

**SURVEY OF
CURRENT DEVELOPMENTS
IN EMPLOYMENT LAW**

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DISCRIMINATION AND HARASSMENT

I. PREVENTION AND INVESTIGATION OF SEXUAL HARASSMENT CLAIMS

A. Introduction

This section will provide an overview on the law of sexual harassment, including the elements of a claim, the basis for employer liability, and recent cases addressing the current definition of sexual harassment. Furthermore, the paper concludes with practical advice for preventing and defending claims of sexual harassment.

B. Employer Liability for Supervisor Harassment

1. Sources of Law

In June, 1998, the United States Supreme Court issued companion decisions that articulated a new standard for determining employer liability for sexual harassment by supervisors. The two decisions, *Faragher v. City of Boca Raton*, 524 U.S. 775, 118 S. Ct. 2275 (1998), and *Burlington Industries, Inc. v. Ellerth*, 524 U.S. 742, 118 S. Ct. 2257 (1998), address not only what employers must do to reduce the risk of liability, but also how harassment cases will be litigated once such claims are made. In response to these cases, the Equal Employment Opportunity Commission ("EEOC") promulgated enforcement guidance on vicarious employer liability for unlawful harassment by supervisors. See EEOC Enforcement Guidance: Vicarious Employer Liability for Unlawful Harassment by Supervisors, 8 FEP Manual 405:7651 (June 18, 1999) [hereinafter "EEOC Enforcement Guidance" or "Guidance"]. This Guidance sets forth how the EEOC interprets these cases and how it will apply them in its enforcement of federal laws prohibiting discrimination. In addition, numerous lower courts have weighed in on the issues raised by *Faragher* and *Ellerth*.

a. The *Faragher* And *Ellerth* Decisions

Faragher and *Ellerth* set a new standard of liability for sexual harassment by supervisors. If the harassing behavior by a supervisor culminates in a tangible employment action, such as termination or material change in duties, the employer is automatically liable for the actions of their supervisor, without regard to whether the employer knew or should have known about the harassing behavior or other showing of fault. An employer does have, however, an affirmative defense to vicarious liability for acts of a supervisor that do not involve a tangible employment action.

As defined by the Supreme Court, the affirmative defense is comprised of two elements, both of which must be present for an employer to escape vicarious liability:

- (i) that the employer exercised reasonable care to prevent and correct promptly any sexually harassing behavior, *and*;

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- (ii) that the plaintiff employee unreasonably failed to take advantage of any preventive or corrective opportunities provided by the employer or to avoid harm otherwise.
- b. The EEOC's Enforcement Guidance

When it was issued, the EEOC's Enforcement Guidance received substantial publicity in the media, for it explains and addresses many of the issues that are raised by the *Faragher* and *Ellerth* decisions, as well as subsequent decisions by the federal circuit and district courts. The purpose of the Guidance is to provide technical assistance to employers subject to Title VII. Therefore, it is not clear what level of deference, if any, the Guidance will receive from federal courts. In the months since its issuance, the Guidance has not received significant attention from the courts. Although federal courts normally accord substantial deference to regulatory interpretations promulgated by administrative agencies, the EEOC's Enforcement Guidance does not interpret a statute or regulations; it interprets two decisions of the United States Supreme Court. Ultimately, although federal courts may refer to the Guidance as "a body of experience and informed judgment," it is rather obvious that courts, not the EEOC, have primary responsibility for interpreting and applying the *Faragher* and *Ellerth* decisions. *Smith v. Midland Brake, Inc.*, 180 F.3d 1154, 1165 n.5 (10th Cir. 1999) (citing *Meritor Savings Bank v. Vinson*, 477 U.S. 57 (1986)).

2. *Determining Liability After Faragher and Ellerth: Threshold Issues*

Although the analytical framework of *Faragher* and *Ellerth* may appear straightforward, it raises at least as many questions as it answers. Who is a supervisor? What is the effect of an employee's inadequate complaint or utter failure to complain? What is a tangible adverse employment action? Assuming no tangible employment action, is the hostile work environment standard still a viable basis for summary judgment? Finally, is the employer nevertheless liable "if everything goes right," i.e., if an employee makes a complaint which is promptly, thoroughly and effectively investigated and remedied? The EEOC Guidance in several important respects goes beyond the holdings and even the dicta in *Faragher* and *Ellerth* to answer these questions. Similarly, as lower courts have been filling in the blanks left by the Supreme Court, they are effectively writing (or re-writing) employment policy. Because so many court decisions have been issued, the following section attempts to synthesize the lower court reaction, with particular attention to decisions by courts within the Third Circuit, and the EEOC's response to the open questions left tantalizingly unresolved by the Supreme Court.

a. Harassment Covered by *Faragher* and *Ellerth*

Although *Faragher* and *Ellerth* are sexual harassment cases, most federal courts have extended the concepts of automatic liability and affirmative defenses to other forms of harassment, such as racial harassment or disability harassment. Furthermore, the EEOC's Enforcement Guidance applies the *Faragher/Ellerth* vicarious liability standard to all forms of

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harassment, not just sexual harassment. In particular, the guidance states that employers are vicariously liable for supervisor harassment based on race, color, religion, national origin, protected activity (retaliation), age, and disability. See EEOC Enforcement Guidance, 8 FEP Manual at 405:7653.

Finally, it is also important to remember that the *Faragher/Ellerth* standard only applies to claims of harassment committed by a supervisor. The employee continues to bear the burden of proving employer negligence in causes of action for harassment by co-workers or customers and other third parties. Similarly, the significant change in the sexual harassment jurisprudence did not lessen the viability of the hostile work environment standard. Rather, the "hostile work environment standard" continues to require proof that the victim's work environment was objectively hostile--"an environment that a reasonable person would find hostile or abusive"--and that the victim subjectively perceived the environment to be abusive. *Harris v. Forklift Sys., Inc.*, 510 U.S. 17, 21-22 (1993). Furthermore, vicarious liability does not attach unless the supervisor's harassment was severe or pervasive enough to create a "hostile work environment." See *Ellerth*, 118 S. Ct. at 2265.

b. Who Is a "Supervisor"?

Because liability under the *Faragher/Ellerth* standard depends upon whether the harasser was a supervisor, the definition of "supervisor" can be a critical question in a sexual harassment case. Title VII, however, does not define "supervisor." Therefore, the definition of "supervisor" must be based on the logic and policy of the *Faragher* and *Ellerth* decisions.

The EEOC, in its Enforcement Guidance, takes a broader view of who may qualify as a supervisor, including employees who recommend, but do not take, tangible employment actions and employees who have authority only to direct the harasser's daily work activities. See EEOC Enforcement Guidance, 8 FEP Manual at 405:7654. This broad definition of "supervisor" conflicts with federal court decisions applying *Faragher* and *Ellerth*. For instance, in *Parkins v. Civil Constructors of Illinois, Inc.*, 163 F.3d 1027 (7th Cir. 1998), the Seventh Circuit held that foremen with "minimal authority" did not qualify as supervisors:

[I]t is manifest that the essence of supervisory status is the authority to affect the terms and conditions of the victim's employment. This authority primarily consists of the power to hire, fire, demote, promote, transfer, or discipline an employee. Absent an entrustment of at least some of this authority, an employee does not qualify as a supervisor for purposes of imputing liability to the employer.

Parkins, 163 F.3d at 1034. This definition seems more consistent with the concept of supervisory authority discussed in *Faragher* and *Ellerth*.

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c. Harassment Culminating in a "Tangible Employment Action"

The affirmative defense is not available if a supervisor's harassment culminates in a "tangible employment action." See *Faragher*, 118 S. Ct. at 2293; *Ellerth*, 118 S. Ct. at 2270. Moreover, in the Third Circuit, even if the affirmative defense would have been available at some point during a supervisor's course of harassment, the affirmative defense is lost once a "tangible employment action" is taken. See *Durham Life Ins. Co. v. Evans*, 166 F.3d at 154 ("When harassment becomes adverse employment action, the employer loses the affirmative defense even if it might have been available before.").

The Supreme Court in *Ellerth* defined a "tangible employment action" as "a significant change in employment status, such as hiring, firing, failing to promote, reassignment with significantly different responsibilities, or a decision causing a significant change in benefits." *Ellerth*, 118 S. Ct. at 2268. The following decisions contribute to the evolution of the definition of "tangible employment action":

- *Morris v. Oldham County Fiscal Ct.*, 201 F.3d 784, 789 (6th Cir. 2000): A "downgraded" evaluation following an alleged harassing remark or incident is not a tangible employment action when the plaintiff is not "in danger of being fired, demoted or transferred" because of the lower evaluation.
- *Durham Life Ins. Co. v. Evans*, 166 F.3d 139, 153-54 (3d Cir. 1999): Loss of office, secretary, files and assignments, which resulted in 50% pay decrease and motivated employee to resign, was a tangible employment action.
- *Hedberg v. Rockford Stop-N-Go, Inc.*, No. 99-2491, 1999 WL 1100303, at *3 (7th Cir. Dec. 1, 1999): Denial of transfer not a tangible employment action because employee was neither denied new benefits, nor were her current benefits, salary, location or responsibilities taken away.
- *Savino v. C.P. Hall Co.*, 199 F.3d 925, 933 n.8 (7th Cir. 1999): Reassignment to a comparable office is neither sufficiently adverse nor significant to constitute a tangible employment action. *But see Knox v. State of Ind.*, 93 F.3d 1327, 1334 (7th Cir. 1996) (moving an employee "from a spacious, brightly lit office to a dingy closet" could constitute an adverse employment action).
- *Caridad v. Metro-North Commuter R.R.*, 191 F.3d 283, 294 (2d Cir. 1999), *petition for cert. filed*, 68 U.S.L.W. 3433 (Dec. 27, 1999) (No. 99-10): A constructive discharge does not constitute a tangible employment action because "co-workers, as well as supervisors, can cause the constructive discharge of an employee. And, unlike demotion, discharge, or similar economic sanctions, an employee's constructive discharge is not ratified or approved by the employer."

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- *Scott v. Ameritex Yarn*, 72 F. Supp.2d 587, 594 (D.S.C. 1999): Constructive discharge not a tangible employment action because no official or corporate action has occurred.
- *Suber v. Pitney Bowes, Inc.*, No. 98 CIV. 2914, 1999 WL 102815 (S.D.N.Y. Feb. 26, 1999): Constructive discharge *can* give rise to a tangible employment action.
- *Corcoran v. Shoney's Colonial, Inc.*, 24 F. Supp. 2d 601, 606 (W.D. Va. 1998): Termination by a supervisor *other* than the individual supervisor who had harassed the plaintiff does not constitute a tangible employment action.
- *Watts v. Kroger Co.*, 170 F.3d 505, 510 (5th Cir. 1999): Change in work schedule and expanded work duties not a tangible employment action.
- *Reinhold v. Commonwealth of Va.*, 151 F.3d 172, 175 (4th Cir. 1998): Assignment of extra work not a tangible employment action.
- *DeCesare v. National R.R. Passenger Corp.*, No. 98-3851, 1999 WL 330258, at *4 (E.D. Pa. May 24, 1999): Assignment to more difficult tasks not a tangible employment action because plaintiff did not suffer any direct economic harm.
- *But see* EEOC Enforcement Guidance, 8 FEP Manual at 405:7656 & n.32: Taking the position that a change in work assignments can constitute a tangible employment action if the change is substantial and blocks the employee's opportunity for a promotion or a salary increase.

The EEOC's Enforcement Guidance asserts that the definition of tangible employment action includes a "tangible job benefit" obtained because of the employee's submission to the supervisor's sexual demands. See EEOC Enforcement Guidance, 8 FEP Manual at 405:7657. At least one court has rejected this "tangible job benefit" theory. See *Hetreed v. Allstate Ins. Co.*, 15 NDLR ¶ 175, 1999 WL 311728, at **4-5 (N.D. Ill. May 12, 1999) (permitting defendant to assert affirmative defense because plaintiff received promotions and bonuses rather than "negative repercussions" as a result of her submission to the supervisor's sexual advances; "harassment itself does not constitute tangible employment action; there must be . . . a company act, and in most cases . . . direct economic harm."). Furthermore, the EEOC's "tangible job benefit" theory is inconsistent with the language of the *Ellerth* decision itself, which speaks in terms of "injury" and "harm." *Ellerth*, 118 S. Ct. at 2268-69. Conceptually, an employee who submits or acquiesces to a supervisor's overtures in order to secure a benefit is arguably subject to a hostile work environment if the submission or acquiescence is unwilling. This category of cases is not resolved by *Faragher* and *Ellerth*.

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The EEOC's Enforcement Guidance also suggests that a recommendation of adverse action constitutes a tangible employment action. See EEOC Enforcement Guidance, 8 FEP Manual at 405:7654. However, a recommendation that does not eventuate in a tangible employment action, appears not to be the sort of "official company act" upon which the Supreme Court based its theory of vicarious liability. See *Ellerth*, 118 S. Ct. at 2269.

d. Causal Connection Between Harassment and "Tangible Employment Action"

In order for vicarious employer liability to attach, a causal connection must exist between the supervisor's harassment and the tangible employment action suffered by the employee. If there is no causal connection between the harassment and the tangible employment action (i.e., if the employer proves a non-discriminatory reason for the tangible employment action), the affirmative defense is available. See, e.g., *Burrell v. Star Nursery, Inc.*, 170 F.3d 951, 956 (9th Cir. 1999) (finding it unclear whether employee's termination resulted from her misconduct or from her resistance to her supervisor's sexual advances); *Newton v. Cadwell Lab.*, 156 F.3d 880, 883 (8th Cir. 1998) (denial of transfer and discharge for poor sales performance not related to rejection of supervisor's sexual overtures); *Llampallas v. Mini-Circuits Lab, Inc.*, 163 F.3d 1236, 1247-51 (11th Cir. 1998) (no causal link between supervisor's harassment and employee's termination where president of company, not supervisor, terminated employee and plaintiff could not show that her supervisor's discriminatory animus motivated president's decision to terminate employee), *cert. denied*, 120 S. Ct. 327 (1999).

e. Application of the Affirmative Defense

An employer may raise the affirmative defense when harassment by a supervisor does not culminate in a tangible employment action.^{1/} The affirmative defense requires proof of two elements:

- (i) that the employer exercised reasonable care to prevent and correct promptly any sexually harassing behavior, *and*

^{1/} It is unsettled whether an employer is able to assert the affirmative defense for a single, severe act of supervisor harassment, such as rape, even though a tangible employment action has not occurred. See *Todd v. Ortho Biotech, Inc.*, 175 F.3d 595, 598 (8th Cir. 1999) (noting that the affirmative defense "may not protect an employer from a single, severe, unanticipatable sexual harassment" and remanding the issue to the lower court).

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- (ii) that the plaintiff employee unreasonably failed to take advantage of any preventive or corrective opportunities provided by the employer or to avoid harm otherwise.

Faragher, 118 S. Ct. at 2293; *Ellerth*, 118 S. Ct. at 2270.

In general, an employer satisfies the first prong of the affirmative defense by promulgating a reasonable sexual harassment policy, by investigating complaints promptly, and by taking appropriate remedial action. Although not required in every instance as a matter of law, an anti-harassment policy and complaint procedure are "important consideration[s] in determining whether the employer has established the first prong of the affirmative defense." An anti-harassment policy and complaint procedure need not be successful, only reasonable. Nevertheless, the affirmative defense fails if an employer promulgates, but fails to enforce, an anti-harassment policy.

An employee's failure to take advantage of the employer's complaint procedure is normally sufficient to establish the second prong of the affirmative defense. Subjective discomfort about discussing harassment does not excuse an employee's failure to use the employer's complaint procedure, unless the employee had a credible fear of retaliation.^{2/} Similarly, a plaintiff's desire to give the alleged harasser an opportunity to stop does not qualify as a reasonable failure to complain. See *Leugers v. Pinkerton Sec. & Investigative Servs.*, No. 98-3501, 2000 WL 191685, at *3 (6th Cir. Feb. 3, 2000). Furthermore, even if the employee complained, the second prong of the affirmative defense may be established if the employee put herself in a situation that permitted the harassment to continue. In *Brown v. Perry*, 184 F.3d 388, 397 (4th Cir. 1999), the court held that the plaintiff-employee "utterly failed to 'avoid harm otherwise'" when, after previous incidents of harassment by supervisor, employee went bar-hopping with supervisor and then went to his hotel room late at night. As a result of plaintiff's actions, the appellate court affirmed summary judgment in favor of the employer because both prongs of the affirmative defense had been satisfied. See *id.*

^{2/} See *Caridad*, 191 F.3d at 295 (finding plaintiff's reluctance to complain about sexual harassment insufficient to preclude summary judgment in favor of employer and explaining that "for that reluctance to preclude the employer's affirmative defense, it must be based on apprehension of what the employer might do, not merely on concern about the reaction of co-workers."); *Shaw*, 180 F.3d at 813 ("While a victim of sexual harassment may legitimately feel uncomfortable discussing the harassment with an employer, that inevitable unpleasantness cannot excuse the employee from using the company's complaint mechanisms."); *Fierro v. Saks Fifth Avenue*, 13 F. Supp.2d 481, 492 (S.D.N.Y. 1998) (holding employee's "generalized fears" of repercussions from utilizing employer's internal complaint mechanism insufficient as a matter of law without evidence that "other employees were subjected to retaliation for availing themselves of the employer's complaint procedures.").

