Ten HR Issues from 2006[1]
Employment Roundtable
December 14, 2006

The following are ten important developments in labor and employment law during 2006:

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[1] This memorandum contains a summary of information obtained from laws, regulations, court cases, administrative rulings, and legal publications and should not be viewed or relied upon as legal advice. Ater Wynne LLP urges readers of this memorandum to consult legal counsel regarding specific legal issues and factual circumstances.

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1. YOUR RELEASE AGREEMENT MIGHT NOT BE BINDING

If your organization asks employees to sign a release of claims as a condition of receiving severance pay, it is taking an important step in limiting potential wrongful termination and other claims. Release agreements can be a powerful tool in managing potential liability arising from employment terminations. If your organization is using a form of separation and release agreement that was drafted years ago, however, it may be time to update the form in light of recent cases and changes in the law.

A number of recent cases have invalidated employer release forms. Similarly, there are legal principles and specific statutes that affect the enforceability of release agreements. For example:

- While it is permissible to require an employee to waive the right to file a lawsuit or collect monetary damages as a condition of receiving severance, the EEOC's position is that it is impermissible to condition benefits upon the waiver of the right to file an EEOC charge.[2]

- An employer was found to have unlawfully retaliated against an employee when it required the employee to dismiss her discrimination charge filed with the EEOC as a condition of receiving severance and included in the release agreement a prohibition on the employee pursuing any "charges" against her employer. The court held that the employer unlawfully retaliated against the employee by denying her severance benefits while providing these benefits only to employees who agreed to refrain from participating in protected activity, i.e., the right to file and maintain an EEOC charge of discrimination.[3]

- FMLA regulations provide that "employees cannot waive, nor may employers induce employees to waive, their rights under FMLA."[4] At least two courts have interpreted this regulation to invalidate a release of claims to the extent it purported to waive the employee's right to assert a claim for a FMLA violation.[5]

- For a release of wage claims to be valid under Oregon law, the release must apply to a "known and identified claim." [6] The release cannot require the employee to relinquish a claim for additional or future violations of the wage statutes.[7] The statute does not address what makes a claim "known and identified," but a conservative approach would require the existence of a dispute over wages that is

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[2] *See* Enforcement Guidance on non-waivable employee rights under Equal Employment Opportunity Commission (EEOC) enforced statutes; http://www.eeoc.gov/policy/docs/waiver.html; *see also*, *EEOC v. SunDance Rehabilitation Corp.,* 328 F Supp 2d 826 (ND Ohio 2004).
[3] *EEOC v. Lockheed Martin Corporation,* 444 F Supp 2d 414 (D Md. 2006).
[4] 29 CFR 825.220(d).
[5] *Dierlam v. Wesley Jensen Corp.,* 222 F Supp 2d 1052 (ND Ill 2002); *Dougherty v. Teva Pharmaceuticals USA,* 2006 WL 2529632 (ED Pa 2006).
[6] ORS 652.360.
[7] *Id.*

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identified in the release agreement. A general release of "all claims for unpaid wages" would probably not be effective.[8]

- The standard for enforceability of a release in the employment context is that the employee entered into it "knowingly and voluntarily." A number of considerations may be relevant in this inquiry including: (1) the employee's experience, background, and education; (2) the amount of time the employee had to consider whether to sign the waiver, including whether the employee had an opportunity to consult with a lawyer; (3) the clarity of the waiver; (4) the consideration provided in exchange for the waiver; as well as (5) the totality of the circumstances.[9]

- Like any other part of a release, a covenant not to sue must be clear and understandable to the employee or it will be invalid, at least as it pertains to age claims. For example, IBM had its employees sign a general release that included "claims arising from the Age Discrimination in Employment Act." The release also included a covenant "[to] never institute a claim of any kind against [the employer]," that also said "[t]his covenant not to sue does not apply to actions based solely under the Age Discrimination in Employment Act." The court found that the covenant was confusing and, therefore, unenforceable. As a result, employees who had signed the release and received severance pay and benefits were nevertheless allowed to go forward with age discrimination claims.[10]

LESSON

It is important to periodically review and update standard forms, as the recent cases involving releases demonstrate. Moreover, release forms are not "one size fits all." For example, to be effective, a release of age-related claims must contain additional language for employees age 40 and over. When offered in connection with a reduction in force affecting more than one employee, those employees over age 40 must receive specific information as to the age and job titles of the employees being let go. It is, therefore, important to consult counsel when release forms are used in new circumstances or when a lot of time has elapsed since their last use.

2. CLASS ACTION UPDATE

Employment-related class actions have been rising over the last few years, in stark contrast to the overall decrease in class action litigation. In fact, employment cases now make up 27% of all

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[8] *Vento v. Versatile Logic Systems Corp.,* 167 Or App 272, 3 P3d 176 (2000) (payment of $1,000 to terminated employee in exchange for general release of all claims was not effective as waiver of employee's claims for unpaid overtime, liquidated damages and statutory penalty under state law that exceeded $1,000).

[9] These standards originated in the Age Discrimination in Employment Act (ADEA) and EEOC regulations applicable to the waiver of an age claim. *See 29 USC § 626(f); 29 CFR 1625.22.* However, many of the requirements have been held applicable to a release of employment claims generally. *See, e.g., Adams v. Philip Morris,* 67 F3d 580 (6th Cir 1996).

[10] *Syverson v. International Business Machines Corporation,* 461 F3d 1147 (9th Cir 2006).

