

Legal Issues in Employee Fraud¹

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In 2008, a former U.S. Bank fraud investigator was sentenced to 37 months in prison for embezzling \$1.5 million of the money he had recovered from individuals accused of defrauding the bank.² The thefts occurred between 2002 and 2005, and the U.S. Bank employee apparently used the proceeds to finance various real estate investments. His scheme involved underreporting the amounts recovered from third parties. Reportedly, red flags about his behavior were not acted upon:

Two former U.S. Bank investigators say they raised concerns about Shelofsky's honesty with bank managers shortly after he was hired in 1997. In 1999, co-workers recommended that the bank keep better tabs on the assets he recovered. ****

Estimates of the cost of employee theft vary greatly, in general because the definition of “theft” varies throughout the surveys, but \$40-\$50 billion a year is often quoted.³ Another estimate is that seven percent of a company’s annual revenue is lost to employee fraud.⁴ Signs are that employee theft increases during times of economic stress.⁵ Taking appropriate steps to minimize and mitigate against employee theft can improve your bottom line. Such steps include (1) conducting investigations of suspected fraud or theft; (2) disciplining and terminating employees when necessary; (3) understanding avenues to recoup your losses, and

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.

² See http://blog.oregonlive.com/business_impact/2008/03/exbank_investigator_gets_3_yea/print.html.

³ See generally, Ron Ruggless, *Preventing Employee Theft Safeguards Bottom Line, Ensures a Stronger Staff*, Nation’s Restaurant News (11/24/08), 2008 WLNR 23128529 (\$40 billion); Kevin M. Hart, *Preventing Employee Theft*, 193 N.J.L.J. 453 (2008) (\$50 billion); John B. Phillips, Jr., *Stop Thief! How to Control Employee Theft*, 22 No. 3 Tenn Emp L Letter 3 (March 2007) (\$4 billion to \$40 billion).

⁴ ACFE 2008 Report to the Nation.

⁵ See Patrick M. O’Connell, *Area employee thefts appear to be up because of economy*, *St. Louis Post-Dispatch* (12/30/08) (“times are tough and the economy triggers people making bad decisions”); Derk Boss, *Preventing Employee Theft* teleconference materials (March 11, 2009) (“The national economy is exposing the extent of employee theft in business today”).

(4) implementing safeguards to prevent future thefts. This article addresses the issue of employee theft/fraud in the context of a non-union, private (non-governmental) organization. Collective bargaining agreements and constraints on government employers provide added complexity, which is beyond the scope of this article.

I. INITIAL RESPONSE

There are a number of common ways that an organization may be alerted to an employee's fraud or theft. A co-worker may turn in an employee who has been bragging about his exploits, an outside auditor may raise questions, or an employee may discover suspicious paperwork that arrives while the wrongdoer is on vacation. Upon learning of potential wrongdoing, the first step is generally to place the suspect (if known) on leave, followed by a thorough investigation.

A. Placing the Alleged Perpetrator on Leave

If a particular suspect is identified, the employer will generally immediately place the alleged perpetrator on leave. This removes the individual from the workplace, preventing further wrongdoing during the pendency of the investigation. Removing the individual from the workplace also prevents him or her from tampering with evidence or trying to influence witnesses. Remote access to computers or other electronic equipment should be suspended, as should any card key or other security access. The suspected wrongdoer should be instructed to preserve records and to not communicate with co-workers about the matter. The employer's communication to co-workers about the reason for the absence should be minimal and should not reflect suspected wrongdoing. Neither should the organization lie about the reason for the absence (*e.g.*, "he's out on medical leave"). Simply state that the individual is on a leave of absence. No further explanation is necessary to nosy co-workers. It is critical that no information be given at this point to avoid defaming the individual if it turns out he or she has not engaged in wrongdoing. Typically employers pay the employee during the administrative leave (employment contracts and policies may require that they do so). An employee on unpaid leave may file a claim for unemployment benefits or claim that the employee was constructively discharged, triggering an unintended employment termination.

B. Selecting an Investigator

The investigator plays a critical role and should be carefully selected. At a minimum the individual should be trained and experienced in conducting investigations. The individual should not be implicated in the wrongdoing, should be unbiased (not someone who had a prior run-in with the suspect), and should be schooled in handling highly sensitive and confidential information.

An internal human resources representative may be an appropriate investigator under certain circumstances if he or she has received special training. Alternatively, an outside specialist may be more appropriate in certain cases. For example, if complex financial transactions are involved, a trained forensic accountant may be called for. An outside investigator may be perceived as less biased than an internal investigator, which can be helpful in workplaces that are polarized against certain departments or against management in general. When the extent of involvement is unknown, an outside investigation is also advisable.

An additional consideration in selecting an investigator is whether or not the organization anticipates making a claim against an insurance policy or pursuing civil or criminal charges. In such cases, an investigator with experience in these types of proceedings and the documentation required, and perhaps experience testifying in court, may be desired. When a criminal investigation is occurring in parallel with the internal investigation, it may be helpful to hire an investigator with past law enforcement experience, as they may be able to coordinate with the police more easily than others. Investigations entailing numerous interviews may be more suited to an individual with law enforcement experience whereas an investigation that will be document and number intensive may be more suited to a forensic accountant.

