Employment Law **Update**

June 2014

KRAMER LEVIN

In this Issue

Editors

If you have any questions or would like more information concerning any of these topics, please contact:

Kevin B. Leblang 212.715.9306
kleblang@kramerlevin.com

Robert N. Holtzman 212.715.9513
rholtzman@kramerlevin.com

The Faithless Servant Doctrine Is Alive and Well

Under New York law, the faithless servant doctrine permits an employer to recover an employee's already-received compensation where (a) the employee's material and substantial misconduct violates the contract of service or (b) the employee has engaged in misconduct that constitutes a breach of the duty of loyalty or good faith. Two recent cases, one from the United States District Court for the Southern District of New York and one from New York's trial court, highlight the application of the faithless servant doctrine, which can be a powerful weapon in the arsenal of an employer that discovers wrongdoing by a current or former employee.

Morgan Stanley Employee Ordered to Repay $31 Million in Compensation

In *Morgan Stanley v. Skowron*, 12 Civ. 8016 (SAS), 2013 WL 6704884 (S.D.N.Y. Dec. 19, 2013), United States District Judge Shira A. Scheindlin addressed Morgan Stanley's claims for disgorgement of more than $31 million in compensation it had paid to the defendant, a former senior portfolio manager and managing director. The defendant had previously pled guilty to conspiracy to commit insider trading from April 2007 through November 2010 and lying to the SEC regarding his receipt of material non-public information, and Morgan Stanley sought to recover all compensation paid to him during this period.

The defendant was hired when Morgan Stanley acquired FrontPoint Partners LLC in December 2006. His offer letter and standard sign-on agreement both required compliance with the firm's Code of Conduct. The Code of Conduct specifically prohibited insider trading, required employees to cooperate fully with investigations (both governmental and internal) and also required employees to immediately inform the firm of any violations of law or Morgan Stanley's policies.

While acknowledging violations of the Code of Conduct, the defendant argued that his misconduct "did not permeate his service in substantial part." Judge Scheindlin soundly rejected that proposition:

> Insider trading is the ultimate abuse of a portfolio manager's position and privileges because it goes to the heart of his "primary areas of responsibility." Indeed,

continued on page 3

U.S. Supreme Court's First Decision on SOX Extends Coverage to Employees of Contractors of Publicly Traded Companies

In *Lawson v. FMR LLC*, 134 S. Ct. 1158 (2014), the United States Supreme Court held that the whistleblower provision of the Sarbanes-Oxley Act of 2002 ("SOX" or the "Act") extends to employees of contractors of public companies, such as accounting firms, mutual fund investment advisors and other privately held companies that provide services to public companies. This is the first decision by the Supreme Court interpreting the whistleblower provision of the Act.

Section 806 of SOX, codified at 18 U.S.C. § 1514A, which is titled "Protection For Employees of Publicly Traded Companies," provides:

> No [public] company . . . , or any officer, employee, contractor, subcontractor, or agent of such company, may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of [whistleblowing or other protected activity].

The plaintiffs in *Lawson*, former employees of FMR LLC, a privately held investment advisor providing investment advising services to the Fidelity family of publicly traded mutual funds, asserted violations of Section 1514A against FMR LLC and other related private companies ("FMR"). The employees claimed that they had been retaliated against after disclosing potential securities law violations related to the publicly traded funds for which their employers performed services. FMR argued that the listing of "contractor" and "subcontractor" in the Act merely indicated that such entities are barred from retaliating against employees of public companies, but that the Act's protections do not extend to employees of private contractors. The plaintiffs asserted that both the employees of the public companies and the employees of those public companies' contractors and subcontractors are protected under SOX.

The United States Court of Appeals for the First Circuit had held that SOX's whistleblower protection is limited to employees of publicly traded companies. *Lawson v. FMR LLC*, 670 F.3d 61 (1st Cir. 2012). In reversing, the Supreme Court resolved a conflict between the First Circuit's view and that expressed by the Department of Labor's Administrative Review Board ("ARB") in *Spinner v. David Landau & Assocs. LLC*, No. 10-111, 10-115, 2012 WL 2073374 (Dep't of Labor May 31, 2012). In *Spinner*, the plaintiff, an accountant with David Landau & Associates ("DLA"), which provides internal audit services, alleged he was discharged for reporting internal control and reconciliation problems at one of DLA's publicly traded clients. The ARB relied on the language of the statute, the Department of Labor regulations and legislative history to conclude that Congress intended SOX to protect "employees of private firms that work with, or contract with, publicly traded companies when such employees blow the whistle on fraudulent corporate practices."

The Supreme Court's 6-3 decision based its conclusion on the statute's text, together with the purpose of the Act. The opinion pointed to the language in Section 1514A that "no . . . contractor . . . may discharge . . . an employee," determining that "[t]he ordinary meaning of 'an employee' in this proscription is the contractor's own employee." Because "[c]ontractors are not ordinarily positioned to take adverse actions against employees of the public company with whom they contract," the Court reasoned that a contrary interpretation of the statute "would shrink to insignificance the provision's ban on retaliation by contractors." The Court stated that its reading was consistent with the legislature's purpose in enacting SOX — to "ward off another Enron debacle." The Court further found that "[a]lso clear from the legislative record is Congress' understanding that outside professionals bear significant responsibility for reporting fraud by the public companies with whom they contract, and that fear of retaliation was the primary deterrent to such reporting by the employees of Enron's contractors."

