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In this Issue

1 SOX Update

2 Department of Labor Puts Unpaid Internships under the Spotlight

3 The Top 10 Ways to Avoid and Win Retaliation Claims

6 Arbitration Update: Favorable Developments for Employers

8 New York Department of Labor Interprets Section 193 of Labor Law as Forbidding Deductions from Wages for Amounts Owed to an Employer

9 The ADA Amendments Act: Disability Claims Are Increasing

10 A Split of Authority Regarding the Confidentiality of an Employee's Personal E-mails on a Company Computer

11 *Faragher-Ellerth* Defense Not Applicable under the New York City Human Rights Law

11 Do Not Judge a Person by His or Her Title: Avoiding the Government's Crackdown on Misclassification of Individuals as Independent Contractors

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SOX Update

Section 806 of the Sarbanes-Oxley Act of 2002 (the "Act" or "SOX") protects employees of public companies who "blow the whistle" by reporting conduct that they reasonably believe constitutes a violation of federal law relating to financial, securities or shareholder fraud. A number of important decisions recently have been handed down by federal courts addressing key issues, including whether a complainant must name an individual respondent in his/her administrative complaint before asserting SOX claims against the individual in court, whether complaints by internal auditors constitute "protected activity" under the Act, whether a federal court may engage in *de novo* review of SOX claims pending before the Department of Labor ("DOL") for more than 180 days and the Act's application to non-public investment advisors for publicly traded mutual funds.

SOX Claimants Must Exhaust Their Administrative Remedies

Before an employee may assert a claim in federal court under the Act, the employee must file a complaint, within 90 days of the date on which the violation occurs, with the DOL's Occupational Safety and Health Administration ("OSHA") to afford that agency the opportunity to resolve the claims administratively. 18 U.S.C. § 1514(b)(1)(A); 29 C.F.R. § 1980.103(c). In *Bridges v. McDonald's Corp.*, 2009 WL 5126962 (N.D. Ill. Dec. 21, 2009), a federal judge dismissed the complainant's SOX claims against her supervisor while allowing the same claims to proceed against the company. The complainant, a senior director of executive compensation, sued McDonald's Corporation alleging she was discharged because she objected to certain aspects of the company's proxy statement. While she identified her supervisor as an actor and witness in

> The court further ruled that the mere fact that the supervisor was mentioned in the body of the OSHA complaint was insufficient because the supervisor would not have known that the complainant was pursuing a claim against her individually.

continued on page 4

Department of Labor Puts Unpaid Internships under the Spotlight

With the publishing of Fact Sheet #71, the U.S. Department of Labor Wage and Hour Division ("WHD") has sent clear warning signals to for-profit employers who hire unpaid interns that interns are not free labor. Acting Director of the WHD Nancy J. Leppink crisply summarized the WHD's position regarding the difficulty of satisfying its standards for unpaid internships: "If you're a for-profit employer or you want to pursue an internship with a for-profit employer, there aren't going to be many circumstances where you can have an internship and not be paid and still be in compliance with the law."

Under the Fair Labor Standards Act ("FLSA") an internship is not considered employment, and is thus exempt from minimum-wage requirements, if it meets *all* criteria of a six-factor test. Fact Sheet #71 updates the long-established test:

1. The internship, even though it includes actual operation of the facilities of the employer, is similar to training which would be given in an educational environment;
2. The internship experience is for the benefit of the intern;
3. The intern does not displace regular employees, but works under close supervision of existing staff;
4. The employer that provides the training derives no immediate advantage from the activities of the intern and on occasion its operations may actually be impeded;
5. The intern is not necessarily entitled to a job at the conclusion of the internship; and
6. The employer and the intern understand that the intern is not entitled to wages for the time spent in the internship.

Fact Sheet #71 stresses that the "exclusion from the definition of employment is necessarily quite narrow because the FLSA's definition of 'employ' is very broad."

Fact Sheet #71 also offers guidance regarding the factors. An unpaid internship is more likely exempt from minimum-wage requirements if it "is structured around a classroom or academic experience as opposed to the employer's actual operations;" offers training that "can be used in multiple employment settings, as opposed to skills particular to one employer's operation;" or is a job shadowing opportunity that "allow[s] an intern to learn certain functions under the close and constant supervision of regular employees, but the intern performs no or minimal work." Conversely, if an unpaid internship requires engagement in "the operations of the employer or . . . productive work" like filing, assisting customers or other clerical work, is a substitute for regular workers or used to "augment [the] existing workforce during specific time periods," or provides for "the same level of supervision as the employer's regular workforce," then the internship is likely to be considered work for purposes of the FLSA.

