May-June 2011

Weil

Employer Update

SEC Expands Dodd-Frank's Anti-Retaliation Protections

By Allan Dinkoff

On May 25, 2011, the Securities and Exchange Commission approved regulations implementing the whistleblower bounty program and anti-retaliation provisions mandated by Section 922(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The regulations expand significantly the scope of Dodd-Frank's anti-retaliation provisions beyond the express terms of the statute, and this has significant implications for employers.

The Statutory Scheme

The whistleblower provisions of Dodd-Frank are focused principally around creating a bounty program to provide whistleblowers with incentives to bring violations of the federal securities laws to the Commission's attention. The Act's anti-retaliation provisions are part of this statutory scheme, appearing in the same section of the Act as the bounty provisions.[1] The Act is specific in defining "whistleblower" as "any individual who provides, or 2 or more individuals acting jointly who provide, information relating to a violation of the securities laws to the Commission, in a manner established, by rule or regulation, by the Commission." Section 21F(a)(6).[2] This definition applies by its terms both to the bounty provisions and to the anti-retaliation provisions. The regulations apply this definition to the bounty program but create an entirely new definition of "whistleblower" for the anti-retaliation provisions that appears to go beyond the express terms of the statute.

Section 21F(h) protects "whistleblowers" from retaliation by their employer. It prohibits employers from retaliating against "whistleblowers" "because of any lawful act done by the whistleblower" in three enumerated instances: (i) providing information to the Commission, (ii) participating in any investigation or action undertaken by the Commission based on or related to information provided by the whistleblower, or (iii) making disclosures required or protected by the Sarbanes-Oxley Act of 2002. Clearly, under the express language of the statute, only "whistleblowers" as defined by the statute are entitled to the statute's anti-retaliation protections. Retaliation is then defined as adverse action against a "whistleblower" because the whistleblower engaged in certain specified activities.

The SEC Rules

The Commission wrote a new definition of "whistleblower" solely for purposes of the anti-retaliation provisions. The regulations define "whistleblower" in the anti-retaliation context as not only someone who makes disclosures to the Commission, but also someone who makes disclosures "required or protected under the Sarbanes-Oxley Act of 2002 . . . and any other law, rule, or regulation subject to the jurisdiction of the

In This Issue

Commission." Reg. 240.21F-2(b)(ii). The regulations thus expand the definition of "whistleblower" by ignoring the distinction between the definition of "whistleblower" and the whistleblower's activities. Expanding the definition of whistleblower has significant consequences given the scope of Sarbanes-Oxley.[3]

The disclosures protected by Sarbanes-Oxley are extremely broad. Significantly, Sarbanes-Oxley disclosures are protected even if they are not reported to the Commission, and the protected disclosures may extend way beyond matters related to violations of the federal securities laws. For example, section 806 of Sarbanes-Oxley protects individuals from retaliation if they made disclosures to "a person with supervisory authority over the employee (or such other person working for the employer who has the authority to investigate, discover, or terminate misconduct)," assuming that the other prerequisites to Sarbanes-Oxley protections are met. It also protects employees who assist private litigants alleging violations of the federal securities laws and other specified anti-fraud statutes.

The exact parameters of Sarbanes-Oxley's whistleblower protections are still being thrashed out by the Department of Labor and the courts, but a recent *en banc* decision by DOL's Administrative Review Board ("ARB") adopts a very sweeping definition of protected activity. The statute protects a whistleblower who provides information "regarding conduct that the employee reasonably believes constitutes a violation" of enumerated federal statutes, which include wire fraud, mail fraud, bank fraud and securities fraud. A majority of courts, ARB panels and DOL administrative law judges have held that irrespective of which anti-fraud statute the whistleblower sought to rely upon, the fraud must involve fraud on shareholders to be protected by Sarbanes-Oxley.[4] Bucking this trend, the ARB recently held *en banc* in *Sylvester v. Parexel International LLC*[5] that Sarbanes-Oxley protects reports of fraudulent conduct that do not involve fraud on shareholders and that the fraud need not be material. The ARB's *Sylvester* decision is not the final word, but it is a warning that the law is very much in flux and is potentially very far reaching.

The regulations expand significantly the scope of Dodd-Frank's anti-retaliation provisions beyond the express terms of the statute, and this has significant implications for employers.

Converting Sarbanes-Oxley claims into Dodd-Frank claims has significant consequences for those litigating these cases, because we can expect that employees generally will prefer to litigate under Dodd-Frank. First, suits under Dodd-Frank may be brought directly in federal district court without filing first with OSHA as required by Sarbanes-Oxley. Second, whistleblowers are entitled under Dodd-Frank to two times the amount of back pay otherwise owed while only back pay is available under Sarbanes-Oxley. Third, the statute of limitations is considerably longer under Dodd-Frank: suit must be brought within six years, or three years from when "facts material to the right of action are known or reasonably should have been known," but in no event more than ten years after the date of the violation. In contrast, whistleblowers pursuing claims under Sarbanes-Oxley must file a claim with OSHA within 180 days of the violation or the date on which the employee becomes aware of the violation.

The regulations make it explicit that violations of the Dodd-Frank anti-retaliation provisions can result in a Commission enforcement action. This was always the case because the anti-retaliation provisions were inserted into the Securities Exchange Act of 1934, and the SEC is authorized to bring enforcement actions for any violation of that statute. In addition, any violation of the, 34 Act is a criminal offense. In contrast, the SEC does not have authority to investigate violations of Sarbanes-Oxley § 806.[6]

What Employers Should Do

It remains to be seen whether the courts will uphold the Commission's new definition of "whistleblower." But irrespective of whether the statutory definition or the SEC's definition of "whistleblower" ultimately prevails, the stakes have been raised for employers. The basic rules for dealing with whistleblowers remain the same — managers of whistleblowers must be educated on what retaliation means and told in no uncertain terms that they may not retaliate. Any performance management or disciplinary action must be reviewed first by HR and legal. HR and legal must satisfy themselves that any performance management or disciplinary action is being taken for non-retaliatory reasons, including ensuring that others similarly situated are being treated in a similar fashion. HR and legal also should be involved in decisions concerning compensation, performance reviews and promotion to ensure that whistleblowers do not have any legitimate claim that they are being treated less favorably because they came forward with concerns. It may be useful to set up a direct line of communication between whistleblowers and HR so the whistleblower can flag immediately any situation where he or she feels that they are being treated inappropriately, such as not being invited to client or networking events.

The stakes have been raised for employers.

1 Separate sections of Dodd-Frank have whistleblower provisions for reports to the Commodity Futures Trading Commission and the Bureau of Consumer Financial Protection.

2 Section 922(a) of Dodd-Frank adds section 21F to the Securities Exchange Act of 1934, and we will use here the '34 Act references.

3 At least one court adopted the Commission's expansive definition of "whistleblower" for purposes of Dodd-Frank's anti-retaliation provisions shortly before the Commission issued its final rules. *Egan v. TradingScreen, Inc.*, 2011 U.S. Dist. LEXIS 47713 (S.D.N.Y. May 4, 2011).