A vigorous dissent, authored by Justice Sonia Sotomayor (and joined by Justices Anthony Kennedy and Samuel Alito), considered the statute's text "ambiguous" and expressed the view that the majority's ruling would produce absurd results:

> The Court's interpretation gives § 1514A a stunning reach. As interpreted today, the Sarbanes-Oxley Act authorizes a babysitter to bring a federal case against his employer — a parent who happens to work at the local Walmart (a public company) — if the parent stops employing the babysitter after he expresses concern that the parent's teenage son may have participated in an Internet purchase fraud. And it opens the door to a cause of action against a small business that contracts to clean the local Starbucks (a public company) if an employee is demoted after reporting that another nonpublic company client has mailed the cleaning company a fraudulent invoice.

continued on next page

Notably, the Court's opinion referenced certain "limiting principles" offered by the plaintiffs and the Solicitor General in this case — that "contractor" would be limited to a party whose performance of a contract occurs "over a significant period of time," and that Section 1514A protects contractor employees only to the extent that their whistleblowing relates to the contractor "fulfilling its role as a contractor for the public company, not the contractor in some other capacity." The majority sidestepped such questions based on the fact that, in the case at hand, plaintiffs' complaints implicated public company accounting that was related to the contract with the non-public employer: "[W]e need not determine the bounds of § 1514A today, because plaintiffs seek only a 'mainstream application' of the provision's protections."

Although the Supreme Court's decision explicitly avoided opining on the extent to which protection is afforded to employees of publicly traded companies' contractors — *e.g.*, whether SOX protects reports of alleged wrongdoing unrelated to work performed for public companies — private companies that provide services to publicly held companies should expect a new wave of SOX litigation that tests these bounds. In the meantime, the Supreme Court's decision has vast implications for the perhaps millions of private companies that provide contracting services to public companies. Employers who do business with public companies need to familiarize themselves with their obligations and potential liabilities under the whistleblower protections of SOX and implement or assess their whistleblower policies and practices. Additionally, employers should encourage internal reporting of concerns of suspected fraud or other improper conduct that could be covered by SOX and ensure that employees have clear and accessible avenues for reporting such misconduct. Training should be provided to those responsible for receiving reports about improper conduct and care should be taken to prevent retaliation against employees who make a report. Where the employer learns of actual misconduct, appropriate disciplinary and remedial action must be taken. ■

The Faithless Servant Doctrine Is Alive and Well

continued from page 1

> "[t]he duty of an employee not to use or divulge confidential knowledge acquired during his employment is implicit in the employer-employee relation, is an absolute, and not a relative duty." That duty is all the more crucial for a portfolio manager who is "entrusted to lawfully invest hundreds of millions of dollars and to safeguard the Firm's reputation." In addition to exposing Morgan Stanley to government investigations and direct financial losses, Skowron's behavior damaged the firm's reputation, a valuable corporate asset.

The defendant also sought to limit the amount of compensation to be disgorged, relying on principles espoused by the Second Circuit in *Phansalkar v. Andersen Winroth & Co.*, 344 F.3d 184 (2d Cir. 2003), under which a disloyal employee may be permitted to retain certain compensation derived from transactions that were separate from and untainted by his disloyalty. The court ruled, however, that the salary, management fees, and incentive fees he received from Morgan Stanley were not linked to separate and discrete transactions, and thus were not susceptible of apportionment.

Breach of Duties Causes Forfeiture of Vested Options Worth as Much as $60 Million

The plaintiff in *Trimarco v. Data Treasury Corp.*, No. 30324-2003, 2013 WL 7231013 (Sup. Ct. Suffolk Co. Oct. 30, 2013), sought to enforce a series of agreements granting him equity in the defendant, which he had served first as a consultant and later as an employee and its Chief Operating Officer. Plaintiff sought a declaratory judgment enforcing an option to purchase 1.5 million shares of the stock of the defendant, an interest his expert valued at $60 million. The defendant asserted affirmative defenses based upon the plaintiff's alleged breach of the covenant of good faith and fair dealing and breach of his fiduciary duties.

continued on page 5

Second Circuit Lowers Bar for Plaintiffs Seeking to Survive Summary Judgment on Retaliation Claims

The Second Circuit recently issued a troubling decision for employers in *Kwan v. Andalex Grp. LLC*, 737 F.3d 834 (2d Cir. 2013), reviving a former employee's retaliation claims under Title VII, the New York State Human Rights Law and the New York City Human Rights Law based on a finding that the employer's purported "general corporate knowledge" of the employee's alleged complaint and its purportedly inconsistent explanations for firing the employee, coupled with the temporal proximity of the employee's alleged complaint and her termination, were sufficient to defeat summary judgment.