"If you're a for-profit employer or you want to pursue an internship with a for-profit employer, there aren't going to be many circumstances where you can have an internship and not be paid and still be in compliance with the law."

In light of increased scrutiny by the WHD, employers should review their use of unpaid internships for compliance with the FLSA. Below are some tips for employers when evaluating their programs:

- **Know Your Motive:** Be prepared to articulate a purpose for your internship program that does not include a benefit to the company.
- **Be Clear:** Have each unpaid intern sign an agreement that explicitly states that he or she is not entitled to wages.
- **Set Goals:** Structure the internship so that it looks like a college class. For example, create a syllabus explaining what the intern is expected to learn and accomplish.
- **Keep It Short:** Internships should not be indefinite. An internship should last as long as is needed to complete the expressed goals of the program.
- **Do Not Discuss Employment:** In order to prevent any misperception that a job may be available at the end of the internship, do not discuss an intern's potential employment with your company.
- **Get Partners:** Form partnerships with local schools that provide course credit for internships. Unpaid internships that offer course credit are much more likely to pass WHD scrutiny. ■

The Top 10 Ways to Avoid and Win Retaliation Claims

Supervising current employees who have alleged discrimination is one of the most difficult challenges a manager can face. Any criticism or adverse employment action may be interpreted as being retaliatory. On the other hand, reluctance to take appropriate action could empower the employee, diminish the manager's credibility and send the wrong message to other employees. Retaliation claims by current employees are among the fastest growing claims, fueled in part by the weak job market and increased sophistication of employees in asserting such claims. Navigating this treacherous terrain requires careful planning and sound judgment.

Below are the top 10 ways to avoid or win retaliation claims brought by current employees.

10. **Investigate and resolve the initial complaint carefully and thoroughly.** While a retaliation complaint can have validity where the underlying complaint does not, proper handling of the underlying complaint lessens the probability of a retaliation claim being filed and the likelihood that such a complaint has merit if it is brought.

9. **Maintain confidentiality of the initial complaint to the extent practical.** Employees cannot retaliate for a complaint they do not know exists.

8. **Designate a person to investigate complaints of retaliation.** By giving employees a person to complain to about alleged retaliation, problems can be resolved quickly and, if the employee does not avail herself of the designated avenue of complaint, retaliation complaints raised in the future will be suspect.

7. **Follow up with the complaining employee.** By staying in touch with the employee, the employee feels his concerns are being taken seriously and new concerns are dealt with before they become big problems.

6. **If the complaining employee had performance issues before the complaint, advise him that he must meet performance expectations.** In a non-punitive way, be as specific as possible about the performance criteria the employee is expected to meet. Make sure that the performance plan is reasonable and appropriate.

5. **Carefully document any performance issues concerning the complaining employee.** This may not prevent retaliation claims if an adverse action becomes necessary, but it will enhance your ability to win them.

4. **Train managers in managing the complaining employee.** This is a difficult and time-consuming task for the manager, and constant handholding may be necessary. Managers need to know what they can and cannot do in supervising an employee who has complained.

3. **Consider transferring the complaining employee.** If the employee desires a transfer, a fresh start may benefit everyone.

2. **Be careful of temporal proximity between complaint and subsequent adverse employment action.** If not harmful to business concerns, let time pass before taking action — even if quicker action would not be retaliatory.

1. **Don't be afraid to appropriately discipline the employee.** You may get a retaliation claim, but if the action is consistent with the treatment of other employees, can be justified by business concerns, and is well documented, management must not cede authority to the employee or allow him to feel immune to discipline because he complained. ■

SOX Update *continued from page 1*

the complaint, Bridges did not name her supervisor as a respondent in her OSHA complaint. OSHA dismissed the complaint and the complainant filed an action in federal court asserting SOX and retaliatory discharge claims against both McDonald's and her supervisor. The federal court judge dismissed the SOX claims as against the supervisor, holding that OSHA was never provided the opportunity to issue a final decision with respect to the complainant's claims against the supervisor. The court further ruled that the mere fact that the supervisor was mentioned in the body of the OSHA complaint was insufficient because the supervisor would not have known that the complainant was pursuing a claim against her individually.

