# MANAGEMENT UPDATE

JUNE/ JULY 2008

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# Federal Labor Law Pre-empts California's Prohibition on Use of State Funds to Promote or Deter Organizing

The U.S. Supreme Court has held that a California law that prohibits employers who receive state funds from using those funds to "assist, promote, or deter union organizing" is pre-empted by federal labor law. *See Chamber of Commerce v. Brown* (June 19, 2008).

***Background:*** AB 1889 forbids certain employers that receive state funds from using such funds to "assist, promote, or deter union organizing." *See* Cal. Govt. Code Ann. §§16645 – 16649. The statute specifies that the spending restriction applies to "any expense, including legal and consulting fees and salaries of supervisors and employees, incurred for . . . an activity to assist, promote, or deter union organizing." §16646(a). Although it purports to have a neutral purpose, the statute exempts activities performed or expenses incurred in connection with undertakings that promote unionization.

The law requires covered employers to certify that no state funds will be used for prohibited expenditures and to maintain and provide, upon request, "records sufficient to show that no state funds were used for those expenditures." Violators are liable to the state for the amount of the funds spent in violation of the law plus a civil penalty equal to twice the amount of those funds. Suspected violators may be sued by the state attorney general or any private taxpayer, and prevailing plaintiffs are entitled to recover reasonable attorney's fees and costs.

In 2002, several organizations whose members do business in California sued the state to enjoin enforcement of the law. The Ninth Circuit held that the National Labor Relations Act (NLRA) does not preclude enforcement of the law. The Supreme Court overruled this decision.

***Machinists Pre-Emption***: The Court held that AB 1889 is pre-empted under the *Machinists* pre-emption analysis. *Machinists* pre-emption forbids states and the National Labor Relations Board (the Board) from regulating conduct that Congress intended to be left

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# Supreme Court's Anticlimactic Decision in *Glenn* does not Streamline ERISA Litigation

On June 19, 2008, the U.S. Supreme Court issued its decision in *Metropolitan Life Ins. Co. v. Glenn*, which many had hoped would provide more clarity with regard to a court's role in reviewing a plan administrator's decision denying benefits, where the plan administrator also pays benefits under the plan. However, the Court's decision in *Glenn* merely "elucidates" the standards announced by the Court in *Firestone Tire & Rubber Co. v Bruch*, 489 U.S. 101 (1989), which held that a conflict of interest is a factor to be considered in determining whether to affirm a plan administrator's benefits determination. The Court did clarify that an entity administering an employee benefit plan, which both determines whether an employee is eligible for benefits and pays those benefits out of its own pocket, operates under an inherent conflict of interest, a question that was not specifically addressed by the Court's earlier decision in *Bruch*.

***Background:*** In *Glenn*, MetLife served as both an administrator and the insurer of Sears, Roebuck & Company's long-term disability insurance plan, an ERISA-covered employee benefit plan. As the plan administrator, MetLife had discretionary authority to determine the validity of an employee's claim for benefits. As the plan's insurer, MetLife paid valid benefit claims. Glenn applied for long-term disability benefits, which MetLife granted Glenn for 24 months. However, MetLife denied benefits beyond 24 months, finding that Glenn was not qualified for such benefits.

Glenn filed suit in federal court, seeking judicial review of MetLife's denial of benefits. The trial court ruled in favor of MetLife and Glenn appealed to the Sixth Circuit. The Sixth Circuit held that MetLife's conflict of interest (based on its authority to determine who receives benefits and its obligation to pay those benefits) was a relevant factor in determining whether to uphold the decision denying benefits. Ultimately the Sixth Circuit reversed MetLife's denial of benefits.

The Supreme Court agreed to review the Sixth Circuit's decision to determine whether a plan administrator that also pays plan benefits operates under a conflict of interest and, if so, how the conflict affects a court's review of a benefit determination.