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The Eleventh Circuit's decision in *Coates v. Sundor Brands, Inc.*, 164 F.3d 1361 (11th Cir. 1999), *superseding*, *Coates v. Sundor Brands, Inc.*, 160 F.3d 688 (11th Cir. 1998), addressed under what circumstances an employee fails to give sufficient notice of the alleged harassment. The plaintiff alleged that conversations with her direct supervisor, the plant manager, and a consultant for the company placed the employer on notice of alleged sexual harassment. The court rejected the plaintiff's arguments with respect to each conversation. The court found that the conversation with the supervisor was deficient because the plaintiff merely indicated that she would like to speak about a "personal matter" and never mentioned the harassment specifically. By contrast, the plaintiff did show the plant manager a suggestive note from the alleged harasser. Nevertheless, this conversation was also insufficient to establish notice because the primary motivation for plaintiff's conversation was not to discuss harassment, but rather her career and other matters related to her job, and because "nothing [plaintiff] said to [the plant manager] indicated that her receipt of the note represented a problem about which she was concerned or that required immediate attention." *Id.* at 1365. Finally, because the plaintiff requested that the consultant to whom she confided about the harassment refrain from mentioning it to plaintiff's supervisor, the court found this conversation to be a similarly unreasonable failure to put the employer on notice of the harassment. *See id.* at 1366; *See also Watkins*, 1999 WL 1032614, at *5 (although plaintiff reported incidents of unauthorized touching, the employer satisfied the second prong of its affirmative defense in part because the plaintiff "repeatedly expressed her unwillingness to pursue the matter").

Although an employee may claim to have been unaware of the employer's complaint procedure, the employer may be able to prove that the employee had constructive knowledge of the complaint procedure. For instance, in *Shaw v. AutoZone, Inc.*, 180 F.3d 806, 811 (7th Cir. 1999), *cert. denied*, 120 S. Ct. 790, the employer demonstrated constructive knowledge by showing that it distributed to all employees an employee handbook that contained a sexual harassment policy and by showing that the plaintiff had signed an acknowledgment form which stated: "I understand it is my responsibility to read and learn the policies and procedures contained in the AutoZone Handbook and Safety Booklet." *Id.*

Moreover, the EEOC, in its Enforcement Guidance, takes the position that an employee may vitiate the affirmative defense by filing a charge with the EEOC while harassment is ongoing. *See* EEOC Enforcement Guidance, 8 FEP Manual at 405:7671. This position seems to conflict with basic congressional policies underlying Title VII and recognized by the Supreme Court in *Ellerth*:

Title VII is designed to encourage the creation of antiharassment policies and effective grievance mechanisms. Were employer liability to depend in part on an employer's effort to create such procedures, it would effect Congress' intention to promote conciliation rather than litigation in the Title VII context and the EEOC's policy of encouraging the development of grievance procedures. To the extent limiting employer liability could

encourage employees to report harassing conduct before it becomes severe or pervasive, it would also serve Title VII's deterrent purpose.

Ellerth, 118 S. Ct. at 2270 (citations omitted).

One of the most intriguing open questions generated by the *Faragher/Ellerth* decisions is the result when everything “goes right,” *i.e.*, when, after a supervisor’s harassment, an employee promptly and correctly complains and an employer thoroughly and effectively remedies the situation. In *Indest v. Freeman Decorating, Inc.*, 164 F.3d 258 (5th Cir. 1999), the Fifth Circuit attempted to fill this gap. The court held that summary judgment can be appropriate where a plaintiff quickly resorts to an internal complaint procedure which is met with a prompt response. The rationale is “the complained of incidents will not likely have become severe or pervasive enough to create an actionable Title VII claim. . . . By promptly invoking a company’s grievance procedure, a plaintiff has received the benefit Title VII was meant to confer. In such cases, an actionable hostile environment claim will rarely if ever have matured.” In reaching this conclusion, the court found support in the seminal case of *Meritor Savings Bank, FSB v. Vinson*, 477 U.S. 57 (1986), which states the law should give credit to employers who “make reasonable efforts” to discharge their duties under Title VII.

C. Sexual Harassment By Non-Supervisors

Courts continue to hold employers liable for hostile environment sexual harassment by a plaintiff’s co-workers under a negligence standard. *See, e.g., Sharp v. City of Houston*, 164 F.3d 923, 929 (5th Cir. 1999) (noting that *Faragher* and *Ellerth* did not disturb the “negligence standard govern[ing] employer liability for co-worker harassment”). Under this standard, “liability exists [only] where the defendant knew or should have known of the harassment and failed to take prompt remedial action.” *Kunin v. Sears Roebuck & Co.*, 175 F.3d 289, 293 (3d Cir.), *cert. denied*, 120 S. Ct. 398 (1999).

1. Hostile Environment Sexual Harassment

Actionable hostile environment sexual harassment occurs when a non-supervisor’s^{3/} unwelcome gender-based conduct unreasonably interferes with an individual’s job performance or creates a hostile, intimidating, or offensive work environment, even though it may not result in tangible or economic job consequences. The Supreme Court recognized the hostile work environment theory as a viable cause of action in *Meritor Savings Bank v. Vinson*. *See Meritor*, 477 U.S. at 67 (to be actionable, the alleged conduct “must be sufficiently severe or

^{3/} The determination of who is a “supervisor” is a fundamental and evolving issue in harassment law and is discussed in more detail in the supervisor harassment section, *supra*.

pervasive 'to alter the conditions of [the victim's] employment and create an abusive working environment.'").

In *Harris v. Forklift Systems, Inc.*, 510 U.S. 17 (1993), the Supreme Court clarified the standard for hostile environment sexual harassment adopted in *Meritor*. The standard has both an objective and subjective component. To state a cause of action, the plaintiff must show that a *reasonable person* would find the work environment hostile or abusive. *See id.* at 21. However, the plaintiff must also demonstrate that she subjectively perceived the work environment as abusive to show that her conditions of employment were, in fact, altered. *See id.* The Court indicated that the following factors are relevant in determining what constitutes severe or pervasive conduct: (1) "the frequency of the discriminatory conduct"; (2) "its severity"--"whether it is physically threatening or humiliating, or a mere offensive utterance"; (3) "whether it unreasonably interferes with an employee's work performance"; and (4) the "effect on the employee's psychological well-being." *id.* at 23. Nevertheless, the Court rejected the argument that the hostile environment cause of action *required* proof of psychological harm: "So long as the environment would reasonably be perceived, and is perceived, as hostile or abusive, . . . there is no need for it also to be psychologically injurious." *id.* at 22 (citations omitted).

More recently, in *Oncale v. Sundowner Offshore Services, Inc.*, 523 U.S. 75 (1998), the Court further refined the hostile environment sexual harassment landscape, noting that Title VII is not "a general civility code for the American workplace." *id.* at 1002. Although the Court enlarged the scope of Title VII to include same-sex harassment claims, it also redefined the parameters of the statute. According to the Court, "Title VII does not prohibit all verbal or physical harassment in the workplace." *id.* at 1002. The focus is not on the sexual content or connotations of words; rather, the focus is "whether members of one sex are exposed to disadvantageous terms or conditions of employment to which members of the other sex are not exposed." *id.* Moreover, Title VII was interpreted by the Court in *Oncale* to forbid "only behavior so objectively offensive as to alter the 'conditions' of the victim's employment." *id.* at 1003. Therefore, courts and juries should take caution not to mistake "ordinary socializing in the workplace" as representative of a hostile work environment. *id.*

Generally, in order to establish a sexual harassment claim based upon the conduct of a non-supervisory employee, a plaintiff must show that the harassment was (1) unwelcome; (2) based on sex; (3) sufficiently severe or pervasive to create an abusive working environment; and (4) the plaintiff must also establish a basis for employer liability.

a. Unwelcome Sexual Conduct

A crucial inquiry in any sexual harassment case, is whether the alleged actions were "welcome." *See Meritor*, 477 U.S. at 68 (stating that gravamen of sexual harassment claim is that the sexual advances were "unwelcome"). If the alleged actions were indeed welcome, there is no violation. *See, e.g., Scusa v. Nestle U.S.A. Co.*, 181 F.3d 958, 965 (8th Cir. 1999)

(finding conduct "welcome" because the plaintiff engaged in behavior similar to that which she claimed was unwelcome and offensive). In addition, the plaintiff has the obligation to put the harasser on notice that the conduct is unwelcome. Notice, however, may be actual or constructive.

b. Harassment "Because of" Sex

Non-sexual, but gender-based, mistreatment can create a hostile work environment. Even before *Oncale*, some courts held that harassing behavior that is not sexually explicit but is directed at persons of one gender and motivated by discriminatory animus against that gender satisfies the "based on sex" requirement. See *O'Shea v. Yellow Tech. Servs., Inc.*, 185 F.3d 1093, 1098 (10th Cir. 1999). Of course, if offensive conduct is *not* motivated by gender, it does not constitute sexual harassment. See, e.g., *Morris v. Oldham County Fiscal Ct.*, 201 F.3d 784, 790 (6th Cir. 2000) (affirming summary judgment in favor of employer on plaintiff's harassment claims because plaintiff could not establish that the offensive behavior was "because of sex" rather than "simple belligerence").

c. Conduct That Creates a Hostile Environment

In 1994, the EEOC approved enforcement guidance (the "1994 EEOC Policy Guidance") analyzing the Supreme Court's decision in *Harris* and its effect on Commission investigations. "Unless the conduct is severe," the 1994 EEOC Policy Guidance explains, "a single incident or isolated incidents of offensive sexual conduct or remarks generally do not create an abusive environment. . . . A hostile environment claim generally requires a showing of a pattern of offensive conduct." *id.* Whether harassment rises to the level of a hostile work environment depends on the totality of the circumstances: "the frequency of the discriminatory conduct; its severity; whether it is physically threatening or humiliating, or a mere offensive utterance; and whether it unreasonably interferes with an employee's work performance." *Harris*, 510 U.S. at 23; See also *Andrews v. City of Philadelphia*, 895 F.2d 1469, 1485 (3d Cir. 1990) (directing lower courts to consider the totality of the circumstances). Additionally, Title VII does not protect a plaintiff who experiences conduct that is merely offensive or annoying. See *Harris* at 21 (quoting *Meritor*).^{4/} At the same time, a single incident, by itself, may be sufficiently severe to create a hostile work environment.^{5/}

^{4/} In the post-*Faragher* and *Ellerth* era, at least one court has concluded that "the sporadic use of abusive language, gender-related jokes, and occasional teasing are fairly commonplace in some employment settings and do not amount to actionable harassment." *Savino v. C.P. Hall Co.*, 199 F.3d 925, 933 (7th Cir. 1999).

^{5/} Compare *Todd*, 175 F.3d at 598 (considering, but not deciding, whether sexual assault created hostile work environment) with *Porta v. Dukes*, No. Civ. A. 98-2721, 1998 (continued...)

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Because the determination of whether workplace harassment was severe or pervasive enough to be actionable depends on the totality of the circumstances, i.e., the nature of the workplace environment as a whole, a plaintiff may be permitted to show hostile environment harassment based on conduct that was not directed to her or did not occur in her presence. See *Jackson v. Quanex Corp.*, 191 F.3d 647 (6th Cir. 1999) (concluding that evidence of racist conduct directed to African-American employees other than the plaintiff was relevant to determine whether the plaintiff was subjected to a hostile work environment). The court in *Cruz v. Coach Stores, Inc.*, 202 F.3d 560 (2d Cir. 2000), drastically extended this principle. Specifically, this court concluded that offensive remarks or behavior directed at individuals who were not members of the plaintiff's protected class were relevant to the plaintiff's "hostile environment" analysis because these remarks could exacerbate the effect of the harassment that the plaintiff individually experienced. *id.* at 570, 571. Cf. *Cowan v. Prudential Ins. Co. of Am.*, 141 F.3d 751, 758 (7th Cir. 1998) (remarking that the impact of second-hand harassment is not as great as harassment directed at the plaintiff).

The standard to evaluate hostile environment claims contains two requirements: (1) that a reasonable person would find the environment hostile or abusive; and (2) that the victim subjectively perceives the environment to be abusive. Some courts hold that the Supreme Court's use of the "reasonable person" test in *Harris* precludes the consideration of the victim's sex in determining whether the victim objectively found the environment hostile or abusive. Other courts hold that the "reasonable person standard" necessarily includes consideration of the alleged victim's sex.

A plaintiff alleging sexual harassment by a non-supervisor must also show that she subjectively perceived the environment as hostile or abusive. See *Harris*, 510 U.S. at 21-22; *but see Davis v. United States Postal Serv.*, 142 F.3d 1334, 1341 (10th Cir. 1998) (holding that a hostile work environment plaintiff need not show she quit or wanted to quit the employment in question and that feeling "more stressed out," "pretty cracked," and "shocked," were sufficient in order to prevail on the subjective component of the *prima facie* case for sexual harassment).

5/(...continued)

WL 470146, at **1, 3 (E.D. Pa. Aug. 11, 1998) (dismissing plaintiff's Title VII claims because her allegation that a coworker stated to her "The last time I saw you, you were quiet, a virgin, and unmarried," "The way to a man's heart is through his stomach, so I hope you're a good cook," "When the cat's away, the mice will play," and "You must be eating a lot of meatballs and spaghetti...[because] you are filling out nicely and have good child bearing hips," during a single conversation was not sufficiently severe and pervasive to create a hostile work environment).

d. Imputing Employer Liability

An employer is not strictly liable for hostile environments created by non-supervisors. *See, e.g., Porchia v. Cohen*, No. Civ. A. 98-3643, 1999 WL 357352, at *5 (E.D. Pa. June 4, 1999). Rather, the plaintiff alleging sexual harassment by a co-worker must show some factual basis for imputing liability to the employer. Thus, employer liability is part of the plaintiff's *prima facie* case. In *Meritor*, the Supreme Court declined to issue a definitive rule on employer liability for hostile environment harassment, but instructed courts to look to agency principles for the appropriate standard. *See* 477 U.S. at 72. When the abusive and hostile environment is created by a co-worker, the courts almost uniformly apply a negligence standard of liability: the plaintiff must prove that the employer knew or should have known of the harassment but failed to take prompt and appropriate remedial action. *See Andrews*, 895 F.2d at 1486.

If the employer has knowledge of the harassment, whether actual or constructive, it must take prompt remedial action to avoid liability. Such measures include: (1) an effective policy and grievance procedure against sexual harassment; (2) a thorough investigation of the allegations; and (3) a response that is reasonably calculated to end the harassment. For the employer to be liable for co-worker harassment under a negligence theory of liability, the plaintiff must first show that the employer had knowledge of the harassment.

To determine employer liability, courts will evaluate the employer's policy prohibiting sexual harassment. An effective and well-disseminated policy prohibiting sexual harassment may preclude liability.^{6/} However, if the employer fails to provide a "reasonable avenue for complaint," it will likely be held liable for the harassment. The EEOC instructs employers to "take all steps necessary to prevent sexual harassment from occurring, such as . . . developing appropriate sanctions, informing employees of their right to raise and how to raise the issue of harassment . . . , and developing methods to sensitize all concerned." 29 C.F.R. § 1604.11(f). Thus, implementation of an effective policy and a grievance procedure against sexual harassment, and internal publication of them through training, is crucial in avoiding liability.

