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Whistleblower Claims Under SOX and Dodd-Frank: Recent Developments

Section 806 of the Sarbanes-Oxley Act ("SOX") and Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") both extend whistleblower protection to certain individuals who report conduct they reasonably believe constitutes federal mail, wire or bank fraud or a violation of any rule or regulation of the Securities and Exchange Commission ("SEC") or any provision of federal law relating to shareholder fraud. Dodd-Frank also required the SEC to implement a new whistleblower program — the so-called bounty program — that pays awards to whistleblowers who provide the SEC with information about violations of securities laws that leads to a successful enforcement action resulting in monetary sanctions in excess of $1 million.

As described in more detail below, the U.S. Department of Labor ("DOL") has issued final regulations governing the procedures for handling SOX whistleblower claims. The SEC has announced its view that, for purposes of the employment retaliation provision in Dodd-Frank, an employee's status as whistleblower does not depend on whether that individual reported wrongful conduct to the SEC. The Second Circuit Court of Appeals followed suit in a recent decision, creating a circuit split on this issue, which now may be resolved by the United States Supreme Court. Moreover, a number of notable recent federal court decisions, including those issued by two circuit courts, have addressed the standards for establishing "protected activity" under SOX.

The DOL Issues Final Rule on SOX Whistleblower Complaints

Earlier this year, the DOL's Occupational Safety and Health Administration ("OSHA") issued final regulations governing procedures applicable to whistleblower claims under SOX. It had been more than three years since

OSHA had issued an "interim rule," which had during that period governed the agency's approach to SOX retaliation complaints.

The Final Rule does not substantially alter OSHA's approach to investigating retaliation claims under SOX. The key features of the regulations include:

- An employee, or someone on the employee's behalf, may file a retaliation complaint, either orally or in writing, in any language, with OSHA within 180 days from the date of the alleged retaliation or the date on which the employee becomes aware of the violation.
- A complainant must make a prima facie case showing that he or she engaged in protected activity and that activity was a "contributing factor" in the adverse action by the employer. Once the employee makes that showing, the burden shifts to the employer to prove by clear and convincing evidence "that it would have taken the same adverse action in the absence of the protected activity."
- At the conclusion of the investigation, if OSHA determines that there is reasonable cause to believe that the statute was violated, it will issue a preliminary order for relief, including immediate preliminary reinstatement. Employers may request a hearing before an administrative law judge and may apply for a stay of the preliminary order of reinstatement.
- Whistleblowers may be provided "economic reinstatement" — payment of wages in lieu of employment — if OSHA determines that it is not advisable for the employee to return to work. Perhaps surprisingly, if the employer ultimately prevails in the whistleblower action, OSHA will not order reimbursement to the employer of wages paid to the former employees during the economic reinstatement period.

SEC Announces That Internal Whistleblowers Have Full Protections Under Dodd-Frank

The SEC declared on August 4, 2014, that for purposes of the employment retaliation protections provided by Dodd-Frank, an individual's status as a whistleblower does not depend on whether or not he or she reported wrongdoing to the SEC. Among other reasons, the SEC stated that its conclusion "best comports with our overall goals in implementing the whistleblower program." By providing protection for internal whistleblowers, said the SEC, its interpretation avoids a structure that might discourage some individuals from first reporting internally in appropriate circumstances and thus jeopardize the investor-protection and law-enforcement benefits that can result from internal reporting.

Second Circuit Decision Holds That Internal Whistleblowers Are Entitled to Protection Under Dodd-Frank, Creates Circuit Split

On September 10, 2015, the U.S. Court of Appeals for the Second Circuit ruled that the anti-retaliation provisions of Dodd-Frank apply to whistleblowers who report wrongdoing "internally" — to the employer — without the requirement of also reporting to the SEC. *Berman v. Neo@Ogilvy*, 801 F.3d 145 (2d Cir. 2015). The court focused on an "arguable tension" within the statute: While the statute defines "whistleblower" to mean only those who report violations to the SEC, the substantive anti-retaliation provision applies to all whistleblowers who provide information as required or protected under SOX, which extends protection to internal whistleblowers even if they do not report alleged wrongdoing to the SEC. The court therefore found the language of the statute sufficiently ambiguous to warrant deference to the

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interpretation of the SEC, which (as noted above) has announced that Dodd-Frank's retaliation provision includes protection for individuals who provide information internally.

The only other circuit court decision to address the definition of "whistleblower" under Dodd-Frank is *Asadi v. G.E. Energy (USA), L.L.C.*, 702 F.3d 620 (5th Cir. 2013), which found that the language of the Dodd-Frank whistleblower protection provision creates a private cause of action only for individuals who provide information to the SEC relating to a violation of the securities laws. Because the Second Circuit case conflicts with the Fifth Circuit's decision in *Asadi,* the Supreme Court may take up the question of whether individuals who report internally (without also reporting to the SEC) are entitled to protection under Dodd-Frank.

In the meantime, it is worth noting that Dodd-Frank is far broader than SOX in many respects relevant to employers. Dodd-Frank provides the enhanced remedy of double back pay and allows whistleblowers to bring their claims directly in federal court, while SOX provides a successful claimant with the remedies of back pay and reinstatement and requires that a complaint first be filed with the DOL. In addition, under Dodd-Frank, whistleblowers who engage in SOX-protected activity must file in court either within six years after the date when the violation occurs or within three years after the date "facts material to the right of action are known or reasonably should have been known by the employee," but not more than 10 years after the date of the violation. The limitations period under SOX is 180 days.