Zann Kwan ("Kwan"), former Vice President of Acquisitions for the Andalex Group LLC ("Andalex"), a small real estate management company, claimed that she was terminated about three weeks after she allegedly complained to Andalex's COO of gender discrimination and that her termination was in retaliation for her complaint. Andalex denied that Kwan ever lodged such a complaint. Andalex asserted that the decision to terminate Kwan's employment was made by the CIO of Andalex. Kwan was terminated the day after she left work early, which, according to Andalex, she did without permission. The prior day, Andalex terminated a male executive on the basis that Andalex's business focus had changed.

> The Second Circuit found that Kwan's alleged complaint to the COO of Andalex was sufficient to impute to Andalex "general corporate knowledge" of her protected activity sufficient to satisfy the knowledge prong of her *prima facie* case of retaliation.

The Second Circuit held that although the district court properly dismissed Kwan's discrimination, hostile work environment and COBRA claims, the district court had erred in its determination that Kwan failed to satisfy the knowledge and causation prongs necessary to establish a *prima facie* case of retaliation and had thus improperly dismissed Kwan's retaliation claims. While the district court concluded that Kwan could not demonstrate Andalex's knowledge of her alleged protected activity because Kwan did not even allege that the CIO had knowledge of her complaint when he made the decision to terminate her, the Second Circuit nonetheless found that Kwan's alleged complaint to the COO of Andalex was sufficient to impute to Andalex "general corporate knowledge" of her protected activity sufficient to satisfy the knowledge prong of her *prima facie* case of retaliation. While the language used in the court's opinion is expansive, it remains to be seen whether this principle is limited to smaller employers (here, Andalex had fewer than twenty-five employees) or also applies to large companies.

The court found that Kwan satisfied the causation prong of the *prima facie* case through temporal proximity because the three-week period between Kwan's alleged complaint and her termination was sufficiently short to make a *prima facie* showing of causation. Despite the United States Supreme Court's recent decision in *University of Texas Southwestern Medical Center v. Nassar*, 133 S. Ct. 2517 (2013), which held that Title VII retaliation claims must be proved according to traditional principles of "but-for" causation, the *Kwan* court ruled that a plaintiff could still demonstrate causation at the *prima facie* stage on summary judgment through temporal proximity.

Moreover, according to the Second Circuit, the alleged "discrepancies" in the explanations given by Andalex for Kwan's termination could allow "a reasonable juror . . . [to] infer that the explanation given by the defendant was pretextual, and that, coupled with the temporal proximity between the complaint and the termination, the . . . complaint was a but-for cause of Kwan's termination." The court noted that Andalex's "explanations for the plaintiff's firing have . . . evolved over time" as "Andalex initially contended that its change in business focus . . . made the plaintiff's skill set obsolete," but that "[s]ubsequently, it shifted to an explanation that the plaintiff's poor performance and bad behavior were the reasons for the termination." Specifically, the court found that in the position statement that it submitted to the EEOC, Andalex claimed that Kwan, like the male employee who was terminated the day before Kwan, was terminated primarily because its business focus had changed, and not because of performance reasons. But this asserted rationale was undercut by the deposition testimony of the CIO, the decision-maker with respect to the termination, who testified that the business model had already changed by the time that Kwan began to work at Andalex. In seeking summary judgment, Andalex then

continued on next page

argued that Kwan was terminated primarily based on her poor performance, as illustrated by three discrete incidents, only one of which was referenced in Andalex's position statement. In addition, while Andalex claimed on summary judgment that Kwan's behavior contributed to the decision to terminate her, this alleged conduct, although mentioned in the position statement, was not relied on as a primary reason for Kwan's termination.

> The *Kwan* decision establishes a troubling legal precedent that is inconsistent with the Supreme Court's decision in *Nassar* and with firmly established standards of proof for plaintiffs in retaliation cases.

The *Kwan* decision establishes a troubling legal precedent that is inconsistent with the Supreme Court's decision in *Nassar* and with firmly established standards of proof for plaintiffs in retaliation cases. As noted in the lengthy dissent to the portion of the decision reinstating the plaintiff's retaliation claims, "Kwan's prima facie case was particularly weak" as she relied entirely on temporal proximity between her purported complaint and her termination, which at best has "modest probative value," and "the legal fiction of general corporate knowledge" without even alleging that her complaint "was actually communicated to or known by the executives who terminated her . . . ." In addition, Andalex presented extensive evidence of legitimate, non-discriminatory reasons for its termination of Kwan, which were "complementary justifications" for her termination and based on a consistent set of facts. As observed by the dissent, "[a]s our precedent recognizes, . . . it is not uncommon for an employer to have multiple reasons for terminating an employee, and . . . where the employer offers variations . . . on the same theme rather than separate inconsistent justifications, there is not sufficient evidence of pretext to preclude the entry of summary judgment." Moreover, Kwan failed to present evidence refuting Andalex's justifications for her termination and thus did not meet her burden of demonstrating that retaliation was the "but-for" cause of her termination, as she must under *Nassar*. After *Kwan*, plaintiffs in the Second Circuit may have an easier time evading summary judgment on retaliation claims and getting before a jury on such claims.