Another consideration is whether to engage the investigator through legal counsel in order to take the position that the investigation is subject to attorney-client privilege. Attorney-client privilege may protect certain communications associated with the investigation from discovery by outside parties.⁶ Oregon Rule of Evidence 503 provides in part that the client “has a privilege to refuse to disclose * * * confidential communications made for the purpose of facilitating the rendition of professional legal services to the client: (a) Between the client or the client’s representative and the client’s lawyer or a representative of the lawyer.” Typically, a letter is sent from the lawyer to the investigator establishing that the investigator is being hired as a representative of the lawyer and that the investigation is being undertaken, and any reports obtained, for the purpose of assisting legal counsel in providing legal advice to the client.

Preserving privilege may be important, for example, where an employee’s suspected fraud may also implicate the employer’s accounting or other regulatory violations. Conducting an investigation under privilege generally provides the organization with greater control over disclosure of the information.⁷ It is important that company personnel who learn of or are involved in communications with the organization’s legal counsel, or with investigators engaged by legal counsel, be instructed to maintain any privilege by not disclosing the communications to others.

C. Conducting a Prompt and Thorough, but Fair, Investigation

Acting promptly is important to preserve evidence. Delay may allow theft or fraud to continue—increasing the organization’s losses. Memories can fade quickly; employees with relevant knowledge may leave or otherwise become unavailable. Acting promptly also shows you take the allegations seriously. In smaller organizations, the cost of paying the suspected employee while they are on leave is added incentive to complete the investigation promptly. Finally, such investigations cause significant disruption and lost productivity.

⁶ See generally Oregon Rules of Evidence 503. ORS 40.225.

⁷ The attorney-client privilege may be waived if the attorney's investigation is used as an affirmative defense in a legal action. For example, in *Fultz v. Federal Sign*, 1995 WL 76874 *2-3 (ND Ill Feb. 17, 1995), the court overruled defense counsel's attorney-client privilege objections to deposition questions in a sexual harassment case in which defense counsel had conducted the investigation. In so doing, the court stated:

*** [I]f the investigation or its results is to be used as evidence at trial, then clearly the privilege which it enjoys would be waived.

On the other hand, an overly aggressive mode of investigation, or jumping to the conclusion of “guilt” without a thorough investigation may cause its own set of problems. A mishandled investigation may result in claims for defamation, false imprisonment, intentional infliction of emotional distress, breach of contract, invasion of privacy or discrimination claims, as discussed below. Therefore, employers should go about the investigation in a thoughtful manner.

D. Reporting Theft to Law Enforcement; the Insurer; Licensing Agencies

In addition to removing the wrongdoer from the workplace and identifying an investigator, the organization will also need to consider whether or not to report the matter to their insurance company and/or law enforcement personnel. Insurance claims are discussed below. *Infra* at Section IV.F. Most policies require timely notification of a claim.

A number of considerations are important in deciding whether to involve law enforcement. Among the considerations are the desire to see justice imposed against the wrongdoer, or the desire to prevent the individual from defrauding their next employer, the requirement of a police report in order to pursue an insurance claim, the time, effort, and possibly the publicity of a criminal prosecution, and the organization’s comfort level with opening up the company’s operations and books to law enforcement personnel.

Finally, an employer, and the individuals with knowledge of the events, may need to consider whether they have an obligation to report the activity to a licensing or regulatory authority.⁸

II. PARTICULAR LEGAL ISSUES IN CONDUCTING INVESTIGATIONS

Generally, an investigation will involve examining relevant documents and data and interviewing witnesses. There are a number of legal constraints that must be observed in investigating employee misconduct.

A. Fair Credit Reporting Act

The Fair Credit Reporting Act (“FCRA”) may impose administrative requirements on investigations in the workplace.⁹ Specifically, when a third party investigator is hired to conduct the investigation, FCRA generally requires the employer to (a) protect the employee’s privacy (any investigation report may generally be disclosed only to the employer/agent and to state and

⁸ For example, nurses licensed in Oregon are required to report a pattern or serious incident of “conduct derogatory” to the practice of nursing. OAR 851-045-0090. Attorneys are required to report another lawyers committed a violation of the Rules of Professional Conduct that raises a substantial question as to that lawyer's honesty, trustworthiness or fitness as a lawyer. Rule 8.3 of the Oregon Rules of Professional Conduct. Recipients of Medicare and Medicaid payments are required to self-report overpayments to the federal government. *See* Sections 6402(a) and 6506 of the Patient Protection and Affordable Care Act.

⁹ 15 USC 1681a(x).

federal agencies, self-regulatory bodies, and as required by law) and (b) provide the employee a summary of the report containing the “nature and substance” of the report.

B. Searching The Employee’s Workspace; Surveillance; Accessing E-Mail¹⁰

Searching desks, lockers and offices, downloading or accessing email, voicemail and other electronic data, videotaping or otherwise conducting surveillance of employees, whether at work or off the job, raises significant privacy issues.