California District Court Limits Protected Activity Under Dodd-Frank

In *Nazif v. Computer Sciences Corp.*, No. 13-cv-5498 (N.D. Cal. June 17, 2015), a suit brought by a CPA who was allegedly fired by Computer Sciences Corp. for complaining to his managers about various purported errors in the company's accounting practices, the Northern District of California granted the employer summary judgment, dismissing Nazif's claims. The court concluded there was no evidence that his purported belief that the company violated securities laws was objectively reasonable under SOX.

The court relied on Ninth Circuit precedent for the proposition that to have an objectively reasonable belief of a violation of one of the SOX-enumerated laws — in this case, securities fraud — the complaining employee's theory of such fraud "must at least approximate the basic elements of a claim of securities fraud." According to the court, this means that the plaintiff must have had an objectively reasonable belief that his employer's violations involved a material misrepresentation or omission, scienter (intent or knowledge of wrongdoing), a connection with the purchase or sale of a security, reliance, economic loss, and loss causation.

The court reviewed Nazif's evidence, including his purported belief that the aggregate effect of the various alleged accounting irregularities would have resulted in approximately $15 million in misstatements. It concluded that no objectively reasonable accountant could have believed that a revenue misstatement of this size was sufficiently material to a company as large as this one, which reported annual revenue of over $14 billion. "At best," held the court, "a jury could conclude that Nazif reported 'minor or technical' GAAP violations to his superiors." Because Nazif's complaint concerned a trivial matter in terms of its relationship to shareholder interests, held the court, he did not engage in protected activity under SOX.

Sixth Circuit Rejects 'Specifically and Definitively' Standard for SOX Whistleblower Protected Activity

In *Sylvester v. Parexel Int'l LLC,* DOL ARB No. 07-123 (May 25, 2011), the DOL's Arbitration Review Board ("ARB") held that complainants only have to express a "reasonable belief" of a violation of law to engage in SOX-protected activity — the protected activity does not have to

describe an *actual* violation of the law. In doing so, the ARB rejected the "definitive and specific" evidentiary standard announced in the ARB's 2006 decision in *Platone v. FLYI Inc.*, DOL ARB No. 04-154 (2006), which had held that protected conduct had to definitively and specifically describe a violation of one or more of the laws listed in SOX.

In 2012, the Sixth Circuit adopted the *Platone* standard in *Riddle v. First Tennessee Bank, National Association*, 497 F. App'x 588 (6th Cir. 2012) (unpublished). But in *Rhinehimer v. U.S. Bancorp Investments, Inc.*, 787 F.3d 797 (6th Cir. 2015), the Sixth Circuit abandoned the *Platone* "definitive and specific" standard, ruling that an employee who reports allegedly fraudulent conduct engages in protected activity under SOX when he or she has a reasonable belief that the conduct reported is prohibited under SOX, even if that belief is mistaken.

> "[A]n employee need not establish the reasonableness of his or her belief as to each element of the violation . . . Instead, the reasonableness of the employee's belief will depend on the totality of the circumstances known (or reasonably albeit mistakenly perceived) by the employee at the time of the complaint, analyzed in light of the employee's training and experience."

Rhinehimer was a certified financial planner at U.S. Bancorp who was terminated after he complained to his supervisor about allegedly inappropriate trades. He claimed to believe that the trades compromised his elderly client's estate plan and constituted fraud. The jury issued a verdict in favor of Rhinehimer in the amount of $250,000. On appeal, the company argued that, based on Riddle, Rhinehimer was required to establish facts from which a reasonable person could infer each element of an unsuitability fraud claim, including the misrepresentation or omission of material facts and that the broker acted with intent or reckless disregard of the client's needs. According to the company, the evidence did not support a finding by the jury that Rhinehimer had engaged in protected activity.

The court made an about-face from its holding in *Riddle*, stating it agreed with the ARB's standard as set forth in *Sylvester*. It explained that under this standard, "an employee need not establish the reasonableness of his or her belief as to each element of the violation" and that "[i]nstead, the reasonableness of the employee's belief will depend on the totality of the circumstances known (or reasonably albeit mistakenly perceived) by the employee at the time of the complaint, analyzed in light of the employee's training and experience." Based on the totality of the circumstances, the court found that the evidence was sufficient to sustain the jury's finding and that Rhinehimer reasonably believed that the trades constituted unsuitability fraud.

Fifth Circuit Reverses Dismissal of SOX Whistleblower Claims

On July 31, 2015, in *Wallace v. Tesoro Corp.*, 796 F.3d 468 (5th Cir. 2015), the Fifth Circuit revived a SOX whistleblower complaint that was dismissed by the United States District Court for the Western District of Texas, holding that the plaintiff's alleged belief that the company violated SEC rules, as pleaded in the complaint, could be found to be objectively reasonable. The Fifth Circuit also affirmed the dismissal of claims not included in the OSHA complaint on the grounds that they were not administratively exhausted.

The plaintiff, formerly the vice president of pricing and commercial analysis at Tesoro Corp., claimed that the company retaliated against him after he complained that the company allegedly counted taxes as revenues on certain financial forms, in violation of GAAP. After OSHA dismissed his complaint, the plaintiff filed a complaint in federal district court pursuant to SOX's "kick out" provision, which permits a complainant to

withdraw an unresolved complaint from OSHA's administrative process after 180 days. Once in federal court, he filed several amended complaints, alleging the same categories of protected activity as in his OSHA complaint but also alleging — for the first time — that he engaged in protected activity when he investigated and reported suspected wire fraud. The District Court dismissed the complaint, finding that the plaintiff's purported belief that booking taxes as revenue violated SEC rules was not objectively reasonable and that his other allegations did not constitute protected activity. The court also dismissed the plaintiff's claim relating to wire fraud because it alleged activity outside the scope of the OSHA complaint.