In order to best protect themselves against the precedent created by *Kwan*, employers in the Second Circuit must ensure that they are consistent in the explanations they provide for adverse employment actions both before any litigation commences and during the entire course of any ensuing litigation. Accordingly, employers are strongly advised to conduct a complete investigation of claims at the outset to understand any and all rationales for the adverse employment action at issue, and to involve legal counsel as soon as possible, including in any agency proceedings and submissions. In the wake of *Kwan*, an employer's proffered reason(s) for taking an adverse employment action will be scrutinized by both the plaintiff's counsel and the courts and must be consistent throughout the litigation. ■

The Faithless Servant Doctrine Is Alive and Well

continued from page 3

The option was fully vested, and the plaintiff was not required to remain employed by the defendant to retain that interest — indeed, the termination of his employment would have had no impact on the option. Given that the option was, by its terms, not subject to forfeiture, the plaintiff argued that any breach by him of the covenant of good faith and fair dealing or his fiduciary duties should not adversely affect his rights. The court rejected this argument, finding that "[i]nfidelity is a bar to a claim for enforcement of a contract."

Conclusion

The faithless servant doctrine is a powerful tool that may be used by employers that are the victims of wrongdoing by employees to recover compensation already paid and avoid payment of additional compensation that may otherwise be due. In addition to claims for damages arising out of misconduct by current or former employees, employers are advised to consider claims they may have under the faithless servant doctrine. ■

Second Circuit Clarifies How Private Equity Firms and Other Investors Can Insulate Against WARN Liability

Private equity firms and other investors that become directly involved in the day-to-day business activities of portfolio companies run the risk of being held directly liable for the Worker Adjustment Retraining Notification ("WARN") Act violations of those entities. The Court of Appeals for the Second Circuit recently clarified the standards that apply to such liability, and other courts have further defined the contours of acceptable and riskier behavior.

In analyzing the plaintiff's claims, the Second Circuit formally adopted a five factor test created by the Department of Labor (the "DOL") to determine whether related entities should be considered a single employer for purposes of the WARN Act.

In *Giuppone v. BH S&B Holdings LLC*, 737 F.3d 221 (2d Cir. 2013), York Capital, Bay Harbour Management, and certain of their affiliates faced possible liability for alleged violations by the successor entity to Steve and Barry's Industries, Inc. In analyzing the plaintiff's claims, the Second Circuit formally adopted a five factor test created by the Department of Labor (the "DOL") to determine whether related entities should be considered a single employer for purposes of the WARN Act. Under the five-factor test, a court considers: (1) common ownership; (2) common directors or officers; (3) *de facto* exercise of control; (4) unity of personnel policies emanating from a common source; and (5) dependency of operations. In adopting this standard, the court specifically rejected York Capital's suggestion that the test the court had applied in *Coppola v. Bear, Stearns & Co.*, 499 F.3d 144 (2d Cir. 2007), which by its terms applied to lenders to distressed companies, should also apply to private equity investors. While only a handful of cases relied upon the DOL's test prior to 2011, it has now become the prevalent analysis applied by courts analyzing the potential liability of related entities for violations of the WARN Act.

In analyzing the nature of the relationships between the private equity firms and the employing entity, the following factors were most significant:

- *Common Ownership:* Because the employing entity was owned by two unrelated private equity funds, it had different ownership than those funds. A private equity sponsor that owns all of the equity of a portfolio company would be at risk with respect to this factor. *See, e.g., Young v. Fortis Plastic, LLC,* 294 F.R.D. 128 (N.D. Ind. 2013) (Monomoy Capital Partners' motion to dismiss WARN Act claims denied; Monomoy owned all of the equity of the employer).
- *Common Directors or Officers:* Because four of seven board members were appointed by the private equity firms, the court found that this factor favored the plaintiff. Nonetheless, it noted that this factor is of limited value, as courts assume that directors are wearing their "subsidiary hats" when acting on behalf of a downstream entity.
- *De Facto Control:* Courts repeatedly emphasize that this is the most important factor in the DOL's test. Here, the court found that the plaintiff failed to allege that the investors had controlled the decision-making process, ruling that the alleged conduct occurred at the level of the holding company, as the parent to the employing entity.

The fate of the investor in the *Young v. Fortis Plastics, LLC* case demonstrates how an investor may find itself subject to potential liability. There, the plaintiff alleged that Monomoy Capital Partners L.P. was the sole owner of Fortis, but the plaintiff failed to make any allegations regarding overlapping directors and officers, unity of personnel policies, or dependency of operations.

A Cautionary Tale

The fate of the investor in the *Young v. Fortis Plastics, LLC* case demonstrates how an investor may find itself subject to potential liability. There, the plaintiff alleged that Monomoy Capital Partners L.P. was the sole owner of Fortis, and the court thus found that this factor favored the plaintiff, but the plaintiff failed to make any allegations

continued on next page

regarding overlapping directors and officers, unity of personnel policies, or dependency of operations. As to the *de facto* exercise of control factor, the plaintiff alleged the closing of the Fortis facility was "ordered by Defendants," which was defined to include both Fortis and Monomoy, named specific Monomoy employees he alleged were involved in the exercise of control over Fortis through weekly calls, and alleged that Monomoy received $500,000 in management fees from Fortis.