***Conflict of Interest***: The Court had long held that a conflict of interest is clear where it is the employer who both funds the plan and evaluates the claims, noting that the employer's fiduciary interest may counsel in favor of granting a borderline claim while its immediate financial interest counsels to the contrary. "Thus, the employer has an 'interest . . . conflicting with that of the beneficiaries,' the type of conflict that judges must take into account when they review the discretionary acts of a trustee of a common-law trust." The Court here found that, while the conflict is less clear when the plan administrator is a professional insurance company instead of the employer, a conflict nevertheless exists. However, the Court noted that the different circumstances faced by an insurer versus an employer may be considered in determining the significance of the conflict of interest.

***"Elucidating" Firestone's Standard in Conflict of Interest Situations***: The Court did not change the deferential standard to be used when reviewing the discretionary decision making of a conflicted trustee. The Court held that the conflict of interest remains a factor "among the many a reviewing judge must take into account." Acknowledging that its decision does not provide "a detailed set of instructions" for reviewing a benefit determination, the Court held that any such formula would fail to take into account the "all the impalpable factors involved in judicial review."

**Employers' Bottom Line:**

*Glenn* does not dramatically change the analysis most courts will use in reviewing benefits determinations. It reaffirms the sliding scale of deference the majority of federal appeals courts have employed in reviewing benefit denials. The decision in *Glenn* will, however, have a more significant impact on cases in the Eleventh Circuit (covering appeals from federal district courts in Alabama, Georgia, and Florida) insofar as it renders the standard set forth in *Brown v. Blue Cross & Blue Shield of Ala.*, 898 F.2d 1556 (11th Cir. 1990), essentially obsolete. In *Brown*, the Eleventh Circuit held that if the administrator's decision was deemed de novo wrong, the administrator would have to be given the chance to demonstrate that its decision was not tainted by self-interest. This was because "[e]ven a conflicted fiduciary should receive deference when it demonstrates that it is exercising discretion among choices which

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unregulated and controlled by the free play of economic forces. The Court found that the California law is pre-empted under *Machinists* because it regulates within a zone protected and reserved for market freedom.

In holding that the NLRA pre-empts the California law, the Court emphasized that both the First Amendment and § 8(c) of the NLRA protect noncoercive speech about unionization. According to the Court, this policy judgment, which suffuses the NLRA as a whole, favors "uninhibited, robust, and wide-open debate in labor disputes." Further, the Court held that "Congress' express protection of free debate [as set forth in § 8(c) of the NLRA] forcefully buttresses the pre-emption analysis in this case."

***Use Versus Receipt of State Funds***: The Court rejected the Ninth Circuit's analysis that the law is permissible because the spending restrictions apply only to the use of state funds and are not a restriction on the receipt of funds. The Supreme Court held that just as California may not directly regulate noncoercive speech about unionization, it cannot indirectly regulate such conduct by imposing spending restrictions on the use of state funds. The Court held that the Ninth Circuit's distinction between use and receipt of state funds is not consequential because the law couples the "use" restriction with compliance costs and litigation risks that are calculated to make union related advocacy prohibitively expensive for employers that receive state funds. By doing so, the law reaches beyond the "use of funds over which California maintains a sovereign interest."

***NLRB Regulation***: The Court also rejected the Ninth Circuit's analysis that *Machinists* pre-emption does not apply because this is not an area that is free from all regulation, since Board has regulated employer speech that takes place on the eve of a union election. The Court held that regardless of the Board's regulation of speech in special settings such as imminent elections, Congress has clearly denied it the authority to regulate the broader category of noncoercive speech encompassed by the California law. "It is equally obvious that the NLRA deprives California of this authority, since '[t]he States have no more authority than the Board to upset the balance that Congress has struck between labor and management.'"

***Federal Regulation***: Finally, the Court rejected the Ninth Circuit's analysis that Congress could not have intended to pre-empt AB 1889 because it enacted similar restrictions in three federal statutes. "[T]he mere fact that Congress has imposed targeted federal restrictions on union-related advocacy in certain limited contexts does not invite the States to override federal labor policy in other settings."

**Employers' Bottom Line:**

The Court's decision is good news for employers because it should preclude other states from enacting similar legislation. Additionally, the decision will likely impact the outcome of litigation challenging a similar New York law (New York Labor Law 211-a). In 2005, a federal trial court found the law to be pre-empted by the NLRA; however, in 2006, the Second Circuit reversed this decision and remanded the case for further proceedings. *See Healthcare Ass'n of New York State v. Pataki*, 471 F.3d 87 (2d Cir. 2006).

