Labor & Employment Issues

In Focus

Pitta LLP

For Clients and Friends

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ROUND ONE IN "JANUS II" GOES TO UNIONS – NO RETROACTIVE APPLICATION SAYS FEDERAL DISTRICT COURT

Following the U.S. Supreme Court's decision in *Janus v. Am. Fed'n of State, Cty. & Mun. Employees, Council 31*, 138 S. Ct. 2448 (2018), well-funded anti-union organizations raced to the federal courts to seek retroactive repayment of fair share fees collected prior to the June decision. With cases pending in jurisdictions across the country, Judge Robert J. Bryan, of the Western District of Washington, issued unions a resounding victory in the first ruling on this contentious matter, shielding AFSCME Council 28 from pre-*Janus* liability. *Danielson v. Am. Fed'n of State, Cty. & Mun. Employees, Council 28, AFL-CIO*, 18-cv-05206-RJB (W.D. Wash. Nov. 28, 2018),

While Supreme Court constitutional decisions generally apply retroactively, unions defending post-*Janus* suits have argued that prior dues collection constituted good faith application of the prevailing law for the past fifty years, since *Abood v. Detroit Bd. Of Ed.*, 431 U.S. 209 (1977). The good faith defense derived from public sector law and the precise application of it to private parties is very much in dispute in these post-*Janus* actions.

The Washington district court concluded that there was "ample authority" for the application of the good faith defense in this case. Judge Bryan explained that the constitutional defect addressed in *Janus* – compelling fees used for political or ideological activities in violation of the First Amendment – "could not have been identified by the Union Defendant, because although the Supreme Court hinted at overruling *Abood*, it did not explicitly do so until *Janus*." Judge Bryan noted that after the *Janus* decision, AFSCME Council 28 ceased collection of fees immediately. The Court explained that application of the good faith defense also avoided the inconsistency of holding the Union liable for monetary damages while the State of Washington incurred no such liability.

The Court further rejected Plaintiffs' contentions concerning the mechanics of the good faith defense. Judge Bryan denied Plaintiffs' attempt to analogize its First Amendment claim to state law conversion (i.e., taking of another's property), to which good faith does not apply. Instead, he reasoned that the First Amendment claim more closely resembled certain dignitary torts, since Plaintiffs' claim did not turn on the Union Defendant's receipt of property, "but upon the dignitary harm resulting from being compelled to support speech with which they disagree." Moreover, Judge Bryan denied Plaintiffs' request for discovery on the issue, recognizing that while discovery on subjective state of mind is common in good faith defense cases, assessment of the Union's belief that the Appeals Court in *Janus* would be overruled produces an "awkward result." In a particularly forceful passage, he explained that "[i]nviting discovery on the subjective anticipation of an unpredictable shift in the law undermines the importance of observing existing precedent and ignores the possibility that prevailing jurisprudential winds may shift. This is not a practical, sustainable or desirable model."

As delighted as unions should be by this thoroughly reasoned decision, it is no guarantee that the many other courts considering this issue will reach the same result. Reason for optimism exists in that Judge Bryan was appointed by President Ronald Reagan. But the Freedom Foundation already announced its intention to appeal this decision, potentially setting the stage for the first circuit court decision to be issued in the Ninth Circuit.

BREAKING NEWS - IRS PROPOSES TO EXPAND PLAN HARDSHIP DISTRIBUTION RULES

On November 14, 2018, the Internal Revenue Service (IRS) issued proposed regulations amending the rules relating to hardship distributions from Internal Revenue Code (IRC) Section 401(k) plans. The regulations reflect recent changes made by the Bipartisan Budget Act of 2018. The regulations, when finalized, will affect participants in, beneficiaries of and administrators of plans that contain cash or deferred arrangements or provide for employee or matching contributions. The following is a brief summary of the proposed rules.

Plans determine an individual's eligibility for a hardship distribution on the basis of all the relevant facts and circumstances and in accordance with nondiscriminatory and objective standards (note, the proposed rules offer one general standard for determining whether a hardship distribution is necessary); alternatively, to simplify administration, plans can use the safe harbor under which distributions for any one of six types of expenses are deemed to be made on account of an immediate and heavy financial need. For plans utilizing the safe harbor hardship reasons, the proposed rules add a seventh allowable expense. An employee will be deemed to have an immediate and heavy financial need if the hardship distribution is requested for expenses and losses (including loss of income) incurred by the employee on account of a disaster declared by Federal Emergency Management Agency (FEMA), provided that the employee's principal residence or principal place of employment at the time of the disaster was located in an area designated by FEMA for individual assistance with respect to the disaster. Also, for one of the existing six safe harbor expenses, the proposed rules add "primary beneficiary under the plan" as an individual for whom qualifying medical, educational, and funeral expenses may be incurred.