The Fifth Circuit ruled that the District Court erred in dismissing Wallace's claim that he engaged in protected activity under SOX when he reported that the company booked taxes as revenue. The court concluded that Wallace's basis for his belief that the practice violated SEC rules, including the level and role of his accounting expertise and how that should weigh against him, are grounded in factual disputes that cannot be resolved on a motion to dismiss. However, the court affirmed the dismissal of Wallace's allegations that were not raised before OSHA, holding that the exhaustion requirement applicable to Title VII claims filed with the EEOC applies with equal force to SOX claims filed with OSHA. The court stated that "[b]y failing entirely to reference a distinct category of protected activity in his OSHA complaint, Wallace did not file a complaint whose investigation would reach that activity."

Conclusion

Recent decisions serve as a reminder that courts may well take a broad view of what constitutes protected activity under SOX and the Dodd-Frank Act. Employers should take great care to ensure that management and human resources professionals receive proper training to ensure that potential whistleblower complaints are promptly and thoroughly investigated and assessed. ■

New Legislation Limits NYC Employers' Use of Credit and Criminal History

The New York City Council recently passed two pieces of legislation that will change the way many employers conduct and use background checks with respect to applicants and employees. First, the City Council approved a bill amending the New York City Human Rights Law, NYC Administrative Code, § 8-101 et seq. ("NYCHRL") to prohibit most employers from making employment decisions based on an applicant's or employee's consumer credit history. The law went into effect on September 3, 2015. Second, the Council passed a bill to amend the NYCHRL to further limit employers from inquiring into or considering an applicant's or employee's criminal history in employment decisions. This law went into effect on October 27, 2015.

Credit History Discrimination Ban

On April 16, 2015, the NYC Council passed the "Stop Credit Discrimination in Employment Act" by a vote of 47-3, and on May 6, 2015, the Mayor signed that bill into law. The law adds a new provision to the NYCHRL making it an "unlawful discriminatory practice" for employers to request or use for employment purposes the consumer credit history of an applicant or employee, except in limited circumstances, such as:

- When required by state or federal law or regulations;
- When required by a self-regulatory organization as defined by the Securities Exchange Act of 1934. The term "self-regulatory organization" means any national securities exchange, registered securities association, or registered clearing agency, such as FINRA. Broker-dealer firms subject to FINRA's regulatory authority may request certain credit check information from registered job applicants under FINRA Rule 3110(e), which became effective

on July 1, 2015. That rule requires FINRA members to verify information provided on the applicant's Form U-4, such as disclosures about bankruptcies and outstanding judgments or liens;

- For employment as a police officer or certain positions with the New York City Department of Investigation;
- For positions in which an employee is required to be bonded under city, state or federal law;
- For positions in which an employee is required to possess security clearance under federal or state law;
- For nonclerical positions having regular access to "trade secrets" (which is defined under the law and specifically excludes client, customer or mailing lists);
- For positions that have signing authority over third-party funds or assets of $10,000 or more or that involve fiduciary responsibility to the employer with authority to enter financial agreements on behalf of the employer for amounts of $10,000 or more; or
- For computer security positions where the regular duties allow the employee to modify digital security systems established to prevent the unauthorized use of an employer's or client's networks or databases.

In addition, employers may request or receive consumer credit history information pursuant to subpoena, court order or law enforcement investigation.

On September 1, 2015, the New York City Commission on Human Rights ("NYC Commission"), the city agency charged with enforcing the law, published on its website Legal Enforcement Guidelines concerning the new law. In addition, the NYC Commission published separate fact sheets for employees and employers, aimed at providing basic information about the law. The Guidelines confirm that the NYC Commission views credit checks as "rarely relevant to employment positions." Importantly, the Guidelines state that "all exemptions to coverage under the [law's] anti-discrimination provisions are to be construed narrowly" and that employers who claim an exemption as a defense to liability have the burden of proving the exemption by a preponderance of the evidence.

The NYC Commission further recommends (but does not require) that employers wishing to avail themselves of an exemption inform the applicant or employee of the claimed exemption and keep a log of all exemptions utilized for five years from the date the exemption is used. The log should include details regarding (i) the exemption claimed; (ii) why the exemption is applicable; (iii) the name and contact information for all individuals considered for the exempted position; (iv) the job duties of the position; (v) the qualifications necessary to perform the position; (vi) a copy of credit history obtained for the individual for whom the exemption was claimed; (vii) how the credit history was obtained; and (viii) how the credit history resulted in the employment action taken. Employers are required to provide the above information to the Commission upon request.

The Guidelines confirm that the NYC Commission views credit checks as "rarely relevant to employment positions." Importantly, the Guidelines state that "all exemptions to coverage under the [law's] anti-discrimination provisions are to be construed narrowly" and that employers who claim an exemption as a defense to liability have the burden of proving the exemption by a preponderance of the evidence.

Finally, the Guidelines remind employers that there are substantial penalties for violations of the law (up to $250,000 for willful, wanton, or

malicious violations, and up to $125,000 for other violations) in addition to other remedies available under the NYCHRL.