More importantly, the Court's decision reiterates the importance of an employer's right to engage in noncoercive speech about unionization. An employer's right to provide employees with information about unions has never been more important, as unions increasingly engage in more aggressive organizing tactics.

If you have any questions regarding this decision or other labor or employment related issues, please contact the Ford & Harrison attorney with whom you usually work.

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reasonably may be considered to be in the interests of the participants and beneficiaries."

*Glenn* appears to have eliminated this burden-shifting presumption that existed from the advent of *Brown*. Still, the presence of conflict will remain a factor in determining how much deference to afford the administrator's decision.

If you have any questions regarding the Court's decision in *Glenn*, please contact the Ford & Harrison attorney with whom you usually work or any member of our Employee Benefits Practice Group.

# Supreme Court Finds State Disability Pension Plan does not Violate ADEA

The U.S. Supreme Court recently held that Kentucky's disability retirement program, which imputes years of service to employees who become disabled **before** becoming eligible for a regular pension, but does not do so for employees who become disabled **after** becoming pension eligible, does not violate the Age Discrimination in Employment Act (ADEA). See *Kentucky Retirement Systems v. EEOC* (June 19, 2008). In its five to four decision, the Court rejected the argument of the Equal Employment Opportunity Commission (EEOC) that such a plan automatically discriminates because of age. The Court found that Kentucky's plan distinguishes among employees based on pension status, not age. In such cases, a person challenging the plan must present evidence that the different treatment was "actually motivated" by age, not pension status, which the EEOC failed to do.

***Background***: Under Kentucky's retirement plan, policemen, firemen and other employees in "hazardous positions" can retire after either working for 20 years or working for 5 years and reaching age 55. The pension under the normal retirement plan is calculated by multiplying the employee's years of service times 2.5% times final pre-retirement pay.

Under the disability retirement provision, an employee who has worked for five years or becomes disabled in the line of duty is eligible for immediate retirement. In calculating that employee's benefits, the state adds a certain number of ("imputed") years to the employee's actual years of service. The number of imputed years equals the number of years that the disabled employee would have had to continue working in order to become eligible for normal retirement benefits, i.e., the years necessary to bring the employee up to 20 years of service or to at least 5 years of service when the employee would turn 55 (whichever number of years is lower). However, an employee who continues to work beyond the normal retirement age and becomes disabled is not entitled to imputed years of service in making the pension calculation.

Charles Lickteig, an employee who continued to work after reaching retirement age and then became disabled, filed an EEOC charge claiming the way the state calculated his pension payments was discriminatory. The EEOC subsequently sued the state, claiming the plan violates the ADEA because it imputes years of service to employees who become disabled before reaching age 55, but not to those who become disabled after reaching this age. The EEOC claimed the only reason the state refused to impute years of service in calculating Lickteig's benefits was because of his age, which violates the ADEA.

The trial court ruled in favor of the state and the Sixth Circuit reversed this decision. The Supreme Court agreed to review the case and reversed the Sixth Circuit's decision.

***Supreme Court Decision***

In holding that Kentucky's disability pension plan does not violate the ADEA, the Court relied on its earlier decision in *Hazen Paper Co. v. Biggins,* 507 U. S. 604 (1993), in which it held that where a plaintiff claims age-related "disparate treatment" – that is, intentional discrimination because of age – the plaintiff must prove that age actually motivated the employer's decision. The Court held that Kentucky's pension plan permissibly makes age, in part, a condition of pension eligibility.

The Court further held that, considering the factual circumstances involved in the case, the disability pension plan's difference in treatment was not actually motivated by age. The Court emphasized that this decision does not change the rule that a statute or policy that facially discriminates based on age is sufficient to show disparate treatment under the ADEA. Instead, this case dealt with differential treatment based on pension status, where the pension status, as permitted by the ADEA, turned, in part, on age.

