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# U.S. Employment Law for Global Employers

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# U.S. Employment Law for Global Employers

## **Abstract**

[Excerpt] Companies operating in the United States today face an increasingly complex and ever-evolving maze of federal, state, and local labor and employment laws. This can be particularly daunting for companies new to the United States who are trying to familiarize themselves with these laws. As such, the goal of this guide is to provide an overview of U.S. labor and employment laws to global employers operating in the United States.

## **Keywords**

Baker & McKenzie, employment law, multinational corporations, United States

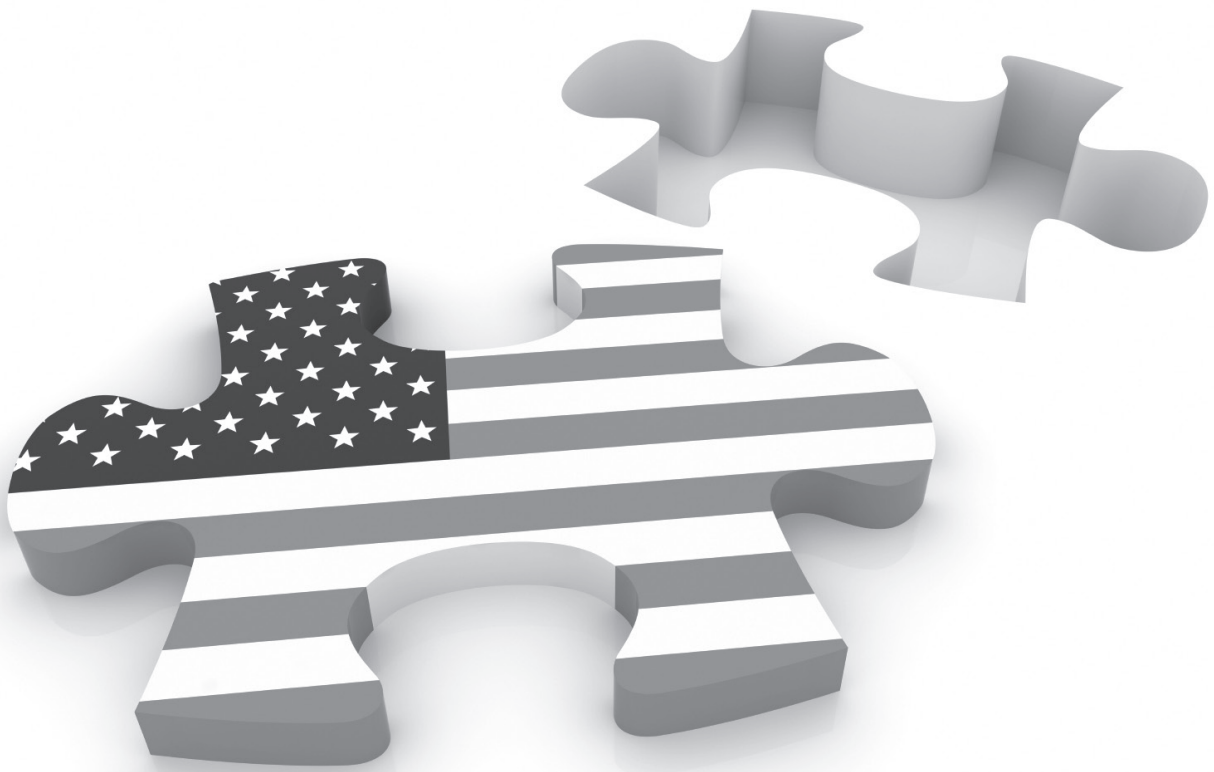
## **Comments**

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# U.S. Employment Law for Global Employers

2011



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## Editors' Note

Baker & McKenzie's North American Compensation and Employment Law Practice Group is pleased to provide you with this complimentary copy of the 2011 edition of the *U.S. Employment Law for Global Employers*.

Companies operating in the United States today face an increasingly complex and ever-evolving maze of federal, state, and local labor and employment laws. This can be particularly daunting for companies new to the United States who are trying to familiarize themselves with these laws. As such, the goal of this guide is to provide an overview of U.S. labor and employment laws to global employers operating in the United States.

Assisting multinational clients with their global operations and employment issues is one of the things we do best. The over 100 practitioners who make up our North America Compensation and Employment Law Practice Group help employers comply with, and successfully navigate, these laws through our well-recognized counseling, transactional and litigation practices. As a result, we are among the top 10 firms U.S. general counsel list most often as “go-to” advisors on employment matters; our practitioners are constantly top-ranked in *Chambers* and *Best Lawyers in America*, among others. With our nine offices in the United States augmented by a global team of more than 500 employment lawyers, we are uniquely positioned to help clients succeed in North America and around the world.


We would like to thank all our talented and dedicated colleagues in the North American Compensation and Employment Law Practice Group who have contributed to this legal guide. Our colleagues in the Employment Counseling and Litigation group have contributed numerous chapters, ranging from the chapters on at-will employment and offer letters to compliance with wage and hour laws, terminating employment and handling litigation challenges. Colleagues in the Employee Compensation and Employee Benefits group have outlined issues relating to U.S. employee benefits and obligations under the Consolidated Omnibus Budget Reconciliation Act of 1986 (“COBRA”). Colleagues in the Global Immigration and Mobility group have advised on U.S. immigration laws. Last but not least, our dedicated colleagues in the Global Equity Services group have advised on equity issues.

To learn more about how we may be able to assist you and your organization, please visit our website at [www.bakermckenzie.com/naemployment](http://www.bakermckenzie.com/naemployment) or reach out to any of the editors or contributing authors.



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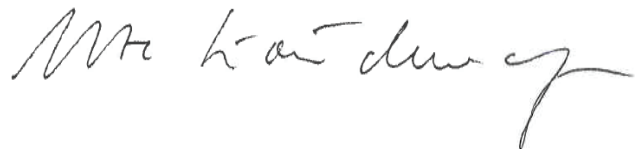
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## Introduction

Doing business in the United States gives rise to a multitude of legal obligations. Employment laws are of particular significance as not only are they likely to be encountered by a company immediately upon commencing business operations in the United States, but also because compliance is heavily regulated. Before turning to specific employment law issues, it is probably helpful to explain some important characteristics of the U.S. legal system as it affects labor and employment laws.

The American legal system is part of the common law tradition (with the exception of Louisiana and Puerto Rico, which follow the civil law tradition). U.S. labor and employment laws derive from a variety of legal sources, that is, constitutional law, statutory law, administrative regulations, and common law (which includes unwritten customs, principles and rules and case law). All these sources are present on different levels, so that labor and employment law provisions can be found in the federal and state constitutions, federal and state statutes, administrative regulations by both federal and state agencies, and case law by both federal and state courts. In some instances, there are municipal laws as well. This presents companies with an often challenging array of legal requirements and obligations that do not always align. In case of a conflict between federal and state law, the law establishing the stricter standard prevails. In case of a conflict that cannot be resolved by applying the stricter standard, federal law preempts state law. This principle cascades through the various levels and sources of law.

For instance, in order to determine minimum wage requirements for its U.S. workforce, a company should not only familiarize itself with U.S. federal wage and hour laws, but also with the laws of the state and municipality in which it operates. This means understanding its obligations under the federal Fair Labor Standards Law and interpretive guidance by the Wage & Hour Division of the U.S. Department of Labor, wage and hour provisions under any state labor code and any orders and guidance issued by state agencies, as well as municipal ordinances, in addition to any case law by federal and state courts. This is just one example of the sometimes unexpected complexities of managing workforces in the United States.

Against this background, the goal of this Legal Guide is to provide an overview of U.S. labor and employment laws for global employers with U.S. operations.



## I. Hiring

The first time companies starting business operations in the United States are faced with U.S. labor and employment laws typically is when hiring employees. Before even getting to drafting employment offer letters, applications or policies, as further discussed in this chapter, foreign companies without registered presence in the United States should keep in mind that one of the first challenges is determining how the company can lawfully, and practically, engage an individual in the United States, taking into account tax, corporate and employment law considerations.

From a tax perspective, the threshold question is: Would the activities in the United States constitute a taxable presence (or “permanent establishment” under an applicable treaty) even if the activities were not conducted through a U.S. subsidiary or branch? If the activities would create a taxable presence (or permanent establishment), then typically the company will decide to, or will be required to, establish a registered local presence (i.e., a branch or subsidiary). If the activities do not create a taxable presence on their own, the non-U.S. head office may consider directly hiring employees in the local country.

From a corporate perspective, the threshold questions are: (i) Is a foreign corporation permitted to conduct the planned activities in the United States, and specifically, the targeted U.S. state; (ii) do the planned activities rise to the level of “doing business” in the United States and/or U.S. state; (iii) what are the legal requirements for qualifying to do business; and (iv) are there commercial, legal or other reasons why it might be desirable to conduct the planned activities from a U.S.-incorporated entity?

From an employment perspective, the company must consider the local legal requirements to employ an individual, including any mandatory benefits requirements imposed on employers. The company will typically need to engage a payroll provider to ensure appropriate withholdings and deductions for income taxes (federal & state) and social security payments are made. Workers’ compensation insurance is a legal requirement as well.

### 1. The Concept of “At-Will” Employment

#### a. The “At-Will” Employment Doctrine

Although the United States has certain statutory worker protection laws, employees generally have relatively limited rights in the context of terminations absent an express employment contract or collective bargaining agreement when compared to many other developed nations. The primary reason for this is a legal concept unique to the United States known as the “at-will” employment doctrine. This doctrine provides that an employer in the United States is free to terminate an employee at any time, without notice and without cause, so long as it is not for an unlawful reason. Similarly, the employee enjoys the right to terminate employment at any time and for any reason. Accordingly, unless specific statutes apply, or contractual obligations exist, employees can be terminated without any financial payments, that is, without notice or pay in lieu, or severance. In essence, “at-will” employees in the United States work at the will of the employer.

The doctrine of “at-will” employment, however, is not interpreted uniformly in all 50 states. Some states interpret the doctrine broadly while others have created exceptions to the doctrine or otherwise restricted its application. The clear trend in the past decade has been to grant additional rights to workers. Thus, the “at-will” employment doctrine is becoming narrower, and as a result, “wrongful termination” litigation has become a fact of corporate life in the United States. Foreign-based companies and their executives must recognize that exceptions to the “at-will” employment doctrine have steadily eroded the doctrine to the point that employers face significant legal risks when terminating employees.

## b. Employment Contracts and Contract-Based Theories

As further outlined in section II chapter 6 on employment contracts, written employment contracts with individuals are relatively rare in the United States except in the context of employment relationships with high level executives or key employees. In this scenario, the written executive contract will often promise employment for a specific duration during which the employee can be terminated only for “good cause,” or the contract authorizes termination under only certain specific circumstances or requires severance. Collective bargaining agreements in the context of a unionized workforce often create similar employment protections with respect to termination. The details of executive contracts and collective bargaining agreements are heavily negotiated.

In addition to such written contracts, the “at-will” employment doctrine can also be superseded by an oral contract. For example, in some states, if a manager verbally assures an employee that he or she will have a job as long as his or her work is acceptable, the manager can create an oral employment contract with the employee to terminate the employee only for “good cause.”

Employers also can be subject to contractual liability to workers under legal theories of promissory estoppel and the covenant of good faith and fair dealing. Courts will invoke the doctrine of promissory estoppel to enforce promises made to employees in the absence of a contract. To recover for promissory estoppel, an employee must show that an employer made a clear oral promise upon which the employee relied to his or her detriment, and that it would be unjust to allow the employer to escape its promise. A typical example of this concept arises where an employer promises a job to an individual who quits his or her present job in reliance on such a promise. The covenant of good faith and fair dealing is a term which courts in some jurisdictions (most notably, in California) imply as a term of all employment relationships. While the covenant of good faith and fair dealing does not impose any duties or limits beyond those contained in the contract itself, the covenant may sometimes be invoked if the employee can establish that his or her “at-will” employment was terminated as a pretext to cheat the employee out of another contract benefit to which the employee was clearly entitled.

In general, in a breach of employment contract claim – whether the contract is express, oral or by promissory estoppel – the employee will seek to be placed in the monetary situation he or she would have been had the employer fully performed on the contract. The employee, however, has a duty to mitigate his or her own damages. Thus, any money an employee earns at a new job after his or her termination is deducted from any breach of contract award.

## c. Federal and State Anti-Discrimination Laws

The doctrine of “at-will” employment is limited by federal, state and/or local anti-discrimination statutes, which are further discussed in section III chapter 2 on discrimination and harassment, and affirmative action. On the federal level, anti-discrimination law is essentially a patchwork of different statutes. Generally, however, the most relevant statutes are: (i) Title VII of the Civil Rights Act of 1964 (“Title VII”), (ii) the Age Discrimination in Employment Act of 1967 (“ADEA”), (iii) the Americans with Disabilities Act (“ADA”), and (iv) the Civil Rights Act of 1991. Title VII prohibits employment discrimination on the basis of race, color, religion, sex, national origin, pregnancy, childbirth, or related medical conditions. As their titles suggest, the ADEA and the ADA prohibit discrimination based on age (40 and over) and disability, respectively. And, finally, the Civil Rights Act of 1991 provides a federal remedy to employees or applicants alleging racial discrimination and/or harassment in employment.

Title VII, the ADEA, and the ADA apply to all terms and conditions of employment – from the time of hire to an employee’s termination, and virtually all aspects of employment in between. These federal statutes apply to all but the smallest employers, as only companies with fewer than 15 employees in the

United States are generally exempt from these laws. With only minor exceptions, Title VII, the ADEA, the ADA, and the Civil Rights Act of 1991 also apply to foreign-based employers operating in the United States on the same terms as domestic companies.

Almost all states in the United States have employment discrimination / harassment prohibitions that mirror federal law. Moreover, some states provide greater protection than Title VII, the ADEA, the ADA, and/or the Civil Rights Act of 1991. For example, some states expand upon the protected categories set forth by federal law by prohibiting discrimination and/or harassment on the basis of marital status or sexual orientation. In addition, some state laws apply their state employment discrimination / harassment statutes to smaller employers (i.e., less than 15 employees) who are otherwise exempt from federal laws. Further, some local governmental entities add extra layers of ordinances prohibiting discrimination and/or harassment. Therefore, in major metropolitan areas in the United States, it is not uncommon for three sets of laws – federal, state, and local law – to prohibit employment discrimination and/or harassment due to the worker’s status in any of the listed categories.

## **2. Advertisements and Job Postings, Job Descriptions**

Employers in the United States recruit employees through a variety of methods, including job postings and advertisements. There are many sources for recruiting qualified applicants, such as online forums, advertisements in newspapers, employment agencies, employee referrals, educational institutions, and community organizations. Employers should take into account whether the chosen recruiting method(s) discourages diversity among its workforce. Therefore, an employer may wish to consider using several different recruitment agencies or methods to ensure a diverse applicant pool, especially if the majority of the workforce is recruited informally via word of mouth invitations. All recruitment agencies or employment agencies used by an employer should comply with requirements under the ADA and other equal employment opportunity requirements.

Job descriptions and advertisements should not contain any references to physical or mental capabilities and other protected characteristics. Employers should use gender neutral descriptors such as “police officer” instead of “policeman.” Terms that indicate an age preference such as “youthful,” “young,” “recent graduate” should be avoided as employer discrimination based on age can violate the ADEA. Employer advertisements should include an Equal Employment Opportunity (“EEO”) statement and indicate essential job functions.

## **3. Employee Applications**

Employment applications are extremely important documents and often are the most crucial documents in employment-related lawsuits. Therefore, employers should follow the guidelines below and review applications periodically to ensure that all questions posed in an application are lawful.

Most importantly, all questions on an employment application should be job-related. Any non-job related questions in an application or employment interview could form the basis of a lawsuit if they elicit improper information. For instance, an employment application should not contain any medical questions nor questions about prior workers’ compensation injuries. The application should contain a statement that the application itself is not an offer of employment nor a contract, as well as a statement that the employer is an “at-will employer” (if this is indeed the case). The application should indicate a specific time frame for how long the application will be considered active (e.g., four weeks, six weeks, six months). Limiting the time for actively considering applications may serve employers as a defense against claims of continuing discrimination.

Applications may include:

- Requests for general information such as name, address, telephone number, confirmation of legal minimum working age, and the job sought;
- A statement regarding proof that the applicant will be legally authorized to work in the United States when employment commences (which must be confirmed within three days of the employee's commencement of work by completion of a form referred to as I-9) (also see under section III chapter 9 on immigration for further information on U.S. immigration requirements);
- Prior work experience, including names of previous employers and supervisors, wages and rates, job titles and descriptions, and the reason for leaving;
- Educational background, including high school and colleges attended (but *not* the dates due to age discrimination concerns), any degrees and or licenses obtained;
- Military experience relevant to the position sought (employer may ask whether applicant was dishonorably discharged, but should include a statement that a dishonorable discharge will not necessarily preclude a job offer, but that the employer will consider the facts relevant to the discharge);
- Other information as relevant to the position sought, including necessary licenses or certificates, languages spoken, computer skills.

Furthermore, an employment application should not contain any questions which tend to identify any protected category of the applicant, such as the applicant's race, sex, age, religion, disability, national origin, marital status, etc. (see under section II chapter 2 for further information on discrimination and harassment, and affirmative action). An employer should not write anything on the application that would identify these characteristics, even if it is volunteered by the applicant. Questions on an employment application form should be considered from the employer's perspective (what is the motivation for asking the question) and the employee's perspective (how will the employee perceive the question). Employers should ask themselves whether the questions tend to have a disproportionate effect in screening out minorities, females or other protected categories; whether the information is necessary to judge the applicant's competence for performance of this particular job; and whether there are alternative nondiscriminatory ways to secure the necessary information.

Employers ought to implement a formal application procedure and require all applicants to formally apply for any open positions. All individuals hired should be required to fully complete the employer's application form prior to being offered a position. Applicants should sign the application, attest to the truth of the information, and authorize employers to perform a background check (see under section II chapter 4 for further information on background and reference checks). Employers should also make the application format accessible for visually impaired and mobility impaired individuals, such as by offering individuals to assist in physically completing the applications as needed.

#### **4. Background and Reference Checks; Drug Testing**

When compared to many non-U.S. jurisdictions, the United States provides the employer relative leeway in conducting background and reference checks on prospective employees. There are, however, numerous restrictions on how such checks are conducted, as briefly outlined below.

##### **a. References from Former or Current Employers**

Potential employers who wish to obtain references from former or current employers should include in their application form an authorization whereby the applicant agrees to allow the potential employer to check references. This statement should include language releasing the potential employer from any liability resulting from obtaining, using, or later disclosing the former or current employer reference.

Such a release, however, is not necessarily effective and thus, employers are advised to reduce the risk of liability by only seeking and/or providing an employee's title and employment dates.

## **b. Background Checks**

The federal Fair Credit Reporting Act ("FCRA") applies when an employer obtains a background check from a "consumer reporting agency" regarding an applicant when the background information sought by the employer is either a "consumer report" or an "investigative consumer report." Some states within the United States have background check or credit history check restrictions that mirror, and in some cases provide greater protection than, federal law.

The FCRA defines "consumer reporting agency" as any person or entity who regularly engages in the practice of assembling or evaluating, among other things, background or credit information on individuals for the purpose of providing that information to third parties, such as employers. Examples of "consumer reports" include criminal background checks, motor vehicle reports and driving records, credit history reports and general background reports. Examples of "investigative consumer reports" include reference checks and other types of personal interviews. Accordingly, based on these definitions, the FCRA arguably does not apply to employers who conduct reference checks for themselves and do not rely upon third parties. Employers should be aware, however, that some states have certain state level restrictions which apply even under such circumstances.

An employer who obtains and uses a consumer report or investigative consumer report from a consumer reporting agency must comply with several procedural requirements: (a) notice of intention to obtain report; (b) applicant's authorization; (c) employer certification of compliance; (d) employer obligation to provide applicant with a copy of the report; and (e) employer obligations when employment is denied on the basis of a report (also see section III chapter 9 below).

## **c. Drug Testing of Applicants**

Testing applicants or employees for drug use invokes a controversial area of policy and law that is still establishing its parameters in the United States. Employers who wish to drug test their applicants or employees must take care not to impose drug testing in a manner that may violate personal or constitutional rights, such as privacy rights or protections against unlawful disability discrimination. While drug testing is permitted in most states, it is not typically mandated. For those employers who implement drug testing programs, it is imperative that the programs follow state and federal guidelines in order to ensure protection of employee rights.

The Drug-Free Workplace Act of 1988 applies to all federal procurement contracts of \$100,000 or more and provides that no government contract will be awarded unless the prospective contractor certifies to the government agency that it will maintain a drug-free workplace. The Act also applies to recipient of federal grants of any amount. Although the Act furthers the goal of eradicating drug use in the workplace, it does not specifically authorize employee or applicant drug testing. Many state and local governments have adopted similar drug-free workplace programs under state and local laws.

Finally, under some state constitutional provisions and state or local laws, persons have a fundamental right to privacy of their person and property. Drug testing, although in itself deemed legal, may be subject to constitutional or privacy challenges if testing results are indiscriminately divulged, if procedures for obtaining personal specimens do not respect the privacy rights of the person, or if testing is unnecessarily or excessively imposed.