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federal class actions.[11] The majority of these cases are either brought under wage and hour law or the Employment Retirement Income Security Act (ERISA). In a recent study of class actions in federal court from July 1, 2001 through June 30, 2005, federal wage and hour cases were the largest single category of class actions noted: 1,975 cases, or 18% of all class actions,[12] far exceeding other categories, such as employment discrimination.[13]

One of the reasons for the upsurge in wage and hour class actions may be the 2004 changes in federal regulations governing exemptions from overtime-pay requirements. A more likely reason is the ease with which plaintiffs can obtain multiple penalties for the same wage and hour violations, including state penalties for final pay violations. In addition, courts more readily certify federal FLSA "collective actions" than other class actions.

Much attention has been focused on the effect of the Class Action Fairness Act of 2005 (CAFA).[14] Among other things, CAFA allows a new basis for removing some class actions from state to federal court, which can be very beneficial to employers. However, it generally only applies when the amount in controversy exceeds $5 million, which places all but the very large wage and hour cases outside its scope. Thus far, we have not seen any major downward trend in these types of class actions as a result of CAFA.

Another recent trend is the use of arbitration agreements that require arbitration of all employment disputes, but prohibit class actions.[15] Although the viability of such clauses is still uncertain, they may prove to be a very useful preventive tool. On the other hand, arbitration itself is not always preferable to litigation, and some courts have stricken the class action prohibition and still enforced the arbitration agreement – meaning that the class action then must proceed within the arbitration process. As a result, the employer loses certain protections it would otherwise have if the action proceeded in court.

LESSON

Employers should pay careful attention to wage and hour policies, particularly policies that could lead to a similar cause of action across a broad spectrum of its workforce. Even very small claims on a per employee basis can add up quickly, particularly when the court assesses penalties and attorney fees. In addition, employers should consider the use and scope of mandatory arbitration agreements.

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[11] Thomas E. Willging and Emery G. Lee III, *The Impact of the Class Action Fairness Act of 2005: Second Interim Report to the Judicial Conference Advisory Committee on Civil Rules* (Federal Judicial Center, Sept. 2006).
[12] *Id.*
[13] *See also generally,* Charles Edwards, *Wage Suits, Supersized: Multiple-Plaintiff Pay Cases are Increasing. Don't Get Caught Unprepared,* 5/22/2006 Legal Times 33.
[14] 28 USCA §§ 1332(d), 1453, and 1711-1715.
[15] *See, e.g., Gentry v. Superior Court,* 135 Cal App 4th 944, 37 Cal Rptr3d 790*, rev. granted and opinion superseded,* 135 P3d 1, 43 Cal Rptr3d 748 (Cal. 2006). (The upheld clause, as applied, required all employees bound by the arbitration agreement to bring their disputes to arbitration instead of court and to bring those disputes only on an individual, and not a class basis).

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3. E-PAY CARDS

Although state laws vary, an employer's payroll delivery options generally include direct deposit, paper paycheck, or cash.[16] Many states, including Oregon, allow employers to pay by direct deposit provided the employee consents.[17] Recently, some employers have begun paying employees electronically through the use of pay cards similar to a debit card on which the employee's pay is loaded. The employee, then, can access the funds through an ATM. However, the law has not kept up with the technology. Most state wage and hour laws and regulations are silent or unclear on the use of e-pay as a payroll delivery method.[18] Oregon, unfortunately, is no exception. During the 2005 legislation session, BOLI proposed a bill that would have explicitly allowed for e-pay.[19] According to the written testimony, the intent of the bill was to:

> *** modernize payments of wages by specifically authorizing more convenient and flexible methods for employers to pay their employees who agree to use electronic methods of payment. Indeed, as electronic payment devices and banking have become more common, numerous employers have approached the Bureau to inquire whether they may legally pay their employees with such an electronic payment device.
>
> That is why the Bureau chose to introduce this legislation. Current Oregon law, specifically ORS 652.100, does not clearly authorize this type of electronic paycheck arrangement. This bill, if passed would clearly authorize this electronic payment practice so the Bureau can issue advi[c]e to employers that this is a legally acceptable practice.[20]

The bill, however, did not pass. In the absence of such legislation, the adoption of this type of payroll system presents some risk to the employer. BOLI has taken the position that e-pay is permissible,[21] although it is unclear whether courts would follow (or plaintiffs' lawyers would agree with) its position.

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[16] *See, e.g.,* ORS 652.110.

[17] *Id., see also* http://www.boli.state.or.us/BOLI/TA/T_FAQ_Directdeposit.shtml.

[18] The American Payroll Association's Payroll Portal tracks related information. *See* http://www.payrollannex.org/paycard/paycardportal.cfm.

[19] Oregon 2005 SB 141.

[20] Written Testimony of Dan Gardner, Commissioner, Bureau of Labor and Industries, 2005 SB 141 Senate Commerce Committee Exhibit H (March 22, 2005).

[21] *See* BOLI's Q&A on the topic at http://www.boli.state.or.us/BOLI/TA/T_FAQ_Directdeposit.shtml, which states:

> Q: Is it legal for an employer to pay wages by issuing employees a "debit card" that can be "swiped" at local banks or institutions for cash or merchandise?
>
> A. Payment of wages by debit card is legal, provided that the arrangement meets the tests for direct deposit and for the "medium of paying employees" set forth in ORS 652.110.
> Since the electronic deposit of wages to the debit card account is a form of direct deposit, the employee must agree to the arrangement, as required by the statute.

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LESSON

When implementing technological advances in the workplace, employers need to ensure they do not run afoul of employment laws. Any participating pay card program should be voluntary and allow employees to access all of their wages at no cost when those wages become due.