The Court rejected the EEOC's argument that the disability pension plan violates the requirements of the Older Workers Benefit Protection Act (OWBPA), which amended the ADEA to prohibit age-based disparities in the provision of employee benefits unless such disparities are justified by cost-savings. The Court found the OWBPA's cost-justification requirement inapplicable to its determination that the plan's differentiation among employees was not actually motivated by age. Additionally, the Court was not persuaded by the EEOC's regulation and compliance manual provision, which state that such plans automatically violate the ADEA.

If you have any questions regarding this decision or other labor or employment related issues, please contact the Ford & Harrison attorney with whom you usually work.

# How Does California's Same-Sex Marriage Decision Impact Employers?

As most affected employers are aware, California recently became the second state (after Massachusetts) to recognize same-sex marriages. In *In re Marriage Cases*, the California Supreme Court held that denying same-sex couples the right to marry violates the California Constitution's equal protection clause and is a form of unconstitutional discrimination based on sexual orientation. The law also invalidated California's Proposition 22, which provides that only a marriage between a man and a woman is recognized in California.

The primary impact for employers is that any California state law provision referring to "spouse" now includes same-sex spouse. However, even before the California Supreme Court's decision, California law gave registered domestic partners (including same-sex partners) the same rights under state law as spouses. Accordingly, the impact of this decision may be limited.

Some employers have questioned the impact that recognition of same-sex marriages will have on their employee benefit programs. Generally, the federal Employee Retirement Income Security Act of 1974 (ERISA) pre-empts state laws relating to pension benefit plans (that is, retirement plans) and welfare benefit plans (such as health insurance plans). ERISA and the Internal Revenue Code (the Code), as well as other federal laws and any regulations adopted under those laws, must be applied consistently with the federal Defense of Marriage Act (DOMA). The DOMA defines marriage as a legal union between one man and one woman as husband and wife; spouse refers only to a person of the opposite sex who is a husband or a wife. Thus, the California Supreme Court's decision will have little impact on ERISA-covered retirement plans and self-insured welfare plans (i.e., plans that pay benefits out of a company's general assets).

However, ERISA does not pre-empt state laws regulating insurance; thus, insurance companies that issue policies in California to employers providing welfare benefits must comply with California's laws governing policy coverage and benefits. Since California law already required insurance policies issued in the state to cover registered domestic partners to the same extent that the policies covered spouses, employers may not see a significant impact from the Supreme Court's decision.

Tax issues relating to employee benefits could be complicated by the California Supreme Court's decision. Since, for purposes of the Internal Revenue Code and its regulations the term "spouse" is limited by the DOMA to an opposite-sex spouse, benefits provided by an employer to a same-sex spouse or a domestic partner of an employee are not considered to be provided to a spouse or, in most cases, to a dependent. For example, the Code excludes from an employee's gross income the value of accident or health plan coverage provided by an employer for an employee and the employee's spouse and dependents. If an employer provides coverage to a same-sex spouse (either voluntarily or because the employer purchased a policy covered by California law), the value of the coverage provided to the same sex spouse is taxable to the employee and is wages that must be reported on a Form W-2 and subjected to federal income tax and Social Security tax withholding.

Tax issues relating to benefits offered through a cafeteria plan, which is subject to favorable treatment under Code Section 125, may also be affected by the Court's decision. Additionally, there are other types of benefits available to spouses under federal law that are not available to same-sex spouses or domestic partners, such as Health Savings Account payments for medical expenses, reimbursements under Health Reimbursement Accounts, and survivor benefits under a qualified retirement plan, etc.

Employers should review the terms of their benefit plans and employee communications and adopt a clear definition of the term "spouse" to avoid any confusion. Additionally, if benefits are or will be offered to same-sex spouses or non-dependent domestic partners, employers should ensure that their payroll or accounting departments can comply with differing tax treatments under federal law.

If you have questions regarding these issues or need assistance reviewing the terms of your employee benefit plans, please contact Jeffrey Ashendorf, 212-453-5926, jashendorf@fordharrison.com, or any member of our Employee Benefits Practice Group. If you have any questions regarding California laws regulating the workplace, please contact any attorney in our Los Angeles office or the Ford & Harrison attorney with whom you usually work.

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