4 See, e.g., *Livingston v. Wyeth, Inc.*, 520 F.3d 344, 354 (4th Cir. 2008); *Allen v. ARB*, 514 F.3d 468 (5th Cir. 2008); *Bishop v. PCS Admin.* (USA), Inc., No. 05 C 5683, 2006 WL 1460032, at *9 (N.D. Ill. May 23, 2006); *Plantone v. Flyi, Inc.*, ARB Case No. 04-154, ARB Case No. 2003-SOX-00027, at 15 (ARB Sept. 29, 2006); *Marshall v. Northrup*, AFJ Case No. 2005-SOX-00008 (ALJ June 22, 2005). But *see, e.g., Reyna v. Conagra Foods, Inc.*, Case No. 3:04-CV-39 (M.D. Ga. June 11, 2007).

5 ARB Case No. 07-123, ALJ Case Nos. 2007 SOX-039 & 2007-SOX-042 (May 25, 2011).

6 The SEC can, of course, investigate the violations about which the whistleblower complains and may view retaliation as obstructing its investigation, which carries serious consequences.

AT&T Mobility LLC v. Concepcion: A Powerful Development or Hollow Victory for Employers?

By Alex M. Solomon

Introduction

On April 27, 2011, the United States Supreme Court held in *AT&T Mobility LLC v. Concepcion et ux.*,[1] that the Federal Arbitration Act ("FAA") preempted California law prohibiting the enforcement of class action waivers in private arbitration agreements. The Court's decision provides employers with a powerful tool against class action litigation because it enables employers to incorporate class action waivers into mandatory pre-dispute arbitration agreements without fear of such provisions being invalidated under state law. However, some doubts have been raised as to whether the protections afforded by Section 7 of the National Labor Relations Act ("NLRA") may limit the applicability of *AT&T Mobility* in the employment context. If so, NLRA Section 7 could create an exception for employees that swallows *AT&T Mobility*'s general rule.

Factual Background of *AT&T Mobility*

AT&T Mobility arose out of a dispute over $30.22. Respondents Plaintiffs and his wife purchased AT&T mobile phone service, which, as advertised, included free phones. However, they were charged $30.22 in sales tax for the "free phones." Angered that they had to pay sales tax on phones advertised as "free," Respondents Plaintiffs and his wife filed suit in the United States District Court for the Southern District of California, which the District Court subsequently consolidated with a putative class action alleging, *inter alia*, false advertising and fraud.[2]

AT&T subsequently moved to compel a purely bilateral arbitration based on the arbitration provision in its contract for mobile service with the Concepcions. The Respondents Plaintiffs sought to defeat AT&T's motion by contending that the arbitration provision was unconscionable and unlawfully exculpatory under

California law on the grounds that it prohibited the institution of a class action arbitration. The District Court rejected AT&T's position, relying on a California Supreme Court case, *Discover Bank v. Superior Court*,[3] that held as unconscionable — in certain circumstances — class arbitration waivers in consumer contracts of adhesion.[4] The Ninth Circuit Court of Appeals affirmed the District Court's holding. Further, the Ninth Circuit addressed whether the FAA preempted the rule established in *Discover Bank*, and it concluded that California's rule was not preempted.[5]

Some doubts have been raised as to whether the protections afforded by Section 7 of the National Labor Relations Act may limit the applicability of *AT&T Mobility* in the employment context.

The FAA and the Supreme Court's Ruling

Under Section 2 of the FAA, an arbitration agreement is "valid, irrevocable, and enforceable save upon such grounds as exists at law or in equity for the revocation of any contract."[6] Under Supreme Court precedent, " 'generally applicable contract defenses, such as fraud, duress, or unconscionability' " are not preempted by the FAA,[7] or in other words are protected by the savings clause of FAA's Section 2 (i.e. they are grounds existing at law for the revocation of a contract). However, the FAA preempts those rules that specifically target or apply only to arbitration agreements. Thus the question presented to the Supreme Court was whether the FAA preempted California's rule invalidating as unconscionable arbitration agreements that prohibited a claimant from bringing a class arbitration.[8] Resolution of the question presented to the Court hinged on whether California's rule was one of general applicability.

As noted above, the Court, with Justice Scalia writing for the 5-4 majority, concluded that the FAA preempted California's rule. The Court rejected the Concepcions' position that the rule established in *Discover Bank* was one of general applicability, finding that the rule improperly targeted arbitration agreements, much like a rule requiring that the Federal Rules of Evidence apply to arbitrations or that discovery in arbitrations proceed under the relevant Federal Rules of Civil Procedure.[9]

In support of its determination, the majority noted that the core purpose of the FAA is to provide parties with flexibility in determining the terms of arbitrations. Accordingly, arbitrations are often efficient and streamlined when compared to court proceedings, as parties have the leeway to tailor procedures to their benefit, where federal and state rules governing judicial proceedings are often "one-size-fits-all."[10] Further, class arbitrations differ fundamentally from bilateral arbitrations by, for example, involving absent parties and higher stakes as well as presenting concerns about the maintenance of the private and confidential nature of the proceedings. Moreover, according to the Court, class arbitration "sacrifices the principal advantage of arbitration — its informality — and makes the process slower, more costly, and more likely to generate procedural morass than final judgment."[11] Thus, as the California rule established in *Discover Bank* encourages class arbitration, which fundamentally differs from bilateral arbitration, it is inconsistent with the purpose of the FAA because it requires parties to engage in a procedure not agreed to as a matter of contract.[12]

Justice Breyer wrote the dissenting opinion in which he argues, *inter alia*, that California's rule was one of general applicability. To support his opinion, he noted that *Discover Bank*'s prohibition applies to class action waivers in any contract — not just arbitration agreements. Moreover, Justice Breyer identified the advantages of class proceedings, such as incentivizing attorneys to take on individuals', such as the Concepcions', small dollar claims.[13]

The Court's Decision and Section 7 of the NLRA

Although the decision of the Court concerned an arbitration clause in a consumer contract and addressed only California law, on its face, it appears to provide employers with a potent weapon for limiting class claims. As a general matter, *AT&T Mobility* stands for the proposition that any state rule, established by either statute or judicial pronouncement, that serves to invalidate class arbitration waivers is preempted by the FAA. However, doubts have been raised about whether such a waiver would violate Section 7 of the NLRA in the employment context, which was an issue that was neither presented nor considered by the Court in *AT&T Mobility.*

Section 7 of the NLRA provides, in relevant part, that "Employees shall have the right . . . to engage in . . . concerted activities for the purpose of collective bargaining or other mutual aid or protection . . . ."[14] Notably, Section 7 applies to both union-represented and non-represented employees. Activity is concerted when it is taken by two or more employees, or one employee on behalf of others.[15] Decisions from the National Labor Relations Board ("NLRB") establish that an individual's bringing of class or collective action lawsuits — so long as they are brought or maintained without malice or in bad faith — is concerted activity within the ambit of Section 7.[16] To this end, the NLRB's General Counsel issued a Guidance Memorandum on July 16, 2010, providing that "a mandatory arbitration agreement that could be reasonably read by an employee as prohibiting him or her from joining with other employees to file a class action amounts to an overly broad employer rule and hence is unlawful."[17]