4. ARBITRATION UPDATE: MANDATORY ARBITRATION AGREEMENTS THAT COULD PRECLUDE FILING OF ULPS VIOLATE THE NLRA

The National Labor Relations Board (NLRB) has two primary functions: (1) to conduct elections to determine whether employees wish to be represented by a union, and (2) to prevent and remedy unfair labor practices by either employers or unions. This year, in *U-Haul Co. of California*,[22] the NLRB held that an employer violated Section 7[23] of the National Labor Relations Act (NLRA) by maintaining a mandatory arbitration agreement that covered all disputes arising out of employment.

U-Haul's policy covered, among other things, claims for wrongful termination, fraud, breach of contract, harassment, discrimination, wage claims, and "any other legal or equitable claims and causes of action recognized by local, state, or federal law or regulations." Although the policy did not explicitly restrict employees from resorting to the NLRB's remedial procedures, the majority of the Board found that the policy's applicability to claims under all "state or federal law and regulations" would reasonably be read by employees to prohibit the filing of a charge with the NLRB. The Board noted that courts and agencies have consistently found that employees have a non-waivable right to file an administrative charge with the Equal Employment Opportunity Commission (EEOC), and that arbitration agreements purporting to waive such rights are void and invalid as a matter of public policy.[24]

LESSON

Employers seeking to impose mandatory arbitration agreements on employees should be mindful of some important limitations. First, such agreements are subject to the same requirements as other types of contracts, which means that ordinary defenses to the formation of contracts (e.g., lack of consideration) apply. Second, as the NLRB noted in the *U-Haul* case, employees cannot be required to waive their rights to file administrative claims with the NLRB or the EEOC. Finally, employers cannot limit the remedies or increase the financial burdens that employees

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Also, the instrument of payment - in this case, the debit card - must be negotiable and "payable without discount in cash on demand at some bank or other established place of business" in the county where it is issued. The Bureau's interpretation of this statutory language is that the employee must be able to receive the full amount of his or her wages by swiping the card and may not be charged any fee for doing so.

[22] 347 NLRB No. 34 (2006).

[23] Section 7 provides that: "Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, and shall also have the right to refrain from any or all of such activities except to the extent that such right may be affected by an agreement requiring membership in a labor organization as a condition of employment as authorized in section 158(a)(3) of this title." 29 USC § 157. Both union and non-union employees have Section 7 rights.

[24] 347 NLRB No. 34 at n.11.

would have under certain federal employment statutes like Title VII (e.g., by limiting damages or requiring employees to pay prevailing party attorney fees).

5. NLRB DECISION REGARDING DEFINITION OF "SUPERVISOR"

This year, the NLRB issued a trio of decisions that refine the analysis of who should be considered a "supervisor" versus an "employee" under the NLRA. This question, which is relevant in determining who is properly included in a collective bargaining unit, can determine the outcome of an election.

The NLRA defines "supervisor" as an employee who has authority to, among other things, "assign" work to other employees, or who must "responsibly ... direct" other employees, as long as they exercise "independent judgment." Supervisors are typically excluded from a collective bargaining unit represented by a labor union, and they are not permitted to vote in union elections. The NLRB formerly had determined that employees such as nurses, who exercise ordinary professional or technical judgment in directing less-skilled employees, did not qualify as "supervisors" because they did not use "independent judgment." In a 2001 decision, *NLRB v. Kentucky River Community Care*, the U.S. Supreme Court rejected the NLRB's interpretation of "independent judgment" as overly narrow and instructed it to reexamine its interpretation of the terms "independent judgment," "assign" and "responsibility to direct."[25] In response to *Kentucky River*, the NLRB expanded the number of employees likely to meet the statutory definition of "supervisor."[26]

- **"Assign"**

First, the NLRB construed the term "assign" to refer to "the act of designating an employee to a place (such as a location, department or wing), appointing an individual to a time (such as a shift or overtime period), or giving significant overall duties, i.e. tasks, to an employee." In contrast, the term assign does not refer to the "ad hoc instruction that the employee perform a discrete task." The NLRB provided the following example: "The assignment of an employee to a certain department (e.g., housewares) or to a certain shift (e.g., night) or to certain significant overall tasks (e.g., restocking shelves) would generally qualify as 'assign' within our construction. However, choosing the order in which the employee will perform discrete tasks within those assignments (e.g., restocking toasters before coffeemakers) would not be indicative of exercising the authority to 'assign.'"

- **"Responsibly to Direct"**

Second, the NLRB construed the phrase "responsibly direct" as not limited to clearly managerial employees such as department heads, but to any person who has "men under him," who decides "what job shall be undertaken next or who shall do it," and who provides "responsible" direction carried out with "independent judgment." For direction to be responsible, "the person directing and performing the oversight of the employee must be accountable for the performance of the task by the other, such that some adverse consequence may befall the one performing the

[25] *NLRB v. Kentucky River Community Care*, 532 US 706 (2001).
[26] *Oakwood Healthcare, Inc.*, 348 NLRB No. 37 (2006); *Croft Metals, Inc.*, 348 NLRB No. 38 (2006); *Golden Crest Healthcare Center*, 348 NLRB No. 39 (2006).

oversight if the tasks performed by the employee are not performed properly." In other words, to prove "supervisor" status, it must be shown that the employer delegated to the putative supervisor the authority to direct the work and the authority to take corrective action, if necessary. It also must be shown that there is a prospect of adverse consequences for the putative supervisor if he or she does not adequately oversee the work. The goal of this definition is to exclude "individuals whose fundamental alignment is with management."

