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A report to clients and friends of the firm

Edited by **Stacey C.S. Cerrone** and **Russell L. Hirschhorn**

Editor's Overview

This month we look at part one of our three part series on Class Actions. In part one, Robert Rachal, Page Griffin and Madeline Chimento Rea address Rule 23's requirement of commonality and review in-depth the developing body of case law post *Wal-Mart* and *Comcast* and how commonality may be applied to eliminate or cabin class actions. Look for part two addressing Rule 23(b) in our December Newsletter.

As always, be sure to review the Rulings, Filings, and Settlement of Interest where we discuss new DOL guidance on HRAs, FSAs and Employer Payment Plans, IRS guidance on electronic Self-Certification for hardship distributions and Post-Windsor guidance, and cases addressing FICA application to severance pay, excessive fees, PBGC administrative deference and the ACA.

Labor and Employment and ERISA Class Actions After *Wal-Mart* and *Comcast* — Practice Points for Defendants (Part I – Commonality)[*]

By Robert Rachal, Page Griffin and Madeline Chimento Rea

Introduction and Overview

In *Wal-Mart Stores, Inc. v. Dukes*, the Supreme Court made clear that the class action rules apply with full force to employment discrimination cases.[1] *Wal-Mart* directs courts to conduct a "rigorous analysis" to determine whether employment discrimination plaintiffs have proven that they meet the requirements of Rule 23. Moreover, the decision breathes new life into the Federal Rules' commonality requirements and the limitations on "mandatory" classes embodied in Rule 23.

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[1] 131 S. Ct. 2541 (2011).

After *Wal-Mart,* the Supreme Court again altered the landscape of class action litigation when in *Comcast Corp. v. Behrend* [2] the Court applied what it called the "straightforward application of class certification principles" to issues of class damages. Though not a labor and employment case, the import of *Comcast* is clear: plaintiffs' damages theory must (i) match their class liability theory and (ii) be able to prove damages on a classwide basis, free from taint from individualized harms.[3]

This Bloomberg BNA Insights article addresses the impact of *Wal-Mart*, *Comcast* and the developing body of cases applying them. The article focuses on how they may be used to defend against labor and employment and ERISA class actions. The article also briefly addresses the potential impact of *Wal-Mart* and *Comcast* on FLSA and ADEA "collective actions." Some of the key conclusions are:

- By adopting a dissimilarities analysis to determine whether common questions have common answers, *Wal-Mart* makes commonality a significant screen to eliminate or cabin many types of labor and employment and ERISA class actions.

- *Wal-Mart*'s dissimilarities analysis is particularly important (i) to labor and employment class actions involving discretionary or complex multi-level or multi-source decision making, (ii) to ERISA investment cases in 401(k) and similar plans, and (iii) to ERISA (and labor and employment) class actions that depend on allegedly defective or misleading communications.

- *Wal-Mart* requires many, if not all, class actions seeking individualized monetary relief to meet Rule 23(b)(3)'s more stringent predominance and superiority requirements before any class can be certified.

- *Comcast*'s making damages a central part of class analysis is a substantial change in the law, and should bar class actions unless plaintiffs can prove that the alleged class wrong caused a classwide harm. This change is already having a substantial impact in many wage-and-hour cases.

- *Comcast* and *Wal-Mart* both illustrate the importance of expert testimony in class certification, and apply strict standards to that testimony.

This Bloomberg BNA Insight article addresses the impact of *Wal-Mart* and *Comcast* in three parts. Part I discusses the *Wal-Mart* and *Comcast* rulings, and how commonality may be applied to eliminate or cabin class actions after *Wal-Mart*. Part I also discusses adequacy and typicality, and how these requirements may be heightened after *Wal-Mart* and *Comcast*. Part II addresses the Rule 23(b) principles in *Wal-Mart*, including defenses to plaintiff's attempts to circumvent *Wal-Mart* through "issue" or "hybrid" certifications. Part II also

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[2] 133 S. Ct. 1426, 1433 (2013).

[3] *Id.* at 1433-35.

addresses the use of trial plans and subclasses as means to limit or defeat class actions, and ends with a brief discussion on using *Wal-Mart* and *Comcast* to limit or defeat "collective actions" under FLSA and ADEA. Finally, Part III addresses experts in class actions, and how defendants may use expert analysis to defeat or limit class certification.

The Class and the Substantive Aspects of the *Wal-Mart* Ruling

Wal-Mart Stores v. Dukes arose out of the largest labor and employment class action ever filed.[4] In *Wal-Mart*, plaintiffs challenged pay and promotion practices on behalf of a proposed class of one and one-half million current and former female employees of Wal-Mart. Plaintiffs claimed that Wal-Mart's supervisors and local managers exercised their discretion on pay and promotions in a way that discriminated against females. Pay was set within bounded ranges, while promotions included both objective and subjective criteria.[5] Plaintiffs sought to prove their claim through three forms of proof: (i) a "social framework" analysis that purported to show Wal-Mart had a corporate culture that made it susceptible to gender bias; (ii) a statistical analysis that showed disparities in pay and promotions; and (iii) anecdotal statements claiming discriminatory actions.[6]

The *Wal-Mart* Court began its analysis by focusing on the standards applicable to class actions. The Court begin by noting that class actions are exceptions to the rule that litigation is conducted by and on behalf of only individual named parties, and thus plaintiffs bear the burden of proving, not merely pleading, that they satisfied all of Rule 23's requirements. The Court confirmed that lower courts must consider *both* the merits and the evidence—including the quality of any expert evidence—to determine whether a plaintiff met the requirements of Rule 23.[7]

Applying these standards, the Court first held that Plaintiffs failed to meet the commonality requirement of Rule 23(a)(2). Quoting a now famous article by Professor Nagareda, the Court framed the commonality inquiry as follows:

> What matters to class certification … is not the raising of common 'questions'— even in droves—but, rather the capacity of a classwide proceeding to generate common answers apt to drive the resolution of the litigation. ***Dissimilarities*** within the proposed class are what have the potential to impede the generation of common answers.[8]

The Court thus framed the central question as "why was I disfavored." In so doing, the Court held the evidence set forth by plaintiffs failed to provide the

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[4] 131 S. Ct. 2541 (2011).

[5] *Id.* at 2547.

[6] *Id.* at 2553-56.

[7] *Id.* at 2550-52.

[8] *Id.* at 2551 (emphasis added) (quoting Richard A. Nagareda, *Class Certification in the Age of Aggregate Proof*, 84 N.Y.U. L. Rev. 97, 132 (2009) (internal quotations omitted).

“glue” needed to supply a common answer to that question. First, the Court found plaintiffs’ expert’s social framework analysis useless for class purposes, since it could not answer whether 0.5% or 95% of the employment decisions at Wal-Mart were determined by stereotyped thinking on gender. The corporate policy granting discretion to local supervisors was the precise opposite of an employment practice that would generate a common answer to the “why was I disfavored” question.[9] Tellingly, the Court noted that this granting of discretion “is also a very common and presumptively reasonable way of doing business—one that we have said ‘should itself raise no inference of discriminatory conduct.’”[10] Recognizing that discretion can be used in a fashion that causes disparities is ***not*** the same thing as proving it was exercised in the same common and discriminatory fashion. Rather, it was more plausible to assume managers would follow a company’s nondiscrimination policies, and that, in any event, “demonstrating the invalidity of one manager’s use of discretion will do nothing to demonstrate the invalidity of another’s.”[11]

The Court also found plaintiffs’ statistical evidence deficient. The Court noted that the presence of disparities at the national or regional level does not establish the existence of disparities—or discrimination—at the store level where the challenged decisions were made. The statistics’ more fundamental flaw was that it failed to address possible sex-neutral reasons, including the relative availability of qualified and interested women at the store level, that would rebut any bottom-line disparities. Proof of bottom-line disparities does not answer the common question. Rather, the plaintiff must identify the *particular* employment practice causing the disparity and show that it caused the disparity through a common mode of acting.[12] Finally, the Court held that the anecdotal evidence, which did not include 90% of the stores and represented only 1 out of every 12,500 proposed class members, failed to show that the entire company operated under a general policy of discrimination.[13]

The Court also rejected Rule 23(b)(2) certification for plaintiffs’ back pay claims. Although a fair reading of Rule 23(b)(2) would preclude its application to a class seeking *any* form of monetary relief, the Court noted it did not need to reach that issue since Rule 23(b)(2) did not include claims for individualized monetary relief. Rule 23(b)(2) is limited to one final, indivisible injunction for the class as a whole, and precluded claims for individualized monetary relief.[14] The history and structure of Rule 23 compelled this holding as it provides for mandatory classes (classes with no notice or opt-out rights) under Rules 23(b)(1) and (b)(2) precisely because these classes have the rule-prescribed characteristics that

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[9] *Id.* at 2553-54.