To help defend against employee or applicant claims for drug testing, employers should obtain written consent before testing for drugs. Although a consent may be challenged as obtained under duress, it provides the employer with at least some evidence that it had the employee's prior approval. Also, a consent can specify the consequences to the employee if he or she does not consent. In addition, many states have enacted laws requiring that such prior consent be obtained by the employer.

## **5. Offer Letters and Proprietary Information Agreements**

### **a. Offer Letters**

Unlike in most jurisdictions outside the United States, employees in the United States are generally presumed to be "at-will" (see under section I chapter 1 on the concept of "at-will" employment). Further, U.S. employees are automatically covered by federal and state common law and statutory entitlements and protections. Therefore, a written employment contract (see under section I chapter 6 on employment contracts) is not required. Instead, for most employees, a simple offer letter memorializing the basic terms of employment is sufficient and recommended. In fact, it is common practice for U.S. employers to use a simple offer letter rather than a formal employment contract that is typically used outside the United States, especially for employees below the executive level.

Generally, such offer letters are one to two pages in length and, when used, it is a best practice (where applicable) to reiterate that the individual's employment is "at-will" in such documents. Under U.S. law, there is no mandatory employment verbiage nor required terms for an offer letter. In fact, an employment relationship can also be created orally. U.S. employers, however, typically memorialize terms related to the employee's job title, start date, base compensation, bonuses or other incentive payments (including commissions and equity awards), and any employee benefits, vacation, sick-leave or paid-time-off (if provided). In addition, those terms and other provisions relating to the company's intellectual property (including confidentiality), prohibition of discrimination and harassment, and other personnel policies may also be stated in separate, stand-alone agreements (e.g., Proprietary Information and Inventions Agreement ("PIIA"), sales incentive plan, etc.), or in an employee handbook (see under section I chapter 7 on handbooks and policies).

Some states, however, may have more specific requirements. In California, for example, a written employment agreement (i.e., offer letter or more formal employment contract) is mandatory for employers without a permanent and fixed place of business in California who pay commissions for work performed within the state (which agreement must set forth the method by which the commissions shall be computed and paid).

### **b. Proprietary Information and Invention Agreements**

An important component of the employment relationship is ensuring protection of the employer's intellectual property. While various laws protect against misappropriation of trade secrets and proprietary information, many U.S. employers prefer to spell out the employee's confidentiality obligations in a written agreement. Unlike in many countries outside the United States, the common practice in the United States is to provide employees with a stand-alone PIIA, which will be presented with the offer letter. This stand-alone agreement should: (i) restrict the improper disclosure and use of confidential and proprietary information both during employment and after employment ends; and (ii) assure that ownership of any intangible rights that may be developed by the employee in the course of employment will remain and/or vest with the employer. This is obviously particularly important if the U.S. company is or will operate in a technical field and employee inventions can be expected.

A well-drafted PIIA typically contains a broad definition of proprietary information covered by the agreement, including all information about the company’s current and planned products, marketing, forecasts, pricing, customer lists, and other confidential information of the employer. The PIIA should also:

- prohibit the use or disclosure of proprietary information during and after employment;
- assign to the company all inventions developed by the employee that can be legally assigned, and require the employee to identify any inventions not subject to the agreement;
- prohibit an employee from engaging in competitive employment during employment without permission; and
- contain verbiage reiterating “at-will” employment (if applicable).

Some PIIAs also include verbiage regarding non-competition and solicitation of employees or customers for a specific period after employment. However, the permissibility of various types of post-termination restrictions varies from state to state (see section IV chapter 6 below on restrictive covenants).

A PIIA that assigns an employee’s rights in an invention to the employer should exclude certain inventions developed entirely on the employee’s own time, and must provide notice of these rights at the time the agreement is made. In California, this verbiage must track California Labor Code Section 2870 for the assignment of intellectual property to be effective.

The PIIA preferably should be executed before the new employee starts work. If the PIIA is executed after the employee commences employment, the assignment of intellectual property will not be retroactive to cover any inventions created during the period between the commencement of employment and the date the employee executed the PIIA.

## **6. Employment Contracts**

Written employment agreements are generally not required in the United States, unlike in many non-U.S. jurisdictions. Individual written employment contracts are optional, and typically are not used for middle management and lower level employees. Instead, as mentioned above, it is common to use a short “at-will” offer letter with these employees (see under section I chapter 5 on offer letters above). Employment contracts are more commonly used for high level executives or key employees, such as when an executive has negotiated specific terms and conditions of employment that are not otherwise present in an “at-will” employment relationship.

A key exception to the “at-will” employment doctrine is a contract limiting the absolute right of the company and the employee to end the employment relationship. Thus, the company and an employee may negotiate an employment contract that places limits on the circumstances in which employment may be terminated. Such a contract may be for a specific duration (for example, providing term employment for two years) or may provide that employment can be terminated only for “good cause” or “just cause.” The contract may contain specific provisions that authorize the circumstances of a termination, such as a change in control of the company or an act of gross misconduct by the employee. The contract may also set forth detailed compensation and severance provisions.

In general, an employer that breaches an individual employment contract may be liable for the amount of damages that would place the employee in the same monetary situation in which he or she would have

been had the employer fully performed the contract. Employees also have a corresponding duty to mitigate their own damages. Thus, any money an employee earns at a new job after his or her termination (or reasonably could have earned with a reasonable job search or other mitigation efforts) may be deducted from any breach of contract award.

For those U.S. employers that have unionized workforces, different laws govern the employment contracts of employees who are represented by labor unions. Unionization is a voluntary process that is governed by federal labor law. If a particular workforce in the United States is unionized, the company and the union will negotiate and enter into a collective bargaining agreement that sets the terms of employment for all employees in the bargaining unit the union represents. Violation of federal collective bargaining laws may lead to “unfair labor practices” charges, for which the legal exposure can be quite severe. That said, the great majority of employees in the United States do not participate in collective bargaining through labor unions.

## **7. The Role of Personnel Policies and the Essentials of Any Employee Handbook**

Most U.S. employers adopt and utilize personnel policies to govern their employment relationships with their workforce. Most often, these policies are set forth in an employee handbook that is distributed to each employee and is available on the employer’s computer network.

Foreign companies operating in the United States should recognize that personnel policies prevent and minimize employment law liabilities, put employees on notice as to what is expected of them, give employers more discretion and ability to terminate employees who do not follow the company’s rules and expectations, enable employers to treat employees in a fashion which workers regard as more fair and just than if personnel policies were unwritten, and help courts and juries accept an employer’s disciplinary decisions more readily when such policies provide clear rules and procedures. Some U.S. employment laws require the posting of notices or the adoption of policies. For example, government contractors must adopt an EEO policy (see section III chapter 2 on discrimination and harassment and affirmative action below).

Well-drafted, personnel policies serve as defensive mechanisms to help employers control or minimize employment-related exposures and should be viewed as loss-prevention and risk-management devices. Personnel policies appropriate at one company may not be appropriate at another company, but the policies discussed herein should be considered by all employers in order to reduce employment related liabilities.

### **a. Equal Employment Opportunity Policy**

It is important that the employer and any executive or supervisor administering personnel policies adhere to the principle of equal employment opportunity.

All employees should be judged on the merits of their performance and experience, and not on such factors as their sex, age, national origin, religion, race, disability, or other legally protected categories under federal, state or local laws. To that end, every employer should have and follow an EEO policy. When defending an employee-initiated lawsuit, the absence of an EEO policy is particularly suspect and can work to the disadvantage of the employer.



## b. No Harassment Policy and Complaint Procedure

There has been a phenomenal increase in the volume of workplace sexual harassment complaints over the last few years. Court decisions and the Equal Employment Opportunity Commission's ("EEOC") policy guidance memorandum on sexual harassment make clear that an employer cannot mount a viable defense to such complaints unless it has an anti-sexual harassment policy and complaint procedure and that such policy be thoroughly disseminated and rigorously enforced. Moreover, the harassment policy should cover other protected categories such as race, color, religion, age, national origin, disability, retaliation or any other categories protected by federal, state or local laws.

## c. Reasonable Accommodation Policy

The most noteworthy feature of the ADA and its amendments effective January 1, 2009, is that employers are required to provide affirmative help to disabled applicants and employees. In legal terms, that obligation is called the "duty of reasonable accommodation" unless such accommodation would pose an undue hardship on the employer's business or pose a direct threat to the health and safety of the employees. To that end, the personnel policies of any company should include a reasonable accommodation policy which will put all employees on notice that the employer is committed to providing reasonable accommodations to anyone with a disability who asks for one. Such policy also provides management with the correct decision-making process when confronted with a request by an employee for a reasonable accommodation. Since the policy places the burden on employees to ask the employer for a reasonable accommodation on a timely basis, it should help the employer defeat any belated claim by a terminated employee or rejected applicant that the company should have provided them with an accommodation.

## d. Confidentiality Policy

Certain types of business data, company strategies, and other information in the workplace are often confidential. Many companies utilize personnel policies in the workplace to require employees to treat this information on a confidential basis and not to provide such information to any unauthorized recipients. Some employers have employees sign confidentiality agreements (see chapter I section 5 on offer letters and proprietary information agreements above). These mechanisms make it easier for companies to enforce their rights to keep internal business information confidential or to discipline workers for breaching the obligation to keep the company's information secret. These policies need to be carefully drafted so as not to restrict employees from engaging in "protected activities," as defined in the National Labor Relations Act of 1935 ("NLRA").

## e. "At-Will" Employment

Companies should endeavor to maintain an "at-will" employment arrangement with most of their employees to assist in defending a claim by a terminated employee for an alleged breach of contract. This can be achieved with a clear and unequivocal policy which informs all employees of their "at-will" employment status at the time of their hiring and when personnel policies are disseminated to employees. Such policy should assert the employer's right to interpret and enforce all rules and personnel policies in the sole discretion of management.

## f. Ethics Policy

In general, employers have no right in the United States to regulate or monitor the off-duty conduct of employees unless the conduct is somehow work related or damaging to the company's business. An ethics policy gives management the discretion to discipline employees who engage in behavior which damages the company's reputation with its employees, customers, or the public. Such policies need to be

carefully drafted since all the types of specific conduct which might damage the company cannot be anticipated, but at the same time, the policy should not restrict employees' freedom of speech or any rights they have to engage in protected activities under the NLRA.

#### **g. Religious Accommodation Policy**

Employers have an affirmative obligation to accommodate the religious observances of their employees unless it creates an undue hardship. This obligation comes into play in the workplace in many situations, but most often in the case of religious holidays. Most employers in the United States have a set schedule of holidays which includes such holidays as New Year's Day, Memorial Day, July 4th, Labor Day, Thanksgiving, and Christmas. An employer should have a policy that creates a mechanism for persons to seek time off for observing other religious holidays (Islamic, Seventh Day Adventist, Jewish, etc.). Such policy will place the burden on employees to notify the employer if a religious accommodation is needed and in the absence of such a request makes a subsequent lawsuit over alleged religious discrimination easier to defend.

#### **h. Family and Medical Leave and Other Leave of Absence Policies**

Federal and state laws in the United States govern several types of leave of absence rights (see section II chapter 4 on vacation and leaves of absence). An employer should have a personnel policy that describes its basic leave policies and the specific requirements employees must follow to affirmatively seek a leave of absence. This will also provide a company with an appropriate method for responding to requests from employees for a leave of absence.

#### **i. Open Door/Grievance/Complaint Procedure Policies**

Employers should have a procedure whereby employees can raise and resolve work-related grievances or complaints, such as those involving their treatment by supervisors and co-workers, their pay disputes or problems with other working conditions. Some of the advantages of such policies are that a grievance can be identified immediately and resolved promptly before it escalates into a problem causing a worker to seek legal advice or file a lawsuit; an employee's written grievance serves as a contemporaneous record of their problem which locks the worker into a certain version of the story; and the absence of such complaint or grievance often helps to effectively defend subsequent employee-initiated lawsuits.

#### **j. No Solicitation/No Distribution Rule**

Employers often have trouble keeping employees from soliciting for non-work related matters or distributing non-work related matters while at work. Frequently, no solicitation/no distribution rules are drafted and/or applied so broadly that they violate the NLRA (see section II chapter 8 on unions and labor laws relevant to non-union workplaces below).

Solicitation refers to spoken communications and includes an employee being asked to buy a product, tickets to a charity event or to sign a union membership application or an authorization card. Distribution involves giving out handbills, pamphlets, letters, papers, etc.

Generally, an employer can prohibit an employee from soliciting and/or distributing non-work related materials during work time or the work time of the employee receiving the solicitation or distribution. "Work time" does not include the duty free time employees have such as lunch periods, rest periods or before and after work. An employer can also prohibit employees from distributing non-work related items in work areas at any time.

Solicitation and distribution by non-employees (i.e., outside companies and vendors) can be prohibited on the employer's property at all times.

In most cases, the no solicitation and no distribution rules must apply equally to all outside organizations and to all non-work related matters, otherwise they cannot be used to restrict union organizing activity.

#### k. Restricting Use of Employer's Equipment

An employer may limit its employees' use of company property, so long as the restrictions are non-discriminatory (see section II chapter 9 on employee monitoring and data protection). An employer may not prohibit a union or employees supporting a union from using company property for protected purposes if it allows other outside groups or employees to use such property for non-work related activities. Traditionally this rule applied to such things as telephones, bulletin boards and copy machines. However, as e-mail and other electronic forms of communication infiltrate the workplace, employers are forced to address new issues. Also see under section II chapter 9 on employee monitoring and data protection.

## 8. Codes of Business Conduct and Ethics

In general, there is no requirement for a foreign entity opening in the United States to have a code of conduct (also known as a code of ethics). However, under the Sarbanes-Oxley Act ("SOX"), companies traded on national U.S. stock exchanges (directly or as an ADR, i.e., American Depositary Receipt), must have a code applicable to at least their senior financial officers, principal financial officer and comptroller or principal accounting officer, or persons performing similar functions. Such code must promote:

- “(1) honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
- (2) full, fair, accurate, timely, and understandable disclosure in the periodic reports required to be filed by the issuer; and
- (3) compliance with applicable governmental rules and regulations.”

The audit committee must also permit anonymous, confidential reports through a whistleblowing hotline regarding questionable accounting or auditing matters, which is also normally addressed in the code. In addition, various stock exchanges, such as NASDAQ and the New York Stock Exchange ("NYSE"), have additional requirements for the code. For instance, NASDAQ requires the SOX-compliant code to also apply to all directors, officers and employees, and have an "enforcement mechanism." The NYSE requires listed companies to post their code on the company's website and cover certain additional topics.

Finally, many state and federal contractors are required to adopt a code of conduct.

In practice, codes of conduct often cover topics beyond what would be required. Codes often include the following topics:

1. Introduction
2. Observing Laws and Regulations
3. Disclosure and Financial Reporting

4. Maintaining Accurate and Complete Company Records and Internal Controls
5. Insider Trading
6. Antitrust / Anti-Competition
7. Fair Dealing
8. Avoiding Conflicts of Interest
9. Corporate Opportunities
10. Use of Company Assets
11. Protecting Confidential Information
12. Bribes and Kickbacks to Government Officials
13. Non-Governmental Bribes and Kickbacks, including Gifts, Gratuities and Entertainment
14. Compliance with Applicable Export Controls
15. Anti-boycott Laws
16. Political Activity
17. Environment, Health and Safety
18. Mutual Respect
19. Reporting of Suspected Violations
20. Waiver

Because codes are rules of conduct for which employers hold employees responsible, codes have employment and labor law consequences, and therefore require consultation with trade unions in the United States, if any. While the existence of hotlines triggers data privacy implications in some non-U.S. jurisdictions, to date the existence of a hotline does not trigger data privacy obligations in the United States. U.S. data privacy laws should be considered, however, before undertaking electronic or other forms of employee monitoring or surveillance flowing out of code violations (see under section III chapter 9 on employee monitoring and data protection).

## **9. Immigration**

United States law provides many solutions to help employers of foreign nationals. These range from temporary nonimmigrant visas to permanent immigrant visas. Often, more than one solution is worth consideration. Requirements, processing times, employment eligibility, and benefits for accompanying family members vary by visa classification.

Border protection activity by the Customs and Border Protection agency (“CBP”) and enforcement of immigration-related laws that impact employers and foreign nationals by the Immigration and Customs Enforcement agency (“ICE”) increased significantly after September 11, 2001. Employers of foreign nationals unauthorized for such employment are increasingly subjected to civil and criminal penalties at both the federal and state level. The global economic downturn only heightened concerns about the impact of foreign workers on the American labor market and identity theft, precipitating greater enforcement directives by Department of Homeland Security. Employers should not rely on past practices for continued success.

The current administration shifted the emphasis in worksite enforcement from illegal workers to the employers who hire them. Enforcement is not limited to ICE audits. The Citizenship and Immigration Services agency (“CIS”) has demonstrated a pattern of increased scrutiny in its adjudication of L-1 petitions. CIS has also conducted unannounced on-site visits to employers with the purpose of confirming the validity of the H-1B or L-1 work authorization. In the current environment, a company-wide immigration compliance program should be a top priority.

The heightened scrutiny of nonimmigrant visas, as well as the limited supply of immigrant visas for professionals (especially those born in India and China), makes it increasingly important for employers to consider alternative strategies.

Employers involved in mergers, acquisitions, reorganizations, etc., must also evaluate the impact on the employment eligibility of foreign nationals when structuring transactions. Due diligence to evaluate the immigration-related liabilities associated with an acquisition is especially significant as enforcement activity increases.

## a. Business Travel

### B-1 Business Visitor Visa

Foreign nationals coming to the United States on short-term business trips may use the B-1 business visitor visa. The B-1 authorizes a broad range of commercial and professional activity in the United States, including consultations, negotiations, business meetings, conferences, and taking orders for goods made abroad. Employment in the United States is not authorized.

B-1 visa applications are processed at U.S. consular posts abroad. They are valid for a fixed amount of time – generally ten years – and may be valid for multiple or a specified number of entries. The CBP officer at the port of entry makes the determination of whether to admit and for how long.

The permitted length of stay is up to six months, with the possibility of stay extension applications for up to six months – although not generally granted – or a change to another visa status. An accompanying spouse and unmarried, minor children can be admitted under the B-2 tourist visa.

This visa requires proof of the applicant’s nonimmigrant intention to depart the United States, financial ability to stay in the United States without seeking unauthorized employment, and the business purpose of the trip. A departure ticket is recommended.

### Visa Waiver

The normal requirement of first applying to a consular post for the B-1 and B-2 visas is waived for foreign nationals of certain countries. The permitted scope of activity is the same as the B-1 and B-2 visas. The length of stay is up to ninety days only, without the possibility of a stay extension or status change. A departure ticket is required.

The following countries are presently qualified under this program: Andorra, Australia, Austria, Belgium, Brunei, Czech Republic, Denmark, Estonia, Finland, France, Germany, Hungary, Iceland, Ireland, Italy, Japan, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, Monaco, the Netherlands, New Zealand, Norway, Portugal, San Marino, Singapore, Slovakia, Slovenia, South Korea, Spain, Sweden, Switzerland, and the United Kingdom.

The list of qualified countries changes regularly and the updated list can be found at [travel.state.gov/visa/temp/without/without\\_1990.html#countries](http://travel.state.gov/visa/temp/without/without_1990.html#countries).

Foreign national travelers coming to the United States under the Visa Waiver Program must first register on the Electronic System for Travel Authorization (“ESTA”). The free electronic system determines a foreign national’s eligibility to travel to the United States under the Visa Waiver Program. If ESTA authorization is not granted, the foreign national must obtain a nonimmigrant visa from a U.S. Embassy or Consulate before traveling to the United States.

## b. Training

### J-1 Exchange Visitor Visa

The J-1 exchange visitor visa is used for a number of different purposes, including on-the-job training. The purpose is to allow foreign nationals to receive training that is not otherwise available in their home country and that will facilitate their career when they return abroad, while at the same time affording the opportunity for them to more generally exchange information with people in the United States about the two countries. A detailed training program is required.

J-1 training must be administered by a State Department authorized program, but all of the training itself is generally provided by the sponsoring U.S. company. Compensation for training is not required, but is permitted. This visa requires proof of the applicant’s nonimmigrant intention to depart the United States, financial ability to stay without seeking unauthorized employment, and the business purpose of the trip. The length of stay for such training assignments can be for up to eighteen months, including all possible extensions. The spouse and minor, unmarried children may be issued J-2 visas. The J-2 spouse may apply for employment authorization after arrival.

Some, but not all J-1 and J-2 exchange visitors are subject to a requirement that they return to their home country for at least 2 years at the end of the J-1 training before being eligible to immigrate or return to work under certain nonimmigrant visas. The country of residence, field of training, and source of any government funding for the training can give rise to this requirement, which often can be waived.

### H-3 Trainee Visa

The H-3 nonimmigrant visa is designed for foreign nationals coming for training that is not available in the trainee’s own country and that will benefit the trainee’s career abroad. H-3 trainees cannot engage in productive employment, unless merely incidental and necessary to the training. They cannot be placed in a position that is in the normal operation of the business and in which local workers are regularly employed.

In practice, H-3 visa requests are more readily granted for formal, classroom-type trainings and are more likely to be denied when an on-the-job training element is included, regardless of statements that such work may be incidental and necessary. A detailed training program is required.

The maximum duration for such training is two years. The spouse and unmarried children under the age of 21 may be issued the H-4 visa.