Moreover, an investigation, in and of itself, is generally not sufficient to preclude liability. *See Fuller v. City of Oakland*, 47 F.3d 1522, 1529 (9th Cir. 1995). Rather, "an investigation is principally a way to determine whether any remedy is needed and cannot substitute for the remedy itself." *id.* The adequacy of the employer's response depends upon the facts of the particular case, such as the severity and frequency of the harassment. *See Knabe*, 114 F.3d at 414. The employer is not *required* to reprimand, suspend or fire the

^{6/} In *Farley v. American Cast Iron Pipe Co.*, 115 F.3d 1548, 1553 (11th Cir. 1997), the Eleventh Circuit held that an employer is insulated from liability for hostile environment sexual harassment *based on constructive knowledge* "when the employer has adopted an anti-discrimination policy that is comprehensive, well-known to employees, vigorously enforced, and provides alternative avenues of redress."

employee in order to protect itself from liability. The response is adequate if it is reasonably calculated to end the harassment. Moreover, the courts have made clear that the alleged victim does not have the right to dictate the remedial action. Thus, "if the remedy chosen by the employer is adequate, an aggrieved employee cannot object to that selected action." *id.*

D. Other Sexual Harassment Issues

1. Employer Liability for Non-Employees

An employer may be liable for environmental sexual harassment caused by the acts of the employer's clients or independent contractors where the employer has knowledge of such harassment and fails to take appropriate corrective action. 29 C.F.R. § 1604.11(e). *Ellerth* and *Faragher* have not altered this analysis. As the court in *Lockard v. Pizza Hut, Inc.*, 162 F.3d 1062 (10th Cir. 1998) noted, "[a]n employer who condones or tolerates the creation of [a hostile] environment should be held liable regardless of whether the environment was created by a co-employee or a non-employee, since the employer ultimately controls the conditions of the work environment. Guided by this principle, the *Lockard* court held Pizza Hut liable for the sexual harassment of a waitress by two customers because the manager refused to grant the waitress' request that another server wait on those customers and did not otherwise intervene on the waitress' behalf. *id.* Of particular interest is the decision of the New York state appellate court in *D'Amico v. Commodities Exchange Inc.*, 652 N.Y.S.2d 294 (1st Dep't 1997). In *D'Amico*, the plaintiff, a female commodities trader, brought a gender discrimination suit against male traders and the Commodities Exchange, claiming that men on the trading floor sexually harassed and physically intimidated her. *id.* at 295. The court allowed the case to proceed against the Exchange, holding that it was unnecessary to decide whether the plaintiff was its employee because the trading floor was a place of public accommodation, and thus subject to the antidiscrimination proscriptions of New York's Human Rights Law, the state analogue to Title VII. *id.*

2. Non-Traditional Plaintiffs

While nearly 90% of sexual harassment charges are submitted by females alleging harassment by males, the statutory language of Title VII draws no distinction between men and women, either as plaintiffs or as harassers. See Equal Employment Opportunity Commission, *Sexual Harassment Charges FY 1992-FY 1998* (last modified Jan. 14, 1999) <http://www.eeoc.gov/stats/harass/html>. Therefore, any prudent employer's harassment policy considers the harassment of males by females and same-sex sexual harassment. Finally, the EEOC Guidelines suggest that employees who are not directly subjected to sexual harassment may nonetheless state a cause of action under Title VII where they are denied employment opportunities or benefits in favor of an employee who has submitted to sexual advances. 29 C.F.R. § 1604.11(g). Courts are split as to whether observers of consensual conduct which

offends them or employees allegedly tangibly affected by the consensual relationship can state a Title VII claim.^{7/}

E. Practical Implications

After *Faragher* and *Ellerth*, employers must undertake a thorough review of their harassment policies, complaint procedures, and investigatory mechanisms, both to prevent occurrences of sexual and other forms of harassment and to avoid legal liability should they nevertheless occur.

1. *Establishing and Implementing a Harassment Prevention Policy*

The mere existence of boilerplate policy or statements denouncing workplace harassment are likely insufficient to shield against liability for harassment claims. Rather, certain minimum requirements should be met in order to effectively establish that an employer in fact took reasonable steps to prevent harassment.

The EEOC's Enforcement Guidance advises that an employer's anti-harassment policy and complaint procedure should, "at a minimum," contain:

- A clear explanation of prohibited conduct;
- Assurance that employees who make complaints of harassment or provide information related to such complaints will be protected against retaliation;^{8/}
- A clearly described complaint process that provides accessible avenues of complaint;

^{7/} See *Drinkwater v. Union Carbide Corp.*, 904 F.2d 853 (3d Cir. 1990) (hostile work environment not present when romantic relationship between co-worker and supervisor did not prevent plaintiff from being evaluated on grounds other than her sexuality, but consensual romantic relationship of a supervisor and a subordinate may give rise to hostile environment claims on the part of other employees where the atmosphere in the workplace becomes "oppressive and intolerable"); *Dirksen v. City of Springfield*, 842 F. Supp. 1117 (C.D. Ill. 1994) (supervisor's favoritism towards paramour may constitute *quid pro quo* sexual harassment of other workers if the male supervisor generally requires women to provide sexual favors in return for career advancement).

^{8/} Employers should remember, however, that they retain the right to take disciplinary action in the case of false complaints or those not made in good faith.

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- Assurance that the employer will protect the confidentiality of harassment complaints to the extent possible;
- A complaint process that provides a prompt, thorough, and impartial investigation; and
- Assurance that the employer will take immediate and appropriate corrective action when it determines that harassment has occurred.

See EEOC Enforcement Guidance, 8 FEP Manual at 405:7661-62. The EEOC also recommends the use of the following measures, which appear to go beyond the obligations imposed by *Faragher* and *Ellerth* and their progeny:

- Provide information about the time frames for filing charges of unlawful harassment;
- Offer a phone line so employees can discuss questions or concerns about harassment on an anonymous basis; and
- Release specific information about the resolution of the complaint to the parties involved and releasing general information about corrective and disciplinary measures undertaken to all employees.

However, even before drafting the policy and attendant procedures, an employer must establish an adequate foundation to ensure the success of any anti-harassment program. First, individuals must be designated as complaint takers and investigators. These individuals must have the expertise, background, or training to adequately identify and handle sexual harassment issues. Moreover, these individuals should be perceived as impartial and should be respected by both the staff and the administration. Generally, the size and structure of an organization will dictate the appropriate designees, but particular attention must be given to the selection process. While representatives must be both approachable and professional, they must also have sufficient authority to effectively deal with upper-level harassers or at least be perceived as having such command.

The policy also must reflect the underlying principle that the company respects the dignity and professionalism of each of its employees. To this end, employers must clearly articulate a zero tolerance standard and provide a readily accessible complaint mechanism that explicitly addresses all forms of harassment, including harassment by non-employees and same-sex harassment, and is tailored to the circumstances of the workplace.

Once a policy has been carefully drafted, an employer must disseminate it throughout the workforce, as broadly as possible. It should be posted in central locations in every facility

and circulated periodically through the internal mailing system. Additionally, the policy and complaint procedure should be outlined in personnel manuals or handbooks and explained in detail during every new employee orientation.

Furthermore, all current employees, particularly supervisory personnel, must be properly trained. This training should focus on facts: what is inappropriate conduct, why such conduct is not permitted, and to whom violations should be reported. Training must be accessible to all members of the organization, including those with disabilities and those with limited English skills.

2. *Conducting an Investigation*

Employers must be alert to any potential warning signals of harassment. Once so alerted, prompt and effective action is essential. Rumors or informal reports should be taken seriously, for once an employer is advised of a problem, it is on notice and should investigate. Once an investigation is commenced, efficient discovery of all relevant information is paramount. Investigators should be properly trained to interview witnesses and recognize important non-verbal clues so as to elicit pertinent facts. Finally, all documents should be preserved and maintained by an individual with a need to know of the complaint.

F. After the Investigation

Often, this decision can be the most difficult part of this process because often direct contradictions between witnesses exist with no solidly objective basis upon which to make a final decision. Ultimately, three possible conclusions exist: no violation; inconclusive finding; and policy violation. In the event that no violation was uncovered or the findings were inconclusive, both parties should be informed of the employer's conclusion. Thereafter, the policy should be reviewed with the alleged harasser or, if the allegation is sufficiently serious, counseling, training or a leave of absence, or minimizing contact with the alleged victim may be appropriate. If a policy violation is in fact uncovered, appropriate disciplinary action consistent with both the organization's other discipline and personnel policies and the circumstances of the harassment at issue must be taken.

G. Conclusion

Clearly, issues of harassment remain at the forefront of employment law. Unfortunately, the standards and dictates of the law have grown increasingly complex. Therefore, it is more important now than ever for employers to understand the legal definition of harassment, the basis for employer liability and ways of preventing such conduct in the first instance. As the relevant information proliferates and the fundamental concepts evolve, it is vital for employers to continue to create an informed and effective anti-harassment program, take every complaint seriously, investigate the allegations and respond appropriately.

II. ANTICIPATING AND DEFENDING AGAINST PUNITIVE DAMAGES: THE KOLSTAD EFFECT

A. Introduction

The Supreme Court's June decision in the case of *Kolstad v. American Dental Association*, 119 S. Ct. 2118 (1999) continues the High Court's effort to create particularized incentives and disincentives for employers in the areas of workplace discrimination and harassment. *Kolstad*, and its companion keystone cases of *Burlington Industries, Inc. v. Ellerth*, 524 U.S. 742, 118 S. Ct. 2257 (1998) and *Faragher v. City of Boca Raton*, 524 U.S. 775, 118 S. Ct. 2275 (1998) (hereinafter "*Faragher/Ellerth*"), send a clear message that the High Court is prepared to step into the minutiae of workplace relations and suggest workplace policies and practices that go beyond the legal obligation to "not discriminate" or "not harass." The Court's apparent goal: to stem the tide of employment harassment and discrimination claims overwhelming federal dockets around the country. Whether or not *Faragher/Ellerth* and *Kolstad* will accomplish this goal remains to be seen. *Kolstad*, akin to *Faragher/Ellerth*, does, however, hand each employer a "tool kit" to avoid or diminish the negative consequences of employment litigation. In *Kolstad's* case, the tool kit is the implementation of "good faith efforts" to comply with Title VII. See *Kolstad* at 2129. If these efforts are implemented to a court's satisfaction, an employer may avoid vicarious liability for punitive damages, often the least predictable (and therefore the most dangerous) element of damages under Title VII and its analogues, such as various state statutory schemes and the Americans With Disabilities Act ("ADA").

This section will discuss *Kolstad's* effect on workplace policies and practices and will suggest how an employer can prepare to utilize *Kolstad's* principles in employment litigation.

B. Background

In 1991, Congress amended Title VII of the Civil Rights Act of 1964 ("Title VII") to permit victims of intentional employment discrimination to recover both compensatory and punitive damages. See 42 U.S.C. § 1981a ("1991 Act"). Prior to 1991, Title VII offered backpay and other equitable relief. Neither compensatory nor punitive damages were available under Title VII. See 42 U.S.C. § 2000e-5(g) (West 1990). Under the 1991 Act, compensatory and punitive damages were allowed, up to a maximum award of \$300,000. See 42 U.S.C. § 1981a(b)(3).

Punitive damages are not available in every Title VII action; they are available only where an individual or entity has "engaged in a discriminatory practice or discriminatory practices with malice or with reckless indifference to the federally protected rights of an aggrieved individual." *id.*, § 1981a(b)(1). In 1998, the Supreme Court agreed to hear *Kolstad* to determine when punitive damages are available as a remedy in Title VII cases.

C. The *Kolstad* Decision

In *Kolstad*, the Court found that an employer's state of mind, rather than the egregiousness of the discriminatory conduct, determines whether punitive damages may be awarded under the 1991 Act. *See Kolstad*, 119 S. Ct. at 2124. Where an employer either knows that its actions will violate Title VII or understands that there is a risk its actions will violate Title VII, it may be liable in punitive damages. *id.* at 2125. The Court further found that the 1991 Act did not require proof of "egregious conduct" on the employer's part as a prerequisite to a punitive award. *id.* at 2126.

The Court also found that Title VII seeks to prevent discrimination from occurring in the workplace by encouraging employers to implement anti-discrimination programs. *See id.* If an employer is vicariously liable for any Title VII violation committed by a managerial agent who knows the law, the employer has a disincentive to educate his employees about Title VII. *See id.* To ease this tension, the Court created a defense for employers faced with vicarious liability for punitive damages under Title VII:

[I]n the punitive damages context, an employer may not be vicariously liable for the discriminatory employment decisions of managerial agents *where these decisions are contrary to the employer's good faith efforts to comply with Title VII.*

id. (emphasis added). The Court found that such good faith compliance efforts demonstrate that the employer "never acted" with "malice or reckless indifference to . . . federally protected rights," and therefore the employer could not be vicariously liable for punitive damages pursuant to this language in the 1991 Act. *See id.*

D. What Are "Good Faith Efforts"?: *Kolstad* and Its Progeny

The *Kolstad* Court provided some guidance as to what would constitute "good faith efforts." The Court made reference to *Faragher/ Ellerth* and its citing of "antiharassment policies" and "effective grievance mechanisms." *id.* at 2129. The Court also noted that Title VII is advanced where "employers are encouraged to adopt antidiscrimination policies and to educate their personnel on Title VII's prohibitions." *id.* The Court's opinion referred as well to Circuit Judges Tatel's and Harris' opinions in *Kolstad*, when the case was before the D.C. Circuit Court of Appeals. *Id.* According to Judge Tatel's dissent, an employer could demonstrate that it had in good faith attempted to comply with Title VII by showing that it had (a) hired staff and managers sensitive to Title VII responsibilities, (b) required effective anti-discrimination training, and (c) developed and used objective hiring and promotion standards. Judge Harris observed that the "existence of a written policy instituted in good faith" operates in some cases as a "total bar" to punitive damages. 119 S. Ct. at 2129.

A number of decisions since *Kolstad* provide further guidance. In *Deffenbaugh-Williams v. Wal-Mart Stores, Inc.*, 188 F.3d 278 (5th Cir. 1999), the Court of Appeals determined that the defendant had not shown “good faith efforts” to comply with Title VII by merely citing to its policy that employees with grievances contact higher management. *id.* at 286. The Court noted further that the defendant did not provide any evidence regarding (a) how the plaintiff’s initiating internal complaint was handled, (b) specific Title VII-related efforts to comply with that law and (c) how a manager’s biased comment could “pass unrebutted” at a managerial meeting. *id.* The Court did, however, cite with approval a pre-*Kolstad* decision -- *Patterson v. P.H.P. Healthcare Corp.*, 90 F.3d 927 (5th Cir. 1996) -- in which the appellate panel cited an employer’s (a) express written policy of non-discrimination, (b) written explanation of a grievance procedure, (c) constant dissemination of memoranda to all employees concerning the complaint procedure and (d) prompt remedial measures, as a basis for upholding the district court’s refusal to impose punitive damages. *id.* at 282-83.

Similarly, in *Lowery v. Circuit City Stores, Inc.*, 206 F.3d 431 (4th Cir. 2000), the mere existence of an employer’s anti-discrimination policies and procedures were insufficient to establish the requisite good-faith efforts. There, the record established that the employer educated its managers concerning equal employment opportunity issues and had in place a non-discrimination policy as well as three avenues for bringing complaints to the company’s attention. *id.* at 439-40. Nevertheless, the court affirmed the awarding of punitive damages in light of evidence which called into question the bona fides of the company’s commitment to nondiscrimination. Specifically, the court noted the racially discriminatory attitudes of two top executives and the fact that one of those executives implemented the challenged promotional system. Moreover, there was evidence that employees felt either ignored or intimidated after utilizing the internal complaint procedures. *id.* at 446. In short, the court found that the employer’s purported good faith efforts were but a “cover-up [of] a corporate policy of keeping African-Americans in low level positions.” *id.* See also *Passantino v. Johnson & Johnson Consumer Prods., Inc.*, 207 F.3d 599, 622 (9th Cir. 2000) (observing that to escape punitive damages, “an employer must show not only that it has adopted an anti-discrimination policy, but that it has implemented it in good faith.”).

In *Blackmon v. Pinkerton Security & Investigative Services*, 182 F.3d 629 (8th Cir. 1999), an appellate court noted that the following factors established the necessary “malice and reckless indifference” to an employee’s rights: (a) the employer’s failure to investigate the employee’s complaints, (b) the employer’s repeated retaliation against the employee (c) the employer’s attempts to “escape legal liability” by soliciting negative information about the employee and masking her retaliatory termination with the simultaneous termination of another employee, and (d) the active involvement of the employer’s supervisory employees in explicit harassing acts. 182 F.3d at 636. See also *Sowemimo v. D.A.O.R. Sec., Inc.*, 97 Civ. 1083, 2000 WL 546439 (S.D.N.Y. May 4, 2000) (finding punitive damages appropriate where the employer failed to investigate the plaintiff’s sexual harassment complaints). While the opinion addressed mainly whether certain conduct rose to the level of “malice and reckless indifference” standard, the Court’s holding in this case suggests that even where an employer

might have evidence of “good faith efforts,” particularly bad facts specific to the plaintiff or the deep involvement of supervisory personnel in those facts may compel punitive damages liability.

In *EEOC v. Wal-Mart Stores, Inc.*, No. 98-2015, 1999 WL 638210 (10th Cir. Aug. 23, 1999), the Tenth Circuit appellate panel noted that the employer’s assertion of a “generalized policy of equality and respect for the individual” does not demonstrate “good faith” efforts to comply with, in this instance, the ADA. The Court further noted “a broad failure to educate” employees, “especially” supervisors, on the requirements of the ADA in particular and the prevention of discrimination in general.

Interestingly, in *Deters v. Equifax Credit Information Services, Inc.*, 202 F.3d 1262, 1271 (10th Cir. 2000), the Eighth Circuit Court of Appeals held that the employer was subject to punitive damages, notwithstanding the existence of its good-faith policies against sexual harassment, where the harasser was the company-designated official in charge of implementing the sexual harassment policy and processing sexual harassment complaints.

E. What Are “Good Faith Efforts”?: A Summary

Kolstad creates a strong incentive for employers to undertake efforts to comply with anti-discrimination laws. Set forth below are some concrete suggestions to demonstrate “good faith efforts.”

The first step employers should take in protecting themselves from vicarious liability for punitive damages under Title VII and the ADA is the creation and implementation of an effective anti-discrimination policy. That policy and its implementation may include the following: (1) a formal, written policy prohibiting discrimination based on race, sex, religion, national origin, and disability; (2) distribution of copies of the policy against discrimination to all employees by multiple means of delivery (*i.e.*, e-mail, posting, etc.); (3) training all employees about the anti-discrimination policy; (4) prompt and thorough investigation of all reported incidents of anti-discrimination policy violations; and (5) enforcement of the policy by taking appropriate actions against employees who violate it.