[10] *Id.* at 2554 (quoting *Watson v. Fort Worth Bank & Trust*, 487 U.S. 977, 990, 108 S.Ct. 2777, 101 L.Ed.2d 827 (1988)).

[11] *Id.*

[12] *Id.* at 2555-56.

[13] *Id.* at 2556.

[14] *Id.* at 2557.

make them unitary and cohesive.[15] The Court thus held claims for individualized monetary relief belong in Rule 23(b)(3), where the procedural protections of predominance, superiority, notice, and opt-out apply.[16]

The Court then rejected the argument that monetary relief in a Rule 23(b)(2) class action is permitted if the injunctive relief "predominated." The Court noted the perverse incentives this would create to limit monetary claims as well as the unworkable nature of such a test in employment discrimination classes, where the class members lose their right to prospective injunctive relief as they leave employment.[17] According to the Court, any individualized monetary relief could not be deemed incidental to injunctive relief. Rather, citing *Teamsters*[18] (which set up a two-phase proceeding for pattern-and-practice cases), the Court held that class analysis must assume defendants will be entitled to litigate their defenses to back pay claims and courts cannot use "trial by formula" or the like to defeat or impair those rights.[19]

Wal-Mart's impact on class issues is analyzed in the following sections of this article. Of note here, a subtle but important point embedded in *Wal-Mart* is its ruling on the substantive law of employment discrimination. Class rulings often have a "law declaring" function, as courts have to decide whether the substantive law permits aggregate proof for the claim at issue.[20] Rule 23(f) exists to facilitate appellate review of class rulings precisely because these rulings may raise important questions of law.[21] *Wal-Mart* illustrated this: to determine whether commonality was met the Court had to decide what the substantive law required. The majority ruled that a policy granting discretion is "a very common and presumptively reasonable way of doing business" and "should itself raise no inference of discriminatory conduct."[22] Proof of disparities from a discretionary practice is not enough, since proof that one or even some supervisors exercised discretion in a discriminatory fashion does not prove others did, particularly when the company's policy prohibits such conduct thus precluding any common answer to the key "why was I disfavored" question.[23] In contrast, the dissent believed that if delegated discretion results in discriminatory outcomes, that

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[15] *Id.* at 2557-58.

[16] *Id.* at 2558-59.

[17] *Id.* at 2559-60.

[18] *Int'l Bhd. of Teamsters v. United States,* 97 S. Ct. 1843 (1977).

[19] *Wal-Mart,* 131 S. Ct. at 2560-61.

[20] Richard A. Nagareda, *Class Certification in the Age of Aggregate Proof,* 84 N.Y.U. L. Rev. 97, 98-108 (2009).

[21] *See Fed. R. Civ. P.* 23(f) advisory committee's note to 1998 amends., subdiv. (f) (discussing use of interlocutory appeals to decide novel or unsettled questions of law). *See also, e.g., Langbecker v. Elec. Data Sys. Corp.,* 476 F.3d 299, 306-07 (5th Cir. 2007) (noting in a rule 23(f) appeal that the court must consider and decide substantive law to the extent it impacts class certification issues).

[22] *Wal-Mart,* 131 S. Ct. at 2554 (internal quotation marks and citation omitted).

[23] *Id.* at 2555-56.

practice is itself actionable under Title VII, and commonality could be met under such circumstances.[24]

Practice Pointers:

- For discrimination claims based on challenges to the exercise of discretionary policies, the substantive rulings in *Wal-Mart* may be just as important as the class rulings.
- Experts will often be critical to class certification. At the beginning of the case consider how to attack plaintiff's experts and what expert proof is needed for defendants.

Comcast and Classwide Proof of Damages

In *Comcast Corp. v. Behrend,*[25] the Court addressed the proof of harm and damages required for Rule 23 class certification. *Comcast* arose out of an antitrust claim based on the notion Comcast had acquired monopolistic power over the Philadelphia. Plaintiffs proffered four theories of antitrust injury that they argued drove up cable subscription rates.[26] The judge found only one of these, the "deterrence of overbuilding" theory, capable of classwide proof, and that the others could not be determined in a manner common to the class.[27] Plaintiffs' economics expert calculated damages by comparing the current market to one without Comcast's alleged anti-competitive activity.[28] Plaintiffs' economic expert admitted that he had *not* isolated the damages resulting from the different theories of antitrust impact.[29]

The Court concluded plaintiffs failed to satisfy Rule 23's requirements. The Court held that regardless whether defendants challenged its admissibility, expert evidence used to prove class certification requirements are met must be persuasive, and must carry plaintiff's burden of proof at the class stage.[30] To this end, the Court found plaintiffs failed to satisfy the predominance requirements of Rule 23(b) (3) because they could not show damages capable of classwide proof.[31] Specifically, the Court held that the damages model must be consistent with the liability model. Any model purporting to serve as evidence of damages in a class action must measure only damages attributable to the classwide theory of

[24] *Id.* at 2565, 2567 (Ginsburg, J., dissenting).

[25] 133 S. Ct. 1426 (2013).

[26] *Id.* at 1430-31.

[27] *Id.* at 1431 & n.3.

[28] *Id.* at 1432.

[29] *Id.*

[30] *Id.* at 1433-35. *See also, e.g.*, *Ellis v. Costco Wholesale Corp.*, 657 F.3d 970, 982 (9th Cir. 2011) (finding that an expert's testimony must be admissible under *Daubert* and persuasive on the class issues under the "rigorous analysis" standard applied to class certification).

[31] *Comcast*, 133 S. Ct. at 1433.

harm.[32] In contrast, the plaintiffs' damages model included the impact of the claims that supported only individualized damages.[33] Thus, plaintiffs proffered no "but for" damages model limited to the class claim—and likewise provided no requisite proof that the claimed damages were *caused* by the classwide wrong.[34]

Justice Ruth Bader Ginsburg's dissent illustrates the importance of *Comcast*. Justice Ginsburg noted that before *Comcast*, courts often held damage issues could be ignored at the class certification stage.[35] Although the dissent argued *Comcast* should be limited to its facts to avoid any change in the law,[36] the majority opinion explicitly stated it was setting forth the "straightforward application of class-certification principles."[37] Notably, the Court vacated a wage-and-hour ruling to be reconsidered in light of its *Comcast* ruling.[38]

Of equal importance, the back-and-forth between the majority and dissent on the expert evidence reveals *Comcast*'s holding as to class proofs. In the view of the dissent, the expert evidence tendered was sufficient for class purposes since it purported to show that Comcast's conduct resulted in higher prices even though it failed to show causation.[39] The majority imposed a far more rigorous standard: plaintiffs must prove the claimed class wrong *caused* the injury classwide, free of taint from individual factors. Absent such proof, plaintiffs cannot satisfy Rule 23's requirements that common issues predominate for class claims seeking damages.[40]

Comcast has obvious import to labor and employment cases, and for certain claims in ERISA cases. For example, on discrimination claims, *Comcast* should directly bar use of bottom-line statistics to prove class damages. *Comcast* further supports the notion that such statistics cannot be used to show a class claim of liability since liability and damages must sync up to satisfy Rule 23. In ERISA cases, disclosure and investment claims may raise *Comcast* issues on whether there is classwide proof of damages. Finally, as discussed in Part II of this article, defendants are applying *Comcast* in wage-and-hour claims to defeat or limit class on issues such as whether eligibility for overtime can be determined classwide, and to determine whether there is a classwide method to prove damages.

