December 2013

Weil

Employer Update

Use of Conviction Data in Hiring Determinations

By Jeffrey S. Klein, Nicholas J. Pappas, and Valerie Wicks

In This Issue

Employers in many states customarily include on their job applications a request that the applicant list all prior convictions of any crimes. State laws in such states typically permit such requests, and further allow employers to use the answers in determining whether to extend an offer of employment, but only to the extent the conviction would be directly relevant to the applicant's qualifications to perform the job in question.

Other states provide more restrictive rules, with some prescribing the point at which an individual's criminal record may be revealed in the hiring process, while other states have moved to protect employers by adopting laws, in conjunction with other reforms, limiting the liability of employers that hire people with criminal records. In addition to complying with these various state law regimes, employers are likewise required to comply with federal law, which includes a "disparate impact" theory of liability under Title VII of the Civil Rights Act of 1964.

In recent years, the Equal Employment Opportunity Commission (EEOC) has aggressively pursued claims against employers claiming that their use of criminal convictions had an unlawful disparate impact. For example, in June 2013 the EEOC brought enforcement actions against Dollar General and BMW North America challenging their use of criminal convictions in their hiring processes.[1] In their complaint against Dollar General, the EEOC alleged that Dollar General automatically disqualified applicants for felony convictions such as flagrant non-support, possession of drug paraphernalia, and illegal dumping, and for misdemeanor convictions such as improper supervision of a child, reckless driving (allowed one charge in a five-year period), and failure to file an income tax return (allowed one charge in a five-year period). Among other allegations in its suit against BMW North America, the EEOC alleged that the company barred long-standing warehouse and distribution employees of a BMW North America contractor from employment based on prior convictions like simple assault.

In light of the EEOC's more aggressive posture in challenging employers' use of criminal convictions in the hiring process, employers may wish to reexamine their practices for using criminal conviction data in hiring, and to consider ways in which they may avoid challenges by the EEOC or by private litigants. In this article, we summarize the EEOC's pronouncements regarding employers' use of criminal convictions in hiring, and outline several

considerations employers may analyze as they re-examine their practices.

Background

As noted above, many states allow employers to use criminal conviction data in hiring, but they impose various conditions for using such data. In New York, for example, an employer cannot reject an applicant because of his or her criminal conviction record unless there is "a direct relationship" between the previous criminal offense and the employment sought or the applicant's employment would pose "an unreasonable risk to property or to the safety or welfare of specific individuals or the general public." N.Y. Correc. Law §752.

Notwithstanding the various state law regimes governing the use of criminal convictions in hiring, the EEOC maintains that the use of criminal conviction data in hiring may violate Title VII under a disparate impact theory of discrimination. According to the EEOC's April 2012 Guidance on the use of criminal background checks in hiring, over the last 20 years there has been a "significant increase in the number of Americans who have had contact with the criminal justice system and, concomitantly, a major increase in the number of people with criminal records in the working-age population."

In light of the EEOC's more aggressive posture in challenging employers' use of criminal convictions in the hiring process, employers may wish to reexamine their practices for using criminal conviction data in hiring.

The commission has further noted that increases in arrest and incarceration rates are "particularly high for African American and Hispanic men."[2] Under a Title VII disparate impact theory of discrimination, an unlawful employment practice may be found if the employer maintains a neutral policy which disproportionately affects members of a protected group, but the practice is not job related or consistent with business necessity. See 42 U.S.C. §2000e-2(a), (k).

Analysis

Employers routinely make use of criminal conviction data consistent with state law requirements. However, if the EEOC were to challenge an employer's criminal conviction policy, whether through an investigation or filing suit, and the agency or a court found that the policy caused a disparate impact on a protected class,[3] the employer may still prevail if the policy is job related and consistent with business necessity. Put differently, courts have supported the idea that employers may consider criminal conviction data without running afoul of Title VII, even if the policy causes a disparate impact, where there is a demonstrated nexus between the nature of the position and the nature of the individual's criminal conviction record.

