Agree – there are many different financial incentives that could be at play, including the fact that some businesses use these dollars to augment salaries and to make additional hires. Because the Mayor's Office does not know the motivations behind the choices made by businesses, we are focused on working with businesses to ensure they understand the components of the HCSO, its benefits for their employees, and the importance of being in compliance, to ensure that the ultimate goals of the Health Care Security Ordinance are met.

Finding 14: "By submitting personal medical invoices directly to their employers, employees are forced to reveal their medical history."

Response: Partially Disagree. There are a range of privacy regulations affording employee protection regarding health status and the majority of HRA's are administered by a third party, according to OLSE's data. That being said, if there is data showing privacy concerns on the part of employees, then this should become part of the policy discussion.

The Mayor's Office response to the Civil Grand Jury's recommendations is as follows:
Recommendation 1: "Disallow employers subject to the Office of Labor Standards Enforcement regulations from adding surcharges on customers' bill to pay for the HCSO employer mandates and mandated paid sick days."

Response: Will Not be implemented. The Mayor's Office supports businesses identifying how to cover their costs within their individual business models, as long as it is done in compliance with the HCSO.

Recommendation 2: "The Office of the Treasurer and Tax Collector investigate the under-reporting of sales taxes on surcharges."

Response: Will Not be implemented. Given that sales tax is collected by the State Board of Equalization, this recommendation falls outside of the purview of the City and County of San Francisco's Treasurer and Tax Collector.

Recommendation 3: "The District Attorney open an investigation to review the Jury's survey findings for possible consumer fraud."

Response: Requires Further Analysis. The Mayor's Office supports the District Attorney's response.

Recommendation 4: "Disallow the use of the employer HRA option."

Response: Will Not be implemented. The Mayor's Office believes that the HRA, while used by a relatively small percentage of employers in San Francisco, is an important tool for businesses in respect to coming into compliance with the HCSO. The Mayor's Office is focused on strengthening HRA practices, to ensure that employees are aware of the benefits available to them and that employers make those benefits readily available.

Recommendation 5: "Eliminate time limits for employees to use their MRA funds."

Response: Will Not be implemented. The Mayor's Office refers to the Department of Public Health's response.

Thank you again for the opportunity to comment on this Civil Grand Jury report.

Sincerely,

Edwin M. Lee
Mayor

Office of the Treasurer & Tax Collector
City and County of San Francisco

José Cisneros, Treasurer

August 31, 2012

The Honorable Katherine Feinstein
Presiding Judge
Superior Court of California
City and County of San Francisco
400 McAllister Street, Room 206
San Francisco, CA 94102-4512

Re: In the Matter of the 2011-12 Civil Grand Jury – Treasurer-Tax Collector Response

Dear Judge Feinstein:

I write to provide the Office of the Treasurer & Tax Collector's required response to the San Francisco Civil Grand Jury Report: "Surcharges and Healthy San Francisco: Healthy for Whom?" The Civil Grand Jury has requested a response from the department to Finding F3, and Recommendation R2.

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

Response: The Finding is not reasonable.

The Office of the Treasurer & Tax Collector shares the Civil Grand Jury's concerns about the possible under-reporting of sales taxes. However, the Office of the Treasurer & Tax Collector does not collect the sales tax. Revenue and Taxation Code Section 6451 specifies that the sales tax is due and payable to the State Board of Equalization. The Treasurer defers to the State Board of Equalization for their response regarding sales tax investigations.

Recommendation R2: "The Office of the Treasurer & Tax Collector investigate the under-reporting of sales taxes on surcharges."

City Hall - Room 140 • 1 Dr. Carlton B. Goodlett Place • San Francisco, CA 94102-4638
415-554-4400 telephone • 415-554-5507 fax

Response: Recommendation R2 will not be implemented by the Office of the Treasurer & Tax Collector because it is not reasonable.

The Office of the Treasurer & Tax Collector shares the Civil Grand Jury's concerns about the possible under-reporting of sales taxes. However, the Office of the Treasurer & Tax Collector does not collect the sales tax. Revenue and Taxation Code Section 6451 specifies that the sales tax is due and payable to the State Board of Equalization. The Treasurer defers to the State Board of Equalization for their response regarding sales tax investigations.

Respectfully Submitted,

José Cisneros
Treasurer

Greg Kato
Policy and Legislative Manager

CITY AND COUNTY OF SAN FRANCISCO

EDWIN M. LEE, MAYOR

GENERAL SERVICES AGENCY
OFFICE OF LABOR STANDARDS ENFORCEMENT
DONNA LEVITT, MANAGER

September 07, 2012

The Honorable Judge Katherine Feinstein
Presiding Judge
Superior Court of California, County of San Francisco
400 McAllister Street, Room 206
San Francisco, CA 94102

RE: Responses to Civil Grand Jury Report

Dear Judge Feinstein,

I write to provide the Office of Labor Standards Enforcement's responses to the Civil Grand Jury's report entitled "Surcharges and Healthy San Francisco: Healthy for Whom?" I appreciate the Civil Grand Jury's attention to this important matter. My responses are provided in the enclosed chart.

If you have any questions, or require additional information, please do not hesitate to contact me at 415.554.6239 or via email at donna.levitt@sfgov.org.

