Morgan Lewis

VENTURE CAPITAL & PRIVATE EQUITY FUNDS
DESKBOOK SERIES

Employment Issues for Fund Managers

Fund managers face a number of significant employee-related issues throughout the employment cycle. In addition to making investment decisions, managers must ensure compliance with federal, state, and local rules and regulations regarding fair employment practices. Significant liability, meanwhile, can result from a failure to comply with nondiscrimination, retaliation, sexual harassment, and leave-related laws. Finally, fund managers must be aware of and comply with countless rules regarding day-to-day operations, including recruitment, qualifications, application processes, interview standards, payment of wages, performance reviews, discipline/termination, and defamation in references. Since fund managers typically do not incorporate significant administrative support, these employment-related issues can be daunting.

This article outlines the highlights and some of the details of the principal federal employment laws that apply on a nationwide basis.[1] *More specifically, in this article we provide a brief overview of the following:*

- The primary federal antidiscrimination statutes
- The Fair Labor Standards Act
- The Family and Medical Leave Act
- The Fair Credit Reporting Act
- Sexual harassment: A brief primer on managing and minimizing risk
- Day-to-day management considerations
- Postemployment restrictive covenants
- Whistleblower protections for employees, such as under the Sarbanes-Oxley Act of 2002

Additionally, it is important to note that state and local laws often require additional compliance measures and may vary from federal law—sometimes significantly. We encourage you to use this information as the basis for further questions and legal guidance where necessary.[2]

1 Because of the summary nature of this overview, we do not attempt to review every federal employment law that may be applicable; therefore, employers should consult with counsel to determine the laws applicable to their organizations.

2 Employers are required to conspicuously post notice of the statutes discussed in this overview (as well as applicable state and local laws) in the workplace.

Nuts and Bolts of Employment Discrimination

The Major Federal Laws

- Title VII of the Civil Rights Act of 1964
- Americans with Disabilities Act
- Age Discrimination in Employment Act
- Family and Medical Leave Act

Basic Rule

An employer violates applicable fair employment practices laws when it takes an adverse employment action because of an employee's protected status.

Protected Status: Immutable characteristics an employer is prohibited from considering in making employment decisions. For example, under federal antidiscrimination laws, the following are protected characteristics: race, color, religion, national origin, sex or gender, age (40 years of age or older), disability, and military status. Sexual orientation is also protected under many state and local laws.

Adverse Employment Action: An employer may be liable under the fair employment practices laws if the employee can prove that an adverse employment action was based on the employee's protected status or conduct. Adverse employment actions can include:

- Failure to hire, train, or promote
- Discharge or layoff from employment
- Demotion or poor performance evaluation
- Unequal pay or benefits
- Failure to provide a reasonable accommodation
- Harassment by management or coworkers
- Constructive discharge

Types of Discrimination

Disparate Treatment: Treating an employee differently than others similarly situated because of his or her protected status or protected conduct.

Disparate Impact: A neutral employment policy or practice that disproportionately impacts individuals in a particular protected status without legitimate business justification.

Harassment: Harassment on the basis of any protected status is a form of discrimination.

Retaliation: Employers are prohibited from retaliating or taking an adverse action against an employee because he/she engaged in protected conduct. Examples of protected conduct include any of the following:

- Filing an internal complaint against another employee
- Filing a charge of discrimination with the U.S. Equal Employment Opportunity Commission (EEOC) or similar state or local agency, or assisting another employee in doing so
- Filing a lawsuit in court, or assisting another employee in doing so
- Requesting a reasonable accommodation
- Requesting family or medical leave or military leave

- Assisting or participating in an EEOC (or similar state or local agency) investigation or an internal investigation of an administrative charge with such an agency

Enforcement

The EEOC is the federal agency with primary responsibility for enforcing federal employment discrimination laws. Upon receipt of a formal charge of discrimination and/or retaliation from an employee or job applicant, the EEOC notifies the employer and typically commences an investigation of the charge to *determine* whether there is "reasonable cause" to support the allegations of discrimination/retaliation. The investigation may include a request for information to the employer, fact-finding conference(s), or on-site investigation(s).

If the EEOC determines there is reasonable cause, it may file suit against the employer directly, or dismiss the charge and allow the employee to sue on his/her own behalf. In many cases, regardless of whether reasonable cause is found, the EEOC will dismiss the charge and issue a "notice of right to sue" to the employee. The employee has 90 days to file suit in court from receipt of the "right to sue" letter. States and many cities have agencies whose mandate is to enforce state and local fair employment practice laws and perform other administrative functions similar to the EEOC.

Potential Liability

- Back pay
- Compensatory damages (including emotional distress damages)
- Punitive or liquidated damages
- Front pay or reinstatement
- Attorneys' fees and costs

Title VII of the Civil Rights Act (Title VII) (42 U.S.C. §§ 2000e et seq.)

Scope

Title VII is a federal statute that prohibits employment discrimination on the basis of race, color, religion, sex, or national origin. Title VII also prohibits retaliation against employees for filing charges of discrimination under Title VII and/or participating or cooperating in investigations or proceedings related to alleged discrimination. Finally, Title VII, via the Pregnancy Discrimination Act, prohibits discrimination based on pregnancy or a pregnancy-related condition.

Title VII applies to employers with 15 or more employees for each working day in each of 20 or more calendar weeks in the current or preceding calendar year.

Employer's Obligation

An employer cannot hire, fire, promote, demote, or in any way alter employment conditions because of an employee's race, color, religion, sex, national origin, or pregnancy.

Primary Defense for Discrimination and Retaliation Claims

An employer can generally defend particular job actions if it can demonstrate a legitimate nondiscriminatory reason for the adverse action taken.

Sexual Harassment

Title VII prohibits sexual harassment. There are two types of sexual harassment:

Quid Pro Quo: "This for that." Employee's submission to or rejection of sexual advances or conduct is the basis of an employment decision, e.g., offering an employee a benefit, such as a job promotion or pay increase, for agreeing to sexual demands.

Hostile Environment: Unwelcome sexual conduct or speech that is severe or pervasive enough to unreasonably interfere with an employee's work performance or create an intimidating, hostile, or offensive work environment, e.g., sexual comments or jokes, displaying calendars or posters showing sexual images, or unwelcome touching.

Primary Defense for All Harassment Claims

The employer took reasonable and prompt preventive and corrective steps to address harassment (for example, the employer had a policy prohibiting harassment with an effective complaint procedure); and

The employee unreasonably failed to take advantage of any preventive or corrective opportunities provided by the employer.

Note: It is strongly recommended that employers undertake training of all employees regarding discrimination/harassment (as covered in further detail below).

Americans with Disabilities Act (ADA) (42 U.S.C. §§ 12101 et seq.)

Scope

Title I of the ADA is a federal statute that prohibits discrimination in employment against a qualified individual with a disability with regard to job application procedures, hiring, advancement, discharge, compensation, training, and other terms, conditions, and privileges of employment.

The ADA applies to employers that have 15 or more employees for each working day in each of 20 or more calendar weeks in the current or preceding calendar year.

Disability

An individual is considered to have a covered disability when he or she (1) has a physical or mental impairment that substantially limits one or more major life activities, (2) has a record of such impairment, or (3) is regarded as having such impairment.

Impairment: Any physiological disorder or condition, cosmetic disfigurement, or anatomical loss affecting one or more major body systems, or any mental or psychological condition, such as mental retardation, mental illness, or specific learning disabilities.

Major Life Activities: Include caring for oneself, walking, seeing, hearing, speaking, and working.

Qualified Individual with a Disability

An employee may be a qualified individual with a disability if (i) the employee has a covered disability, and (ii) the employee can perform the essential functions of the job, with or without reasonable accommodation.

Essential Functions

Consideration is given to the employer's judgment as to what functions of the job are essential, and if an employer has prepared a written description before advertising or interviewing applicants for the job, this description is considered evidence of the essential functions of the job. 42 U.S.C. § 12111(8).