Although the H-3 visa does not impose specific compensation requirements, low salaries are sometimes criticized for the possibility of exploiting foreign labor, while high salaries can be criticized for possibly indicating productive labor. This visa requires proof of the applicant's nonimmigrant intention to depart, financial ability to stay without seeking unauthorized employment, and the business purpose of the trip.

#### B-1 Visa in lieu of H-3

Foreign nationals may be admitted to participate in H-3 type training programs using the B-1 visa, provided that they have been customarily employed by and will continue to receive a salary from the foreign company. The requirements and permitted activities are unchanged, but the duration is reduced to visits of up to six months. Otherwise, the B-1 visa comments provided earlier apply equally here.

### c. Employment Assignments

#### L-1 Intracompany Transfer Visa

Multinational companies seeking to temporarily transfer foreign employees for assignment to U.S. operations most often rely on the L-1. This visa is initially valid for assignments of up to three years, and can be extended in two-year increments for a total period of five or seven years, depending upon the nature of the U.S. job duties. Executive and managerial-level employees can hold L-1A status for up to seven years, whereas employees working in a capacity involving specialized knowledge have a maximum stay of five years under L-1B status.

The spouse and unmarried children under the age of 21 may be issued the L-2 for the same period. The L-2 spouse may apply for employment authorization after arrival.

Qualified foreign nationals must have been outside the United States for at least 12 months during the three years immediately preceding the L-1 visa request and during that period employed by the U.S. petitioning employer or a company with a qualifying intra-company relationship. There are a number of relationships that qualify, but all generally rely on common majority control (*e.g.*, parent-subsidiary, subsidiaries of a common parent, branch or representative office). The intra-company relationship need not have existed throughout the period of required employment.

Executive and managerial-level employment is generally shown through the management of subordinate employees or through the management of an essential function within the organization. Employment in a specialized knowledge capacity requires proof that the employee holds knowledge of the organization's products, services, research, equipment, techniques, management, *etc.*, or an advanced level of expertise in the organization's processes and procedures.

Additional rules apply to companies during the first year of business operations in the United States and to those who intend to place the foreign employee at a job site not controlled by the sponsoring employer (*e.g.*, outsourcing).

Large multinationals may take advantage of special "blanket" L-1 rules for faster government processing.

#### H-1B Specialty Occupation Visa

U.S. employers of foreign professionals have long relied on the H-1B visa. Status is initially valid for up to three years, with extensions in three year increments available for up to six years total stay. A potentially unlimited number of extensions beyond the six years may also be available to qualified H-1B

visa holders in the immigration process. The spouse and unmarried children under the age of 21 may be issued the H-4 for the same period.

The job offered must be in a specialty occupation, which are jobs that normally require at least a bachelor's degree in a specific field. The foreign national must hold the required degree from an American university or its equivalent. Foreign degree, employment experience, or a combination may be considered equivalent.

Employers must promise to give H-1B professionals wages, working conditions and benefits equal to or greater than those normally offered to similar employed workers in the United States. A strike or labor dispute at the place of employment may impact eligibility. Detailed recordkeeping requirements apply and government audits to ensure compliance are authorized.

Recently enacted legislation also places new recruitment and non-displacement requirements on recipients of Troubled Assets Relief Program ("TARP") funds seeking to hire H-1B employees. These provisions, primarily affecting institutions in the financial sector, have been in effect starting February of 2011.

Only a limited number of new H-1B visa petitions can be granted each fiscal year. Historically, the limited supply has been quickly exhausted. In recent years, the annual quota has been reached within the first day of the filing period. Perhaps as a result of the more stringent requirements for TARP recipients and the poor state of the economy, the annual quota for new H-1B visa petitions remained open for many months in fiscal year 2010 and the same is expected for fiscal year 2011 as well.

Given the limited number of H-1B visas available, the government uses random selection to determine which requests to process – making this visa often an unreliable choice when the demand for H-1Bs far exceeds the supply. This problem does not exist for foreign professionals granted H-1B status with other employers that are generally exempt from limits, including requests filed by qualified educational institutions, affiliated research organizations, nonprofits and government research organizations.

#### H-1B1 Free Trade Agreement Visa

Prospective employers of foreign professionals who are citizens of Singapore and Chile may take advantage of additional quota allocations and more streamlined processing rules. Although limited in number, the supply of these visas is consistently greater than the demand – making them more readily available. The scope of authorized work is essentially the same as the H-1B, but status is granted for up to 18 months, with extensions in increments of up to 12 months available. The spouse and unmarried children under the age of 21 may be issued the H-4 for the same period. This visa requires proof of the foreign national's nonimmigrant intention to depart the United States.

#### E-3 Free Trade Agreement Visa

Prospective employers of foreign professionals who are citizens of Australia can take advantage of similar Free Trade Agreement benefits using the E-3 visa. Although limited in number, the supply of these visas, too, is consistently greater than the demand. The scope of authorized work is similar to the H-1B, but status is granted for up to 24 months, with extensions in increments of up to 24 months available. The spouse and unmarried children under the age of 21 may be issued the E-3 for the same period. The E-3 spouse may apply for employment authorization after arrival. This visa requires proof of the foreign national's nonimmigrant intention to depart the country.



## TN North American Free Trade Agreement Visa

Employers of foreign professionals who are citizens of Canada and Mexico can take advantage of somewhat different Free Trade Agreement benefits using the TN visa. There are no numerical limits, so the supply of these visas is always available. The job offered must be in one of the professions covered by NAFTA, each of which has its own education or experience requirements. TN status is granted for up to 36 months, with a potentially unlimited number of 12-month extensions available. The spouse and unmarried children under the age of 21 may be issued the visa for the same period. This visa requires proof of the foreign national's nonimmigrant intention to depart.

Some of the more common professionals covered by the TN include: computer systems analysts, engineers (all types), economists, lawyers, management consultants, biologists, chemists, industrial designers, accountants, and scientific technicians. A complete list of the NAFTA professions can be found at [www.amcits.com/nafta\\_professions.asp](http://www.amcits.com/nafta_professions.asp).

## E-1 and E-2 Treaty Trader and Investor Visas

Foreign-owned companies doing business in the United States may temporarily employ qualified foreign workers to facilitate international trade or investment activities. E visa status is granted for up to five years, with a potentially unlimited number of extensions in five-year increments. The spouse and unmarried children under the age of 21 may be issued the E visa for the same period. The spouse may apply for employment authorization after arrival.

The list of countries with E-1 trade and E-2 investment treaties changes often and the government's regularly updated list can be found at [http://travel.state.gov/visa/fees/fees\\_3726.html](http://travel.state.gov/visa/fees/fees_3726.html). Qualifying companies must be at least 50 percent owned by citizens of the same treaty country. E visa status is only available to citizens of that same country.

The E-1 requires proof of substantial trading activity between the United States and the treaty country. The level of trade can be measured by its value, frequency and volume. Only the trade between the U.S. and treaty country is considered, and that must account for at least 50 percent of the trade of the sponsoring employer. Items of trade range from goods to services, transportation, communications, data processing, finance, *etc.*

The E-2 requires proof of substantial capital investment that has either already been made or that is in the process of being made when the visa is requested. No minimum value threshold is set for the investment. The amount is measured in relation to the total cost of the U.S. business. Only funds or the value of property committed to capital investments are considered, and not the cost of operating expenses.

E visa status is available to individual investors with a majority ownership interest, as well as to employees coming to work in either a supervisory role or a position involving skills essential to the venture.

### d. Other Comments

There are many additional nonimmigrant visas less frequently used for global mobility assignments worth a brief mention. Foreign students with the F-1 visa are often granted authorization for employment related to their studies before and after graduation. The O-1 visa authorizes the employment of foreign nationals of extraordinary ability. Foreign nationals with skills in short supply in the United States may be able to obtain the H-2B visa.

Immigrant visas generally take longer to obtain, but in some situations compare favorably to nonimmigrant visas. Permanent resident status is often a goal for foreign nationals and U.S. employers rely on immigrant visas to continue to have access to their work after the limited duration of nonimmigrant visas is exhausted. Selecting a nonimmigrant visa that is consistent with a long-term immigrant visa option can be crucial. U.S. employers are well advised to develop policies and practices that recognize the value of the immigration process to recruit and retain skilled foreign professionals, while ensuring corporate compliance with U.S. law.

In addition to employment-based immigrant visas, immigration to the United States is possible through family-based immigrant visas by qualified U.S. citizens or permanent resident relatives. Immigrants are often interested in becoming U.S. citizens. Naturalization to citizenship generally requires five years of continuous residence after immigrating, during at least half of which time the immigrant must be physically in the country. Lengthy travel abroad, therefore, can detrimentally impact eligibility.

Further, immigrant status itself can be lost through lengthy travel abroad. U.S. residents may be reluctant to accept assignments outside the United States for this reason. It is often possible to address these concerns. The CIS can issue reentry permits to help immigrants maintain status while abroad. Further, immigrants working abroad for U.S. owned companies or their foreign subsidiaries may qualify to protect their eligibility for citizenship. Both requests are time sensitive and should be made before the assignment abroad begins.

Further, U.S. law generally requires immigrants to continue to file federal income tax returns even when all income is earned abroad and immigrant status can be impacted if a nonresident tax return is filed or if no U.S. return is filed.

In the wake of September 11, 2001, greater focus is placed on registration laws requiring all foreign nationals (*e.g.*, tourists, nonimmigrants, permanent residents) to submit the CIS Alien's Change of Address notice within 10 days of changing U.S. residence address.

## II. Managing

Once the employer has worked through all the relevant steps to engage an employee in the United States, there are ongoing employment obligations in managing a U.S. workforce, including compliance with the complicated area of wage & hour laws, discrimination and harassment rules, etc.

### 1. Wage & Hour

In U.S. terminology, wage & hour relates to the area of law dealing with minimum wage rules, overtime requirements, and classification of employees as those subject to wage & hour restrictions, or exempt from them.

#### a. The Fair Labor Standards Act and Related State Statutes

The Fair Labor Standards Act of 1938 (“FLSA”) is a Depression-era statute enacted to provide incentives to employers to hire additional workers. The statute sets a minimum hourly wage rate (which currently stands at \$7.25 per hour under federal law, although various states have higher minimum wage requirements) and a standard 40-hour work week. As a general rule, all employees are covered by the FLSA unless they are working in occupations specifically exempted from coverage under the statute. Employees must be compensated for any time worked, i.e., paid for each hour of work during the work week, and any time worked above 40 hours must be paid at a rate 1 1/2 times their standard hourly rate of pay. The definition of “time worked” is quite broad and includes non-minimal preparation and post-work duties, such as cleaning, maintenance of equipment, preparation and suiting up for work, etc.

FLSA violations typically revolve around one of two statutory issues – underpayment of wages for time worked, including overtime (which is usually a result of failure to account for all time worked by an employee); or misclassification of employees which is a mistaken belief that employees are exempt from coverage under the statute.

Various states have more stringent requirements than set forth under the FLSA, and compliance with the laws of the state(s) where a company’s workforce is located is thus not always an easy exercise. Additionally, wage & hour laws are probably one of the most complicated and most litigated legal areas in U.S. labor and employment laws, and compliance is crucial.

#### b. Underpayment for Time Worked; Overtime Requirements

Underpayment of wages cases are normally the result of an inadvertent or intentional failure by the employer to properly record the amount of time an employee actually works over the course of a week, or failure to record and compensate for time spent by the employee engaged in compensable work related activities.

U.S. employers must keep track of hours worked by all of their non-exempt employees in order to avoid FLSA and state law wage payment liability. This includes time spent working away from the jobsite or office site, as well as in some cases, waiting time, meal periods (if the employee is subject to being summoned to work during that time) and during certain types of training. In addition, travel time between worksites (although not to the job from home or to home from the job) is also generally compensable under the statute.

Overtime payments, or so-called “time and a half pay,” are determined based on the “regular rate of pay” that an employee receives during the course of a work week. This regular rate includes the normal hourly

compensation received by the employee, as well as additional payments for certain types of bonuses, premium pay, or other types of additional compensation.

Frequently, determining regular rates of pay and actual time worked will come down to an interpretation of the individual employee's specific circumstances measured against the FLSA's complicated and extremely broad regulations, as well as any applicable state laws. Consultation with counsel in evaluating these situations is usually necessary.

### **c. Misclassification Issues**

The FLSA applies to all employees except those specifically exempt by the law itself. For example, FLSA requirements do not apply to independent contractors or people who may not be considered "employees" under the statute. In addition, businesses that are not engaged in interstate commerce, or in the production of goods for interstate commerce are typically exempt from FLSA coverage.

Employee exemption questions usually revolve around the so-called "white collar" exemptions that are contained in FLSA regulations. These regulations include exemptions for executive employees who supervise two or more subordinates, administrative employees who perform office work that is directly related to management policies or general business operations and exercise discretion in their jobs, or to professional employees in positions that typically require advanced study in a particular field, or artistic merit and discretion. There are special exemptions for teaching and highly paid computer occupation professionals as well. Finally, the statute also contains specific exemptions for certain types of employees, such as limited circulation newspaper, amusement recreational or similar employees, and certain types of agricultural employees.

As with the compensation issues, exemptions turn on highly nuanced interpretations of FLSA's statute and regulations. Consulting counsel is crucial in these determinations because the ramifications of a misclassification case can be literally millions of dollars in back wage liabilities and penalties.

### **d. Enforcement**

Liability for an FLSA violation can be significant. Individual employee amounts of recovery are usually small, but become significant when grouped together with all employees affected by the misclassification or failure to adequately monitor time. In addition, the statute requires a doubling of all back pay damages as a matter of course and the law adds an additional third year of liability onto an award if the employer is found to have willfully violated the statute. As with most employment statutes in the United States, a prevailing plaintiff in an FLSA case is entitled to recover attorney's fees.

FLSA violations and damages can be awarded either as a result of a U.S. federal Department of Labor investigation and determination, or as a result of a civil lawsuit. It is possible for an employer to find itself facing an investigation by the Department of Labor and a lawsuit by aggrieved employees simultaneously.

In addition to the federal FLSA, most states have some variation of the FLSA embedded in their state code. To the extent these state laws provide for better benefits than the federal law, e.g., a higher minimum wage, or a less inclusive exception scheme, the state law will supersede federal requirements.

The FLSA has been described as the statute most likely being violated by employers because of its complexity and arcane application. Employers should regularly evaluate their payroll practices and compensation decisions, as well as their job descriptions, in order to ensure that they are not running afoul of FLSA requirements.

## 2. Discrimination & Harassment; Affirmative Action

Federal law prohibits discrimination against employees and applicants based on the individual's race, color, religion, sex (including pregnancy), national origin, age (for those aged 40 or older), disability or genetic information. The majority of these prohibitions are found in a law which is commonly referred to as Title VII of the Civil Rights Act of 1964 ("Title VII"). Age discrimination, for persons aged 40 and over, is prohibited by a separate law called the ADEA. The ADA prohibits discrimination based on a disability. The Genetic Information Nondiscrimination Act of 2008 ("GINA"), prohibits genetic information discrimination in employment. Finally, the Civil Rights Act of 1991 establishes damage remedies under Title VII, the ADEA, and the ADA, and clarifies various issues under these laws. These laws prohibit employers from taking an individual's membership in a protected category into consideration in almost every employment-related situation. These laws also prohibit employers from discriminating or retaliating against a worker or applicant because the worker or applicant complained about discrimination, filed a charge of discrimination, or participated in an employment discrimination investigation or lawsuit.

Federal employment discrimination laws are broad in scope and protect all types of workers – those who have contracts, those who are employed "at-will," and even those covered by collective bargaining agreements. Title VII, the ADEA, the ADA, GINA, and the Civil Rights Act of 1991 apply to all terms and conditions of employment – from the time of hire to the time of the employee's termination, and virtually all aspects of employment in between (including promotions, training, wages, and benefits). Most employers with 15 or more employees (20 or more employees in age discrimination matters) are covered by these federal non-discrimination statutes.

In addition, most of the fifty states have employment discrimination prohibitions that mirror federal law. Some states provide even greater protection. Examples of state laws that are broader than federal law include those that prohibit discrimination on the basis of marital status or sexual orientation. These state laws may also apply to smaller employers (with fewer than 15 or 20 employees) who are otherwise exempt from federal employment discrimination laws. In addition, many local governmental entities have ordinances prohibiting discrimination. Therefore, in major metropolitan areas in the United States, it is not uncommon for three sets of laws – federal, state, and local – to prohibit employment discrimination.

### a. Anti-Harassment Laws

Federal, state, and local discrimination laws also make it illegal to harass employees based on the various protected categories. Harassment on the basis race, color, religion, sex (including pregnancy), national origin, age (40 or older), disability or genetic information is defined as unwelcome verbal or physical conduct relating to those categories, when:

1. Submission to such conduct is made either an explicit or implicit condition of employment or is used as the basis for an employment decision affecting the harassed employee; or
2. The harassment unreasonably interferes with an employee's work performance or creates an intimidating, hostile or offensive working environment.

Harassment can take the form of slurs, graffiti, offensive printed or visual material, offensive comments, or other verbal or physical conduct. Sexual harassment (including unwelcome sexual advances, unwelcome physical contact, requests for sexual favors, and other conduct of a sexual nature) is a serious legal problem for employers in the United States. Notions of appropriate workplace behavior are

changing, and a large number of claims are being brought against employers and supervisors each year. Claims of this sort increasingly land executives in court to answer for lawsuits brought by employees who allege that an executive has committed some act that constitutes sexual harassment. The employer could also be liable for harassing conduct beyond that of an executive, including the conduct of the employee's supervisor, a supervisor in another area, a co-worker, or someone who is not even an employee of the employer, such as a client or customer.

## **b. Avoiding Discrimination and Harassment Claims**

Court decisions indicate that the best possible defense to a charge of discrimination or harassment is for an employer to have an anti-discrimination and anti-harassment policy and complaint procedure. Without such policy, it is very difficult for an employer to defend against such charges. Accordingly, the personnel policies of any prudent employer should include such a policy and a concomitant complaint procedure. The policy should define discrimination and harassment (including sexual harassment), prohibit it as a matter of company policy, provide alternative avenues for aggrieved employees to make complaints regarding what they believe to be discrimination or harassment, and authorize disciplinary action against any discriminators or harassers. To avoid liability under Title VII, an employer must immediately investigate any complaints of discrimination and harassment, and where warranted, institute prompt remedial measures designed to prevent any future reoccurrences of discrimination or harassment.

Supervisor sensitivity training is equally important in reducing harassment and discrimination problems. Supervisors must be made aware that federal and state laws prohibit discrimination harassment on the basis of sex as well as due to membership in any other protected categories (i.e., race, religion, age, etc.). Since the line between illegal harassment and lawful yet immature or crude behavior is sometimes difficult to discern under the evolving law of harassment, supervisors should be taught to take special care to avoid any potential situations or relationships with workers which might lead to Title VII charges. Supervisors must be made aware that the best way to avoid a charge of harassment is to steer far clear of any activity that comes anywhere near the line between legal and illegal conduct.

Employers should also ensure that all government mandated non-discrimination notices are posted in areas accessible to employees. Such notices are available through the EEOC and the Department of Labor.

## **c. Affirmative Action Laws**

Certain employers who are federal government contractors and subcontractors may also be subject to additional non-discrimination laws. For instance, certain federal contractors may be subject to Executive Order 11246, as amended, Section 503 of the Rehabilitation Act of 1973, as amended, and the Vietnam Era Veterans' Readjustment Assistance Act, as amended. These laws collectively ban discrimination based on race, color, religion, sex, national origin, disability and veteran status, and require certain government contractors to take affirmative action to ensure that equal opportunity is provided in all aspects of their employment. In addition, covered government contractors and subcontractors must include an equal employment opportunity clause in non-exempt contracts.

Certain non-construction contractors, with 50 or more employees and government contracts of \$50,000 or more, are required under Executive Order 11246, to annually prepare and maintain a written Affirmative Action Program ("AAP") for each establishment. An AAP must include the following quantitative analyses: an organizational profile, a job group analysis, placement of incumbent employees in job groups, a determination of the availability of qualified women and minorities in the relevant labor market, an analysis comparing incumbency to availability, and placement goals as applicable. The AAP must

also include an identification of problem areas, action-oriented programs, a designation of responsibility for implementation, and periodic internal audits.

### **3. Preference of Foreign-Born Employees Over Workers Of American National Origin**

Courts have interpreted U.S. employment discrimination laws to have a narrow exception to the rule against discrimination on the basis of national origin. Courts have determined that in limited circumstances, foreign employers operating within the United States may discriminate in favor of their own foreign nationals in certain management and technical positions. This issue often arises in mass lay-off situations when foreign-based employers favor employees of foreign national origin on assignment to the United States and discriminate against employees of American national origin. The issue also arises when foreign executives are rotated through the facilities of U.S. subsidiary corporations on E-1 immigration visas or are compensated off a different payroll than workers of American national origin. Not surprisingly, unemployment and U.S. trade imbalances have made this subject an emotional issue for employees. These types of personnel practices have led to an increasing number of lawsuits that claim that foreign employers should not be immune from Title VII for such favoritism.