"Ban the Box" Legislation

On June 10, 2015, by a 45-5 vote, the New York City Council passed a bill called the "Fair Chance Act," which puts significant restrictions on employers' ability to request or use criminal history in hiring and other personnel decisions. Mayor de Blasio signed the bill into law on June 29, 2015 and it went into effect on October 27, 2015.

Even before the Fair Chance Act was enacted, under New York State and City law, employers could not ask about or take adverse action based upon any arrest or criminal accusation of an employee or candidate not then pending against that person which was followed by a termination of that criminal action or proceeding in favor of such person — that is, an accusation or arrest that resulted in acquittal or dismissal of charges may not be the subject of an inquiry or the basis for taking an adverse action. In addition, before denying employment based on an individual's conviction record, the law requires employers to consider multiple factors, listed in Article 23-A of the New York State Correction Law, to determine whether (a) there is a direct relationship between the criminal offense and the employment sought or held by the individual, or (b) employing the individual would involve an "unreasonable risk to property or to the safety or welfare of specific individuals or the general public."

The Fair Chance Act prohibits employers from asking about criminal history at any time prior to extending a conditional offer of employment, such as in an initial employment application or interview or otherwise (referenced commonly as a "ban the box" provision). In addition, the law bars employers from stating on any job advertisement or publication that employment is dependent on an applicant's arrest or conviction history. Before taking any adverse action on the basis of criminal history, the law requires employers to:

- Provide a written copy of the criminal history inquiry to the applicant;
- Provide an Article 23-A analysis to the applicant in writing, which must include "supporting documents" that formed the basis of and reasons for the adverse action; and
- After providing the applicant with all of the required documentation, allow the individual at least three business days to respond and, during that time, hold the position open for the applicant.

The NYC Commission has prepared a Fair Chance Notice, available on its website, that employers may use to comply with the requirement. The Commission has stated that the form may be adapted to an employer's preferred format, as long as the material substance does not change.

Finally, the law does not apply to any actions taken by an employer pursuant to any federal, state, or local law requiring criminal background checks for employment purposes or barring employment based on criminal history. For this purpose, "federal law" includes the rules or regulations of a self-regulatory organization as defined by the Securities Exchange Act of 1934 (such as FINRA). Employers in the financial services industry, to the extent they must assess whether employees are subject to statutory disqualification due to certain criminal convictions, will be exempt from the requirements of the law. Further, to the extent employers must comply with FINRA Rule 3110(e), which requires member firms to conduct background investigations of applicants for FINRA registration, the law does not apply to such actions. The law also appears to exempt banking institutions subject to the Federal Deposit Insurance Act, which prohibits the employment of individuals convicted of certain offenses without FDIC consent and requires covered employers to inquire into a job applicant's conviction record. The law also provides exceptions for certain public positions.

The Commission has also published on its website Legal Enforcement Guidelines concerning the Fair Chance Act. The Guidelines confirm the goal of the new law: to "ensure[] that individuals with criminal histories are considered based on their qualifications before their conviction histories" and states that "[i]f the employer wishes to nevertheless withdraw its offer it must first give the applicant a meaningful opportunity to respond before finalizing its decision." The Guidelines provide the following suggested language for employers that wish to inquire about criminal histories after a conditional offer is made:

> Have you ever been convicted of a misdemeanor or a felony? Answer "NO" if your conviction: (a) was sealed, expunged or reversed on appeal; (b) was for a violation, infraction or petty offense such as "disorderly conduct;" (c) resulted in a youthful offender or juvenile delinquency finding; or (d) if you withdrew your plea after completing a court program and were not convicted of a misdemeanor or felony.

The Guidelines also provide specific suggestions concerning the proper methods of evaluating the applicant using the Article 23-A factors, providing the applicant an opportunity to respond to the employer's inquiry and written notice, and addressing background report errors or misrepresentations with applicants.

Like the credit history law, exemptions to coverage under the Fair Chance Act will be construed narrowly, and employers that assert an exemption will have the burden of proving the exemption by the preponderance of the evidence. Here too, the Commission suggests, but does not require, that employers maintain an "exemption log" so that they may promptly respond to inquiries by the Commission. The suggested log should contain (1) the exemption that is claimed; (2) how the position fits into the exemption and, if applicable, the law or rule allowing the exemption; (3) a copy of the inquiry and the name of the employee who made it; (4) a copy of the Article 23-A analysis and the names of any employers that participated in it; and (5) the final employment action that was taken based on the applicant's criminal history.

Importantly, the Guidelines also contain the Commission's recommendation that the results of any criminal history inquiry be collected and maintained on separate forms and kept confidential so that they are used only by those involved in making an employment decision.

With regard to enforcement of the law, the Commission has stated that it will presume, unless rebutted, that an employer was motivated by an applicant's criminal history records if it revokes a conditional offer of employment. In addition, the Commission will presume that "any reason known to the employer before its conditional offer is not a legitimate reason to later withdraw the offer" — that is, if an employer makes a conditional offer of employment after learning negative information regarding an applicant, it almost certainly would not be able to withdraw the offer based upon that same information.

Like the credit history law, exemptions to coverage under the Fair Chance Act will be construed narrowly, and employers that assert an exemption will have the burden of proving the exemption by the preponderance of the evidence.