Reasonable Accommodation

Employers are required to make reasonable accommodations to the known physical or mental limitations of applicants or employees with disabilities. An accommodation is not required if it would place "an undue hardship" on the employer. 42 U.S.C. § 12112(b)(5)(A). Factors that bear on the hardship question include the nature and cost of the accommodation, the size and the overall financial resources of both the facility and the covered entity as a whole, and the impact the accommodation would have on the employer's operations. Id. § 12111(10)(B). Examples of accommodations include making facilities accessible, job restructuring, part-time or modified work schedules, flexible leave policies, acquisition or modification of equipment devices, providing qualified assistance, reassignments, and transfers.

Employee Medical Information

The ADA strictly limits most medical examinations and inquiries, and requires medical documentation to be kept separate and confidential (with some limited exceptions). Before requesting medical documentation or inquiring about an employee's medical condition, it is prudent to first consult with counsel.

Age Discrimination in Employment Act (ADEA) (29 U.S.C. §§ 621 et seq.)

Scope

The ADEA is a federal statute that protects employees 40 years of age or older from discrimination based upon age, including with regard to hiring, discipline, termination, setting wages, promotions, or assigning shifts. The ADEA also prohibits hostile work environment harassment on the basis of age, such as age-based comments or age-related teasing, and retaliation against persons who assert rights under the ADEA.

The ADEA applies to employers that have 20 or more employees for each working day in each of 20 or more calendar weeks in the current or preceding calendar year.

Older Workers Benefit Protection Act (OWBPA) (29 U.S.C. §§ 621, 623)

The OWBPA is an amendment to the ADEA that prohibits discrimination in employee benefit plans, and also *provides* specific and rigorous standards (both as to content and timing) necessary to obtain a valid release and waiver of ADEA claims by an employee. It is recommended that employers consult with counsel with respect to the preparation of ADEA releases.

THE FAIR LABOR STANDARDS ACT[3]

Introduction

The Fair Labor Standards Act (the FLSA), 29 U.S.C. § 201 et seq., was adopted in 1938 to establish federal wage and hour standards for covered employees in the public and private sectors. The FLSA applies to employers with one or more employees. Generally, the FLSA sets a minimum wage to be paid to all covered employees and requires premium compensation (i.e., overtime) of one and one-half the rate of pay for hours worked in excess of 40 hours per week. The FLSA also contains various provisions regarding child

3. Please note that state and local laws governing the payment of wages should also be consulted.

labor, record keeping, and discrimination between men and women with respect to wages. The Wage and Hour Division of the United States Department of Labor (DOL) administers the FLSA.

The overtime provisions of the FLSA do not apply to persons who are not employees or who are expressly exempted from coverage—"exempt" employees. Effective August 23, 2004, new DOL regulations slightly revised the overtime exemptions for employees who earn certain levels of compensation and who are employed in a bona fide executive, administrative, or professional capacity. In addition, the regulations also create exemptions for, among others, persons employed as outside salespersons or computer systems analysts or programmers and for highly compensated employees who earn at least $100,000 annually. Regulations established under the FLSA set forth the specific requirements for these exemptions. See 29 C.F.R. § 541.

The FLSA imposes no limitations on the number of hours that an employee may work in any workweek, as long as the employer pays the required overtime compensation to an employee for hours worked in excess of the maximum 40-hour workweek prescribed by the FLSA. Failure to comply with the FLSA's requirements can result in extensive administrative investigations, civil lawsuits, awards of double damages to aggrieved employees for lost wages (such as unpaid overtime), injunctive relief, and awards of attorneys' fees. See 29 U.S.C. § 216. Willful violations of the FLSA may result in civil fines of up to $1,100 per violation, criminal fines of up to $10,000, and even imprisonment for up to six months. Id.

Either the aggrieved employee or the DOL can bring an action under the FLSA. An FLSA pay claim is subject to the statute of limitations contained in the Portal-to-Portal Act of 1947, as amended, 29 C.F.R. § 255(a), which imposes a two-year statute of limitations, except in cases of a willful violation, where the statute of limitations is three years.

White Collar Exemptions

The overtime provisions of the FLSA do not apply to persons who earn certain levels of compensation and who are employed in a bona fide executive, administrative, or professional capacity or in the capacity of an outside salesperson or computer systems analyst or programmer. Regulations established under the FLSA set forth the specific requirements for these so-called "white collar" exemptions. 29 C.F.R. §§ 541.0-541.52.

The 2004 Regulations and Their Impact on the White Collar Exemptions

On April 20, 2004, the DOL promulgated new regulations that took effect on August 23, 2004 (the New Regulations). As a general matter, the New Regulations raise the salary necessary to qualify for exemption to $455 per week and collapse the short and long tests into a single duties test. Some of the highlights of the New Regulations are described below.

The Salary Basis Test

The New Regulations raise the salary level for exempt executive, administrative, and professional employees from $150 or $170 per week to $455 per week, and maintain the salary for hourly paid computer employees at $27.63 per hour. New Regulations §§ 541.100, 541.200, 541.300, 541.400. The New Regulations expressly approve of additional pay to salaried exempt employees (e.g., bonuses, overtime, straight-time pay) without loss of the exemption.

While docking an employee's pay under certain circumstances may jeopardize the employee's overtime exempt *status*, the New Regulations specifically permit deductions for certain absences of work and other instances. Id. § 541.602. For example, unpaid disciplinary suspensions of one or more full days for infractions of written workplace conduct rules applicable to all employees may be permitted, if the deductions are imposed in good faith in accordance with a clearly communicated policy. Id. Employers should consult with counsel concerning any deductions from salary and/or compensation calculations (i.e., commissions) to ensure those deductions do not jeopardize the exempt status of an employee.

The Highly Compensated Employee

The New Regulations exempt those employees who are guaranteed annual compensation of at least $100,000 (*including* nondiscretionary bonuses and commissions) and who "customarily and regularly perform any one or more of the exempt duties or responsibilities of an executive, administrative or professional employee."

The highly compensated employee exemption does not apply to "non-management production-line workers and non-management employees in maintenance, construction and similar occupations such as carpenters, electricians, mechanics, plumbers, iron workers, craftsmen, operating engineers, longshoremen, *construction* workers, laborers and other employees who perform work involving repetitive operations with their hands, physical skill and energy . . . no matter how highly paid they might be." New Regulations § 541.601.

The Duties Tests

Executive Exemption

Under the New Regulations, an employee is exempt under the executive exemption if:

- He or she is compensated on a salary basis at a rate of not less than $455 per week
- His or her primary duty is management of the enterprise in which the employee is employed or of a customarily recognized department or subdivision thereof
- He or she customarily and regularly directs the work of two or more employees
- He or she has the authority to hire or fire other employees, or his or her suggestions and recommendations as to the hiring, firing, advancement, promotion, or any other change of status of other employees are given particular weight.

New Regulations § 541.100

Whether an employee's primary duty is management and satisfies the second requirement above is a factual analysis that is determined on a case-by-case basis.

Administrative Exemption

Under the New Regulations, an employee is exempt under the administrative exemption if:

- He or she is compensated on a salary basis at a rate of not less than $455 per week
- His or her primary duty "is the performance of office or non-manual work directly related to the management or general business operations of the employer or the employer's customers"
- His or her "primary duty includes the exercise of discretion and independent judgment with respect to matters of significance."

New Regulations § 541.200.

An employee will not qualify for the exemption unless his or her "primary duty is the performance of work directly related to the management or general business operations of the employer or the employer's clients." Id. § 541.200(a)(2).