Indeed, a federal court recently noted, while rejecting an EEOC challenge to an employer's use of criminal conviction data, that "[f]or many employers, conducting a criminal history…background check on a potential employee is a rational and legitimate component of a reasonable hiring process."[4] Employers have demonstrated this "nexus" for positions which implicate public safety, present a high risk for employee theft, or pose some threat of danger which affects employee morale.

Public Safety

Courts have found that it is consistent with business necessity for an employer to consider certain criminal conviction data in connection with a position that implicates public safety. For example, in *El v. Southeastern Pennsylvania Transportation Authority (SEPTA)*, 479 F.3d 232 (3d Cir. 2007), the U.S. Court of Appeals for the Third Circuit explained that a transportation provider's bright-line policy of refusing to hire individuals to drive paratransit buses with any violent criminal convictions or record of driving

under the influence of drugs or alcohol, no matter how distant, was consistent with business necessity if it "accurately distinguish[ed] between applicants that pose[d] an unacceptable level of risk and those that [did] not." The court accepted the assertion by SEPTA's expert that "former violent criminals who have been crime free for many years are at least somewhat more likely than members of the general population to commit a future violent act," that disabled people are more likely than others to be the victims of violent crimes, and that "transportation providers commit a disproportionate share" of the crimes committed against disabled people.

Because operating a paratransit bus implicated public safety concerns, the court found that barring applicants with violent criminal conviction history and/or alcohol or drug-induced driving offenses was job related and consistent with business necessity. The court also observed that SEPTA's policy did not automatically eliminate applicants with any criminal conviction history, but rather, only those with convictions that were job related.

Similarly, in *Foxworth v. Pennsylvania State Police*, 402 F.Supp.2d 523 (E.D. Pa. 2005), a court upheld a police force's policy of automatically disqualifying police cadet candidates who had previously engaged in any "criminal behavior" more serious than a low-level misdemeanor. The court explained that even if the applicant-plaintiff in this particular case had successfully demonstrated that the policy caused a disparate impact to African-American applicants, the policy was nonetheless "almost certainly" justified by business necessity. The policy served the purpose of "ensuring both public safety and that police officers do not disregard, nor are perceived as disregarding, the law." Once again, there was an acceptable nexus between the requirements of the position and the disqualifying criminal history criteria.

Protection Against Theft

Courts have also accepted that excluding applicants with a theft-related criminal conviction history is consistent with business necessity for an employer susceptible to employee theft. In *EEOC v. Carolina Freight Carriers Corporation*, 723 F.Supp. 734 (S.D. Fla. 1989), the court explained that a lifetime bar to employment based upon a conviction for a theft crime resulting in a prison sentence was justified by this particular trucking company's business needs. Even if the EEOC had been able to demonstrate that this policy caused a disparate impact on Hispanic truck drivers, the employer would nonetheless prevail because its practice was job related and consistent with business necessity.

The court explained that this particular truck driving job required the transportation of expensive cargo without significant supervision. Further, the employer offered evidence demonstrating that the company had a serious problem with theft, the majority of which, management determined, was committed by employees. The conviction policy, the employer argued and the court accepted, was necessary to minimize its losses from employee theft. Here, the requirements of the position were sufficiently connected to the exclusion based on criminal history.

Employee Morale

In *Fletcher v. Berkowitz Oliver Williams Shaw & Eisenbrandt*, 537 F.Supp.2d 1028 (W.D. Mo. 2008), a pro se plaintiff alleged that his employer's decision to terminate his employment because of a decades-old rape conviction violated Title VII. Carl Fletcher sought to enjoin his former employer from using a blanket discharge policy based on a prior felony conviction without considering the nature and gravity of the offense, the time elapsed since the conviction and sentence completion, and the nature of the job sought.