These relatively thinly pleaded allegations were found to be sufficient to withstand a motion to dismiss. Of course, on a full factual record, Monomoy may well be able to establish facts that preclude liability and justify summary judgment dismissing the plaintiff's claims. In the meantime, it will be forced to incur the costs and distraction of defending the litigation.

Avoiding Liability

To reduce the risk of liability, investors should strive to ensure separation from the employer's decision to lay off employees or close facilities. Certainly, this does not require that the third party abstain from all involvement in the employer's financial matters, but specific decisions and determinations should be left to the management and board of directors of the employer. Direct orders or instructions to conduct layoffs or plant closings should be avoided; establishing expense reduction requirements or requiring financial covenant compliance are far less likely to lead to liability. Greater care is called for when a single private equity firm or other investor is the sole or primary owner of the equity of the employing entity.

Critically, the corporate formalities must be observed. Appropriate documentation should reflect that the relevant decisions were made by the employer's officers or board of directors, not the investor, including through board resolutions, minutes of meetings, and internal memoranda. Demonstrating a lack of control over the determination will go a long way toward insulating the third party from liability for any WARN violations by the employer. ■

Status of the NLRB's Continuing Efforts to Impact Non-Unionized Workplaces

Over the past few years, the National Labor Relations Board (the "NLRB") has expanded its traditional focus on unionized workplaces (or employees' attempts to unionize), promulgating or extending legal principles in a manner specifically calculated to reach employers that have non-unionized workforces. When targeting non-unionized employers, the NLRB focuses on Section 7 of the National Labor Relations Act (the "NLRA"), which sets forth the right of employees to "engage in . . . concerted activities for the purpose of collective bargaining or other mutual aid or protection." Below, we summarize notable recent developments in NLRB proceedings and court actions that may assist employers in understanding the scope of the NLRB's latest enforcement efforts.

Constitutionality of Recess Appointments

Before the end of its current Term, the Supreme Court will rule on the constitutionality of President Obama's January 2012 "recess appointments," with the potential to invalidate years of cases decided by the Board when it was comprised in part of members appointed during that recess and implicating recess appointments across the federal government. When President Obama made three appointments to the NLRB, he controversially used the recess appointments clause of the Constitution to complete the five-member Board. The clause permits the President to "fill up all Vacancies that may happen during the Recess of the Senate, by granting Commissions which shall expire at the End of their next Session."

The Supreme Court challenge to the recess appointments derives from the NLRB's ruling against Noel Canning in February 2012. Two of the recess appointees were on the three-member panel and voted against Noel Canning. The D.C. Circuit reversed the decision, finding that these two panelists were improperly added to the Board because the Senate was not in recess at the time Presidential Obama appointed them. In doing so, the court found that because

continued on page 8

Status of the NLRB's Continuing Efforts to Impact Non-Unionized Workplaces

continued from page 7

there were only two properly appointed Board members, the NLRB had no power to issue any rulings at that time.

The Court heard oral argument in *National Labor Relations Board v. Noel Canning* on January 13, 2014, and the Justices' questions focused on the meaning of "recess" and how a recess is triggered. If the NLRB appointments are found invalid, the Board will likely be forced to issue

Even though the Fifth Circuit eviscerated the rationale of *D.R. Horton* — and the Second, Eighth, Ninth, and Eleventh Circuits have ruled similarly — the NLRB has refused to follow suit.

new opinions on more than 100 cases currently now on appeal by parties challenging the Board's decisions on the basis of the recess appointments.

The Rejection of its Seminal Decision Banning Class Waivers Won't Stop the NLRB

While a variety of courts have disagreed with the NLRB's decision in *D.R. Horton, Inc. and Michael Cuda*, Case 12-CA-25764 (Jan. 3, 2012) ("*D.R. Horton*"), which ruled that employers cannot require employees to sign arbitration agreements waiving their rights to bring joint, class, or collective actions, the Fifth Circuit put a critical nail in the coffin, finding in the appeal from that decision that D.R. Horton's class waiver arbitration agreement did not violate the NLRA. The NLRB apparently is unfazed, and maintains that its decision in *D.R. Horton* is still binding authority.

On December 3, 2013, the Fifth Circuit ruled that the NLRB was incorrect in its blanket rejection of class action arbitration waivers, upending the NLRB's holding. *D.R. Horton, Inc. v. NLRB*, 737 F.3d 344 (5th Cir. 2013). Specifically, the court dismissed the NLRB's argument that employees have a substantive right to class action procedures when pursuing NLRA claims and ruled that the NLRA does not override the FAA. On separate grounds unrelated to the NLRA, the Fifth Circuit ruled that the arbitration provision was invalid.