Significantly, the New Regulations also contain a new provision, titled "Administrative Exemption Examples," which makes clear that the following types of employees are generally exempt under the administrative exemption:

- Insurance claims adjusters, whether they work for an insurance company or other type of company
- Employees in the financial services industry if their duties include "work such as collecting and analyzing information regarding the customer's income, assets, investments or debts; determining

which financial products best meet the customer's needs and financial circumstances; advising the customer regarding the advantages and disadvantages of different financial products; and marketing, servicing or promoting the employer's financial products. However, an employee whose primary duty is selling financial products does not qualify for the administrative exemption"

- Project leaders or managers
- Executive assistants to high-level executives
- Human resource managers
- Purchasing agents

Id. § 541.203.

Learned Professional Exemption

Under the New Regulations, an employee is exempt under the learned professional exemption if:

- He or she is compensated on a salary basis at a rate of not less than $455 per week; and
- His or her primary duty is "the performance of work requiring knowledge of an advanced type in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction."

New Regulations § 541.300.

Creative Professional Exemption

Under *the* New Regulations, an employee is exempt under the creative professional exemption if:

- He or she is compensated on a salary basis at a rate of not less than $455 per week; and
- His or her primary duty is "the performance of work requiring invention, imagination, originality or talent in a recognized field of artistic or creative endeavor."

New Regulations § 541.300.

Computer Professional Exemption

Under the New Regulations, an employee is exempt under the computer professional exemption if he or she is compensated on a salary basis at a rate of not less than $455 per week (or on an hourly basis at a rate not less than $27.63 an hour) and his or her primary duties consist of:

- The application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software, or system functional specifications;
- The design, development, documentation, analysis, creation, testing, or modification of computer systems or programs, including prototypes, based on and related to user or system design specifications;
- The design, documentation, testing, creation, or modification of computer programs related to machine operating systems; or
- A combination of the aforementioned duties, the performance of which requires the same level of skills.

New Regulations § 541.400.

Outside Sales Exemption

Under the New Regulations, an employee is exempt under the outside sales exemption if:

- His or her primary duty is making sales within the meaning of section 3(k) of the FLSA or obtaining orders or contracts for services or for the use of facilities for which a consideration will be paid by the client or customer; and

- He or she is customarily and regularly engaged away from the employer's place or places of business in performing such primary duty.

New Regulations § 541.500.

ENFORCEMENT OF THE FLSA

Wage and Hour Division

The Wage and Hour Division of the DOL enforces and administers the FLSA. The Wage and Hour Administrator, the lead official of the Wage and Hour Division, is responsible for the various regional offices of the division located throughout the United States.

Judicial Enforcement

The Secretary of Labor can bring a suit against an employer for damages and injunctive relief. 29 U.S.C. § 216(c). The Secretary is also empowered to negotiate and supervise a settlement of back pay claims on behalf of employees. Id. In fact, a private waiver or release is only valid if entered into under the supervision of the Secretary or a court.

In addition, an employee may file an action against his or her employer to recover unpaid minimum wages, overtime compensation, or both, and an equal amount for liquidated damages. Id. § 216(b).

Remedies

Backpay and Liquidated Damages

The FLSA states that upon a finding of a violation of the minimum wage or overtime provisions, employers "shall be liable . . . [for unpaid wages and for] an additional equal amount as liquidated damages." 29 U.S.C. § 216(b). The Portal-to-Portal Act amended the FLSA to provide employers with a defense to the mandatory damages; it permits the district court, in its sound discretion, to award a smaller amount of liquidated damages or none at all. Id. § 260. The employer has the burden of persuading the court that "the act or omission giving rise to such action was in good faith and that [the employer] had reasonable grounds for believing that [its] act or omission was not a violation" of the FLSA. Id. § 260.

Attorneys' Fees

In general, an award of attorneys' fees to a prevailing plaintiff under the FLSA is mandatory, but the amount of the award is within the discretion of the trial judge. 29 U.S.C. § 216(b).

Civil Penalties for Repeated Violations

Employers that repeatedly or willfully violate the minimum wage or overtime provisions may be subject to civil penalties of up to $1,100 per violation. 29 U.S.C. § 216(e); 29 C.F.R. § 578.3(a). A violation is considered "repeated" when there has been a prior finding of either a minimum wage or overtime violation against the employer by the Wage and Hour Division, or by a court or tribunal with authority to make such a finding. 29 C.F.R. § 578.3(b).

Criminal Penalties for Willful Violations

An employer that willfully violates the FLSA may be subject to a criminal fine of up to $10,000 and/or six months in jail. 29 U.S.C. § 216(a). A violation is "willful" when an employer knows conduct is prohibited or acts with reckless disregard. 29 C.F.R. § 578.3(c). "Reckless disregard" occurs where there is a failure to inquire as to legality when an inquiry should have been made. Id. § 578.3(c)(3).

RECORDKEEPING REQUIREMENTS AND ELECTRONIC DATABASES

Recordkeeping

The FLSA requires records to be kept for employees covered by the statute as well as for employees not covered by the statute. There are specific records to be kept for employees earning below the minimum wage, home workers, and child labor. The records are to be kept on the employer's premises or in a place where they can be made available within 72 hours. 29 C.F.R. § 516.7. A willful violation of the recordkeeping requirements is grounds for criminal prosecution.

No particular order or form of records is prescribed by the regulations concerning FLSA recordkeeping. The regulations, however, provide the following with respect to electronic databases:

> The records may be maintained and preserved on microfilm or other basic source document of an automatic word or data processing memory provided that adequate projection or viewing equipment is available, that the reproductions are clear and identifiable by date or pay period and that extensions or transcriptions of the information required by this part are made available upon request.

Id. § 516.1(a).

Records to Be Kept for All Employees

The following records should be kept for all employees whether or not they are covered by the FLSA:

- Name and identifying number or symbol
- Home address and zip code
- Date of birth, if under 19
- Sex
- Occupation in which employed

29 C.F.R. §§ 516.2, 516.11.

Records to Be Kept for Employees Subject to the Minimum Wage or Overtime Provisions of the FLSA

In addition to the records listed above, the following records must be kept for employees subject to the FLSA minimum wage and overtime provisions:

- Time of day and day of week workweek begins
- Rate of pay
- Hours worked each workday and each workweek
- Total daily and hourly straight-time earnings
- Total weekly overtime earnings
- Total additions or deductions to wages each pay period
- Hourly rate of pay for each week overtime is worked
- Total wages each pay period
- Date of payment and pay period covered by the payment

29 U.S.C. § 211(c); 29 C.F.R. § 516.2.

Every employer must preserve payroll records, collective bargaining agreements, employment contracts, plans, trusts, and sale and purchase records for at least three years. 29 C.F.R. § 516.5. Records on which wage computations are based must be retained for two years (i.e., time cards and piecework tickets, wage rate tables, work and time schedules, and records of additions to or deductions from wages). Id. § 516.6.

Notices

Finally, every employer covered by the FLSA must display the FLSA poster on minimum wage, overtime compensation, and child labor in a conspicuous place for employee review. See 29 C.F.R. § 516.4.

THE FAMILY AND MEDICAL LEAVE ACT[4]

The Family and Medical Leave Act of 1993 (FMLA or Act) generally requires employers to grant certain employees up to 12 weeks of unpaid leave during a 12-month period, with a continuation of group health benefits and the assurance of job restoration. Although the statute may appear to be simple, the FMLA has resulted in a number of legal issues, including what constitutes a "serious health condition" that entitles the employee to leave, and what constitutes adequate notice by an employee of the need to take FMLA leave. Many of these issues continue to cause employers to struggle with the implementation of the FMLA's requirements. This section provides a general overview of basic issues that employers must keep in mind in dealing with the FMLA.

EMPLOYER COVERAGE/EMPLOYEE ELIGIBILITY UNDER THE FMLA

Covered Employers:

Covered employers under the FMLA include public agencies (federal, state and local) and private-sector employers that employ 50 or more employees in each workday in 20 or more workweeks in the current or preceding calendar year. 29 C.F.R. § 825.104(a).
Part-time employees are counted toward the 50-employee threshold even though they themselves might not be eligible for FMLA leave. Id. § 825.105(c). Separate but related entities may be treated as a "single employer" for purposes of determining whether the 50-employee threshold has been met in certain circumstances.