However, in January 2011 an NLRB Administrative Law Judge ("ALJ") in *D.R. Horton, Inc.*, declined to follow the NLRB General Counsel's guidance and held that a class arbitration waiver did not prohibit employees from engaging in protected concerted activities.[18] The ALJ explicitly rejected the General Counsel's July 16, 2010 memorandum, and instead focused on Eleventh Circuit case law supporting the use of arbitration in employment disputes, and Supreme Court case law recognizing "the consensual nature of private dispute resolution."[19]

It remains to be seen whether the reasoning in *D.R. Horton* ultimately carries the day. The Supreme Court's decision in *AT&T Mobility* recognized, and voiced strong support, for the many policy benefits of arbitration. Thus, the Court's decision can be viewed as an endorsement of the strong congressional policy favoring arbitration. Contrasted against the FAA, Section 7 was not drafted with class arbitration or class action waivers in mind, but rather was enacted to protect more traditional types of concerted activities such as, for example, organizing labor unions, striking, and approaching an employer about collective terms and conditions of employment. Thus, courts may choose to reconcile Section 7 with the FAA by weighing more heavily the well-recognized strong congressional policy favoring arbitration over Section 7, which in the first instance was not enacted specifically to apply to class action arbitrations and waivers.

While the conflicting policies behind the FAA and NLRA Section 7 may create some doubt as to the reach of the Supreme Court's decision in AT&T Mobility, employers should seriously consider requiring employees to arbitrate all disputes with the company and waive their right to process through class or collective action

Practical Implications

While the conflicting policies behind the FAA and NLRA Seciton 7 may create some doubt as to the reach of the Supreme Court's decision in *AT&T Mobility*, employers should seriously consider requiring employees to arbitrate all disputes with the company and waive their right to process through class or collective action. Following the Supreme Court's decision in *AT&T Mobility*, the benefits of arbitration include the very real possibility that the company can avoid class/collective actions if they couple their arbitration program with a class/collective action waiver. The risks and liability associated with class and collective actions are simply too great not to consider taking advantage of this powerful tool, notwithstanding the arguments which may be raised that such a provision runs afoul of Section 7 of the NLRA.

---

1 131 S. Ct. 1740 (2011).

2 *Id.* at 1744.

3 113 P.3d 1100 (2005).

4 *Laster v. T-Mobile USA, Inc.*, No. 05cv1167 DMS (AJB), 2008 WL 5216255, *14 (S.D. Cal. Aug. 11, 2008).

5 *Laster v. AT&T Mobility LLC*, 584 F.3d 849 (9th Cir. 2009).

6 9 U.S.C. § 2.

7 *AT&T Mobility*, 131 S. Ct. at 1746 (quoting *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687 (1996)).

8 *AT&T Mobility*, 131 S. Ct. at 1746 ("The question in this case is whether § 2 preempts California's rule classifying most collective-

arbitration waivers in consumer contracts as unconscionable. We refer to this rule as the *Discover Bank* rule.").

9 *Id.* at 1748.

10 *Id.* at 1749.

11 *Id.* at 1750.

12 *Id.* at 1751

13 *Id.* at 1756-62 (Breyer, J. dissenting).

14 29 U.S.C. § 157.

15 1 JOHN E. HIGGINS, JR., *The Developing Labor Law* 83 (5th ed. 2006).

16 *See, e.g., Harco Trucking, LLC*, 344 NLRB 478 (2005) (individual engaged in protected activity when he filed and maintained a lawsuit against company).

17 Gen. Counsel Mem. 10-06, 4 (June 16, 2010), *available at* http://mynlrb.nlrb.gov/link/document.aspx/09031d4580376447. NLRB General Counsel Memoranda are "issued to field offices and/or Washington offices by the General Counsel to provide policy guidance." Research Resources, NLRB, http://www.nlrb.gov/research (last visited May 20, 2011).

18 *D. R. Horton, Inc.*, 12-CA-25764, 2011 WL 11194 (NLRB. Div. J. Jan. 3, 2011). The arbitration provision at issue stated, "[T]he arbitrator will not have the authority to consolidate the claims of other employees into a proceeding originally filed by either the Company or the Employee. The arbitrator may hear only Employee's individual claims and does not have the authority to fashion a proceeding as a class or collective action or to award relief to a group or class of employees in one arbitration proceeding." *Id.*

19 *Id.* (citing *Stolt-Nielsen S.A. v. Animal Feeds*, 130 S. Ct. 1758, 1773-75 (2010); *Caley v. Gulfstream Aerospace Corp.*, 428 F.3d 1359, 1367 (11th Cir. 2005); *Weeks v. Harden Mfg. Corp.*, 291 F.3d 1307, 1313 (11th Cir. 2002)). Nonetheless, the arbitration agreement was invalidated on grounds that it would "lead employees reasonably to believe they could not file charges with the [NLRB]." *D. R. Horton, Inc.*, 2011 WL 11194.

Supreme Court Rules in *CIGNA Corp. v. Amara*

By Jeffrey S. Klein, Nicholas J. Pappas and Millie Warner

On May 16, 2011, the U.S. Supreme Court issued *CIGNA Corp. v. Amara*, — S.Ct. —, 2011 WL 1832824 (2011), a decision much anticipated by the ERISA litigation bar and ERISA plan fiduciaries. While the full impact of *Amara* on circuit precedent will not be known for some time, the case addresses a number of longstanding and significant issues that frequently arise in ERISA litigation. In particular, the Court addressed the scope of two of ERISA's remedial provisions, §§ 502(a)(1)(B) and 502(a)(3). Parties frequently litigate the scope of these two remedial provisions because § 502(a)(1)(B) allows for monetary relief, but restricts the claims that may be brought under that section to claims for benefits under the terms of the plan, whereas § 502(a)(3) allows for plaintiffs to sue for a broader set of wrongs, but provides for "appropriate equitable relief" only, which the Supreme Court, in a series of cases, has narrowly circumscribed. Three of the most notable holdings by the *Amara* Court are as follows:

- ERISA § 502(a)(1)(B), which authorizes participants to assert claims for payment of benefits under the terms of the plan, allows a court to enforce a benefit plan as written, but does not permit a court to reform the terms of the plan, even to remedy violations of other provisions of ERISA;
- Summary plan descriptions, and other summaries of ERISA plans, are not part of the "plan," and, therefore, their terms cannot be enforced under ERISA § 502(a)(1)(B); and
- Courts cannot award relief under ERISA § 502(a) (3) for "appropriate equitable relief" based on a finding of "likely harm" to a class of plan participants; rather, the court may award relief only to participants who have demonstrated causation and actual harm.

In this article, we summarize *Amara*, and offer our observations as to the impact of the case on circuit precedent.