- **"Independent Judgment"**

Finally, the NLRB concluded that whether a putative supervisor exercises "independent judgment" must be determined by assessing the degree of discretion exercised. At a minimum, a supervisor must "act, or effectively recommend action, free of the control of others and from an opinion or evaluation by discerning or comparing data." In contrast, "independent judgment" is not exercised with respect to acts that "are of a merely routine or clerical nature" or that are "dictated or controlled by detailed instructions, whether set forth in company policies or rules, the verbal instructions of a higher authority, or in the provisions of a collective-bargaining agreement." For example, "a decision to staff a shift with a certain number of nurses would not involve independent judgment if it is determined by a fixed nurse-to-patient ratio. Similarly, if a collective-bargaining agreement required that only seniority be followed in making an assignment, that act of assignment would not be supervisory. . . . [I]f the registered nurse weighs the individual needs of a patient against the skills or special training of available nursing personnel, the nurse's assignment involves the exercise of independent judgment."

LESSON

Although the leading NLRB decision, *Oakwood*, and the *Kentucky River* cases involved charge nurses, the cases have broader applications to other industries. For a company facing unionization efforts, the NLRB's decisions may exclude some employees as "statutory supervisors" from the unit that a union proposes to represent. In particular, the company may be able to challenge a union's inclusion of forepersons or lead employees in proposed units, and organizing efforts by those employees may be objectionable. Moreover, for those companies that already have a union workforce, the new "supervisor" guidelines may exclude employees from current bargaining units.

6. EEO UPDATE

- **Changes to EEO-1 Forms**

Employers with over 100 employees, as well as certain federal contractors with 50 or more employees, must file an annual EEO-1 Report, more formally known as the "Employer Information Report," with both the EEOC and the Office of Federal Contract Compliance Programs (OFCCP).[27] Employers must list the number of employees in each job category and

[27] *See generally* http://eeoc.gov/eeo1/qanda.html; *see also* 29 CFR §1602.7. The penalties for noncompliance by federal contractor or subcontractor may include termination of the federal government contract and debarment from future federal contracts. Executive Order 11246 §209(a).

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by ethnicity, race, and gender. The count may be derived from any pay period in July through September of the applicable year.[28]

This year, the EEO-1 Report includes some changes in classifications and reporting. Employers must use the revised survey for the reporting period beginning September 30, 2007. Copies of the 2007 form and instructions for its use are available on the EEOC website.[29] Employers are strongly encouraged by the EEOC to submit the reports electronically.[30]

The revised EEO-1 Report includes new and renamed ethnic classifications (*e.g.,* new classifications for employees of mixed race; "Asian or Pacific Islander" is now "Asian" and "Native Hawaiian or other Pacific Islander;" "Hispanic" is now "Hispanic or Latino"). The EEOC requires employee self-identification of race and ethnic categories when possible, in lieu of visual identification by employers.[31]

To comply with the reporting requirement, employers should be asking new hires to self-identify using the new race and ethnic classifications. Employers are encouraged to resurvey, if possible, those employees who have previously been categorized into the old classifications, although this is not mandatory for the 2007 reporting year.[32] The EEOC suggests the following as appropriate methods for requesting self-identification:

> [A]n employer that periodically asks its employees to update their personal information may use these periodic requests to ask employees to confidentially self-identify using the new EEO-1 race and ethnic categories. Alternatively, an employer could provide a page on its internal (private) website, where employees could voluntarily and confidentially self-identify. Other methods that achieve the same result would be acceptable.[33]

Job categories have also changed. For example, the former category "Officials and Managers" is now divided into two levels, "Executive/Senior Level Officials and Managers" and "First/Mid-Level Officials and Managers," and business and financial occupations have been moved to the "Professionals" category.[34]

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[28] *See EEOC's Questions and Answers - Implementation of Revised Race and Ethnic Categories,* http://www.eeoc.gov/eeo1/qanda-implementation.html ("As has always been the case with EEO-1 reports, employers must use employment figures from any one pay period between July and September of the survey year in question. The revised EEO-1 report due on September 30, 2007, therefore, must be based on employment figures from any one pay period between July and September, 2007.").

[29] *Final Revisions of the Employer Information Report (EEO-1)*, http://eeoc.gov/eeo1/index.html.

[30] *EEO-1: How to File,* http://eeoc.gov/eeo1survey/howtofile.html.

[31] "Self-identification is the preferred method of identifying the race and ethnic information necessary for the EEO-1 report. Employers are required to attempt to allow employees to use self-identification to complete the EEO-1 report. If an employee declines to self-identify, employment records or observer identification may be used." *See Instruction Booklet,* http://eeoc.gov/eeo1/instruction_rev_2006.html.

[32] *EEOC's Questions and Answers - Implementation of Revised Race and Ethnic Categories,* http://www.eeoc.gov/eeo1/qanda-implementation.html.

[33] *Id.*

[34] *Id.*

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LESSON

Employers subject to EEO-1 reporting requirements should be implementing self-identification procedures now. It is important to keep in mind that EEO-1 records should be kept separately from the employees' basic personnel file or other records available to those responsible for personnel decisions.[35]

- **EEOC Issues Q&A on Deafness and Hearing Impairments in the Workplace and the Americans with Disabilities Act**

On July 26, 2006, the EEOC issued a new Q&A fact sheet on the application of the Americans with Disabilities Act (ADA) to job applicants and employees who are deaf or who have hearing impairments.[36] This is the sixth in a series of Q&As addressing specific disabilities in the workplace. Since older age is associated with increased hearing problems, such issues are expected to increase as the baby-boomer generation reaches age 65. Therefore, employers may want to review the EEOC's guidance, which addresses such topics as:

- When a hearing loss is a disability under the ADA;
- When an employer may ask an applicant or employee about a hearing impairment and what it should do if an applicant voluntarily discloses the impairment;
- What type of reasonable accommodation an applicant or employee with a hearing disability may need; and
- What an employer should do if it has safety concerns about an applicant or employee with a hearing impairment.[37]