"Protected Activity" under the Act

The DOL's Administrative Review Board ("ARB") recently decided that an internal auditor for Morgan Stanley's credit card subsidiary was engaged in protected activity when she complained that the company was delaying writing off bankruptcies, resulting in misrepresentations in the firm's financial statements. *Robinson v. Morgan Stanley*, 2005-SOX-44 (Jan. 10, 2010). The ARB rejected the argument that the complaints of retaliation were unprotected because they were made in the course of the complainant's audit duties, noting that nothing in the language of the Act implies that an employee's report must involve actions outside the employee's assigned duties in order to constitute protected activity. Notwithstanding this ruling, the ARB decided that the record showed that the complainant was terminated for failing to meet performance standards, noting that her problems were set forth by her supervisors and peers in performance reviews.

The ARB rejected the argument that the complaints of retaliation were unprotected because they were made in the course of the complainant's audit duties, noting that nothing in the language of the Act implies that an employee's report must involve actions outside the employee's assigned duties in order to constitute protected activity.

In a second decision involving internal auditors, a federal judge in Washington ruled recently that Boeing Company did not violate SOX when it terminated two auditors for leaking information to a newspaper. In *Tides v. Boeing Co.*, 2010 WL 537639 (W.D. Wash. Feb. 9, 2010), the auditors complained to supervisors about perceived audit deficiencies but eventually came to the conclusion that Boeing's audit culture was unethical and that the work environment was hostile to those who sought change. Eventually, the auditors contacted a newspaper reporter and provided her with information and documents. Boeing learned about their conduct and discharged the employees.

The court dismissed the claims, holding that whistleblowing to the media is not protected activity. The court stated that the Act prohibits retaliation against an employee who provides information or assistance to a federal regulatory or law enforcement agency, any member or committee of Congress, or a person with supervisory authority over the employee (or other person working for the employer with the authority to investigate, discover, or terminate misconduct), but does not protect communications with the media.

The court dismissed the claims, holding that whistleblowing to the media is not protected activity.

To qualify as having engaged in "protected activity" under the Act, a complainant must establish by a preponderance of the evidence that he or she had a reasonable belief that the acts complained of violated the laws specified in the Act. In *Harkness v. C-Bass Diamond, LLC*, 2010 WL 997101 (D. Md. Mar. 16, 2010), a federal court dismissed a lawsuit under SOX brought by the employer's general counsel, finding that the complainant failed to show that she believed the company's conduct to be violating the law. The court ruled that SOX did not protect the complainant where she did not adequately research whether the CEO was violating the law before she reported him to an audit committee for disclosing inside information to an outside investor. The court held that, as an attorney with over 20 years of legal experience, the complainant should have been familiar with performing legal research to ascertain the applicability of various laws and, in light

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of her experience and the resources available to her, her belief of a violation of the laws specified in the Act was not objectively reasonable.

Fourth Circuit Decision Confirms a Complainant's Right to *De Novo* Review in Federal Court if the DOL Delays Issuing a Final Decision

The Act establishes an aggressive timetable for both the complainant who claims retaliation and for the DOL to ensure timely disposition of SOX claims. If the DOL has not issued a final decision within 180 days of the filing of the complaint and there is no showing that the delay is due to the bad faith of the complainant, the individual may bring an action for *de novo* review in federal court. 18 U.S.C. § 1514(b)(1).

DOL's initial administrative ruling takes the form of preliminary OSHA findings, which can be challenged before an ALJ. 29 C.F.R. § 1980.106(a). The ALJ's decision "will contain appropriate findings, conclusions, and an order . . . ." *Id.* § 1980.109(a). A complainant can further challenge an adverse ALJ ruling through the filing of a petition for review with the ARB. *Id.* § 1980.110(a). If

"For the goals of SOX to be met, contractors and subcontractors, when performing tasks essential to insuring that no fraud be committed against shareholders, must not be permitted to retaliate against whistleblowers."

the ARB does not accept the petition for review, then the ALJ's decision will become the final order of the DOL. *Id.* § 1980.110(b). If the ARB accepts a complainant's petition for review, then the ALJ's decision will be inoperative until the ARB issues an order adopting the decision.

In *Stone v. Instrumentation Laboratory Co.*, 591 F.3d 239 (4th Cir. 2009), the Fourth Circuit Court of Appeals ruled that the Act's "kick-out" provision gives plaintiffs the right to *de novo* review in federal court if the DOL does not reach a "final decision" within 180 days as required under SOX. The complainant in *Stone* filed a federal court action following the DOL's issuance of preliminary findings, an order by an ALJ, and his filing of a petition to the ARB for review of the ALJ's order. Before any briefs were submitted with the ARB, the complainant filed a notice stating his intention to bring a *de novo* action in federal court. Acknowledging that the statute's language will result in duplication of efforts if an ALJ has already issued a ruling, and the possibility that a complainant will turn to a district court while an appeal is pending before the ARB, the Fourth Circuit held that "neither the [DOL] nor the courts have the authority to engage in creative interpretation of the statute to avoid duplication of efforts." The court refused to grant the employer's motion to dismiss based on preclusion principles, stating that "Congress has the right to create a complainant-friendly statutory scheme that affords no deference to non-final agency findings."