Sincerely,

Donna Levitt

Donna Levitt
Manager

Enclosure: Office of Labor Standards Enforcement's Responses to Civil Grand Jury Report: "Surcharges and Healthy San Francisco: Healthy for Whom?"

City Hall, Room 430 1 Dr. Carlton B. Goodlett Place San Francisco CA 94102-4685 Tel. (415) 554-6235 Fax (415) 554-6291

Office of Labor Standards Enforcement's Responses to Civil Grand Jury Report: "Surcharges and Healthy San Francisco: Healthy for Whom?"

Finding	OLSE Response	Text of OLSE Response
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.	The Office of Labor Standards Enforcement (OLSE) partially disagrees with the finding.	At the time the Grand Jury report was issued, the City had not reported the number of businesses adding surcharges to pay for Health Care Security Ordinance (HCSO) employer mandates and mandated paid sick days. However, the OLSE had collected Annual Reporting Forms from employers, which required them to self-report 1) whether they imposed a surcharge on customers at any time in 2011 to cover, in whole or in part, the costs of the health care requirement under the HCSO, and 2) the amount collected from any such charges. In August 2011, the OLSE issued an analysis of these Annual Reporting Forms, which is now available at www.sfgov.org/olse/hcso. The 2011 Annual Reporting Form did not require employers to report on surcharges that are imposed to pay for mandated paid sick days and the OLSE has no information on this topic.
F4. The City has neither a plan nor sufficient staff at the OSLE to audit employers' surcharges in compliance with HCSO regulations.	OLSE partially disagrees with the finding.	OLSE requires employers to report the amount of the surcharges collected as well as the health care expenditures made each year on the HCSO Annual Reporting Form. Upon receiving data from the 2012 Annual Reporting Forms, the OLSE will enforce the provisions of Administrative Code Section 14.3(d). It is true that the OLSE does not have sufficient staff or resources to initiate proactive audits of all businesses that impose health care surcharges. The OLSE does, however, plan to audit employers' surcharges in the course of investigating employee complaints about violations of the HCSO. Furthermore, the City's 2012-13 budget provides for an additional staff person to be hired at OLSE to enforce the HCSO.
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.	OLSE partially disagrees with the finding.	It is true that the HCSO did not require employers to *reconcile* their health care surcharges collected prior to January 1, 2012 with their health care expenditures. However, employers were required to *report* their health care expenditures and the dollar amount of the health care surcharges they collected in 2011 on their Annual Reporting Forms for 2011. The OLSE collected this data for statistical purposes.

Office of Labor Standards Enforcement's Responses to Civil Grand Jury Report: "Surcharges and Healthy San Francisco: Healthy for Whom?"

Finding	OLSE Response	Text of OLSE Response
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.	OLSE partially disagrees with the finding.	The Ordinance regulates surcharges imposed on customers "to cover in whole or in part the costs of the health care expenditure requirement." It will be difficult in some circumstances to determine which, if any, portion of a surcharge is imposed on customers for this specific purpose. However, the OLSE will work to ensure that employers understand this provision of the Ordinance and are in compliance with it.
F8. Employers with HRAs in 2010 allocated $62 million for medical care, reimbursed employees $12 million, and retained up to the remaining $50 million.	OLSE partially disagrees with the finding.	The OLSE's Analysis of the 2010 Annual Reporting Forms provides that employers allocated $62 million to *all* types of health care reimbursement programs—not only HRAs, but also other types of reimbursement programs such as Flexible Spending Accounts (FSAs), Health Saving Accounts (HSAs) and Medical Spending Accounts (MSAs).[1] The $12 million represents the amount that employers reported reimbursing to employees from all of these types of accounts. The Annual Reporting Form did not ask employers to report what happened to the $50 million in unreimbursed funds. These allocations and reimbursements were reported by 2,960 employers who submitted 2010 Annual Reporting Forms to the OLSE.
F10. Significant numbers of restaurants utilizing HRAs in 2010 paid out no medical expenses for their employees.	OLSE partially disagrees with the finding.	A total of 184 employers reported on their Annual Report Forms that they did not reimburse any of the funds they allocated to HRAs or other reimbursement accounts in 2010. The OLSE did not require employers to report their industry sector. Therefore, OLSE has no data specific to restaurants that utilized HRAs or other reimbursement programs in 2010.

[1] See IRS Publication 969 for more information about types of health care reimbursement accounts: http://www.irs.gov/pub/irs-pdf/p969.pdf.

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City and County of San Francisco

Edwin M. Lee
Mayor

Department of Public Health

Tangerine M. Brigham
Deputy Director of Health
Director of Healthy San Francisco

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September 19, 2012

Angela Calvillo
Clerk of the Board
San Francisco Board of Supervisors
City Hall, Room 244
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102-4689

Re: San Francisco Civil Grand Jury 2011-12 "Surcharges and Healthy San Francisco: Healthy for Whom?"

Dear Ms. Calvillo:

Enclosed please find a copy of the San Francisco Department of Public Health's response to the above-referenced report. The Department's responses were provided to the San Francisco Civil Grand Jury pursuant to California Penal Code section 933.5 and by the stated September 17, 2012 deadline.

If you have any questions, or require additional information, please do not hesitate to contact me at 415.554.2779 or via electronic mail at tangerine.brigham@sfdph.org.