Background

Prior to 1998, CIGNA Corporation ("CIGNA") sponsored a traditional defined benefit pension plan for its employees, which provided retired employees with an annuity based on salary and length of service. *Id.* at *1. In 1998, CIGNA converted the plan into a cash balance plan, under which retiring employees would receive a lump-sum cash payment calculated based on a specified annual contribution from CIGNA, increased by compound interest. *Id.*

CIGNA announced the creation of the new plan to its employees in late 1997 in a newsletter. *Id*. at *4. CIGNA stated that the converted plan would "significantly enhance" the "retirement program," would produce "an overall improvement in . . . retirement benefits," and would provide "the same benefit security" with "steadier benefit growth." *Id*. at *5. In order to prevent employees from losing benefits they had accrued prior to 1998, CIGNA promised to make an initial contribution to each employee's plan account equal to the value of that employee's already earned benefits. *Id*. at *4. CIGNA informed employees that this initial deposit "represent[ed] the full value of the benefit [they] earned for service before 1998," and that "[o]ne advantage the company *will not* get from the retirement program change is cost savings." *Id*. at *5 (emphasis and alternations in original).

The Supreme Court held that ERISA § 502(a)(1)(B) speaks of "'enforc[ing]' the 'terms of the plan,' not of changing them,'" and does not, therefore, permit a court to reform the terms of the plan.

A group of plan participants challenged CIGNA's adoption of the new plan, alleging that the converted plan reduced their previously-accrued benefits and that CIGNA had misrepresented the plan in its communications to participants. *Id*. at *1. The participants sought to have the plan reformed to provide the greater level of benefits to which the participants claimed they were entitled based on CIGNA's descriptions of the plan.

The United States District Court for the District of Connecticut found that in contrast to CIGNA's statements to its employees, the plan in fact saved CIGNA $10 million annually, the initial deposit did not represent the full value of earned benefits, and the new plan made some employees worse off. *Id*. at *5. The district court further found that certain of CIGNA's communications regarding the new plan were "significantly incomplete and misled its employees." *Amara v. CIGNA Corp*., 534 F. Supp. 2d 288 (D. Conn. 2008).

Moreover, the district court found that CIGNA's initial contribution, which CIGNA told employees was equal to accrued benefits under the old plan, disadvantaged some employees in certain respects. For example, under the new plan, employees, rather than CIGNA, bore the risk of reduced benefits as a result of declining interest rates in the future.

Accordingly, as a result of the disclosures that the district court found misleading, the district court found that CIGNA violated ERISA § 204(h), which requires notice of a reduction in future pension benefits, and ERISA's disclosure obligations set forth in §§ 102(a) and 104(B). The district court did not, however, require each plan participant to show that he or she had been harmed as a result of CIGNA's misleading disclosures. Rather, the district court held that class-wide relief was appropriate because there was "likely harm" suffered by class members. As relief, the district court reformed the plan's guarantee to change it from the greater of (a) the amount to which participants would have been entitled as of January 1, 1998 under the old plan, or (B) the amount in their accounts at retirement, to the sum of (a) and (B). *Amara v. CIGNA Corp*., 559 F. Supp. 2d 192 (D. Conn. 2008).

CIGNA appealed the district court's ruling to the United States Court of Appeals for the Second Circuit, which affirmed the district court's judgment for the reasons stated by the district court. *Amara v. CIGNA Corp*., 2009 WL 3199061 (2d Cir. Oct. 6, 2009).

Supreme Court Decision

The Supreme Court reversed and remanded. In a unanimous opinion, the Supreme Court held that ERISA § 502(a)(1)(B), the remedial provision upon which the district court relied to reform the terms of the plan, did not authorize such relief. 2011 WL 1832824, at *3. ERISA § 502(a)(1)(B) authorizes a participant or beneficiary to bring "a civil action" to "recover benefits due to him under the terms of his plan." 29 U.S.C. § 1132(a)(1)(B). This provision speaks of "'*enforc*[*ing*]' the 'terms of the plan,' not of *changing* them.'" 2011 WL 1832824, at *10 (emphasis and alterations in original). Thus, the Court held that ERISA § 502(a)(1)(B) does not permit a court to reform the terms of the plan.

The Court also rejected the Solicitor General's alternative justification for the district court's reliance on § 502(a)(1)(B). The Solicitor General argued in an *amicus* brief that the district court correctly enforced the plan's terms as written because the "plan" includes the disclosures that constituted the summary plan descriptions. *Id*. The Supreme Court held that even if the district court had viewed the summaries as "plan" terms (which it did not), the terms of plan summaries cannot be enforced under § 502(a)(1)(B) as the terms of the plan itself for three reasons.

First, the "syntax" of ERISA § 102(a), which requires plan administrators to furnish summary plan descriptions advising participants of their rights and obligations "under the plan," "suggests that information *about* the plan provided by those disclosures is not itself *part of* the plan." *Id*. at *10 (emphasis in original). Second, the statute carefully divides authority between the plan's sponsor and the plan's administrator, and provides that the sponsor, like a trust's settler, creates the basic terms of and conditions of the plan and executes a written instrument memorializing those terms, whereas the administrator, "a trustee-like fiduciary, manages the plan, follows its terms in doing so, and provides participants with the summary documents that describe the plan (and modification) in readily understandable form." *Id*. The statute "carefully distinguishes these roles," and the Court found "no reason to believe that the statute intends to mix the responsibilities by giving the administrator the power to set plan terms indirectly by including them in the summary plan descriptions." *Id*. Finally, the Court found the Solicitor General's interpretation inconsistent with the purpose of a summary plan description: "clear, simple communication." *Id*. The Court reasoned that "[t]o make the language of a plan summary legally binding could well lead plan administrators to sacrifice simplicity and comprehensibility in order to describe plan terms in the language of lawyers," which might "bring about complexity that would defeat the fundamental purpose of the summaries." *Id*.

As a result, the Supreme Court vacated the opinions below and remanded to the district court to "revisit its determination of an appropriate remedy for the violations of ERISA it identified." *Id*. at *15. Although the district court had not determined whether relief might be available under ERISA § 502(a)(3), a majority of the Court went on to consider whether the relief ordered by the district court under § 502(a)(1)(B) might be available under § 502(a)(3). *Id*. at *11. That provision allows a participant, beneficiary, or fiduciary "to obtain other appropriate equitable relief" to redress violations of ERISA "or the terms of the plan." 29 U.S.C. § 1132(a)(3). The Court observed that the remedies ordered by the district court may be regarded as reformation of the terms of the plan to remedy the disclosure violations, estoppel to hold CIGNA to what it had promised, and an injunction for the fiduciary to pay already retired beneficiaries money owed under the plan as reformed. *Id*. at *12. A majority of the Court believed that each of these remedies was traditionally available in equity, and thus "within the scope of the term 'appropriate equitable relief' in Section 502(a)(3)." *Id*. Despite the fact that the injunction required the plan administrator to pay money to retired beneficiaries, the majority did not believe this would render the relief unavailable under § 502(a)(3). *Id*. The majority stated that equity courts traditionally had the power to award the remedy of surcharge, i.e., monetary compensation for a loss resulting from a trustee's breach of duty or to prevent the trustee's unjust enrichment. *Id*. at *13. The Court distinguished the instant case from *Mertens v. Hewitt Associates*, 508 U.S. 248, 253 (1993), in which the Court held that the "compensatory damages" sought by the plaintiff was not "appropriate equitable relief" available under § 502(a)(3). Whereas in *Mertens*, the defendant was a non-fiduciary third-party actuary, the defendant in the instant case (the plan administrator) was a fiduciary, and thus analogous to a trustee. This, a majority of the Court noted, made "a critical difference," and brought the remedy within the realm of remedies traditionally available in equity. *Id*. at *13. The majority took care to state, however, that the Court was not deciding "which remedies are appropriate on the facts of this case," and it will be for the district court to determine on remand whether to exercise its discretion to impose any remedy under § 502(a)(3). *Id*. at *14.