Employee Eligibility:

To be eligible for FMLA benefits, an employee must have worked (1) for a covered employer for at least 12 months (even if not consecutive);[5] (2) at least 1,250 hours during the 12-month period preceding the date the leave is taken (determined under the FLSA's principles of "hours worked"); and (3) at a location where at least 50 employees are employed by the employer within a 75-mile radius, measured as of the date leave commences. 29 C.F.R. § 825.110.

LEAVE ENTITLEMENT

An eligible employee will be entitled to up to 12 weeks of unpaid leave during a 12-month period for (1) the birth of a child or placement of a child with the employee through adoption or foster care; (2) the need to care for an immediate family member (spouse, child, or parent) with a "serious health condition"; or (3) the employee's own "serious health condition." Additional provisions were recently added to allow eligible employees up to 26 weeks of unpaid leave in a 12-month period to care for a covered family member who becomes ill or injured as a result of military service. 29 C.F.R. § 825.127.[6]

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4. In addition, employers should ensure compliance with applicable state and local leave-related laws.

5. Employers are required to look at prior service for up to seven years before the leave is taken in order to determine employee eligibility. Since FMLA recordkeeping requirements only extend three years, however, if the period of eligibility includes a period outside the employer's records, the burden to establish eligibility for the period beyond the employer's records falls on the employee.

6. In addition, a separate federal statute—the Uniformed Services Employment and Reemployment Rights Act (USERRA)—mandates that uniformed members of the military are to be provided with a leave of absence for the purpose of providing military service. Moreover, USERRA requires that a person who is a member of, applies to be a

The FMLA defines "serious health condition" as an illness, injury, impairment, or physical or mental condition that involves (1) inpatient care (i.e., an overnight stay) in a hospital, hospice, or residential medical care facility, and subsequent treatment or period of incapacity relating to the same condition, id. § 825.114(a)(1); or (2) continuing treatment by a healthcare provider, which includes a period of incapacity (i.e., inability to work or perform other regular daily activities) of more than three consecutive calendar days, and any subsequent treatment or period of incapacity relating to the same condition.[7] Id. § 825.114(b). "Treatment" includes examinations to determine if a serious health condition exists, but does not include routine physical examinations. Id. The FMLA requires that serious health conditions create an "inability to work, attend school, or perform other regular activities due to that condition, its treatment, or recovery therefrom." See Id. § 825.114(a)(2)(i).

All covered employers are generally required to maintain health coverage for an employee on FMLA leave whenever such insurance was provided before the leave was taken, and on the same terms that would have existed if the employee had continued to work. Id. § 825.209(a).

RESTORATION OF JOB AND BENEFITS ON RETURN FROM FMLA LEAVE

In general, an employee returning from FMLA leave must be restored to his or her original job, or to an "equivalent" job with equivalent pay, benefits, and other employment terms and conditions. 29 C.F.R. §§ 825.214, 825.215. An employee's use of FMLA leave cannot result in the loss of any employment benefit that the employee earned or was entitled to before using FMLA leave. Id. § 825.215(d)(2). Of course, if an employee would have been terminated during FMLA leave even if he or she had not gone on leave, he or she is not entitled to job restoration.

NOTICE AND CERTIFICATION REQUIREMENTS

The FMLA imposes a variety of notice requirements on the employer, including requiring the posting of notices at the worksite and in employee handbooks and provision of information at the time an employee takes FMLA leave. See 29 C.F.R. § 825.300-301. Employers must follow the same recordkeeping requirements as the FLSA in maintaining records under the FMLA. See Id. § 825.500. Employers must also designate qualifying employee leave time as FMLA leave.

The FMLA also imposes certain notice requirements on employees. For example, employees seeking to use FMLA leave may be required to provide 30-day advance notice of the need to take FMLA leave when the need is foreseeable (e.g., pregnancy). Otherwise, such notice as is practicable under the circumstances must be given, generally, within two days after learning of the need for the leave. Id. § 825.302(a). The FMLA regulations state that an employee "shall provide at least verbal notice sufficient to make the employer aware that the employee needs FMLA-qualifying leave, and the anticipated timing and duration of

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member of, or has performed or has an obligation to perform service in a uniformed service "shall not be denied initial employment, reemployment, retention in employment, promotion, or any other benefit of employment by an employer on the basis of [military] membership, application for membership, performance of service, application for service or obligation." 38 U.S.C. § 4311(a). Thus, USERRA provides a remedy for an employee who is subjected to an adverse employment action on the basis of uniformed member status. USERRA also prohibits retaliation against an individual who exercises his or her rights under USERRA or testifies, assists, or otherwise participates in an investigation or proceeding under USERRA. Id. § 4311(b). Unlike other federal statutes, USERRA applies to employers of all sizes, irrespective of the number of employees employed. Employers should consult with counsel in handling requests for leaves of absence, and/or reinstatement after leave, by members of the uniformed services.

7. Continuing treatment must also involve (1) treatment two or more times by a health care provider (or by a provider of health care services on order of a health care provider) within a 30-day period from the onset of the initial incapacity, with the first visit taking place within seven days of the first day of incapacity and the necessity of the second visit at the determination of the provider, 29 C.F.R. § 825.114(a)(2)(i)(A); or (2) treatment by a health care provider on at least one occasion that results in a regimen of continuing treatment under the supervision of the health care provider, id. § 825.114(a)(2)(i)(B).

the leave. The employee need not expressly assert rights under the FMLA or even mention the FMLA, but may only state that leave is needed for an expected birth or adoption, for example." Id. § 825.302(c).

If FMLA leave is requested for a serious health condition, the employer may request the employee provide the following medical certifications from a healthcare provider: (1) for the serious health condition of the employee, a certification that the employee "is unable to perform the functions of the position of the employee"; or (2) for the serious health condition of a family member, a certification that the employee is "needed to care" for the family member. Id. § 825.305(a).

Once the certification has been completed, an employer may not request additional information from the healthcare provider. An employer may contact the employee's healthcare provider for clarification and verification of information contained in a medical certification after giving the employee seven days to cure a deficiency; however, under no circumstances may the employee's direct supervisor contact the employee's healthcare provider. Id. § 825.307 (emphasis added). An employer may seek a second opinion on a certification, but may not use a health care provider employed by or under contract with the employer for a second opinion. Id. § 825.307(b) (emphasis added). In the event of a conflict between the first and second opinions, the employer may require, at its own expense, a third medical opinion, which will be binding upon the employer and employee. The third opinion is to be obtained from a healthcare provider selected jointly by the employer and the employee. Id. § 825.307(c).

ENFORCEMENT AND AVAILABLE REMEDIES

The FMLA is enforced by the U.S. Department of Labor's Employment Standards Administration, Wage and Hour Division. If violations cannot be resolved satisfactorily, the department may bring an action in court to compel compliance. 29 C.F.R. §§ 825.400(a)(1), 825.401. An eligible employee may also bring a private civil action against an employer for violations. Id. § 825.400(a)(2). In such an action, an employer who is found to have violated the Act may be liable to the employee for damages in an amount equal to the amount of wages, salary, employment benefits, or other compensation denied or lost because of the violation, or any actual monetary losses capped at 12 weeks sustained by the employee as a direct result of the violation, as well as interest, liquidated damages doubling the damages awarded, equitable relief, attorneys' fees, and costs of suit. Id. § 825.400(c).

RECORDKEEPING AND POSTING REQUIREMENTS

In general, employers must follow the same recordkeeping requirements as the FLSA in maintaining records under the FMLA. 29 C.F.R. § 825.500(a). Employers shall post in a conspicuous place in the workplace, where notices to employees and applicants are usually posted, a notice, to be prepared or approved by the Secretary of Labor, setting forth excerpts from, or summaries of, the pertinent FMLA provisions and information pertaining to the filing of a charge.