With respect to searches, the employer’s potential liability under various common law tort theories hinges primarily on whether the employee had a reasonable expectation of privacy.¹¹ BOLI, for example, has advised employers who may wish to conduct searches that:

Your best bet is to have a clear policy stating that your workplace is subject to searches, and providing advance notice to employees that they should not have any expectation of privacy in their desk drawers, filing cabinets, lockers, computers, etc.¹²

Oregon has recognized that employees may bring an invasion of privacy claim against their employer. For example, in *McLain v. Boise Cascade Corp.*,¹³ an employer conducted surveillance on an employee who had made a workers’ compensation claim. Private investigators were hired to videotape the employee, who was filmed engaging in activities outside his home. The employee brought an action for invasion of privacy and trespass. Finding in favor of the employer, the court nonetheless noted that “if the surveillance is conducted in an unreasonable and obtrusive manner the defendant will be liable for invasion of privacy.”¹⁴

In addition to common law privacy protections, state and federal law regulates an employer’s right to search, access, and intercept electronic data.¹⁵ Very generally, if the

¹⁰ The Fourth and Fourteenth Amendments to the U.S. Constitution provide additional protections to public sector employees. The Fourth Amendment protects against unreasonable search and seizure by government agents. The Fourteenth Amendment extends the privacy rights of the Fourth Amendment to state and local governments.

¹¹ See, e.g., *K-Mart Corp. v. Trotti*, 677 S.W.2d 632 (Tx. App. 1984) (employee had reasonable expectation of privacy in locker at employer’s workplace where she purchased her own lock); see also generally *Cause of Action to Recover Damages for Invasion of Private Sector Employees’ Privacy*, 18 Causes of Action 2d 87 (2008).

¹² See also generally *Searching for Answers About Workplace Privacy* (BOLI April 17, 2007), http://www.boli.state.or.us/BOLI/TA/TA_COL_041707_Workplace_Privacy.pdf and *Employee May Have Gambled Away Her Job* (BOLI April 16, 2006) (discussing surveillance that showed employee taking money from coworker’s wallet), http://www.boli.state.or.us/BOLI/TA/TA_COL_041806_Employees_Gambling_Problem.pdf.

¹³ *McLain v. Boise Cascade Corp.*, 271 Or. 549, 533 P.2d 343 (1975).

¹⁴ 533 P.2d at 346. See also ORS 163.700 (crime of invasion of personal privacy if visual recording contains nudity); *Thygeson v. U.S. Bancorp*, 2004 WL 2066746 (D.Or. Sep 15, 2004) (search of employee’s computer files).

¹⁵ See 18 USC §§ 2510-2522, 2701-2711 (Electronic Communications Privacy Act, or ECPA), which prohibits certain conduct with respect to e-mail and voicemail, and allows states to enact stricter

electronic systems (hardware, software, Internet service) are owned by the employer and if the employer has a written (and disseminated) policy clearly stating that all systems belong to the employer, are not private, and may be accessed at any time by employer, electronic data and systems may be searched as part of an investigation. Complications arise when the employee uses their own laptop and/or personal email account or when, for example, the employee pays for personal use of the service.¹⁶ Consultation with legal counsel prior to using these investigation methods is advisable.

C. Americans with Disabilities Act

The Americans with Disabilities Act and comparable state laws require accommodation in the investigation process. A suspect-employee or witness-employee must be provided accommodation to allow them to fully participate in the investigation process. This may require, for example, deaf interpreters or assistance for a vision impaired employee in reviewing documents as part of an interview. It would not be unusual, for example, for an employee to request a delay in a scheduled interview due to a medical condition.

D. Obtaining Data From Third Parties

Often in conducting investigations it is desirable to obtain information from third parties. For example, in investigating apparently padded expense reimbursement requests, the investigator may desire to call a hotel directly to confirm that the employee stayed at the hotel on the nights indicated. The investigator may want to see the employee's bank or telephone records. Office or equipment supply account information may need to be accessed. Whether or not the employer can obtain this data without the employee's consent depends upon the situation. Under most circumstances, unless the data sought relates to the employer's own account, the information will not be provided without the employee's consent. It may be appropriate to ask the employee to sign a written authorization allowing the third party to disclose the employee's records to the employer. It is important to tailor such requests so as not to overreach and face possible invasion-of-privacy claims.

E. Confidentiality; Defamation; False Imprisonment Claims

The investigator should generally not promise confidentiality or anonymity to the suspect, or to the witnesses. Obviously, if a criminal complaint is filed, anonymity is not possible. However, it is appropriate to state that the information will be kept as confidential as is possible given the company's need to investigate and respond to the allegation. In addition, it is appropriate to instruct each person interviewed that this is an important process and that the witness needs to be completely truthful. The investigator should keep the process confidential to the greatest extent possible.

prohibitions; *see also*, Brown, *Developing Corporate Internet, Intranet and E-Mail Policies*, 520 P.L.I. 347, 352 (1998). Oregon has adopted stricter prohibitions than the ECPA. *See* ORS 165.540.