The legal issues surrounding these particular personnel practices implicate the provisions of international treaties known as Treaties of Friendship, Commerce, and Navigation (“FCN treaties”) that the United States entered into with various trading partners after World War II. Under FCN Treaties, such as the U.S. – Germany FCN Treaty, U.S. – Greek FCN Treaty, U.S. – Japan FCN Treaty, U.S. – Korea FCN Treaty, U.S. – Pakistan FCN Treaty, etc., companies of one country have the right to engage in business activities in the other country without discrimination (referred to as “national treatment rule”). Beyond this rule, however, most FCN Treaties allow companies of one country to assign certain key managerial and technical personnel of their choice to their operations in the host country. Thus, if a foreign-based company protected by the FCN Treaties desires to favor its own executive personnel because they are of the same national origin, the treaty accords the company that right.

This treaty exemption to federal employment discrimination laws is quite narrow. The numbers and types of managerial and technical positions covered by FCN Treaties are limited. Also, various FCN Treaties do not apply to domestically incorporated subsidiaries of a foreign corporation, e.g., a U.S. subsidiary of a Japanese parent company. Finally, there are only about two dozen FCN Treaties between the United States and foreign countries, and such treaties are not in force with many countries whose corporations do business in the United States.

Accordingly, foreign-based employers and their executives should not favor individuals of their home country without careful consideration of the requirements of Title VII.

### **4. Vacation & Leaves of Absence**

#### **a. Vacation**

It may come as a surprise to foreign employers starting operations in the United States that there is no state or federal law in the United States requiring employers to grant employees paid vacation. That said, it is common to provide at least some vacation to employees, often about 2 weeks per year, increasing with seniority.

If vacation is granted, however, note that it may be subject to various applicable rules. In California, for instance, vacation is considered wages and accordingly, “use it or lose it” policies (i.e., a provision that vacation forfeits at the end of a vacation year) are not permissible.

## b. Statutory Leaves of Absence

Federal and state laws in the United States govern various types of employee leave of absence rights. Like with vacation, it may come as a surprise to foreign companies operating in the United States that there is no entitlement under federal law to paid sick leave. San Francisco is one of the few locales in the United States that does require paid leave. There is some legislation pending, however, that may change paid sick and paid vacation requirements in the United States.

At this point, employees are entitled to various (mostly unpaid) leaves of absence, as further outlined below.

### The Federal Family Medical Leave Act

The federal Family Medical Leave Act (“FMLA”) governs employers with 50 or more employees at any U.S. worksite, and requires unpaid leaves to be used for employees’ own or their family members’ serious health condition, child birth or baby bonding, and certain military-related leaves.

To be eligible for an FMLA leave, the employee must have (i) been employed for at least 12 months; (ii) worked at least 1,250 hours during the 12 months immediately preceding the start of the leave, and (iii) worked at a worksite where 50 or more employees are employed by the employer within 75 miles.

Eligible employees are entitled to take up to 12 weeks of unpaid FMLA leave during a 12-month period for the birth of a child; leave for bonding with a newborn, adopted or foster child; leave for caring for an employee’s spouse, child or parent who suffers from a serious health condition; or leave necessitated by the employee’s own serious health condition.

Eligible employees who are a spouse, son, daughter, parent or next of kin of a military service member are entitled to 26 weeks of unpaid leave during a 12-month period to care for a service member with a “serious injury or illness” (i.e., undergoing medical treatment, recuperation, or therapy, is otherwise on outpatient status, or is otherwise on the temporary disability retired list) incurred in the line of active duty. Employees may also take up to 12 weeks of unpaid leave during a 12-month period because of a “qualifying exigency” arising out of the fact that the spouse, son, daughter or parent of the employee is on active duty in the military.

Most employees are entitled to be reinstated to a same or similar condition upon return of leave, and cannot be retaliated against for taking the leave. Certain salaried “key employees” who are in the highest paid ten percent of the workforce working within 75 miles of the worksite do not have to be reinstated if reinstatement would cause “substantial and grievous economic injury” to the employer’s operations.

Employers who are governed by the FMLA have specific posting and notice requirements, and timing to respond to employee requests for leave and reinstatement. Employers should use the forms issued by the Department of Labor when employees request FMLA leave, for any required doctor’s certifications, and when approving FMLA leave.

Often the need for leave under the additional statutory leaves discussed in the sections below may also be a FMLA-qualifying leave. Depending on the applicable state law, this can arise in the case of disability leave, pregnancy leave, workers’ compensation leave, and other types of state or local leave for an employee’s or family member’s illness. In such situations, the employer must follow the FMLA notice requirements for the leave, in addition to satisfying any requirements for the other type of applicable leave.



## Military Leave

Under the Uniformed Services Employment and Reemployment Rights Act (“USERRA”), employers of any size must allow employees to take unpaid leave due to service in the Armed Forces Reserve, the National Guard, or other uniformed services.

Generally, employees may take up to five years of cumulative leave to serve in the military, including military training. Employees are required to provide advance verbal or written notice of the need to leave, unless giving notice is impossible, unreasonable, or precluded by military necessity.

Upon return, the employee must provide a certain amount of notice depending on the length of leave, and be reinstated to the position the employee would have been in had the employee not taken the leave with no loss of seniority. The reinstatement must also include any salary increases, promotions, or increased training the employee would have received during the leave.

An employee returning from a military leave under USERRA cannot be terminated without cause for a certain period of time after returning to work, depending on the length of the military leave.

## Disability Leave

Under the ADA, employers with 15 or more employees may be required to grant an employee with a known disability an unpaid leave of absence as a reasonable accommodation, unless providing leave is an undue hardship. The reasonable length of the leave may vary, and is fact-specific based on the position and the needs of the employee and employer. The leave should not be unending. Reinstatement may be required depending on the length of leave, whether reinstatement is reasonable for the particular position or other open positions, and whether the employer offers reinstatement to other employees returning from leave.

## Workers’ Compensation Leave

U.S. employers are required to carry workers’ compensation insurance or to pay into an agency fund in order to cover workers injured in the course of employment. Workers’ compensation requirements are governed by state law and can vary from state to state. Employers therefore should be familiar with the workers’ compensation system in all the states in which they have employees.

Workers’ compensation leave provides time off for employees who are injured in the course of employment. The employee is normally entitled to the amount of leave required by the workers’ compensation physician, and the employee may be entitled to accommodations of work restrictions upon return to work. The employee’s lost wages are normally covered by the workers’ compensation insurer or system. Workers’ compensation systems under state law will govern whether the employees are entitled to reinstatement, and payments due in the event of termination.

## Other Leaves Required by State or Local law

There are numerous additional leaves required under state law, including pregnancy leave. Most of the required leaves are unpaid, with a few exceptions such as the San Francisco paid sick leave ordinance. Employers should be familiar with the state and local leave law requirements for the locations where their employees work. Below is an example of the types of leaves that can be required under state law:

- Family Care Leave
- Maternity/Paternity Leave

- Child Suspension Leave
  - Court Attendance and Witness Duty Leave
  - Crime Victim Leave
  - Domestic Violence and Sexual Assault Leave
  - Jury Duty Leave
  - Kin Care
  - School Activities Leave
  - Voting Time Leave
  - Volunteer Firefighter, Reserve Peace Officer, and Emergency Rescue personnel Leave
  - Organ Donor Leave
  - Religious Observance Leave
  - Mandatory Evacuation Leave
- c. **Leave of Absence Policies.**

An employer should have a personnel policy describing the applicable leaves. Most of the leave laws discussed above have specific return-to-work requirements, notice, timing, and posting requirements, and prohibit discrimination against employees for taking leave. The policy should track the requirements for each leave, require employees to affirmatively request the appropriate leave, turn in necessary medical certifications, and follow the company's leave of absence process in compliance with the applicable leave laws. Having such a written policy will serve the employer's interests, as well as provide a company with an appropriate method for responding to requests from employees for a leave of absence.

## **5. Employee Benefits**

As a general rule, employers are only obligated to fund specific federal benefits and unemployment compensation for their employees. These mandatory funding obligations include federal Medicare benefits (health benefits for retired or active workers aged 65 or older and disabled persons), federal Social Security benefits (pensions for retired workers) and unemployment compensation. Employers and employees split the cost of Medicare and Social Security benefits. In 2010, employers and employees each pay 6.2% of an employee's annual wages up to \$106,800 (the wage cap is adjusted periodically) for Social Security benefits, and 1.45% of an employee's annual wages (without any cap) for Medicare benefits. Beginning in 2013, high income employees will be subject to an additional Medicare tax of 0.9% (employers will not share that additional tax burden). In addition, employers are obligated to make contributions to the Federal unemployment tax fund (although these contributions may be offset by contributions to state unemployment funds). The maximum federal contribution for unemployment benefits in 2010 is 6.2% of the first \$7,000 of wages paid to an employee.

In 2010, new federal legislation affects health care benefits. Prior to the enactment of the 2010 Patient Protection and Affordable Care Act, as modified by the Health Care and Education Reconciliation Act of 2010 (together the “Health Care Act”), health care was typically provided by employers to their employees. Although retired workers are eligible for Medicare, part-time employees and unemployed residents have little or no access to health care. As a result of the Health Care Act, employers are not obligated to provide health care benefits to their employees, but they will be subject to penalties if they do not provide essential and affordable health care.

Although other benefits are voluntary, most U.S. employers provide some form of pension plan and offer medical, dental and vision insurance, life insurance, and disability income plans. The costs for funding most of these plans are generally shared by the employer and employee, although certain benefits may be offered on a noncontributory basis to eligible employees. These voluntary employer-provided benefits are subject to regulation under the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), the federal law governing employee benefits in the United States, and the Internal Revenue Code of 1986, as amended (“IRC”). ERISA is an exacting and complex statute which contains numerous requirements on how companies must establish and maintain pension and profit-sharing retirement plans, and ensure that pensions are adequately funded and protected. This statute also regulates welfare benefit plans which provide benefits for sickness, accidents, disability, death and severance.

In addition, most pension and welfare plans sponsored by employers are established to conform to the extensive requirements of the IRC. Conformity with the IRC results in the favorable tax treatment not only of the contributions to these plans but also to the benefits paid by these plans. In other words, compliance with the IRS permits many of these benefits to be paid on a tax-deductible basis by employers and be offered on a tax-deferred or a tax-free basis to employees.

#### a. Pension Plans

ERISA and the IRC regulate employer-provided pension benefits. In general, if a pension plan is offered to a non-discriminatory group of employees and the benefits do not discriminate in favor of highly compensated employees, then the costs of funding the pension are tax-deductible by the employer; the benefits are tax-deferred because the pension is not taxable to the employees until it is paid; and the investment gain on the pension funds (which generally must be held in a trust) is tax-exempt. Because of these valuable tax benefits, both the design and the operation of pension plans are highly regulated, and the failure to conform to the complex regulatory scheme destroys the favorable tax results. Both ERISA and the IRC have overlapping provisions that govern the rules regarding eligibility to participate in the pension, coverage requirements, maximum vesting periods, spousal rights to benefits, and funding obligations.

Like in most other countries, there are two basic types of pensions in the United States: defined benefit plans and defined contribution plans. Because of the strict funding requirements for defined benefit plans, they are less prevalent today than in the past. The predominant form of pension program is a defined contribution plan that requires employees to defer a portion of their own wages in order to receive a matching contribution from the employer. These plans are called “401(k) plans” because section 401(k) of the IRC regulates the deferral process. Employees who participate in 401(k) plans are generally given a menu of investment choices and they, rather than a professional investment advisor or the trustee, make the decisions regarding the investment of their account balance under these plans. It is common for 401(k) plans to pay benefit in a single cash lump sum on retirement or termination of employment.

ERISA also provides significant federal regulation of pension plans. When enacted, ERISA was intended to provide for the uniform regulation of employee benefit plans and to achieve that goal, ERISA preempts

state laws that affect employee benefits. Under this federal statutory scheme, ERISA requires use of a tax-exempt trust to fund pension plans (although certain insurance products may be used as a substitute), and requires funding on a regular basis. In addition, ERISA imposes fiduciary obligations on the plan sponsor, the trustee, and others who have control over the administration of the plan and investment of the plan's assets. These rules hold the plan fiduciaries to the high standards applicable to trustees; for example, plan fiduciaries must act solely in the interests of the plan participants, must adhere to duties of loyalty, avoid self-dealing, and monitor the activities of their co-fiduciaries. These fiduciary obligations translate into an ongoing commitment to establish prudent procedures by a plan committee to meet regularly and monitor the plan's operations, the trust fund's investments, the costs charged by the plan's service providers and to consider the effect of changes in the law.

ERISA also subjects employers to numerous disclosure requirements, including:

- distribution to the plan participants of a plain-English summary of the key provisions of the pension plan and timely updates of material plan amendments;
- annual filing of reports with the IRS and the U.S. Department of Labor for each pension plan, as well as audited plan financials when there are more than 100 plan participants; and
- other periodic notices to participants.

Pension plans must also include a claims procedure and dispute resolution process that satisfies ERISA. Generally, benefit claims must be determined promptly and, when denied, the appeal of a denied claim must not only be determined within certain time limits, the person or group hearing the appeal cannot be subordinate to the person or group that denied the initial claim. After exhausting the internal claims process, a claimant may sue, but ERISA gives an employer the right to have the case decided in a federal court, which may be a strategic advantage over state court.

## **b. Welfare Plans**

As noted above, employers may voluntarily offer welfare plans to their employees. These plans include group medical, dental and vision plans (which may be insured or self-funded), and more conventional insurance benefits, such as group term life insurance and long-term disability income plans. In addition, most broad-based severance plans that provide employees with replacement income when employment ends involuntarily are also considered welfare plans.

ERISA governs welfare plans. Unlike ERISA pension plans, however, there is no obligation to fund these plans and it is not unusual for the benefits to be paid from insurance, the company's general assets, or a combination of both. As noted above, ERISA preempts most state laws, with the goal of having a uniform federal regulation of employee benefit programs. One important exception to this federal preemption is state insurance law. For insured welfare plans, the state insurance laws will prevail, which means that a state may impose mandatory benefits on insured arrangements. For example, it is possible a state will mandate coverage under an employer's group health plan for annual mammograms, coverage of domestic partners of employees on the same basis as spouses of employees, and coverage of adult children to a specified age. ERISA has its own mandated group health benefits. ERISA-mandated benefits include a prohibition against discriminating against employees and others on the basis of their health status, claims experience, genetic information or disability when it comes to enrollment or costs, minimum hospital stays for mothers and newborns, and parity for mental health and substance abuse benefits when compared to medical and surgical benefits.

The Health Care Act establishes a federally mandated health care system that becomes effective gradually over a period of several years between 2010 and 2018. The Health Care Act does not require employers to offer group health plans to their employees, but imposes cash penalties on employers with at least 50 full-time employees who fail to offer “affordable” health plans that provide an “essential” level of benefits to their employees and their family members. Employers who fail to offer these plans will be subject to a “free rider” penalty in 2014. The penalty is \$2,000 per full-time employee if qualified health care is not offered to full-time employees. If the health care plan is unaffordable or the benefits are insubstantial, then the employer must pay a penalty of \$3,000 for each full-time employee who receives a subsidy to purchase coverage through the state insurance exchange (see the next paragraph).

Beginning January 1, 2011, calendar year group health plans must offer coverage that complies with the Health Care Act. The various coverage requirements are phased in over several years. Among the mandated benefits are coverage of adult children (up to age 26) of employees, prohibition of annual and lifetime limits on benefits, elimination of coverage exclusions for pre-existing conditions, and automatic enrollment of employees after permitted waiting periods expire. Although employers may offer these programs going forward, the states are required to establish insurance exchanges for individuals who do not have coverage as well as for small employers.

There are several financing mechanisms that will fund the insurance exchanges established by the Health Care Act. Among those funding sources is a new higher 2.35% Medicare rate that applies to employees whose income exceeds \$200,000 (\$250,000 for joint filers). (Employees exercising stock options that result in additional compensation may find themselves subject to this increased tax.) There is no tax increase on the employer portion of the Medicare tax, but employers are subject to mandatory withholding of this increased Medicare tax. This tax increase is scheduled to become effective January 1, 2013. In addition, net income from investments and other passive income will be subject to a new 3.8% Medicare tax for individuals with income of more than \$200,000 (\$250,000 for joint filers). This means that certain employer-equity paid to employees, such as dividends paid on vested shares and capital gains recognized on the sale of shares will be subject to this new tax.

Similar to ERISA pension plans, the annual reports to the IRS and the U.S. Department of Labor apply to ERISA welfare plans, but only if the welfare plan has more than 100 participants. The ERISA audit is required only if the welfare plan is funded other than through insurance or the employer’s general assets; practically speaking, few welfare plans are required to engage an auditor. Regardless of the number of plan participants, ERISA requires welfare plans to provide a plain-English summary description of the material features of the plan (summary plan description) to the plan participants.

In addition to the standard claims and dispute resolution procedures that apply to ERISA pension plans, there are particular ERISA claims procedures that apply to medical and disability benefit claims. Under the Health Care Act, there are also specific new requirements regarding the claims procedures and federally prescribed explanations of health care coverage.

Most employers offering group health benefits split the cost of these programs with their employees. Provided that the requirements of the IRC are satisfied, the employer’s payments are not considered income to the employees, and the value of the benefits paid by the plan is also excluded from the employees’ income. Many employers offer their employees a means of paying the employee share of the cost with pre-tax dollars. This pre-tax approach requires establishing a cafeteria plan, also known as a “premium only plan.” There are nondiscrimination tests associated with these plans, and other rules that limit an employee’s ability to change coverage options during a plan year. These plans are popular with employers, however, because the tax savings for employees makes it more tolerable to shift more of the cost to employees. In addition, the employee contributions to the cafeteria plan are excluded from the

wages used for payment of the federal Social Security and Medicare taxes, providing both employers and employees with reduced tax costs.

### c. Fringe Benefits

In addition to pension and welfare plans, an employer may wish to offer additional benefits to employees. Although these so-called fringe benefits are not governed by ERISA, they may qualify as tax-free benefits under the IRC. Examples of common fringe benefits include employer-subsidized tuition reimbursement plans, tax-free dependent care plans, and tax-free transportation reimbursement plans. These last two programs are a popular way of permitting employees to use their own funds, on a tax-free basis, to pay some or all of the cost of day care expenses for tax dependents (generally, children under the age of 13) or the costs of taking mass transit to work (or parking expenses associated with commuting to work). A full discussion of all the types of tax-free fringe benefits is beyond the scope of this book. However, whenever there are tax-free benefits, there are also regulatory requirements that apply.

### d. Executive Compensation

In addition to the broad-based pension and welfare benefits that may be offered to its employees generally, it is not uncommon for an employer to provide additional special benefits and compensation to its key management and executives. Those arrangements may include bonus plans that are based on the employer's performance, or a combination of the employer's and the employee's performance over a particular period. There may also be supplemental pension benefits that exceed the statutory limits for tax-qualified pension plans, executive-only medical plans that provide additional reimbursements of certain medical expenses, supplemental life insurance, tax-planning services and enhanced severance in connection with a change in control of the company. In addition, it is possible that an employer will offer its key employees an opportunity to defer a portion of salary or bonus in order to defer the taxation of those amounts to a future date, with additional compensation added to the ultimate payout.

In some cases, the executive compensation arrangements will be regarded as a deferral of compensation. For example, a supplemental pension benefit (paid at retirement) and a salary or bonus deferral plan are forms of deferred compensation. The IRC regulates these deferred compensation arrangements by restricting when participation in a deferred compensation plan may begin, limiting the events that permit the compensation to be paid, and many other aspects of these deferral arrangements. A failure to comply with the requirements of the IRC will cause adverse tax consequences to the executive (including an additional penalty tax of at least 20%). In addition, if the deferred payments are made at termination of employment and the employer is a public company at the time of the payment, then the IRC requires delaying the payments to the top-paid employees for at least six months after the termination of employment. The idea is to subject these executives to the credit risk that the employer will be unable to satisfy its obligations after the six months' period. The establishment of a deferred compensation program for officers of a public company may also require public disclosure at the time of adoption and the program and the value of the benefits under the program will be included in the compensation discussion for the named executive officers and directors in the annual proxy.

Regardless of whether the compensation arrangement for executives is deferred, the company may be limited in its ability to deduct the full amount of the payment. Under the IRC, payments by a public company to the CEO and a limited number of key executives may not be deducted to the extent that the total payments to each executive exceed \$1,000,000 unless the compensation payments are considered performance-based pay. The requirements for performance-based compensation include shareholder approval of the arrangement and the active involvement of outside directors sitting on the compensation committee. The methods used to preserve the tax deduction for compensatory arrangements can be complex, and because a failure to satisfy all of the procedures required by the IRC to establish, approve

and pay performance-based pay will affect the deductibility of these payments, the process should be reviewed with counsel specializing in these aspects of executive compensation.

## 6. Equity

Aside from regular salary and employee benefit plans, many U.S. employers also operate equity incentive plans under which they grant equity-based awards to employees. Often, awards are granted only to employees above a certain level, but some companies make broad-based awards and grant to all (or almost all) of their employees. The following award types are the most commonly used:

- Stock options
- Restricted stock
- Restricted stock units
- Stock appreciation rights

Income from equity awards is generally treated like compensation and is subject to income tax and Social Security contributions (unless the applicable wage cap has already been reached) as well as Medicare. The employer has to withhold and report these taxes, as well as pay the employer portion of Social Security contributions. However, depending on the type of award and the conditions of the award, favorable tax treatment may be available for the employees and/or the employer. In addition, some employers operate Employee Stock Purchase Plans (“ESPPs”), usually operated in accordance with Section 423 of the IRC to provide favorable tax treatment to the employees.