Sincerely,

Tangerine Brigham

Tangerine M. Brigham

City and County of San Francisco

Edwin M. Lee
Mayor

Department of Public Health

Tangerine M. Brigham
Deputy Director of Health
Director of Healthy San Francisco

September 6, 2012

Mr. Mario Choi
Foreperson Pro Tem
2011-2012 Civil Grand Jury
San Francisco Civil Grand Jury
Superior Court of California
400 McAllister Street, Room 008
San Francisco, CA 94102

Re: San Francisco Civil Grand Jury 2011-12 "Surcharges and Healthy San Francisco: Healthy for Whom?"

Dear Foreperson Choi:

This letter is in response to your July 16, 2012 letter in which you provided the San Francisco Department of Public Health (DPH) with the above-referenced report and asked for DPH responses to the report by September 17, 2012 pursuant to California Penal Code section 933.5.

DPH would like to thank the San Francisco Civil Grand Jury for its work and for this report. DPH's responses follow and have been organized based on the two categories of discussion in the Civil Grand Jury's report and correspond to the numbering system used by the Civil Grand Jury. Please note that several of the findings and/or recommendations relate to the administration of a Health Care Security Ordinance provision that is not under the purview of DPH. In those instances, DPH has deferred to the responses of the appropriate City and County departments.

Customer Surcharges for Health Care Mandates

No.	Civil Grand Jury Position	Agree/Disagree	DPH Response
F1	The Jury could not identify any government investigation that reports that number of businesses adding surcharges to pay for HCSO employer mandates and mandated paid sick days	None Provided – See DPH Response	The Department of Public Health (DPH) does not oversee or enforce employer or business labor practices. DPH defers to the response provided by the Office of Labor Standards Enforcement which enforces labor laws adopted by San Francisco voters and the San Francisco Board of Supervisors.

Employer Health Reimbursement Accounts (HRAs)

No.	Civil Grand Jury Position	Agree/Disagree	DPH Response
F8	Employers with HRAs in 2010 allocated $62 million for medical care, reimbursed employees $12 million and retained up to the remaining $50 million.	None Provided – See DPH Response	The Department of Public Health (DPH) does not oversee or enforce employer or business labor practices. DPH defers to the response provided by the Office of Labor Standards Enforcement which enforces labor laws adopted by San Francisco voters and the San Francisco Board of Supervisors.
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, strict HRA guidelines and employees' unwillingness to disclose their medical conditions to their employer	Partially disagree	DPH has no demographic information on employees who receive either MRAs or HRAs so cannot comment on any potential similarities between the populations. In fiscal year 2011-12, the MRA usage rate was 55%. Employees with MRAs are sent notification of the creation of their accounts and information on how to access funds from their accounts to reimburse them for health care costs. Employees also receive quarterly statements with account balance information and a list of allowable health care expenses. The statements are in English, Chinese and Spanish. Use of the MRA does not require the employee to disclose their health needs or medical condition to their employer.
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	None Provided – See DPH Response	The Civil Grand Jury's position relates to employer HRA's established in compliance with the Employer Spending Requirement provisions of the Heath Care Security Ordinance. DPH does not oversee or monitor employer HRA, this is done by the Office of Labor Standards Enforcement (OLSE). DPH defers to any response provided by the OLSE. DPH oversees the MRA provision under the City Option for those employees who elect it to meet the Employer Spending Requirement.
F12	HRAs may not be an allowable option in meeting the federal requirements under the Affordable Care Act	Unable to respond pending federal guideline or regulations	In 2011, the federal government exempted certain HRAs from ACA provisions. Specifically, HRAs are not required to comply with higher minimum annual limits required of group health plans and health insurance prior to 2014. The ACA may prohibit stand-alone HRAs, but federal government guideline in this area has yet to be released.

No.	Civil Grand Jury Position	Agree/Disagree	DPH Response
F13	The financial incentive to retain unspent HRA funds could be a motivating force for employer to restrict employee access to these funds	None Provided – See DPH Response	The Civil Grand Jury's position relates to employer HRA's established in compliance with the Employer Spending Requirement provisions of the Heath Care Security Ordinance. In addition, this position appears to apply to those employers that self-administer an HRA or provide direct reimbursement to their employees for medical expenses and not to all HRAs. DPH does not oversee or monitor employer HRA, this is done by the Office of Labor Standards Enforcement (OLSE). DPH defers to any response provided by the OLSE.
F14	By submitting personal medical invoices directly to their employers, employees are forces to reveal their medical history	None Provided – See DPH Response	The Civil Grand Jury's position relates to employer HRA's established in compliance with the Employer Spending Requirement provisions of the Heath Care Security Ordinance. In addition, this position appears to apply to those employers that self-administer an HRA or provide direct reimbursement to their employees for medical expenses and not to all HRAs. DPH does not oversee or monitor employer HRA, this is done by the Office of Labor Standards Enforcement (OLSE). DPH defers to any response provided by the OLSE.
R4	Disallow the use of the employer HRA option	None Provided – See DPH Response	DPH defers to the response provided by the City Attorney's Office which is responsible for providing legal advice to officers, department heads, boards, commissions or other units of local government.