1. Develop and Implement a Policy Prohibiting Discrimination.

The policy should contain the following characteristics:

- (a) The policy should be specific with regard to the types of discrimination it prohibits as well as to the laws which prohibit that discrimination.
- (b) The policy should describe the grievance mechanism the employer has created to deal with violations of the policy.

2. *Disseminate the Anti-discrimination Policy.*

An anti-discrimination policy affords employers no protection if their employees are unaware of it. Employers should therefore take steps to ensure dissemination of their anti-discrimination policy.

3. *Train All Employees About the Policy.*

To further ensure that their employees are aware of and understand their anti-discrimination policy, employers should train their employees regarding its contents.

4. *Promptly and Thoroughly Investigate All Reported Incidents of Anti-discrimination Policy Violations.*

Once an employee has done his or her part to report an incident of discrimination, the employer must conduct an investigation of the alleged discrimination.

5. *Enforce the Policy by Taking Appropriate Action Against Employees Who Violate the Policy and by Remediating Any Wrong Suffered by Others.*

In order to demonstrate an employer's "good faith" commitment to its anti-discrimination policy, it is imperative that the employer take appropriate action against employees who violate the policy and remedy those wrongs suffered by those employees who are the victims of such policy violations.

MANAGING WHISTLEBLOWERS

I. FEDERAL WHISTLEBLOWER LAWS

There are a variety of federal statutes that provide job protection to an employee for reporting the illegal conduct of his or her employer. Each of these statutes contains both civil and criminal penalties. Thus, a company that violates the substantive requirements of one of these statutes and fires an employee who reports the violation could face both criminal prosecution for the initial violation of the statute and an administrative or civil action by the discharged employee for violation of the statute's whistleblower provisions.

Federal law protections applicable to private sector employees in the securities industry include the following statutes:

A. Federal Civil Rights Legislation

Title VII of the Civil Rights Act of 1964 ("Title VII"), 42 U.S.C. § 2000e-3a, the Age Discrimination in Employment Act ("ADEA"), 29 U.S.C. § 623, and the Americans with Disabilities Act ("ADA"), 42 U.S.C. § 11203, provide virtually identical whistleblower protections. Each of the laws make it unlawful for an employer to discriminate against an employee or applicant for employment because the employee has opposed any practice which is an unlawful employment practice under the statute, or because the employee has made a charge, testified, assisted or participated in any manner in an investigation proceeding or hearing pursuant to the statute. The remedies available for retaliation claims under these statutes are the same as those available for discrimination claims. *See* 42 U.S.C. §§ 2000e-5-10; 42 U.S.C. § 12203(i); 29 U.S.C. § 626.

B. The Family and Medical Leave Act ("FMLA")

The FMLA prohibits employers from interfering with, restraining or denying an employee from exercising his/her rights under the FMLA. It is also unlawful for an employer to discharge or otherwise discriminate against an employee for filing a charge or instituting a proceeding under the statute, providing information in connection with a proceeding under the statute, or testifying in a proceeding under the statute.

C. The National Labor Relations Act ("NLRA")

The NLRA, the primary federal law governing private sector labor-management relations, prohibits retaliation against any "employee because he or she has filed a charge or given testimony" under the Act. 29 U.S.C. § 158(a)(4). The NLRA differs from the anti-retaliation provisions of the federal civil rights legislation in that it does not provide protections to employees for merely opposing an

employer's action; the NLRA only provides protection to those employees who have "participated" in NLRA proceedings. Significantly, the NLRA anti-retaliation provision only protects "employees," as defined in the Act, and therefore, it generally does not protect supervisors who participate in NLRA proceedings. The remedies and procedures for a retaliation claim under the NLRA are governed by the same provisions as any other claim of an unfair labor practice.

D. The Fair Labor Standards Act ("FLSA")

The FLSA, which *inter alia*, sets minimum wage and overtime requirements, makes it an unlawful practice for "any person . . . to discharge or in any other manner discriminate against any employee because such an employee has filed any complaint or instituted or caused to be instituted any proceedings under or related to [the FLSA], or has testified or is about to testify in any proceedings . . ." 29 U.S.C. § 215(a)(3). The FLSA gives broader protection than does the NLRA and protects all persons, not just employees. An employee who violates the anti-retaliation provision of the FLSA shall be liable for such legal or equitable relief as may be appropriate, including without limitation, reinstatement, back wages and an additional equal amount as liquidated damages. The action can be filed in any federal or state court of competent jurisdiction. Attorney's fees and costs are available to prevailing plaintiffs.

E. The Employment Retirement Income Security Act ("ERISA")

Section 510 of ERISA, 29 U.S.C. § 140, makes it unlawful for any person to discharge, fine, suspend, expel, discipline, or discriminate against an employee benefit plan participant or beneficiary for exercising any right to which he or she is entitled under the provision of the plan, ERISA, or the Welfare and Pension Plans Disclosure Act 29 U.S.C. § 301 *et seq.*, or for the purpose of interfering with the attainment of any right under any of the above provisions. The Secretary of Labor, a participant, or beneficiary may bring a civil action to enjoin the conduct violative of 29 U.S.C. § 1140, or to obtain other appropriate equitable relief, which can include backpay.

F. Civil Rights Act of 1871, 42 U.S.C. 1985

This Reconstruction-era statute creates a cause of action against public or private conspiracies to interfere with the administration of justice in the federal courts by forbidding intimidation of parties or witness. *Kush v. Rutledge*, 460 U.S. 719, 103 S. Ct. 1483 (1983) clarified that this law applies to private conspiracies and does not require state action.

G. Occupational Health and Safety Act (“OSHA”)

OSHA provides that each employer has a general duty to furnish to each of his employees a place of employment that is free from recognized hazards that are causing or that are likely to cause death or serious physical harm to his or her employees. 29 U.S.C.

§ 654(a)(1). OSHA also states that each employer must comply with specific occupational safety and health standards promulgated under the statute. 29 U.S.C. § 654(a)(2). An employer may not discharge or discriminate against an employee who institutes any proceeding related to OSHA, testifies in such a proceeding or exercises any rights under OSHA on behalf of him/herself or others. 29 U.S.C. § 660(c)(1). If an employee is subject to such action, he or she may file a complaint with the Secretary of Labor. If the Secretary determines that the employment action violated OSHA, the secretary must bring an action in federal district court for relief. 29 U.S.C. § 660(c)(2).

H. Federal Deposit Insurance Act (“FDIA”)

No federally insured depository institution may discharge or otherwise discriminate against any employee because the employee provided information to any federal banking agency or to the Attorney General regarding a possible violation of any law or regulation by the depository institution or any of its officers, directors, or employees. 12 U.S.C.

§ 1831j(a). An employee subject to such action may file a civil action in federal district court, and the court may order the institution to reinstate and pay compensatory damages to the employee. 12 U.S.C. § 1831j(b) and (c).

I. False Claims Act ("FCA")

The FCA provides that anyone who knowingly submits to the federal government a false or fraudulent claim for money is liable for a civil penalty of up to \$10,000 plus three times the amount of damages the government sustains because of the false claim. 31 U.S.C.

§ 3729(a). The FCA makes it unlawful for an employer to discharge, demote, suspend, threaten, harass, or in any other manner discriminate against in the terms and conditions of employment because an employee has, *inter alia*, investigated, initiated, testified in, or otherwise assisted in an action under the FCA. An employee may bring an action in the appropriate federal district court. Relief shall include reinstatement with the same seniority status such employee would have had but for the discrimination, two times the amount of back pay, and compensation for any special damages sustained as a result of the discrimination, including litigation costs and attorneys' fees. 31 U.S.C. § 3730(h).

J. Additional Federal Whistleblower Acts

Federal whistleblower acts that may apply to other industries include: Federal Water Pollution Control Act, Toxic Substances Control Act, Solid Waste Disposal Act, Clean Air Act, Safe Drinking

Water Act, The Energy Reorganization Act of 1974, Federal Employers' Liability Act, Federal Credit Union Act, and The Mine Safety and Health Act.

II. STATE WHISTLEBLOWER LAWS

Many states have laws concerning employee whistleblowing. These states give statutory and/or common law protection to employees who report their employers' illegal activity or misconduct. For states that follow the employment-at-will doctrine, this protection is often a recognized exception.

A. New York

Section 215 of the New York Labor Code protects employees from discharge, penalty or any manner of discrimination for making a complaint to their employer or to the Commissioner of Labor that the employer has violated any provision of the New York Labor Law or for instituting a proceeding or testifying in a proceeding under the New York Labor Law. If an employer violates this provision, it may be assessed a civil penalty between \$200 and \$2,000. An employee may also bring a civil action against its employer or anyone else who violated this provision. The court will have the power to restrain violations of this provision and order rehiring, reinstatement, payment of lost compensation, damages, and/or reasonable attorneys' fees.

Section 740 of the New York Labor Code protects private employees against retaliatory action for disclosing to a supervisor or public body that its employer violated a "law, rule or regulation" that presented a "substantial and specific danger" to the public health or safety. New York Labor Code § 740.2. An employee will not be protected if he reports generalized suspicions; the report must establish an "actual violation" that relates to public health or safety. *See Bordell v. General Elec. Co.*, 88 N.Y.2d 869, 644 N.Y.S.2d 912, 667 N.E.2d 923 (1996). Allegations of fraudulent economic practices are not covered by the law. *See Schultz v. North Am. Ins. Group*, 34 F. Supp.2d 866, 869 (W.D.N.Y. 1999). Also, the employee must be able to prove that the termination was a result of the disclosure. *See Lambert v. General Elec. Co.*, 244 A.D.2d 841, 666 N.Y.S.2d 289 (3d Dep't 1997). Remedies include injunctive relief, reinstatement, lost wages, and plaintiff's costs and attorneys' fees. New York Labor Law § 740.2(a)-(e). There is no provision for a jury trial or punitive damages. *See Scaduto v. Restaurant Assocs. Indus., Inc.*, 180 A.D.2d 458, 579 N.Y.S.2d 381 (1st Dep't 1992).

One court has noted that a routine release of claims as part of a separation agreement cannot prohibit an employee from exposing an employer's wrongdoing. *See McGrane v. Reader's Digest Ass'n., Inc.*, 822 F. Supp. 1044, 1051 (S.D.N.Y. 1993), *modified by*, 1993 WL 525127, *5 (S.D.N.Y. Dec. 13, 1993). Hence, "[a]ny arrangement or agreement, formal or informal, designed to

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preclude a former employee from reporting wrongdoing by a former employer to proper authorities would be unenforceable.” *id.*

New York courts have declined to create a public policy exception to the at-will doctrine because employees “have already been afforded express statutory protection from firing for engaging in certain protected activities.” *Murphy v. American Home Prods. Corp.*, 58 N.Y.2d 292, 302 n.1, 461 N.Y.S.2d 232, 235-36, 448 N.E.2d 86, 90 (1983).

B. New Jersey

The New Jersey Conscientious Employee Protection Act (“CEPA”), N.J. Stat. Ann. § 34:19-3 (West 2000) is broader than the New York law and prohibits private employers from retaliating against an employee for a wide range of protected whistleblowing activities. Specifically, it provides:

An employer shall not take any retaliatory action against an employee because the employee does any of the following:

- (a) Discloses, or threatens to disclose to a supervisor or to a public body an activity, policy or practice of the employer or another employer, with whom there is a business relationship, that the employee reasonably believes is in violation of a law, or a rule or regulation promulgated pursuant to law;
- (b) Provides information to, or testifies before, any public body conducting an investigation, hearing or inquiry into any violation of law, or a rule or regulation promulgated pursuant to law by the employer or another employer, with whom there is a business relationship; or
- (c) Objects to, or refuses to participate in any activity, policy or practice which the employee reasonably believes: (1) is in violation of a law, or a rule or regulation promulgated pursuant to law; (2) is fraudulent or criminal; or (3) is incompatible with a clear mandate of public policy concerning the public health, safety or welfare or protection of the environment.

N.J.S.A. 34:19-3.

An employee needs only a reasonable belief, and not certainty, that the employer was acting improperly to fall within the protection of the statute. N.J.S.A. 34:19-3. However, the statute only protects “whistleblowing” activity where an employee reports or refuses to participate in activities that are actually illegal or wrongful. *See Smith-Bozarth v. Coalition Against Rape and Abuse, Inc.*, 329 N.J. Super. 238, 244-46, 747 A.2d 322, 325-326 (2000) (employee who was terminated for failing to

turn over victim's file to head of agency could not allege C.E.P.A. claim because there was no clear mandate of public policy prohibiting employee from disclosing such information to the head of agency); *Young v. Schering Corp.*, 275 N.J. Super. 221, 236, 645 A.2d 1238, 1246 (1994) (employee who was fired for disagreeing with employer's decision to research a certain drug could not assert a C.E.P.A. claim because the employer's activity was lawful), *aff'd*, 141 N.J. 16, 660 A.2d 1153 (1995). *See also Roach v. TRW, Inc.*, 326 N.J. Super. 493, 495, 742 A.2d 135 (1999) (C.E.P.A. does not protect employee's disclosures regarding co-employee's illegal activity or misconduct). Also, the employee must be able to prove that the adverse employment action resulted from the whistleblowing activity. *See Kolb v. Burns*, 320 N.J. Super. 467, 476, 727 A.2d 525, 530 (1999).

The definition of an employee under C.E.P.A. is broad enough to include an in-house attorney for a corporation. *See Parker v. M & T Chems., Inc.*, 236 N.J. Super. 451, 566 A.2d 215 (1989) (finding that in-house attorney was constructively discharged in violation of New Jersey's whistleblower statute because he objected to his employer's theft or misappropriation of another company's trade secrets and rejecting the employer's argument that the whistleblower statute unconstitutionally impinges on the state's rules of professional conduct which provide that a lawyer shall withdraw from representation if discharged).

An employee must make an internal report of the wrongdoing before bringing it to the attention of a public body, except in emergency situations. N.J.S.A. 34:19-3. However, an employee's complaint must be reasonable and an employee cannot take destructive or violent actions to remedy an employer's wrongdoing. *See Haworth v. Deborah Heart & Lung Cetr.*, 271 N.J. Super. 502, 638 A.2d 1354 (1994) (employee was terminated for demonstrating his objections to hospital's blood-identification practices by destroying a number of blood samples).

Although the statute itself does not make any reference to waivers or releases, a New Jersey Superior Court decision suggests that failure to specifically identify that the employee was waiving claims against CEPA in the release would raise a material issue of fact sufficient to preclude summary judgment dismissing a claim based on the release. *See Keelan v Bell Comm.*, 289 N.J. Super. 531, 545, 674 A.2d 603 (App. Div. 1996) ("Given the particular importance of CEPA in protecting whistleblowers' rights and thereby ensuring public health and safety, defendant's failure to mention CEPA claims by name and the effect, if any, upon the issue of whether the release was knowing and voluntary, raised a material issue which should have precluded a grant of summary judgment").

Remedies under C.E.P.A. can include injunctive relief, reinstatement, lost wages, punitive damages, costs, attorneys' fees, and civil fines for employers. *See, e.g.*, N.J.S.A. 34:19-5, 19-6; *Moody v. Marlboro*, 855 F. Supp. 685 (D.N.J. 1994), *aff'd*, 54 F.3d 769 (3d Cir. 1995) (award of attorneys' fees under the Act is at the court's discretion).

C. Other States

Other states with specific whistleblowing statutes include: California, Colorado, Connecticut, Florida, Hawaii, Illinois, Iowa, Louisiana, Maine, Michigan, Minnesota, Montana, Nebraska, New Hampshire, North Carolina, Ohio, Oregon, Rhode Island, Pennsylvania, Tennessee, Texas, and Wisconsin.

III. PREVENTIVE PLANNING

Employees often “blow the whistle” because they believe it would be futile to address alleged improprieties within the organization. If employees understand that their companies have effective internal mechanisms for addressing complaints and concerns, they are less likely to complain outside their companies.

An employer might require that disclosures initially be made internally. An employer should expressly confirm its commitment to ethical practices and perhaps adopt a code of ethics. An employer might also adopt a policy that disclosures will be kept confidential or consider designating an ombudsman to alleviate tension before a problem develops. Also, releases should include specific references to whistleblower claims and applicable whistleblower statutes.

IV. ONCE THE WHISTLE HAS BEEN BLOWN

One of the most difficult and critical periods is after the whistle has been blown and before any employer action has been taken. During this period, key evidence can be identified and developed. Since the determinative liability issue is often whether the employee suffers adverse action due to the whistleblowing activities, the conduct of the parties after the whistle has been blown usually represents the evidentiary guts of the case.

As soon as it becomes apparent that a whistleblower problem is likely to arise, even before a lawsuit is filed, the employer should begin gathering information. Immediate and comprehensive internal investigation is called for. If the investigation reveals that the employee's complaints are well-founded, the employer will be able to obtain favorable publicity by taking quick, corrective measures. If the complaint is unfounded, the employer could still obtain favorable publicity by demonstrating concern about the alleged problems. If the employee cannot be deterred and the employer is certain that there is no violation, the employer might consider seeking a temporary restraining order against disclosure.