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[32] *Id.*

[33] *Id.* at 1433-34.

[34] *Id*. at 1433-35.

[35] *Id.* at 1437 (Ginsburg, J., dissenting).

[36] *Id.*

[37] *Id.* at 1433.

[38] *See Ross v. RBS Citizens, N.A.,* 667 F.3d 900 (7th Cir. 2012), vacated, 133 S. Ct. 1722 (2013) (vacating and remanding in light of Comcast).

[39] *Id.* at 1441.

[40] *Id.* at 1433-35.

Practice Pointers:

> *Comcast* supports that there cannot be a class certified unless plaintiffs can prove a classwide theory of harm, uninfected by individual issues. In discrimination claims challenging complex decisions or actions, *e.g.,* multistep hiring procedures or compensation claims, this may be difficult for plaintiffs to do. The same analysis may apply in ERISA disclosure or investment claims.

> *Comcast* provides grounds to attack economic experts' class analysis since (i) it held that what those models prove are not "questions of fact," and (ii) those models must show the asserted class claim caused the harm or disparities across the proposed class.

> In wage-and-hour cases, anything that would make classwide liability or damages non-mechanical are possible grounds to defeat class certification, *e.g.,* whether each person's actual job duties qualify for overtime and whether actual time worked can be calculated without individualized inquiries.

Commonality After *Wal-Mart*

Commonality and Discrimination Claims Challenging Discretionary Conduct

In *Wal-Mart* the Court noted that an employer's policy of granting discretion to supervisors is "a very common and presumptively reasonable way of doing business" and "should itself raise no inference of discriminatory conduct."[41] Moreover, the mere existence of disparities from a discretionary practice is not enough for class certification since proof that one or some supervisors exercised that discretion in a discriminatory fashion does not prove that others did-particularly when company policy prohibits such conduct.[42] For example, in *Wal-Mart,* regional and national disparities could not demonstrate the uniform store-by-store disparity required for a claim premised on discriminatory decision making by store-level managers.[43] Prior decisions of the Supreme Court, notably *Watson v. Fort Worth Bank & Trust*[44] and *Wards Cove Packing Co., Inc. v. Atonio,*[45] require that a plaintiff identify the specific employment practice causing the disparity. *Wal-Mart* recognized this rule when it found reliance on bottom-line disparities arising out of a discretionary system insufficient,[46] a point further buttressed by *Comcast.*

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[41] *Wal-Mart,* 131 S. Ct. at 2554.

[42] *Id.* at 2554-56. *see also, e.g., Bolden v. Walsh Constr. Co.,* 688 F.3d 893, 896-97 (7th Cir. 2012) (applying same to decertify discrimination class).

[43] 131 S. Ct. at 2554-56.

[44] 108 S. Ct. 2777 (1988).

[45] 109 S. Ct. 2115 (1989).

[46] *Wal-Mart,* 131 S. Ct. at 2555-56.

Wal-Mart thus clarifies the difference, from a class perspective, between a policy that grants discretion to individual managers, which plaintiffs claim is implemented in a discriminatory way, and a policy (such as a test) that itself has a disparate impact. In the case of the discretionary policy, the class claim must focus on the implementation, not the overarching lawful policy of granting discretion. But when the claim is that a test causes disparate impact without business justification, the claim is based on the test itself, and whether it is being used in an unlawful manner.[47] Notably, even before *Wal-Mart,* many courts recognized that employment discrimination claims that depend on managerial discretion (even when exercised in the context of common policies) are not proper for class certification.[48]

In contrast, in *McReynolds v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,*[49] the Seventh Circuit held post-*Wal-Mart* that an otherwise lawful policy permitting discretion can be the basis for a class claim if the policy "influences" the managers' exercise of discretion in a discriminatory manner. *McReynolds'* "influences" theory arguably contradicts *Wal-Mart*'s pronouncement that the alleged discriminatory act is the exercise of discretion and not the otherwise lawful policies that typically bound and channel—and thus "influence"—that discretion. *Wal-Mart* further held that (at least absent compelling proofs) a court cannot presume discretion by the individual actors is exercised in a common and discriminatory manner, particularly when the corporate policy is to the contrary.[50]

McReynolds appears to be developing into an outlier. For an excellent illustration of *Wal-Mart*'s limitations on class claims when discretion is involved see *Tabor v. Hilti Inc.*,[51] in which the Tenth Circuit considered sex discrimination challenges to the promotion of inside sales representatives to account managers. The defendant had a facially neutral policy with some objective criteria but also allowed managers substantial discretion in employee evaluation.[52] Records showed managers used their discretion to constantly override the objective criteria.[53] Plaintiffs claimed the managers exercised their discretion in a way that

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[47] Thus, testing cases can be distinguished based on the unique characteristics of the claim. *See, e.g., Gulino v. Bd. of Educ. of City Sch. Dist. of City of New York,* 907 F. Supp. 2d. 492, 505-09 (S.D.N.Y. 2012) (using Rule 23(c)(4) to certify a class of teachers for declaratory and injunctive relief in a discriminatory impact testing claim).

[48] *See, e.g., Gaston v. Exelon Corp.,* 247 F.R.D. 75, 87 (E.D. Pa. 2007) (holding that certification pursuant to Rule 23(b)(2) would be inappropriate in this case involving facially neutral practices because "this case, in very large measure, turn[ed] on the individual determinations of autonomous managers rather than on common questions of fact and law").

[49] 672 F.3d 482, 490 (7th Cir. 2012), *cert. denied*, 133 S. Ct. 338 (2012).

[50] *See, e.g.*, *Bolden v. Walsh Constr. Co.*, 688 F.3d 893, 896-97 (7th Cir. 2012) (applying same to decertify discrimination class); *Bell v. Lockheed Martin Corp.*, No. 08-6292 (RBK/AMD), 2011 WL 6256978, at *6-7 (D.N.J. Dec. 14, 2011) (applying *Wal-Mart* to conclude that there was no class based on objective policies that gave managers discretion within certain boundaries).

[51] 703 F.3d 1206, 1211 (10th Cir. 2013).

[52] *Id.* at 1212.

[53] *Id*.

favored males; plaintiffs also had anecdotal evidence that males were favored in promotions.[54]

The Tenth Circuit found that only one of the plaintiffs raised a triable issue of intentional discrimination and disparate impact.[55] On the disparate impact claim, the court found that in light of the discretionary nature of the policy and, in particular the consistent promotion of unqualified candidates under the policy, the statistics showing stark "bottom line" disparities between male and female sales representatives was sufficient to identify the employment practice—management discretion—and make out the claim.[56] However, the court agreed this was *not* a class claim.[57] Referring to *Wal-Mart*, the court noted that considerations on the validity of a disparate impact claim is different from the considerations of whether it is a proper class claim—namely, uniformity.[58] The court also held that there was no commonality regarding promotions under such a haphazard policy, as illustrated by the two named plaintiffs.[59] One appeared qualified and had a valid claim but the other was subject to numerous defenses based on poor performance.[60] Also, there was no predominance under Rule 23(b) (3) because a court would have to look at the individual circumstances and defenses tendered as to both claims.[61]

The Third Circuit came to a similar conclusion in a race discrimination claim involving discretionary decisions.[62] And following in the footsteps of *Wal-Mart* and *Tabor*, the Sixth Circuit also recently denied class certification in a gender discrimination case.[63] In *Davis*, the plaintiff was twice denied employment as a sales representative.[64] She alleged that the defendant's hiring practices were discriminatory and moved for class certification.[65] While the defendant had a well-defined companywide hiring policy, local managers made the final hiring decisions based on the needs of the individual location.[66] The Sixth Circuit noted that "bottom line" hiring disparities did not prove that there was a common

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[54] *Id.* at 1212-13.