No.	Civil Grand Jury Position	Agree/Disagree	DPH Response
R5	Eliminate time limits for employees to use their MRA funds	Disagree	There is no time limit for employees to use their MRA funds. All MRA accounts are activity unless there has been 18 months of continuous inactivity by both the employee (i.e., not seeking reimbursement) and employer (i.e., not making health care expenditures). An employee could continue to access their MRA account even if an employer is no long making expenditures for deposit into the employee's MRA (e.g., after 18 months) as long as there are fund in the account. The account would remain active. Likewise an employer could continue to make expenditures on behalf of an employee, but the employee not accessing funds from their MRA (e.g., in excess of 18 months). This account would remain active. If a MRA is closed due to 18 months of continuous inactivity by both the employee and employer, then the employee may contact the program and ask to have their closed MRA account reinstated. In such cases, DPH would work collaboratively with the San Francisco Health Plan and the MRA vendor (SHPS) to reinstate the account. The MRA vendor archives and retains closed account information for seven years from the date of account closure for auditing purposes. Employee requests done within this time frame are readily accommodated. DPH would not recommend implementation of this recommendation for the reasons noted above.

DPH thanks the Civil Grand Jury for this opportunity to provide comments. If you have any questions, or require additional information, please do not hesitate to contact me at 415.554.2779 or via electronic mail at tangerine.brigham@sfdph.org.

Sincerely,

Tangerine M. Brigham

C: Barbara A. Garcia, MPA, Director of Health

CITY AND COUNTY OF SAN FRANCISCO

George Gascón
District Attorney

OFFICE OF THE DISTRICT ATTORNEY

JUNE D. CRAVETT
Assistant Chief District Attorney
DIRECT DIAL: (415) 551-9537
E-MAIL: JUNE.CRAVETT@SFGOV.ORG

August 23, 2012

The Honorable Katherine Feinstein
Presiding Judge
Superior Court of California
City and County of San Francisco
400 McAllister Street, Room 206
San Francisco, CA 94102-4512

Re: In the Matter of the 2011-2012 Civil Grand Jury—District Attorney's Response

Dear Judge Feinstein:

I write to provide the District Attorney's Office response to Findings 2 and 7, and to Recommendation 3, of the Civil Grand Jury's report entitled "Surcharges and Healthy San Francisco: Healthy for Whom?"

Finding 2 states: "The City has not investigated health care related surcharges to determine whether or not employers are generating profits from these surcharges." We disagree with this finding as it relates to the District Attorney's Office. In October 2011 we opened a preliminary review into this issue. That review is still pending.

Finding 7 states: "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."
We disagree with this finding as phrased. We would agree with a finding phrased as follows: Consumer fraud is committed if the consumer's receipt states that a surcharge is being assessed for a stated purpose and there is sufficient evidence to prove that: (1) the surcharge was not used for the stated purpose; and (2) the business knew at the time the payment was received that the surcharge would not be used for the stated purpose.

Recommendation 3 states: "The District Attorney open an investigation to review the Jury's survey findings for possible consumer fraud." We agree that the Jury's survey findings should be considered and analyzed as part of our ongoing review of the issue. The extent to which these findings will be useful depends on whether the underlying documents from which the data were derived are made available to our office for review.

Respectfully,

George Gascón
District Attorney

June D. Cravett
Assistant Chief District Attorney

WHITE COLLAR CRIME DIVISION
732 BRANNAN STREET · SAN FRANCISCO, CALIFORNIA 94103
RECEPTION: (415) 553-1752 · FACSIMILE: (415) 551-9504

CITY AND COUNTY OF SAN FRANCISCO

OFFICE OF THE CITY ATTORNEY

DENNIS J. HERRERA
City Attorney

DIRECT DIAL: (415) 554-4748
E-MAIL: tara.collins@sfgov.org

September 17, 2012

The Honorable Katherine Feinstein
Presiding Judge
San Francisco Superior Court
400 McAllister Street, Department 206
San Francisco, CA 94012

Re: Response Civil Grand Jury Report

Dear Judge Feinstein:

In accordance with Penal Code Sections 933 and 933.05, the City Attorney's Office submits the following response to the Civil Grand Jury Report entitled, "Surcharges and Healthy San Francisco: Healthy for Whom?", issued in June 2012. The Civil Grand Jury Report asked the City Attorney's Office to respond to Findings No. 5, 6, 7 and 12, and Recommendations No. 1, 3 and 4 of the Report, set forth below.

Finding No. 5: 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.

Response to Finding No. 5: Partially disagree. Although the Health Care Security Ordinance ("HCSO") did not require employers to reconcile health care surcharges and health care expenditures with respect to surcharges collected prior to January 1, 2012, the Office of Labor Standards Enforcement ("OLSE") did require employers to report the amount of health care surcharges they collected on their 2011 Annual Reporting Forms, in addition to their health care expenditures.

Finding No. 6: Due to the varied wording in describing surcharges on consumers' bills, and the wording of the ordinance, the auditing of surcharges will be difficult.

Response to Finding No. 6: Because the auditing of surcharges imposed on customers falls within the jurisdiction of the OLSE, the City Attorney defers to the OLSE's response to this finding.

Finding No. 7: Consumer fraud is committed if the consumer's receipt states that a surcharge is being assessed for a stated purposes and is not being used for that purpose.

Response to Finding No. 7: Agree. A business commits consumer fraud if it assesses a surcharge for a stated purpose with the knowledge that it will use the money for a different purpose.

Finding No. 12: HRAs may not be an allowable option in meeting the federal requirements under the Affordable Care Act.