### Stock options

Stock options entitle the employee to purchase shares in the employing company or another company in the employer’s company group at a fixed price (often called the strike price or exercise price) during the term of the option. Options typically vest over a period of time, conditional upon the employee’s continued employment with the employer until the respective vesting date. Once vested, the employee generally is free to exercise the option and purchase the shares at any time until the end of the term of the option. The strike price typically is at least equal to the market value of the company’s stock on the grant date. If an option is granted at a strike price that is less than the market value of stock on the grant date, it is considered to be a discounted option which will subject the option to the rules for non-qualified deferred compensation arrangements under Section 409A of the IRC with undesirable tax consequences for the employee and employer.

Options can be granted as non-qualified (or non-statutory) stock options or as incentive (or statutory) stock options. Incentive Stock Options (“ISOs”) receive favorable tax treatment, but have to comply with the requirements of Section 421 of the IRC which means, among other things, that in order to receive the tax benefits, the employee may not sell any of the shares subject to the option for a period of at least two years from the grant date and more than one year from the date of exercise. If all of the necessary requirements are complied with, tax is deferred until the underlying shares are sold and the income is taxed as a capital gain (i.e., generally at a lower tax rate), rather than as compensation income.

### Restricted Stock

Upon the grant of a restricted stock award, an employee becomes the immediate owner of the shares (with dividend and voting rights) but is restricted from selling or otherwise disposing of the shares for a certain period of time or until certain performance criteria have been met (the vesting period). Generally, the

employee does not have to pay anything to receive the award or the underlying shares. Tax is due when the restrictions lapse (i.e., at vesting) on the market value of the underlying shares minus any price paid for such shares by the employee (typically, nil). However, if permitted by the company, employees can enter into so-called Section 83(b) elections at the time of grant of the restricted stock award pursuant to which they elect to disregard the restrictions applicable on the shares and pay tax at grant on the market value of the underlying shares. Any increase in value after the time of grant will then be taxed as capital gain, rather than compensation income; however, if the shares are later forfeited, no tax credit is available.

### Restricted Stock Units

Restricted Stock Units (“RSUs”) are an unfunded promise to issue shares to the employee after the expiration of a vesting period. Typically, the employee has to remain employed with the company during the vesting period to receive the shares. Alternatively, a time-based vesting period can be combined with the achievement of performance criteria, such that vesting occurs only if the employee remains employed and the performance criteria are met. For accounting reasons (as further explained below), most companies wish to settle RSUs in shares only; however, it is possible to retain the discretion to settle the RSUs by making an equivalent cash payment to the employee at vesting. Tax is due at settlement on the market value of the underlying shares (or the cash payment). It is not possible to enter into Section 83(b) elections, as is the case for restricted stock awards. If permitted by the company, employees may be able to elect to defer receipt of the shares pursuant to a deferral election which can delay the taxable event, but will have to be carefully structured to comply with the requirements of Section 409A of the IRC.

### Stock Appreciation Rights

Stock Appreciation Rights (“SARs”) entitle the employee to acquire shares upon exercise of the right which are equal in value to the appreciation of the stock between the date of grant and the date of exercise. SARs are similar to stock options in that they are granted with an exercise price which is typically at least equal to the market value of the underlying shares at grant (to avoid application of Section 409A of the IRC), vest over a certain period of time and can be exercised during the term of the SAR. However, at exercise, the employee is not required to actually pay the exercise price. Instead, the difference (or appreciation) between the exercise price and the market value of the shares at exercise is used to calculate the number of shares which are to be issued to the employee at exercise. Companies may retain the discretion to pay the appreciation to the employee in cash (as opposed to shares), but as explained below, this will result in unfavorable accounting treatment. (SARs settled in shares are referred to as stock-settled SARs, and SARs settled in cash are referred to as cash-settled SARs.) SARs are taxed at exercise on the value of the appreciation.

### Employee Stock Purchase Plans

In addition, some U.S. employers operate ESPPs under which employees are able to elect to contribute a percentage of their compensation by way of payroll deductions. These contributions are used at the end of a period (usually six months or less) to purchase shares in the employing company or another company in the employer’s company group at a discount. Most ESPPs are established to comply with the requirements of Section 423 of the IRC which provides for tax-favored treatment, provided certain conditions are met. The main requirements are as follows:

- The purchase price cannot be less than the lesser of (i) 85% of the market value of the stock at the beginning of the purchase period, and (ii) 85% of the market value of the stock on the purchase date (this is referred to as the look-back feature).



- The maximum term of a purchase period cannot exceed 27 months for ESPPs with a look-back feature. If the purchase price is simply determined to be 85% or more of the market value of the stock on the purchase date, the purchase period can be up to five years.
- In order to receive tax-favorable treatment at the time of sale, shares acquired under an ESPP may not be disposed of for a period of at least two years from the date of grant and more than one year from the date of purchase.
- An employee may not receive a right to purchase more than US\$25,000 worth of stock (determined based on the market value of the stock on the first date of the purchase period) for each calendar year in which rights are outstanding.
- The ESPP has to be offered to all employees of the issuing company and subsidiaries of the company which have been designated as participating in the ESPP (with certain limited exceptions).

Under an ESPP that qualifies under Section 423 of the IRC, the employee will not be subject tax when he or she purchases the shares. In addition, if the employee sells or otherwise disposes of the shares in a “qualifying disposition” (i.e., when the holding periods noted above are met), the employee generally will be taxed on the majority of the gain only at capital gains tax rates, while a small portion is taxed as ordinary income.

#### Employer Tax Obligations

The following discussion describes federal tax withholding and reporting obligations. State and local tax withholding and reporting obligations may also exist.

Generally, any income resulting from an equity awards (as than an ISO and a Section 423 ESPP) is treated as supplemental wages and taxed at the flat statutory rate of 25%. The employer must report the income as ordinary income on the employee’s year-end Form W-2 (Wage and Tax Statement). The flat 25% withholding rate applicable to supplemental payments will not apply to the extent the current payment, when combined with prior supplemental payments in the same taxable year, exceeds US\$1 million. This excess will be subject to withholding at the highest income tax rate currently in effect (35%, for 2010).

In the event an equity award falls within the scope of Section 409A of the IRC (e.g., an option granted at a discount), then the employer must withhold and report in the year of accelerated income inclusion under Section 409A (e.g., the year the options vest) the income from the award, as determined under Section 409A of the IRC and applicable regulations. These amounts are considered supplemental wages, regardless of whether the employer paid the employee any regular wages during the calendar year. There is no withholding required currently with respect to the additional 20% tax, plus interest, imposed under Section 409A of the IRC on the employee.

The employer does not have a withholding obligation with regard to the exercise of an ISO or the purchase of shares under an IRC Section 423 ESPP. If the employee disposes of the shares at a time when the applicable holding periods are not met, the employer must report the amount of taxable income on the employee’s year-end Form W-2 for the year of disposition. Section 6039 of the IRC also requires the employer to provide certain information to the employee by January 31 of the year following the exercise/purchase and to file a return with the IRS by March 1 or 31 of such following year, depending on whether electronic filing is made.

## Shareholder Approval Requirements

To grant ISOs, the plan has to be approved by shareholders within 12 months before or after the Board of Directors of the company has adopted the plan. The same requirement applies to an ESPP that is intended to qualify under Section 423 of the IRC.

In addition, if the underlying stock is listed on the NYSE or on any of the NASDAQ markets, the NYSE and NASDAQ rules will require that any equity plan be adopted by shareholders (with limited exceptions). Shareholder approval will also be required for any material amendment to the plan.

## U.S. Securities Law Issues

The Securities Act of 1933, as amended (the “Securities Act”) and state securities laws (the “Blue Sky Laws”) regulate grants of equity awards by an issuer to employees. These laws also apply to the issuance of the underlying shares by employers, as well as any subsequent resale of those shares. In general, the Securities Act requires that such transactions be registered with the U.S. Securities Exchange Commission; similarly, Blue Sky Laws require the issuer to obtain a permit or otherwise obtain the approval of the securities authorities for such transactions in the particular states where employees reside, absent valid exemptions from such registration requirements at the federal level and in each of the relevant states. The Securities Act and state Blue Sky Laws provide exemptions from these registration and reporting requirements under certain limited circumstances.

Rule 701 promulgated under the Securities Act is the most commonly used exemption from registration at the federal level. Rule 701 covers the grant of equity awards and the subsequent sale of stock with respect to equity awards issued to employees and other service providers (with some limitations). Rule 701 is generally available to privately-held employers so long as the aggregate offering does not exceed \$1,000,000 (or such greater amount as determined under Rule 701) in a rolling 12-month period.

Various state securities law exemptions are also available to privately-held employers; however, state regulations of equity compensation varies widely by state and generally, employers will have to undertake some due diligence on this issue at the time the equity compensation program is established.

Publicly-traded companies have previously registered their stock with the Securities Exchange Commission and generally are able to grant equity awards by filing a short-form registration statement called a Form S-8.

## Accounting Considerations

U.S. companies granting equity-based awards have to expense the awards under Financial Accounting Standard (FAS) 123R of the U.S. Generally Accepted Accounting Principals (GAAP). If awards are granted by a foreign parent company, the accounting treatment is determined by the accounting standards applicable in the jurisdiction of the issuing company (*e.g.*, under the International Financial Reporting Standards (IFRS)). However, the U.S. employer will still be required to expense the awards on its local books under FAS 123R [need to confirm].

For stock-settled awards (such as stock options, restricted stock awards and RSUs and SARs settled in shares), FAS 123R generally requires that the fair value of the award be determined and expensed ratably over the vesting period of the award. By contrast, cash awards (including cash-settled RSUs and SARs) are subject to liability accounting which means that the value of the award has to be re-measured during each reporting period while the award vests. Liability accounting, also known as variable accounting, may lead to higher volatility and is generally considered less desirable.

If the terms of an award are modified after the award has been granted, this is generally viewed as a modification of the award which can result in an additional expense.

There are plans to phase out U.S. GAAP and adopt IFRS for U.S. companies. Since there continue to be certain important differences between the accounting treatment for share-based awards under GAAP and under IFRS, this would facilitate the grant of share-based awards by foreign parent companies to U.S. employees. However, it is not expected that any convergence will be completed before 2015 at the earliest.

## **7. Workplace Safety and Workers' Compensation**

### **a. Workplace Safety**

The Occupational Safety and Health Act of 1970 (“OSHA”) went into effect in 1971. The purpose of OSHA is to provide “every working man and woman in the Nation safe and healthful working conditions.” As a result, employers in the United States are required to provide a workplace free of safety and health hazards, and to comply with standards set by the Occupational Safety and Health Administration.

Employees in all states, the District of Columbia, Puerto Rico, the Virgin Islands and many other U.S. possessions are covered by the Act. However, OSHA does not apply to federal and state public employees. OSHA is enforced by the U.S. Secretary of Labor and the Assistant Secretary of Labor for Occupation Safety and Health. There are also regional and area offices which are responsible for safety and health inspections.

23 states and two territories have adopted “mini-OSHA” laws that must be at least as effective as the federal law. State workplace safety plans must be approved by the Secretary of Labor.

#### **Regulations and Standards**

The standards that OSHA provides for employers fall into three categories: construction standards, for the construction industry; agricultural standards, for the agricultural industry which regulates environmental conditions (including pesticides) and the safety of farm equipment; and general industry standards, for all other employers.

OSHA contains a general duty clause which provides that all employers provide a workplace “free from recognized hazards that are causing or are likely to cause death or serious physical harm.” Any unsafe condition not covered under a specific standard is covered by the general duty clause.

#### **Inspections**

Employers may be subject to inspections and investigations by OSHA compliance officers. Compliance officers may enter a workplace during a reasonable time and regular working hours. An employer may use the reasonable time requirement to request to postpone an inspection only if there truly is a legitimate reason to do so.

Employers are entitled to request a search warrant before a compliance officer performs an inspection. However, most employers do not do so. Employers most often request search warrants when no management representative is available, or when there is labor unrest within the facility.

OSHA inspections begin with an opening conference during which the employer should find out why the OSHA inspector has chosen to inspect the particular facility, e.g., due to an employee complaint, to investigate an accident, or as part of a general administrative agenda. Knowing why the facility is being

inspected allows the employer to properly limit the scope of the inspection. The opening conference is an excellent opportunity for the employer to outline the company's safety program to the inspector. The employer should take care, however, not to volunteer information about any outside or self-audits of workplace safety.

The second stage of an OSHA inspection is the walk-around. The company representative is entitled to and should remain with the inspector throughout the walk-around and take detailed notes of the entire process. The inspector may take video or audio recordings during the walk-around, but must inform the employer that he or she will be making a recording. The inspector may request interviews with employees; however, the company attorney or management representative has a right to supervise any such interviews.

An OSHA inspection ends with the closing conference. During the conference the employer may request additional information to learn more facts of alleged violations. The employer should be careful never to admit to any violations or to argue with the inspector. The employer should also request information about how to correct any alleged violations.

#### Citations

After an inspection, OSHA will send citations (if any) by certified mail to inform the employer of regulations and standards alleged to have been violated. The employer must post a copy at or near the place where the violation occurred for three days or until the violation is abated, whichever is longer.

The employer may choose to correct the violations within the abatement period and pay any penalties. To comply with citations, the employer must send a letter to the OSHA Area Director stating that the employer has taken the corrective action within the abatement period and will pay any penalties required. The Area Director may require additional proof, depending on the severity of the violation.

If the employer believes that the citation is incorrect, the employer has 15 working days to contest the citations in writing by filing a Notice of Intent to Contest. Employers may also file a petition for modification of abatement if the employer is unable to meet the abatement date.

After a citation, OSHA may conduct a follow-up inspection in order to verify that the employer has complied with all requirements.

#### Penalties for Violations

Penalties for violating OSHA vary widely. Violations are classified as serious, non-serious, willful, or repeated. A serious violation is when there is a substantial probability that death or serious physical harm could result and the employer knew or should have known of the risk. Serious violations carry a mandatory penalty of up to \$7,000 per violation.

Non-serious violations carry a discretionary penalty of up to \$7,000, which may be reduced by up to 95% depending on the employer's good faith, history of previous violations and the size of the business. A willful violation is committed knowingly with plain indifference to the law. Willful violations carry a mandatory minimum penalty of \$5,000 with a maximum of \$70,000. Willful violations resulting in death can lead to criminal convictions which carry fines of up to \$250,000 for an individual or \$500,000 for a corporation, with the possibility of up to six months of jail time. However, employers rarely receive jail sentences.

An employer may be cited for a repeated violation if the employer has been cited for the same or a substantially similar violation anywhere in the nation within the last three years. Repeated violations can carry fines of up to \$70,000 for each repeated violation.

Other specific penalties are: up to \$7,000 for each day a violation continues beyond the abatement date; criminal fines of \$10,000 or up to six months in jail for falsifying records; and up to \$7,000 in fines for violating posting requirements.

#### Retaliation

Employers may not punish or discriminate against employees who seek safety and health on the job. If an employee feels that his employer has retaliated against him or her for exercising his or her safety and health rights, the employee has 30 days to report the retaliation to OSHA.

#### Reporting and Record Keeping Requirements

Employers covered by OSHA with 10 or more employees are required to keep a log of workplace injuries resulting in death, lost time, restricted work capability, requiring medical treatment or resulting in illness. Employers must also report each incident that results in the hospitalization of three or more employees. Such records should be made available to all employees and employers must post an annual summary of injuries and illnesses. Additionally, all employees should be informed of the process for reporting injuries and illnesses to the employer. More stringent reporting and recording standards apply to certain hazardous industries.

### b. Workers' Compensation

Workers' compensation is mandatory for nearly every employer in every state. Workers' compensation is best understood as a no-fault insurance system for paying workers who are injured during accidents that occur on the job. Typically, the manner and circumstances in which the accident occurred is not relevant (except for intentional injuries, safety violations, or injuries and accidents involving drugs or alcohol). Therefore, an employee's entitlement to workers' compensation benefits does not depend on whether the injury is a result of the employee's or the employer's negligence.

Employers must be qualified self-insurers, or carry workers' compensation insurance, or contribute and participate in a state workers' compensation fund. Employers should be careful to ensure that they have the correct workers' compensation insurance. For example, if an employer is based out of Michigan, but has employees who travel and do work in Illinois, the employer should go beyond paying into Michigan's workers' compensation fund and have the proper insurance in Illinois and every other state in which they do business.

Additionally, some of the federal workers' compensation insurance statutes require specific insurance to cover injuries, particularly for employees who work on or near waters and railroads (see the Longshore and Harbor Workers' Compensation Act, Jones Act, and Federal Employers' Liability Act).

#### Injuries Covered by Workers' Compensation

Workers' compensation coverage is broad, however, not all workplace injuries/illnesses are covered. An injury must occur during the course of employment and must also arise out of employment (work-related). An employee must be engaged, either directly or indirectly, with furthering the employer's interests or the activity must have been an inherent part of the conditions of employment.

Certain occupations and industries require automatic participation in workers' compensation plans, including construction; excavating or electrical work; mining; any work having to do with explosives;

most manufacturing; beauty parlors that use chemicals, solutions or heated tools; and many others. Employers do not need to procure workers' compensation coverage for independent contractors and employees of independent contractors. Whether an individual is an independent contractor or an employee is, however, a highly fact specific inquiry.

Injuries sustained in the following circumstances are generally compensable under workers' compensation insurance: when a worker is traveling and rendering reasonable services for the employer, recreational or social activities on company time; activities that occur for personal convenience during break time or lunch time, particularly if the employer requires the employee stay on its grounds or in its facilities; injuries in parking lots supplied by the employer; repetitive trauma; suicide - if the complainant can show that the injury was the causative factor of the suicide; and many others.

Employers are not required to provide workers' compensation coverage when an employee is injured while intoxicated if the employee was so intoxicated he or she was unable to perform his or her work. Workers' compensation also does not cover an injury resulting from an "act of God," unless the employee can demonstrate that but-for his or her employment, he or she would not have been in the situation for the injury to occur (such as lightening, hurricanes, tornados, etc.). Similarly, there is no workers' compensation protection if the employee voluntarily assumed the risk of sustaining an injury for his or her own convenience. Finally, employees are not usually covered for injuries resulting from horseplay, when the employee is the aggressor in an altercation at the workplace, violations of safety rules, and from willful misconduct.

#### Procedural Requirements

Employees are required to report accidents and injuries to the employer as soon as practicable. Employers should be certain to ensure that an injured employee receives medical attention. Then the employer should follow the procedural steps necessary to make payments to the injured worker and or properly and promptly challenge a claim for benefits. The procedures and documentation required to address a claim for workers' compensation vary state by state.

#### Benefits Provided

Benefits provided by workers' compensation insurance coverage are typically based on whether the disability is temporary or permanent, and partial or total.

Temporary disabilities are when the worker is still receiving medical care but has not reached maximum recovery. If the worker is as fully recovered as possible, no longer receiving medical care, and is still disabled, then the worker is permanently disabled.

A total disability is the result of an employee's complete inability to work at all, in any job. Partial disability means that an employee can work, but at a reduced capacity.

Typically, the loss of extremities (fingers, hands, arms, toes, feet, legs) as well as hearing and sight are awarded payments based on a schedule and the percentage of loss, which is then multiplied by a disability rate (usually 60-66% of the employee's pay). Again, these rates and schedules vary state by state. Injured employees may also be entitled to ongoing medical benefits and rehabilitation care during their recovery period.

Should an employee die due to a work injury, his or her dependents are entitled to receive death benefits. Who qualifies as a dependent and the standards used in making such determinations vary state by state.

However, most states provide children and spouses with a death benefit until the widow dies or remarries, or children reach the age of 18.

## 8. Unions and Labor Laws Relevant to Non-Union Workplaces

The NLRA is the federal law that establishes the right of workers to engage in collective activity, including to form, join, and assist unions. The Act also regulates what employers can and cannot do in response to employee collective activity and in terms of bargaining with unions. Employers violating the NLRA are subject to what are known as “unfair labor practice” charges. Allegations of such charges go before the U.S. National Labor Relations Board (“NLRB”), the federal agency charged with enforcement responsibility for the NLRA. The NLRB acts as a quasi-judicial body, and it has substantial latitude and discretion in its interpretations of federal labor laws. The NLRB also investigates potential complaints, holds hearings, and enters remedies for violations of the law. The legal exposure to employers from unfair labor practice charges can be quite severe.

The subjects of unions, strikes, picketing, and boycotts are usually associated with workplaces covered by collective bargaining agreements. Currently, only 12.4% of the total U.S. workforce, and 7.6% of the private sector workforce, are unionized. However, federal labor laws pertaining to unions and collective bargaining agreements in the United States are not limited to workplaces where unions exist. In certain circumstances, the protections and rights afforded to union-represented employees extend to unrepresented employees in non-union workplaces as well. The three most common situations where U.S. labor laws impact non-union workplaces involve: (i) the hiring and firing of union organizers; (ii) restrictions on the right to fire employees engaged in concerted activities; and (iii) the legal status of employer-employee committees.