[55] *Id.* at 1216-26.

[56] *Id.* at 1219-26.

[57] *Id.* at 1230.

[58] *Id.* at 1222.

[59] *Id.* at 1229-30.

[60] *Id.*

[61] *Id.*

[62] *See Rodriguez v. National City Bank* F3d, 2013 WL 4046385 at *8 to *111 (3d Cir. Aug. 12, 2013) (applying *Wal-Mart* to refuse to certify a class challenging discretionary mortgage charges applied in an alleged discriminatory fashion to minorities).

[63] *Davis v. Cintas Corp.,* 717 F.3d 476, 479-80 (6th Cir. 2013).

[64] *Id.* at 479.

[65] *Id.*

[66] *Id.* at 480-81.

question because the disparities did not demonstrate the existence of a uniform companywide exercise of discretion in a way that favored men over women.[67] Tellingly, there were also disparities between offices, with some underhiring and some overhiring women during the class period.[68] Citing *Wal-Mart* extensively, the Sixth Circuit affirmed the district court's determination that the class could not be certified pursuant to Rule 23(a)(2) because the plaintiff could not show that the proposed class of women "who failed to obtain employment at many places, over a long time, under a largely subjective hiring system, shared a common question of law or fact."[69] As in *Wal-Mart,* the Sixth Circuit also denied certification pursuant to Rule 23(b)(2) because the requested individualized monetary relief was not incidental to the injunctive and declaratory relief sought.[70]

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[67] *Id.* at 487-88.

[68] *Id.*

[69] *Id.* at 487-89. *See also In re Countrywide Fin. Corp. Lending Practices Litig.,* 708 F.3d 704, 706, 708-10 (6th Cir. 2013) (holding that there was no commonality even though there were bottom-line statistics showing minority borrowers paid more than white borrowers).

[70] *Davis, 717* F.3d at 490-91.

Practice Pointers:

> Demonstrate that your client has a facially neutral policy that is communicated to supervisors and managers. Evidence on monitoring and enforcement of that policy may also be helpful.

> Show business reasons for the challenged policy and that, under *Wal-Mart,* a policy of granting discretion is not inherently suspect, and is not sufficient to show a common mode of acting for class certification.

> Show that any discretion is exercised in the context of anti-discrimination policies and that discretion exercised in a discriminatory fashion is prohibited and punishable.

> Attack plaintiffs' use of statistics that do not match the decisional unit, *e.g.,* use of regional or national statistics when the decisions are made at the store level like in *Wal-Mart.*

> Consider putting on affirmative proof of statistics and anecdotes to rebut any claims that there was a common mode of exercising the challenged discretion in a discriminatory fashion.

> Consider using *Comcast* to show how individual choices defeat any classwide proof of damages, and break the required connection between the class liability and class damages theories.

Commonality and Claims Challenging ERISA Disclosures

Commonality issues can arise in many contexts in ERISA cases, including even on claims involving plan terms.[71] ERISA disclosure claims often raise issues of reliance and causation and, at a minimum, they can raise issues as to whether there is a common answer to the questions of what each participant knew, whether he was misled, and on what he relied. As Professor Nagareda notes in his seminal article relied on in *Wal-Mart,* even claims predicated on common and single classwide misrepresentation do not necessarily prove classwide reliance; in addition to issues of whether each proposed class member actually read the claimed misrepresentation, there are, absent compelling facts, typically individualized issues on whether and why each proposed class member acted.[72] These are the types of dissimilarities that can defeat class certification for disclosure claims.[73] In ERISA cases there are also often multiple representations, individual and group, over the proposed class period that individually and

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[71] *See, e.g., Lipstein v. United Health Group,* 2013 U.S Dist. LEXIS 138045 at *15 to *33 (Sept. 26, 2013) (applying *Wal-Mart* to conclude there was no commonality for a proposed class of plans challenging how Medicare offsets were calculated; plans had different language on the issue and different standards of review).

[72] *E.g.*, *Poulos v. Caesars World, Inc.*, 379 F.3d 654, 667-68 (9th Cir. 2004) (noting cannot assume classwide reliance unless it is the only common sense or logical behavior of the class in response to the claimed misrepresentation, and that in the case at issue people gambled for a myriad of reasons and motivations).

[73] Richard A. Nagareda, *Class Certification in the Age of Aggregate Proof*, 84 N.Y.U. L. Rev. 97, 131-32 (2009).

collectively call into question what each participant knew and upon what he relied. Thus if, for example, a participant understood the matter at issue, he cannot prove a material misrepresentation for purposes of sustaining a claim for fiduciary breach.[74]

Consistent with *Wal-Mart*, courts have declined to certify class actions in ERISA communication suits when individualized issues regarding the class member knowledge and understanding impact the outcome of the underlying legal issues.[75] Likewise, causation and reliance cannot be presumed classwide in ERISA cases, at least absent unusual and compelling circumstances.[76] Plaintiffs sometimes argue their cases raise compelling circumstances warranting a form of presumed reliance, or that their case fits within the *Affiliated Ute* presumption of reliance for omissions.[77] But as a court recently held in *Bacon v. Stiefel Labs., Inc.*,[78] such forms of presumed reliance are unlikely to apply in ERISA contexts, as the reasons why participants make decisions on benefits (in that case selling their shares back to an ESOP) are typically complex and often individualized. Similarly, the Court, in *Cigna Corp. v. Amara*, rejected a form of presumed reliance (*i.e.*, assumptions of "likely prejudice") for claims based on defective

[74] *See Bell v. Pfizer, Inc.*, 626 F.3d 66, 75-76 (2d Cir. 2010) (holding there is "no sustainable claim," in an ERISA disclosure case, if the participant was not misled); *Ballone v. Eastman Kodak Co.*, 109 F.3d 117, 125 (2d Cir. 1997) (explaining that materiality of ERISA misrepresentations is "fact-specific and will turn on a number of factors" including what each employee knew and understood).

[75] *See Groussman v. Motorola, Inc.*, No. 10 C 911 (N.D. Ill. Nov. 15, 2011) (denying ERISA disclosure class for lack of commonality, typicality, and adequacy due to "difference[s] as to what each Plaintiff understood … and … rel[ied] upon"); *Carr v. Int'l Game Tech.,* Nos. 3:09- cv-00584, 0585 (D. Nev. Mar. 16, 2012) (holding no typicality due to individualized issues of reliance on alleged misrepresentations and defenses).

[76] *E.g.*, *Walsh v. Principal Life Ins. Co.*, 266 F.R.D. 232, 259-60 (S.D. Iowa 2010) (no proof common letters drove 401(k) roll-over decisions, and the evidence offered for each individual plan participant regarding their reliance on the letters and any misrepresentations and omissions that continued through the phone calls differs, strongly suggesting that the Court would have to engage in extensive individualized inquiries regarding causation if this case proceeded as a class action); *Heffner v. Blue Cross & Blue Shield of Ala., Inc.*, 443 F.3d 1330, 1344-45 (11th Cir. 2006) (holding that class certification was inappropriate because the ERISA breach of fiduciary duty claim would require each class member to show that he or she relied on the "no deductible" term when purchasing their prescription drugs).