Even though the Fifth Circuit eviscerated the rationale of *D.R. Horton* — and the Second, Eighth, Ninth, and Eleventh Circuits have ruled similarly — the NLRB has refused to follow suit. In a recent decision, an administrative law judge ("ALJ") wrote "I am bound by *D.R. Horton* until either the Board or the Supreme Court overturns it." *Domino's Pizza LLC and Fast Food Workers Committee*, Case 29-CA-103180 (Mar. 27, 2014). The NLRB clearly has no intention of overturning *D.R. Horton*, so employers will have to wait for the Supreme Court to rule that class action waivers in employment arbitration agreements must be enforced — or continue to appeal adverse rulings by the NLRB to the federal courts.

The NLRB's Latest Frontier: Dress Codes

In a decision adopted by the Board, an ALJ found that an employer's policy that banned clothing containing language or images "derogatory to the company" was an unlawful restriction and could reasonably be construed to prohibit protected activity. The employee involved in *Alma Products Co. and District 2*, Case 07-CA-089537 (Aug. 14, 2013), wore a t-shirt with the images of a time clock, a ball and chain, and the word "slave" printed on the back. Almost twenty years earlier, employees had worn such shirts during a labor dispute, and when the employee learned in 2012 that contract negotiations were going poorly, he wore the shirt to work. The employer sent the employee home without pay when he refused to remove the shirt.

The ALJ rejected as "disingenuous" the employer's argument that the shirt was racially offensive and unreasonably interfered with the employer's public image, finding that the word "slave" did not reference race. The ALJ rejected as a red herring the employer's argument that permitting an employee to wear such a shirt could result in liability for racial harassment because he found that the shirt could not "single-handedly create an environment so pervasively offensive as to begin to approach the threshold for actionable racial harassment." Of course, responsible employers are attentive to all conduct that could contribute to a racially insensitive environment, whether or not the conduct could "single-handedly" result in liability.

Limiting Conduct to "Fair Criticism" Violates Section 7

Employers have yet another reason to review their codes of conduct. In *William Beaumont Hospital and Jeri Antilla*, Case 07-CA-093885 (Jan. 30, 2014), an ALJ found that a policy prohibiting comments or gestures "that exceed the bounds of fair criticism" and behavior "counter to promoting teamwork," was unlawful. The ALJ wrote

continued on next page

that such phrases violate the NLRA because they "may reasonably chill the exercise of Section 7 rights."

Secrets Don't Make Friends: Questioning Internal Confidentiality Policies

Employers often enact policies governing the internal and external sharing of confidential or proprietary information, but the NLRB may now have such internal policies in its crosshairs. Earlier this year, the Board issued a decision holding that the prohibition of the "dissemination of confidential information within [the Company], such as personal or financial information" is unlawful. *MCPc, Inc. and Jason Galanter*, Case 06-CA-063690 (Feb. 6, 2014). The Board focused on its belief that such a policy would lead reasonable employees to believe that they could not discuss wages or other terms and conditions of employment with their co-workers.

The Board found that the use of such a policy to justify terminating an employee who discussed his workload and the compensation of an executive violated the NLRA. But Board member and Republican Phillip A. Miscimarra noted that he did not agree with the Board's handling of policies that do not explicitly prohibit Section 7 activity and are not used by the employer to discipline protected activity. Mr. Miscimarra asserted that such policies should not be deemed unlawful, indicating that the Board should focus on the employer's actions. He "advocates a re-examination of this standard in an appropriate future case."

Conclusion

The current Board appears intent on battling every conceivable interpretation of an employer policy or action that could be interpreted as infringing, or even merely chilling, the exercise of Section 7 rights. While the longevity of this approach is in doubt — the NLRB has a history of reversing course when its membership changes, and the federal courts have rejected many of the Board's efforts to extend its authority — employers are well-advised to consider reviewing their policies to determine whether modifications are appropriate to limit the risk of becoming a target of a Board investigation or proceeding. ■

State and Local Governments Impose a Raft of New Obligations on Employers

State and local governments have been hard at work promulgating new legislation and regulations that impose new, significant burdens on employers.

New York Department of Labor Law Issues Regulations Regarding Deductions from Wages

The New York State Department of Labor (the "DOL") has issued regulations implementing the recent amendment to Labor Law § 193, which broadened the scope of permissible deductions that employers may take from employees' wages. Categories of permissible deductions include: (a) those made for the employee's benefit, specifically those that provide financial or other support to the employee, the employee's family or a charitable organization; (b) those made to correct an accidental overpayment; and (c) those made to recoup an advance of salary or wages.

Deductions for the benefit of the employee must be specifically authorized by the employee and are limited to the following categories:

- Health and welfare benefits, including insurance premiums, gym membership dues, and daycare and before/after-school care expenses;
- Pension and savings benefits;
- Charitable benefits;
- Representational benefits, such as dues for a labor organization;
- Transportation benefits, including for parking passes, fare cards, etc., that entitle the employee to use mass transit; and
- Food and lodging benefits.

Deductions for accidental overpayments are permitted only for overpayments due to clerical or mathematical errors. Notice of any deduction in this category must be given within eight weeks of the error and within either three days or three weeks before the deduction (depending on the amount of the deduction). Once notice is timely provided, deductions can be taken over a period of up to six years.

continued on page 10

State and Local Governments Impose a Raft of New Obligations on Employers continued from page 9

Deductions for repayment of advances must be agreed to in writing before the advance is given, including the amount, timing and duration of the repayment deductions. Note that the regulations define an "advance" as "the provision of money . . . based on the anticipation of the earning of future wages" and that "[a]ny provision of money that is accompanied by interest, fee(s) or . . . anything other than the strict amount provided, is not an advance" under the regulations and cannot be repaid through wage deductions.