### a. Avoiding Unfair Labor Practice Charges from Union Organizers

Federal labor law issues may arise in a non-union workplace by virtue of the NLRA’s application to the hiring process. This occurs if a person employed by a union as a business agent or organizer applies for a job at a non-union workplace. Some unions, especially in the construction industry, have begun to embark on new types of organizing strategies which utilize this aspect of the NLRA. The union will urge its members to flood a non-union employer with job applications. In turn, union members and organizers will state in writing on the application forms that they are union organizers, even though the employer’s application form does not ask for union affiliation. Usually the number of applications from union organizers far exceeds the number of available jobs or the applications submitted by non-union workers. The employer is then caught in a difficult position. If the employer hires the organizer-applicants, the union will immediately seek recognition and bargaining since many union members will have been hired and its members would constitute a majority of the workforce. On the other hand, if the employer does not offer jobs to the organizer-applicants, the union will file an unfair labor practice charge alleging discriminatory hiring practices.

Although an employer is free to reject the application of an applicant-organizer for any reasons unrelated to union affiliation, discrimination on the basis of affiliation with a union is unlawful under the NLRA. Unfair labor practices alleging a discriminatory refusal-to-hire are filled with fact-sensitive issues: Was the motive for the hiring decision based on discrimination against the union’s members or did the employer decline to hire them for a perfectly logical, acceptable, and legitimate reason? In these circumstances, the NLRB has often sided with unions and concluded that employers have violated the NLRA in refusing to hire organizer-applicants.

To counter this problem, it is recommended that employers adopt hiring policies which specify that individuals are disqualified from consideration for employment if they seek only temporary employment or work simultaneously for more than one employer. Organizer-applicants differ from regular applicants

in several respects. Most are paid by the union for organizing activity. Accordingly, they are often under directives that require them to leave their non-union jobs on the pain of union fines and discipline whenever their union instructs them to do so. Organizer-applicants also generally have no interest in working for an employer other than to organize its workplace. Thus, such a hiring policy would permit an employer to reject an applicant who is a paid union organizer or who has no intention of working after an employer's labor force is signed up to join a union.

Beyond union organizers trying to get hired, the topic of union organizing is a difficult one for many employers in the United States to properly handle. The NLRA permits employees to discuss their job terms with each other and to solicit other employees to join a union. In order to minimize these risks, employers in the United States are well advised to develop and implement what are known as "non-solicitation/non-distribution" policies. When properly drafted, these policies can be used by an employer to lawfully prohibit employees from being solicited to join a union on company property and/or during company work time.

#### **b. Restrictions on an Employer's Right to Fire Employees Engaged in Concerted Activities**

The NLRA's protections are not limited to union-represented employees. The law protects almost all employees below the supervisory, managerial, and executive levels. The protections of U.S. labor laws extend to all such employees, regardless of union representation, insofar as all employees have the right to engage in what is known as "protected concerted activity." The NLRA makes it unlawful for any employer to interfere with, restrain, or coerce employees in the exercise of protected concerted activities. Although the primary purpose of this provision of the NLRA is to protect the right of workers to organize and bargain collectively through unions, the law also extends the right to employees to engage in "other concerted activities" for the purpose of "mutual aid or protection." Based on this language, courts have construed the NLRA to protect non-union employees who raise group concerns in a non-union workplace relative to pay, hours, or working conditions. For example, an employee engages in "protected concerted activity" when he or she voices concerns on behalf of co-workers with respect to working conditions at the company.

The issue of when conduct is protected concerted activity is determined on a case-by-case and totality-of-circumstances basis. Generally, concerted activity is present when a reasonable inference can be drawn from all the surrounding facts and circumstances that the employees acting together thought that they had a work-related grievance, and in turn, asserted their grievance to management personnel. The fact that the protest or grievance lacks merit will not undermine the right of the employees to engage in concerted activity.

The NLRA prohibits employers from taking any adverse action in response to employees who undertake concerted activities. Courts will deem a termination to be unlawful due to interference with protected concerted activity if: (1) the activity was "concerted"; (2) the concerted activity was protected; (3) the employer knew of the concerted nature of the activity; and (4) the concerted activity was a motivating factor in the employer's decision to discharge or discipline the employee. Accordingly, employers and supervisors should carefully consider any termination decisions whenever the basis for the proposed firing stems from group protests or grievances. Employees who circulate petitions, file complaints over work conditions, or protest any terms and conditions of employment may well be protected from discrimination by the NLRA. In contrast, workers who protest by threatening violence or using abusive or insulting language will not be protected by the NLRA if their conduct interferes with the efficient operation of the employer's business.



### c. The Legal Status of Employer-Employee Committees

Management through employee participation in workplace decisions is increasing in popularity in U.S. companies. This concept generally involves committees comprised of supervisors and workers that are charged with the task of addressing certain workplace issues. These have many forms or labels such as “quality control circles,” “employer-employee teams,” or “employee involvement committees.” A common characteristic of these committees is the goal of enhancing employee productivity and loyalty, both by increasing employee involvement in workplace decisions and in allowing employees to gain a sense of empowerment.

The status of employer-employee committees is unclear under U.S. labor laws. Different than in many EU jurisdictions, for instance, there are no mandatory works councils or other employee representative groups in the United States. Instead, any such groups are optional. The NLRB has determined that in some circumstances it can be an unfair labor practice for an employer to establish employer/employee committees in a non-union workplace. This is because the NLRA prohibits an employer from dominating or interfering with a “labor organization,” which includes any organization or committee which exists to deal with employers concerning wages, hours, or conditions of work. Thus, depending on the degree of an employer’s control or involvement with employee involvement committees, an employer may inadvertently “dominate” a “labor organization.” This can make an employer potentially liable for an unfair labor practice, even in a non-union workplace. However, some courts disagree with the NLRB’s analysis of this issue. Accordingly, employers should evaluate carefully the propriety of establishing any employee committees so as to avoid a violation of the NLRA. The subjects that such committees can discuss should focus on workplace morale, productivity, training, and customer service. Grievances, wages, hours of work, and conditions of employment are topics which may run afoul of the NLRA.

## 9. Employee Monitoring and Data Protection

Employers today have the tools to easily monitor their employees’ activities, both at work and in their personal lives. Federal, state, and local laws, however, have restricted an employer’s ability to monitor employees in the face of employee concerns that their privacy rights are curtailed through intense monitoring. Therefore, employers who wish to monitor or search an employee’s space (including offices, cubicles, desks, drawers, computers, emails, company telephones, or other company systems) must observe several laws and regulations regarding employee privacy. When implementing a monitoring system or developing a surveillance or privacy policy, the employer must balance the benefits of monitoring employee activity with the employee’s privacy concerns. Generally, an employer may monitor an employee’s electronic communications if the employee consents to such monitoring by expressly accepting an equipment use policy that explicitly states the company may monitor employee communications and activities on company systems and equipment. Accordingly, many U.S. employers have a “pop-up” window appearing every day when an employee logs into the employer’s computer system informing him/her of the employer’s monitoring of the employee’s computer use. Some states, however, have laws requiring the consent of both the drafter and the recipient to monitor or record telephonic, electronic or stored communications.

Accordingly, in addition to the federal laws discussed below, employers should also check privacy laws for each state and locality in which employees are performing work or where company systems or electronic devices are located. Employers should also check for any data protection obligations under contracts with federal, state or local governments and other private companies.

#### a. Federal Constitutional Law

The United States Constitution does not generally apply to monitoring conducted by private companies, but rather only employee monitoring conducted by federal, state, or local government agencies.

#### b. The Electronic Communications Privacy Act

The Electronic Communications Privacy Act (“ECPA”) merits careful consideration for any employer wishing to conduct employee monitoring. The ECPA, which includes the Wiretap Act and the Stored Communications Act (“SCA”), aims to protect the privacy of electronic communications on devices such as telephones (including cellular phones and texting), fax machines, and computers. The Wiretap Act prohibits unauthorized interception of electronic communications while in transit, such as a voice-mail message that is retrieved by a third party before it has been received by the intended recipient. The SCA prohibits unauthorized access to electronic communications that have been stored, such as emails that have been received, and voice-mail messages. There are exceptions in the ECPA, however, for employer monitoring if the employer either: (i) obtains consent through a company policy that expressly states that communications may be subject to monitoring; or (ii) monitors electronic communications on the company’s equipment and servers to promote quality control, prevent loss of trade secrets, or investigate employees. Therefore, employers should reduce the risk of violating the ECPA by obtaining specific consent to such monitoring on all company equipment and systems. Generally, employers may review their own systems and equipment without violating the ECPA. Nevertheless, some courts have prohibited employers from accessing personal webmail accounts, even if the employee accessed the account from the employer’s computer.

#### c. Fair Credit Reporting Act

Any employer conducting background checks on current or prospective employees may be subject to the FCRA (see section II chapter 4 b on background checks). In particular, if in the course of conducting background checks a third party consumer reporting agency is used to obtain an investigative consumer report or consumer report, the employer must comply with specific notice, consent, and disclosure requirements outlined in the FCRA. For example, the employer must certify to the consumer reporting agency the employer’s identity, the purposes for which the information is sought, and that the information will only be used for the disclosed purpose. If the employer takes adverse action on the basis of the consumer report, the employer must disclose the adverse action along with the name and address of the consumer reporting agency and a statement that the consumer reporting agency did not make the decision to take adverse action. The employer must disclose the report if the employee requests a copy.

If the report is obtained as part of an investigation into suspected misconduct during employment, however, the employer is not required to give notice or obtain consent, but must disclose a summary after taking adverse action. For purposes of the FCRA, “adverse action” may be any decision “that adversely affects any current or prospective employee.”

The Federal Trade Commission may conduct employer audits to ensure that employers conducting background checks are in compliance with the FCRA, and may seek civil penalties for noncompliance. Finally, any employer possessing consumer reports or information derived from a consumer report “must properly dispose of such information by taking reasonable measures to protect against unauthorized access or use of the information in connection with its disposal.” Therefore, employers should create a policy for disposal of the information so that it cannot be easily read or reconstructed.

#### d. Health Insurance Portability and Accountability Act

Employers who administer health plans for their employees may be subject to the Health Insurance Portability and Accountability Act of 1996 (“HIPAA”), which, among other things, maintains standards for privacy and security of individually identifiable health information. Individuals are entitled to notice regarding use or disclosure of information regarding their mental or physical health, healthcare, or payment for health services. Individuals may request an accounting of such disclosures, may view and correct any disclosures, and may limit the purposes for which the information may be used without the individual’s consent.

If covered by HIPAA, documents regarding the health plan must include provisions stating that the covered entity will comply with all the requirements of HIPAA. Violations of HIPAA may lead to significant civil or criminal liability, even if the plan administrator, rather than the employer, commits such violations.

The Health Information Technology for Economic and Clinical Health Act (“HITECH”) established important amendments to HIPAA regarding privacy and security breaches of health information. The amendments require: (i) mandatory notification to the employee in the event of a security breach of the employee’s information according to strict timelines; (ii) extension of certain HIPAA provisions to business associates of covered entities; and (iii) extension of notification requirements to vendors of personal health records and other non-HIPAA covered entities. Employers covered by HIPAA should (in their capacity as a health plan or other covered entity) review their business associate (which is a highly complicated definition subject to numerous interpretations) contracts to ensure compliance with HITECH.

#### e. Federal Trade Commission Section 5

Federal Trade Commission interprets Section 5 of FTC Act, which prohibits fair and deceptive practices, to affirmatively require employers to adequately protect and destroy consumer and employment documents if the employer represents that it has privacy policies in place (even through general statements on a website). The FTC has previously charged entities for violations such as throwing completed employment applications containing personal information in a trash can or dumpster without shredding it, failing to adequately train employees in sensitive industries (such as pharmaceuticals) on consumer and employment data privacy, and failing to have adequate data privacy policies in place for the handling of consumer and employment personal data. Employers should carefully review all data privacy policies to ensure the employer complies with its representations, and train employees on proper data protection processes.

### III. Terminating

#### 1. Evaluation, Discipline and the Termination Process

As described in section II chapter 1, employees in general have relatively limited rights in the context of discipline and termination as a result of the legal concept known as the “at-will” employment rule. This rule of law provides that an employer in the United States is free to discipline and/or terminate an employee for any reason, without notice, and at any time, without any financial obligation whatsoever to the discharged worker.

However, as also described above, the “at-will” employment rule is subject to a number of exceptions. The most important exceptions to the “at-will” employment rule are set forth in the above-described federal and state statutes that prohibit discrimination against workers based upon age, sex, national origin, race, color, religion, disability, pregnancy, genetic information, sexual harassment and other individual characteristics. And, as further described above, in addition to the anti-discrimination laws, many states have recognized additional exceptions to the “at-will” employment rule through the “common law.”

Accordingly, employers can, and should take special care in evaluating, disciplining and terminating employees in order to minimize their potential exposure to discrimination and other employment-related claims. Employers should take special care in requiring supervisors to thoroughly and honestly evaluate the job performance of an employee. Performance evaluations are critical to employee morale and documentation of performance. Equally significant is the importance of performance evaluations in the defense of employment-related litigation. Performance evaluations done incorrectly can scuttle an employer’s defenses to any potential employee-initiated claim. The typical scenario involves an employee discharged for poor job performance. The employee files a lawsuit and claims that discrimination rather than poor work performance motivated the employer to terminate the worker. The job evaluation done by the employer therefore becomes critical to the issues in the case. If the evaluations do not substantiate the employer’s claim that the worker’s job performance was unacceptable, the lawyer for the employee can easily argue that discrimination rather than performance reasons motivated the discharge.

A common problem with job performance evaluations concerns a supervisor’s inability to be frank and candid with an employee, especially where a worker’s performance has been less than acceptable. This stems from the inability of managers to be both “a judge” and “a coach” of their subordinates. Another problem is that many times a supervisor will criticize the employee in a face-to-face meeting, but rate the employee in an acceptable fashion on the written performance evaluation form. This is generally because a supervisor wishes to motivate the subordinate, to free them from the uncertainty that could harm future performance, or to enlist their loyalty. The supervisor’s actions do the company no good in attempting to create a record of the employee’s deviation from acceptable standards of work. Instead, managers who soft-peddle performance criticisms unintentionally convey the misleading impression to an employee that their performance is acceptable.

The goal of any performance evaluation system, therefore, is to ensure that a supervisor is objective and honest with an employee with respect to their strengths and weaknesses, and that the supervisor documents the performance evaluation in a contemporaneous written record. The documentation underlying the performance evaluation should be dated and signed by the supervisor performing the evaluation. In turn, the employee should be required to sign the performance evaluation form. This creates a mechanism to show that the worker received the performance appraisal, acknowledged the company’s expectations as to future performance, and understood the consequences of a failure to

improve their performance (i.e., possible termination). If performance evaluations are done correctly, terminations on account of poor performance should never surprise the worker.

Another problem particular to the evaluation and disciplinary process is when management applies standards inconsistently or tolerates “indiscretions” by high-level workers or those who cannot be readily replaced. Discipline and evaluation must be conducted in a fair, impartial, and even-handed fashion. Supervisors should not apply standards or rules in a “political” way, either by overreacting to minor problems to accomplish some other objective or by turning a deaf ear to an obvious violation of a workplace rule.

The evaluation and disciplinary process is also important with respect to the control of potential employment-related liabilities. It should be the goal of any disciplinary system that similarly-situated employees be treated equally and consistently. Discrimination charges are many times brought and are often times successful if employees guilty of the same offense are disciplined in a disparate or inconsistent fashion. At the same time, while progressive discipline is a rational and appropriate system, companies should reserve their right to suspend some or all of the steps in their disciplinary policy and to fire employees whenever such is necessary in management’s judgment. Obviously, every position has a unique set of expectations, and a person in a high management position may be disciplined more harshly than a worker in an entry level position for a similar infraction.

The focal points of any evaluation and disciplinary system are the concepts of *notice* and *fairness*. If a company adheres to the concepts of notice and fairness, its exposure to employment-related liabilities will be reduced substantially. Managers who make reliable and fair-minded judgments about employees they terminate can decrease the chance of being sued or saddling their employer with an expensive judgment or out-of-court settlement.

To accomplish these goals, supervisors should endeavor to discipline employees deviating from an employer’s rules and policies. The discipline should be confirmed in writing. In this respect, the employer puts the employee “on notice.” A “paper trail” is thereby created so that there is an accurate record of what actually occurred during the worker’s employment history. Written documentation of discipline should include all relevant facts and be written in clear and concise language. Derogatory or emotionally charged remarks have no place in disciplinary documentation.

Fairness in this context means that after an employee is put on notice of what is expected of them, the company is willing to allow the worker the opportunity to improve. The employee should be disciplined promptly. When managers tolerate unacceptable performance for an extended period of time and then fire an employee abruptly, the employee may claim that the action was arbitrary and discriminatory. Thus, to the extent a supervisor identifies performance deficiencies on the part of an employee, specific goals and timetables should be provided in an effort to counsel the worker. Before a firing for poor performance, an employer should endeavor to issue a final warning to an employee that includes the possibility of a termination if performance does not improve. In other words, the employee should be given the opportunity to succeed, and the chance to fail, too. By making the employee an active participant in the disciplinary process, the process is more fair and effective. Supervisors should never ignore an employee’s side of the story. If a worker has an explanation for their problem, the supervisor should hear them out. Thus, fairness also includes understanding what is fair from the vantage point of the employee.

In the United States, most lawsuits arise between workers and their employers when an employee is fired. Indeed, over 80 percent of employment-related lawsuits stem from the firing of workers. For this reason, loss control procedures take on added importance in the termination process. To reduce the risk of

lawsuits over terminations, employers should strive to address the notice and fairness concepts: In other words, did the employer warn the employee in writing of the problems (put them on “notice”) and did the worker have sufficient opportunity to improve performance (was the worker treated with “fairness”)? Unless these elements are satisfied, the termination decision is probably premature, and especially risky in the case of a worker exhibiting poor job performance.

The concepts of notice and fairness have various consequences with respect to procedures and mechanisms for implementing terminations. To ensure that this process works correctly, employers should avoid summary or “on-the-spot” firings. Termination decisions made hastily and in heated circumstances are very risky. An employee should be summarily terminated in only the rarest of circumstances. It is more prudent for employers to ensure that the ultimate decision with respect to firings should rest with upper-level managers. Although front-line supervisors play a vital role in the disciplinary process, final decision-making authority for a termination should be reserved to upper-level managers.

Terminations of employees protected by a federal or state employment law (e.g., a woman, an African-American, a disabled worker, etc.) also warrant special consideration. When dealing with such an employee, it is critical that the termination decision be reviewed by an upper-level manager to ensure that the decision is appropriate and fair. The facts should be reviewed independently by someone who has no supervisory responsibility for the employee or emotional involvement in the termination decision. Moreover, information pertinent to the employee and their situation should be gathered from all relevant sources; the decision-maker should do more than simply listen to the line-supervisor’s account of the reason for the termination. Accordingly, the final decision to terminate should not be exercised until all of the facts regarding the conduct of the employee have been carefully investigated.

While it is true that federal and state employment laws do not require employers “to be fair” (i.e., the laws simply obligate companies to refrain from discrimination), employers who endeavor to be fair are sued less often; those who are sued lose these claims less often, too. This is because juries often equate unfair treatment by employers with discrimination against employees. Thus, an employer risks potential liabilities in following through with a firing unless the termination decision can pass a “fairness” test. This is especially true when the worker in question is protected by federal or state discrimination laws. It is also important for employers to carry out a firing without delay once the termination decision is made. Companies do harm to the integrity of their disciplinary systems if they do not follow through on a final warning with respect to a firing. Employers who wait too long only weaken the case for the termination; it also sends the wrong signal to the employee who rightly assumes that his or her performance is acceptable.

Employers always should notify the employee of the termination decision in person. This is usually done in what is known as an “exit interview.” When the decision is conveyed to the worker, all appropriate information should be at hand with respect to severance, benefits, reference, and outplacement. This provides an opportunity for a final accounting of all employer and employee responsibilities, including the worker’s return of keys, computer disks, and other miscellaneous items of company property. In addition, two representatives of management should be present – one to convey the decision and one to witness the discussion. The management witness can substantiate the discussions if the worker subsequently sues. To that end, it also is important to ensure the proper documentation of any discussions about the firing with the employee being terminated. Without appropriate documentation, it is difficult to defend employment-related lawsuits stemming from the discharge of the worker.

Management’s communication of the termination decision to an employee is a difficult task that must be handled in a professional manner. The fashion in which the news is broken to the worker will be critical

to the employee. If it is done correctly, it may assuage the worker's feelings and evoke a favorable statement – for example, “I admit my performance was bad,” or “I realize I was not a victim of discrimination” – that can be used in later litigation if the employee changes his or her mind and sues the company. Accordingly, employers should attempt to be compassionate in conveying the termination decision. Imagine what it would be like to be on the other side of the table in terms of the firing.

Finally, the conduct of the management representative during the termination meeting is critical. Extreme care should be exercised to stay clear of subsequent problems. Managers should avoid words or statements to the effect that they think that the “corporate decision” to fire was “unjust”; that the worker should retain an attorney; that some other person is to blame for the termination; or that the firing was done abruptly. Instead, managers should ensure that the reason for the employee's termination is communicated to the worker in an accurate fashion. Informing the worker of the non-discriminatory reason for the firing is essential in avoiding a later claim that the true motivation for the discharge was unlawful discrimination.

In the present environment of ever escalating claims brought by terminated employees, companies should consider whether it is in their interest to obtain a release of liability from the worker at the time of their termination.

## 2. Releases

Under U.S. law, employees can waive their employment claims by a written agreement, called a “release” or a “release agreement.”