[77] *See, e.g.*, *Rogers v. Baxter Int'l, Inc.*, 521 F.3d 702, 705 (7th Cir. 2008) (Easterbrook, J) (cautioning plaintiffs not to conflate securities and ERISA litigation; declining to apply *Affiliated Ute* presumption); *Heffner v. Blue Cross & Blue Shield of Ala., Inc.*, 443 F.3d 1330, 1344-45 (11th Cir. 2006) (noting importance of proof of individualized reliance when pleading classwide claim of misrepresentation and therefore not allowing for *Affiliated Ute*'s presumed reliance); *Kenney v. State Street Corp.*, No. 09-10750-DJC (D. Mass. Sept. 15, 2011) (considering *Amara* and rejecting the import of a presumed reliance theory from securities litigation); *Stanford v. Foamex L.P.*, No. 07-4225 (E.D. Pa. Aug. 20, 2008) (rejection of presumed reliance); *In re Elec. Data Sys. Corp. "ERISA" Litig.*, 224 F.R.D. 613 (E.D. Tex. Nov. 8, 2004), *vacated on other grounds sub nom. Langbecker v. Elec. Data Sys. Corp.*, 476 F.3d 299 (5th Cir. 2007) (rejecting the "fraud on the market" theory and presumed reliance and holding that reliance must be established). *But see Harris v. Amgen, Inc.*, 717 F.3d 1042, 1058-59 (9th Cir. 2013) ("We see no reason why ERISA plan participants who invested in a Company Stock Fund whose assets consisted solely of publicly traded common stock should not be able to rely on the fraud-on-the-market theory in the same manner as any other investor in publicly traded stock.").

[78] 275 F.R.D. 681, 698-99 (S.D. Fla. 2011).

SPDs, and instead required proof of actual harm and causation to warrant monetary relief.[79]

Thus, the absence of common answers to the questions of knowledge or reliance often means there is no common answer to key questions such as "was I misled" or "did I rely" or "was I harmed." These dissimilarities should typically defeat class certification.

Practice Pointers:

> For ERISA disclosure claims, one key way to defeat class certification is to focus on the dissimilarities, since often there will be multiple "plan wide" and individual communications at issue.

> Anecdotal and documentary evidence of different communications and of different understandings or choices help to show dissimilarities.

> Expert evidence, including statistical evidence, can often show there is no factual basis to assume classwide reliance, common actions, or common harms.

Typicality and the Importance of Considering the Impact of Defenses on Class Claims

Commonality is a meaningful and appropriate focus of many class claims and issues in the *post-Wal-Mart* landscape. However, even when some claims have at least one major common issue and common answer, typicality may be a material issue because defenses, or the varying circumstances of the named plaintiffs and class members, make the claims atypical of each other. Of import here, *Wal-Mart* held that the class analysis must assume that defendants will be entitled to litigate their defenses, and that plaintiffs cannot use "trial by formula" or similar assumptions to impair those rights.[80]

Thus, if the facts show that the named female plaintiffs have better pay than average males in the same office, these facts can create unique defenses that make their claims atypical of the class and them inadequate class representatives.[81] Likewise, weaknesses in plaintiffs performance or claims can defeat typicality.[82] Accordingly, analysis of named plaintiffs' claims may show that success or failure of the claims depends on facts unique to the named plaintiffs,

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[79] 131 S. Ct. 1866, 1880-82 (2011).

[80] *Wal-Mart,* 131 S. Ct. at 2560-61.

[81] *Cf., e.g., Randall v. Rolls-Royce Corp.,* 637 F.3d 818, 823-24 (7th Cir. 2011) (noting that named plaintiffs' pay in several years exceeded that of men and that such unique defenses made them inadequate class representatives and their claims atypical of the class).

[82] *E.g., Drake v. Morgan Stanley & Co., Inc.,* No. CV 09-6467 ODW (RCx)(C.D. Cal. Apr. 30, 2010) (holding, in state law wage claim for financial assistants at Morgan Stanley, that named plaintiffs' claims were atypical and they were inadequate representatives because they were subject to unique defenses on performance issues and counterclaims for expenses due).

raising issues of commonality, typicality, and adequacy.[83] Further, individualized issues with respect to defendants' affirmative defenses, such as the statute of limitations defense, can preclude a finding of commonality and typicality.[84] Contractual agreements, such as releases or agreements to arbitrate, can bar named plaintiffs from pursuing their claims, and make their claims atypical of the class.[85]

Practice Pointers:

> Affirmative defenses (*e.g.*, statute of limitations, releases, arbitration) can defeat typicality or limit classes.

> Defects or weaknesses in the merits of plaintiff's claims can also be grounds to defeat typicality. If this is the case, it may be better to put off class certification until summary judgment motions are filed so that the court will have the factual record needed, such as in *Tabor.*

Adequacy and Class Conflicts

Wal-Mart's discussion of the "predominance" test, and how the test created perverse incentives for named plaintiffs to forgo monetary claims of absent class members, illustrates the type of conflicts that often lurk in class actions.[86] Manipulating a class to exclude these claims of absent class members may confirm – not absolve – the conflict.[87] Further, under Rule 23(a)(4), a plaintiff cannot adequately represent a class if there are conflicting interests with or among the proposed class members. For example, factual investigation or expert analysis may show a substantial number of class members benefitted from the challenged policies or practices. As discussed in Part II of this article, conflicts can arise over prospective relief, particularly if some of the absent class members are benefitting from the policy or practice at issue. Conflicts can also arise because the claims of different groups are of different relative strengths.

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[83] *E.g., Tabor v. Hilti, Inc.* 703 F.3d 1206, 1229 (10th Cir. 2013) (finding commonality requirement not met when courts have to look at circumstances of individual claims-the two named plaintiffs illustrated this because one had a much weaker claim).

[84] *See Novella v Westchester Cnty.,* 661 F.3d 128, 148-49 (2d Cir. 2011) (noting statute of limitations defense often precludes certification of an ERISA class); *In re Unisys Corp. Retiree Med. Benefits Litig.,* No. 969 (E.D. Pa. Feb. 4, 2003) (decertifying class for ERISA fiduciary breach claim based on misrepresentations because statute of limitations defense would require "myriad of individual determinations").

[85] The Supreme Court's embrace and enforcement of arbitration agreements may make them more common in the employment context. *See, e.g., Am. Express Co. v. Italian Colors Rest.,* 133 S. Ct. 2304 (2013) (holding that arbitration agreements can bar class arbitration even if a party cannot effectively vindicate his federal rights absent a class action).

[86] *See Wal-Mart*, 131 S. Ct. at 2559-60.

[87] *See, e.g., Beyond Knowles: Fairness to Absent Class Members and the Manipulation of Class Action Claims*, BNA Class Action Litig. Rep. (Sept. 13, 2013) (discussing conflicts brought about by claims splitting); *see also* discussion in forthcoming Part II discussing claims splitting issues arising from hybrid or issue certification.

Thus, at a minimum, subclasses may need to be created to represent and protect the interests of each discrete group.[88]

Further, it is a core requirement of Rule 23 and due process (albeit sometimes forgotten) that absent class members are entitled to have named plaintiff and putative class lawyers not make arguments—or take positions or bring claims—that conflict with the absent class members' interests.[89] Thus, no class should be certified when the proposed class members have different financial interests as to the claims or the relief sought, or where some of the proposed class members benefit from the very program or practice the plaintiffs are challenging.[90] For example, conflicts can arise in the labor and employment area over the proposed goals and remedies sought in the litigation.[91] These conflicts can arise in ERISA cases over, *e.g.*, whether the litigation may be harming current participants' investments in an ESOP,[92] or where there are different interests as to who benefitted and who lost, or over who may want to keep the challenged investments.[93]

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[88] *E.g.*, *In re Literary Works Copyright Litig.*, 654 F.3d 242, 249-52 (2d Cir. 2011) (creating subclasses to represent each group because of differences in relative strengths of claims).