The Supreme Court's ruling that demonstrating "likely harm" on a class-wide basis is not sufficient appears to have raised the bar for the showing that a class of ERISA plan participants must make to obtain relief.

Justices Scalia and Thomas did not join in the portion of the opinion dealing with the availability of relief under § 502(a)(3). Instead, they issued a concurring opinion, criticizing the majority for exceeding the scope of the district court's ruling and addressing a question that the district court expressly had declined to address. *Id*. at *16. Because the question of the availability of relief under § 502(a)(3) had not been addressed below, and was not, therefore, properly before the Court on appeal, Justices Scalia and Thomas characterized the majority's opinion on the availability of relief under § 502(a)(3) and *Mertens* as "purely dicta, binding upon neither us nor the District Court." *Id*. at *17.

Finally, the majority analyzed the appropriate legal standard for determining whether members of the relevant employee class were injured. *Id*. at *14. As neither ERISA's disclosure provisions nor ERISA § 502(a)(3) set forth a standard for determining harm from defective disclosures, the Court looked to the law of equity. *Id*. The Court found that it was necessary to show detrimental reliance for the remedy of estoppel, but not for other equitable remedies, such as surcharge. *Id*. at *15. Even where detrimental reliance was not required, however, it was always necessary to show actual harm, which may "sometimes consist of detrimental reliance, but . . . might also come from the loss of a right protected by ERISA or its trust-law antecedents." *Id*. Thus, the Court held that to obtain relief by surcharge for violations of ERISA's disclosure provisions, each plan participant must show actual harm and causation, which may or may not involve a showing of detrimental reliance. *Id*.

Impact of *Amara*

The Supreme Court's ruling in *Amara* is significant for at least four reasons.

First, the Supreme Court's ruling that ERISA § 502(a)(1)(B) allows a court to enforce the plan only as written, and does not permit a court to reform the terms of the plan, appears to resolve a circuit split. Most circuits have held that the text of ERISA § 502(a)(1)(B) limits claims under the section to claims for benefits "under the terms of the plan," and participants may not assert claims for statutory violations of ERISA (*i.e.*, that the terms of the plan are illegal) under § 502(a)(1)(B) in the absence of an entitlement to benefits under the terms of the plan as written. *See Eichorn v. AT&T Corp*., 484 F.3d 644, 652 (3d Cir. 2007); *Anderson v. Consolidated Rail Corp*., 297 F.3d 242, 252 (3rd Cir. 2002); *Carrabba v. Randalls Food Markets*, 252 F.3d 721 (5th Cir. 2001); *Ross v. Rail Car Am. Group Disability Income Plan*, 285 F.3d 735, 739-40 (8th Cir. 2002). In 2007, however, the Sixth Circuit Court had permitted a claim based on a statutory violation of ERISA under ERISA § 502(a)(1)(B), on a theory that ERISA's requirements are "implied" terms of any employee benefit plan, *West v. AK Steel Corp. Ret. Accumulation Pension Plan*, 484 F.3d 395, 405 (6th Cir. 2007), and the Supreme Court denied *certiorari*. *AK Steel Corp. Retirement Accumulation Pension Plan v. West*, 129 S. Ct. 895 (January 12, 2009). The Supreme Court's holding in *Amara* that § 502(a)(1)(B) does not permit a court to alter the terms of the plan, even where the court has determined that statutory violations have been committed, appears to resolve the circuit split created by the *AK Steel* case.

Second, prior to *Amara*, some lower courts had held that a plan sponsor was obligated to provide the level of benefits set forth in the summary plan description, even if the summary plan description erroneously described more generous benefits than those provided pursuant to the plan document. The Supreme Court's ruling in *Amara* appears to foreclose such arguments, and should give some comfort to plan sponsors struggling to describe often lengthy and complex plan provisions in a succinct and straightforward manner in plan summaries.

Third, the Court's ruling that demonstrating "likely harm" on a class-wide basis is not sufficient appears to have raised the bar for the showing that a class of participants must make to obtain relief. Where a participant is seeking a remedy tantamount to estoppel, the participant must establish detrimental reliance, which frequently may preclude class certification because reliance typically raises individualized issues of fact. Even where participants seek other types of equitable relief, participants will need to show actual injury and causation on an individual basis.

Finally, there likely will be further litigation over the scope of relief available under ERISA § 502(a)(3) against plan fiduciaries, in light of the majority opinion in *Amara*. Defendants can be expected to argue that, as noted by Justices Scalia and Thomas in their concurrence, the majority's discussion of relief under § 502(a)(3) is dicta and is not binding on lower courts.

Reprinted from the June 6, 2011 edition of the New York Law Journal.

Five Fundamentals to Maintain the Integrity of an Internal Investigation

By Margaret Hope Allen

With the increased focus on corporate compliance, the premium placed on self-reporting by various statutes and sentencing guidelines, and the proliferation of whistleblower statutes, internal investigations are becoming an integral part of corporate life. These investigations frequently will be scrutinized by external auditors, regulators, prosecutors, and the courts. They may also wind up scrutinized by the media, as the recent events surrounding Dominique Strauss-Kahn have demonstrated. As a result, the *integrity* of the investigative process is essential, especially with regard to the selection of the investigative team, the gathering of evidence, the review of the facts, and the recommendation of remedial measures to be implemented. Below are five tips to protect the integrity of an internal investigation.

Have a plan

Confucius said that "a journey of a thousand miles begins with a single step." He might have been right, but a *good* journey begins with a map. Internal investigations happen fast and can eat up company resources. It is important for the company to identify the scope of the investigation and map out a plan with the fundamentals discussed below in mind so that resources are not wasted and the integrity of the process is maintained.

Independence and diversity of the investigative team

The usual suspects for conducting an internal investigation are in-house personnel, outside legal counsel, or a special committee of the board of directors. Often, it's a mix of all three. In-house personnel can include in-house legal counsel, human resources generalists, or persons in an employee relations department.