SOX's Application to Contractors and Subcontractors of Publicly-Held Companies

Liability under the Act may attach not only to a publicly-traded employer but also to any officer, employee, contractor, subcontractor, or agent of any such entity. 18-U.S.C. § 1514(A)(a). In *Lawson v. FMR LLC*, ___ F. Supp. 2d ___, 2010 WL 1345153 (D. Mass. Mar. 31, 2010), two former employees of Fidelity Investments — investment advisors for the Fidelity family of mutual funds — brought claims under SOX. The named defendants were privately-owned organizations that provided management and administrative functions for the operation of the mutual funds, which are publicly held companies supervised by a board of trustees and without any employees. The court decided that SOX applied to the defendants, citing the provision prohibiting retaliatory conduct by "any officer, employee, contractor, subcontractor or agent" of a publicly-traded entity. 18 U.S.C. § 1514A(a). "For the goals of SOX to be met, contractors and subcontractors, when performing tasks essential to insuring that no fraud be committed against shareholders, must not be permitted to retaliate against whistleblowers." The court further stated that "[i]f Section 806 only protected employees of public companies, then any reporting of fraud involving a mutual fund's shareholders would go unprotected, for the simple reason that no 'employee' exists for this particular type of company." ■

Arbitration Update: Favorable Developments for Employers

Recent decisions rendered by the United States Supreme Court, the United States Court of Appeals for the Second Circuit and the New York State Court of Appeals generally bode well for employers with respect to the enforcement of their arbitration agreements with employees.

In *Stolt-Nielsen v. Animalfeeds Int'l Corp.*, 130 S. Ct. 1758 (2010), the Supreme Court ruled that an arbitration panel exceeded its powers under the Federal Arbitration Act (the "FAA") by imposing class arbitration on class antitrust claims. The Court held that the parties could not be compelled to submit claims to class arbitration when the arbitration clauses in their agreements were silent on the question of class arbitration. In so holding, the Court found the arbitration panel's imposition of its policy choice in favor of class action arbitration to be at odds with the fundamental FAA principle that arbitration is a matter of consent and the differences between simple bilateral and complex class action arbitrations to be too great for a presumption that the parties implicitly authorized class action arbitration solely from the fact of an agreement to arbitrate.

The Court held that the parties could not be compelled to submit antitrust claims to class arbitration when the arbitration clauses in their agreements were silent on the question of class arbitration.

In *Ragone v. Atlantic Video at the Manhattan Ctr.*, 595 F.3d 115 (2d Cir. 2010), the Second Circuit ruled that an arbitration agreement, as modified by the defendants' waivers of certain provisions, was enforceable. The arbitration agreement at issue contained several questionable provisions, including (i) a limitations provision mandating the employee had to make a demand for arbitration within 90 days after her claim arose, (ii) a fee-shifting provision which required that attorneys' fees must be awarded to the prevailing party and (iii) a clause which forbade any appeal of the arbitrator's decision. The defendants agreed to waive the statutes of limitations and fee shifting provisions and represented to the district court that clause (iii) would not prevent the employee from moving to vacate the arbitration award in court pursuant to the FAA. The Second Circuit found that New York law would permit the enforcement of the arbitration agreements as modified by the defendants' waivers. The court further held that in light of the defendants' actions, the employee "ha[d] not been chilled in asserting her Title VII rights." The court cautioned, however, that it was "not at all clear that [it] would [have] reach[ed] the same result had the defendants attempted to enforce the arbitration agreement in its entirety" and emphasized that it was affirming the district court's holding that the arbitration agreement was enforceable as modified by the defendants' waivers "with something less than robust enthusiasm."

In *Brady v. Williams Capital Group, L.P.*, 14 N.Y.3d 459, 902 N.Y.S.2d 1 (2010), an employer's employee manual required the submission of any disputes to arbitration before the American Arbitration Association ("AAA") and further provided that the employer and each employee agreed to equally share the fees and costs of the arbitrator. Following the employee's submission of discrimination claims to the AAA, the AAA sent an invoice to the employer for the entire advance payment for the arbitrator's compensation, consistent with its rule requiring the employer to pay all arbitration expenses and the arbitrator's compensation in connection with an arbitration arising from an "employer promulgated plan" such as one in an employee manual. Relying on the arbitration agreement, the employer refused to pay the entire sum and demanded that the employee pay half in accordance with their agreement. Thereafter, the AAA canceled the arbitration. The employee — unemployed for 18 months at the time — then commenced an Article 78 proceeding against the employer to pay the arbitrator's fee or to enter a default judgment against the employer.