Response to Finding No. 12: The City Attorney agrees that HRAs may not be an allowable option under the Affordable Care Act, but this question will likely be answered definitively by forthcoming regulations from the Secretary of Health and Human Services.

Recommendation No. 1: Disallow employers subject to the Office of Labor Standards Enforcement regulations from adding surcharges on customers' bill to pay for the HCSO employer mandates and mandated paid sick days.

Response to Recommendation No. 1: This is a question for San Francisco's policymakers, specifically, the Mayor and the Board of Supervisors. Should the policymakers wish to consider this recommendation, the City Attorney will provide them with the appropriate legal advice.

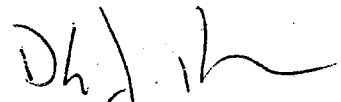
Recommendation No. 3: The District Attorney open an investigation to review the Jury's survey findings for possible consumer fraud.

Response to Recommendation No. 3: Because this recommendation is directed at the District Attorney, the City Attorney defers to the District Attorney's response.

Recommendation No. 4: Disallow the use of the employer HRA option.

Response to Recommendation No. 4: This is a question for San Francisco's policymakers, specifically, the Mayor and the Board of Supervisors. Should the policymakers wish to consider this recommendation, the City Attorney will provide them with the appropriate legal advice.

Sincerely,



DENNIS J. HERRERA
City Attorney

SEP 1 2012

STATE OF CALIFORNIA

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BETTY T. YEE
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Second District, Lancaster

MICHELLE STEEL
Third District, Orange County

JEROME E. HORTON
Fourth District, Los Angeles

JOHN CHIANG
State Controller

CYNTHIA BRIDGES
Executive Director

September 10, 2012

Honorable Katherine Feinstein, Presiding Judge
Superior Court of California
County of San Francisco
Civic Center Courthouse
400 McAllister St., Room 008
San Francisco, CA 94102

Dear Presiding Judge Feinstein:

In correspondence dated July 16, 2012, both the State Board of Equalization (BOE) and the Honorable Betty T. Yee, the BOE's Member from the First Equalization District, received notice that a response was required to a San Francisco Civil Grand Jury report: *Surcharges and Healthy San Francisco: Healthy for Whom?* This report, which documents the Jury's findings with respect to its investigation of several issues regarding the San Francisco Health Care Security Ordinance (SFHCSO), makes it clear that the BOE as an agency, and not Ms. Yee as an individual Board Member, is the responding party or entity that is required to respond to the relevant findings. Pursuant to California Penal Code section 933.5, a responding party or entity must either agree with the particular finding at issue or disagree with it in whole or in part, explaining the basis for any disagreement.

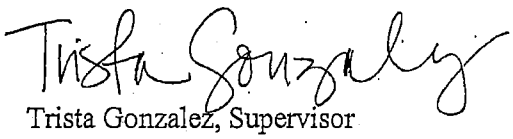
A review of the Jury's report indicates that Finding F3 states in part that the State of California, to the Jury's knowledge, has not "investigated whether sales tax is being added to the surcharges" and requests in part that the Board of Equalization (BOE) respond to the Jury's finding. Preliminarily, we believe it would be helpful to explain the imposition and application of tax in general. The California Sales and Use Tax Law imposes a sales tax upon retailers for the privilege of selling tangible personal property at retail in the State of California. The use tax is complementary to the sales tax and is imposed, when sales tax does not apply, upon the consumer for the storage, use or other consumption of tangible personal property in the State of California. Either the sales tax or the use tax applies to all retail sales of tangible personal property to consumers in California, unless otherwise exempted by statute or type of transaction. When subject to tax, the kind of transactions discussed in the report will generally be subject to sales tax, not use tax. The measure of tax (i.e., the amount of the "total selling price" to which the applicable tax rate is applied) for a transaction subject to sales tax is called "gross receipts."

California Revenue and Taxation Code section 6012, provides that "gross receipts" mean in part the total amount of the sale or lease or rental price, as the case may be, of the retail sales of retailers, valued in money, whether received in money or otherwise, except for the cost of the property sold; the cost of the materials used, labor or service cost, interest paid, losses, or any

As stated above, the BOE is committed to verifying that all taxpayers have accurately collected and remitted sales and use taxes in accordance with Sales and Use Tax Law. BOE will continue to investigate employers' practices regarding sales tax reimbursement collection on the measure of the surcharge, when separately stated, pursuant to our ongoing audit and compliance programs.

I hope this information is helpful. If there are any questions regarding this response, please call me at (916) 324-2916 or you may contact me via e-mail at *trista.gonzalez@boe.ca.gov*.

Sincerely,



Trista Gonzalez, Supervisor
Audit and Information Section

THG:lsc:dmt

Enclosure: Special Notice, *Sales Tax Applies to the San Francisco Health Care Security Ordinance Surcharge*, April 2009

cc: Honorable Betty T. Yee, Member, First District
Mr. Alan LoFaso (MIC 71)
Ms. Cynthia Bridges (MIC 73)
Mr. Jeffrey L. McGuire (MIC 43)
Mr. Randy Ferris (MIC 83)
Ms. Susanne Buehler (MIC 92)

Civil Grand Jury Office
Superior Court of California
County of San Francisco
Civic Center Courthouse
400 McAllister St., Room 008
San Francisco, CA 94102-4512

September 12, 2012

Honorable Katherine Feinstein
Presiding Judge of the Superior Court
400 McAllister Street, Room
San Francisco, CA 94102-4512

RE: San Francisco Civil Grand Jury Report Surcharges and Healthy San Francisco: Healthy for Whom?