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The employer also must investigate the employee's job history. The employer may find that an irresponsible whistleblower has a history of unfounded internal complaints to previous employers that were not publicized.

If an employee who is on the verge of being fired or disciplined blows or threatens to blow the whistle, the employer should investigate the claim and confirm that there is an appropriate and defensible basis for the discipline or discharge before taking any adverse action.

Once the whistle is blown, the employer should evaluate possible responses, such as confrontation, transfer to an equivalent position, cutting off access to sensitive materials, or self-disclosure to government agency, if appropriate. This evaluation is aided by the investigations we just mentioned and assessing the possible statutes under which the employee could have a claim if an adverse action is taken.

One course of action open to an employer in this situation is to self-disclose to the relevant government agencies. This has many possible advantages and disadvantages.

Also, as soon as the whistle is blown, the supervisor of the whistleblower should be advised that the company has an obligation not to retaliate. This can be reinforced by a directive that no adverse action can be taken without approval of higher management or the general counsel's office.

ISSUES RELATING TO ARBITRATION OF EMPLOYMENT CLAIMS

I. FINALITY OF ARBITRATION AWARDS AFTER *HALLIGAN* AND *CHISOLM*

The Second Circuit's 1998 decision in *Halligan v. Piper Jaffray, Inc.*, 148 F.3d 197 (2d Cir. 1998), *cert. denied*, 119 S. Ct. 1286 (1999) seemingly redefined the "manifest disregard" standard of judicial review of arbitration awards. While arbitration awards have long been subject to a "severely limited" review for manifest disregard of the law, *Halligan* expanded that review to include a probing examination of the record to determine whether the arbitrator(s) manifestly disregarded the evidence in reaching their decision. In addition, although it has long been the rule that arbitrators are not required to provide a rationale for their awards, *Halligan* held that, in certain limited circumstances, the lack of a written rationale could be taken into account in determining whether the arbitrator(s) manifestly disregarded the law or the evidence.

During the past two years, several courts have applied the new standard of review enunciated in *Halligan*. The Second Circuit applied this new standard in another case in which it distinguished and seemingly limited *Halligan* in rejecting a request to vacate an arbitration award. *See, Chisolm v. Kidder, Peabody Asset Management, Inc.*, 164 F.3d 617 (2d Cir. 1998). Several district courts in the Second Circuit have also read *Halligan* narrowly in rejecting requests for vacatur. *See, e.g., Sobol v. Kidder, Peabody & Co.*, 49 F. Supp. 2d 208 (S.D.N.Y. 1999); *Campbell v. Cantor Fitzgerald*, 21 F. Supp. 2d 341 (S.D.N.Y. 1998), *reconsideration denied*, 21 F. Supp. 2d 341, 347 (S.D.N.Y. 1998); *Cowle v. PaineWebber, Inc.*, No. 98 Civ. 2560, 1999 WL 194900 (S.D.N.Y. April 7, 1999). As more fully explained below, these cases suggest that arbitration awards will continue to be confirmed where ample basis for the award can be inferred from the record evidence, at least in the absence of "overwhelming" or "extremely strong" evidence to the contrary. It still remains to be seen, however, whether arbitration awards will be confirmed where the record includes both ample basis to support the award and strong or overwhelming evidence to the contrary.

What is clear, though, is that the Second Circuit has departed from decades of precedent by creating a new standard of review which has the potential of turning the judiciary into super-arbitrators, with courts sorting through hundreds of exhibits and thousands of pages of transcripts to respond to arguments that arbitrators incorrectly discerned the facts and weighed the evidence. Such an intrusive standard of review is clearly inconsistent with the strong federal policy favoring arbitration, and the interests of efficiency and finality that policy promotes.

A. The Federal Arbitration Act

When the Federal Arbitration Act (“FAA”) was enacted in 1947, it severely limited the circumstances under which an arbitration award could be vacated to certain enumerated narrow grounds, such as fraud, bias or arbitrator misconduct. For the next 50 years, courts consistently exercised restraint in limiting judicial review of arbitration awards to avoid undermining the twin goals of arbitration, namely, settling disputes efficiently and effectively, and avoiding long and expensive litigation.^{9/}

B. The Manifest Disregard Standard Of Review

In addition to the grounds for vacatur enumerated in the FAA, an arbitration award can be vacated if the arbitrators “manifestly disregarded the law” in reaching their decision.^{10/} The reach of this doctrine has historically been viewed as “severely limited,”^{11/} and as requiring “more than error or misunderstanding with respect to the law.”^{12/} Indeed, the courts have long acknowledged that “it is [not] the function . . . of the district courts to review the record of the arbitration proceedings for errors of law or fact.”^{13/}

In recent years, the Second Circuit handed down three important decisions involving securities industry employment arbitration’s in which the Court clarified and then redefined the manifest disregard standard. The first of these cases was *DiRussa v. Dean Witter Reynolds Inc.*, 121 F.3d 818 (2d Cir. 1997), *cert. denied*, 522 U.S. 1049 (1998). There, the Court upheld an arbitration panel’s award even though the panel had declined to award attorneys’ fees to the prevailing claimant as required by the Age Discrimination in Employment Act (“ADEA”). The panel did not explain why they did not award attorney’s fees, nor, according to the Second Circuit, “were they required to do so.”^{14/} Although the ADEA mandates the award of attorneys’ fees to a prevailing claimant such as *DiRussa*, the Court concluded that the arbitrators had not been aware of this provision of the statute, and therefore, being ignorant of the law, could not have manifestly disregarded it. In so concluding, the Court held that to

^{9/} See *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*, 808 F.2d 930, 933 (2d Cir. 1986).

^{10/} See *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 942 (1995).

^{11/} See *Government of India v. Cargill, Inc.*, 867 F.2d 130, 133 (2d Cir. 1988).

^{12/} See *Bobker*, 808 F.2d 933.

^{13/} See *Saxis S.S. Co. v. Multifacs Int’l Traders, Inc.*, 375 F.2d 577, 582 (2d Cir. 1967).

^{14/} See *DiRussa*, 121 F.3d at 822.

vacate an award for manifest disregard of the law, a court must find “both that (1) the arbitrators knew of a governing legal principle yet refused to apply it or ignored it altogether, and (2) the law ignored by the arbitrators was well defined, explicit and clearly applicable to the case.”^{15/}

C. The *Halligan* Case

In *Halligan*, the Second Circuit was again asked to review a securities industry arbitration panel’s award under the manifest disregard standard. This time, however, the Court not only vacated the award, it redefined the manifest disregard standard. Specifically, the Court departed from its long history of judicial restraint, as reaffirmed in *DiRussa*, and conducted its own independent review of the record of the arbitration proceeding. The Court then held, based on that review, that the award should be vacated because the arbitrators manifestly disregarded “the law or the evidence or both.”^{16/}

Halligan involved a challenge to an NASD arbitration award in which the panel rejected an age discrimination claim after 26 days of hearing during which 25 witnesses testified. The District Court confirmed the award, holding that where, as in that case, the arbitration panel “was faced with the task of evaluating conflicting witness testimony,” the Court should not second-guess the credibility determinations and fact-finding done by the arbitrators.^{17/}

The Second Circuit disagreed. In reversing the District Court and vacating the award, the Court reviewed the record of the arbitration proceeding and found what it variously described as “strong,” “very strong” and “overwhelming” evidence of discrimination.^{18/} The Court then held that “in view of the strong evidence that Halligan was fired because of his age and the agreement of the parties that the arbitrators were correctly advised of the applicable legal principles, we are inclined to hold that [the arbitrators] ignored the law or the evidence or both.”^{19/}

^{15/} *Id.* at 821 (citations omitted).

^{16/} *Halligan*, 148 F.3d at 204.

^{17/} *Halligan v. Piper Jaffray, Inc.*, No. 96 Civ. 4472, 1997 WL 181028 at *9 (S.D.N.Y. April 14, 1997).

^{18/} *Id.* at 203-04.

^{19/} *Id.* at 204.

Significantly, the Second Circuit's decision was based on its finding that Halligan's evidence of discrimination was "strong" or "overwhelming," not that it was undisputed or incontrovertible. Moreover, the decision appears to have been based upon the Court's own independent assessment of the evidentiary record with little, if any, deference to the arbitrators. Thus, in explaining why it was not remanding the case to the arbitrators for a written explanation of their award, the Court stated that if the arbitrators had issued a new award explaining that they had "credited Piper's witnesses rather than Halligan's," such an explanation "on this record would have been extremely hard to accept."^{20/}

Before *Halligan*, it was well-settled that a court could not review an arbitration award for evidentiary errors.^{21/} It was also well-settled that where "a ground for the arbitrator's decision can be inferred from the facts of the case, the award should be confirmed."^{22/} When *Halligan* was decided, it raised questions concerning whether these longstanding rules were being abandoned in favor of greater judicial scrutiny of the evidentiary record in arbitrations. Although the law is still evolving, the case law since *Halligan* suggests that while courts are applying greater scrutiny in their review of arbitration awards, they will not reweigh the evidence, and the award will be confirmed as long as ample basis for the decision can be inferred from the record evidence.

D. Absence Of A Written Rationale For The Award

It has long been accepted that arbitrators are not required to provide any rationale or explanation for their awards.^{23/} Nonetheless, the Halligan Court took the absence of a written explanation for the award into account in determining that the arbitrators had engaged in manifest disregard. The Court reasoned that "where a reviewing court is inclined to find that arbitrators manifestly disregarded the law or the evidence and that an explanation, if given, would have strained credulity, the absence of explanation may reinforce the reviewing court's confidence that the arbitrators engaged in manifest disregard." Although the Court added that it was not holding that written explanations are required "in every case or even in most cases," parties seeking vacatur of arbitration awards where no written rationale was provided can now

^{20/} Id.

^{21/} See *United Paperworkers v. Misco, Inc.*, 484 U.S. 29, 36 (1987) (courts may not "reconsider the merits of an award even though the parties may allege that the award rests on errors of fact").

^{22/} *Willemijn Houdstermaatschappij, BV v. Standard Microsystems Corp.*, 103 F.3d 9, 13 (2d Cir. 1997).

^{23/} See *United Steelworkers v. Enterprise Wheel & Car Corp.*, 363 U.S. 593, 598 (1960).

be expected to argue in every case that the absence of a written rationale buttresses their contention that the arbitrators manifestly disregarded the law or the evidence in rendering their award. *See Neary v. Prudential Ins. Co. of Am.*, No. 96 Civ. 1513, 1999 WL 692393 (D. Conn. Aug. 27, 1999) (failure of NASD arbitration panel to explain their award buttresses conclusion that panel manifestly disregarded the law or the evidence); *See also Rembert v. Ryan's Family Steak Houses, Inc.*, 596 N.W.2d 208, 230 (Mich. Ct. App. 1999) (arbitration awards must include written findings of fact and conclusions of law to allow for sufficient review).

The absence of a written rationale has historically made it more difficult to challenge an arbitration award. Under *Halligan*, the converse may be true in cases where it is claimed that the arbitrators disregarded the law or the evidence.

E. The *Chisolm* Decision

Shortly after *Halligan* was decided, the Second Circuit revisited the manifest disregard standard in *Chisolm v. Kidder, Peabody Asset Management, Inc.*, 164 F.3d 617 (2d Cir. 1998). In *Chisolm*, the Court issued a Summary Order refusing to vacate an NASD arbitration award in which the arbitrators dismissed the claimant's discrimination claims without issuing findings of fact, conclusions of law, or the rationale for their decision. The Summary Order is unpublished, and may not be cited as precedent. Nonetheless, it is instructive in its application of the *Halligan* "manifest disregard of the law or the evidence" standard. In finding that *Chisolm* had not made a sufficient showing under that standard, the Court stated that "[u]nlike *Halligan*, where there was 'strong evidence that *Halligan* was fired because of his age'", there was "ample basis" in *Chisolm* from which to conclude that *Chisolm*'s claims lacked merit.^{24/} Thus, *Chisolm* indicates that as long as there is "ample basis" in the record to support an arbitrator's decision, the Second Circuit will not vacate the award. What is less clear is whether the same result would follow if the record includes both "ample basis" to support an award and "strong" or "overwhelming" evidence to the contrary.

F. Cases Since *Halligan* and *Chisolm*

In the years since *Halligan* and *Chisolm* were decided, several district courts have applied *Halligan* in reviewing arbitration awards issued by NASD panels in employment cases. *See, e.g., Ahing v. Lehman Bros., Inc.*, 2000 WL 460443 (S.D.N.Y. April 18, 2000) (racial and sexual discrimination, harassment and a hostile work environment); *Sobol v. Kidder, Peabody, Inc.*, 49 F. Supp. 2d 208 (S.D.N.Y. 1999) (gender and age discrimination claims); *Campbell v. Cantor Fitzgerald & Co. Inc.*, 21 F. Supp. 2d 341 (S.D.N.Y. 1998) (wrongful discharge and defamation claims); *reconsideration denied*, 21 F. Supp. 2d 341, 347 (S.D.N.Y.

^{24/} *Chisolm*, 164 F.3d at 617.

1998); *Cowle v. PaineWebber, Inc.*, No. 98 Civ. 2560, 1999 WL 194900 (S.D.N.Y. April 7, 1999) (breach of contract claims); *Neary v. Prudential Ins. Co. of Am.*, No. 96 Civ. 1513, 1999 WL 692393 (D. Conn. Aug. 27, 1999) (wrongful discharge claim). In *Ahing*, *Sobol*, *Campbell* and *Cowle*, the court confirmed the arbitration award even though it did not include findings of fact, conclusions of law or the rationale for the arbitrators' decision. In *Neary*, the court vacated an arbitration award granting summary judgment dismissing the claimant's claims. All of these cases, like *Chisolm*, are instructive in their application of *Halligan*.

In *Ahing*, the court sustained the arbitrators' decision to dismiss Ahing's racial and discrimination claims because, unlike *Halligan*, there was "ample basis" in the record for the arbitrators to have concluded that the plaintiff's termination was due to her own shortcomings and not discrimination. In so doing, the court reaffirmed the pre-*Halligan* principle that the court's role is limited to reviewing the evidence to determine whether a basis exists for the outcome reached. As the court observed, it is not the court's function to weigh the evidence anew or to make findings of fact.

In *Sobol*, the court declined to infer that the arbitrators manifestly disregarded the law when they denied Sobol's discrimination and Equal Pay Act claims because, unlike the plaintiff in *Halligan*, Sobol had not presented "overwhelming" evidence of discrimination sufficient to justify a finding that the panel manifestly disregarded the law or the evidence in rejecting her claims,^{25/} and Kidder, Peabody had offered "legitimate business reasons" for any pay disparity between Sobol and other comparable employees.^{26/} The court also reaffirmed the pre-*Halligan* principle that courts are not permitted to review the weight accorded to conflicting evidence by an arbitration panel.^{27/}

In *Campbell*, the court applied *Halligan* in the context of wrongful discharge and defamation claims. In rejecting Campbell's arguments for vacatur, the court held that unlike the plaintiff in *Halligan*, whom the court described as having presented "extremely strong" evidence of discrimination, Campbell did not demonstrate that she had presented "strong evidence" to support her claims.^{28/} In that regard, the court emphasized that Campbell failed to provide the Court with transcripts of the arbitration proceedings, while the respondents presented excerpts of the proceedings from which the arbitrators' reasoning could be

^{25/} Sobol, 49 F. Supp. 2d at 221-23.

^{26/} Id. at 221.

^{27/} Id.

^{28/} Campbell, 21 F. Supp. 2d at 345.

inferred.^{29/} The court also emphasized that Campbell “never identifie[d] any principle of law that the panel purportedly failed to follow, and instead focused his arguments on the credibility of the evidence presented, which the court held was not a proper basis upon which to vacate an arbitration award.”^{30/} In rejecting Campbell’s subsequent motion to vacate the court’s order confirming the award, the court further observed that the respondents had submitted evidence to contradict her claims at the arbitration hearing, and that “it was up to the arbitrators to make factual findings, weight the evidence, resolve evidentiary conflicts, and access the credibility of witnesses.”^{31/} As the court explained, “*Halligan* does not stand for the proposition ... that district courts may reweigh the evidence and second-guess the arbitrators’ credibility determinations.”^{32/} Rather, arbitration awards must still be confirmed where, as in that case, “there is at least a colorable justification for the outcome reached’ by the arbitration panel.”^{33/}

In *Cowle*, the court applied *Halligan* in the context of a breach of contract claim. After citing *Halligan* for the proposition that a court may vacate an arbitration award where “... there is strong evidence’ contrary to the findings of the panel and the panel has not provided an explanation of its decision”,^{34/} the court confirmed the award in that case without opining on the strength of Cowle’s evidence. Instead, the court simply observed that the arbitrators had been presented with evidence which supported their award.^{35/} Thus, it appears that the court was prepared to confirm the award as long as ample basis for the award could be inferred from the record evidence.