The court found that Fletcher failed to demonstrate that his former employer in fact had such a policy regarding individuals with felony convictions, or that such a policy would cause a disparate impact on African-Americans. Though business necessity analysis was not required given these deficiencies, the court nonetheless observed that an employer's decision to decline to employ or terminate an individual with a rape conviction would be consistent with business necessity in a "sufficiently unguarded" law firm setting where "opportunities for misconduct exist." Further, in this case, the plaintiff was discharged only after female employees

raised serious concerns about working with him, based on his previous conviction. The court found that protecting "employee morale" constituted an acceptable business necessity.

Practical Considerations

As described above, even if an employer's use of criminal conviction data causes a disparate impact on members of a protected class, such use does not violate Title VII if it is job related and consistent with business necessity. Courts analyze the question of business necessity under Title VII by assessing whether the employer's use of criminal conviction data actually helps determine the applicant's fitness for the particular position. To this end, the EEOC recommends, and employers may wish to consider, developing a targeted screen to identify convictions that are inconsistent with business necessity by using the following factors:

- The nature and gravity of the offense or conduct;
- The time that has passed since the offense or conduct and/or completion of the sentence; and
- The nature of the job held or sought.

The substance of this analysis will vary across employers, as one employer's considered decision that a particular conviction is inconsistent with business necessity will not necessarily translate to another's. The EEOC further suggests, and employers may contemplate, giving screened applicants individualized assessments to determine whether the policy as applied is job related and consistent with business necessity in each instance. In a time when the EEOC is aggressively targeting employers' use of criminal conviction information in hiring through investigations and litigation, in addition to doing the close analysis required by state law, employers may wish to review their policies and practices for an appropriate nexus between their use of such data and the requirements of the particular positions they are seeking to fill.

1. See *EEOC v. Dollar General*, 1:13-cv-04307 (filed June 11, 2013 N.D. Ill.); *EEOC v. BMW Mfg.*, 7:13-cv-01583 (filed June 11, 2013, D. S.C.).
2. EEOC Enforcement Guidance No. 915.002, April 25, 2013, "Consideration of Arrest and Conviction Records in Employment Decisions Under Title VII of the Civil Rights Act of 1964."
3. The EEOC recently suffered a notable loss with regard to the use of criminal conviction data in hiring in *EEOC v. Freeman*, —F.Supp.2d—, No.09cv2573, 2013 WL 4464553 (D. Md. Aug. 9, 2013), where the commission was unable to identify a particular policy or submit an admissible expert report demonstrating a disparate impact.
4. *Freeman*, 2013 WL 4464553, at *1.

The Trade Secret Exception to California's Ban on Employee Non-competition and Non-solicitation Agreements After *Edwards v. Arthur Andersen LLP*

By Jeffrey S. Klein, Nicholas J. Pappas, and Daniel J. Venditti

In California, employee covenants not to compete or solicit customers or clients are void, subject to certain specific exceptions. Historically, those exceptions arose both from statute (e.g., permitting non-competes in connection with the sale of a business) and from common law (e.g., permitting non-competes that are "narrow restraints" or necessary to protect trade secrets). In 2008, the California Supreme Court in *Edwards v. Arthur Andersen LLP*, 189 P.3d 285 (Cal. 2008) refused to recognize and adopt one of those common law exceptions to California's general prohibition against non-competition/solicitation agreements, which had developed in the federal courts. Before *Edwards*, some courts would enforce an employee non-competition/solicitation agreement that was found to create only a "narrow restraint" on the former employee's business or trade. The California Supreme Court rejected the narrow restraint exception because that exception was not expressly authorized by the California legislature. However, the court in *Edwards* expressly declined to address the trade secret exception, which also developed at common law. Under the trade secret exception, a court may enforce an employee non-competition/solicitation agreement that is necessary to protect the former employer's trade secrets.

Some lower courts have read *Edwards*' rejection of the narrow restraint exception as broadly rejecting, or at least casting doubt on, all other non-statutory exceptions to California's prohibition against non-competition/solicitation agreements, including the trade secret exception. There is language in *Edwards* that supports that view. The court held that "[n]on-competition agreements are invalid under section 16600 in California even if narrowly drawn, unless they fall within the applicable statutory exceptions of sections 16601, 16602, or 16602.5." 189 P.3d 285, 296 (Cal. 2008). The court also noted that California courts "have been clear in their expression that section 16600 represents a strong public policy of the state which should not be diluted by judicial fiat." *Id.*, at 291-92.