The New York State Court of Appeals ruled that the terms of the parties' arbitration agreement — requiring the splitting of the arbitrator's compensation — controlled, rather than the AAA's "employer pays" rule, basing this ruling on the principles that "arbitration is a creature of contract" and the judiciary's role is "to interfere as little as possible with the freedom of consenting parties in structuring their arbitration relationship." Addressing the enforceability of the arbitration agreement's fee and cost-sharing provision, the Court of Appeals rejected

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the Appellate Division's holding that the "equal share" provision was unenforceable as against public policy on the facts before it and determined that the proper analysis was to "resolve the question whether [the employee] was financially able to share the arbitration costs." The court held that "the issue of a litigant's financial ability is to be resolved [by the trial court] on a case-by-case basis and that the inquiry should at minimum consider the following questions: (1) whether the litigant can pay the arbitration fees and costs; (2) what is the expected cost differential between arbitration and litigation in court; and (3) whether the cost differential is so substantial as to deter the bringing of claims in the arbitral forum." The court expressly noted that it was not deciding what the remedy should be if the "equal share" provision contained in the arbitration agreement was found unenforceable by the trial court, leaving to the trial court the decision "whether to sever the clause and enforce the rest of the Arbitration Agreement, or . . . offer [the employee] a choice between accepting the 'equal share' provision or bringing a lawsuit in court."

The New York State Court of Appeals ruled that the terms of the parties' arbitration agreement — requiring the splitting of the arbitrator's compensation — controlled, rather than the AAA's "employer pays" rule, basing this ruling on the principles that "arbitration is a creature of contract" and the judiciary's role is "to interfere as little as possible with the freedom of consenting parties in structuring their arbitration relationship."

Ramifications for Employers

These decisions generally bode well for employers:

- Extended to employment-related disputes, the *Stolt-Nielsen* decision should preclude an employee's ability to bring wage and hour or discrimination claims as class action arbitrations in the absence of a provision in the parties' arbitration agreement expressly authorizing class arbitrations.
- The *Ragone* court expressly recognized that New York courts have accepted offers to waive the enforcement of certain provisions of arbitration agreements and evaluated those agreements as modified by the waivers. Thus, it is critical for New York employers to insert New York choice of law provisions in their arbitration agreements. Because of the strong cautionary language in the *Ragone* court's opinion, employees should nevertheless avoid over-reaching, not seek to push their ability to waive provisions after-the-fact too far and strive instead to insert fair provisions in their agreements (so the next court does not rule that the employer has abused its privilege).
- Courts must resolve conflicts between arbitration agreements and the arbitral forum's arbitration rules in favor of the agreements. Accordingly, employers should educate themselves regarding the arbitration rules of the arbitral forum they select for their agreements and adjust their agreements accordingly.
- The burden of demonstrating that an arbitration agreement's provision for the equal sharing of arbitration fees and costs is unenforceable remains on the employee. Faced with the possibility that an individual claimant may meet this burden, an employer may need to choose between paying the arbitration costs and expenses itself or forgoing arbitration of that dispute — or leave it to the court to make such choice for it. In addition, employers should consider including in their arbitration agreements a provision requiring that any issue regarding the split of costs be resolved by the arbitrator. ■

New York Department of Labor Interprets Section 193 of Labor Law as Forbidding Deductions from Wages for Amounts Owed to an Employer

In an opinion letter dated January 10, 2010, the New York State Department of Labor ("NYDOL") stated its position that employers cannot deduct from an employee's wages amounts owed by the employee to his employer, including for overpayments or repayment of a loan, even with the employee's written authorization.

Section 193 of the Labor Law (entitled "Deductions from Wages") prohibits deductions from wages, except those which are

a. "made in accordance with the provisions of any law or any rule or regulation issued by any governmental agency;" or

b. "are expressly authorized in writing by the employee and are for the benefit of the employee, provided that such authorization is kept on file on the employer's premises. Such authorized deductions shall be limited to payments for insurance premiums, pension or health and welfare benefits, contributions to charitable organizations, payments for United States bonds, payments for dues or assessments to a labor organization, and similar payments for the benefit of the employee."