Cowle is also significant because of the court’s discussion of Paine Webber’s motion for sanctions. Although sanctions were denied in that case on procedural grounds, the court admonished the plaintiff’s counsel for its lack of good faith in advancing “frivolous” arguments in favor of vacatur, and put counsel for similarly situated parties “on notice” that the court will not tolerate the assertion of frivolous arguments in an attempt to use the federal courts to delay the effect of an arbitration award.

^{29/} Id.

^{30/} Id.

^{31/} Id. at 348-49.

^{32/} Id. at 349.

^{33/} Id.

^{34/} *Cowle*, 1999 WL 194900 at * 4.

^{35/} Id. at *6.

In *Neary*, the court vacated an arbitration award that granted summary judgment dismissing the claimant's claims. In vacating the award, the court held that the arbitration panel manifestly disregarded the legal standard for summary judgment because the claimant had presented what the court described as "overwhelming" evidence that "undeniably" raised a genuine issue of material fact sufficient to defeat summary judgment.^{36/} In so doing, the court reviewed the evidence proffered by the claimant, and held that the panel "appears to have disregarded this evidence and certainly disregarded the requirement that all reasonable inferences must be drawn in favor of the non-movant on a motion for summary judgment."^{37/} The court also observed that its conclusion was reinforced both by certain questions asked by the arbitration panel which suggested that the panel was focusing on whether Prudential had valid grounds for terminating the claimant, not on whether the evidence, when properly construed in favor of the claimant, gave rise to a genuine issue of material fact, and because the panel failed to explain its decision in the award.^{38/}

G. Conclusion

In the aftermath of *Halligan*, claimants in employment arbitrations who are disappointed with the results of arbitration are seeking vacatur by arguing that the award was contrary to "strong" or "overwhelming" evidence presented to the arbitrators, particularly in cases where there is no written rationale for the award. The courts are then being asked to conduct a probing review of the arbitration record to determine whether, as stated in *Chisolm*, *Ahing*, and *Campbell*, there is "ample basis" or a "colorable justification" for the award, or whether, under *Halligan* and *Neary*, there is "strong" or "overwhelming" evidence to the contrary. Thus far, courts that have conducted such reviews have usually found ample basis for confirmation of the award, at least where the arbitration panel rendered its award after a hearing on the merits. These cases also indicate that even after *Halligan*, courts will not reweigh the evidence or second-guess the arbitrator's credibility determinations. Nonetheless, by expanding the judicial review of arbitration awards to include a review of the evidentiary record, the Second Circuit has undermined the twin goals underlying the strong federal policy favoring arbitration - finality and cost reduction - and thereby created a precedent with significant legal and practical consequences for parties and courts nationwide.

^{36/} *Neary*, 1999 WL 692393, at *2.

^{37/} *Id.* at * 3.

^{38/} *Id.*

RESTRICTIVE COVENANTS

I. BACKGROUND

The monetary value of trade secrets and established customer relationships emphasizes the need for precautionary measures to protect these employer interests. Restrictive covenants, to the extent that they are legal in a given state, provide the best means of protection. There are a variety of restrictive covenants including covenants not to disclose information (trade secrets), covenants not to solicit customers, and covenants not to compete.

The enforceability of such covenants is a matter of state law, and states have significantly divergent views of the legality of such contracts. The underlying policy for limiting the enforceability of such contracts is that they restrain trade and limit the ability of employees to pursue their livelihoods. For example, California prohibits the use of contracts restraining the pursuit of a lawful profession, trade, or business. Cal. Bus. & Prof. Code § 16600 *et seq.* (West 1997). Other states, such as New York and New Jersey, generally disfavor restructure covenants, but permit covenants not to compete as long as certain requirements are met. Consequently, the law of a particular state should be thoroughly reviewed before drafting a restrictive covenant applicable in that state.

II. REQUIREMENTS

A. Reasonableness

The basic requirement for an enforceable restrictive covenant is that it be reasonable. The factors considered in determining whether a particular contract is reasonable vary from state to state. For example, in New York reasonableness is determined by considering:

- whether the covenant is reasonable in time and area;
- whether the contract is necessary to protect the parties' legitimate interests; and
- whether it causes undue hardship on the employee.

Pilot Communications, L.L.C. v. Corle, 242 A.D.2d 982, 665 N.Y.S.2d 377 (4th Dep't 1997).

1. Time

The reasonableness of a restrictive covenant's duration depends on the nature of the business interest being protected. New York courts have consistently held that no-solicitation covenants of one year are reasonable. *See Greenwich Mills Co., Inc. v. Barrie House Coffee Co.*, 91 A.D.2d 398, 459 N.Y.S.2d 454 (2d Dep't 1983) (9 month and one year no-solicitation covenants on salesmen are reasonable because the covenants are of "relatively short duration" and do not bar competition in general); *Giffords Oil Co. v. Wild*, 106 A.D.2d 610, 483 N.Y.S. 2d 104 (2d Dep't 1984) (three year no-solicitation covenant on salesman reasonable and enforceable); *Stanley Tulchin Assoc., Inc. v. Vignola*, 186 A.D.2d 183, 587 N.Y.S.2d 761 (2d Dep't 1992) (one year no-solicit reasonable and enforceable).

Courts also consider the nature of the industry in evaluating the reasonableness of a non-compete agreement's duration. In the securities industry, New York courts have also held that a one year provision is reasonable. *See Citicorp Investment Services v. Diondo*, No. 19807/97 (N.Y. Sup. Ct., Kings County, June 18, 1997)("Neither the duration (*i.e.*, one year) or scope of the restrictions are unduly burdensome"). *See also, Maltby v. Harlow Meyer Salvage, Inc.*, 166 Misc. 2d 481, 633 N.Y.S. 2d 926 (N.Y. Sup. Ct. 1995)(where the court reasoned that the six month duration was reasonable in that it was the amount of time the employer needed to recover from the plaintiffs' departure, but not so unduly long as to cause permanent injury or loss of ability to earn a livelihood).

2. Geographic Area

Likewise, the reasonableness of a geographic restriction turns on the particular facts of a given case. The general rule is that geographic limitations should be no broader than the area in which the employee is active, even where the employer's business spans a broader region. In today's global market place, however, courts have become more willing to enforce noncompete agreements that lack geographic restrictions. *See Lowry Computer Prods., Inc. v. Head*, 984 F. Supp. 1111, 1116, (E.D. Mich. 1997) (enforcing one-year world-wide restriction); *Platinum Management, Inc.*, 666 A.2d at 1040 (finding reasonable one-year restriction without geographic restraint where covenant sought to protect customer relationships).

3. Legitimate Protectible Employer Interests

Covenants not to compete are only enforced to the extent necessary to protect an employer's legitimate business interests. Such interests, however, can be broadly defined, and include trade secrets, customer goodwill, goodwill of a business sold, the loss of unique abilities of an employee and an employee's specialized training and skills. *Weber v. Tillman*, 913 P.2d 84 (Kan. 1996) (customer contacts); *Terry D. Whitten, D.D.S., P.C. v. Malcolm*, 541 N.W.2d 45 (Neb. 1995) (customer good

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will); *American Software USA, Inc. v. Moore*, 448 S.E.2d 206, 208 (Ga. 1994) (trade secrets); *Arthur Murray Dance Studios v. Witter*, 105 N.E.2d 685, 694-99, 708-11 (Ohio C.P. 1952) (specialized training and skills); *Thermo-Guard, Inc. v. Cochran*, 596 A.2d 188, 193-94 (Pa. Super. 1991) (listing such interests).

The New York Court of Appeals has recently restated that an employer has recognizable interests in “the protection against misappropriation of [its] trade secrets or of confidential customer lists, or protection from competition by a former employee whose services are unique or extraordinary.” See *BDO Seidman v. Hirschberg*, 93 N.Y.2d 382, 690 N.Y.S.2d 854 (New York Court of Appeals 1999). Even absent the existence of trade secrets, a non-solicitation covenant may be enforced upon a showing that the employee provided services that qualify as “special, unique and extraordinary,” and that the loss of such services “would cause the employer irreparable injury” *Purchasing Assocs., Inc. v. Weitz*, 13 N.Y.2d 267, 274, 246 N.Y.S.2d 600, 605-06 (1963) See also *Reed, Roberts Assocs., Inc. v. Strauman*, 40 N.Y.2d 303, 308, 386 N.Y.S.2d 677, 680 (1976).

It is clear under New York law that the relationships cultivated between salespeople and their clients can, under certain special circumstances, qualify as “special, unique and extraordinary” under the *Purchasing* standard. See *Chernoff*, 234 A.D.2d 200, 651 N.Y.S.2d 504; *Contempo Communications, Inc. v. MJM Creative Services, Inc.*, 182 A.D.2d 351, 582 N.Y.S.2d 667 (1st Dep’t 1992). In *Contempo*, the court enforced two year non-solicitation covenants preventing former salespersons/producers from working on any account on which they worked while in plaintiff’s employ, stating that the “the services of defendants vis-a-vis the companies they serviced as plaintiff’s employees were special, unique and extraordinary’ and therefore, entitled to protection.” 182 A.D.2d at 354. In *Chernoff*, the court enforced two year non-solicitation covenant against an insurance agent because he had “obtained, while in plaintiff’s employ, invaluable and otherwise unobtainable information concerning the business practices and resulting insurance needs of these clients due to his position as their trusted professional advisor.” 234 A.D.2d at 202, 651 N.Y.S.2d at 506. Both the *Contempo* and *Chernoff* courts stress the fact that the covenants were reasonable because they did not prevent former employees from pursuing their careers or even from competing with their former employers. See *Contempo*, 182 A.D.2d at 354; *Chernoff*, 234 A.D.2d at 202. Rather, the courts point out that the covenants were limited to the employees’ specific knowledge of their clients and customers. See *id.*

New York courts have held that when a company spends “considerable time and money” to develop and cultivate customers, those customer contacts can merit trade secret protection in certain limited circumstances. See, e.g., *Ivy Mar Co., Inc. v. C.R. Seasons Ltd.*, 907 F. Supp. 547, 556-57 (E.D.N.Y. 1995). See also *Town & Country House & Home Service, Inc. v. Newberry.*, 3 N.Y.2d 554, 558-60, 170 N.Y.S. 2d 328 (1958) (“The testimony in the instant record shows that the customers of plaintiff were not and could not be obtained merely by looking up their names in the telephone or city directory or by going to any advertised locations . . . So there appears to be no

questions that the plaintiff is entitled to enjoin defendants from further solicitation of its customers . . .”); *Chernoff*, 234 A.D.2d at 202 (finding information regarding business practices and clients’ needs to be trade secrets); *HBD Inc. v. Ryan*, 227 A.D.2d 448, 448-449, 642 N.Y.S.2d, 913, 914 (2d Dep’t 1996) (finding customer lists to be trade secrets); *Gillman & Ciocia, Inc. v. Reid*, 153 A.D.2d 878, 545 N.Y.S.2d 387, 388 (2d Dep’t 1989) (“The plaintiff . . . demonstrated a prima facie right to permanent injunctive relief based on allegations that the defendant had misappropriated customer lists compiled by the plaintiff, and that she has used those lists for her own benefit in violation of her contractual and fiduciary obligations to the plaintiff.”); *Webcraft Tech v. McCaw*, 674 F.Supp. 1039, 1047 (S.D.N.Y. 1987) (deliberate theft of trade secrets warrants enjoining competition “even if there was no covenant not to compete”).

Furthermore, in *Merrill Lynch v. Feeney*, the New York Supreme Court granted Merrill Lynch injunctive relief *even in the absence of an express contract*:

[The] documents and data which . . . defendant took from [Merrill Lynch’s] files in connection with her precipitate departure. . . included statements of plaintiff’s clients’ net financial worth, annual incomes, trading histories and investment objectives. These records, which the plaintiff treated as confidential and repeatedly instructed its employees was confidential, were assembled and created by the plaintiff over a period of years, at its expense. Its expenses included advertising, sales support staff, training programs, salaries, registration fees, computer services and equipment, sales literature, seminars, operational publications, promotional events, quotron machines and clerical services. . . .

See also, Citicorp Investment Services v. Biondo, (“[I]nformation of the type which is sought to be protected under such restrictive covenants has been held to be deserving of such protection as trade secrets.”); *Panther Systems II v. Panther Computer Systems*, 784 F.Supp. 53 (E.D.N.Y. 1991).

B. Adequate Consideration

The mere fact that a restrictive covenant is ancillary to an employment relationship is not dispositive of enforceability. A restrictive covenant must also be supported by adequate consideration. Sufficient consideration can be found in the employment of an individual if the covenant is contained in the original terms of employment or it can be found in a change of employment conditions where the covenant is entered into post-employment. *Davis & Warde, Inc. v. Tripodi*, 616 A.2d 1384, 1387 (Pa. Super. 1992), *appeal denied*, 637 A.2d 284 (Pa. 1993).

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States have different requirements for adequate consideration with respect to post-employment restrictive covenants. Some states, including Pennsylvania, require something more than the continued employment of the employee. Consequently, a restrictive covenant entered into subsequent to the commencement of the employment relationship might be supported by new consideration such as a corresponding benefit to the employee or a beneficial change in his employment status. *See Insulation Corp. of Am. v. Brobston*, 667 A.2d 729, 733 (Pa. Super. 1995) (annual \$2000 raise and change of employment status from at-will to written year-to-year contract sufficient consideration for incumbent employee's restrictive covenant); *Davis & Warde*, 616 A.2d at 1387 (continued employment with new responsibilities, cash payments, new severance package and guarantee of certain job benefits sufficient consideration to support restrictive covenant).

Under New York law, an essential element of the enforceability of a post-employment restrictive covenant is the former employer's continued willingness to provide employment. *See, International Paper Co. v. Suwyn*, 951 F.Supp. 445, 448 (S.D.N.Y. 1997) (continued employment "for a substantial period" following the signing of the covenant constitutes the consideration necessary to support a covenant entered into after the start of employment).

Other states, however, including New Jersey, find adequate consideration in the continuation of an at-will employment relationship. *See, e.g., Hogan v. Bergen Brunswick Corp.*, 378 A.2d 1164 (N.J. Super. App. Div. 1977) (where employee could have been discharged if he had not signed a non-competition agreement and the employer extended his employment after the covenant was made, continued employment constituted sufficient consideration); *Camco, Inc. v. Baker*, 936 P.2d 829, 831 (Nev. 1997) (applying Nevada law); *Central Monitoring Serv., Inc. v. Zakinski*, 553 N.W.2d 513, 518 (S.D. 1996) (applying South Dakota law); *Ranch Hand Foods, Inc. v. Polar Pak Foods, Inc.*, 690 S.W.2d 437 (Mo. Ct. App. 1985) (applying Kansas law).

III. ENFORCEMENT AND REMEDIES

A. Enforcement

1. Modification

Where a restrictive covenant is unenforceable according to its terms, some states permit judicial modification of such a covenant to render it reasonable and enforceable. In New York courts can modify overly broad restrictive covenants to make them reasonable in scope. *See, e.g., Muller v. New York Heart Ctr. Cardiovascular Specialists P.C.*, 656 N.Y.S.2d 464, 466 (3d Dep't 1997).

Other states, however, have much more restrictive rules with respect to modification. For example, Georgia prohibits judicial modification of non-competition agreements in order to make them reasonable and enforceable. *AmeriGas Propane, L.P. v. T-Bo Propane, Inc.*, 972 F. Supp. 685

(S.D. Ga. 1997). *See also Roto-Die Co. v. Lesser*, 899 F. Supp. 1515, 1523 (W.D. Va. 1995) (predicting, given lack of Virginia law on point, that Virginia would not permit court to rewrite noncompetition covenant); *Vlasin v. Len Johnson & Co.*, 455 N.W.2d 772, 776 (Neb. 1990) (“[i]t is not the function of courts to reform unreasonable covenants not to compete solely for the purpose of making them legally enforceable.”).

Even states which prohibit “blue-pencilling” of covenants, however, permit courts to selectively enforce distinctly severable provisions of contracts. *See Hartman v. W.H. Odell & Assoc., Inc.*, 450 S.E.2d 912 (N.C. Ct. App. 1994) (under North Carolina law, court may not rewrite covenant, but could decline to enforce distinctly severable provision of covenant), *review denied*, 454 S.E.2d 251 (N.C. 1995). As a federal district court in Virginia noted: “The difference between “blue pencilling” and severing is a matter of focus. The former emphasizes deleting, and in some jurisdictions adding, words in a particular clause. The latter emphasizes construing independent clauses independently.” *Roto-Die Co.*, 899 F. Supp. at 1523 (citing *Sunstates Refrigerated Servs., Inc. v. Griffin*, 449 S.E.2d 858, 860 (Ga. 1994) (Georgia’s rejection of the “blue pencil” theory does not require invalidating provisions in same agreement concerning nondisclosure, return of documents, and interference with employee’s contractual relationships).

B. Enforcement Where the Employer Terminates the Employee

The Southern District of New York has recently held that the fact that an employer terminated the employment relationship does not preclude enforcement of a reasonably limited post employment restrictive covenant—as long as the termination was for cause. *See, UFG Int’l, Inc.*, 225 B.R. 51 (S.D.N.Y. 1998).