These regulations, and the underlying statutory change, expand the range of deductions that employers may properly implement in appropriate circumstances, and in particular provide welcome methods to recover overpayments and advances that were unavailable under prior law.

New York Unemployment Insurance Benefits Narrowed

New York amended the Unemployment Insurance Law, effective January 1, 2014, to specifically provide that no unemployment insurance benefits will be paid during the period of time the claimant receives dismissal pay (*e.g.*, severance). If the dismissal pay is paid in a lump sum amount, the dismissal payments are to be allocated on a weekly basis and the claimant will not be eligible to receive unemployment insurance benefits for any week to which the dismissal pay is allocated. The offset does not apply, however, unless payment of the severance begins within thirty days of the date of termination.

The Labor Law also was amended to bar employers from receiving a credit for overpayments of benefits to a former employee where the overpayment was made because the employer failed to timely or adequately respond to the DOL's request for information. Employers sometimes choose not to respond to a notice of potential charges because they do not intend to contest the former employee's rights to benefits. Now, if it is later determined that the employee was erroneously granted benefits, an employer that failed to respond to the DOL's notice may be barred from receiving the economic benefits of a reversal.

U.S. DOL and New York State Join Forces to Battle Worker Misclassification

The United States Department of Labor, the New York State Department of Labor and the New York Attorney General signed a memorandum of understanding to cooperate with respect to efforts to reduce misclassification of employees as independent contractors. In a press release, the United States Department of Labor noted that "legitimate independent contractors are an important part of our economy" but that misclassification leads to employees being denied benefits and protections to which they are entitled. The agency also noted that misclassification "can create economic pressure for law-abiding business owners, who find it difficult to compete with those who are skirting the law."

New York City Requires Accommodations for Pregnancy

New York City amended the New York City Human Rights Law (the "NYCHRL") to require all employers with four or more employees to provide reasonable accommodations for pregnancy, childbirth and related medical conditions, unless the provision of such accommodations would cause an undue hardship. This is a significant expansion of coverage for pregnant women. Under previously existing law, including the Pregnancy Discrimination Act, the Americans with Disabilities Act and the New York State Human Rights Law, pregnancy itself is not considered a disability (although pregnancy-related impairments or complications are disabilities under the ADA and the state human rights law).

The reasonable accommodations required under the NYCHRL are those necessary to enable the woman to perform "the essential requisites of the job." Although the new law does not provide an exhaustive list of what might constitute a reasonable accommodation, specific examples include: bathroom breaks, leave of absence for a period of disability related to childbirth, breaks to facilitate increased water intake, periodic rest for those who stand for long periods of time, and assistance with manual labor. It is unlawful to refuse requests for reasonable accommodations when the employee's pregnancy, childbirth or related medical condition is known, or should have been known, to the employer unless the employer can show the accommodation would cause an undue hardship.

Factors that an employer may consider in determining whether a requested accommodation is an undue hardship include the nature and cost of the accommodation, the overall financial resources of the facility and the employer, the number of persons employed at the particular facility,

continued on next page

and the overall size of the business. An employer also can raise an affirmative defense that even with the requested accommodation the employee could not meet the "essential requisites of the job."

The new law also requires that employers provide all employees (not just female employees) with a notice describing employees' right to be free from discrimination related to pregnancy, childbirth, and related medical conditions. Notice must be provided to new employees at the start of their employment and within 120 days of the effective date of the new law (*i.e.*, May 30, 2014) to existing employees. New York City has provided posters in seven languages at *http://www.nyc.gov/html/cchr/html/publications/pregnancy-employment-poster.shtml*.

New York City Earned Sick Time Act

Last year, over then-Mayor Bloomberg's veto, the New York City Council passed the Earned Sick Time Act, mandating that as of April 1, 2014 employees of businesses with twenty or more employees be provided up to forty hours of paid sick time each year (unpaid leave must be provided to employees in businesses with less than twenty employees) and, as of October 1, 2015 expanding the requirement of paid leave to businesses with fifteen or more employees. In late February 2014, the New York City Council expanded the law to cover all businesses with five or more employees as of the original bill's effective date of April 1, 2014. The City Council also broadened the definition of "family member" for which sick time can be used to include not only children, spouses/domestic partners and parents, but also grandchildren, grandparents and siblings.

Most employers that provide vacation and sick days or have a paid time off ("PTO") program often are able to comply with the Earned Sick Time Act without having to provide additional time off, but modifications to existing policies typically will be required.