- **EEOC Issues Policy Guidance on Race and Color Discrimination**

On April 19, 2006, the EEOC issued a new section to its Compliance Manual[38] that updates the guidance on prohibited discrimination in employment based on race and color.[39] A companion Q&A was issued at the same time.[40] The manual clarifies that race discrimination "includes discrimination on the basis of ancestry or physical or cultural characteristics associated with a certain race, such as skin color, hair texture or styles, or certain facial features ***** Color

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[35] *See generally* 29 CFR §§ 1602.12-1602.14 (recordkeeping requirements and specifications).
[36] *New Eeoc Publication Addresses Employment Rights of People With Hearing Loss*, http://www.eeoc.gov/press/7-26-06.html; *Questions and Answers about Deafness and Hearing Impairments in the Workplace and the Americans with Disabilities Act;* http://eeoc.gov/facts/deafness.html.
[37] *Id.*
[38] *EEOC Issues Policy Guidance Specific to Race and Color Discrimination,* http://www.eeoc.gov/press/4-19-06.html.
[39] EEOC *Compliance Manual, Section 15: Race and Color Discrimination,* http://www.eeoc.gov/policy/docs/race-color.html.
[40] EEOC *Questions and Answers About Race and Color Discrimination in Employment*, http://www.eeoc.gov/policy/docs/qanda_race_color.html.

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discrimination occurs when a person is discriminated against based on his/her skin pigmentation (lightness or darkness of skin), complexion, shade, or tone."[41]

The Q&A provides examples to help explain the ways in which inadvertent discrimination may occur:

> Some neutral employment policies or practices may exclude certain racial groups in significantly greater percentages than other racial groups. If there is a business necessity for the practice and there is no equally effective alternative, the practice will be lawful despite its impact.
>
> However, if there is not a business necessity for the practice or the business need could readily be met in a way that has less impact, the practice will be unlawful.
>
> Example: An employer has a "no-beard" rule, which disproportionately excludes African American men because they have a higher incidence of pseudofolliculitis barbae, an inflammatory skin condition caused by shaving. The employer must be able to demonstrate that beards affect job performance or safety. Also, there must be no alternatives to a strict "no-beard" rule that would meet the employer's business or safety needs.

LESSON

Employment discrimination based on race and color continue to comprise a significant number of claims filed. In 2005, allegations of race and/or color discrimination were included in 35.5% of the charges received by the EEOC, making it the most frequently alleged basis of employment discrimination under federal law.[42] While equal opportunity has increased dramatically over the last few decades, the EEOC believes there to be significant work that needs to be done.[43]

- **Update on Sidley Austin Age Discrimination Case**[44]

Most state and federal employment laws only apply to common law employees and provide no protection to independent contractors, partners, and certain shareholders in a company because, as business "owners," these individuals are thought to have sufficient bargaining power to adequately protect their own interests. As a result, the business community is closely watching the EEOC's age discrimination case against the law firm Sidley Austin Brown & Wood.

The EEOC case started in 2005 with a complaint from a Sidley Austin employee about the firm's mandatory retirement policy for partners. Until October 1999, the firm's policy had required partners to retire at 65. In October 1999, the law firm amended its retirement age to a sliding scale system that begins at age 60. The EEOC contends that Sidley Austin violated the ADEA "by maintaining and implementing an age-based retirement policy and by downgrading or

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[41] *Id.*
[42] *See EEOC Charge Statistics 1992 through 2005;* http://www.eeoc.gov/stats/charges.html.
[43] *See note 27, supra.*
[44] *See generally, U.S. Supreme Court Denial of Review Ends Sidley & Austin Bid to Avoid Monetary Relief Issue in Age Bias Case,* http://www.eeoc.gov/press/10-2-06a.html.

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expelling a class of attorney employees age 40 years and older on account of their age."[45] The EEOC seeks to recover lost wages and reinstatement for about 30 former partners who were forced to either leave Sidley Austin as a result of the retirement policy or be subject to involuntary downgrade from partner status. In addition, the agency wants to force Sidley Austin to terminate its mandatory retirement program.

The EEOC takes the position that Sidley Austin's centralized management structure precludes the former partners from having the type of control necessary to be excluded from the ADEA definition of "employee." Sidley Austin argued the EEOC could not seek monetary relief for the individual partners because the partners had never filed individual charges under the ADEA and their claims are time-barred. However, the Seventh Circuit disagreed, upholding the district court decision, finding that the EEOC had a statutory right to seek damages on behalf of the partners.[46] The U.S. Supreme Court recently denied *certiorari* on this issue,[47] leaving the EEOC free to move forward with its case at the district court level.

The Supreme Court's decision leaves intact the Seventh Circuit decision holding that the EEOC's right to address violations within its jurisdiction is separate and more expansive than an individual's right to relief under federal employment statutes. While this means the lawsuit will go forward, the EEOC still must demonstrate that the ADEA applies to the former Sidley Austin partners. To do so, it must show that the former "partners" are actually "employees."

LESSON

The Sidley Austin case emphasizes the importance of correctly analyzing whether "partners" or "shareholders" are actually employees for the purpose of federal and state employment laws. Partners and shareholders who meet the definition of employee under common law will almost certainly be considered and counted for the purpose of determining whether the employer meets the threshold number of employees required for coverage. Conversely, if these individuals qualify as "owners," they may be excluded from consideration and, in addition, they will not be entitled to protection under these laws.