¹⁶ *Quon v. Arch Wireless Operating Co., Inc.*, 554 F3d 769 (9th Cir. 2009), *cert granted sub no*, *City of Ontario, Cal. v. Quon*, 130 S Ct. 1011 (2009).

Witnesses who are interviewed should be told that they are not to discuss confidential matters with anyone at work or outside work. Breaches of confidentiality may subject the company or the witness to claims of invasion of privacy or defamation by the alleged wrongdoer. Finally, employees who have not yet been interviewed may, intentionally or unintentionally, alter their version of the facts based on what they have learned from others.¹⁷

Documentation of the investigation (witness notes, *etc.*) should not be placed in the employee's personnel file. Remember that employees have the right to inspect their personnel files. Investigation materials may contain confidential witness statements that would be inappropriate to provide to the perpetrator.

A proper investigation will help the employer defend claims for false imprisonment, defamation, or intentional infliction of emotional distress.¹⁸ Conversely, an overly aggressive approach can subject the employer to liability. For example, in *Buckel v. Nunn*,¹⁹ a security guard confronted an employee suspected of theft, directed her back to a small storage room, placed himself between her and the door, informed her that he would decide whether she would go home or go to jail, and he repeatedly accused her of stealing from the store. She was allowed only one telephone call, and was not allowed to answer other calls from her husband and mother-in-law. The employee was visibly upset during the questioning, which lasted about three hours. The security guard was later joined in the interrogation by another employee. The security guard and second employee kept insisting that the employee had stolen items, although they had no proof that she had taken anything. The appellate court upheld a jury's award of \$85,000 in favor of the employee on an intentional infliction of emotional distress claim.

A defamation claim generally requires a plaintiff to demonstrate that the defendant made (1) an unprivileged publication to a third person, (2) consisting of false and defamatory matter concerning the plaintiff, and (3) that causes damage to plaintiff's reputation.²⁰ Statements that an employee was terminated for stealing are actionable *per se* (general damages are presumed without proof of harm).²¹ Several defenses exist for defamation claims. Truth, for example, is an absolute defense. *See also* ORS 30.178 (liability of employer for disclosing information

¹⁷ *See, e.g., Jernigan v. Alderwoods Group, Inc.*, 489 F Supp2d 1180, 1196-1197 (D. Or. 2007) (citing evidence that the employer immediately intervened and disciplined employees who breached confidentiality as evidence that it took reasonable care in conducting its investigation into claims of sexual harassment).

¹⁸ *See, e.g., Downs v. Waremart, Inc.*, 137 Or App 119 (1995), *affirmed in part, reversed in part nc.*, 324 Or 307 (1996) (summary judgment granted to employer on intentional infliction of emotional distress claim based upon employer reporting and requesting police interrogation of plaintiff-employee where employer had a good faith belief a theft had occurred, there was no evidence that plaintiff was targeted for investigation for protected retaliatory reasons, and the interrogation stopped when the employee protested); *see also Hall v. The May Department Stores*, 292 Or 131, 637 P2d 126 (1981) (intentional infliction of emotional distress claim stemming from store personnel's interrogation related to shortages in a cash register).

¹⁹ 133 Or App 399 (1995).

²⁰ *Marleau v. Truck Ins. Exchange*, 333 Or. 82, 94, 37 P.3d 148 (2001).

²¹ *See Cook v. Safeway Stores, Inc.*, 266 Or 77, 84-85, 511 P2d 375 (1973) (slander action where manager told three other employees that plaintiff was discharged for stealing from the company).

about employee to new employer; no action based on compelled self-publication²²). A common law qualified privilege also applies to certain work-related statements regarding employees' work performance.²³ Where a privilege applies, the employee must prove that the defendant acted with actual malice.²⁴ The employee must show that the defendant "abused the privileged occasion, in order to recover from the defendant."²⁵ When suspected wrongdoing first surfaces, the facts are rarely clear, making defamation claims a risk. The employer should instruct everyone with knowledge of the circumstances to maintain the information in strict confidence.

F. Polygraphs

The federal Polygraph Protection Act permits the use of lie detectors on employees only in connection with an ongoing investigation of theft, industrial espionage or similar actions.²⁶ The Act expressly forbids asking the employee questions regarding religion, race, politics, sexual behavior, or labor organizations. Oregon employers may not subject any employee or applicant to a polygraph or "psychological stress test," even if he or she consents.²⁷

G. Foreign Language Interpreters

Foreign language interpreters may be advisable to ensure that the non-English-speaking witnesses understand the questions.²⁸

III. EMPLOYEE DISCIPLINE AND TERMINATION

Upon completion of the investigation, the employer must decide whether wrongdoing occurred and what to do about it.

Oregon is an at-will employment state; therefore employees, absent some contractual obligation, can be terminated at any time for any reason that is not against public policy or prohibited by antidiscrimination laws.²⁹ However, to avoid discrimination claims, it is important for employers to treat employees consistently for the same types of disciplinary issues. If there are contractual restraints on the employer, then the employer must comply with them or risk liability for breach of contract. For example, some employers have mandatory disciplinary procedures or restrictions that limit the employer's freedom to discharge. Unionized employers, of course, must follow the applicable collective bargaining agreement.