Regardless, the baseline requirement for the persons conducting the internal investigation is that they be independent. In this regard, the selection of the investigative team depends on the seriousness of the allegations at issue, and who may be involved as witnesses in the investigation. For example, while human resources generalists may be a reasonable choice to review minor issues, persons in the employee relations department may be a better choice to review formal complaints because they generally have more independence from management. This also means that in-house legal counsel may be a good choice to investigate alleged misconduct that does not involve the legal department. But in-house legal counsel generally are not the best candidates to conduct investigations involving high-level executives, executives or employees with whom they are in close contact, or individuals otherwise connected with the legal department. In those situations, outside legal counsel can bring greater objectivity and credibility because of the lack of self–interest in evaluating the alleged misconduct. In most circumstances, if outside legal counsel is selected, it should be a firm that does not presently work for the company and has not performed substantial work for it in the past. Outside counsel can then retain independent forensic accountants, fraud investigators, or other experts to help investigate the allegations.

Aside from independence, the investigation team should be comprised of diverse individuals. Diversity does not just mean diversity in the context of gender, race, or sexual orientation, although diversity in those areas when investigating gender, racial, or sexual issues in the workplace is important. The key to having diversity benefit the investigation is having a team comprised of individuals who are diverse in their outlooks and experiences with respect to the specific issues at hand. The company's fact-finding team needs people who interpret documents, witness statements, and situations differently based on their own personal experiences, and who are not afraid to voice their opinions about the evidence.[1] People from different backgrounds will interpret emails, as well as witnesses' statements and truthfulness, differently.

Documents should be gathered and preserved expeditiously

The need to gather documents as a critical step in any internal investigation is obvious, but how to do it correctly and expeditiously is not always. Several steps should be taken to protect the document gathering process from scrutiny after the fact.

First, the integrity of the collection process is crucial. A meeting with the company's information technology personnel will provide insight into potential technological issues and the available data. Discussions with these personnel may reveal that the company's electronic documents and email are subject to a periodic, automatic deletion process. This process should be halted for key document custodians.

Ideally, electronic documents should be gathered by someone other than the primary document custodians, such as through the company's email and document servers. If a list of search terms is used to narrow the scope of electronic documents, the list should be thorough, and the breadth of the search should be dictated by the scope and type of investigation. The investigative team and the company will need to stand by and attest to the adequacy of the search terms, and it is not uncommon for third parties, like auditors, to want to review the terms that were used. If there is any risk of missing, corrupted, or erased documents, it may be prudent to hire an independent forensics consultant to gather the documents. Independent forensics consultants can help ensure that the collection of data from hard drives or the company's servers is complete, and not corrupted or accidentally altered when retrieved.

Second, review the documents. The documents will likely reveal the key dates, players, and events that may not have been obvious at first blush, and can be used to focus the investigation and develop questions for interviews.

Third, use the documents wisely. Documents are an important tool for interviewing witnesses. Nothing jogs a witnesses' memory better than her own email on the subject written a few months earlier. But an interviewer should reflect on whether each particular witness should see certain documents, especially if those documents may be damaging to another employee's reputation or the witness is unlikely to have any knowledge about the document or the relevant situation.

Confucius said that "a journey of a thousand miles begins with a single step." He might have been right, but a good journey begins with a map.

Last, follow up. To ensure that the document collection and review have been thorough, witnesses and persons involved should be asked to provide relevant documents. If a witness mentions during an interview that they may have relevant documents, circle back and double-check that those documents are collected and reviewed.

Interviews should be conducted in a manner that fosters disclosure and honesty

In almost every internal investigation, interviews are conducted to gather background facts. There are several simple measures interviewers can take to protect the integrity of the interviewing process.

First, consider the location for the interviews. Holding the interviews on the company's premises is usually less intrusive and more convenient for the witnesses. But depending on the issue being investigated, the identity of the investigation's target, and the culture of the company, it may be prudent to hold the interviews at a location away from the company's office, or at least away from the company's legal department, so as not to call undue attention to the investigation or those being interviewed. Holding the interviews outside of the company's premises can also have the effect of taking the witnesses outside of their comfort zones, which may or may not be desirable. If outside legal counsel is retained, their office is usually a good choice.

Second, consider the order in which witnesses will be interviewed, keeping in mind that the goal is for the interviews to be effective. If the identity of the complainant is known, it usually makes sense to interview him or her first. If the complainant is anonymous, or there is no specific complainant, it may be effective to interview the target of the investigation first, then other witnesses, and then re-interview the target after all information has been gathered and analyzed. In general, however, the need for second interviews should be minimized, and should not be needed because of poor planning or inadequate preparation by the interviewers. Regardless, the company should not discourage the investigation team from interviewing — or re-interviewing — any potential witness, because doing so creates the appearance that the company is not fully cooperating with the investigation.

Third, consider who should be present during the interviews. If possible, each interview should have two interviewers. This so-called "FBI Rule" helps to ensure that an interviewer's memory of the interview is accurate, because it can be checked against someone else's. Underscoring the value of diversity of the investigative team, two interviewers also provide two interpretations of the witness's statements, which can aid in the search for the truth. The interviewers should be chosen based on their abilities to relate to the witness, with respect to characteristics such as conversational style, gender, or cultural or educational background. For instance, perhaps the witness is skittish, so the interviewer's ability to build a comfort level with the witness will be paramount. Or perhaps the witness is a high-level executive with a sky-high ego, and the interviewer will need a firm hand that will not let the executive wiggle out of tough questions.

Fourth, give corporate Miranda warnings and consider potential conflicts. The Supreme Court's *Upjohn Company v. United States* decision clarified how companies can assert privilege, and extended the attorney-client privilege between corporate counsel and the company's employees.[2] But this means that the company can waive the privilege as to information gathered in an interview to the detriment of the witness. To avoid the risk of a witness attempting to claim privilege over information disclosed during the interview, interviewers should inform each witness that the interviewers represent the company, not the witness, that what the witness says may be reported up to the highest levels of the organization, that the interview is privileged, and that the company is the sole holder of the privilege and may chose to waive it by disclosing information obtained during the interview to third parties, including government agencies. Depending on the circumstances, it may be appropriate to identify the governmental authorities to whom the company may make disclosure, such as the Department of Justice or the Securities and Exchange Commission.

Fifth, tell witnesses not to discuss the investigation with others. If the witness chit-chats at the water cooler or at a restaurant, he may inadvertently waive the company's privilege, or taint other witnesses' memories of what did or did not happen.

Sixth, open the door and keep it open. Most people have never been made to sit in an interview room being peppered with questions. For many, the thought of that conjures up images of police interrogations on television, which almost always end badly for the witness. To curb witnesses' anxiety and encourage them to tell the whole story, witnesses should be told that the interviewer wants to hear the good, the bad, and the ugly, and that the company wants to have a complete picture of what happened, regardless of whether the truth might hurt the company. In addition, a witness may remember something important a few days or weeks later. The likelihood of the witness following up increases if the interviewer gives the witness the names of several people (such as the interviewer and in-house counsel) who the witness can call if a detail is remembered.

The company's fact-finding team needs people who interpret documents, witness statements, and situations differently based on their own personal experiences, and who are not afraid to voice their opinions about the evidence.