Releases are obtained to avoid potential employment claims by the employee following termination. The primary reason to obtain a release is to buy peace of mind and avoid legal claims. Former employees may file lawsuits against the company or company officials, and the costs of defending these claims is substantial. The release may be a relatively low cost investment, especially given the cost to employers in terms of attorney's fees and the time of company officials spent in defending against a lawsuit. Nevertheless, an employer does not need a release from every departing employee. After all, the legal exposure from a resigning employee, or from terminating a worker should be minimal if an employer has appropriate personnel policies, maintains an “at-will” employment arrangement with the employee, and carries out workplace practices which avoid claims of discrimination or retaliation related to the termination.

Generally speaking, employers should consider requesting a release from a departing employee if there are facts that may suggest the employee will or could make a claim of unlawful discrimination or retaliation, the termination is questionable, open to challenge, or undocumented, if the employer is offering severance, or the employer wishes peace of mind regardless of the circumstances of the termination decision. Approaching an employee to seek a release must, itself, be handled delicately. If drafted inappropriately, or offered or signed prior to a dispute arising, the release may be ineffective or the employee may be able to use the form release as evidence *against* the employer.

### a. Waivable Rights

Most employment claims can be waived by the employee under U.S. or state law. The following is a list of employment claims that cannot be released:

- undisputed wage claims
- undisputed business expenses incurred

- federal wage and overtime claims (unless approved by a court or the Department of Labor)
- workers' compensation claims
- claims for unemployment
- military discrimination claims under the federal USERRA
- the employee's ability to seek government investigation (although the employee's ability to recover monetary damages by such government agencies can be waived)
- future claims (for this reason, the employee should sign the release, or re-execute it, on his/her final day of work and not before).

#### b. Consideration and Timing

A release is only valid if the employee is provided some money or other benefit which the employer has no legal obligation to give the worker, referred to as "consideration" for the release. In this respect, the employee should receive greater money or severance than required by company rules or an employment contract. Consideration for the release cannot include earned wages, earned bonuses, or earned commissions, or any other benefit already promised to the employee or to which the employee is entitled by law. (For this reason, any offers of severance by company policy or contract entered into at the outset or during employment should expressly state the severance is only offered in exchange for a release and waiver by the employee.) Adequate "consideration" is most commonly additional money or severance, but it can be anything else of value. Employers have many options in terms of the amount or type of "consideration" that will be offered to workers in order to obtain a valid waiver of claims.

Severance is normally offered to employees at the time of termination when final pay and benefit obligations are also being addressed. When that occurs, the agreement should clearly separate out what is being paid or offered due to the termination of employment (regardless of whether the employee signs the release), and what is being offered as additional consideration if the employee signs the release. Federal tax law may require the agreement state when the release offer will expire if the employee does not sign, and exactly when the severance payment will be made if the employee does sign. In addition to adequate consideration, the release must be entered into knowingly and voluntarily by the employee, and cannot be coerced, to be effective.

For employees under age 40, state law will govern how much time the employee must be given to sign the release. Most states do not have a requirement or only require "reasonable" time to consider the release, which is most commonly seven days or longer.

For publicly-traded companies, there can be additional timing and tax limitations, as well. Because releases cannot release or waive claims in the future for conduct that has not yet occurred, releases should not be signed until at or after the time of termination. For this reason, releases are most commonly issued at or after the time of termination. If the employment agreement is entered into at the beginning of employment, or for a severance plan or policy, the agreement or plan should state that the severance will only be paid if the employee signs a release at or after the time of termination.

#### c. Requirements under the Older Workers Benefit Protection Act

Under U.S. federal law - the ADEA - employers with 20 or more employees are prohibited from discriminating against employees or applicants on the basis of their age if the person is aged 40 or over.



Under the ADEA, releases from employees aged 40 or over must meet additional requirements to effectively release claims of age discrimination, as follows:

- (1) the release agreement must be written in a way that can easily be understood by the employee;
- (2) the release must specifically state that rights or claims arising under the ADEA, as amended by the Older Workers Benefit Protection Act (“OWBPA”), are being waived;
- (3) the employee cannot be asked to waive claims challenging the validity of the release agreement as required under the ADEA;
- (4) the employee must be advised in writing to consult with an attorney prior to executing the agreement;
- (5) the employee must be given at least 21 days to consider the agreement (or 45 days for mass lay-offs or releases obtained under a severance program, discussed below); and
- (6) the employee must be given seven days after signing the agreement to revoke (the release will not become effective or enforceable until the revocation period has expired).

For releases obtained by employees aged 40 or over in connection with a group termination of two or more employees, or releases obtained under a severance program or plan, there are three additional requirements to release age discrimination claims:

- (1) the employee must be given a longer period of at least 45 days to consider the agreement;
- (2) the release agreement must identify the eligibility factors for the severance program; and
- (3) the employee must be given a list of the job titles and corresponding ages of the employees eligible for and offered severance, and those not eligible for severance. The list must include all positions in the particular decisional unit or business group the employer used to determine who to layoff and offer severance. The decisional unit or business group is the class, unit, or group of employees from which the employer chose the employees who were selected for layoff or offered severance. An example is as follows:

Employees Laid Off Within Accounting Department and Offered Severance

<b>Title</b>	<b>Age</b>
Accountant Level I	37
Accountant Level II	44

Employees Retained Within Accounting Department

<b>Title</b>	<b>Age</b>
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Accountant Level I	34
Accountant Level II	53
Sr. Accountant	57

#### d. Forms of Releases

Because of these above requirements, many U.S. employers have at least three employment release forms to be used as appropriate: (1) employees aged 40 and over for individual terminations; (2) employees aged 40 and over for group terminations or part of a severance program; and (3) employees under age 40.

The employer should also consult the law of the state where the employee worked for additional requirements for an effective employment release of state law claims.

Drafting releases for publicly traded companies, or when determining state requirements, whether a group release form is required, the correct decisional unit to list, and how to handle successive or mass terminations can be complex. Employers are encouraged to contact employment counsel to advise on these issues when entering into releases or severance agreements with U.S. employees, or when drafting severance programs or policies.

### 3. Requirements under the Consolidated Omnibus Budget Reconciliation Act

Under federal law, the COBRA employees and their family members who lose coverage under an employer's group health plan due to specified events are eligible for continued coverage in that plan for a fixed period after the date group coverage ends, provided that the participant makes the required premium payments. COBRA amended provisions of the IRC and ERISA that address employer-sponsored group health plans for employers with 20 or more employees. ERISA requires group health plans to provide notice to employees and their covered family members about their COBRA rights, and when an event occurs that triggers the right to COBRA coverage, the group health plan is obligated to provide the employee and family members with a notice to elect COBRA coverage. Although ERISA generally preempts state laws, some states have enacted their own versions of COBRA under state insurance laws and those provisions are typically directed at small employers that are not subject to the federal COBRA requirements. Because COBRA amended the IRC, the failure to comply with COBRA can also trigger tax penalties for employers.

Although most employers sponsoring group health plans outsource COBRA administration to third parties, the legal obligation to comply with COBRA can not be shifted to these administrators. Therefore, employers need to be aware of the basic COBRA requirements, including the individuals who qualify for COBRA coverage, the events that qualify for COBRA continuation rights, the duration of COBRA coverage, and the COBRA notice and election procedures.

#### a. Group Health Plans Subject to COBRA

Group health plans subject to COBRA include health plans that provide hospital care, physician care, surgery and the major medical benefits, as well as prescription drugs, dental and vision care. However, COBRA does not cover life insurance or disability plans.

## b. Individuals with COBRA Rights – Qualified Beneficiaries

An employee covered by an employer’s group health plan has COBRA rights. In addition, a covered employee’s spouse and dependent children also have COBRA rights. These individuals are called “qualified beneficiaries.” Because COBRA is a federal right, a spouse is limited to a person of the opposite sex, so a same sex spouse does not have COBRA rights. Also, COBRA does not protect the coverage rights of domestic partners of employees. However, an employer may voluntarily extend COBRA coverage to the same sex spouse and domestic partner of their employees.

## c. Events that Trigger COBRA Coverage – Qualifying Events

COBRA continuation rights are triggered only if a “qualifying event” has occurred that results in the employee or family members losing coverage under the employer’s group health plan. Coverage generally ends when an employee’s employment is terminated, and also when an employee’s hours are reduced (most employers limit participation in their group health plans to full-time employees, although under the Health Care Act, coverage will be extended to certain part-time employees). Family members of an employee who are also qualified beneficiaries also have COBRA continuation rights for those same reasons, and also when their coverage is lost due to the employee’s enrollment in Medicare, the death of the employee, the divorce or legal separation of the employee and his or her spouse, or when a child exceeds the maximum age for coverage under the group health plan. In addition, the employer’s bankruptcy is also a qualifying event.

## d. COBRA Costs

An individual who elects COBRA coverage is generally required to pay the cost of that coverage. An employer who subsidizes the cost of group health coverage for its active employees is not required by COBRA to subsidize the costs of continuing COBRA coverage. COBRA simply requires employers to offer employees and their family members the opportunity to purchase continued group health coverage from the business for a period of up to 18 to 36 months. The cost of COBRA coverage is generally passed through to the employee or family members. In some situations, such as large scale reductions in force, it is not unusual for an employer to continue to subsidize the cost of COBRA coverage for its former employees for all or part of the COBRA continuation period, but this is a voluntary action on the part of an employer.

The COBRA premium may equal the full cost of coverage plus a 2% administration charge, for a total premium of 102% of the applicable group rate; for COBRA coverage extended due to disability the COBRA premium may increase to 150% of the applicable group rate during the extension period. In 2009 and 2010, the COBRA premiums for up to 15 months of COBRA coverage were temporarily reduced for employees who lost coverage due to involuntary termination of employment. The federal government provided the subsidy for this reduction.

## e. COBRA Notice Requirements

As noted above, COBRA imposes notice requirements on group health plans. First, when employees enroll in a group health plan, the plan is obligated to provide a covered employee and spouse, if any, with a general notice of their COBRA rights. This notice may be provided as a separate document as part of the enrollment process or it may be included in the summary plan description that provides a nontechnical explanation of the group health plan. This notice must be provided within 90 days of the date the employee first becomes covered by the group health plan.

When a COBRA qualifying event occurs, there is another COBRA notice requirement. At that time, a specific COBRA election form is required to be delivered to the employee and any family member who is

eligible for the COBRA coverage. This notice is required to be given within 14 days of the qualifying event, and the notice must give the employee or other qualified beneficiaries at least 60 days to decide whether to elect COBRA coverage. This notice will include details about the duration of COBRA coverage, the COBRA premium costs, the time of payment, and other information.

In order to comply with these COBRA timing rules, the plan must be notified of the qualifying event. Where a third party administers the COBRA obligations, timely notice must be given to the third party. Depending on the qualifying event, either the employer or the covered employee or family member must provide notice to the plan. The employer has 30 days to notify the plan of the following qualifying events: termination or reduction in hours of the covered employee; death of the covered employee; the employee enrolls in Medicare; the employer becomes bankrupt. A covered employee or a covered family member must notify the plan within 60 days of any of the following qualifying events in order to preserve their rights to COBRA coverage: divorce, legal separation, or a child's loss of dependent status.

Within 14 days after the plan receives notice of a qualifying event, the plan administrator (or the third party COBRA administrator) must provide the qualified beneficiaries with a COBRA election notice. In general, the covered employee or other qualified beneficiary will have at least 60 days from the date the COBRA election form is received to elect whether to enroll in COBRA continuation coverage. Separate elections may be made by the former employee, the spouse and the dependent children.

**f. COBRA Coverage and Duration**

Coverage under COBRA should be the same coverage that the employee or other qualified beneficiaries had before the qualifying event. In general, the coverage is the same that is offered to other similarly situated active employees and their family members.

COBRA coverage is temporary. The duration is limited to 18, 29 or 36 months depending on the reason coverage was lost and whether any intervening events occurred. The duration may also be cut short as described below. In general, loss of employment or reduced hours provides a COBRA period of 18 months. However, if the employee became disabled within a short period following the termination or reduced hours and obtains a Social Security Administration determination of disability, then coverage may be extended for up to an additional 11 months (with an increase in the premium to 150% of the applicable cost for the extended period). Further, if the qualifying event is the employee's enrollment in Medicare (within 18 months of the qualifying event), or the qualifying event is death, divorce, legal separation, or a loss of dependents status, then the COBRA period is 36 months. Special rules apply if there is a second qualifying event after an employee's termination or reduction in hours.

<b>Qualifying Event</b>	<b>Qualified Beneficiary</b>	<b>Maximum COBRA Coverage Period</b>
Termination of employment (other than for gross misconduct) or reduction in hours of employment	Employee Spouse Dependent Child	18 months -may be extended up to 29 months for disability; may be eligible for an additional 18 months for a second qualifying event
Employee enrolls in Medicare	Spouse Dependent Child	36 months

<b>Qualifying Event</b>	<b>Qualified Beneficiary</b>	<b>Maximum COBRA Coverage Period</b>
Divorce or legal separation	Spouse Dependent Child	36 months
Death of employee	Spouse Dependent Child	36 months
Loss of “dependent child” status under the plan	Dependent Child	36 months

The maximum COBRA coverage periods may be shortened. COBRA coverage may end if the employee or other qualified beneficiary fails to pay the COBRA premium on time, if the employer no longer offers any group health plan, or when the employee or other qualified beneficiary is covered under another group health plan (without an exclusion or coverage limits for preexisting conditions), or the qualified beneficiary enrolls in Medicare.

#### **4. Reductions in Force**

A Reduction in Force (“RIF”) is allowed in the United States for any legitimate business need, including economically-driven position eliminations, reorganizations, and acquisitions or divestitures. Employers undertaking a RIF in the United States should consider unions, contractual entitlements, advance notice obligations, precautions to avoid discrimination claims when selecting among employees, severance and employee waivers and releases.

##### **a. Unions and Consultation.**

No consultation is required if the employer’s U.S. employees are not members of a union.

Special issues arise when the employer’s workforce is unionized. Under the NLRA, employers with an organized workforce have a duty to bargain with employees’ representatives in good faith over “wages, hours, and other terms and conditions of employment,” including some types of reduction in force. Before undertaking any employment action, an employer should determine whether it has a statutory duty to bargain with the union over the RIF, which employees are terminated, or any other obligations under a collective bargaining agreement. There are limits to the meaning of “terms and conditions of employment,” and the National Labor Relations Board and United States Supreme Court have provided guidance as to when employer RIFs, plant closings or plant relocations require consultation or bargaining.

##### **b. Contractual Entitlements to Notice, Cause, or Severance**

Non-union U.S. employees can be terminated for any reason, without severance, and in smaller RIFs without any advance notice, unless there is a contractual entitlement requiring otherwise. Employers should review offer letters, employment contracts, and employee policies for such entitlements, and must satisfy those contractual entitlements when conducting the RIF.

If advance notice or severance has been consistently offered in the past without a written policy, this can also create an implied contractual entitlement. The employer should determine whether there is a company policy and/or practice of giving advance notice or severance, and the amount of severance, and

whether a release was required. In some instances, such implied contractual entitlements can be superseded by a written policy.

### c. Advance Notice under WARN

Unless the company has a policy, practice, or contractual obligation requiring advance notice, U.S. employees in small RIFs can be terminated without any advance notice and for any reason, giving significantly more flexibility to U.S. employers when compared to most other jurisdictions around the world. For certain large RIFs, however, the Federal Worker Adjustment and Retraining Notification Act (“WARN”) requires sixty days’ advance notice of termination.

WARN covers employers with 100 or more employees in the United States, excluding “part time” employees. “Part time” is defined as either (i) an employee who is employed an average of fewer than 20 hours per week or (ii) an employee who has been employed fewer than 6 of the 12 months preceding the notice date.

If WARN covers the employer, then 60 days’ advance notice is required if the company is conducting a “plant [or business unit] closing” or a “mass layoff,” as defined by the WARN Act. A “plant closing” means the shutdown of a single facility, or elimination of a business unit at a single facility, resulting in the terminations of 50 or more employees from that facility. A “mass layoff” means a RIF involving the termination from a single facility of: (i) 50 employees *and* 33% of the employees (excluding “part time” employees); or (ii) 500 employees. Employees who work remotely are counted at the facility to which they report. A “mass layoff” also includes a temporary shut-down that results in a break of employment of more than 6 months, or a reduction in more than 50% of the work hours during each month of any six-month period. Employees will not be counted toward WARN if either: (i) they are offered relocation to a different site of employment which is within a reasonable commuting distance and with no more than a six-month break in employment; or (ii) they are offered relocation to any location (regardless of commuting distance) and with no more than a six-month break in employment and the employee accepts such relocation within 30 days of the offer or of the layoff, whichever is later.

In certain very limited situations, an employer can give less than the normally required 60 days’ notice under WARN. Reduced notice is permissible if the RIF is caused by a business circumstance not reasonably foreseeable at the time notice otherwise would have been required. This exception is very narrowly interpreted, and only arises under circumstances totally outside the employer’s control, such as a natural disaster, termination of a major contract by a principal client, a strike at a major supplier, or a government order to close an employment site. WARN also recognizes shortened notice where a faltering company was actively seeking capital or business to avoid the shutdown, and giving notice would have precluded the employer from acquiring the capital or business. In all situations where the WARN law permits reduced notice, the employer must still give notice as soon as is practicable, and the notice must contain the reason for the shortened period.

If WARN is triggered, the employer must provide 60 days’ advance notice to the following parties: (1) employees being terminated; (2) head of local dislocated workers’ unit; (3) chief elected official; and (4) union representative (if any).

The notice must include:

- Name and address of the employment site
- Statement as to whether the mass layoff or plan closing is permanent or temporary

- Expected date or a 14-day period in which the terminations are expected to occur
- Indication of whether bumping rights exist
- Names and job titles of employees who will be affected
- Name and telephone number of company official to contact for further information

U.S. employers should also check the state laws for the states in which they are conducting RIFs for additional notice requirements. Many states have enacted statutes similar to federal WARN. These state statutes can have lower triggers, and may require longer notice.

#### d. Protected Employees

Many U.S. and state laws protect employees on leaves of absence, including family and medical leaves, pregnancy leaves, and military leaves. Most of these laws, however, allow an employer to terminate an employee on leave as part of an RIF, provided the employee's selection for termination had nothing to do with the employee's leave and would have occurred even if the employee had not taken the leave.

#### e. Selecting Among Employees

Employers are prohibited under U.S. law from selecting employees for termination based on numerous protected categories, such as the employee's sex, race, national origin or citizenship, religion, age (over 40), disability, unlawful retaliation, union or veteran status, whistleblowing activities, and in some States such as California, salary. The employer should therefore be able to demonstrate legitimate, non-discriminatory reasons for the RIF and each employee's selection for termination.

Employees who are not retained may try to argue that they were selected for termination for an unlawful discriminatory reason. To defend against such claims, the employer must be able to demonstrate the legitimate, non-discriminatory reason for the employee's selection for termination over another. This can be accomplished by ranking employees in the same position based upon objective business factors. There may be different factors for different positions, and factors may be weighted differently. Commonly used factors include: seniority, prior performance, prior warnings or commendations, degrees or certificates held, cross training, productivity, indispensability, etc. Rankings should be supported by documentary evidence, such as performance reviews, commendations, criticisms, sales numbers, etc.

A RIF is not an opportunity to terminate employees for performance problems if the employer is otherwise replacing the same position. Performance-related terminations should be handled separately from elimination of positions due to an RIF. When selecting between several employees, an employer can, however, use performance as a factor supporting selection for termination.

Once the selection is complete, employers should have their attorneys conduct an adverse impact analysis in order to ensure that protected classes of employees are not inadvertently selected more than others. This is done through a statistical analysis of the percentages of employees in protected categories (e.g., sex, race and age), before and after the RIF, by organizational unit and company wide. Where there is a statistically significant decrease in the percentage of employees in a protected category post-RIF, this is a "red flag" to employers to re-evaluate the selection to ensure no discriminatory motive for selection for layoff.

## f. Severance

Severance to terminated employees is not required under U.S. law. Nevertheless, many employers choose to voluntarily offer severance to U.S. employees terminated as part of an RIF, and require the employee to waive all claims against the employer in order to receive the severance. Such severance and release agreements can prevent the risk of discrimination claims. The amount of offered severance can be any monetary amount or additional benefit the employer chooses (including post-termination benefits, outplacement services, etc.), and can be based on position, length of service, or location. The severance offered for a waiver must be in addition to anything the employee is entitled to by law or contractual entitlement. The ADEA requires releases provided to employees age 40 and over to meet certain requirements. Consequently, the release forms for employees terminated as part of an RIF will normally differ for employees under age 40, and employees aged 40 and over (see under section III chapter 2c above).

Some severance benefits will be covered by ERISA. Where the company has a prior practice or policy of providing severance from which they wish to deviate, or where the calculation for severance is other than a simple lump-sum payment, where continued administration of the severance is required (such as through continued pay or company-paid benefits), or where the company may use administrative judgment to determine employee eligibility for severance, then an ERISA-compliant Severance Benefit Plan is required. Even if not technically required, many companies elect to prepare such an ERISA Severance Plan, because ERISA preempts state law claims and provides a more limited remedy to employees who dispute their severance. An ERISA Severance Plan must satisfy statutory requirements and includes administrative filings, and should be coordinated by the company's attorneys to ensure compliance with ERISA (see under section II chapter 5 above).