²² See *Downs v. Waremart, Inc.*, 324 Or 307, 926 P2d 314 (1996); *Volm v. Legacy Health Sys.*, 237 F. Supp. 2d 1166 (D Or 2002) (discussing doctrine of compelled self-publication and noting that in 1997 ORS 30.178(2) was adopted, which prohibits compelled self-publication claims brought by former employees).

²³ *Wallulis v. Dymowski*, 323 Or. 337, 350-351, 918 P.2d 755 (1996).

²⁴ *Delong v. Yu Enterprises, Inc.*, 334 Or 166, 170, 47 P3d 8 (2002).

²⁵ *Wallulis*, 323 Or. at 348, 918 P2d 755 (1996).

²⁶ See 29 USC § 2007(b).

²⁷ ORS 659A.300.

²⁸ See Eric Akira Tate, *The When, Who, and How of Workplace Investigations (With Form)*, 16 No. 2 Prac. Litigator 7 (Mar. 2005) (citing to *Henderson v. Simmons Foods, Inc.*, 217 F3d 612,616 (8th Cir 2000) (supervisors interviewed non-English speaking employees without aid of interpreter).

²⁹ See generally, *Patton v. J.C. Penney Co.*, 301 Or 117, 120, 719 P2d 854 (1986).

IV. RECOUPING LOSSES

A. Deductions from Paychecks

Upon discovering an employee's theft, it may be tempting to deduct the amount stolen from the employee's final paycheck; however, the circumstances under which an employer can deduct amounts from an employee's paycheck are limited by statute.³⁰ For example, it is not permissible to deduct from an employee's final paycheck to account for computer equipment loaned to the employee that the employee has failed to return or to account for till shortages or theft. It is also not permissible to take payroll deductions if an employee admits to stealing and agrees in writing to pay the money back through payroll deductions.³¹ Instead, the employer must seek to enforce its rights through standard legal process.³² An employer may not unilaterally deduct the amount owed from the employee's 401(k) plan account.³³

B. Agreements to Pay

An employer may request restitution from an employee. The employer and employee can voluntarily enter into an agreement (such as a promissory note or confession of judgment³⁴) that requires the employee or former employee to pay back the sums owed over time. Such sums must not be deducted from the employee's paycheck, as discussed above. Threatening an employee with criminal action to obtain an agreement to pay may result in charges of extortion,³⁵ although it is a defense to such charges that "the defendant reasonably believed the threatened charge to be true and that the sole purpose of the defendant was to compel or induce the victim to take reasonable action to make good the wrong which was the subject of the threatened

³⁰ ORS 652.610(3).

³¹ See http://www.boli.state.or.us/BOLI/TA/T_FAQ_Tadeduct.shtml.

³² ORS 652.610(5)(c) states: "This section does not: ***** (c) Diminish or enlarge the right of any person to assert and enforce a lawful setoff or counterclaim or to attach, take, reach or apply an employee's compensation on due legal process." See also generally, Douglas B. Kauffman, *You've Caught a Thief Amongst You—What Now?*, 69 Ala Law 30 (January 2008) (discussing the FLSA's additional overtime and minimum wage restrictions on deductions related to employee fraud).

³³ See generally *Guidry v. Sheet Metal Workers National Pension Fund*, 493 U.S. 365, 110 S.Ct. 680 (1990) (Court invalidated various employer attempts to recoup embezzled amounts from employee's 401k plan, finding the anti-alienation provisions of ERISA prohibited imposition of constructive trust to freeze 401(k) assets to satisfy judgment against employee).

³⁴ See ORCP 73.

³⁵ ORS 164.075 Theft by extortion:

(1) A person commits theft by extortion when the person compels or induces another to deliver property to the person or to a third person by instilling in the other a fear that, if the property is not so delivered, the actor or a third person will in the future:

(d) Accuse some person of a crime or cause criminal charges to be instituted against the person;

(e) Expose a secret or publicize an asserted fact, whether true or false, tending to subject some person to hatred, contempt or ridicule;

charge.”³⁶ It is generally advisable to be sure you know the full extent of the losses before entering into a settlement agreement.