Give Recommendations in the Right Form

The report of a final investigation to the client can take several formats, including oral, written or slide presentation. The report typically summarizes the circumstances that led to the investigation; a review of internal policies, procedures or practices that led to the event in question; the investigation's scope; arguments for and against disciplinary action or sanctions; and any appropriate remedial actions. In the report, counsel should not be afraid to give recommendations to the client, especially with respect to remedial actions. In crafting the report, careful consideration should be given both to maintaining the privilege and to drafting the report with an eye towards its possible eventual disclosure to the government, plaintiffs' lawyers, or the media.

1 The importance of comprising an investigative team of persons who are willing to voice dissent, and are willing to consider dissenting opinions, can not be overstated. On January 28, 1986, the space shuttle Challenger tore apart 73 seconds after takeoff. All seven members of the crew died. The immediate cause of the explosion was a technical problem with the "O-rings," but the real culprit was NASA's failure to foster a functioning culture of organizational communication, which lead to engineers refusing to speak up when they saw potential problems in favor of going with the flow. This phenomenon is called "group think," and can destroy the integrity of any investigative team.

2 *See Upjohn Co. v. United States*, 449 U.S. 383 (1981).

Managing Director Service Agreements

By Stephan Grauke and Mareike Pfeiffer

Under German law, a managing director of a limited liability company (*GmbH*) is subject to two different regimes: (i) the corporate regime governing the relationship of the managing director as corporate representative of the limited liability company and (ii) the service agreement governing the internal relationship between the managing director and the company.

The shareholders' meeting is competent for both the appointment as managing director and the conclusion of the service agreement. The service agreement typically contains provisions regarding compensation (including bonuses and other benefits, such as company car/car allowance, death benefits, payments in case of long-term illness), the contractual term and/or termination provisions, as well as stipulations regarding the participation in pension schemes, leave entitlement, and a contractual and/or post-contractual non-competition clause.

The main consequence of these two different regimes is that a removal of the managing director from his/her corporate position does not automatically result in a termination of his/her service agreement. Consequently, the service agreement must be terminated separately. Whereas a removal from the corporate position as managing director is possible without any cause and at any time, a service agreement can only be terminated in observance of the contractually agreed notice period (except for a termination for good cause). In practice, managing director service agreements often provide for a minimum term of up to three years during which a termination other than for good cause is excluded. The shareholders of a company removing a managing director from his/her corporate position are often surprised that they have to continue to pay such director under the terms of the managing director service agreement until a termination becomes possible.

Non-Applicability of German Employment Law

As the managing director legally represents the company, he/she is not considered to be an employee in general. Some employment laws thus expressly exclude their applicability to managing directors, such as the Protection against Unfair Dismissal Act (*KSchG*) and the Labor Procedural Code (*ArbGG*) with the consequence that disputes arising in connection with service agreements are subject to the jurisdiction of the German civil courts rather than the labor courts. However, even if not expressly excluded, the applicability of the rather strict provisions of German employment law to managing directors is denied in general.[1]

However, the details are not always as clear. Recently, German labor courts ruled on some borderline cases whether managing directors are to be treated as employees. Most of these cases are of practical relevance, and we have been confronted with comparable issues in our day-to-day work. Further, the European Court of Justice (*EuGH*) recently caused a stir by deciding in deviation from the above principle that the provisions of the European Directive on Maternity Protection of Employees are applicable to managing directors:

Danosa Decision of the European Court of Justice

On November 11, 2010, the European Court of Justice decided in the matter of Dita Danosa versus the Latvian entity LKB Lizzings SIA that a managing director may be considered an "employee" for the purpose of Directive 92/85/EEC on Maternity Protection of Employees and therefore declared a removal of a pregnant managing director from her office to be inadmissible as Article 10 of the Directive affords pregnant employees protection against dismissal.[2] According to the European Court of Justice and for the purposes of Directive 92/85/EEC, the essential feature of an employment relationship is that, for a certain period of time, a person performs services for and under the direction of another person for remuneration. The court considered these requirements given since Ms. Danosa, as sole board member, provided services to LKB Lizzings SIA regularly and in return for remuneration by performing the duties assigned to her under the company's statutes and the rules of procedure of the board of directors.

European directives such as the Directive on Maternity Protection of Employees do not directly apply to citizens of the European Union. They require integration into national law by each member state of the European Union. The legal consequences of the Danosa Decision on German law incorporating European law are currently being discussed in legal literature and are deemed to be material: At least the removal and termination of managing directors due to pregnancy is no longer considered to be valid.[3] In addition, several authors expect that further German employment laws will need to be amended or reinterpreted in light of the Danosa Decision to the extent such laws are based on European directives and exclude or limit their applicability to managing directors, such as the General Equal Treatment Act (*AGG*).[4] This may also apply to the German TUPE law, which is based on the European Directive 2001/23/EC and currently does not apply to managing directors.

New Rulings on the Applicability of General Terms and Conditions Law to Managing Directors

Recently, the German Federal Labor Court[5] decided that if the terms of a service agreement with a managing director are standard terms pre-formulated by the company, the German laws on general terms and conditions can apply. This means that stipulations in a service agreement which are surprising or which constitute an unreasonable disadvantage to the managing director could be considered invalid and that any ambiguities in the interpretation of the agreement lie within the responsibility of the company.

This judgment may affect the validity of some clauses typically contained in managing director service agreements, in particular bonus provisions: Several provisions in connection with bonus plans, such as the voluntary nature of the bonus payment, the possibility to bind the employee to the company by agreeing on forfeiture or repayment provisions, have been subject to rather strict rulings of the German labor courts concerning employees under general terms and condition law in the past. There is a risk that the civil courts competent for disputes with managing directors may transfer the outcome of these labor court rulings to agreements with managing directors in the future.

A European Court of Justice ruling may afford managing directors the status of employees for German labor law purposes, thereby substantially impacting the current practice.

New Rulings on the Termination of Managing Directors

The German Protection against Unfair Dismissal Act provides that termination of employees (also in observance of the applicable notice period) is only admissible in case a "social justification" for such termination exists, provided, however, that the company employs more than 10 individuals and the affected employee was employed with the company for more than six months. The Protection against Unfair Dismissal Act considers a "social justification" to be given only in the following cases: (i) reasons lying in the person of the employee (such as long-term illness), (ii) reasons based on the behavior of the employee (such as theft), and (iii) operational reasons (such as restructurings). As mentioned above, the German Protection against Unfair Dismissal Act expressly excludes its applicability to managing directors. The Danosa Decision will generally not impact the scope of the Protection against Unfair Dismissal Act since this Act is not based on European law.