7. USING THIRD-PARTY VENDORS FOR E-DISCOVERY IS NOT RISK FREE

On December 1, 2006, the new Federal Rules of Civil Procedure applicable to electronic discovery went into effect. Although an organization may be capable of identifying and taking necessary steps to preserve and retrieve the relevant electronic data necessary to comply with the new rule, in many cases it will be more efficient and cost effective to hire a third-party vendor to perform those tasks. Indeed, vendors that specialize in electronic discovery and litigation support may be able to provide technical assistance, storage, expert witness, and search capabilities that far exceed anything an organization can do on its own, at a fraction of the cost.

Given the comparative expertise of the electronic discovery vendor as compared to the typical litigant or law firm, delegating responsibility to a third party vendor seems like the sensible thing to do. However, if something goes wrong – the vendor fails to meet deadlines, its software

[45] Complaint, available at http://www.alas.com/articles/lphl05-12-l01.pdf.
[46] *EEOC v. Sidley Austin LLP,* 437 F3d 695 (7th Cir 2006).
[47] *Sidley Austin LLP v. EEOC,* 127 S Ct 76 (2006).

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doesn't work, or data is lost or destroyed – it is the organization and its attorneys that are likely to pay for those mistakes. Therefore, before taking the plunge, organizations should carefully consider the risks associated with hiring a vendor and take steps to help minimize those risks.

First and foremost, select carefully. Make sure you select a vendor that has skills and staffing appropriate to meet your needs. It is also important that you and your counsel understand and are satisfied with how their system works, including their procedures for verifying accuracy in data entry, duplication, storage, and retrieval, as well as safety precautions to prevent data loss while in storage. The vendor should be willing to provide periodic certification of its progress and accuracy of its results.

Second, it is important to select a vendor that can and is willing to provide accurate and credible testimony in court regarding its efforts on your behalf. Make sure you are satisfied with any witnesses the vendor may designate to testify at deposition or trial.

Finally, it is important to consider what remedies will compensate for the vendor's failure to perform as promised. Parties who fail to preserve evidence, produce discovery late, or otherwise fail to comply with a discovery order risk monetary sanctions (which often includes paying the opposing party's discovery and/or attorney fees), an adverse jury instruction, or even dismissal of a claim or defense. While indemnification might compensate for a bad outcome in litigation, vendors (especially those with a relatively modest project) may not be willing to agree to it or may substantially limit the amount of damages for which they will agree to be responsible. Those who are willing to provide contractual indemnity may not have the resources to actually pay up.

LESSON

With the increasing demand for electronic discovery in native format, parties to litigation will more often be forced to rely on experts to help them. Given the significant risks associated with even a negligent failure to comply with court discovery rules, due diligence in selecting the appropriate vendor is critical.

8. COURT UPHOLDS EEOC RULE ALLOWING EMPLOYERS TO COORDINATE RETIREE HEALTH BENEFITS WITH MEDICARE ELIGIBILITY - ALMOST

An EEOC rule and cases decided under it have long prevented employers from coordinating (*i.e.*, decreasing) retiree health benefits with eligibility for Medicare. If coordination of benefits resulted in retirees 65 or older receiving benefits inferior to those given to retirees younger than 65, this was considered a violation of the ADEA. However, with the significant increase in the cost of health care benefits over the last several years, employers started to eliminate retiree health care benefits. The EEOC viewed this outcome as poor policy and an unintended consequence of the ADEA. To address this problem, the EEOC proposed a rule to exempt from the ADEA "the practice of altering, reducing, or eliminating employer-sponsored retiree health benefits when retirees become eligible for Medicare or a State-sponsored retiree health benefits program."[48] In March 2005, a federal district court in Pennsylvania enjoined the EEOC from

[48] 68 FR 41, 542 (July 14, 2003).

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implementing the rule as contrary to the intent of Congress.[49] In September 2005, that court reconsidered its ruling and reversed itself based on new guidance from the U.S. Supreme Court regarding deference to agency authority.[50] However, the court maintained its stay of the EEOC rule because the parties indicated that they would appeal to the Third Circuit. To date, there has been no decision from the Third Circuit, and the old rule remains in effect.

LESSON

It has become far too expensive for most employers to maintain retiree health care benefits. With access to Medicare at age 65, allowing coordination of retiree health benefits with Medicare would allow more employers to provide some level of retiree health benefits. Although not binding in Oregon, a favorable decision from the Third Circuit would allow the EEOC rule to become final and provide some level of protection to employers here that elect to coordinate retiree health care benefits with Medicare eligibility.

9. EMPLOYERS SUED OVER 401(K) PLAN FEES

Fiduciaries may use ERISA 401(k) plan assets for only two things: to pay plan benefits or to pay the *reasonable* expenses of administering the plan.[51] The decision to pay expenses from the assets of a plan is subject to ERISA's strict fiduciary rules.[52] If the fiduciary does not know how much compensation a plan service provider receives from the plan and third parties for providing those services, the fiduciary cannot ensure that the fees paid are "reasonable."

In September, a law firm in St. Louis filed a dozen or so class actions against Fortune 500 companies, corporate officers, and plan administrative committees,[53] in which the plaintiffs alleged that 401(k) plan fiduciaries (1) caused the plans to pay unreasonable, excessive fees, (2) failed to seek out and understand the various fee payments and revenue sharing arrangements among plan service providers, and (3) failed to adequately disclose to participants the fees paid by the plan. The last allegation is especially important because, if proven, it will prevent the fiduciaries from taking advantage of certain defenses available under ERISA that could protect them from personal liability for fees and expenses.