Furthermore, the rules propose to eliminate the safe harbor requirements that a distribution will be deemed necessary to satisfy the immediate and heavy financial need only if (i) elective contributions and employee contributions are suspended for at least six months after the hardship distribution is made and, (ii) if available, nontaxable plan loans are taken. The proposed regulations modify the rules to permit hardship distributions from 401(k) plans of elective contributions, qualified nonelective contributions, qualified matching contributions and earnings on these amounts, regardless of when contributed or earned. Note, however, plans may limit the type of contributions available for hardship distributions and whether earnings on those contributions are included.

Also, the proposed regulations clarify that the limitation under the Tax Cuts and Jobs Act of 2017 that provides that for taxable years 2018 through 2025, the deduction for a personal casualty loss generally is available only to the extent the loss is attributable to a federally declared disaster does not apply for purposes of the safe harbor expense for repairing damage to an employee's principal residence that would qualify for the casualty deduction under IRC Section 165.

Note, the proposed new rules relating to a hardship distribution of elective contributions from an IRC Section 401(k) plan generally apply to Section 403(b) plans as well. However, income attributable to Section 403(b) elective deferrals continues to be ineligible for distribution on account of hardship.

Generally, these rules apply to distributions made in plan years beginning after December 31, 2018. Plan sponsors will need to amend their plans' hardship distribution provisions in order to take advantage of the new rules in the ample time to do so. For an individually designed plan, that is not a governmental plan, the deadline for amending the plan to reflect these changes is the end of the second calendar year that begins after the issuance of the IRS's Required Amendments List that includes this change.

We suggest that you confer with counsel about these changes and the deadline for amending your plans.

NEW SECOND CIRCUIT DECISION ENSURES ARBITRAL CLARITY OVER FINALITY

A recent commercial arbitration decision by the U.S. Court of Appeals for the Second Circuit creates a limited exception to the finality of an arbitration award, including a labor arbitration award, which "fails to address a contingency that later arises or . . . is susceptible to more than one interpretation." *General Re Life Corp. v. Lincoln National Life Ins. Co.*, 2d Cir. No. 17-2496-cv (Nov. 28, 2018).

General Re contracted to pay claims submitted to it by Lincoln on behalf of Lincoln customers, with Lincoln paying premiums one year in advance. The contract allowed General Re to increase premiums under certain circumstances and then Lincoln to either continue or reject the contract. General Re claimed an increase and the arbitration panel agreed over Lincoln's objections. Should Lincoln reject the revised contract, the award stated that "[a]ll premium and claim transactions following the effective date . . . (April 1, 2014) shall be unwound" and retained jurisdiction. Lincoln rejected the more costly contract, demanding refund of the advance premiums while General Re insisted it could keep the advance premiums but not provide coverage for claims beyond April 1, 2014. On submission to the arbitrators, they ruled that General Re could keep the advance premiums but must provide coverage for the period included in coverage. General Re moved to confirm the first award and Lincoln the second.

The district court confirmed the second "clarified" award and the Second Circuit affirmed. Writing for herself and Judges Wesley and Chin, Judge Pooler first rejected General Re's argument that Lincoln had waived any right to the advance premiums since the issue was not raised in the first arbitration. That contingency did not arise, noted the Court, until Lincoln rejected the contract after the awarded increase and so could not be waived in the first proceeding. Next, while noting the general rule that an award is final and cannot be revisited by the arbitrator, the Second Circuit joined the Third, Fifth, Sixth, Seventh and Ninth Circuits in recognizing an exception where the award does not address a later contingency or is unclear, if the modification "merely clarifies the award rather than substantively modifying it" and "the clarification comports with the parties' . . . agreement that gave rise to the arbitration." Here, the first award gave rise to three different interpretations and so met the ambiguity element. The second award merely clarified the process for unwinding premiums and coverage but did

not substantively change the first award. Finally, the arbitrators remained loyal to the parties' agreement since it contemplated an unwinding, even if General Re did not benefit from it. Clarification would be allowed, explained Judge Pooler, because it serves the "twin objectives of arbitration: settling disputes efficiently and avoiding long and expensive litigation."

While not a labor case, the Appeal's Court exception to arbitral finality in the interest of clarity may be readily adapted to labor disputes. Labor awards addressing a living relationship can easily miss a later contingency or suffer ambiguity in application. Rather than endure an award that misses the mark or is stricken, neither ending the parties' dispute, the Second Circuit now allows the parties to revisit the arbitrator on that point for greater finality in accordance with federal arbitration and labor policy.

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