THE FAIR CREDIT REPORTING ACT

The Fair Credit Reporting Act (FCRA), 15 U.S.C. §§ 1681 et seq., generally controls the procurement and use of background information about individuals.[8] This includes information about a person's creditworthiness, character, general reputation, personal characteristics, or mode of living. The statute contains sweeping language intended to protect individual privacy. Under the FCRA, an employer must provide specific written notice and receive written consent from an applicant (or current employee) before obtaining such information. Furthermore, an employer must provide certain disclosures and provide the applicant (or employee) with an opportunity to respond to the information before taking any adverse action

8. Please note that state and local laws governing the procurement and use of background information of individuals should also be consulted.

(e.g., refusing to hire an applicant). An employer that violates the FCRA is subject to criminal penalties, as well as potential civil liability (including actual damages, punitive damages, and attorneys' fees).[9]

Under the FCRA, an employer must have a permissible purpose for obtaining a "consumer report" or an "investigative consumer report." A consumer report, the most typical report obtained by employers that perform regular background checks, is any

> communication of any information by a consumer reporting agency bearing on a consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics or mode of living which is used or expected to be used or collected in whole or in part for the purpose of serving as a factor in establishing the consumer's eligibility for . . . (B) employment purposes . . . .[10]

Id. § 1681a(d)(1). The term "consumer" means an individual. Id. § 1681a(c).

As mentioned above, one of the permissible purposes for obtaining a consumer report is for "employment purposes." Id. § 1681b(a)(3)(B); see also id. § 1681a(d)(1). This means that the report must be used to evaluate a person for "employment, promotion, reassignment or retention as an employee." Id. § 1681a(h). An employer may not obtain or use a consumer credit report for any other purpose except those expressly provided by the statute. Id. § 1681b(a).

A special kind of consumer report is an "investigative consumer report." This is an in-depth consumer report in which information on a consumer's character, general reputation, personal characteristics, or mode of living is obtained through personal interviews with neighbors, friends, or associates of the consumer reported on or with others with whom he or she is acquainted or who may have knowledge concerning any such items of information. Id. § 1681a(e). Investigative consumer reports are less commonly used by employers and typically are reserved for high-level management positions (e.g., senior vice presidents, chief executive officers).

Requirements for Employers Obtaining or Using Consumer Reports

In order to obtain a consumer report to be used for employment purposes, an employer must (1) provide a clear and conspicuous written disclosure to the individual or a separate document before the report is procured (typically a page attached to an employment application); (2) receive written authorization from the individual to obtain the report for that purpose; and (3) certify to the consumer reporting agency that the employer complied with the above requirements and that the employer will not use the report in violation of any "applicable Federal or State equal employment opportunity law or regulation." 15 U.S.C. §§ 1681b(b)(1), 1681b(b)(2)(A).

Before taking any "adverse action" based "in whole or in part" on the consumer report, the employer must give the individual a copy of the consumer report obtained and a summary of the individual's rights under the FCRA. Id. § 1681b(3)(A). An adverse action includes "a denial of employment or any other decision for employment purposes that adversely affects any current or prospective employee." Id. § 1681a(k)(1)(B)(ii). The statute does not specify how long an employer must wait after giving the individual a copy of the

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9. Civil penalties can include a fine of between $100 and $1,000, or the actual damages of the consumer, whichever is greater, as well as punitive damages and attorneys' fees. 15 U.S.C. §§ 1681n, 1681o. Criminal penalties include imprisonment of up to two years. Id. §§ 1681q, 1681r.

10. The time period that is covered by the consumer report is statutorily proscribed by 15 U.S.C. § 1681c. The statute generally excludes from consumer reports information that is more than seven years old, with the exception of filings for bankruptcy, which have a 10-year lookback period. Id. § 1681c(a). The statute further provides that the limitations set forth in subsection (a) do not apply if a consumer credit report is to be used in conjunction with "the employment of any individual at an annual salary which equals, or which may reasonably be expected to equal $75,000, or more." Id. § 1681c(b)(3).

report and a summary of rights before it takes the adverse action, but the FTC has indicated in advisory letters that the intent is to provide the individual with the opportunity to discuss the information with the employer and that a five-business-day period would be reasonable under most circumstances.

If an employer decides to take adverse action based in whole or in part on the credit report, it must (1) provide notice of the adverse action to the individual; (2) provide the name, address, and telephone number of the consumer reporting agency that furnished the report to the employer; (3) provide a statement that the consumer reporting agency did not make the decision to take the adverse action and is unable to provide the specific reasons for the adverse action; (4) provide the individual with notice of his or her right to obtain a free copy (within 60 days) of the consumer report from the consumer reporting agency; and (5) provide notice of the individual's right to dispute with a consumer reporting agency the accuracy or completeness of any information in a consumer report furnished by the agency. Id. § 1681m(a).

Special Requirements for Investigative Consumer Reports

To obtain an investigative consumer report, an employer must (1) comply with the requirements for obtaining and using a consumer report; (2) clearly and accurately disclose in writing to the individual that an investigative consumer report including information regarding his or her character, general reputation, personal characteristics, and mode of living may be made; and (3) include in the disclosure notice of the individual's right to request in writing an additional disclosure concerning the nature and scope of the investigation requested and the individual's right to receive the written summary of rights. 15 U.S.C. § 1681d(a).

If, within "a reasonable period of time" after receipt of the employer's disclosure, the individual so requests in writing, the employer must (within five days of receipt of the request) provide the individual with "a complete and accurate disclosure of the nature and scope of the investigation requested." Id. § 1681d(b). Thus, the form of this disclosure will necessarily depend upon the nature of the investigation requested.

Sexual Harassment: A Brief Primer in Managing and Minimizing the Risk[11]

Despite increased corporate awareness of, and sensitivity to, harassment in the workplace, sexual harassment allegations continue to be both a focus of media attention and a source of significant potential liability for employers. The higher media profile not only results in a negative public image for the employer involved but also informs potential claimants about a powerful legal weapon against employers generally. In this environment, employers in all employment sectors must take prudent, preventive steps to protect themselves from liability and manage the risk of a sexual harassment claim. While the courts credit those employers that take those steps, they also look dimly upon those employers that do not. From a practical standpoint, employers should at a minimum (i) be familiar with the contours of sexual harassment and (ii) institute training and other internal practices and procedures to deal effectively with sexual harassment claims.

Defining the Issue: What Is Sexual Harassment?

Put simply, sexual harassment is the imposition of some unwanted condition of employment because of a person's sex. It may be unwelcome sexual advances, requests for sexual favors, inappropriate and offensive verbal or physical conduct, or other conduct of a sexual or gender-based nature. Although the Supreme Court has rejected the use of categorical denominations, within this broad definition of sexual harassment courts have generally identified two types of sexual harassment claims: "quid pro quo" sexual harassment and "hostile environment" sexual harassment.

11. Although this primer deals primarily with sexual harassment, employers should be aware that federal, state, and local laws also prohibit harassment on the basis of race, age, religion, and other protected characteristics.

Quid Pro Quo

Quid pro quo ("this for that") harassment exists when sexual favors are requested or demanded from an employee in exchange for a job benefit (e.g., promotion, pay raise, scheduling, or work assignments) or in order to avoid a job detriment (e.g., termination, demotion, or discipline). This type of sexual harassment typically arises between a manager and a subordinate and is a potential source of tremendous liability for the employer. Under current law, an employer may be held strictly liable when quid pro quo harassment is perpetrated by someone who has the authority to make decisions regarding hiring and firing, or who can affect the terms and conditions of employment. Quid pro quo harassment can take several forms, some more obvious than others. Clearly, a supervisor withholding a promotion from a subordinate unless he sleeps with her is engaging in a form of quid pro quo sexual harassment. Less obvious are oblique sexual propositions or dating invitations by a supervisor that, in the supervisor's mind, may have no relation to a job benefit or detriment but nevertheless may be determined by a fact finder to be quid pro quo sexual harassment. A finding of harassment is especially likely if the supervisor is in a position to evaluate, promote, demote, or terminate the employee and takes an adverse employment action (e.g., a demotion) against that employee. In this area, the principal issue is not the supervisor's intent, but the potentially coercive and unequal relationship between manager and subordinate.