[89] *E.g.*, *Langbecker v. Elec. Data Sys. Corp.*, 476 F.3d 299, 317-18 (5th Cir. 2007) (holding intra-class conflict negated adequacy under Rule 23(a)(4)); *Cent. States Se. & Sw. Areas Health & Welfare Fund v. Merck-Medco Managed Care, L.L.C.*, 504 F.3d 229, 246 (2d Cir. 2007) (finding antagonistic interests and refusing to certify the class where the interests of the class representatives would not advance the interests of class members who participated in self-funded ERISA plan).

[90] *E.g.*, *Langbecker*, 476 F.3d at 317-18 .

[91] *See Gilpin v. Am. Fed'n of State, County, & Mun. Employees, AFL-CIO*, 875 F.2d 1310, 1313 (7th Cir. 1989) (affirming decision to refuse certification when different groups of employees had differing interests as to the remedies to be sought from a union); *United Indep. Flight Officers v. United Air Lines*, 756 F.2d 1274, 1284 (7th Cir. 1985) (affirming refusal to certify class when members had divergent and antagonistic interests regarding the goals of the lawsuit and benefits sought).

[92] *See, e.g.*, *Hans v. Tharaldson*, No. 3:05-cv-115, 2010 WL 1856267, at *6-8 (D.N.D. May 7, 2010), *amended by* 2010 WL 4723008 (D.N.D. Aug. 27, 2010).

[93] *See, e.g.*, *Langbecker*, 476 F.3d at 316 n.28, 318 (stating "[a] few class members cannot hijack litigation 'on behalf of the plan' to pursue their preference at the expense of others," and holding plan claims could not proceed without class procedural safeguards in light of the class conflicts); *Spano v. The Boeing Co.*, 633 F.3d 574, 586-87 (7th Cir. 2011) (named plaintiffs did not satisfy adequacy of representation requirement in action claiming fiduciaries caused plan to pay excessive fees and maintained imprudent investment options, where many members of proposed class had no complaint about investment options offered by employer, in light of dates when they first invested and date when they exited, and would be harmed by the relief sought by named plaintiffs); *cf. Abbott v. Lockheed Martin Corp.*, __ F. 3d __, 2013 WL 4010226 at *9 to *10 (7th Cir. Aug. 7, 2013) (narrowing a prudent investment class to those in stable value fund that underperformed against benchmark should sufficiently limit or eliminate intra-class conflicts).

Practice Pointers:

> Investigate whether there are any tensions or conflicts between what plaintiffs want and the interests of the various class members. It is not unusual for plaintiffs to challenge policies or practices that benefit a large number of class members.

> Conflicts are more likely to arise when plaintiffs plead broad classes or try to include in one class those that may have differing interests, such as former versus current employees.

> Experts can be very useful to develop data showing class conflicts, such as members who benefitted from challenged policies or practices.

Rulings, Filings, and Settlements of Interest

Agencies Release Guidance on HRAs, FSAs, and Employer Payment Plans

By James Napoli and Stacy Barrow

> On Friday, September 13, 2013, the IRS released Notice 2013-54 and the DOL issued Technical Release 2013-03 in substantially identical form. This guidance, which is generally effective January 1, 2014, provides much needed clarification on the application of certain provisions of the Patient Protection and Affordable Care Act ("ACA") (annual limits and preventive care) to account-based plans such as HRAs and FSAs, and other types of arrangements that reimburse premiums (referred to in the guidance as "Employer Payment Plans").

The guidance indicates that the agencies are generally viewing HRAs, FSAs, and Employer Payment Plans as group health plans for purposes of ACA. This means that these arrangements will qualify as "minimum essential coverage" for covered employees (i.e., they will preclude employees from receiving a premium credit), unless they are "excepted benefits" under HIPAA. This also means that these arrangements will need to comply with ACA's annual dollar limit prohibition and preventive care requirements, unless they are integrated with a compliant group health plan (or are excepted benefits).

The guidance confirms that "retiree-only" HRAs continue to be excepted benefits (and therefore exempt from the annual dollar limit prohibition and preventive care rules). Health FSAs, on the other hand, are excepted benefits only if the employer also makes available group health plan coverage that is not limited to excepted benefits and the health FSA is structured so that the maximum benefit payable to any participant cannot exceed 2x the participant's salary reduction election for the FSA for the year (or, if greater, $500 plus the amount of the participant's salary reduction election).

Moreover, the guidance makes clear that an FSA that is otherwise an excepted benefit must be offered through a Section 125 cafeteria plan in order to be exempted from the annual dollar limit prohibition.

The guidance also provides that, at least through 2014, coverage under an employee assistance program (EAP) will be considered an “excepted benefit” as long as the EAP does not provide significant treatment in the nature of medical care or treatment. For this purpose, employers may use a reasonable, good faith interpretation of whether an EAP provides significant benefits in the nature of medical care or treatment.

The guidance permits employers to offer employees the choice of taxable compensation (cash) or an after tax payment to be applied to health coverage. Employers may establish a payroll practice of forwarding employee contributions to an insurance carrier without the arrangement being considered a group health plan; however, the arrangement generally must comply with the rules for “voluntary” plans under ERISA, with one such requirement being that the employees pay 100% of the cost of the coverage. These rules generally eliminate tax preferences for employers that wish to reimburse employees for the cost of individual health insurance policies.[94]

The guidance provides clarification on a number of other issues, including when an HRA will be considered “integrated” with a group health plan for purposes of satisfying the annual dollar limit prohibition and preventive care requirements. One of the requirements to be an “integrated” HRA is that participants must have the ability to opt-out of the HRA on an annual basis. This is because the benefits provided by the HRA generally will constitute minimum essential coverage, which will preclude the individual from claiming a premium tax credit. The guidance further clarifies that a retiree covered by a standalone HRA for any month will not be eligible for a premium tax credit to purchase subsidized coverage through a Marketplace.

Notably, the guidance provides that a group health plan, including an HRA, will not be considered “integrated” with an individual health insurance policy for purposes of satisfying ACA’s annual dollar limit prohibition or preventive care rules. This means that employers will not be permitted to reimburse employees for the cost of individual insurance premiums on a non-taxable basis. In other words, if the HRA reimburses individual insurance policies, employers may not use the so-called “defined contribution” model, under which they would provide employees a tax-free pool of funds to use for the purchase of individual health insurance policies in the Marketplace or directly from a carrier.

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[94] However, some ambiguity remains – the rules for integrated HRAs seem to indicate that as long as an HRA is integrated with a group health plan, it may reimburse any medical expenses under Section 213(d) of the Internal Revenue Code, which would include individual insurance premiums. This seems in contrast to the general principles of the guidance; perhaps there will be a technical correction in the future that clarifies the application of this rule.

This latest guidance has widespread implications for employers and plan sponsors. Employers should carefully consider these rules as they design their employee benefit plans for 2014.

Court Says ERISA Plan Custodian Had to Comply with State Order Attaching Plan Assets

By Todd Castleton

> A recent decision by the 7th U.S. Circuit Court of Appeals serves as a reminder to plan custodians that they cannot assume that federal law will always trump state law when it comes to assignment of plan assets. In *Johnson vs. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 719 F.3d 601 (7th Cir. 2013), the court held that Merrill Lynch, as a custodian holding ERISA plan assets, had "no choice" but to comply with a state court order freezing payment of plan benefits and it dismissed a federal suit brought by the plan's administrator seeking to block the state court action.

ERISA's anti-alienation provision generally prohibits qualified retirement plan participants from assigning or otherwise encumbering their benefit proceeds from the plan. Although there are exceptions to this rule, it generally prohibits state courts from garnishing or attaching a participant's retirement benefits to satisfy state court judgments. This general prohibition, however, does not always stop state courts from issuing orders anyway that hinder a plan from complying with both the anti-alienation statute and the plan's anti-alienation provisions.