Under New Jersey law, a court will review the nature of the employee’s departure in deciding whether to enforce a restrictive covenant. *Ingersoll Rand Co. v. Ciavatta*, 542 A.2d 879 (N.J. 1988). In *Ciavatta*, an engineer signed an agreement assigning all rights to the engineer’s inventions to his employer. *id.* at 881. Following the engineer’s termination by the employer, the engineer patented a new invention and the employer sought to enforce the restrictive covenant. *id.* at 883. The court noted that the manner of an employee’s departure was a factor to be considered in deciding whether the employer would suffer a hardship if the covenant were not enforced. *id.* at 890. The court reasoned that the fact of the engineer’s firing suggested the engineer did not set out to “steal an invention” from the employer. *id.* The court ultimately refused to enforce the restrictive covenant. *id.* *See also Karlin v. Weinberg*, 390 A.2d 1161, 1169 (N.J. 1978) (court should examine reason for employee’s termination to determine whether enforcement would cause undue hardship).

C. Remedies

1. Injunctive Relief

The nature of the harm suffered by an employer when a noncompetition, non-solicitation, or non-disclosure contract is breached is extremely difficult to ascertain in terms of monetary damages. Consequently, when such a contract is breached, injunctive relief is usually sought. New York requires that the following elements be satisfied before a preliminary injunction can be granted (other states have similar requirements):

- (1) a likelihood of success on the merits;
- (2) the threat of irreparable harm to the employer; and
- (3) a balance of equities favoring the employer's position.

Merrill Lynch Realty Assoc., Inc. v. Burr, 528 N.Y.S.2d 857, 860 (2d Dep't 1988).

2. Damages

Damages are appropriate when necessary to compensate employers for damage suffered prior to the issuance of an injunction or in the absence of equitable relief. The calculation of damages is often difficult, but courts have devised a variety of methods to reach a reasonable figure.

Although often difficult to compute with mathematical certainty, an employer's lost profits or sales are typically used as the basis for awarding damages for breach of a noncompete covenant. *See Scobell Inc. v. Schade*, 688 A.2d 715, 718-19 (Pa. Super. 1997). In *Scobell*, for example, the court held that the proper method of measuring damages was to determine the contracts won by the new employer as a result of the defection of the plaintiff's former employee. *id.* at 719. In addition to lost profits or sales, expenses incurred by an employer in repairing the damage caused by an employee's contract breach may also be recoverable. *See, e.g., Mercer Management Consulting, Inc. v. Wilde*, 920 F. Supp. 219, 239 (D.D.C. 1996) (appropriate damages for breach of restrictive covenant included cost of replacing former employees); *Frederick Chusid & Co. v. Marshall Leeman & Co.*, 326 F. Supp. 1043 (S.D.N.Y. 1971) (cost of training a replacement for the defendant part of damage assessment). *But See Certified Labs. of Tex. Inc. v. Rubinson*, 303 F. Supp. 1014, 1026-17 (declining to award training costs as damages where former employee had worked for plaintiff employer for several years and employer had already recovered its investment).

While the general rule is that damages for breach of a restrictive covenant must be measured by the plaintiff's loss and not by the defendant's gain; in some cases the defendant's gain can be helpful in

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determining the plaintiff's loss. *See, e.g., Atlas Ready-Mix of Minot v. White Properties, Inc.*, 306 N.W.2d 212, 219 (N.D. 1981); *B & Y Metal Painting, Inc. v. Ball*, 279 N.W.2d 813 (Minn. 1979).

OVERVIEW OF SELECT FAIR LABOR STANDARDS ACT ISSUES

I. FLSA ACTIONS IN THE SECURITIES INDUSTRY

Over the past three years, numerous national collective actions have been brought against securities firms by full-time, non-exempt employees asserting a failure to pay overtime in violation of the FLSA.

These suits are typically brought by one or more named plaintiffs and seek recovery on behalf of the named plaintiff(s) and others alleged to be similarly situated. While the complaints typically define the putative class broadly enough to encompass a variety of non-exempt positions within the defendant firm, typically the named plaintiffs are former Sales Associates (“SAs”).

Although the complaints typically seek recovery for all “similarly situated” full-time, non-exempt employees, it appears that the plaintiffs’ bar views securities firms as particularly vulnerable to FLSA suits on behalf of SAs. The difficulty in complying with the FLSA with respect to SAs is attributable, in part, to the SAs’ duties and compensation scheme. SAs most commonly function as secretarial and support staff for Financial Consultants (“FCs”) and, therefore, cannot be designated as “exempt” from payment for overtime under the FLSA. SAs are generally paid a fixed salary based upon a 35-40 hour workweek. By agreement with the FCs they support, SAs also generally receive some amount of supplemental compensation based upon the production of the FCs. Additionally, many SAs are paid annual bonuses based on their own performance and/or that of the FC or the firm.

In the recent FLSA actions against securities industry firms, the plaintiffs typically allege that (i) the SAs are unable to complete their assigned duties within the regular workday hours and the firm discourages or expressly prohibits overtime; (ii) the SAs typically work more than eight hours per day (most also claim that their work load does not permit them to take lunch) but do not record overtime hours; (iii) the firm’s written policy provides for overtime to be paid but that SAs must obtain prior approval to work overtime and that approval is rarely given; (iv) if overtime is worked without prior approval, the overtime is not paid; (v) FCs and other supervisors expect and/or require SAs to work overtime; (vi) supervisors often state that the firm does not permit or pay for unapproved overtime and that SAs are not permitted to record more than seven hours worked per day; (vii) the SAs’ managers and supervisors alter time reports submitted by SAs to remove overtime and/or require the SAs to remove overtime from their time reports and resubmit them; and (viii) the firm failed to include all monies regularly paid to the SAs by FCs, including any bonuses which are not discretionary as to both the fact of payment and the amount paid to SAs by FCs or the firm. Because of the substantial amount of money paid by FCs to their SAs it also appears that SAs commonly refrain from recording

overtime hours worked, not because of any directive from their FCs, but out of concern that reporting overtime might adversely affect their bonuses or rate of compensation or because they mistakenly believe (as do their FCs) that the supplemental compensation they receive includes payment for overtime worked.

Another common allegation in these actions is that the failure to pay overtime extends to locations outside a particular branch office, and, in fact, to all offices nationwide. In the industry, written overtime policies generally apply nationwide but are administered at the local or branch level. Relying upon national written policies, plaintiffs typically allege that the failure to pay overtime is a national practice affecting non-exempt employees in all offices.

II. FLSA ISSUES IN THE SECURITIES INDUSTRY

In order to understand better the unique FLSA issues faced by the securities industry, and the bases for the recent FLSA litigation against securities firms, it is helpful to review the requirements of the FLSA. Accordingly, this section briefly reviews (1) the circumstances under which employees may be exempt from the overtime requirements of the FLSA, (2) the extent to which the FLSA requires that non-exempt employees who work more than 40 hours in a single workweek be paid overtime pay for each hour worked in excess of 40, and (3) the extent to which bonuses paid to non-exempt employees must be included as part of their "regular rate of pay" for purposes of calculating how much overtime should be paid.

A. Exemptions

To be exempt from the overtime requirements of the FLSA, an employee must be employed in a bona fide executive, professional or administrative capacity. To fall within the executive exemption, employees must: (1) customarily and regularly direct the work of two or more other employees, and (2) have as their primary duty the management of the department to which they are assigned, and (3) be compensated on a salary basis at a rate not less than \$250 per week.

To meet the professional exemption, an employee must: (1) perform work that requires advanced knowledge in a field of science or learning, customarily acquired by prolonged, specialized, intellectual instruction, and (2) be compensated on a salary basis at a rate of not less than \$250 per week.

Based on our experience, the principal concern of securities firms relates to the administrative exemption. To qualify for an exemption as a bona fide administrative employee, the employee must:

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- (1) perform office or non-manual work directly related to management policies or the general business operations of the company or the company's customers, and
- (2) exercise discretion and independent judgment in the performance of his or her duties; and
- (3) be compensated on a salary or fee basis at a rate of not less than \$250 per week, exclusive of board, lodging or other facilities.^{39/}

Since this definition creates many gray areas and its application to a particular employee's functions can be difficult, we have provided a brief explanation that we hope will be helpful. Specifically, this exemption is limited to employees who perform activities relating to the administrative operations of a business. It is not enough, however, that an employee performs administrative-type functions. Rather, the administrative activities performed must be directly related to the management policies or general business operations of the employer or the employer's customers.^{40/} This requirement limits the exemption to employees who perform work of substantial importance to the management or operation of the business, such as individuals who affect or implement management policies. Thus, an employee who performs secretarial or clerical work, which involves routine administrative functions, is not exempt from overtime requirements.

Moreover, 50 percent or more of the employee's time must ordinarily be spent performing these exempt responsibilities. However, an employee who spends less than 50 percent of his or her time performing such duties might nonetheless qualify for the exemption if other factors, such as (1) the relative importance of the qualifying administrative duties as compared with his or her other duties, (2) the extent to which he or she exercises independent discretion and is free from supervision and (3) the relationship between his or her salary and the wages paid to other employees for similar kinds of non-exempt work, supports such a conclusion.

In addition to performing administrative duties that are related to management policies or general business operations, an employee must also exercise discretion and independent judgment. To meet this criterion, the employee must have the authority or the power to make

^{39/} Employees earning less than \$250 per week must meet more onerous requirements to fall within any of the three FLSA exemptions.

^{40/} An employee performs work directly related to the management policies or business operations of a customer if he or she performs important functions to a customer's business as an advisor or consultant.

an independent choice, free from immediate direction or supervision, with respect to matters of significance.

Finally, the employee must be compensated on a salary basis at a rate of not less than \$250 per week. To be compensated on a salary basis; an employee must receive (i) a predetermined amount constituting all or part of his or her compensation, which amount is not subject to reduction because of variations in the quality or quantity of work performed, and (ii) not less than \$250 in any week in which he or she performs work, without regard to the number of hours worked. The employee need not be paid for any week in which he or she performs no work.

In addition, no deductions may be made from the employee's pay for absences occasioned by the company or by the operating requirements of the business or for absences caused by jury duty, attendance as a witness or temporary military leave. Deductions are permitted, however, (i) for absences due to personal reasons, other than sickness or disability; (ii) for absences occasioned by sickness or disability, if the deduction is made in accordance with a bona fide plan, policy or practice of providing compensation for loss of salary occasioned by both sickness and disability; (iii) for setoffs for any amount received by an employee as jury or witness fees or military pay; and (iv) during an employee's initial and terminal weeks of employment (employees may be paid on a pro-rata basis for such weeks).

Determinations concerning the application of this exemption are fact specific and often involve a detailed analysis of all the relevant facts and circumstances relating to each employee.

B. Bonus Payments and Supplemental Compensation

Given the compensation structure of securities industry firms, an additional concern is whether bonuses and supplemental compensation paid to non-exempt employees must be included as part of their "regular rate of pay" for purposes of calculating overtime.

As a general rule, bonus payments in the nature of gifts may be excluded from an employee's regular rate of pay for purposes of computing overtime, while incentive and production bonuses are deemed to be part of an employee's regular earnings and therefore must be included in the employee's regular rate of pay when calculating overtime pay under the FLSA. This includes bonuses based upon attendance, individual or group production, quality or quantity of work, length of service, hours of straight time or overtime worked, or even subjective factors such as cooperation, courtesy or attitude. This also includes any supplemental compensation received, for example, by CAs (also referred to as Administrative Assistants) from the Brokers or FCs with whom they work. Employers who give such bonuses and compensation are required to pay additional overtime compensation for each hour of overtime worked during the period covered by the bonus or compensation, unless (1) the

payment qualifies as a discretionary bonus payment or (2) the payment is based upon a percentage of the employee's total earnings, including overtime.

C. Exclusion For Gifts

Bonus payments in the nature of gifts made at Christmas time or on other special occasions may be excluded from an employee's regular rate for purposes of computing overtime compensation only if they (1) are not measured by or dependent upon factors such as productivity, hours worked, efficiency, attendance and the like and (2) are not paid pursuant to any prior agreement or promise. 29 C.F.R. § 778.212. Such bonus payments may be excluded from the regular rate even if they are provided as a "reward for services" and are paid with regularity so that employees come to expect them, and even if the amount paid varies with the amounts of each employee's salary or length of service.

In most scenarios within the industry, bonuses and supplemental compensation are based in substantial part upon factors such as productivity, attendance and hours worked. In fact, it is common for CAs to enter into written agreements with their FCs setting forth the basis for such supplemental compensation and its relation to performance. Thus, to exclude such payments from overtime computations on the basis that the payments constitute gifts, firms would need to change the entire focus of the bonus and supplemental compensation program to one in which such payments are not tied to performance and make commensurate revisions in its correspondence and memoranda relating thereto.^{41/}

D. Discretionary Bonus and Supplemental Compensation Payments

Even if bonus and supplemental compensation payments cannot be excluded as gifts, they may nonetheless be excluded if they qualify as discretionary bonus payments. For a bonus to qualify as discretionary, the employer must retain absolute discretion to determine both (a) whether *any* bonus payment will be made and (b) the amount of payment, and such discretion must be retained until at or near the end of the period covered by the bonus. Moreover, the employer must not enter into any agreement or make any promise which would lead the employees to expect a bonus, and must not announce *any* decision regarding bonus

^{41/} It should be noted that even if bonus payments were not based on factors such as productivity and hours worked and were not promised in advance, it is possible that they still would not be considered in the nature of gifts if the payments were so substantial that employees would naturally consider them to be part of their wages. See 29 C.F.R. § 778.212. Within the industry, in most circumstances bonuses represent a significant percentage of each employee's total annual compensation. Under the circumstances, it may not be possible for securities firms to qualify bonus payments as gifts that may be excluded from the computation of an employee's regular rate.

awards until the end of the period covered by the particular bonus. Thus, performance bonuses which must be announced in advance in order to obtain the desired result of enhanced performance and bonuses contingent on the employee's continuing in employment until the time payment is made cannot qualify as discretionary. See 29 C.F.R. § 778.211.

Thus, firms wishing to benefit from this exclusion for discretionary bonus payments, should (1) change the entire focus of the bonus and supplemental compensation program to one which is not tied to performance, (2) retain absolute discretion with respect to *both* (i) whether *any* bonus or payment will be paid and (ii) the amount of any such bonus or payment until at or near the end of each year, and (3) take precautions to make certain that employees are not promised or otherwise led to believe that they can expect to receive bonus or supplemental compensation payments on an annual basis either at the time they are hired or at any time thereafter.

Whether such precautionary steps would make sense from a management perspective is questionable. In that regard, we understand that one important purpose of most firms' bonus and supplemental compensation payments is to provide incentives by rewarding and thereby encouraging exemplary performance.

Moreover, even with these precautionary steps, it is still possible that bonuses and supplemental compensation would be viewed as non-discretionary and, therefore, part of the employees' regular rate of pay if they are sufficiently large and paid on such a regular basis that employees come to expect them as part of their compensation package. Indeed, although the issue is not entirely free from doubt, there is some authority for the proposition that where bonus payments are substantial in amount and paid regularly over a period of years, employees may reasonably come to expect some bonus as part of their regular pay and, in that event, the bonuses could be viewed as non-discretionary even though the amount of the bonus varies dramatically from year to year. Therefore, securities firms may want to consider paying bonuses based upon a percentage of earnings rather than straight dollar amounts so that it can benefit from the broad FLSA overtime-pay exclusion available for percentage-of-wage bonuses.

E. Percentage-of-Wages Bonuses

Bonuses that are based on a *percentage* of an employee's total earnings (including both straight time and overtime) may be excluded from overtime wage computations regardless of whether or not payment is discretionary. The only requirements for a bonus to qualify as a percentage of wages bonus are (1) that the earnings used for computing the bonus include all overtime earnings in the bonus period and (2) that payment of the bonus not be made conditional upon continued employment with the Firm. Such bonuses may be excluded from overtime computations regardless whether they are promised or announced in advance and may be based upon production, attendance and other such factors. It is important to note, however, that for purposes of calculating an employee's total earnings for overtime rate purposes, any

supplemental compensation an employee receives, for example, through a CA's arrangement with an FC, may need to be included.

One helpful aspect of percentage-of-wage bonuses is that employers are permitted to give percentage-of-wage bonuses to employees in departments where overtime is worked and straight dollar bonuses in departments where it is not. Therefore, each department head could review the amount of overtime worked in the department each year before deciding whether bonuses in the department will be based upon a percentage of total earnings or in straight dollar amounts.

In order to avoid liability, securities firms may want to review their overtime policies and practices to ensure that they are in compliance with the FLSA, particularly with respect to the treatment of bonuses and supplemental compensation to non-exempt employees. It is also critical that managers and supervisors diligently enforce existing overtime policies as to CAs and other non-exempt employees. CAs and FCs must be made aware of, and adhere to the policies. Efforts must be made to eliminate the belief, to the extent it exists, that overtime is to be worked and not reported. CAs must also understand that they may not work "off the clock" voluntarily. Additionally, all regular payments by FCs to CAs and non-discretionary bonuses must be included in the CAs' regular rate for purposes of calculating overtime. Finally, only individuals who truly meet the standards of the executive, professional or administrative exemptions should be treated as exempt.