Hostile Environment

"Hostile environment" sexual harassment is deemed to occur when sexual or offensive conduct "has the purpose or effect of unreasonably interfering with an individual's work performance" or is severe or pervasive enough to create an "intimidating, hostile or offensive work environment." If the definition suggests that "hostile environment" harassment may be in the eye of the beholder, the suggestion is valid; courts have held that the standard for determining whether a "hostile environment" exists is whether a "reasonable person" would find the conduct hostile or abusive or, in some instances, whether a "reasonable woman" would find the conduct hostile or abusive. If a hostile work environment is found to have been created by the conduct of a supervisor, the employer may be strictly liable unless it proves by a preponderance of the evidence an affirmative defense comprising two elements: (i) that the employer exercised reasonable care to prevent and promptly correct any sexually harassing behavior, and (ii) that the employee unreasonably failed to take advantage of any preventive or corrective opportunities provided by the employer.

In contrast, where the hostile work environment harassment is perpetrated by a nonsupervisory coworker, an employer may be liable if it is determined that the employer either provided no reasonable avenue of complaint or, after learning of the harassment, did nothing about it. Because conduct can vary from workplace to workplace, hostile environment sexual harassment is more difficult to identify than quid pro quo harassment. Hostile environment conduct can range from a suggestive comment about someone's appearance; to the telling of "dirty jokes"; to the use of certain swear words with sexual connotations; to inappropriate physicality such as hugs, kisses, and "massages"; to, in the extreme, actual sexual assault. The participants in these behaviors need not be offended or affected; a hostile environment may be created by the "spillover effect" of the behavior on others in the workplace.

Courts make very fact-specific and context-specific inquiries to determine when hostile environment sexual harassment has occurred. No one factor is dispositive or required—courts look at the totality of the circumstances, such as the frequency of the conduct, the severity of the conduct, whether it was physically threatening or humiliating or just a mere offensive utterance, whether it unreasonably interfered with an employee's work performance, and whether the conduct created an environment a reasonable person would find hostile or abusive. Naturally, decisions vary. In one case, a court held that receiving bizarre and suggestive love letters from a coworker created a hostile environment even though there was no physical contact and limited verbal contact. In another case, a court held that the plaintiff's allegations of sexual touching, pestering, and unwelcome requests for dates, even if credible, were so sporadic and relatively innocuous that they did not create a hostile environment. These cases demonstrate the fact-intensive and potentially subjective judgments that are made in determining whether a hostile environment exists.

Managing the Issue: What Can an Employer Do?

Generally, an employer can limit its exposure to sexual harassment claims by (i) having a clearly articulated and widely disseminated policy against sexual harassment, a procedure for handling sexual harassment complaints, and a training program in the policy's requirements for, at a minimum, the employer's managers and supervisors; (ii) taking immediate investigative action once a complaint is made; and (iii) making an appropriate and fair remedy for the alleged conduct if it occurred.

Specifically, the following practical steps are suggested:

(1) ***Employers should have a written, widely disseminated policy that sexual harassment will not be tolerated.*** A written, widely disseminated policy that specifically addresses sexual harassment reduces an employer's exposure. If an employer is able to establish that its policies and implemented measures were such that employees knew or should have known that sexual harassment was not tolerated in the workplace, hostile environment harassment is less likely to be found. In one case, for example, a court cited as crucial evidence of a nonhostile environment the statement by the employer company chairman that offensive behavior would not be tolerated.

In another case, the court cited specific actions by the employer as negating a finding of hostile environment: (i) an active and firm policy against sexual harassment; (ii) the sponsoring of employee seminars to discuss the issue; (iii) the distribution of a zero-tolerance policy statement to all employees; (iv) the publication of the company's civil rights policy statement; and (v) the dissemination of contact numbers for the company's EEO staff. These cases demonstrate that strong, broadly disseminated and fully implemented policies can have a positive, even protective, effect for employers.

The reference to employee seminars is noteworthy. The law places the burden on a company's managers and supervisors to abide by and enforce compliance with the company's sexual harassment policy. Employers may thus benefit greatly by ensuring that, at a minimum, all managers and supervisors undergo training in the requirements of the sexual harassment policy, the identification of workplace behaviors that may violate that policy, and the effective managerial responses demanded by the policy. Such training is also powerful evidence of a corporate commitment to creating and maintaining an appropriate work environment. Equally important, it provides managers and supervisors with the tools to enforce compliance with the policy in the workplace. Many employers currently go beyond the managerial level and train the entire workforce. Naturally, the broader the training, the more powerful the inference of an appropriate work environment.

(2) ***Employers should have a confidential complaint procedure for complainants to use without fear of retaliation.*** A sexual harassment policy that does not provide a means for dealing with complaints is not enough to protect employers from liability. A sexual harassment policy should encourage employees to come forward with their complaints of sexual harassment and should also identify at least one member of management—an "ombudsperson"—who is not the employees' direct supervisor to receive complaints. Thus, if an employee feels uncomfortable talking to his or her supervisor, he or she can go to the ombudsperson to discuss the issue. Policies with more than one avenue for complaining have met with court approval. The policy should also provide that the complaint will be kept confidential to the extent consistent with the employer's duty to investigate and should further provide that retaliation against a complaining employee is prohibited.

(3) ***There should be an immediate and thorough investigation into any complaint of sexual harassment.*** Once a complaint is made, the clock begins ticking. Courts will examine how quickly and effectively a complaint was handled as one of the bases for determining

liability. An employer's swift investigative response to an employee's complaint pursuant to the employer's sexual harassment policy may be enough to preclude a finding of employer liability in a hostile environment claim.

(4) ***There should be an adequate and definitive remedy to the situation.*** Once an investigation has determined that harassment has occurred, an employer needs to take prompt corrective action reasonably calculated to end the harassment and deter other employees from engaging in similar conduct. It may not matter if the harassing employee is disciplined in the manner the complainant would like, so long as the employer's action is prompt and appropriate.

These four steps—a strong policy; a clearly defined and open avenue for complaint; prompt, responsive investigation; and, if necessary, appropriate remedial action—provide valuable protection to employers against liability for sexual harassment claims, particularly those that are hostile environment claims. The absence of any one of these measures, however, may prove fatal to an employer's defenses. In the current environment, employers should consult with counsel to ensure that all steps are being taken to both reduce the occurrence of harassment and take advantage of the employer protections afforded by this area of the law.

Day-to-Day Management Considerations

Issues to Consider in the Hiring and Termination Process

Recruitment Process

Role of recruiting:

- Recruiting is essential to a company's operations. If conducted effectively, recruiting attracts candidates who have the skills and attitudes that the company needs to achieve its organizational goals.
- Employers should be aware, however, that federal and state laws have placed restrictions on how they may recruit workers. Employers must be sensitive to these limitations, and conform their recruitment policies accordingly.

Word-of-mouth advertising and employee referrals:

- These kinds of recruiting approaches may tend to perpetuate past biases.
- These policies are acceptable, however, if used in tandem with other forms of recruiting.

Employment Qualification Standards

The company should establish job specifications for each position.
Make sure that the job specifications established for a particular position do not have an adverse impact on protected individuals. If they do, make sure that those standards are related to job performance.

Education

Since requiring a particular educational level may have an adverse impact on minorities, an employer should be certain that any educational requirement is related to job performance.

Experience

Experience requirements, like any other ability standard, can tend to discriminate against minorities. Thus, an employer must ensure that its experience requirements relate to job performance.

Appearance

Although the dress and appearance of employees can play a significant role in portraying a good company image, certain requirements can create problems based on sex, religion, or race. Again, ensure that the requirements are necessary.