These state court orders can cause real problems for plan sponsors, trustees and custodians who become faced with a difficult choice of either violating the state court order and risking contempt- of- court sanctions, or complying with the garnishment order and thereby violating ERISA and the plan document — at the risk of disqualifying the plan for preferential tax treatment.

The 7th Circuit Court's ruling should provide some comfort to plans that decide not to ignore state court orders alienating ERISA-plan benefits, even if those orders are contrary to ERISA's anti-alienation provision. Even so, the ruling does not absolve a plan of all responsibility to fight such a court order and attempt to meet ERISA's and the plan's anti-alienation provisions. IRS still could attempt to disqualify a plan if the administrator fails to follow the plan's provisions, even though a federal court lacks jurisdiction in a civil suit. It is important, therefore, to contact plan counsel to help navigate through these decisions, because a plan can neither simply follow, nor simply ignore, state court orders.

Electronic Self-Certification for Hardship Distributions May Be Insufficient, IRS Says

By Todd Castleton

> The IRS recently has reminded plan sponsors to verify and document that hardship distributions comply with their plan document and the law, according to a recent posting by IRS Director of Employee Plans Examinations Monika Templeman on the IRS website, "Examination Tips for Hardship Distributions." In some cases, allowing participants to apply for loans or hardship withdrawals online may not allow the plan sponsor adequate opportunity to verify and document the reason the participant is seeking this emergency funding.

Many 401(k) plans allow participants to take distributions from their accounts in the case of a hardship, but the plan document must provide for hardship distributions and describe the circumstances under which hardship distributions will be allowed.

The IRS posting emphasized, however, that the plan sponsor must verify that the participant meets the eligibility criteria for hardship distributions specified in the plan document and maintain records establishing this eligibility, including proof that the participant has exhausted other permissible plan distribution options, such as loans. Plan sponsors that rely on third-party recordkeepers should check with their vendors to ensure that the appropriate documentation is being collected from the participant and retained for plan audit purposes.

Supreme Court to Decide Whether RIF-Related Severance Pay Is Subject to FICA

By Elizabeth M. Mills and Robert Projansky

> Although some would argue that the next U.S. Supreme Court term is not shaping up to be as monumental as the last term, employers should have their eye on the recent decision of the Court to hear United States v. Quality Stores, Inc. The Court's decision in this case in the next term will finally put to rest the question of whether severance payments made to former employees pursuant to an involuntary reduction in force are wages for the purposes of Social Security and Medicare withholding under FICA.

By way of background, just over a year ago, the Sixth Circuit held in this case that severance payments were not wages for this purpose. This was significant because it created a Circuit Court split on this issue. In 2008, the Federal Circuit reached the precise opposite decision in CSX Corp. v. United States. This has become a particularly relevant issue, given the increase in workforce reductions over the past several years. A more detailed discussion of the impact of the Sixth Circuit's decision can be found here.

While we continue to believe it is prudent for employers to continue to withhold FICA taxes on severance pay in the context of involuntary terminations in most cases, the Supreme Court's decision to hear this case is a reminder for employers to consider filing protective refund claims to preserve their rights and prevent the statute of limitations expiring on tax refund claims for still open years. The deadline for filing a protective claim is three years from April 15 of the calendar year following the year in which a payment was made. Thus, April 15, 2014 is the deadline for filing a protective claim for 2010.

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Additional Post-Windsor Guidance – IRS Releases Optional Streamlined Procedures for Employers to Make Claims for Refunds or Adjustment of Overpaid Employment Taxes on the Value of Benefits Provided to Employees' Same-Sex Spouses

By Tzvia Feiertag, Thelma Ofori and Abraham Gutwein

> Continuing its implementation of the United States Supreme Court decision in *U.S. v. Windsor*, the Internal Revenue Service (IRS) recently issued Notice 2013-61, which provides guidance for employers to make claims for refunds or adjustments of overpayments of Federal Insurance Contributions Act (FICA) and Federal income tax withholding (employment taxes) for 2013 and prior years with respect to certain fringe benefits and remuneration provided to same-sex spouses of employees.

In Revenue Ruling 2013-17 issued in August, the IRS announced that effective September 16, 2013, for Federal tax purposes, it would recognize same-sex marriages and was adopting a "place of celebration" rule pursuant to which all same-sex couples married in a state or foreign jurisdiction permitting such marriages would be recognized as spouses for federal tax purposes, regardless of their state of residence. It also announced that it intended to distribute streamlined procedures for employees who wish to claim refunds for federal income taxes paid on the value of health coverage to same-sex spouses and guidance for employers who wish to claim refunds for payroll taxes paid on such benefits.

Notice 2013-61 provides these special streamlined administrative procedures. Under these procedures, if an employer that withheld employment taxes for same-sex spouse benefits paid to or on behalf of an employee in the third quarter of 2013 ascertains the amount withheld on those benefits and repays or reimburses the employee for these amounts before filing the third quarter Form 941 (Employer's Quarterly Federal Tax Return) due on October 31, 2013, an employer need not report these wages and withholding on the third quarter Form 941. If an employer does not repay or reimburse the employee for the overcollected amount before it files the third quarter 2013 Form 941, an employer must report the amount of the overcollection on that return and can use one of two special administrative procedures to make an adjustment or claim a refund.

First Special Administrative Procedure for 2013

Under the first alternative special administrative procedure, an employer must repay or reimburse its employees for the amount of the overcollected FICA and income tax withholding for the same-sex spouse benefits for the first three quarters of 2013 on or before December 31, 2013, and then, on its fourth quarter 2013 Form 941, it may reduce the fourth quarter wages, tips, and other compensation on line 2, taxable Social Security wages on line 5a (subject to the wage base limitation for the year), and taxable Medicare wages and tips on line 5c, by the amount of the same-sex spouse benefits treated as wages for the first three quarters of 2013. The amount of overcollected FICA and income tax that is repaid or reimbursed for the first three quarters of 2013 will also reduce the amounts shown as tax withheld on the Form 941. Same-sex spouse benefits not includable in wages or subject to withholding for the fourth quarter of 2013 would not be included in wages or withheld upon in the first instance.

Second Special Administrative Procedure for 2013

Alternatively, employers may correct overpayments of the FICA taxes with respect to same-sex spouse benefits paid in all quarters of 2013 by filing Form 941-X provided that the employer satisfies the usual requirements for filing Form 941-X. These requirements include filing Form W-2c (if applicable), repaying or reimbursing the overcollected employee FICA tax to employees (or, for refund claims, securing consents from employees), and obtaining the required written statements from employees. If employing this correction method, the employer must write “WINDSOR” in dark, bold letters across the top margin of page 1 of the Form 941-X.

Special Administrative Procedure for Years Before 2013

Notice 2013-61 also provides procedures employers should follow for overpaid FICA taxes paid on same-sex spouse benefits for pre-2013 years for which the statute of limitations has not expired. Under this procedure, an employer may file one Form 941-X for the fourth quarter for the prior year that would include the adjustments or refunds for all overpayments of employer and employee FICA taxes for same-sex spouse benefits provided during that prior period, including overpayments reflected in the Form 941 for the first three quarters. The employer should write “WINDSOR” in dark, bold letters across the top margin of page 1 of Form 941-X. This special administrative method also is subject to the normal requirements that apply to correcting overpayments in earlier years, including the filing of Forms W-2c, *Corrected Wage and Tax Statement*, repaying or reimbursing employees, and obtaining the required written statements (and consents) from employees.

The IRS also confirmed that for pre-2013 calendar years, employers may not refund federal income taxes withheld from employees' wages. However, for "open" years (generally, tax years 2010 to 2012), employees may receive refunds of income tax paid with respect to same-sex spouse benefits by filing a Form 1040X.