C. Small Claims Lawsuits

If the employee owes the employer \$750 or less, then the claim must be brought in small claims court.³⁷ If the amount is \$7,500 or less, then the claim may be brought to the small claims court, although it may be transferred if the defendant claims the right to a jury trial. *Id.* In general, attorneys do not appear in small claims court actions (even if the plaintiff is a corporation),³⁸ although employers may still want advice on how to proceed and present their case. The judge’s consent is required before an attorney may represent a party before the small claims court.³⁹

Small claims court can be a simple, relatively quick, low-cost method of obtaining a judgment. The claim itself must include the name and address of the parties, followed by a “plain and simple statement of the claim, including the amount and date the claim allegedly accrued.”⁴⁰ It must also include an affidavit stating that the plaintiff made a bona fide effort to collect the claim from the defendant before filing the claim. *Id.* Forms and other information, including instructions on how to serve the employee-defendant, are generally available through the applicable court. *See also* UTCR Chapter 15 (small claims forms)⁴¹; *see also, e.g.*, Multnomah County SLR Ch. 15. Liens may be created and further collection may take place as specified under applicable statutes.⁴²

D. Civil Action

Employers may also choose to file a claim in the appropriate county circuit court—Oregon’s trial court of general jurisdiction. Corporations must be represented by an attorney.⁴³ Cases involving less than \$50,000 generally proceed in a mandatory arbitration program.⁴⁴

Potential causes of action in a typical case of employee embezzlement include Fraud, Money Had and Received and Conversion. Considerations in deciding to bring a civil action against the employee include the effort and cost of bringing an action, the likelihood of recovery, public disclosure of the employee’s acts, and the potential for counterclaims by the employee. Unfortunately, in many cases, the employee’s theft is fueled by gambling or drug addiction, leaving few assets from which to recover the losses.

³⁶ ORS 164.035(2).

³⁷ ORS 55.011 (justice court small claims); ORS 46.405 (circuit court small claims).

³⁸ *See* ORS 55.090(2) (“Notwithstanding ORS 9.320, a corporation, state or any city, county, district or other political subdivision or public corporation in this state may appear as a party to any action in the department without appearance by attorney”) and ORS 46.415 (same).

³⁹ ORS 55.090; ORS 46.415.

⁴⁰ ORS 55.030; ORS 46.425

⁴¹ http://www.ojd.state.or.us/mul/LocalCourtRules/Documents/2008_UTCR.pdf.

⁴² ORS 46.488 and ORS 55.130.

⁴³ ORS 9.320.

⁴⁴ *See generally*, ORS 36.400 to 36.425.

E. Provisional Process

In certain cases it may be appropriate to take steps to immediately freeze the employee's accounts in order to prevent the employee from transferring or hiding ill-gotten gains. ORCP 83 sets out the process for obtaining orders attaching accounts and other means of securing assets.

Additionally, under Oregon law, a plaintiff can obtain a constructive trust on property purchased with wrongfully obtained funds and the proceeds from sales of property purchased with these funds.⁴⁵ This area of law is technical and specialized. It is advisable for the general practitioner to work with an attorney experienced in these types of proceedings.⁴⁶

F. Insurance and Employee Bonds

Insurance and bonds are another potential source of recovery for the employer if all the prerequisites for coverage are met. Losses from employee fraud typically are not covered by property insurance policies. Instead, such coverage must be separately purchased as an endorsement or as a separate policy. A fidelity bond (also called fidelity insurance) indemnifies an employer for loss it may sustain through the dishonest or fraudulent acts of its employees.⁴⁷ A surety bond may also be required for some trades and professions.⁴⁸ Fidelity policies often contain strict requirements regarding notifying the insurer of a claim:

For the victimized company, the road to insurance recovery comes in three major steps. The first step involves giving prompt notice to the fidelity insurance company providing the employee theft or "fidelity" insurance coverage. The second step is the preparation of a proof of loss explaining and documenting the loss. The third step is responding to the barrage of defenses insurance companies typically interpose to even the most clearly covered claims.⁴⁹

Fidelity insurance is often hotly litigated. Common issues include the definition of "employee" (are temporary staff, consultants, contractors, those with an ownership interest employees?) and the intent of the employee (did the employee intend to steal or did they regard the theft as a "loan"?)⁵⁰ Typically, notice must be given within a very short time (for example, 60 days) after discovering the loss.

⁴⁵ *Lane County Escrow Service, Inc. v. Smith and Coe*, 277 Or 273, 285 (1977) (issuing injunction prohibiting the allegedly embezzling defendants from disposing of any assets during the pendency of the action).

⁴⁶ See generally CREDITORS RIGHTS AND REMEDIES (Oregon CLE 2002 and 2006 Supplement).

⁴⁷ See generally 3 ADVISING OREGON BUSINESSES §48.42-§48.44 (Oregon CLE Rev. 2003); 1 COUCH ON INS. §1:16.

⁴⁸ See generally 3 ADVISING OREGON BUSINESSES §48.42-§48.44 (Oregon CLE Rev. 2003).

⁴⁹ Robert M. Horkovich, Adam A. Reeves, Peter J. Andrews, *Insurance Coverage for Employee Theft Losses: A Policyholder Primer on Commonly Litigated Issues*, 29 U Mem L Rev 363, 365 (1999).