## 5. Resignations

Upon notice of an employee's resignation, employers should arrange for an exit interview to give the individual an opportunity to comment on the job, the company, the supervisor, and his/her resignation. An exit interview will therefore provide the employer with a final opportunity to correct or address any potential complaints. This can substantially minimize the risk of wrongful termination litigation. The exit interview should be conducted by the employer as soon as possible after it learns of the resignation. The exit interview should be arranged at a time and place that will ensure privacy and minimize interruptions. To minimize potential conflicts between the employee and the supervisor, the employer should consider having someone other than the employee's immediate supervisor conduct the termination meeting.

The person conducting the interview should describe the employee's benefits, including coverage under COBRA (see section IV chapter 3 above), vested pension or IRC 401(k) benefits, and any other benefits that might apply. The person, depending on the applicable state law, may also be required to deliver the final paycheck.

If the employee has entered into an agreement promising not to disclose confidential company information or otherwise unfairly compete with the company, the employee should be reminded of his or her continuing obligations. If no agreement has been signed, and the employee has had access to proprietary information, counsel for the company should prepare an appropriate notice or agreement covering these issues.



The employer may also be required by state laws to provide information to the resigning employee. The employer should therefore, consider preparation of a termination letter including such required information and to also confirm in writing the employee's voluntary resignation.

## **6. Restrictive Covenants**

Protecting against unfair competition by current and former employees is often a major concern of companies. To address this concern, many employers implement contractual agreements in which an employee agrees to not compete with the employer and/or agrees to not solicit the employer's customers or other employees. These agreements are generally known as restrictive covenants.

It is important to note that restrictive covenants are generally governed by state law. With this, there is not an exact set of laws that apply uniformly throughout the United States, and a court will impose different laws and analyze a restrictive covenant differently depending on the state's law that controls the agreement. Because some states do not allow for restrictive covenants, and in those that do, the specific limitations can vary, it is critical to determine and consider the controlling state law before entering into a restrictive covenant.

Restrictive covenants may purport to apply to the employee during his term of employment or after the employment relationship ends. In general, restrictive covenants during the term of the employment relationship will usually be enforceable, whether analyzed under the state's restrictive covenant laws or under duty of loyalty or conflict of interest laws. Note, however, some states have "moonlighting" laws that limit the employer's ability to take adverse employment action against an employee for working for a different employer if the second employment does not compete or interfere with the employee's ability to adequately perform his or her job.

The remainder of this chapter will focus on post-termination restrictive covenants. Although the various states may treat restrictive covenants differently depending on the industry involved, the employee's position and duties within the company (i.e., executives versus lower-level positions), the type of restrictive covenant at issue (i.e., covenant not to compete versus covenant not to solicit), and the context surrounding the covenant (i.e., company-to-company, franchise, company-to-employee), this chapter focuses on general issues common to most states' restrictive covenant laws.

### **a. Protectable Interest of Employers**

Most jurisdictions will permit restrictive covenants narrowly aimed at protecting legitimate employer interests. States vary widely, however, in how they interpret this general principle. Many states require that a restrictive covenant must seek to protect an employer's trade secrets, non-public confidential information, or other proprietary information. To increase the likelihood of enforcement, the covenant should be drafted and narrowly tailored to include the company's legitimate business interests. In any event, most courts will not enforce a restrictive covenant that is meant to simply stifle competition without protecting the employer's legitimate business interest.

### **b. Consideration**

In most states, a restrictive covenant must be supported with consideration to be found valid. States vary on what will be deemed sufficient consideration. On one end of the spectrum, some states permit mere continuing employment to be sufficient consideration. In somewhat more restrictive jurisdictions, only the offer of new employment, a substantial promotion, or a substantial increase in duties may be sufficient consideration. In other jurisdictions, the employer must provide the employee with confidential information or trade secrets to meet the consideration element for a valid restrictive covenant. Finally,

some states only allow for restrictive covenants as part of the sale of the stock, assets, or goodwill of a business.

### c. Restrictions Must Be Reasonable

Restrictive covenants generally must contain reasonable limitations as to time, geographical area, and scope of activity. These limitations must not impose a greater restraint than is necessary to protect the employer's legitimate business interest and must not impose undue hardship on the restricted employee. If the limitations are found to be overbroad, the restrictive covenant generally will not be enforceable unless the applicable state law allows for enforcement to the extent it is not overbroad. Although most states do not have exact limitations, in states that allow for restrictive covenants, courts have provided examples of reasonable time, geographic area, and scope of activity limitations.

A number of states have found that one to two-year time durations are generally reasonable. Although restrictive covenants with longer time durations have been upheld in some jurisdictions, employers should consider drafting their agreements as narrow as possible while still protecting their interests. This will typically increase the likelihood of the agreement being found enforceable.

Geographic restrictions must also be reasonable, must not impose a greater restraint than is necessary to protect the employer's business interest, and must not impose undue hardship on the restricted employee. Whether a geographic area limitation in a covenant not to compete is reasonable depends on the nature and extent of the employer's business and the degree of the employee's involvement in the business. A reasonable area is generally considered to be the territory in which the employee worked. Some states will also allow a restrictive covenant to limit an employee's contact with the customers and clients where the employee worked.

A restrictive covenant's scope of activity limitation must also be written in a narrow fashion so as to only prohibit employee activity that is reasonably necessary to protect the employer's legitimate business interest. Generally, the scope of a restrictive covenant is unreasonable, and therefore unenforceable, unless it relates to the activities that the employee provided to the employer. For instance, an agreement that restricts competing anywhere and with anyone will most likely be considered overbroad. In addition, a covenant not to compete that contains an industry-wide exclusion from subsequent employment would most likely be found unreasonable unless special circumstances are present. Most states' laws will not enforce a non-compete that puts an employee out of work in their entire industry. Thus, it is in the employer's best interest to narrow the scope of their restrictive covenants so that the employee will still be able to find employment (in a position that would not compete against the company).

### d. Reformation of Unreasonable Restraints

Assuming all the other requirements of an enforceable restrictive covenant are met, but the time, geographical area, or scope of activity limitations are overbroad and therefore unreasonable, a court may be able to modify and narrow the limitations rather than strike the restrictive covenant in its entirety. However, not every state allows its courts to reform an unreasonable limitation. Further, in states that do allow reformation, some courts will only "blue pencil" the restrictive covenant, in which the court crosses out the unenforceable provisions, but does not write in any additional terms. With this, if the restrictive covenant is reasonable without the eliminated provisions, the agreement will be enforced. It is therefore critical to tailor the relevant limitations as narrowly as possible while still protecting the employer's business interests. Further, depending on the reformation laws of the applicable jurisdiction, the company may consider including tailored cascading restrictive covenants and/or severability clauses in the agreement.

### e. Enforcement of Restrictive Covenants and Damages

If an employee violates a restrictive covenant, the employer is generally able to seek enforcement of the covenant through court injunction ordering the employee to discontinue the competitive activity. Although each state's requirements differ, in general, an employer seeking to enjoin a former employee from competitive activity under the terms of a restrictive covenant must establish that: (1) the employer will suffer irreparable harm unless the injunction is granted; (2) the injury to the employer by not enforcing the restrictive covenant outweighs the injury to the employee; (3) the employer is likely to prevail on the merits and show that the former employee's activities violate the restrictive covenant; and (4) granting the injunction serves the public interest. Many times, a critical issue is whether the injunction is needed to protect the employer's confidential information or client relationships.

In some states, employers may also seek monetary damages against former employees who have violated a restrictive covenant. These are often times limited to lost profits that the employer can prove it would have realized had the employee not violated the restrictive covenant. However, in some jurisdictions, the existence of identifiable and adequate money damages can preclude injunctive relief, as it contradicts the existence of "irreparable harm."

Noteworthy, a court may also assess damages against the employer. For example, in some states, if the employee establishes that the employer knew at the time of the execution of the agreement that the restrictive covenant's limitations regarding time, geographical area, or scope of activity were not reasonable, the court may award the employee costs, including reasonable attorneys' fees incurred in defending the action. Moreover, in California, a state that does not allow non-competition agreements unless related to the sale of a business, a court may assess significant punitive damages against an employer for terminating an employee for refusing to agree to a post-employment covenant not to compete.

## IV. Litigating

Employees in the United States are said to be litigious, and there is truth to it. Employment and labor litigation in the United States occurs in federal courts, state courts, federal administrative agencies, state administrative agencies, or in private courts (arbitration). Sometimes there are disputes as to which forum is the proper one in which to resolve the dispute.

### 1. Federal Courts

#### a. District/Trial Courts

Most employment and labor litigation occurs in federal courts for two reasons. Federal courts hear cases arising under federal laws (federal question) and cases involving citizens of two different states (diversity jurisdiction). As a general rule, most employment litigation is based on federal laws. Virtually all labor litigation (litigation involving labor unions) is based on federal laws. Consequently, a federal question is typically present in any labor and employment litigation. In addition, corporations are deemed to be citizens of both the state of incorporation (usually Delaware), and in which their headquarters are located. Since most corporations have the majority of their operations outside Delaware and away from their headquarters, diversity jurisdiction usually exists.

Federal courts are located in major cities or in commercial or political centers within each state. Special rules (venue rules) dictate the particular federal court in which a claim will be heard. While the parties may agree to venue, they may not agree as to federal jurisdiction.

All federal court litigation occurs under uniform procedural rules. Some areas of procedure are left to local rules, which vary from court to court. In federal court, a lawsuit starts with the filing of a complaint by the plaintiff. The complaint contains a short statement of the court's jurisdiction, the basis for venue and enough facts to establish a plausible claim. A complaint must contain all claims the plaintiff has. A plaintiff may ask the court to allow the claims to proceed on behalf of a class of similarly situated individuals, a claim known as a "class action." Essentially, a class action is a means to aggregate the claims of many employees into a single lawsuit.

The defendant typically then files an answer to the complaint and any counterclaims it may have against the plaintiff. Instead of filing an answer, a defendant may choose instead to file a procedural or dispositive motion in an effort to immediately put an end to the litigation.

Once an answer is filed, discovery is permitted under the court's supervision. Discovery consists of written questions to be answered under oath, requests to produce documents or data, requests for inspections and examinations, and depositions (the oral examination of prospective witnesses under oath outside the court's presence).

At the conclusion of discovery, the parties may file a dispositive motion, usually a motion for summary judgment. If granted, this motion averts a trial.

The majority of employment cases are decided on motions rather than trials. Before a case proceeds to trial, the parties prepare a pre-trial order. This is a preview of the trial. It contains a list of witnesses and their testimony, copies of exhibits and the objections to their admission into evidence, proposed jury selection questions, motions to exclude evidence, proposed jury instructions, and a legal brief explaining the law which applies to the dispute. If the parties can not agree on these topics, then each party submits its own proposal.

The federal courts are divided into trial courts, also referred to as district courts. The district courts are combined courts, meaning they hear legal and equitable claims alike. (They also hear and decide criminal cases.) Federal court judges are appointed by the President and confirmed by the Senate. They are appointed for life. Most, but not all employment disputes in the federal courts are heard by six-person juries which are selected using the jury selection questions from the pre-trial order discussed above. Claims or parts of claims which are designated as equitable in nature are decided by the judge, while claims which are legal are decided by the jury. When a claim involves common issues of fact (i.e., an overlap), the findings of fact by the jury are binding on the judge. Decisions by juries can be appealed to the district court judge who supervised the trial. The district judge may set aside the jury's verdict and order a new trial or may modify the verdict.

Class action litigation varies in one significant aspect, that is, the parties frequently litigate whether a class action is an appropriate means to resolve the dispute. The requirements for a class action under federal law are:

- the number of employees must be so numerous that individual suits are impractical or would impose an undue burden on the court;
- the claims of the employees in the proposed class must be legally and factually similar;
- the claims and defenses at issue must be typical of both the employees and the defendants;
- the representative parties (the individuals who will actually present at the trial) must adequately protect the interest of the entire class;
- common issues of fact and law will predominate; and
- a class action is a superior means of resolving the disputes at issue.

#### b. Appellate Courts

Either or both parties may appeal a final judgment or final order by the trial court judge to a Court of Appeals for the particular circuit. There are twelve courts of appeals each within a designated judicial circuit. Appellate courts sit and hear cases virtually all year round. In addition, the Court of Appeals review the final orders of most administrative agencies.

Typically, a panel of three judges selected from the appellate judges appointed to that particular appellate court will hear and decide an appeal. Any party is guaranteed the right to have an appellate court review the final decision of the trial court or administrative agency.

Atop the federal court system is the United States Supreme Court. Review by the Supreme Court usually is within the Court's discretion. There are nine justices on the Court, each of whom was appointed by the President and confirmed by the Senate. All nine justices hear the appeals in those cases selected for review. An unsuccessful litigant's only recourse after losing an appeal at the Supreme Court is to ask Congress to change the law. In addition to its appellate review, the Supreme Court establishes the rules of procedure governing all litigation in the federal court system.

## **2. State Courts**

Each state establishes its own court system which is tasked with deciding claims arising under state law. State courts must also decide claims arising under federal laws, unless Congress made the federal courts the exclusive forum for deciding cases under that particular law.

While there are many differences between the state courts, in each state there are some common elements. Most states have separate courts to hear civil cases and criminal cases. Trial judges do not have life time appointments, but instead are either elected by the voters in the area or are appointed. Most trial judges do not issue published opinions.

Virtually all states have an intermediate appellate court or courts. The precedential effect of the appellate court's decisions vary from state to state. Usually, review by the state Supreme Court is discretionary. If a matter involves an issue arising under the U.S. Constitution, the parties may appeal the decision of the state Supreme Court to the United States Supreme Court.

## **3. Administrative Agencies**

There a myriad of administrative agencies both on the federal and state levels. Many administrative agencies have police powers, meaning they can initiate an investigation on their own without awaiting the filing of a charge (or complaint). Other agencies have more limited powers, in that they can not act unless and until a charge or complaint of unlawful conduct is filed.

Administrative agencies must follow certain minimal due process requirements imposed by the U.S. Constitution, the Administrative Procedures Act, or by the courts. Many state agencies have additional due process requirements imposed by the state.

Investigations are informal and rarely involve sworn oral testimony. At the conclusion of an investigation, some agencies may conduct hearings at which sworn testimony is received, make findings of fact, and issue remedial orders. Other agencies must refer the findings of their investigations to a designated prosecutorial function which independently decides whether to take the matter to court. In some states, violations of labor codes are criminal, thus the investigation is of utmost importance.

The trial procedure in administrative agencies is much less complex than in the courts. While there is a complaint and an answer, typically there is no discovery. The administrative law judges or the hearing officers are civil service employees with set terms of employment. The decisions of administrative law judges may be reviewed by the courts.

## **4. Arbitration**

Arbitration has been a controversial means of resolving disputes for most of the history of the United States. Initially the courts were hostile to arbitration and refused to enforce arbitration agreements. Congress then passed a law making agreements to arbitrate enforceable.

Arbitration occurs only when the parties have agreed to arbitrate their disputes. The typical arbitration agreement contains a description of the claims which will be arbitrated, the procedure for selecting the arbitrator, a description of the requirements of the arbitrator's award, and the permissible discovery which can be conducted before the hearing. There has been substantial litigation over the permissible terms of the arbitration agreement. But now, most issues have been resolved by the courts and there is a generally accepted view of the minimum standards which must be present before an arbitration agreement will be enforced.

Arbitrators generally are used by the parties for a single dispute. Some arbitrators are professional arbitrators, many others are professors or individuals with flexible work schedules. In the selection of an arbitrator, a preference is usually given to those arbitrators who have some familiarity with the industry and area of law.

Arbitration awards are virtually immune from judicial review. Absent proof of fraud or corruption, a court will likely enforce an award no matter how unreasonable it may seem. The fear of not being able to appeal a “bad” arbitration award has limited the use of arbitration.

## **5. Litigation Holds**

It is crucial that as soon as a company learns of pending or imminent litigation, or reasonably anticipates litigation, it implements a so-called litigation hold. This is a requirement for the company to preserve all data that may relate to legal action involving the company. An attorney may issue a litigation hold letter or a company may issue a hold order internally. The order applies not only to paper-based documents but also to electronically-stored information.

## V. Extraterritorial Application of U.S. Employment Laws Abroad

United States law generally applies only to the territorial United States. Congress does, however, have the authority to extend the application of laws extraterritorially beyond the borders of the United States. In particular, Congress has chosen to extend the protections of Title VII, the ADA, and the ADEA (see section III chapter 2 on discrimination and harassment and affirmative action above) to certain U.S. citizens employed outside the borders of the United States. In contrast, U.S. courts have held that the federal FLSA does not apply to employees in foreign jurisdictions, nor do most other U.S. labor and employment laws apply outside the United States unless there is a specific nexus to the United States.

### 1. Employees Covered

In order for Title VII, the ADA and the ADEA to protect an employee working abroad, the employee must be a U.S. citizen. The extraterritorial application does not extend to non-U.S. citizens, meaning that permanent legal residents, such as holders of green cards, are generally not subject to the laws' protections while working outside the United States. There are some limited exceptions to the extent there is sufficient nexus to the United States, for instance, if an employee spends time in the United States working for the U.S. employer on business or for training.

### 2. Employers Covered

In addition, the U.S. citizen must work for a covered employer. Employers meeting the statutory minimum number of employees for coverage under the three laws will only be covered by Title VII, the ADA and the ADEA under the following circumstances:

- The employer is incorporated in the United States; or
- The employer is incorporated outside the United States, but is “controlled” by a U.S. company.

To determine sufficient “control,” courts will look to the following four factors: (1) interrelation of operations between the foreign employer and a U.S. company; (2) the extent of common management between the foreign employer and a U.S. company; (3) the degree of centralized control of both companies' labor operations; and (4) common ownership or financial control between the two companies. This four-factor test is sometimes referred to as the “integrated employer” test.

In practice, this means that if a U.S. citizen employee engaged by a controlled German subsidiary of the U.S. parent is terminated as part of the RIF, for instance, the company needs to ensure that any termination agreement entered into in Germany also validly releases claims under Title VII, the ADEA and ADA. If the employee is aged 40 or above, this will require the release to comply with the various requirements of the ADEA.

Note that it must be the U.S. employer controlling the foreign company. Courts have held that if it is the foreign parent controlling the U.S. subsidiary, the extraterritorial application does not come into play.

### 3. Conflicting Foreign Law Defense

In certain circumstances, employers covered by the extraterritorial application of Title VII, the ADA and ADEA can take otherwise prohibited actions against U.S. citizen employees without violating the U.S. employment laws by invoking the “foreign law defense.”

Under the foreign law defense, an employer will not be liable for acts violating these employment laws where compliance with the U.S. laws would require the employer to violate the law of a foreign country.



The extent of this foreign law defense is a point of contention among U.S. courts, as some courts have defined “foreign law” to include even foreign collective bargaining agreements. For instance, one court found that a Delaware radio broadcast company did not violate the ADEA when it required its Munich, Germany workforce, including U.S. citizens working in Munich, to retire by the age of 65 pursuant to a German collective bargaining agreement.

#### **4. Application of U.S. Laws to Foreigners**

While the topic of extraterritorial application of U.S. laws abroad is important for U.S. multinationals operating around the globe, foreign companies with operations in the United States should keep in mind that U.S. labor and employment laws generally apply to any employee working in the United States. This means that both U.S. and non-U.S. citizens working in the United States (and typically even undocumented aliens not authorized to work in the United States) will be entitled to the protections of U.S. laws, whether their employer is a U.S. or a foreign company.

## Index of Abbreviations

AAP	Affirmative Action Program
ADA	Americans with Disabilities Act
ADEA	Age Discrimination in Employment Act
CBP	Customs and Border Protection
CIS	Citizenship and Immigration Services
COBRA	Consolidated Omnibus Budget Reconciliation Act
ECPA	Electronic Communications Privacy Act
EEO	Equal Employment Opportunity
EEOC	Equal Employment Opportunity Commission
ERISA	Employee Retirement Income Security Act
ESPP	Employee Stock Purchase Plan
ESTA	Electronic System for Travel Authorization
FAS	Financial Accounting Standard
FCN Treaties	Treaties of Friendship, Commerce, and Navigation
FCRA	Fair Credit Reporting Act
FLSA	Fair Labor Standards Act
FMLA	Family Medical Leave Act
GAAP	Generally Accepted Accounting Principals
GINA	Genetic Information Nondiscrimination Act
HIPAA	Health Insurance Portability and Accountability Act
HITECH	Health Information Technology for Economic and Clinical Health Act
ICE	Immigration and Customs Enforcement
IFRS	International Financial Reporting Standards
IRC	Internal Revenue Code
ISO	Incentive Stock Option
NLRA	National Labor Relations Act
NLRB	National Labor Relations Board
NYSE	New York Stock Exchange
OSHA	Occupational Safety and Health Act
OWBPA	Older Workers Benefit Protection Act
PIIA	Proprietary Information and Inventions Agreement

RIF	Reduction in Force
RSU	Restricted Stock Unit
SAR	Stock Appreciation Right
SCA	Stored Communications Act
SOX	Sarbanes-Oxley Act
TARP	Troubled Assets Relief Program
USERRA	Uniformed Services Employment and Reemployment Rights Act
WARN	Worker Adjustment and Retraining Notification Act

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