Presiding Judge Feinstein.:

I am writing in response to a letter dated July 16, 2012 from Mario Choi of the 2011 – 2012 San Francisco Civil Grand Jury demanding responses from the Golden Gate Restaurant Association (GGRA) regarding the Grand Jury's report entitled *San Francisco Civil Grand Jury Report Surcharges and Healthy San Francisco: Healthy for Whom.*

The authorizing statute for the Civil Grand Jury states that "[t]he grand jury shall investigate and report **on the operations, accounts, and records of the officers, departments, or functions of the county.**" CA Penal Code Section 925. The section does not authorize the Grand Jury to demand responses from private citizens or non-profits that are not affiliated with county government. We believe that the inclusion of the GGRA's name in the report, the demand for responses by the GGRA, as well as the subject matter of private business contracts and practices are all inappropriate and beyond the jurisdiction of the Civil Grand Jury.

However, since the GGRA's name was publically published in the report, even after we raised the issue with Foreperson Pro Tem Mario Choi prior to publication, we felt obliged to invest the time and resources to respond to the reports many misleading and erroneous findings and recommendations.

The GGRA feels very strongly that the Civil Grand Jury should not again be permitted to demand responses or list names of private entities in future reports. It sets a very dangerous precedent for a government investigatory body to go so far afield from its stated purpose and jurisdiction.

Sincerely,

Rob Black
Executive Director
Golden Gate Restaurant Association
cc: San Francisco Civil Grand Jury

100 Montgomery Street, Suite 1280, San Francisco, CA 94104 t. 415.781.5348 f. 415.781.3925

GOLDEN GATE RESTAURANT ASSOCIATION

RESPONSES TO FINDINGS AND RECOMMENDATIONS IN SAN FRANCISCO GRAND JURY REPORT ENTITLED "SURCHARGES AND HEALTHY SAN FRANCISCO: HEALTHY FOR WHOM?"

I. CUSTOMER SURCHARGES FOR HEALTH CARE MANDATES

Responses to 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.

Disagree partially. As of January 2012, San Francisco Administrative Code Section 14.3(d) requires all Covered Employers to inform OLSE on an annual basis if they add a surcharge for the purpose of covering, in whole or in part, the cost of the employer expenditure mandate. This is reported annually in the OLSE "Analysis of the Health Care Security Ordinance." The law requiring disclosure does not address mandated paid sick days.

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

Disagree. As of January 2012, San Francisco Administrative Code Section 14.3(d) requires all Covered Employers to inform OLSE on an annual basis whether they add a surcharge for the purpose of covering, in whole or in part, the cost of the employer expenditure mandate. The City also requires the reporting of all healthcare expenditures for covered employees. All of this information is reported annually in the OLSE "Analysis of the Health Care Security Ordinance."

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

Disagree. In April 2009, the State Board of Equalization issued a special notice to businesses regarding the applicability of sales tax to HCSO surcharges and how the tax should be calculated. Any tax audit by the Franchise Tax Board or the Treasurer's Office would identify businesses that are underreporting their individual sales tax.

F4. NO RESPONSE REQUESTED

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.

Disagree. Under San Francisco Administrative Code Section 14.3(d) all Covered Employers must inform OLSE on an annual basis whether they add a surcharge for the purpose of covering, in whole or in part the cost of the employer expenditure mandate. The reporting requirement under this code section applied to 2011. The City also required reporting of all healthcare expenditures for covered employees for 2011.

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

Disagree. San Francisco Administrative Code Section 14.3(d) requires all Covered Employers to inform OLSE on an annual basis whether they add a surcharge for the purpose of covering, in whole or in part the cost of the employer expenditure mandate. The City also requires the reporting of all healthcare expenditures for covered employees. All of this information is reported annually to the OLSE making a review of the data very simple.

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.

Disagree partially. As of January 2012, this issue is addressed under San Francisco Administrative Code Section 14.3(d) by requiring that a "Covered Employer must irrevocably pay or designate an amount equal to that difference for health care expenditures for its Covered Employees" and the amount collected in a surcharge for that purpose. The statute also authorizes OLSE to "refer any potential cases of consumer fraud to appropriate authorities."

It is possible that under certain circumstances that this could be considered consumer fraud. However, fraud is a fact based question depending on the individual circumstances involved. Consumer fraud requires intent on the part of the defendant, harm on the part of the plaintiff, as well as several other elements. If information conveyed during a business transaction is done without the intent to deceive for example, there is no consumer fraud.

Responses to Recommendation

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

Disagree. This recommendation is not warranted or reasonable. As discussed above, recent amendments to the HSCO which became effective in January 2012 adequately address the issue of consumer fraud. San Francisco Administrative Code Section 14.3(d) addresses the issue by requiring that "the Covered Employer must irrevocably pay or designate an amount equal to that difference for health care expenditures for its Covered Employees" and the amount collected in a surcharge for that purpose. The statute also authorizes OLSE to "refer any potential cases of consumer fraud to appropriate authorities."

