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Management Update

October 2009

Use of Independent Contractors May Create Unexpected Liability

With a struggling economy, many businesses may be tempted to classify their workers as independent contractors rather than employees because of the benefits this classification provides to employers. For example, many federal antidiscrimination laws do not apply to independent contractors, since they only cover "employees." Additionally, a company may be shielded from certain other types of liability to which it would be subject if the individual was an employee.

Employers should be aware, however, that misclassifying employees as independent contractors can result in litigation and potentially significant legal liability. For example, a federal trial court in Georgia recently ordered an adult entertainment night club to reinstate a group of entertainers that it fired after the workers sued the nightclub. In *Clincy v. Galardi South Enterprises* (N.D. Ga. Sept. 2, 2009), the entertainers filed suit under the Fair Labor Standards Act (FLSA), claiming they were denied minimum wage and overtime payments because the club misclassified them as independent contractors. Additionally, the workers claimed the club retaliated against them by firing them after they filed the lawsuit. The workers asked the court to grant a preliminary injunction ordering the employer to reinstate them and ordering that they and other similarly situated individuals not be adversely affected by participation in the lawsuit.

A party seeking a preliminary injunction must demonstrate "(1) a substantial likelihood of success on the merits of the underlying case; (2) the movant will suffer irreparable harm in the absence of an injunction, (3) the harm suffered by the movant in the absence of an injunction would exceed the harm suffered by the opposing party if the injunction issued, and (4) an injunction would not disserve the public interest." The court found that the workers met these requirements and granted the preliminary injunction, ordering the employer to reinstate them.

As this case demonstrates, courts will closely examine employee misclassification claims, thus it is important that any company who wishes to classify its workers as independent contractors do so only after a careful review of the factors considered by courts and the Department of Labor (DOL) in analyzing whether a worker truly is an independent contractor. These factors include:

- the nature and degree of the alleged employer's control over the manner in which the work is to be performed;
- the alleged employee's opportunity for profit or loss depending upon his managerial skill;
- the alleged employee's investment in equipment or materials required for his task, or his employment of workers;
- whether the service rendered requires a special skill;
- the degree of permanency and duration of the working relationship;
- and the extent to which the service rendered is an integral part of the alleged employer's business.

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Additionally, even if an individual is properly classified as an independent contractor, that person's actions may subject the employer to liability under federal discrimination laws. For example, in *Halpert v. Manhattan Apts., Inc.* (decided Sept. 10, 2009), the Second Circuit held that an employer potentially can be held liable for discrimination by an independent contractor who acts for the employer. In this case, Halpert sued Manhattan Apartments, Inc., under the Age Discrimination in Employment Act (ADEA), claiming the person who interviewed him for a job showing rental apartments told him he was "too old" for the job. Manhattan Apartments claimed it couldn't be liable for these alleged comments because the interviewer was an independent contractor, not an employee.

The Second Circuit disagreed, holding that the ADEA's prohibition on age discrimination applies regardless of whether the employer uses its own employees or independent contractors to interview for open positions. "If a company gives an individual authority to interview job applicants and make hiring decisions on the company's behalf, then the company may be held liable if that individual improperly discriminates against applicants on the basis of age." The court also held that an independent contractor can act as an agent, or an apparent agent, of the company for the limited purpose of interviewing and potentially hiring job applicants while still retaining his independence for any number of other purposes. In this case, the court found that there were factual issues regarding whether the interviewer was acting as the hiring agent or apparent hiring agent for Manhattan Apartments when he interviewed Halpert, or whether he was simply hiring on his own account. Accordingly, the court reversed the trial court's grant of summary judgment in favor of Manhattan Apartments.

As these cases demonstrate, a variety of legal issues may arise with the use of independent contractors. Additionally, courts and the DOL will closely examine a worker's status where a claim of misclassification is raised. If you have any questions about the appropriate classification of workers or other wage and hour issues, please contact the Ford & Harrison attorney with whom you usually work. This article was written by Heath Edwards, hedwards@fordharrison.com, 404-888-3868.