⁵⁰ See generally, Toni Scott Reed, *Employee Theft Versus Manifest Intent: The Changing Landscape of Commercial Crime Coverage*, 36 Tort & Ins. L.J. 43 (2000); see also *Karen Kane Inc. v. Reliance Insurance Co.*, 202 F3d 1180 (9th Cir 2000) (interpreting "per occurrence" policy limit for employee

G. Claims Against Third Parties

Employers who have experienced embezzlement or employee fraud may also look to third parties to recover their losses. Claims against accountants or auditors for failure to discover the wrongdoing; claims against recruiters or placement agencies for recommending the individuals for hire and claims against banks for failing to detect the fraud involving the employer's accounts with the bank are examples of third-party claims.⁵¹

V. BACKGROUND CHECKS AND SCREENING METHODS

Careful hiring practices, audits, and employee awareness and communication programs are commonly recommended to reduce an employer's exposure to employee fraud. Many state and federal laws, however, limit the types of information that may be obtained about prospective employees and/or the manner in which that information is used. These and other considerations are addressed below.

A. Applications

At a minimum, each applicant should be required to provide his or her complete education and employment history, references, criminal convictions,⁵² licenses, and accreditation. The applicant should be required to certify that the information provided on the application is truthful and accurate. The application should also require the applicant to authorize the employer to solicit information about the applicant's previous employment and background from third parties, to verify that the information provided on the application is true. Questions that would require the applicant to disclose his or her sex, race, religion, marital status, age, or mental or physical condition are improper (except self-disclosure for EEO reporting purposes).

The application should notify the applicant of the employer's requirements pertaining to pre-employment drug testing and criminal or credit checks. The application should also state that omissions and false or misleading information will disqualify the applicant from further consideration and, in the event the applicant is hired, result in termination of employment.

B. Checking References

Employers may obtain a release from the applicant that authorizes former employers and third parties to release information. Former employers that are not willing to discuss the details of the applicant's performance or reasons for leaving may nevertheless be willing to say whether or not the employee is eligible for rehire, or provide other insight into the applicant's work history. Prospective employers may also ask applicants for copies of recent employment

theft occurring over three policy periods); *Adolf Jewelers Inc. v. Jewelers Mutual Insurance Co.*, 2008 WL 4682035 (ED Val) (insurer bad faith case stemming from employee embezzlement claim).

⁵¹ See *Maduff Mortgage Corp v. Deloitte Haskins & Sells*, 98 Or App 497 (1989), discussing jury instructions in case where accounting firm allegedly failed to discover irregularities arising from fraud on the part of plaintiff's employees and directors).

⁵² Some states limit inquiries about criminal convictions—employers can only ask about felonies (not misdemeanors) and cannot ask about crimes committed beyond seven to ten years ago, for example.

evaluations.⁵³ Even if the reference checks result in little or no useful information, the efforts should be documented. Such records can be useful in the event someone who alleges they were harmed by an employee files a claim that the injury resulted from the employer's failure to adequately screen its employees.

C. Criminal and Credit Checks

Employers may desire to conduct criminal background checks and credit checks on applicants. Note that bankruptcy cannot be the basis for refusing to employ an applicant.⁵⁴ This is consistent with the public policy of affording individuals a true "fresh start" after bankruptcy. Short of bankruptcy, it may be desirable to consider applicant's credit worthiness and criminal background prior to hire, but there are restrictions on this practice.

When hiring a third party to conduct a consumer credit and/or criminal background check, an employer must comply with the requirements of the Fair Credit Reporting Act (FCRA).⁵⁵ This law requires the employer to notify the applicant in writing that the records will be sought, obtain the applicant's written authorization to obtain the records, and notify the applicant that a poor credit history or conviction will not automatically result in disqualification from employment. Certain other disclosures are required upon the employee's request, and prior to taking any adverse action based on the reports obtained.⁵⁶ Employers may themselves obtain data found in public records through a variety of online sources. Such public records searches by employers (not using a third party) are not subject to FCRA.

Some state laws require employers to (for example): (1) notify applicants if they intend to conduct a criminal or other background check; (2) obtain a written authorization before conducting a check; and (3) provide specific disclosures about the information sought or obtained.⁵⁷ Such requirements may exceed and/or conflict with FCRA's requirements. It is, therefore, important to always check state law.

Oregon law prohibits the use of credit history for employment purposes with four exceptions: (1) bank and credit union employers; (2) employers that are required by state and federal law to use credit histories for employment purposes; (3) public safety officer employers; (4) employers that can demonstrate that credit information is "substantially job-related" and that provide written disclosure of the reasons for the use of the credit check. As of the date of this article, the Oregon Bureau of Labor and Industries had issued proposed regulations stating that

⁵³ Most states require employers to furnish an employee a copy of his or her personnel file upon request, with various limitations. *See, e.g.*, ORS 652.750.

⁵⁴ 11 USC §525.

⁵⁵ *See* 15 USC § 1681. Employers should not assume that their credit agency's forms, notices, or conduct complies with FCRA, as liability for noncompliance rests with the employer.

⁵⁶ An employer who willfully fails to comply with the requirements under FCRA is liable to the employee or applicant in the amount of actual damages of not less than \$100 nor more than \$1,000, punitive damages, and attorney fees. 15 USC § 1681(n). An employer who *negligently* fails to comply is liable to the employee or applicant for actual damages and attorneys' fees. 15 USC § 1681(o).