Violation of the new laws could expose employers to potential damages and penalties available under the NYCHRL, including punitive damages and attorney's fees. Employers should review and revise their background check policies and practices to comply with the new laws. In particular, many employment applications include questions about past convictions — a practice that will be prohibited once the new law goes into effect. ■

New York's New Women's Equality Laws

On October 21, 2015, New York State Governor Andrew Cuomo signed into law a number of bills intended to advance women's equality in the workplace. The bills address pay equality, sexual harassment, discrimination on the basis of sex, family status discrimination, and pregnancy discrimination. Employers should familiarize themselves with these bills before they become effective on January 19, 2016. Moreover, employers should review their relevant employment policies and pay practices to ensure compliance and decrease their risk of exposure.

Pay Equality

New York Labor Law Section 194(1) prohibits an employee from being paid a lower wage than another employee of the opposite sex when he or she performs equal work under "similar working conditions" in a job that requires "equal skill, effort and responsibility." This section was amended to more clearly define the permitted exceptions to the rule.

The bill acknowledges a number of exceptions to the general prohibition on unequal pay — "a seniority system, a merit system, a system which measures earnings by quantity or quality of production, or a bona fide factor other than sex, such as education, training or experience." This suggests an increase in the standard, as employers now are required to offer proof of a "bona fide factor," while under the previous version of the law an employer could prevail by showing that the pay disparity resulted from simply "any other factor other than sex."

Further, the amendment provides that "no employer shall prohibit an employee from inquiring about, discussing, or disclosing the wages of such employee or another employee." However, the bill makes clear that individuals with access to wage information of other employees as part of an essential job function, such as payroll administrators, are excepted from the prohibition.

Finally, the bill substantially increases the amount of liquidated damages available to an employee who has been paid less than the wage to which he or she is entitled. Under the bill, an employee can recover up to 300% — up from 100% — of unpaid wages for willful violations and may also recover attorney's fees.

The amendment provides that "no employer shall prohibit an employee from inquiring about, discussing, or disclosing the wages of such employee or another employee."

Sexual Harassment

An amendment to New York Executive Law Section 292(5) expands protection for employees facing sexual harassment to employees of all employers — even those with fewer than four employees, the previous threshold. All employees are now able to file workplace sexual harassment complaints and bring an action in court.

Discrimination on the Basis of Sex

An amendment to New York Executive Law Section 297(10) states that the court may in its discretion award reasonable attorney's fees to the prevailing party in a case involving employment or credit discrimination on the basis of sex. This applies to successful plaintiffs and to successful defendants who can show that the plaintiff's claims were frivolous.

Family Status Discrimination

An amendment to New York Executive Law Section 296(1) and (1)(a) prohibits employers, licensing agencies, employment agencies, and labor organizations from discriminating on the basis of familial status. The amendment adds familial status to the existing list of unlawful discriminatory practices based on age, race, creed, color, national origin, sexual orientation,

military status, sex, disability, predisposing genetic characteristics, marital status and domestic violence victim status.

Pregnancy Discrimination

An amendment to New York Executive Law Section 292(21-e) requires employers to provide reasonable accommodations to employees with "pregnancy-related conditions." An exception is made where the accommodations would impose an undue hardship on the employer's business. A pregnancy-related condition means a condition related to pregnancy or childbirth, limited to conditions 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." An employee must provide information necessary to verify the existence of the pregnancy-related condition. ■

When Is an Unpaid Intern an Employee? Second Circuit Provides Clarity

Finally resolving conflicts concerning the standard to be used in determining when an unpaid intern should be properly classified as an employee, on July 2, 2015 the Second Circuit Courts of Appeals decided *Glatt v. Fox Searchlight Pictures*, No. 13-4478-cv, 2015 WL 4033018 (2d Cir. July 2, 2015). In addition to providing much-needed clarity to lower courts and employers in the circuit, the *Glatt* decision is being widely heralded as an employer-friendly result.

In *Glatt*, two former production interns on the "Black Swan" film sued Fox claiming that they should have been classified as "employees" under the Fair Labor Standards Act ("FLSA") and the New York Labor Law ("NYLL") and were thus entitled to be paid the minimum wage plus overtime. The District Court agreed with the plaintiffs and found that they were indeed "employees" under the FLSA and the NYLL and were entitled to be paid.

The Second Circuit reversed the lower court's finding and rejected its use of the Department of Labor's ("DOL") test, which requires the existence of six factors in order to find that an individual qualifies as a bona fide intern — the standard advocated by the plaintiffs. Under the DOL's test, an intern is to be considered an employee when the employer obtains an immediate advantage from the intern's work. In contrast, the Second Circuit adopted a test establishing that "the proper question is whether the intern or the employer is the primary beneficiary of the relationship." This "primary beneficiary" test was proposed by Fox and adopted by the court because "it focuses on what the intern receives in exchange for his work" and "accords courts the flexibility to examine the economic reality as it exists between the intern and the employer." Moreover, the court noted, this test "reflects a central feature of the modern internship — the relationship between the internship and the intern's formal education."

The Second Circuit adopted a test establishing that "the proper question is whether the intern or the employer is the primary beneficiary of the relationship."

The primary beneficiary test is far more flexible and involves "weighing and balancing" seven nondispositive factors listed below, as well as any other factors considered to be relevant by a court, to determine whether an unpaid intern properly should be classified as an employee under the FLSA:

1. The extent to which the intern and employer clearly understand that there is no

expectation of compensation. Any promise of compensation, express or implied, suggests that the intern is an employee — and vice versa.