Ninth Circuit Permits In-House Counsel to Proceed with SOX Whistleblower Claims

The Ninth Circuit recently issued its first decision addressing the substantive requirements necessary to establish a claim under the whistleblower protection provision of the Sarbanes-Oxley Act (SOX). *See Van Asdale v. International Game Technology* (9th Cir. August 13, 2009). In overturning the trial court's grant of summary judgment to the employer, the Ninth Circuit relied on the text of the statute and the Department of Labor's (DOL) regulations interpreting the statute.

In this case, the plaintiffs were hired as in-house attorneys for International Game Technology (IGT) in 2001. A couple of years after the plaintiffs were hired, IGT merged with Anchor Gaming. IGT discharged the plaintiffs in 2004. Subsequently, the plaintiffs sued IGT under the SOX whistleblower provision and under state law, claiming they were discharged in retaliation for reporting possible shareholder fraud in connection with IGT's merger with Anchor.

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The SOX whistleblower provision prohibits a publicly traded company from discriminating against an employee for providing information regarding any conduct which the employee reasonably believes constitutes mail, wire, or bank fraud, any rule or regulation of the Securities and Exchange Commission or any provision of federal law relating to fraud against shareholders.

The Ninth Circuit held that the plaintiffs established a prima facie case of retaliation under SOX and that the employer failed to show that it would have taken the same adverse action in the absence of protected activity. Citing the DOL regulations, the court held that the requirements of a prima facie case of a SOX whistleblower claim are: (a) the employee engaged in protected activity or conduct; (b) the named person knew or suspected that the employee engaged in protected activity; (c) the employee suffered an unfavorable personnel action; and (d) the circumstances were sufficient to raise the inference that the protected activity was a contributing factor in the unfavorable action. The court found that the plaintiffs met all of these requirements.

The primary issue in this case was whether the plaintiffs engaged in protected conduct. Relying in part on the decision of the DOL's Administrative Review Board (ARB) in *Platone v. FLYi, Inc.* (Sept. 29, 2006), the court held that to constitute protected activity under the Act, the communications in question must "definitively and specifically" relate to one of the listed categories of fraud or securities violations listed in the Act. The court found that the plaintiffs' statements to their superiors regarding the nondisclosure of certain information prior to the IGT/Anchor merger met this requirement. The court noted that the plaintiffs were not required to "cite a code section" they believed was violated to trigger the protection of the Act.

The court also found that the plaintiffs had a subjective belief that the conduct being reported violated the law and that this belief was objectively reasonable. In reaching this decision, the court emphasized that it was not holding that shareholder fraud actually occurred, only that the plaintiffs reasonably believed that there might have been fraud and were fired for even suggesting further inquiry. "Requiring an employee to essentially prove the existence of fraud before suggesting the need for an investigation would hardly be consistent with Congress's goal of encouraging disclosure."

Further, the court also found that the proximity between the plaintiffs' disclosure of their concerns and their discharges created an issue of fact regarding whether their protected activity was a contributing factor in their discharges. Accordingly, the court reversed the decision in favor of the employer and remanded the case to the trial court for further proceedings.

Employee Who E-Mailed Company Documents to Home Computer Did Not Violate Computer Hacker Laws

The Ninth Circuit recently issued an opinion that demonstrates the importance of implementing clear computer access policies and ensuring that former employees' passwords are deactivated after their employment ends. In *LVRC Holdings v. Brekka* (9th Cir. Sept. 15. 2009), the court held that an employee who e-mailed company documents to his home computer did not violate the Computer Fraud and Abuse Act (CFAA).

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LVRC Holdings operates a residential treatment center for addicted persons in Nevada. Brekka worked for LVRC conducting internet marketing programs, among other duties. At the time he worked for LVRC, Brekka also owned two consulting businesses that obtained referrals for addiction rehabilitation services and provided referrals of potential patients to rehabilitation facilities through the use of internet sites and advertisements.

While Brekka worked for LVRC, he commuted between Florida, where his home was, and Nevada, where LVRC was located. At times, Brekka e-mailed work-related documents from his work computer to his personal computer. While he was employed, Brekka was given an administrative user name and password, which enabled him to access information about LVRC's web site. Brekka left LVRC's employment in September 2003 after negotiations to purchase an ownership interest in the company broke down. According to the court decision, shortly before his employment ended, Brekka e-mailed documents containing the names of the treatment facility's past and current patients to his personal computer.