⁵⁷ *See, e.g.*, ORS 181.555(2)(b) (requiring employers to advise an employee or applicant prior to seeking a criminal background check that such information may be sought).

“substantially job-related” is a case-by-case determination and may be based upon whether the position (a) is a managerial position which involves setting the direction or control of the business; (b) involves access to customer or employee personal or financial information (other than normal retail transaction information); or (c) involves a fiduciary responsibility including authority to issue payments, transfer money, or enter into contracts.⁵⁸

As of the date this article was written, the EEOC was reportedly considering issuing rules constraining the use of criminal history due to the purported adverse impact of such criteria against minorities.⁵⁹

D. Pre-Employment Drug Testing

Drug testing is another way to obtain valuable information about a potential employee. Current illegal drug users are not protected under federal law and may be excluded from employment based on a failed drug test.⁶⁰ Drug tests may or may not be permitted under state law.

Drug tests are not considered medical *examinations* under the ADA.⁶¹ However, drug testing is a form of medical *inquiry*. Therefore, the ADA requires that drug testing be conducted after an offer of employment has been made and on a consistent basis (*e.g.*, to everyone hired into a particular category of jobs such as safety sensitive positions).⁶²

Public employers face additional constraints on drug testing, an analysis of which is beyond the scope of this article.

E. Tests and Assessments

In addition to background screening of applicants, testing and assessments⁶³ can be useful tools for selecting qualified candidates, placing them within the organization, identifying needed training, and predicting future success. The *Uniform Guidelines on Employee Selection Procedures (Guidelines)*, which apply to employers covered by Title VII of the 1964 Civil Rights Act and/or Executive Order 11246,⁶⁴ prohibit the use of any test or selection procedure that creates an adverse impact on a protected class unless the procedure is shown to be

⁵⁸ Proposed OAR 839-005-0085.

⁵⁹ <http://3bns.net/blog/2010/04/18/are-you-a-criminal-or-a-deadbeat-uncle-sam-wants-you-as-a-potential-class-member/>

⁶⁰ The term “qualified individual with a disability” does not include individuals currently engaging in the illegal use of drugs when the employer acts on the basis of such use. 42 CFR § 1630.3(a).

⁶¹ 42 USC § 12114(d).

⁶² See 42 USC § 12112(3); 29 CFR § 1630.14.

⁶³ Tests are most often used for jobs requiring a particular skill or ability (*e.g.*, typing for a clerical position, physical agility for firefighting, physical strength for a laborer position). Assessment centers are more often used to measure a wider range of abilities needed for a higher level or managerial position. See generally, Onet, *Testing and Assessment: An Employer’s Guide to Good Practices*, http://www.onetcenter.org/dl_files/empTestAsse.pdf.

⁶⁴ 29 CFR § 1607.2.

job-related for the position in question and its continued use is justified by business necessity.⁶⁵ The *Guidelines* apply to selection procedures used to make employment decisions (*e.g.*, hiring, promotion, disciplinary action, opportunity for training or advancement, certification and licensing, termination). Adverse impact occurs when there is a substantially different selection rate that disadvantages a particular protected group. Adverse impact is typically indicated when the selection rate for a particular group is less than 80% or four-fifths that of the group with the highest rate (the “four-fifths rule”).⁶⁶

Tests and assessments should not be used unless they are both reliable and valid. Reliability refers to the extent to which a test consistently measures a characteristic.⁶⁷ Test validity refers to how well the test measures the particular characteristic the test was designed to measure. It is permissible under the *Guidelines* to rely on validity studies conducted by others only when evidence from available studies meets certain specified criteria.⁶⁸ There must be some proof (1) of a correlation between test performance and job performance (“criterion-related validation”); (2) that test items measure important requirements and qualifications for the job (“content-related validation”); and/or (3) that the test measures what it claims to measure and this characteristic is important to successful performance on the job.

F. SOCIAL NETWORKING SITES

An analysis of the legal implications of screening applicants’ social networking websites (Facebook, Twitter, blogs, *etc.*) is beyond the scope of this article. In summary, there are pros and cons to viewing applicants’ on-line information and an employer should do their research, consult counsel, and develop policies and procedures if they decide to incorporate this resource into their screening program.

VI. CONCLUSION

Employee fraud and embezzlement cause substantial losses to business and show no signs of slowing. The manner in which an organization screens applicants and responds to suspected employee fraud can substantially impact whether the organization is able to prevent losses or recover lost amounts. In addition, sound practices in investigating and responding to employee fraud should reduce the likelihood of legal claims being asserted against an organization by employees who believe they have been wrongly accused, defamed, or otherwise damaged by an employer’s response to a situation.

⁶⁵ 29 CFR §§ 1603, 1611.

⁶⁶ 29 CFR § 1607.4.

⁶⁷ Factors such as the test-taker’s psychological state at the time of testing, environmental factors (*e.g.*, comfort, distractions), test form, and multiple raters may affect an individual’s test scores. Test manuals typically report a statistic called the “standard error of measurement” that is the margin of error you should expect in an individual test score due to the imperfect reliability of the test.

⁶⁸ 29 CFR § 1614B.