As a consequence of not being subject to the Protection against Unfair Dismissal Act, a managing director can be terminated without giving any reason as long as the applicable termination period is observed (or for cause with immediate effect). However, in the recent past, the German labor courts decided in some borderline cases in which the applicability of termination protection was in question:

Possibility to Agree on Statutory Termination Protection

On February 24, 2009, the Frankfurt Higher Regional Court ruled that, due to the special position of a managing director as legal representative of the company who generally acts free without being subject to instructions and who may be removed from his/her office at any time without reason, the applicability of the Protection against Unfair Dismissal Act cannot be validly agreed in a service agreement. On May 10, 2010, the German Federal

Supreme Court overruled the judgment of the Higher Regional Court and decided that it is admissible to agree on termination protection with a managing director.[6] The Federal Supreme Court argued that the applicability of termination protection does not violate the internal structure of the company due to the dual nature of the position of the managing director. The limitation of the possibility to terminate the service agreement does not affect the possibility of the company to remove the managing director from his/her office at any time.

However, it is uncommon to agree on statutory termination protection for the benefit of a managing director. In general, depending on the negotiation power of the managing director, longer termination periods are agreed or termination is excluded for an initial term of employment in order to achieve an actual protection of the managing director. However, several authors in the German legal literature focused on the above judgment, which might result in managing directors increasingly requesting the agreement of termination protection.

Termination Protection on the Borderline Between Employees and Managing Directors

In practice, occasionally employees of the company are promoted and appointed as managing directors without agreeing on new employment terms in a service contract — or managing directors are removed from their office without immediate termination of their service agreements. The formal status and, thus, the legal treatment of these individuals as managing directors or as employees has recently been subjected to several judgments of the German labor courts:

Case 1: An employee of a company is appointed as managing director. The employment agreement is replaced by a managing director service agreement setting forth employment terms for managing directors of the company. This case generally does not bear any risks that statutory termination protection may apply in case the managing director is removed from his/her office in the future. The German Federal Labor Court decided in 2008 that the conclusion of a written managing director service agreement terminates a former employment contract even if the termination is not expressly declared.[7] In 2009, it confirmed that this rule also applies in case the removed managing director continues to be active for the company after his/her removal.[8] However, the Federal Labor Court also pointed out that the parties may conclude an employment contract by implied behavior in case the managing director continues to work for the company after his/her removal. It is therefore recommendable to expressly terminate the service contract and stop any actual employment of the managing director without considerable delay after the removal from office.

When appointing or removing a managing director, the underlying service agreement must always be taken care of. Removing managing directors from the board does not automatically mean that they are no longer employed with the company.

Case 2: An employee of a company is appointed as managing director. No managing director service agreement or any other new agreement is concluded in connection with the appointment. The managing director thus renders his/her services only on the basis of the original employment contract. In a decision of 2007, the German Federal Labor Court argued that termination protection does not apply if the managing director is not removed.[9] As a consequence, there is a substantial exposure that the German Protection against Unfair Dismissal Act applies if the termination notice is issued only after the removal of the managing director from his/her office. This result was recently confirmed by the Cologne Higher Labor Court.[10]

Case 3: An individual is employed as an employee by a parent company and is delegated as a managing director to an affiliate without separate contact. The German Federal Labor Court decided in 2007 that no termination protection applies to the managing director in such a case as long as he/she actually holds the formal position of managing director when the termination notice is issued.[11] However, the Düsseldorf Higher

Labor Court decided in 2011 that a managing director is subject to statutory termination protection and argued that the individual had never been managing director of the parent company and that the parties always treated the managing director as an employee of the parent company.[12]

Consequently and in order to avoid any risks in connection with the applicability of termination protection to managing directors, it is recommendable not to employ managing directors on the basis of employment agreements, to make a clear-cut agreement in case an employee is appointed managing director of a company, and to terminate service agreements simultaneously with the removal from office.

1 German Federal Supreme Court, *e.g.,* judgment dated February 9, 1978, case no. II ZR 189/76; generally confirmed by the German Federal Labor Court that, however, considers exemptions to be given in individual cases, German Federal Labor Court dated May 26, 1999, case no. 5 *AZR* 664/98.

2 European Court of Justice (2nd Division) dated November 11, 2010, case no. C-232/09.

3 Robert von Steinau-Steinrück/Ulrich Mosch, NJW-Spezial 2011, p. 178, 179; Natalie Oberthür, *NZA* 2011, p. 253, 257.

4 Natalie Oberthür, *NZA* 2011, p. 253, 257; Jobst-Hubertus Bauer, *GWR* 2010, p. 568.

5 German Federal Labor Court dated May 19, 2010, case no. 5 *AZR* 253/09.

6 German Federal Supreme Court dated May 10, 2010, case no. II *ZR* 70/09.

7 German Federal Labor Court dated June 5, 2008, case no. 2 *AZR* 754/06.

8 German Federal Labor Court dated August 26, 2009, case no. 5 *AZR* 522/08.

9 German Federal Labor Court dated October 25, 2007, case no. 6 *AZR* 1045/06.

10 Higher Labor Court Cologne dated March 3, 2011, case no. 10 *Ta* 301/10.

11 German Federal Labor Court dated October 25, 2007, case no. 6 *AZR* 1045/06.

12 Higher Labor Court Düsseldorf dated January 12, 2007, case no. 12 *Sa* 1411/10.

Employer Update is published by the Employment Litigation Practice Group and the Executive Compensation and Employee Benefits Group of Weil, Gotshal & Manges LLP, 767 Fifth Avenue, New York, NY 10153, +1 212 310 8000, http://www.weil.com.

Editors

Lawrence J. Baer (lawrence.baer@weil.com) + 1 212 310 8334
Allan Dinkoff (allan.dinkoff@weil.com) + 1 212 310 6771

Practice Group Contacts

Jeffrey S. Klein
Practice Group Leader
New York
+1 212 310 8790
jeffrey.klein@weil.com

Boston
Thomas Frongillo
+1 617 772 8335
thomas.frongillo@weil.com

Dallas
Yvette Ostolaza
+1 214 746 7805
yvette.ostolaza@weil.com

Frankfurt
Stephan Grauke
+49 69 21659 651
stephan.grauke@weil.com

Houston
Melanie Gray
+1 713 546 5045
melanie.gray@weil.com

London
Joanne Etherton
+44 20 7903 1307
joanne.etherton@weil.com

Ivor Gwilliams
+44 20 7903 1423
ivor.gwilliams@weil.com

Miami
Edward Soto
+1 305 577 3177
edward.soto@weil.com

New York
Lawrence J. Baer
+1 212 310 8334
lawrence.baer@weil.com

Allan Dinkoff
+1 212 310 6771
allan.dinkoff@weil.com

Gary D. Friedman
+1 212 310 8963
gary.friedman@weil.com

Andrew L. Gaines
+1 212 310 8804
andrew.gaines@weil.com

Mark A. Jacoby
+1 212 310 8620
mark.jacoby@weil.com

Michael K. Kam
+1 212 310 8240
michael.kam@weil.com

Steven M. Margolis
+1 212 310 8124
steven.margolis@weil.com

Michael Nissan
+1 212 310 8169
michael.nissan@weil.com

Nicholas J. Pappas
+1 212 310 8669
nicholas.pappas@weil.com

Shanghai
Helen Jiang
+86 21 3217 9511
helen.jiang@weil.com

Washington, DC
Michael Lyle
+1 202 682 7157
michael.lyle@weil.com