To many observers, the lawsuits were neither surprising nor unwarranted. In April 1998, the U.S. Dept. of Labor (DOL) expressed concern about the adequacy of information available to plan fiduciaries regarding the expenses charged to the plan.[54] Two years ago, the ERISA Advisory Council's Working Group on Plan Fees and Reporting concluded that the shift to asset-based fees and the growth of revenue sharing arrangements between mutual funds and plan

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[49] *AARP v. EEOC*, 383 F Supp 2d 705 (ED Pa, Mar. 30, 2005).
[50] *AARP v. EEOC*, 390 F Supp 2d 437 (ED Pa, Sept. 27, 2005).
[51] ERISA §§403(c)(1) and 404(a)(1)(A).
[52] *See*, DOL Adv. Op. 2001-01A; DOL Adv. Op. 97-03A.
[53] *See*, http://www.forbes.com/personalfinance/retirementcollege/2006/10/03/business-beltway-401k-lawsuits-biz-cz_ae_1004beltway.html.
[54] Study of 401k Plan Fees and Expenses, http://www.dol.gov/ebsa/pdf/401kRept.pdf.

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service providers made it difficult for plan fiduciaries to understand or even know about all the fees paid to the service providers.[55]

In early 2003, a Securities and Exchange Commission (SEC) investigation into the sales practices of mutual fund companies led to enforcement proceedings against several companies based on the SEC's conclusion that brokerage firms failed to disclose revenue sharing arrangements with mutual fund companies that provided financial incentives to promote specific mutual funds or brands.[56] In May 2005, the SEC concluded that pension consultants similarly failed to disclose conflicts of interest that might affect the advice they provided to retirement plan fiduciaries.[57] Earlier this year, the DOL proposed changes to the Form 5500 that would require plan fiduciaries to disclose all direct *and indirect* compensation paid to service providers, including revenue sharing arrangements.[58]

The amount of fees charged and by whom are issues critical to individuals administering 401(k) plans because, as fiduciaries, they are personally liable for any breaches of duty to plan participants. Before a fiduciary uses plan assets to pay an expense (whether directly, or indirectly, as an offset to the plan assets), the fiduciary should answer the following questions:

(1) Does the plan document permit (or at least not prohibit) the payment?

(2) Does the expense (and, therefore, the goods and services obtained) relate to plan administration and not the plan sponsor's "settlor" functions?

(3) Is the expense prudent and the amount reasonable?

(4) Is the provider of the good or service a "party in interest?"

(5) Is the fee adequately disclosed to the plan participants?

Obtaining answers to these questions may require some digging into the investment prospectuses and provider service agreements, and demanding that the plan's service providers disclose all revenues received that are related to the services they provide to the plan. ERISA compliance is much more dependent on the decision-making process used by the fiduciaries than the results of their decisions. Therefore, if a fiduciary cannot explain (or even worse, is unaware) that the plan invests in "retail" mutual funds instead of lower-cost "institutional" funds and cannot explain what additional services the plan receives pursuant to the investment in the higher-cost fund, a court is likely to award damages even if the fund's investment returns are positive. Courts are willing to give fiduciaries broad latitude in running the plan, but not when the fiduciary is totally incapable of explaining why an expense is being paid.

Fiduciaries operating under a well-documented investment and administration policy are more likely to avoid liability, because that process is more likely to ensure a better outcome than being ignorant or careless. Such a policy would required fiduciaries to obtain a detailed report regarding the amount of fees, expenses, or revenue sharing arrangements the plan is paying

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[55] Report of the Working Group on Fee And Related Disclosures To Participants, http://www.dol.gov/ebsa/publications/AC_111704_report.html.
[56] http://www.usatoday.com/money/perfi/funds/2004-01-13-fund-sales-abuses_x.htm.
[57] http://www.sec.gov/news/studies/pensionexamstudy.pdf.
[58] http://www.dol.gov/ebsa/newsroom/pr072006.html.

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(including indirectly) from plan assets, and to compare those fees to those paid by similar plans and consider the services the plan receives. Having that information could enable the fiduciary to negotiate lower fees with various providers or switch to new providers with lower fees or better services. Fiduciaries should regularly repeat the process to ensure that they are fulfilling their ongoing duty to monitor all the plan's service providers and the fees paid by the plan.

Although the initial wave of lawsuits focuses on larger companies, it is just a matter of time before other law firms seek targets among smaller plans, for which the proper level of fiduciary oversight is much less likely to occur. Indeed, a well-known Seattle plaintiff's class-action firm is actively soliciting such cases:

> Our investigation has revealed that in many instances *particularly involving small or mid-size companies*, plan trustees are not aware of kickback and fee sharing arrangements between Investment and Service Providers and the mutual fund companies selected by the Investment and Service Providers. Instead, the trustees are lead [sic] to believe that the Investment/Service Providers selected funds based on an objective evaluation of the merits of the funds. In truth, the basis for the selection is often undisclosed or unexplained kickbacks paid to the Investment/Service Provider.[59]

LESSON

Individuals performing administrative services for an ERISA plan must understand and comply with ERISA's fiduciary rules. The most basic rule of fiduciary conduct is knowing at all times what the plan is doing and why. Fiduciaries should consult with legal counsel before signing service, investment provider, or consultant agreements and analyze investment option prospectuses, to enable the attorney to document the fiduciary's proper exercise of his or her authority. Failing to properly exercise fiduciary authority will enable a plan participant or the government to pursue the fiduciary for personal damages related to the expenses paid by the plan.