Employment Application and Interviewing Process

Conducting the Application Process

Employers are required to conduct the applicant screening process in a nondiscriminatory manner. As a result, both federal and state laws restrict the kinds of questions that can be asked in the information-gathering phase of the screening process.

Preemployment Inquiries

Many state EEO agencies have promulgated rulings on inquiries that prohibit employers from asking certain questions, either in an application or in a personal interview.

- **Age:** Cannot ask applicant his/her date of birth; however, can ask whether applicant is 18 years of age or older.
- **Arrest Record:** Cannot inquire into whether applicant has ever been arrested. Can ask whether applicant has been convicted of or pled guilty to a felony crime. Many states and local laws prohibit discrimination on the basis of prior arrests and/or convictions.
- **Disability:** Cannot ask if applicant has a disability.
- **Birth Control:** Cannot inquire into capacity to reproduce or whether applicant is an advocate of birth control.
- **Marital Status:** Cannot inquire into applicant's marital status.
- **Protected Classification:** Cannot inquire into applicant's status in a protected classification.

It is also unlawful to ask any questions the answers to which will indirectly reveal information as to a prohibited inquiry.

- **Birthplace:** Cannot inquire into applicant's birthplace (national origin discrimination).
- **Citizenship:** While an employer can ask if applicant is a United States citizen (and related questions), it cannot ask what country applicant is a citizen of or whether he or she is a naturalized or native-born United States citizen.
- **Photograph:** Cannot require applicant to affix a photograph to application.

Whenever possible, ensure that all applicants are asked the same questions.

Documentation

- An employer should keep statistics on the number of applicants from each protected class, as well as the reasons the applicants were rejected.
- The EEOC requires employers to retain employment applications for six months. The use of an employment-at-will disclaimer on the application form is recommended.

Interviewer Training

Make sure that all interviewers are trained to prevent even the slightest hint of discrimination.

Interviewers should be briefed that their representations may later bind the employer to a contract. They should be urged to avoid "overstating" job security.

Whenever possible, try to involve minority personnel in the interviewing process.

For those applicants who have been previously employed by the company, ask where they worked, when they worked, what positions they held, who they reported to, and why they left. After the interview, the interviewer should contact the human resources department, which will have the applicant's personnel records reviewed.

Confirm the office skills/information listed by the applicant. If an applicant lists business machines that he or she can operate, ask what type of training he or she received and how much experience he or she has in operating the machines.

Be sure to note all pertinent responses. Do not rely on memory for information not contained on the application, particularly with regard to names, dates, and telephone numbers.

Benefits and Liabilities of Performance Evaluations

A written performance evaluation is a formal system for accomplishing several purposes:

- Measuring an employee's performance of job duties and the employee's contribution to the organization
- Directing an employee's activities and performance toward accomplishing organizational goals and objectives
- Providing feedback to an employee regarding performance and contribution to the organization's goals
- Identifying talent within the organization
- Identifying individual professional development and training needs or opportunities
- Creating a formal record of an employee's performance

Written performance evaluations can be used in a number of different ways, including:

- Rewarding/recognizing performance
- Compensation decisions
- Advancement (promotion/transfer)
- Training opportunities
- Discipline/warning/criticism
- Reduction-in-force decisions
- Termination
- Litigation of claims involving any of the above (and more)

A successful performance evaluation system should include several elements:

- Objective performance criteria related to the particular job being evaluated
- Same criteria for same jobs

- Similar criteria for similar jobs
- Different criteria for different jobs
- Reasonably measurable competencies/characteristics related to the requirements of the job or profession
- An accurate critique of performance conducted by a trained evaluator
- Professional development/improvement objectives and plans
- Employee input on the evaluation

Performance evaluations should accurately, objectively, and candidly reflect an employee's performance and his or her strengths and weaknesses.

- Soft, uncritical, and sugar-coated evaluations can be strong ammunition for a plaintiff challenging a manager's or organization's employment decisions.

  Example: The employee rated "satisfactory" who gets terminated for poor performance.

  Example: The employee who receives "satisfactory" or "excellent" ratings in competencies/characteristics in the written evaluation and later is deemed not to have "potential for advancement."

Failure to make performance distinctions in the evaluation process will impede the employer's ability to make distinctions among employees in employment decisions.

Example: Reduction-in-force (RIF) decisions.

- Efforts to distinguish among employees at the time of the RIF can be overcome by the more contemporaneous evaluation documents reflecting little or no distinction in assessments of performance.
- Assessments of strengths and weaknesses made at the time of the RIF can also be overcome by the more contemporaneous performance evaluations.
- Statements in an evaluation can arguably contradict the rationale for decisions made in the RIF.
- Silence in an evaluation as to a weakness or strength identified at the time of the RIF can undermine an employer's stated reasons for its decisions.
- The most conservative approach in RIFs is to prohibit any distinction based on performance unless it is objectively supportable by prior evaluations.

An accurate, candid performance evaluation system can be used to defend subsequent employment decisions and allows proper and accurate differentiation among employees.

Discipline/Termination Process

Checklist

Have a management representative meet with any employee who is to be disciplined, suspended, or terminated. This gives the employer a chance to explain the specific reasons for the disciplinary action and allows the employee to "let off steam."

Provide a disciplined/terminated employee with a brief explanation of the reason(s) for the action taken.

Exit interviews generally are associated with voluntary departures, but can be helpful even when termination is involuntary. Providing an opportunity for a complete and final accounting of employer and employee responsibilities, such interviews typically involve informing the employee of the discharge

decision, and allowing him or her to "react" to the discharge decision, or to make other observations about the company or the employment relationship in particular.

When conducting an exit or termination interview, it is prudent to have a prepared checklist of items to be discussed, such as benefits to which the employee is entitled upon departure, employee identification badges or company materials to be surrendered, accounts to be settled, loans to be repaid, etc.

Before any deductions or offsets are made in an employee's pay, state and local laws on the subject should be reviewed.

Discrimination Claims

Under Title VII, ADEA, and ADA, an employer cannot discharge an employee for discriminatory reasons or for complaining or testifying about discriminatory employment practices.

In determining whether there is an actual or potential EEO issue relating to the termination, the employer should, among other things, compare the characteristics of the employee in question with those of other similarly situated employees who are not being terminated, other employees who have been terminated in the recent past, and the individuals involved in the termination decision.

Consider whether any affirmative action and/or reasonable accommodation requirements apply.

Special considerations attach where the employee in question is disabled or pregnant; is on or has sought approval for workers' compensation, or disability, medical, or family leave; or has recently complained about alleged discriminatory practices.

There are any number of other issues that can arise under federal, state, or municipal law relating to a termination, depending upon the specific facts and circumstances. Some of the activities of employees that are protected and therefore require special consideration include the following:

- Union activities and the concerted activities protected under the National Labor Relations Act. Generally, any activity where employees act in concert with respect to a matter relating to their wages, hours, or terms or conditions of employment is protected.
- Some states prohibit discrimination in employment due to certain protected off-duty activities, such as political activities (except journalism), use of "consumable products" (including lawful off-duty use of tobacco or alcohol), and recreational activities.
- Whistleblower activities.

Reference Policy

Adopt a "neutral" reference policy (e.g., disclose only when hired, when left, positions held—nothing more than "name, rank, and serial number").

Any negative comments made to a prospective employer may be used against the company in a subsequent defamation suit.

- Although employers have a qualified privilege to release this information, this privilege may be lost if action was with malice.
- Privilege is also lost if the company gives the prospective employer more information than it asked for.

The company should, of course, be careful not to say anything that may appear to be discriminatory.

Defamation in Employment References

Typical claim is that post-termination statements by the employer or its managers/supervisors are defamatory.

For example:

- The statements concerning the former employee are factually false.
- They were published/said to a third party (written or oral).
- They caused injury to the former employee.

Often, defamation claims accompany other claims of wrongful termination or employment discrimination.