All of these alternative special procedures are voluntary and employers who prefer to use the regular procedures for correcting employment tax overpayments related to same-sex spouse benefits may do so.

Notice 2013-61 addresses claims for refunds or credits for federal tax purposes only. Where income was imputed under state tax law for same-sex spouse benefits, employers and employees will need to look to state tax law procedures to determine how the benefits will be treated for state income tax purposes. A number of states, including California, Minnesota, North Dakota, Oklahoma, Rhode Island, and Wisconsin have issued guidance regarding the state tax treatment of same-sex marriages.

California Governor Signs New Law Reducing State Tax Penalty for Section 409A Violations

By Sean McGrath and Colleen Hart

> California Governor Jerry Brown has signed into law a measure that will reduce the California income tax penalty for violations of Section 409A of the Internal Revenue Code of 1986, as amended, ("Section 409A") from 20% to 5%.

California law previously provided for a state income tax penalty equal to the federal income tax penalty for violations of Section 409A (*see* California Revenue and Taxation Code Section 17501). This resulted in a 20% state income tax penalty in addition to the 20% federal income tax penalty on amounts previously deferred and includible in income as a result of a Section 409A violation.

The new law, AB 1173, Chapter 536, adds CA Revenue and Taxation Code Section 17508.2, which substitutes the phrase "five percent" in lieu of the phrase "20 percent" as the additional income tax penalty for violations of Section 409A.

The reduced income tax penalty is applicable for taxable years beginning on or after January 1, 2013.

The federal tax provisions and the California state interest penalty provisions are unaffected by the new law and remain applicable to Section 409A violations.

As a reminder, certain violations of Section 409A can be corrected under federal and state correction programs that may reduce or eliminate these penalties but the programs remain available for a limited number of taxable years after the violation. As we approach the end of the year, now would be a good time for employers to review their deferred compensation plans and processes and take any appropriate corrective action.

* * *

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Sixth Circuit Rejects Challenge to ACA Based on Religious Beliefs

By Brian Neulander

> The Affordable Care Act (ACA) requires non-grandfathered health plans to cover certain preventative health services. In a case seeking an injunction to bar enforcement of ACA's so-called "contraception mandate" on the ground that it infringed plaintiffs' deeply held religious beliefs, the Sixth Circuit held that secular, closely held for-profit corporations were not "persons" protected by the Free Exercise Clause of the First Amendment. *Autocam Corp v. Sebelius*, 2013 WL 5182544 (6th Cir. Sept. 17, 2013). The court reasoned that the statute burdened the corporations, not the individual owners, and there was no authority to pierce the corporate veil with respect to the owners' religious beliefs. The Sixth Circuit's ruling, which joins the Third circuit, deepens the circuit split on the enforceability of ACA's contraception mandate. The Third, Seventh and Tenth Circuits that concluded religious protections extend to for-profit companies.

Seventh Circuit Again Grants Class Certification In Excessive Fee Case

By Todd Mobley

> On remand from the Seventh Circuit, a federal district court in Illinois granted class certification in a case where participants in a Boeing 401(k) plan alleged that Boeing breached its fiduciary duties under ERISA by: (i) causing the plan to pay excessive administrative fees; (ii) failing to disclose material information regarding administrative fees; and (iii) investing imprudently in certain mutual funds. *Spano v. Boeing Co.*, 2013 U.S. Dist. LEXIS 133948 (S.D. Ill. Sept. 19, 2013). In so ruling, the district court determined that plaintiffs' decision to create subclasses (one for each of the mutual funds at issue) and limit putative members to individuals who participated in the plan during the time in which the alleged fiduciary breaches occurred properly addressed the Seventh Circuit's concern that the original class of all plan "participants from the past and future" was impermissibly "breathtaking in scope."

The PBGC Not Entitled to Administrative Deference for Involuntary Plan Termination

By Justin Alex

> As we previously noted (http://www.erisapracticecenter.com/2013/04/28/pbgc-seeks-involuntary-plan-termination-before-plan-sponsors-proposed-share-sale/), the PBGC filed a complaint (E.D. Pa. Case No. 13-02069) to involuntarily terminate a defined benefit plan prior to a corporate transaction that would change the plan sponsor's controlled group. The PBGC claimed that the plan sponsor, Saint-Gobain Containers, Inc., would join a financially weaker controlled group after it is acquired by the Ardagh Group, S.A. through a share purchase. On October 4, 2013, the Court ruled that it will determine de novo whether to involuntarily terminate the plan, without any administrative

deference for the PBGC's determination. As a result, the Court will consider evidence outside of the PBGC's administrative record.

Section 4042 of the Employee Retirement Income Security Act of 1974, as amended ("ERISA") generally allows the PBGC to seek an involuntary plan termination through court order when the PBGC determines that at least one of the following conditions are met:

1. the plan has not met minimum funding standards;
2. the plan will be unable to pay benefits when due;
3. the plan has made a large distribution to a substantial owner under certain circumstances; or
4. the possible long-run loss of the PBGC with respect to the plan may unreasonably increase without a termination of the plan.

In this case, the PBGC argued that the Court should defer to the PBGC's determination to involuntary terminate the plan based on the "arbitrary and capricious standard" of the Administrative Procedure Act ("APA") because the determination was the end result of an "informal adjudication" and therefore "agency action" under the APA. The Court disagreed, noting that ERISA section 4042(c) requires *the Court* to determine whether to involuntarily terminate the plan. Indeed, the Court noted that the PBGC's determination has no legal or binding effect without a court order. As a result, the Court ruled that it will determine de novo whether to involuntarily terminate the plan.

This decision is significant to note because the PBGC often uses the prospect of an involuntary plan termination in conjunction with its Early Warning Program to negotiate additional contributions or other security for underfunded defined benefit plans within the context of corporate transactions. Due to this precedent that the PBGC is not entitled to administrative deference with respect to involuntary plan terminations, the PBGC may lose some bargaining power in Early Warning Program negotiations.

SunTrust Plan Participants' Stock-Drop Claims Tossed A Second Time

By Joseph Clark

> A federal district court in Georgia recently dismissed a suit brought by participants in the SunTrust Bank 401(k) savings plan alleging fiduciary breaches based on defendants' decision to continue permitting investment in SunTrust stock while its value declined during the subprime mortgage crisis. The court had previously granted in part and denied in part SunTrust's motion to dismiss, and SunTrust appealed. The Eleventh Circuit stayed the appeal until it issued an opinion in *Lanfear v. Home Depot, Inc.*, 679 F.3d 1267 (11th Cir. 2012), which raised similar issues. In *Home Depot*, the Eleventh Circuit ruled that "a fiduciary abuses his discretion by acting in compliance with the directions of the plan only when the fiduciary could not have reasonably believed that the settlors would have intended for him to do so under the

circumstances." Following its decision in *Home Depot*, the Eleventh Circuit reversed the district court's decision in *SunTrust* and remanded plaintiffs' prudence claim for further consideration by the district court. On remand, the district court dismissed the claim. *In re SunTrust Bank, Inc., ERISA Litig.*, 2013 WL 5418130 (N.D. Ga. Sept. 26, 2013). Applying *Home Depot*, the district court reviewed various plan provisions and concluded that: (i) the settlor intended "for the fiduciaries to wait until the company was 'on the brink of financial collapse'" before taking action; and (ii) even at that point the fiduciaries were instructed to seek outside counsel for advice, not sell SunTrust stock. The court also noted that in considering whether to hold a certain investment or sell it, a fiduciary must consider the interests of the plan participants. It was thus not unreasonable to assume that many of the plan participants were at least several years from retirement, and it was not "impossible to say that the opportunity to purchase SunTrust shares at historically low prices was not in the best interests of those participants."

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