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CLIENT ALERTS

EPSTEIN BECKER & GREEN, P.C.

Resurgens Plaza
945 East Paces Ferry Road
Suite 2700
Atlanta, Georgia 30326-1380
404.923.9000

150 North Michigan Avenue
35th Floor
Chicago, Illinois 60601-7553
312.499.1400

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212.351.4500

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26th Floor
San Francisco, California 94111-5427
415.398.3500

One Landmark Square
Suite 1800
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203.348.3737

1227 25th Street, N.W.
Suite 700
Washington, DC 20037-1175
202.861.0900

WWW.EBGLAW.COM

SECOND CIRCUIT REVERSES PREEMPTION RULING, REMANDING NEW YORK'S LABOR NEUTRALITY LAW FOR FURTHER PROCEEDINGS

*In **Healthcare Association of N.Y. State v. Pataki**, No. 05-2570 (2d Cir. Dec. 5, 2006), the latest judicial decision addressing the recent trend of state statutes and regulations prohibiting entities that receive state funds from using the money to encourage or discourage union organization, the Court of Appeals for the Second Circuit reversed a district court ruling that held New York's Labor Neutrality Law was preempted by the National Labor Relations Act ("NLRA"). Concluding that the district court's grant of summary judgment was in error because issues of fact existed regarding the operation of the law, the Second Circuit remanded the case for further proceedings. In light of the Second Circuit's ruling, employers who receive state funds must stay tuned for further developments.*

This Alert provides an overview of New York's Labor Neutrality Law, summarizes the judicial preemption analysis that will likely determine whether the law is upheld, and highlights a few of the more important concerns for employers who receive state funds, should the law ultimately be upheld.

NEW YORK'S LABOR NEUTRALITY LAW

New York's Labor Neutrality Law (NY Labor Law § 211-a), which went into effect in 2002, provides that "no monies appropriated by the state for any purpose shall be used or made available to employers" to use for the following three purposes:

- Training managers, supervisors or other administrative personnel regarding methods to encourage or discourage union organization or participation in a union organizing drive;
- Hiring attorneys, consultants, or contractors to encourage or discourage such organization or participation; and
- Paying employees whose principal job duties are to encourage or discourage such organization or participation.

The law requires any employer that utilizes funds appropriated by the state to maintain for three years financial records that are sufficient to show that the employer did not spend state funds for any of these prohibited purposes.

The law also empowers the Attorney General of New York to sue for both injunctive relief and the return to the State of monies spent for the three prohibited purposes. The Attorney General may also seek a civil penalty of up to $1,000 for a first violation and, in the case of a knowing violation or a second violation within two years, the greater of $1,000 or three times the amount spent in violation of the law.

VARIOUS HEALTHCARE PROVIDERS AND THEIR REPRESENTATIVES CHALLENGE NEW YORK'S LAW IN THE DISTRICT COURT

The plaintiffs, various not-for-profit corporations and trade associations involved in providing healthcare and representing healthcare providers, sought a declaration from the district court that New York's Labor Neutrality Law is preempted by federal labor law governing labor management relations. The plaintiffs arguments were based on two theories of preemption under the NLRA, named for the Supreme Court cases in which they were first articulated. The first theory, known as "*Garmon* preemption," addresses actual or arguable conflicts between state law and the NLRA. The second type of preemption, "*Machinists* preemption," appears in the case of regulations that are found to interfere with Congress's intent to leave certain areas unregulated by not addressing them in the NLRA, as it has been amended.

In light of the statutory intent under the NLRA to allow for the free play of economic forces during the union organizing process, the United States District Court for the Northern District of New York found that New York's Labor Neutrality Law was preempted by the NLRA under the *Machinists* doctrine. The court reasoned that the threat of an enforcement proceeding by the Attorney General and of the monetary penalties, including a fine of treble the amount wrongfully spent, would tie an employer's hands during union-organizing campaigns, thus depriving employers of an economic weapon reserved to them by the NLRA.

Accordingly, the district court declared the law preempted by the NLRA, and enjoined the State from implementing or enforcing the statute. The State appealed the district court's ruling. Because the district court determined that the law was preempted under the *Machinists* doctrine, it did not address whether the statute was also preempted under the *Garmon* theory.