The applicable Labor Law regulations (Section 195.1 of Title 12 of the New York Codes, Rules and Regulations) limit permitted deductions for non-enumerated "similar payments for the benefit of the employee" to ten percent (in the aggregate) of the gross wages due to the employee for a payroll period.

Relying on the language in two cases decided by the New York Court of Appeals several years ago, the NYDOL opined that there are only two categories of payments that may be considered "similar payments for the benefit of the employee":

1. "monetary payments," meaning investments of money for the later benefit of the employee (such as deductions for insurance premiums, pension or health and welfare benefits and payments for US bonds); or
2. "supportive payments," meaning that the wages are used by someone other than the employee or employer to support some other purpose of the employee (such as contributions for charitable organizations or payments for dues or assessments to a labor organization).

The opinion letter stressed that deductions, like repayment of a personal loan or overpayment, that are paid directly to the employer or its subsidiary "violate the letter of the statute and the policy underlying it" and thus are not permissible.

The January 10 opinion letter also addressed the employer's options to recoup from an employee overpayments and other payments that may not be deducted from wages. Section 193 of the Labor Law prohibits employers from "requir[ing] an employee to make any payment by separate transaction unless such charge or payment is permitted as a deduction from wages." In interpreting this provision, the NYDOL stated its view that an employer could not induce or request an action by the employee which, if refused, could result in disciplinary action or retaliation action. Therefore, according to the NYDOL, an employer may ask that the employee separately repay the sums owed to it, *provided that the employer also clearly communicates that the employee's refusal will not result in any disciplinary or retaliatory action*. The NYDOL clarified that while an employer may not require repayment under the threat of discipline, employers may seek relief in a separate proceeding against the employee.

Thus, according to the NYDOL, an employer may not deduct from wages amounts owed to it by an employee and may only request the repayment of such sums if it clearly communicates that the employee's refusal to repay the debt will not result in any adverse action being taken against it; if the employee refuses to repay the sums owed to the employer, the employer's only recourse is to file a proceeding against the employee. Given the NYDOL's position, employers should reconsider their use of loans and advances to employees. ■

The ADA Amendments Act: Disability Claims Are Increasing

Employers should be prepared to confront more disability-related claims and lawsuits in the coming years. In 2009, the Equal Employment Opportunity Commission ("EEOC") received more charges based on violations of the American Disabilities Act ("ADA") and filed more ADA-related actions than in the prior year. This trend promises to continue due to Congress' passage of the employee-friendly ADA Amendments Act ("ADAAA"), which became effective in January 2009.

In 2009, the Equal Employment Opportunity Commission received more charges based on violations of the American Disabilities Act and filed more ADA-related actions than in the prior year.

Displeased with what it believed to be the Supreme Court's overly restrictive interpretation of which individuals were protected under the ADA, Congress passed the ADAAA with the purpose of "reinstating a broad scope of protection to be available under the ADA." The ADAAA expands the definition of "disability" under the ADA and the Rehabilitation Act. Under the ADAAA, the EEOC is required to rewrite its regulations to reflect the changes to the ADA. The EEOC published its proposed rules in September 2009 and plans to announce the final regulations in mid-2010.

The ADA defines "disability" as (i) a physical or mental impairment that substantially limits one or more of an individual's major life activities; (ii) a record of such an impairment; or (iii) being regarded as having such an impairment. The ADAAA broadens the interpretation of "substantially limits," "major life activities" and "regarded as." Additionally, the ADAAA provides that the use of mitigating measures, such as medications, medical supplies, appliances, prosthetics and hearing aids, may not be considered when determining whether someone is disabled — meaning individuals should be evaluated as if they do not have access to these measures (an exception is the use of eyeglasses or contact lenses).

While the overall number of charges filed with the EEOC decreased in 2009, the number of disability charges increased, comprising approximately 23% of charges filed with the agency. Meanwhile, the EEOC filed over twice as many actions in 2009 asserting ADA claims as it did in 2008.

Due to this increase in claims and focus by the EEOC, employers that previously relied on a restrictive definition of what constitutes a disability should revise their policies. If an employer relied on a restrictive definition of disability under the ADA when it declined to hire individuals with medical conditions or refused to engage in a meaningful interactive process with employees requesting accommodations, it will need to reevaluate its approach.

In light of the changes to the ADA, the focus of ADA cases will likely change from determining whether a person is disabled to analyzing the employee's and employer's actions. There will be increased scrutiny of the availability of accommodations, whether the employee was offered a reasonable accommodation, the reasonableness of the accommodations requested by the employee, the good faith of the employer and the employee during the interactive process, the reasonableness of the employer's description of essential job functions, whether the employee was qualified for the job and, ultimately, whether the employer made the employment decision based on the employee's impairment or for a non-discriminatory reason. ■

In light of the changes to the ADA, the focus of ADA cases will likely change from determining whether a person is disabled to analyzing the employee's and employer's actions.