- **Example**: Prospective employer (or regulator) is told either orally or in writing that the former employee was terminated for "poor performance." The former employee alleges that:
- He or she was terminated because of employment discrimination, and
- The statement that the termination was for "poor performance" is defamatory.

The company should establish a policy to have employment references referred to human resources personnel.

- Risk is controlled by centralized processing and limited disclosure.
- Certain immunities apply to statements made in this context.

Managers and supervisors must understand the risks of personally responding to employment inquiries.

- Oral conversations on this subject are rarely restated as the manager recalls or intended.
- Employment references invariably affect a former employee's career, and the claim of injury is often easy to demonstrate.
- Defamation claims carry not only liability for the employer, but also potential personal liability for the individual manager.
- Punitive damages in excess of actual injury are generally available.
- Unwarranted glowing references or inaccurate descriptions of the reason for termination may:
    - conflict with regulatory obligations, or
    - give rise to a negligent or intentional misrepresentation claim by the prospective employer.

Defenses that the statement was true or that immunity applies require mounting those defenses in litigation.

- The risk of liability is present (e.g., the performance evaluations may not support the stated reason of "poor performance").
- The cost and inconvenience of litigation remain.

POSTEMPLOYMENT RESTRICTIVE COVENANTS: A BRIEF OVERVIEW

Given the investment employers make in recruiting, integrating, and training employees, employers are well served to focus on the retention of such employees and to protect their own business interests from threats posed by such employees when they separate from employment. One way to do so is by the use of appropriate restrictive covenants.

Restrictive covenants (often referred to as noncompetes) are common in many industries, but their enforcement has always been a matter of some complexity (and is generally prohibited in California). Courts generally view restrictive covenants as a restraint of trade, and regard them with suspicion. However, courts may be prepared to enforce a post-termination restriction if it achieves, no more than reasonably necessary, protection of the legitimate business interest of the employer as measured by (i) the scope of the activities restricted; (ii) the duration; and (iii) geographic parameters of the restrictions. All three of these measures must therefore be carefully tailored to the specific business of the employer.

The principal "legitimate business interests" protected by most courts are an employer's employees, its customers and suppliers, and its trade secrets and confidential information. Carefully and narrowly tailored restrictions, taking into account the specific nature and scope of the employer's business and the likely scope and nature of the employee's duties and functions as well as his or her exposure to trade secrets and confidential information, will enhance an employer's enforcement efforts through the courts. In this regard, it is essential that employers reflect local law; changes in the business, its growth, and its geographic breadth; and changes in the relevant employee's activities, and employers should adjust their restrictive covenant agreements accordingly.

As part of any agreement with employees designed to protect the goodwill, intellectual property, workforce stability, and customer relationships of the business, employers should consider provisions that require the employee's:

- Exclusive services during employment
- Express obligation to provide information to and cooperate with the employer post employment
- Express obligation to return company property and information upon request and/or termination
- Express consent to the employer's inspection, review, and deletion of computer files and email both during and after employment
- Express commitment to protect confidential information and trade secrets, applicable both during and after employment
- Express agreement to post-termination restrictive covenants covering nonsolicitation, nondealing, and noncompetition—addressed further below

Post-termination restrictions should be drafted after a careful analysis of the employer's business and a determination of the legitimate interests it is necessary to protect. Similarly, covenants should also be tailored to the individual employee (or level of employee). It is generally not prudent for an employer to apply the same restrictive covenants to all employees regardless of the employees' level within the organization, duties, and access to confidential information.

Restrictive covenants (and other related contractual provisions) should regularly be reviewed to ensure that they remain up to date and relevant and reflect changing best practices. Such restrictive covenants should be reassessed, for example, in light of the development and changes in the employer's business (for example, after an acquisition) and in light of the employee's changing position within the business over time. Restrictive covenants can be essential to the growth and protection of an employer's business, but to do so they must be carefully tailored and, ultimately, enforceable.

Whistleblower Protections for Employees: Sarbanes-Oxley Implications

On July 30, 2002, President George W. Bush signed into law the Sarbanes-Oxley Act of 2002, which is aimed at reining in corporate wrongdoers and providing greater oversight of the beleaguered accounting industry. The law also includes two separate provisions designed to prohibit retaliation against employees and others who "blow the whistle" on securities fraud and corruption.

Civil Liability

The first whistleblower provision contained in the law, codified at 18 U.S.C. § 1514A, imposes civil liability. It applies to all companies with a class of securities registered under Section 12 of the Securities Exchange Act of 1934 or that are required to file reports under Section 15(d) of that act, and it also applies to officers, employees, contractors, subcontractors, and agents of such companies. This provision makes it unlawful for a covered employer or individual to discharge, demote, suspend, threaten, harass, or otherwise discriminate against an employee for providing information or otherwise assisting in an investigation regarding conduct that the employee reasonably believes constitutes a violation of (i) any rule or regulation of the SEC; (ii) any provision of federal law relating to fraud against shareholders; or (iii) federal criminal law provisions prohibiting mail fraud, bank fraud, or fraud by wire, radio, or television.

In order to receive the protections of this provision, an employee must have lawfully provided information to or assisted in an investigation conducted by one of the following:

- A federal regulatory or law enforcement agency
- A member or committee of Congress
- A person with supervisory authority over the employee
- A person working for the company who has the authority to investigate, discover, or terminate misconduct

Because the provision expressly protects only "lawful" acts, it would presumably not apply if, for example, an employee attempted to extort money from his or her employer by threatening to disclose securities law violations. The civil liability provision also protects an employee who has filed, testified, and/or participated in any legal proceeding relating to an alleged violation of the laws and regulations described above.

An employee who establishes a violation of the whistleblower provision is entitled to recover "all relief necessary to make the employee whole," including reinstatement, back pay, and "special damages" sustained as a result of the discrimination, including litigation costs, expert witness fees, and reasonable attorneys' fees. Unlike in other federal discrimination laws, however, there is no provision for the recovery of punitive or liquidated damages. The primary method of enforcement of the civil liability whistleblower provision is through the Secretary of Labor as set forth in 49 U.S.C. § 4212(b). An aggrieved employee must file a complaint with the Secretary within 90 days of the alleged violation. While the Secretary is empowered to investigate the complaint, hold a hearing, and issue a final decision on the merits, the complaining employee has the right to initiate a private lawsuit in federal court if the Secretary has not issued a final decision within 180 days of the filing of the complaint.

Criminal Penalties

The Sarbanes-Oxley Act also includes another provision, codified at 18 U.S.C. § 1513(e), that imposes criminal penalties for retaliation against whistleblowers. This criminal provision makes it unlawful to "knowingly, with the intent to retaliate, take any action harmful to any person, including interference with the lawful employment or livelihood of any person, for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any Federal offense." Thus, while this whistleblower provision broadly covers the reporting of any federal offense and any type of retaliatory action, not just an adverse employment action, it applies only in circumstances where the information is provided to a law enforcement officer and the information provided is truthful. Individuals who violate this provision are subject to a fine of up to $250,000, imprisonment for up to 10 years, or both. Corporations may also be subject to criminal penalties under this provision and face fines of up to $500,000.

Recommendations for Employers

In light of these whistleblower provisions, public companies should take special care in dealing with employees who have provided information or assisted in an investigation involving possible violations of federal law, including the securities laws. Indeed, even if the employee is wrong and a violation has not in fact occurred, the employee is still protected from retaliation if he or she reasonably believed that a

violation occurred. Public companies should be educating their officers, employees, and other agents about this law, including advising them that they risk both civil liability and criminal penalties if they violate the law. Employers, if they have not already done so, should also consider establishing policies and procedures to encourage employees to complain about this type of discrimination or harassment. This will allow the employer to become aware of the alleged misconduct, investigate it, and, if necessary, take appropriate remedial action to avoid or reduce the risk of liability.

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For more information on the issues discussed here, please contact your Morgan Lewis Private Investment Funds Practice attorney.

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