2. The extent to which the internship provides training that would be similar to that which would be given in an educational environment, including the clinical and other hands-on training provided by educational institutions.
3. The extent to which the internship is tied to the intern's formal education program by integrated coursework or the receipt of academic credit.
4. The extent to which the internship accommodates the intern's academic commitments by corresponding to the academic calendar.
5. The extent to which the internship's duration is limited to the period in which the internship provides the intern with beneficial learning.
6. The extent to which the intern's work complements, rather than displaces, the work of paid employees while providing significant educational benefits to the intern.
7. The extent to which the intern and the employer understand that the internship is conducted without entitlement to a paid job at the conclusion of the internship.

The court thus remanded the case to the District Court to apply the primary beneficiary test.

In addition to establishing the primary beneficiary test, the Second Circuit in *Glatt* also vacated and remanded the District Court's decision to certify a Rule 23 class and a FLSA collective action. While the court left open the possibility that a new motion to certify based on the primary beneficiary standard might be granted, it suggested that such an outcome was unlikely because "the question of an intern's employment status [under the primary beneficiary test] is a highly individualized inquiry" and noted that "courts must consider individual aspects of each intern's experience."

Guidance for Employers

In *Glatt*, the Second Circuit first and foremost established new law and provided much-needed guidance to lower courts and employers in the Second Circuit regarding the viability of unpaid internships. The primary beneficiary test provides a more flexible standard than the DOL's pre-existing six-factor test and makes clear that the focus when assessing an employer's internship program should be the extent to which it provides educational development to the individual at issue. Moreover, *Glatt* seems to virtually foreclose certifications of Rule 23 class and/or FLSA collective actions brought by unpaid interns. In recent years, there has been a spate of class and collective actions filed by unpaid interns, and the filing of such claims is expected to abate.

Glatt, however, is not without its limitations, and employers must still proceed cautiously with regard to unpaid internship programs. First, *Glatt* is not a panacea; in order to meet the primary beneficiary test, an employer must clearly demonstrate that its internship program provides concrete educational benefits, which may be difficult to show with respect to some internship programs. Many internship programs that escaped challenge when the law in this area was murky must now be recalibrated to meet the standards set forth in *Glatt*. Second, although the Second Circuit's ruling covered the plaintiffs' NYLL claims, it is unclear whether New York state courts will adopt its holding in ruling on cases brought under the NYLL; indeed, the New York State Department of Labor has published a fact sheet titled "Wage Requirements for Interns in For-Profit Businesses" that relies heavily on the DOL six-factor test and is much more difficult to satisfy than the primary beneficiary test. And third, *Glatt* applies only in the Second Circuit. Employers that operate intern programs extending outside the Second Circuit may find that their programs are subject to differing standards of review in different locations. ■

Second Circuit Clarifies Pleading Standard in Title VII Cases

In a case of first impression, the Second Circuit Court of Appeals explained for the first time how district courts are to harmonize recent Supreme Court precedent requiring that claims be "plausible" with the well-known McDonnell Douglas test typically used to assess claims of discrimination. In doing so, the court confirmed that the plausibility standard does apply to claims of discrimination, while at the same time stating that, at the pleading stage, a plaintiff's burden is limited to plausibly alleging a "minimal inference of discrimination." The court also clarified how the "protected activity" element of a retaliation claim is assessed when the plaintiff is a human resources professional acting within the scope of her duties.

Applying the Plausibility Standard to Discrimination Claims

The plaintiff in *Littlejohn v. City of New York*, 795 F.3d 297 (2d Cir. 2015), an African-American woman, worked at the New York City Administration for Children's Services ("ACS") as the Director of its Equal Employment Opportunity ("EEO") Office. ACS and the City's Department of Juvenile Justice ("DJJ") merged, and as a result numerous employees from DJJ were slated to be laid off, demoted, reassigned or terminated. Littlejohn worked within the integration process and alleges that she complained that supervisors showed preferential treatment to white DJJ employees over African-American and Latino DJJ employees during the merger, in violation of anti-discrimination policies and procedures. Littlejohn alleged that as a result of her complaints regarding the treatment of minority employees during the merger, she was involuntarily transferred and allegedly demoted to an administrative staff analyst position in the Office of Personnel Services, and that her transfer and demotion were in retaliation for her complaints. The District Court dismissed the entire case, holding that Littlejohn had failed to adequately plead her hostile work environment, disparate treatment, and retaliation claims.

The Second Circuit reversed the dismissal of several of these claims and, in doing so, clarified the pleading standards required for Title VII employment discrimination cases. Specifically, the court addressed the intersection of the *McDonnell Douglas* quartet of cases (which specifically address standards used in employment discrimination cases) and the United States Supreme Court's 2007 and 2009 decisions in *Bell Atlantic Corp. v. Twombly,* 550 U.S. 544 (2007), and *Ashcroft v. Iqbal*, 556 U.S. 662 (2009), which address more general pleadings standards.

McDonnell Douglas and its brethren delineated a relaxed pleading requirement for employment discrimination claims. The Supreme Court has characterized the burden on plaintiffs during the initial phase of litigation "as 'not onerous' and as 'minimal.'"

In *Twombly,* the Supreme Court held that the pleadings "must include 'enough factual matter (taken as true) to suggest [plausibly] that an agreement was made.'" *Iqbal* similarly made clear that plausibility was the touchstone of the analysis, holding that "a complaint must contain sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its face."

In looking at the "interplay" of these two separate lines of cases, the Second Circuit concluded that "*Iqbal*'s requirement applies to Title VII complaints . . . but does not affect the benefit to plaintiffs pronounced in the *McDonnell Douglas* quartet." *Iqbal* requires facts supporting plausibility, but the Second Circuit explained that "the plausibility standard is not akin to a 'probability requirement,' but it asks for more than a sheer possibility that a defendant has acted unlawfully."