THE SECOND CIRCUIT REVERSES THE DISTRICT COURT AND REMANDS FOR FURTHER PROCEEDINGS

Addressing the question of *Garmon* preemption, the Second Circuit considered the plaintiffs' argument that New York's Labor Neutrality Law was preempted because it interferes with their express right under the NLRA to direct non-coercive speech to their employees during the course of unionization campaigns. Concluding that state action impinging on the NLRA's protection of employer speech may be preempted under *Garmon*, the court set forth to determine whether the state law is aimed at making sure that State funds are only spent on the purposes the State has chosen or whether the State has used its spending power to restrict the plaintiffs' protected speech beyond their dealings with the State. The Circuit Court concluded that it was unable

to determine whether the NLRA preempted the state law, citing the existence of unresolved issues of fact including: (1) whether the state law restricts employers' use of funds earned from fixed-price contracts with the State; and (2) whether the state law as applied creates obligations upon receipt of monies that originated with federal and local governments.

Turning next to the question of *Machinists* preemption, the court observed that "the ultimate question depends on the same factors we considered relevant in our *Garmon* discussion: whether [New York's Labor Neutrality Law] burdens moneys that cannot properly be said to belong to the State (because they either belong to the contractors or to federal or local governments) and whether the State can accomplish its goal of saving money by limiting the kind of costs for which it will reimburse program participants." Accordingly, the court was also unable to rule on the *Machinists* preemption question.

The Second Circuit concluded that unresolved issues of material fact made the entry of summary judgment inappropriate on the issues of *Garmon* and *Machinists* preemption. It therefore reversed the district court's ruling and remanded the case for further proceedings consistent with its opinion.

RELATED PROCEEDINGS IN THE NINTH CIRCUIT

In April 2004, a panel decision from the U.S. Court of Appeals for the Ninth Circuit held that a similar California law was preempted by the NLRA. *Chamber of Commerce v. Lockyer*, 364 F.3d 1154 (9th Cir. 2004). However, the full Ninth Circuit granted rehearing *en banc* and ruled in September 2006 that the California law was not preempted. *Chamber of Commerce v. Lockyer*, 463 F.3d 1076 (9th Cir. 2006) (*en banc*). On January 5, 2007, the Chamber of Commerce petitioned the Supreme Court to review the Ninth Circuit's *en banc* ruling. The Supreme Court has not yet decided whether to review the ruling and will not do so at least until it receives reply papers from California's Attorney General.

Although the Ninth Circuit's decision is not binding upon district courts within the Second Circuit, the Court in *Healthcare Association of N.Y. State v. Pataki* will likely examine and consider the Ninth Circuit's interpretation of the similar California law when it examines the case. Moreover, if the Supreme Court does agree to review the Ninth Circuit's *en banc* decision, any legal principles announced in its ruling would be binding upon district courts within the Second Circuit.

LOOKING FORWARD: POSSIBLE CONCERNS FOR COVERED EMPLOYERS?

While the ultimate fate of New York's Labor Neutrality Law is before the courts, employers in New York who receive state funds must be aware of and comply with its obligations. This means that when contacted by union organizers, if they seek to spend money communicating their point of view to their employees, they must be aware of and observe the following:

- Covered employers must understand which funds count as state funds for purposes of the Law;
- Covered employers must implement and maintain appropriate recordkeeping systems, while also considering the possibility of segregating state funds from private funds, to ensure that state funds are not used for any prohibited purposes; and

- Covered employers whose funding consists solely of state funds may need to consider whether they need to identify other funding sources to enable them to communicate and address these issues.

CONCLUSION

New York's Labor Neutrality Law and similar laws in other states signal organized labor's continuing effort to enlist state and local government to assist them in their efforts to organize the unrepresented. Although the enforceability of such laws is currently being examined in the courts, the outcome of these cases could encourage the adoption of similar laws in other jurisdictions in which organized labor can exert its influence. Adding further uncertainty to the question of enforceability, the Second Circuit recently reversed the district court's ruling that New York's law was preempted by the NLRA and remanded the case for further proceedings. Employers who receive state funds should stay tuned for further developments.

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If you have any questions regarding the Second Circuit's decision in *Healthcare Association of N.Y. State v. Pataki* or governmental regulation of employer activity in connection with union organizing and its impact upon your workplace, please contact **Steven Swirsky** at (212) 351-4640 or **sswirsky@ebglaw.com, Dean Silverberg** at (212) 351-4642 or **dsilverberg@ebglaw.com**, or **Jonathan Trafimow** at (212) 351-4573 or **jtrafimow@ebglaw.com.**

Matthew S. Banner, an associate in EBG's New York office, assisted with the preparation of this alert.