In addition, this recommendation is an attempt to ban a very prevalent and long standing business practice used by many industries for many different purposes and is an inappropriate infringement on the ability of businesses to determine the prices charged for goods and services. Under the Grand Jury's recommendation, if Bank of America used a portion of the money collected through their ATM surcharges to offset the cost of San Francisco mandated healthcare expenditures, they would be prohibited from charging the surcharge. As well, if a business charged a "health care" surcharge but

spent more on healthcare than was collected through the surcharge, they would still be prohibited from charging the fee even though all of the money collected was spent on employee healthcare.

R2. NO RESPONSE REQUESTED

R3. NO RESPONSE REQUESTED

II. EMPLOYERS HEALTH REIMBURSEMENT ACCOUNTS

Responses to 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.

Disagree. The City has no data for 2010 regarding how much of the $50 million was in HRAs, HSAs, FSAs or other reimbursement arrangements. In addition, the City does not know how much of the money that was not utilized by employees remained in the employees possession or account. For example, any money placed in an HSA automatically becomes the sole property of the employee and can never be recaptured by the employer. It is unclear how much of the $50 million was distributed into HSA accounts or into HRA accounts that rolled over. By using 2011 numbers as a guide, this number could be close to 40% or more of the remaining money.

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.

Disagree. The Grand Jury has no basis to conclude that participants in the City's MRA plan have similar demographics to individuals whose employers use private HRA accounts to meet the City's expenditure requirement . More importantly, the recent amendments to the HSCO which became effective in January 2012 require employers to post a multi-language notice in the workplace as well as notify workers on a quarterly basis as to the amount of the benefit, what it can be used for, and how they can access the benefit. These amendments will likely result in similar reimbursements for MRAs and HRAs in 2012 and going forward. Regarding the unwillingness to disclose individual medical conditions to their employers, only 15% of all reimbursement plans are self-administered, so the overwhelming majority (85%) of employers use third-party administrators or provide the type of benefit that would never require the employee to provide the employer with private medical information.

F10. Significant numbers of restaurants utilizing HRA's in 2010 paid out no medical expenses.

Disagree. For 2010, OLSE did not collect data by industry so this assertion as it pertains to restaurants is unfounded.

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

Agree.

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

Agree. Whether an HRA will be an allowable means of compliance with the Affordable Care Act (AFC) is unknown at this time. HRAs may or may not be an allowable option in meeting the federal requirements. The City's MRA option will likely have the same challenges under the AFC as a private sector HRA. However, HRAs could also apply to different workers than those covered under the AFC. The AFC applies to the full time employees of employers with 50 or more employees. The HCSO applies to both full and part-time employees of employers of 20 or more. An HRA may still be an allowable way to meet the requirements under the HCSO for part-time employees and for employers with between 20 and 49 employees.

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

Disagree partially. Under the previous law this could have been the case. Under the recent amendments which became effective in 2012, this issue is addressed in a variety of ways – including posting and quarterly notice requirements so that employees are aware of their benefits and how to use them, and by requiring all unused monies to remain with the employee for a minimum of 24 months, and for at least 90 days post separation from employment. In addition, the law now requires that any benefit plan must be structured as to be "reasonably calculated to benefit the employee." OLSE now has the authority to determine that an overly restricted reimbursement account is not designed to reasonably benefit the employee and therefore the account would not be considered a qualifying expenditure under the HCSO. Previously, there may have been financial incentives for restricting information and benefits, but the new law that went into effect in January 2012 addresses any potential financial incentives for restricting HRAs.

F14. By submitting personal medical invoices directly to their employers, employees are forced to reveal their medical history and current health conditions to their employees.

Disagree. The Civil Grand Jury makes the incorrect assumption that HRA plans require that employees to submit their medical records or receipts to the employer for reimbursement. As discussed above, the overwhelming majority (85%) of employers use third-party administrators or provide the type of benefit that would never require the employee to provide the employer with health information. For those plans that are self-administered, many employers build in other safe guards to ensure that private health information is kept confidential.

Responses to Recommendations

R4. Disallow the use of the employee HRA option.

Disagree. Employee Health Reimbursement Arrangements are federally regulated ERISA benefit plans. Disallowing a particular type of ERISA benefit plan would require hundreds of employers to alter their existing federally regulated benefit plans, fundamentally undermining the rational used by the 9th Circuit Court of Appeals to uphold the HSCO in Golden Gate Restaurant Association v. City and County of San Francisco, 546 F.3d 639, 656 (2008) ("the Ordinance affects employers, but it "leaves[s] plan administrators right where they would be in any case...The scheme does not force employers to provide any particular employee benefits or plans, to alter existing plans, or to even provide ERISA plans or employee benefits at all.") There is no question that disallowing a particular type of benefit plan currently used by hundreds of employers for thousands of employees would force employers to change their existing benefit plans. As a result, any change to the HSCO which would disallow the use of the employer HRA option would be preempted by ERISA.

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

No position. GGRA does not have a position on whether the City should eliminate the time limits for employees enrolled in the City's MRA option. However, it would seem only fair that the City would be subject to the same time limits which it imposes on private HRAs.