A Split of Authority Regarding the Confidentiality of an Employee's Personal E-mails on a Company Computer

Three years ago, in what has been viewed as the seminal New York decision in the area, Judge Charles Edward Ramos of the Commercial Division of the Supreme Court of the State of New York, New York County, ruled in *Scott v. Beth Israel Medical Center Inc.*, 17 Misc. 3d 934 (Sup. Ct. N.Y. Cty. 2007), that an employee's use of his employer's e-mail system to communicate with his attorney deprived those communications of any protection under the attorney-client privilege. In *Stengart v. Loving Care Agency, Inc.*, 990 A.2d 650 (N.J. 2010), the New Jersey Supreme Court recently held that an employee's communications with her counsel from her employer's computer were protected by the privilege. While the fact that these cases occurred in different jurisdictions may explain the different rulings, they may also be harmonized due to the particular facts in each case.

By using a personal, password-protected e-mail account to communicate with her attorney, the court found that the employee took steps to protect her communications with her attorney.

Judge Ramos relied on three factors he found particularly compelling in finding that the employee waived the attorney-client privilege by communicating over his employer's e-mail system: the employer had a policy that prohibited personal use of the e-mail system; that policy specifically allowed for monitoring by the employer; and the employee had notice of the employer's policy.

The facts in *Stengart* were significantly different. There, the employee used a company computer to transmit e-mails on her personal, password-protected, web-based e-mail account. The employer discovered the e-mails at issue during its efforts to preserve electronic evidence for discovery after the employee filed the lawsuit. The court rejected the employer's argument that, based on its electronic communication policy, its employees had no reasonable expectation of privacy in their personal e-mail accounts accessed via company computers. The court found that the scope of the policy was ambiguous inasmuch as it was unclear whether the policy covered personal e-mail accounts. The policy also permitted occasional use of e-mail for personal purposes.

Moreover, by using a personal, password-protected e-mail account to communicate with her attorney, the court found that the employee took steps to protect her communications with her attorney. The court further noted that the e-mails were not illegal or inappropriate in any way and contained a disclaimer from her attorney that they may be attorney-client communications. Thus, the court determined that the employee had a reasonable expectation of privacy and that the employee had not waived the attorney-client privilege. The court admonished the employer for not having promptly notified the employee's attorney when it discovered the e-mails and realized that they were potentially privileged communications.

These cases should not be understood to represent fundamentally opposing positions regarding waiver of the attorney-client privilege in connection with an employee's use of his employer's computer and e-mail systems. Together, however, they emphasize that the content and clarity of the employer's policy is critical to the determination. Employers should ensure that their electronic communication policies are unambiguous in warning employees as to the kinds of communications covered by the policy as well as the types of monitoring the employer will conduct. Employers should also consider whether to establish clear limitations on employees' personal use of company computers and devices and e-mail communication systems. Further, if potentially privileged e-mails of an employee are discovered during the course of litigation, the employer should consider whether such e-mails must be segregated and opposing counsel promptly notified. And employers in both New York and New Jersey should be mindful that these cases leave the door open for employers to argue that an employee's personal e-mails on a company e-mail system are not protected by the attorney-client privilege and similar privileges and doctrines. ■

Employers should ensure that their electronic communication policies are unambiguous in warning employees as to the kinds of communications covered by the policy as well as the types of monitoring the employer will conduct.

Faragher-Ellerth Defense Not Applicable under the New York City Human Rights Law

In *Zakrzewska v. The New School*, 14 N.Y.3d 469 (2010), the New York Court of Appeals settled the open question of whether the *Faragher-Ellerth* affirmative defense available under federal law applies to sexual harassment and retaliation claims brought under the New York City Human Rights Law ("NYCHRL"). Changing the landscape of sexual harassment litigation for New York employers, the *Zakrzewska* court answered in the negative, holding that the *Faragher-Ellerth* defense does not apply to sexual harassment and retaliation claims under the NYCHRL based on the plain language of the statute.

The court explained that the NYCHRL imposes liability on employers in three instances: (1) "where the offending employee 'exercised managerial or supervisory responsibility;'" (2) "where the employer knew of the offending employee's unlawful discriminatory conduct and acquiesced in it or failed to take 'immediate and appropriate corrective action;'" and (3) "where the employer 'should have known' of the offending employee's unlawful discriminatory conduct yet 'failed to exercise reasonable diligence to prevent it.'"