Plausibility is less than Probability, but is greater than Possibility.

Possibility < Plausibility < Probability

This standard is applicable to only the initial assessment of whether the plaintiff has pleaded a prima facie case:

> The facts required by *Iqbal* to be alleged in the complaint need not give plausible support to the ultimate question of whether the adverse employment action was attributable to discrimination. They need only give plausible support to a minimal inference of discriminatory motivation.

The court held that Littlejohn's claims met this "plausibility" threshold requirement.

Assessing Retaliation Claims Brought by Human Resources Professionals

The Second Circuit also addressed Littlejohn's unique role as ACS's director of its EEO Office. Littlejohn did not allege she was retaliated against because she complained about treatment she received, but rather because she complained of the preferential treatment white DJJ employees were receiving over African-American and Latino employees during the merger. Importantly, however, Littlejohn's job at the time of these complaints was as director of the ACS's EEO Office, a job in which she was charged with, among other things, investigating discrimination claims. How the role of a particular employee affects whether conduct is a protected activity was a question of first impression for the Second Circuit — specifically, to what extent "an employee's complaints of discrimination are protected activities under the opposition clause when that employee's job responsibilities involve preventing and investigating discrimination within the company or agency by which she is employed."

Defendants argued "that allowing personnel officers to bring retaliation claims under the opposition clause based on complaints lodged in connection with their official duties would create an automatic prima facie case of retaliation for any terminated human resources or EEO employee . . . and could consequently risk embroiling an employer in gratuitous litigation."

The court, however, was quick to note that there is a clear distinction between simply reporting or even investigating discrimination complaints and communicating the personnel officer's "own 'belief that the employer has engaged in . . . a form of employment discrimination.'" While the former is not inherently "oppositional" in nature,

"The facts required by *Iqbal* to be alleged in the complaint need not give plausible support to the ultimate question of whether the adverse employment action was attributable to discrimination. They need only give plausible support to a minimal inference of discriminatory motivation."

the latter is. "[I]f an employee — even one whose job responsibilities involve investigating complaints of discrimination — actively 'support[s]' other employees in asserting their Title VII rights or personally 'complain[s]' or is 'critical' about the 'discriminatory employment practices' of her employer, that employee has engaged in a protected activity under § 704(a)'s opposition clause." Because Littlejohn was complaining about what she believed to be unlawful discrimination regarding the merger — and not simply relaying others' complaints up her chain of command — the court held that she had engaged in protected conduct. ■

Accommodating Religious Dress

On June 1, 2015, the United States Supreme Court handed down a decision clarifying the circumstances under which employees and prospective employees can establish religious discrimination under Title VII of the Civil Rights Act of 1964 ("Title VII"). *See Equal Employment Opportunity Commission v. Abercrombie & Fitch Stores, Inc.*, 135 S.Ct. 2028 (2015).

In this case the Equal Employment Opportunity Commission ("EEOC") brought suit against the retailer Abercrombie & Fitch ("Abercrombie") on behalf of Samantha Elauf, a practicing Muslim woman who wore a black hijab — a headscarf traditionally worn to show modesty — to her job interview. Wearing a headscarf violates Abercrombie's "Look Policy," which prohibits employees from wearing black clothing or "caps." Although Ms. Elauf otherwise received positive reviews, her interviewer allegedly assumed that she wore the hijab for religious reasons despite the fact that she never mentioned her religion or the need for a religious accommodation to the Look Policy. Ultimately, Abercrombie declined to hire her because her headscarf violated the Look Policy. The EEOC claimed this amounted to disparate treatment because Abercrombie failed to make an exception to its Look Policy and hire Ms. Elauf, notwithstanding the retailer's lack of actual knowledge that she wore the hijab for religious reasons.

Title VII prohibits employers from refusing to hire a job applicant "because of" his or her religion, including a religious practice (such as wearing a hijab), when the applicant can be accommodated without undue hardship to the employer. 42 U.S.C. § 2000e-(2)(a), (j). Reversing the Court of Appeals for the Tenth Circuit, the Court held that to succeed on a disparate treatment claim, a job applicant need not prove that the employer had "actual knowledge" of the applicant's need for a religious accommodation but rather only that the individual's need for an accommodation was a "motivating factor" in the challenged employment decision. Put simply, an employer's assumption concerning an applicant's religious practice may not be a motivating factor in an employment decision.

In the wake of this decision, employers find themselves in a "Catch-22." Employers are discouraged from directly inquiring into an applicant's religious beliefs because such inquiries could result in disparate treatment claims; yet if they do not inquire, they are forced to make assumptions as to whether accommodations are necessary or feasible when making employment decisions — a practice barred by the Court's holding. For this reason, employers are advised to take proactive measures to avoid litigation. Below are some tips for getting started:

- **Affirmatively Discuss Policies and Job Requirements With Applicants:** While it is not prudent to directly ask an applicant about his or her religion, it is appropriate, when an interviewer suspects that an applicant may need a religious accommodation, to make company policies and essential job requirements clear and to ask the applicant if he or she believes he or she can comply. This neutral practice places the applicant on notice of the employer's policy and provides the applicant with an opportunity to raise conflicts without the employer directly asking about the applicant's religion during an interview. Should an applicant raise a concern, the interviewer should engage in an interactive process to see whether an accommodation can be reached, and then should document that process in writing.
- **Revise Job Descriptions:** Revise job descriptions to ensure they contain information about

relevant policies and essential job requirements; include a statement that accommodation requests should be made to the employer's Human Resources department. Job descriptions that include this information not only place an applicant on notice of the potential need for an accommodation but also provide him or her with an avenue through which to inquire about an accommodation and relieve the interviewer of the need to respond on the spot to inquiries concerning accommodations.