However, because the court in *Edwards* expressly declined to address the trade secret exception, some federal courts have continued to enforce employee non-competition/solicitation agreements necessary to protect a former employer's trade secrets, notwithstanding *Edwards*. Because the trade secret exception to California's prohibition against non-competes has never been expressly rejected by the California Supreme Court, California employers may argue that for the time being it remains a tool available for them to consider when drafting and enforcing agreements with employees. But employers who go down that path should carefully consider the unsettled case law that has developed regarding this issue in recent years.

Background

California's prohibition against certain non-competition agreements is codified in Section 16600 of the California Business and Professions Code. Section 16600 provides that "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void." Cal. Bus. & Prof. Code § 16600. This prohibition applies both to agreements forbidding former employees from engaging in work for a competitor, and agreements with former employees not to solicit the former employer's customers or clients.

There are three statutory exceptions to California's prohibition on non-competition/solicitation agreements:

- any person who sells the goodwill of a business, or all of one's ownership interest in a business entity, or substantially all of its operating assets and goodwill, to a buyer who will carry on the business may agree with the buyer not to carry on a similar business within a specified geographic area, if the business will be carried on by the buyer (Cal. Bus. & Prof. Code § 16601);

- upon dissolution of a partnership or dissociation of a partner, such partner may agree not to carry on a similar business within a specified geographic area, if the business will be carried on by remaining partners or anyone deriving title to the business or its goodwill (Cal. Bus. & Prof. Code § 16602); and
- a member of a limited liability company may agree not to carry on a similar business within a specified geographic area, so long as other members or anyone deriving title to the business or its goodwill carries on a like business (Cal. Bus. & Prof. Code § 16602.5).

In addition to the express statutory exceptions to California's prohibition against non-competition agreements, courts in California have recognized certain other, limited, exceptions to Section 16600.

One such exception is the "narrow restraint exception," under which federal courts would enforce non-competition agreements that do not completely prohibit an employee from engaging in his or her profession. The narrow restraint exception permitted non-competition agreements that prevented a party from practicing only a narrow part of his or her profession, rather than completely barring a former employee from engaging in his or her business or trade. For example, in *International Business Machines Corp. v. Bajorek*, 191 F.3d 1033, 1041 (9th Cir. 1999), the Ninth Circuit held that a six-month non-competition provision contained in a stock option agreement did not violate Section 16600 because it excluded defendant from only "one small corner of the market," and not "from engaging in his profession, trade, or business."

A second exception is the "trade secret exception," under which California courts have enforced non-competition agreements which are narrowly tailored to protect the former employer's trade secrets. The trade secret exception has its roots in the 1958 decision of the California Supreme Court in *Gordon v. Landau*, 321 P.2d 456, 459 (Cal. 1958). In *Gordon*, the California Supreme Court reversed a judgment of the trial court after finding that an employment agreement in which a salesman agreed not to solicit his employer's customers for one year after the termination of employment did not violate Section 16600. The agreement was lawful because it did not prevent the salesman from engaging in his chosen business or any other business; it merely prevented him from using the employer's confidential customer lists to solicit his clients. Seven years later in *Muggill v. Reuben H. Donnelley Corp.*, 398 P.2d 147 (1965), the California Supreme Court reaffirmed the existence of the trade secret exception by stating that Section 16600 "invalidates provisions in employment contracts prohibiting an employee from working for a competitor after completion of his employment … unless necessary to protect the employer's trade secrets." *Id.*, at 149. (In *Muggill*, the court relied on 16600 to invalidate a provision in a retirement plan that provided for the suspension or termination of retirement payments to any retired employee who "enters any occupation or does any act which … is in competition with any phase of the business" of the employer.)

California employers who argue that the trade secret exception to the state's prohibition against non-competes remains a tool available for them should carefully consider the unsettled case law.