As to the first two instances, the court stated that an employer's anti-discrimination policies and procedures may mitigate damages, but not prevent liability. As to the third instance, the court held that an employer's anti-discrimination procedures shield against liability, but only in the case where the offending actor was a non-supervisory employee.

Zakrzewska sets the stage for employees to more frequently bring sexual harassment and retaliation claims against New York City employers under the NYCHRL and mandates that such employers and their counsel assess such claims separately from claims under federal and state law. The decision also reaffirms the importance of employers maintaining effective anti-discrimination policies and ensuring that employees are properly notified of, and receive training with respect to, such policies. ■

Do Not Judge a Person by His or Her Title: Avoiding the Government's Crackdown on Misclassification of Individuals as Independent Contractors

In the midst of an uncertain economic climate, many employers have favored hiring individuals they deem to be independent contractors instead of employees. Experts estimate that employer misclassification of independent contractors costs the federal government $2.7 billion each year in reduced income tax, social security and unemployment tax payments. As a result, employers classifying individuals as independent contractors may find themselves audited by the Internal Revenue Service ("IRS") and/or investigated by the Department of Labor ("DOL"). And now there is a bill in Congress to further incentivize companies to avoid misclassifying individuals as independent contractors.

The DOL earmarked $25 million in its 2011 budget to address and deter independent contractor misclassification. It is also hiring 90 new investigators for enforcement purposes. The additional funds are intended to bolster cooperation between federal and state agencies and specifically target the "construction, janitorial, home health care, child care, transportation and warehousing, meat and poultry processing, and other professional and personnel service industries."

Also, in February 2010, the IRS began randomly conducting employment tax audits of 6,000 companies. The IRS intends to pursue this strategy through 2013.

Meanwhile, in April 2010, Senator Sherrod Brown (D-Ohio) and Rep. Lynn Woolsey (D-Cal.) re-introduced the Employee Misclassification Prevention Act ("EMPA"). The EMPA would, among other things, require companies to maintain records regarding independent contractors and create penalties for misclassification.

Because the government is pursuing the misclassification issue from several angles, now is the time for companies to conduct internal audits to determine the propriety of their independent contractor classifications. That an individual has the title of "independent contractor" or is identified in an agreement as an "independent contractor" is largely

continued on page 12

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Do Not Judge a Person by His or Her Title: Avoiding the Government's Crackdown on Misclassification of Individuals as Independent Contractors *continued from page 11*

irrelevant to the determination of whether the person actually is an independent contractor. Several factors are relevant in determining whether an individual has been properly classified, but the most critical factor is the level of control a company has over the individual, which includes a focus on her relationships with others at the company. The more a person is her own boss — that is, she determines how she completes her tasks, where she works and when she works and negotiates the rate, frequency, and method of her payment — the more likely she is to properly be considered an independent contractor.

> That an individual has the title of "independent contractor" or is identified in an agreement as an "independent contractor" is largely irrelevant to the determination of whether the person actually is an independent contractor.

While a company's written contract with an individual, the individual's use of her own equipment and the individual's own insurance coverage may tip the scales in favor of contractor classification, none of these factors will be sufficient if the company controls the day-to-day activities of the individual. The government is more likely to see red flags when it learns of former employees who are converted to contractor status, individuals who have served as contractors with the company for a lengthy period of time or contractors who work for only one company.

Companies should review employee benefit plans and handbooks to ensure that individuals who have been retained as independent contractors are excluded from coverage under such plans and handbooks. Further, in light of the lack of clarity in applicable law and the application of who is and who is not properly classified as an independent contractor, companies should include language in their benefit plans and their agreements with individuals who they retain as independent contractors providing that in the event the individuals are in the future classified as employees, the individuals shall remain ineligible to participate in any employee benefit plan. Such agreements should also expressly provide that the employee understands and agrees to this and expressly waives any right to any such benefits and that the consulting fees she is to receive take into account the fact that she is ineligible in all events to participate in such plans and constitute part of the consideration for such waiver.

The misclassification of workers as independent contractors imposes costly risks of litigation and liability, including unpaid federal, state, and local taxes, Social Security and Medicare contributions, worker's compensation payments, unemployment insurance premiums, unpaid work-related expenses, unpaid overtime, costs associated with the failure to provide benefits according to the employer's employee benefits plans and interest. To limit that potential liability, companies should ensure that the individuals they are treating as independent contractors are properly classified. ■

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