- **Involve Human Resources:** Human resources professionals tend to be well-versed in equal employment opportunity issues and experienced in handling difficult conversations. It therefore is worthwhile to encourage managers and other employer-interviewers who are unsure how to handle sensitive situations to involve Human Resources rather than address them on their own.
- **Increase Training:** Religion is a difficult subject to discuss under even the most comfortable circumstances. Consider providing interviewers and Human Resources personnel with additional training to address how and when to inquire about religious accommodations during an interview or further along in the hiring process; role-playing these awkward conversations may also help these professionals become more comfortable in real-life situations.
- **Reconsider Image-Based Policies:** While neutral policies that regulate appearances are not per se illegal, they can invite litigation because they single out individuals based on their appearance, which may stem from a religious practice, such as wearing a yarmulke, hijab, or cross necklace or growing a beard. These kinds of policies could also expose an employer to age or disability discrimination claims. Accordingly, employers are encouraged to revisit these policies in the wake of *Abercrombie* and consider whether or not they are truly necessary. ■

New York Court of Appeals Rejects Choice of Law Provision in Nonsolicitation Agreement

The New York Court of Appeals recently declined to uphold a Florida choice of law provision in an employment agreement on the grounds that it violated New York public policy. The case, *Brown & Brown, Inc. v. Johnson*, 25 N.Y.3d 364 (2015), serves as a wake-up call to employers seeking to enforce both noncompetition and nonsolicitation agreements against out-of-state employees.

The plaintiffs in *Johnson,* a Florida-based corporation and its New York subsidiary, sought to enforce a nonsolicitation clause in an employment agreement against a New York employee of the subsidiary who began working for a competitor after plaintiffs terminated her employment. The employment agreement included a choice of law provision that designated Florida law as the governing law.

As a general rule, parties are free to reach agreements regarding contract terms, including choice of law; courts will strike down such provisions only where the foreign law is "truly obnoxious" to New York public policy. The Court found that the defendant met this heavy burden, emphasizing the dichotomy between Florida law governing enforcement of a restrictive covenant, which places a "nearly exclusive focus on the employer's interest," and New York law, which requires courts to balance an employer's interests against the hardship and impact enforcement would have on an employee's livelihood. As a result, the nonsolicitation covenant was found to be overbroad.

In the wake of *Johnson*, employers are encouraged to re-evaluate choice of law provisions in their employment agreements for New York employees in instances where the governing law is significantly different from New York's and to consider revising these provisions. The case

also reminds employers of the importance of coordinating choice-of-law and forum selection clauses. Employers who choose not to do so run the risk of exposing their employment agreements to greater scrutiny by an out-of-state court in the event a noncompetition or nonsolicitation provision is challenged. ■

Positive Development for New Jersey Employers: Discrimination Plaintiff May Face Criminal Prosecution for Theft of Employer's Confidential Documents

The New Jersey Supreme Court recently affirmed an employee's indictment for allegedly stealing confidential documents from her employer to support employment discrimination and retaliation claims. In *State v. Saavedra*, 222 N.J. 39 (2015), the court made clear that employees should take heed before engaging in self-help in order to obtain confidential documents that they think support their case, rather than relying on the discovery process.

Saavedra was indicted for official misconduct in the second degree and unlawful taking in the third degree after she allegedly stole sensitive records, both copies and originals, about students and their families from the North Bergen Board of Education. Saavedra voluntarily dismissed her discrimination suit and then moved to dismiss the indictment. The trial court denied Saavedra's motion and the Appellate Division affirmed the trial court's decision. While the Supreme Court's 6-1 decision left open the possibility that Saavedra could establish an affirmative defense at her criminal trial by demonstrating a claim of right to the documents or some other justification for removing the documents from her employer, the court made clear that employees can face criminal prosecution for taking an employer's documents.

The court rejected Saavedra's argument that her indictment contravened public policy as explained in the New Jersey Supreme Court's decision in *Quinlan v. Curtiss-Wright*, 204 N.J. 239 (2010), which she argued stood for the proposition that an employee is entitled to take confidential documents from an employer for use in employment discrimination litigation and, therefore, criminal prosecution for doing so is barred. The *Saavedra* court stated:

> This court's decision in *Quinlan* did not endorse self-help as an alternative to the legal process in employment discrimination litigation. Nor did *Quinlan* bar prosecutions arising from an employee's removal of documents from an employer's files for use in a discrimination case or otherwise address any issue of criminal law.

To the contrary, the court stated, "[h]ad [Saavedra] chosen to invoke it, the discovery process prescribed by our court rules would have afforded to defendant a fair opportunity to seek documents in support of her case."

The court noted that the presence or absence of a confidentiality policy and the circumstances under which the defendant gained access to the documents are key factors the jury should consider in determining whether an employee has a claim of right to the documents if the charges proceed to trial. This serves as yet another reason for employers to ensure that they have in place confidentiality agreements and policies that clearly prohibit the unauthorized taking of confidential documents. Further, employers should assess the company's safeguards for preventing unauthorized access to physical and digital confidential documents. ■