10. REQUIRED YEAR-END BENEFIT PLAN ACTIONS

Every year, Congress amends the federal tax code, ERISA, or both. Plan sponsors must then amend their benefit plan documents to conform to the new statutes. Typically, the amendment adoption deadline is the last day of the year in which the new laws are effective or, if implemented sooner, the year that the change is implemented. For plans that use a calendar year as the plan year, that date is December 31. Although the required plan amendments vary based upon the type of plan, plan sponsor status, and other factors, some changes effective at the end of this year:

- ***401(k) Plans*** – All 401(k) plans and plans with after-tax employee or employer matching contributions must adopt a "good faith" amendment implementing the final 401(k) regulations by the end of the 2006 plan year (December 31 for calendar year plans). These changes affect several aspects of the plan, including employer contribution limits, discrimination testing procedures and methods, safe harbor arrangements, hardship

[59] *See* http://www.erisafraud.com/Default.aspx?tabid=1449 (emphasis added).

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withdrawals, plan termination distributions, deductions of contributions, automatic elections, Roth contributions, treatment of leased employees, and electronic notices (see additional discussions below).

- ***Faster Vesting of Employer Contributions*** – Beginning January 1, all employer contributions to defined contribution plans must vest at least as fast as a three-year cliff vesting schedule or a graded six-year schedule. This change means that discretionary employer contributions, such as a profit sharing contribution, now vest as rapidly as matching contributions. Participant communication items and the Summary Plan Description may also need updating.

- ***Rollovers*** – For distributions after December 31, rollover notices will need to reflect new rollover options, such as rollovers into 403(b) annuities, after-tax rollovers, and non-spousal rollovers of death benefits into "inherited" IRAs or other qualified plans. The forms used for non-spouse beneficiaries and perhaps the Summary Plan Description will also need updating to reflect the new rollover options and related withholding issues.

- ***EGTRRA Restatements*** – Individually designed plans (primarily ESOPs, stock bonus, or cash balance plans) sponsored by an employer with an EIN ending in 1 or 6 must restate the entire plan document, and submit it to the IRS for a favorable determination letter if desired, by January 31, 2007.

- ***Employer Securities*** – Defined contribution plans (other than ESOPs) that hold publicly traded employer securities must provide participant notices regarding the right to divest those securities beginning January 1. Participants must receive the notice at least 30 days before the participant is entitled to exercise the divesting right.

- ***Safe Harbor Notices*** – The 401(k) regulations modified the required content of 401(k) safe harbor notices by adding additional requirements regarding vesting, distributions, and contact information. In addition, because of the accelerated vesting schedule for profit sharing contributions, the notice will need to reflect the correct schedule. Plans that adopted automatic enrollment provisions (see discussion below) must also include information about the deferral procedures. Participants should receive a notice by December 1 for a calendar year plan.

- ***ROTH Amendments*** – If a plan allowed ROTH after-tax deferrals to a 401(k) plan starting in 2006, the plan sponsor must adopt a conforming plan amendment by the end of the 2006 plan year.

- ***Annuity Benefit Disclosures*** – Plans that provide for qualified joint and survivor annuities must begin providing "relative value" explanations for distributions occurring after December 31. The explanation must describe the differences in value between the forms of distribution allowed by the plan. In addition, the plan may provide notices required for QJSA distributions and participant distribution elections up to 180 days before the distribution instead of 90 days.

- ***Electronic Notices*** – Effective January 1, plans may provide nearly all required notices or disclosures using electronic means such as email. The system must meet certain

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requirements regarding access and participants retain the right to hard copy notices, but this may greatly simplify the provision of participant notices and allows the plan administrator a quick and inexpensive way to document delivery.

- ***Automatic Enrollment*** – ERISA now preempts state laws requiring employees' written consent to wage withholding for making a 401(k) plan contribution. If the employer meets certain notice and investment requirements, it can automatically enroll employees in a 401(k) plan unless the employee indicates in writing that they do not want to enroll.

- ***Default Investment Options*** – After December 31, ERISA's statutory protections extend to plan fiduciaries that invest plan accounts of participants that fail to give investment directions. Such protections are available upon satisfying annual notice requirements and forthcoming U.S. Dept. of Labor regulations.

- ***Investment Advice*** – After December 31, plan fiduciaries may receive compensation for providing individually tailored investment advice to participants without violating ERISA's prohibited transaction rules and fiduciary standards. Fees cannot vary based on the participant's investment decisions and objective computer models must guide the fiduciary's investment recommendations.

- ***Definition of Dependent*** – Particularly important for health plans and dependent care plans is the plan definition of "dependent." Based on recent amendments to the tax code, these plans may now include as a dependent child an individual that is married or the dependent of another dependent. They may also include a family member with income that exceeds the limitation in the tax code definition. Other definitions apply to other types of plans, such as a 401(k) plan that provides for hardship withdrawals for medical expenses of a "dependent."

- ***Cafeteria Plan Grace Period*** – Cafeteria or section 125 plans that added 2½-month grace periods to incur claims after year-end must adopt a formal amendment documenting that change.

- ***Discounted Stock Options or Stock Appreciation Rights* (SAR)** – New Tax Code section 409A imposes severe income tax penalties on recipients of some "discounted" options or SARs. A discounted option or SAR is one with an exercise price lower than fair market value on the grant date. The IRS is providing a transition period until December 31, 2006, to correct this situation. Typical corrections include increasing the exercise price, a cash-out of the grant (with a post-2006 payout), replacing the grant with a new grant or conforming the existing grant to the 409A requirements. The decision may affect several other sensitive areas, such as SEC disclosures for public companies, triggering deduction limits or shareholder disclosure and consent.

Additional rules may apply to your particular type of plan or situation. Consulting with your employee benefits attorney should be part of your annual year-end cycle to ensure that your plans stay in compliance and that the plan sponsor and participants avoid any unnecessary taxes or penalties.

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