BOARD of SUPERVISORS

City Hall
Dr. Carlton B. Goodlett Place, Room 244
San Francisco 94102-4689
Tel. No. 554-5184
Fax No. 554-5163
TDD/TTY No. 544-5227

DATE: July 19, 2012

TO: Members of the Board of Supervisors

FROM: Angela Calvillo, Clerk of the Board

SUBJECT: 2011-2012 Civil Grand Jury Report

We are in receipt of the San Francisco Civil Grand Jury (CGJ) report released July 19, 2012, entitled: **Surcharges and Healthy San Francisco: Healthy for Whom?** (Attached)

Pursuant to California Penal Code Sections 933 and 933.05, the Board must:

1. Respond to the report within 90 days of receipt, or no later than October 17, 2012.
2. For each finding:
   - agree with the finding or
   - disagree with the finding, wholly or partially, and explain why.
3. For each recommendation:
   - agree with the recommendation or
   - disagree with the recommendation, wholly or partially, and explain why.

Pursuant to San Francisco Administrative Code Section 2.10, in coordination with the Committee Chair, the Clerk will schedule a public hearing before the Government Audit and Oversight Committee to allow the Board the necessary time to review and formally respond to the findings and recommendations.

The Budget and Legislative Analyst will prepare a resolution, outlining the findings and recommendations for the Committee's consideration, to be heard at the same time as the hearing on the report.

Attachment

c: Honorable Katherine Feinstein, Presiding Judge (w/o attachment)
Mario Choi, Foreperson, 2011-2012 San Francisco Civil Grand Jury (w/o attachment)
Mayor's Office
Ben Rosenfield, Controller
Cheryl Adams, Deputy City Attorney (w/o attachment)
Rick Caldeira, Deputy Clerk

Orig: Joy C-COB, Leg Dep.
GAO
Clerk
Cpage

SUPERIOR COURT OF CALIFORNIA
COUNTY OF SAN FRANCISCO
CIVIL GRAND JURY

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BOARD OF SUPERVISORS
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July 16, 2012

Angela Calvillo
Clerk of the Board
City Hall, Room 244
San Francisco, CA 94102

Dear Ms. Calvillo,

The 2011 – 2012 San Francisco Civil Grand Jury will release its report entitled, Surcharges and Healthy San Francisco: Healthy for Whom?" to the public on July 19, 2012. Enclosed is an advance copy of this report. Please note that by order of the Presiding Judge of the Superior Court, Hon. Katherine Feinstein, this report is to be kept confidential until the date of release.

California Penal Code section 933.5 requires the responding party or entity identified in the report to respond to the Presiding Judge of the Superior Court within a specified number of days. You are required by code to respond to this report no later than October 17, 2012. For each finding of the Civil Grand Jury, the response must either:

1) Agree with the finding; or
2) Disagree with it, wholly or partially, and explain why.

Further, as to each recommendation made by the Civil Grand Jury, the responding party must either indicate:

1) That the recommendation has been implemented, with a summary explanation of how it was implemented;
2) That the recommendation has not been implemented, but will be implemented in the future, with a timeframe for implementation;
3) That the recommendation requires further analysis, with an explanation of the scope of that analysis and a timeframe for the officer or agency head to be prepared to discuss it (less than six months from the release of the report); or
4) That the recommendation will not be implemented because it is not warranted or reasonable, with an explanation of why that is. (California Penal Code sections 933, 933.05)

400 McAllister Street, Room 008
San Francisco, CA 94102-4512
Phone: 415-551-3605

Please provide your responses to the findings and recommendations in this report to Judge Feinstein, with an informational copy sent to the Grand Jury Office at the below address.

Very truly yours,

Mario Choi, Foreperson Pro Tem
2011 – 2012 Civil Grand Jury

400 McAllister Street, Room 008
San Francisco, CA 94102-4512
Phone: 415-551-3605

Print Form

Introduction Form

By a Member of the Board of Supervisors or the Mayor

Time stamp
or meeting date

I hereby submit the following item for introduction (select only one):

☒ 1. For reference to Committee: Government Audit and Oversight Committee
An ordinance, resolution, motion, or charter amendment.

☐ 2. Request for next printed agenda without reference to Committee.

☐ 3. Request for hearing on a subject matter at Committee:

☐ 4. Request for letter beginning "Supervisor _____ inquires"

☐ 5. City Attorney request.

☐ 6. Call File No. _____ from Committee.

☐ 7. Budget Analyst request (attach written motion).

☐ 8. Substitute Legislation File No.

☐ 9. Request for Closed Session (attach written motion).

☐ 10. Board to Sit as A Committee of the Whole.

☐ 11. Question(s) submitted for Mayoral Appearance before the BOS on

Please check the appropriate boxes. The proposed legislation should be forwarded to the following:

☐ Small Business Commission ☐ Youth Commission ☐ Ethics Commission

☐ Planning Commission ☐ Building Inspection Commission

Note: For the Imperative Agenda (a resolution not on the printed agenda), use a different form.

Sponsor(s):

Clerk of the Board

Subject:

Board Response - Civil Grand Jury Report - Surcharges and Healthy San Francisco: Health for Whom?

The text is listed below or attached:

Resolution responding to the Presiding Judge of the Superior Court on the findings and recommendations contained in the 2011-2012 Civil Grand Jury report entitled "Surcharges and Healthy San Francisco: Health for Whom?" and urging the Mayor to cause the implementation of accepted findings and recommendations through his/her department heads and through the development of the annual budget.

Signature of Sponsoring Supervisor: Madeleine Ficarelli

For Clerk's Use Only:

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