ELECTRONIC COMMUNICATIONS IN THE WORKPLACE CAN RAISE HIGH-TECH EMPLOYMENT ISSUES

Electronic mail and Internet use has exploded in the workplace. According to a recent survey, 98% of all companies with more than 1,000 employees have Internet access, and 45% of businesses with 20 to 99 employees are online.^{42/} For many workers, e-mail is replacing the telephone as the preferred means of communication. As of the end of 1998, U.S. workers were sending 1.1 billion e-mail messages a day.^{43/} It is predicted that by 2002, e-mail traffic will reach 8 billion messages a day.^{44/}

This increased access to technology brings both benefits and potential liabilities to employers. E-mail and Internet access greatly facilitate communication in the workplace. With a mere “click” of a mouse, employees can use the Web to access the most current information or research on any given subject, and then share that information instantaneously with co-workers throughout the company.

A single “click” of a mouse can also create liabilities and other problems for employers. For example, an employee could create a hostile work environment by circulating racial or ethnic jokes on the company’s e-mail system. In addition, because sexually explicit material is readily available from the Internet, and this material can be easily downloaded and forwarded to other employees, employers may be exposed to hostile work environment claims resulting from the viewing and transmitting of sexually explicit materials in the workplace. The Internet also could be used to disclose trade secrets and other confidential company information to competitors, or to organize a union using the employer’s time and equipment. To manage these issues and protect against liability, employers should create, implement and enforce clear and effective policies governing employee use of e-mail and the Internet.

A. Recent Cases Highlight Potential Liabilities for Employers

A number of recent cases highlight the potential for employer liability for employee circulation of harassing or discriminatory e-mail or Internet images. Indeed, electronic communications are often key

^{42/} Jan Norman, *Firm-to-Firm E-Buying Web’s Biggest Business*, The Arizona Republic, Mar. 24, 1999, at E-1.

^{43/} Dana Hawkins, *Office Politics in the Electronic Age Workplace*, U.S. News & World Report, Mar. 22, 1999, at 59.

^{44/} Paul Rolfes, *E-mail as Much of a Curse as a Blessing to Business*, Columbus Dispatch, Oct. 11, 1999, at 10.

evidence in discrimination and harassment law suits. For example, four employees sued Chevron for sexual harassment based, in part, on the dissemination of an offensive e-mail message by their co-workers which listed reasons “why beer is better than women.”^{45/} The case settled for \$2.2 million plus attorneys’ fees and court costs.^{46/} In *Trout v. City of Akron*, a jury awarded an employee \$265,000 because she was exposed to pornographic pictures her male co-workers had downloaded off the Internet.^{47/}

In a case involving a broker-dealer, *Owens v. Morgan Stanley & Co.*, two African-American employees brought a \$60 million discrimination and retaliation suit in which they claimed, *inter alia*, that they were retaliated against after they complained about receiving an e-mail containing a racist joke.^{48/} The parties reached a confidential settlement after the court denied Morgan Stanley’s motion to dismiss. In yet another case, two African-American employees brought a putative class action against Citibank based, in large part, on e-mail messages circulated among Citibank managers that allegedly contained racist and ethnic jokes.^{49/} This complaint was ultimately dismissed because the messages were not sufficiently severe or pervasive to create a hostile work environment.

B. Special Issues Relating to Litigation and the Use of Electronic Communications

Discovery requests in litigation can lead to the recovery of old and even deleted e-mails that may reveal an employer’s motives or “private” assessments of individual employees^{50/}. For example, in one case a Seattle woman sued her former employer for age discrimination after she was fired. Her complaint seemed unlikely to succeed -- at least initially -- as the company’s termination letter was

^{45/} Liz Stevens, *Today’s Technology Makes It Easier for Supervisors to Watch Workers*, Milwaukee J. Sentinel, Oct. 6, 1999, at 3.

^{46/} Id.

^{47/} *Trout v. City of Akron*, No. CV-97-115879 (Ohio Ct. C.P. Dec. 15, 1998).

^{48/} No. 96 Civ. 9747, 1997 WL 793004 (S.D.N.Y. Dec. 24, 1997).

^{49/} *Curtis v. Citibank*, No. 97 Civ. 1065, 1999 WL 544729 (S.D.N.Y. July 27, 1999)

^{50/} Deleted e-mail messages played a key role in exposing the Iran-Contra Affair when the deleted e-mail messages from the White House were retrieved from a main frame back-up tape. See *United States v. Poindexter*, Crim No. 88-0080-01, 1990 U.S. Dist. LEXIS 6173, at *12 (D.D.C. May 29, 1990) (referring to White House Prof Notes, which was a form of electronic mail, as evidence supporting the conspiracy allegation).

“picture perfect by human resource standards.”^{51/} During the discovery process, however, plaintiff’s attorney hired a computer consultant specializing in e-mail retrieval. This consultant used sophisticated software to “unerase” a supposedly deleted e-mail message from the company’s president to the head of the personnel department. The president’s e-mail had instructed the supervisor to “get rid of the tight-assed bitch.”^{52/} Faced with this evidence, the company, which had previously viewed the case as nothing more than a nuisance, agreed to settle for \$250,000. This case illustrates the special litigation risks that result from the all too common assumption by employees that they can be careless in their electronic communications because their messages are private and can be deleted without leaving a paper trail.

On the other hand, employer searches of employee e-mail messages may uncover extremely valuable evidence of wrongdoing. For example, Borland International suspected that a former employee who defected to a major competitor had been using the company’s e-mail system to transmit trade secret information to one of the competitor’s top executives. Information uncovered during the search confirmed these initial suspicions, and led to civil and criminal actions against the former employee and the competitor’s executive.^{53/} Searches of employee e-mails may also reveal evidence that an alleged victim of hostile environment sexual harassment actively participated in the sexual banter that later became the subject of her complaint.

Some employees have even gone so far as to fabricate false e-mails in an effort to support their discrimination claims. In *People v. Lee*, a California jury convicted a woman of falsifying an e-mail message in order to advance her sexual harassment case against her employer.^{54/} Before her conviction, the employee had reached a \$100,000 settlement with her employer. In another case involving a discriminatory discharge claim against Morgan Stanley, the plaintiff attempted to show that Morgan Stanley’s proffered reason for his termination was pretextual by claiming that Morgan Stanley

^{51/} E. Wright, *Executive Secrets: Incriminating Data*, Hemispheres, June 1993, at 32.

^{52/} Heidi L. McNeil, & Robert M. Kort, *Discovery of E-Mail: Electronic Mail and Other Computer Information Should Not be Overlooked*, The Oregon State Bar Bulletin, 21, 21 (Dec. 1995).

^{53/} G. Mathiason & R. Juarez, *The Electronic Workplace: An Overview*, CEB California Business Law Review, 188, 189 (1995) (quoting *Borland Int’l, Inc. v. Gordon Eubanks* (Santa Cruz Superior Court No. 123059)).

^{54/} William Schiffman, *Conviction in Oracle Case Upheld*, Associated Press, July 28, 1999, available in 1999 WL 22027986.

conspired with an informant who agreed, for \$10,000, to manufacture false e-mails.^{55/} The plaintiff was eventually arrested on forgery charges after he allegedly paid an undercover police officer to plant a fabricated e-mail at Morgan Stanley to bolster his race discrimination claim.^{56/}

C. Steps Employers Can Take to Reduce the Risks and Potential Liabilities Associated With E-mail and Internet Use

Employers can seek to limit employee abuse of e-mail and Internet systems and protect against costly litigation by adopting, implementing, and enforcing an e-mail and Internet policy that clearly defines the proper use of electronic communications in the workplace. Policies should differ depending on the business needs of the company, the reasonable expectations of its employees, and a balancing of other interests -- in other words, an employer must tailor its policy to its unique needs. For example, broker-dealers must tailor their policies so as to comply with the antifraud provisions of the federal securities laws.

At a minimum, the policy should:

- Specify that the company's e-mail and Internet system is the property of the company, is made available to employees primarily for business use, and should not be used to communicate any derogatory, offensive, defamatory, abusive or otherwise inappropriate messages or images.
- In order to reduce any reasonable expectation of privacy, inform employees that the system and all e-mail and downloaded material are subject to company monitoring at any time without notice, and that the company will in fact monitor and review messages and materials sent over or stored in the system.
- Make clear that using private passwords or codes or marking e-mail confidential or private will not limit the employer's ability to monitor its system, and that the deletion of a message or file may not fully eliminate the message from the system.
- Remind employees that all confidential, copyrighted, or proprietary information stored or communicated electronically must be treated with the same degree of care as if it were in written form.

^{55/} Curry v. Morgan Stanley & Co., No. 99 Civ. 4035 (DC) (S.D.N.Y. 1999).

^{56/} Joel Cohen & Kevin Curnin, *The Risks of Using Paid Informers: Review of the Morgan Stanley Case*, New York Law Journal, July 9, 1999, at 1.

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- Prohibit any solicitation, whether for political, charitable, personal, religious or other purposes, outside the scope of the user's employment.
- Make clear that any improper or unauthorized use of the company's e-mail and Internet system or other violation of the policy may result in disciplinary action, up to and including discharge.

This policy should be given to all employees and placed in employee manuals. Employees should be required to sign a form acknowledging that they have read and understand the policy and the employer's absolute right to monitor all e-mail messages and downloaded materials sent over or stored in the company's system, and expressly consenting to such monitoring. Further notice of the policy can be included on computer screens so that it can be acknowledged each time an employee accesses the system.

Employers should also review their equal employment opportunity and non-harassment policies to ensure that they include explicit prohibitions against the use of the company's e-mail and Internet systems to communicate messages which may be viewed as derogatory, obscene, sexually explicit, racially charged, or otherwise inappropriate. In addition, as part of their harassment prevention training, employers should point out that conduct which is otherwise inappropriate under their policies, is equally inappropriate if conducted through the use of e-mail or the Internet.

Finally, employers should review record retention policies to ensure that they adequately address statutory retention requirements that may apply to electronic messages and computer data. Courts have regularly sanctioned companies for destroying evidence to prevent its use in litigation.^{57/}

Once an appropriate policy is adopted and effectively communicated to employees, employers can and should enforce the policy with appropriate monitoring of employee e-mail and Internet use, often referred to as "cybersnooping,"^{58/} and appropriate disciplinary action. Although the law in this

^{57/} See *United States v. Smithfield Foods, Inc.*, 972 F. Supp. 338 (E.D. Va. 1997) (default entered for plaintiff when defendant could only produce seven months of records and failed to comply with the applicable three-year record retention statute). See also *Prudential Ins. Co. of America Sales Practice Litigation*, 169 F.R.D. 598 (D.N.J. 1997) (haphazard and uncoordinated approach to document retention warranted an inference that destroyed materials were relevant and warranted sanctions -- which included \$1 million fine).

^{58/} Jerry Mahoney, *Watchful Workplace; Employee Monitoring Has New Dimensions and Old Concerns*, *Austin American-Statesman*, Sept. 8, 1996, at H1 (citing study which
(continued...))

area is still unsettled and can vary from state to state,^{59/} courts have generally rejected employee challenges to cybersnooping, finding that employees have no reasonable expectation of privacy in their use of their employer's e-mail and Internet systems once they are on notice that the systems should be used for company business only and are subject to monitoring.^{60/} Such challenges should be even more easily defeated if the employee expressly consents to monitoring.^{61/} Further, in order to reduce the potential for defamation and invasion of privacy claims, the least intrusive method of monitoring communications should be utilized, excessive intrusion into personal communications should be avoided, and disclosure of the information obtained from the system should be limited to those who have a legitimate need to know.

More and more companies are monitoring their employees' e-mail and Internet use.^{62/} This is particularly true in the securities industry where regulatory obligations require broker-dealers to monitor certain incoming and outgoing communications, including but not limited to, e-mail communications.

Employers are also taking increasingly strong measures in dealing with employees who abuse their e-mail and Internet systems. For example, The New York Times recently fired 20 employees,

58/(...continued)

estimated that 25 million employees are subject to electronic monitoring). Employers can also install software developed to monitor Web activities and block certain Web sites.

59/ Before adopting a policy, employers should review the applicable laws of each state in which the policy will be applied.

60/ See, e.g., McLaren v. Microsoft Corp., No. 05-97-00824-CV, 1999 WL 339015 (Tex. Ct. App. May 28, 1999); Bourke v. Nissan Motor Corp., No. B068705 (Cal. Ct. App. July 26, 1993); See also Smyth v. Pillsbury Co., 914 F. Supp. 97 (E.D. Pa. 1996) (finding that an employee has no right to privacy in his e-mail communications despite any assurances by the employer that such communications would not be intercepted).

61/ The only federal statute that specifically addresses the interception of e-mail communications is the Electronic Communications Privacy Act of 1986 ("ECPA"), 18 U.S.C. § 2510 *et seq.*. The ECPA, however, does not establish a general right to e-mail privacy in the workplace because of the various exceptions it contains, including exceptions where a party to the communications consents to monitoring. 18 U.S.C. § 2511(2)(d).

62/ Nick Wingfield, *More Companies Monitor Employees' E-mail*, Wall Street Journal, Dec. 2, 1999, at B8; Kristina B. Sullivan, *Web Monitoring and Filtering Programs Promote Productivity*, PC Week, Dec. 16, 1996, at N-21.

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Edward & Jones terminated 19 employees and disciplined an additional 41 employees, Salomon Smith Barney fired several analysts, Citibank fired or punished five employees, Xerox fired 40 employees, First Union fired 7 employees, and Honda of America fired or disciplined 88 employees for sending inappropriate e-mails or viewing inappropriate Web sites.^{63/}

By taking prompt and appropriate disciplinary action against employees who send offensive electronic communications and images, employers will both deter future abuse and reduce their exposure to potential liability. For example, in one recent case,^{64/} two employees alleged that they were discriminated against based upon four racially harassing e-mails received from a non-managerial employee. After receiving this complaint, the company took immediate action which included issuing a strong verbal warning to the sender and placing a written reprimand in her personnel file. The company's actions also included the holding of two staff meetings, one where the employees were reminded not to use the e-mail system for non-business purposes and one where the employees were allowed to voice their displeasure about the offensive e-mails. Although the plaintiffs' claims were dismissed for failure to exhaust administrative remedies, it is significant that the court took notice of the employer's prompt remedial action.^{65/}

Employers can also face litigation from employees who they terminate for improper use of e-mail. For example, in *Donley v. Ameritech Services, Inc.*, the plaintiff had sent an e-mail message to a co-worker in which he referred to an African American male client as "John Webb the Turd," and replaced all of the "th's" with "t's" in his message and the "the's" to "ta's."^{66/} Upon receipt of the message, the co-worker complained to her supervisor, and the plaintiff was later discharged for sending an e-mail which was offensive and disrespectful to the client.^{67/} The plaintiff sued Ameritech, alleging

^{63/} *How Private is E-mail*, Globe and Mail, Apr. 16, 1998, at A22; *New York Times Says It Fired Employees for Offensive E-mails*, Wall Street Journal, Dec. 1, 1999, at B6; Kelly Dunn, *Xerox Fires Employees for Internet Misuse*, Personnel Journal, Nov. 1, 1999, at 20; Lynn Hulsey, *Honda Cracks Whip On E-mail*, Dayton Daily News, Aug. 28, 1999, at 1A; Paul Rolfes, *E-mail as Much of a Curse as a Blessing to Business*, Columbus Dispatch, Oct. 11, 1999, at 10.

^{64/} *Daniels v. WorldCom Corp.* WorldCom Communications, Inc., No. Civ. A. 3:97-CV-0721-P, 1998 WL 91261 (N.D. Tex. Feb. 23, 1998).

^{65/} *Id.*

^{66/} No. 92-72236, 1992 WL 678509, at *1 (E.D. Mi. Nov. 16, 1992).

^{67/} *Id.*

that he was discriminated against him on account of his race (Caucasian).^{68/} The court granted summary judgment in favor of Ameritech on the grounds that the plaintiff had failed to establish a *prima facie* case of reverse discrimination and the lack of a genuine issue of material fact on whether the e-mail incident was a pretext for intentional discrimination.^{69/} In another case, a female employee sued her former employer for gender discrimination and retaliation after she was terminated, in part, for improper use of the company's e-mail system.^{70/} The court granted summary judgment in favor of the employer holding that the plaintiff failed to establish that the company's proffered reasons for her termination were pretextual.^{71/}

In view of the dramatic increase in employee use of e-mail and the Internet, employers should take steps to reduce the risks and potential liabilities associated with this new technology. At a minimum, employers should adopt an appropriate e-mail and Internet policy, effectively communicate the policy to employees, and enforce the policy by monitoring employee use of e-mail and the Internet and by taking appropriate disciplinary action for any abuses that occur.

^{68/} Id.

^{69/} Id. at *4.

^{70/} Cerwinski v. Insurance Serv. Office, Inc., No. 96-9368, 1997 WL 234672 (2d Cir. May 8, 1997).

^{71/} Id. at *2.