LVRC subsequently sued Brekka, claiming he violated the CFAA when he e-mailed company documents to his home computer for his own personal business interests and when he allegedly accessed the company's computers after his employment ended. The trial court ruled in favor of Brekka and the Ninth Circuit affirmed this decision.

The CFAA prohibits individuals from accessing a protected computer without authorization. The Ninth Circuit held that Brekka did not access a protected computer without authorization when he e-mailed company documents to his home computer, even if he did so to further his personal business interests rather than to further the interests of the employer. According to the court, when an employer authorizes an employee to use a company computer subject to certain limitations, the employee remains authorized to use the computer even if the employee violates those limitations. The court found that no language in the CFAA "supports LVRC's argument that the authorization to use a computer ceases when an employee resolves to use the computer contrary to the employer's interests." Further, the court held that "nothing in the CFAA suggests that a defendant's liability for accessing a computer without authorization turns on whether the defendant breached a state law duty of loyalty to an employer."

Additionally, the court found no evidence that Brekka logged into the company's computer after his employment ended. Accordingly, the court affirmed the trial court's decision in favor of Brekka.

EEOC Issues Guidance Regarding Waivers in Severance Agreements

The EEOC recently issued guidance directed at helping employees understand waivers of discrimination claims included in employee severance agreements. Although the information provided in the guidance is not new, it is timely as U.S. employers continue to face layoff decisions in the current economic climate.

The guidance provides employees answers, and illustrative case law examples, to frequently asked questions regarding the content, validity, and limitations of severance agreement waivers:

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- What does a severance agreement look like?
- What determines whether a waiver of rights under Title VII, the ADA, the ADEA, or the EPA was "knowing and voluntary"?
- What rights are still available to the employee even if the employer obtains a signed waiver?
- What are the additional requirements for group layoffs of employees age 40 and over?
- What should an employee do when offered a severance agreement?

The EEOC guidance informs employees that "provisions in severance agreements that attempt to prevent employees from filing a charge with the EEOC or participating in an EEOC investigation, hearing, or proceeding are unenforceable." Additionally, the guidance details the statutory requirements for individual and group waivers of age discrimination claims under the Age Discrimination in Employment Act (ADEA), as amended by the Older Workers Benefit Protection Act (OWBPA).

It is important that employers be familiar with all of the requirements of a valid waiver, especially where ADEA claims are involved, since it is likely that savvy employees will familiarize themselves with these requirements. The failure to comply with the OWBPA's requirements can be costly, as illustrated by the case of *Ferruggia v. Sharp Elecs. Corp.*, (June 18, 2009) (reconsideration denied August 25, 2009). In that case, a federal court in New Jersey permitted a former employee to proceed with his ADEA claims even though he signed a severance agreement and general release of claims, which he discussed with his attorney and modified before signing. Under the terms of the severance agreement, Ferruggia received over $98,000 in exchange for the release of all claims he might have arising out of his employment. However, because Ferruggia's discharge arose in the context of a reduction in force, the court found that the waiver was not enforceable because it did not comply with the OWBPA's requirements.

Among other things, the OWBPA requires an employer to provide "the job titles and ages of all individuals eligible or selected for the program [that is, the RIF], and the ages of all individuals in the same job classification or organizational unit who are not eligible or selected for the program." The court rejected the employer's argument that Ferruggia's waiver was knowing and voluntary as demonstrated by the fact that he consulted with counsel (the law firm that filed the discrimination lawsuit), which negotiated on his behalf for more favorable terms in the severance agreement. The court held that the OWBPA's statutory requirements are prerequisites to any other consideration of whether a release or waiver is knowing and voluntary. Accordingly, the court found that the release did not bar Ferruggia's ADEA claims.

Employers should ensure that any severance agreements and waivers meet the requirements of all applicable laws. While the EEOC guidance is mainly directed toward employees, it serves as a helpful compliance tool for any employer offering its departing employees severance benefits in exchange for employment-related liability waivers. Moreover, the EEOC and courts are likely to refer to the guidance when reviewing severance agreements.

The EEOC guidance can be found at: http://www.eeoc.gov/policy/docs/qanda_severance-agreements.html.

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