New Jersey Extends Discrimination Protection to Pregnancy

Similar to the extension of the NYCHRL undertaken by New York City, New Jersey has amended its Law Against Discrimination to specifically address workplace discrimination against women because of pregnancy, childbirth, or related medical conditions. Under the amendments, employers must provide reasonable accommodations to pregnant women who request an accommodation on advice of a physician, including bathroom breaks and breaks for increased water intake, periodic rest, assistance with manual labor, modified work schedules and job restrictions, as well as temporary transfers to less strenuous or hazardous work. Employers may deny requests for an accommodation if it would cause an undue hardship. Additionally, the amendments specifically provide that they are not meant to increase an employee's right to leave (whether paid or unpaid).

New Jersey Requires Notice Regarding Gender Equality

New Jersey now mandates that employees be provided with notice of their right to be free from gender-based discrimination in the workplace. Notices are available on the website of the New Jersey Department of Labor and Workforce Development in English and Spanish and include information related to applicable state and federal laws. *See http://lwd.dol.state.nj.us/labor/lwdhome/content/employerpacketforms.html*.

New Jersey employers having fifty or more employees (regardless of whether those employees work in New Jersey or other states) are required to post the notice in a conspicuous place at the workplace or on the employer's intranet. The statute also requires that the notice be distributed directly to employees as follows: (a) to current employees by February 5, 2014; (b) to new employees hired after January 6, 2014 at the time of hire; (c) to all employees annually on or before December 31 of each year; and (d) at any time an employee requests a copy. Furthermore, employers are required to obtain signed acknowledgments or electronic verifications from each employee.

Jersey City Paid Sick Time Ordinance

Jersey City now requires that private sector employers with ten or more Jersey City employees provide a minimum of one hour of paid sick leave for every thirty hours worked by an employee, up to a maximum of five days of sick leave per year. Private sector employers with fewer than ten Jersey City employees are required to provide unpaid sick leave in similar amounts. Employers are required to provide written notice to employees of their rights under the new law. Similar to the expanded New York City sick time law, sick time may be used to take care of children, spouses/domestic partners, parents, grandparents, grandchildren and siblings. ■

NEW YORK
1177 Avenue of the Americas
New York, NY 10036
212.715.9100

SILICON VALLEY
990 Marsh Road
Menlo Park, CA 94025
650.752.1700

PARIS
47, Avenue Hoche
75008 Paris
(33-1) 44.09.46.00

www.kramerlevin.com

Under New York City Law, No Requested Accommodation Is *Per Se* Unreasonable

In the latest example of the broad reach of the New York City Human Rights Law ("NYCHRL"), the New York Court of Appeals ruled that no requested accommodation by a disabled employee — even a request for indefinite leave — can be *per se* unreasonable under that law. In *Romanello v. Intesa Sanpaolo, S.p.A.*, 22 N.Y.2d 881, 976 N.Y.S.426 (2013), the employment of the plaintiff, a banker suffering from depression who had exhausted all available leave under the Family and Medical Leave Act, was terminated after he failed to provide his employer with a return date for work. The plaintiff sued, claiming discrimination on the basis of his disability in violation of the New York State Human Rights Law and NYCHRL.

> The New York Court of Appeals ruled that no requested accommodation by a disabled employee — even a request for indefinite leave — can be *per se* unreasonable under the New York City Human Rights Law.

The Court rejected the plaintiff's State law claim, finding that indefinite leave is not a reasonable accommodation under that law. The Court explained that, under the State law, "disability" is defined as "limited to disabilities which, upon the provision of reasonable accommodations, do not prevent the complainant from performing in a reasonable manner the activities involved in the job or occupation sought or held." Executive Law § 292(21). Because the plaintiff failed to provide his employer with any indication into when he planned to return to work and his complaint "merely" alleged that he sought "a continued leave of absence to allow him to recover and return to work," he failed to state a cause of action.

However, because the definition of "disability" in the NYCHRL does not require that the individual be able to perform his job in a reasonable manner or even mention the concept of reasonable accommodation, the plaintiff's City law claim survived. The NYCHRL defines "disability" solely in terms of impairments, and an employer is required to "make reasonable accommodation to enable a person with a disability to satisfy the essential requisites of a job . . . provided that the disability is known or should have been known by the [employer]." Administrative Code of City of NY §§ 8-102(16); 8-107(15)(a). The employer has the burden of proving hardship and the "'pleading obligation' to prove that the employee 'could not, with reasonable accommodation, satisfy the essential requisites of the job.'" The Court therefore found that the defendant could not make a showing in a motion to dismiss that the plaintiff could not perform his essential job functions without an accommodation.

Employers are reminded that their obligations will differ under federal, state, and city law. Employers covered by the NYCHRL are urged to engage in an interactive process with the employee seeking an accommodation and then to carefully analyze the facts and individual circumstances of each request before making a termination decision. Employers should document all proposed accommodations and why certain requested accommodations would be ineffective or constitute an undue hardship. Before terminating an employee, employers should investigate all potential accommodations.

Critically, it cannot be assumed that a request for indefinite leave will be deemed unreasonable under New York City law. Employers also are reminded that leave under the Family and Medical Leave Act, where applicable, provides a floor for the minimum amount of required leave, and that an employer must consider the accommodation of additional unpaid leave under other federal laws as well as state and city law after the FMLA leave runs out.

The bottom line: Employers covered by the NYCHRL should not deem any requested accommodation as categorically unreasonable. ■