Edwards v. Arthur Andersen

In 2008, in *Edwards v. Arthur Andersen LLP*, 189 P.3d 285 (Cal. 2008), the California Supreme Court took up the question of whether to recognize the narrow restraint exception. The court declined to do so, holding that Section 16600 prohibits employee non-competition agreements unless the agreement falls within a statutory exception. Although the Ninth Circuit had recognized the narrow restraint exception, at the time *Edwards* was decided no reported California

state court decision had endorsed that exception. The California Supreme Court viewed it as the exclusive province of the California legislature to relax the "clear" statutory restrictions or create additional exceptions to the rule prohibiting non-competition and non-solicitation agreements. *Id.*, at 288–292. Notably, however, the court acknowledged the trade secret exception by citing *Muggill* with approval, but expressly declined to address the applicability of that exception to Section 16600. *Id.*, at 289 & n.4.

Since *Edwards*, federal district courts in California have continued to apply the trade secret exception, or have at least suggested that the exception continues to be viable. For example, in *Bank of America v. Lee*, 08-CV-05546 CAS(WJX), 2008 WL 4351348, at *5 (C.D. Cal. Sept. 22, 2008), the court granted a preliminary injunction seeking to enforce employment agreements which prohibited the bank's former employees from using the bank's trade secrets and other confidential information to contact bank clients and solicit them to transfer their accounts to the former employees' new employer. The court explicitly held that the " 'trade secret exception' to § 16600 still applies." *Id.*, *6. More recently, in *Richmond Technologies Inc. v. Aumtech Business Solutions*, 11-CV-02460-LHK, 2011 WL 2607158 (N.D. Cal. July 1, 2011), the court granted a motion for a temporary restraining order seeking to enforce a non-competition clause finding that if the clause was construed to bar only the use of the plaintiff's "confidential source code, software, or techniques developed for [plaintiff's] products or clients, it is likely enforceable as necessary to protect [plaintiff's] trade secrets." *Id.*, at *19. Other federal courts, including the Ninth Circuit, have continued to acknowledge the existence of the trade secret exception after *Edwards*. *See Asset Marketing Systems v. Gagnon*, 542 F.3d 748, 758 (9th Cir. 2008) (noting that "Cal. Bus. & Prof. Code § 16600 invalidates noncompete contracts unless they are necessary to protect an employer's trade secrets.") (citing *Edwards*); *Applied Materials, Inc. v. Advanced Micro-Fabrication Equipment (Shanghai) Co.*, 630 F. Supp. 2d 1084, 1089 n.7 (N.D. Cal. 2009) (finding that "case law amply supports the existence of" the trade secret exception) (citing *Edwards* and *Bank of America v. Lee*).

On the other hand, at least two California state courts post-*Edwards* have staked out a more restrictive position in response to the question of whether Section 16600 continues to permit non-competition/solicitation agreements that are designed to protect trade secrets. *See The Retirement Group v. Galante*, 98 Cal. Rptr. 3d 585 (Cal. App. 4th 2009); *Dowell v. Biosense Webster*, 102 Cal. Rptr. 3d 1, 6, 10 (Cal. App. 2d, 2009). In *The Retirement Group v. Galante*, the Court of Appeals reversed a trial-court-issued injunction which prevented the plaintiff's former employees from soliciting the plaintiff's current customers. One provision of the injunction—which the defendants did not challenge on appeal—also enjoined the defendant from using information "found solely and exclusively" on plaintiff's databases. *Id.*, at 1232. According to the court, because the latter provision of the injunction already protected against the defendant's use of the plaintiff's trade secrets, the only additional effect of the non-solicitation provision would be to bar solicitations *not* involving the use of trade secrets. Therefore, the court found that the non-solicitation requirements were invalid and unenforceable. *Id.*, at 1241. In its discussion, the *The Retirement Group* court stated in broad terms that:

> Section 16600 bars a court from specifically enforcing (by way of injunctive relief) a *contractual* clause purporting to ban a former employee from soliciting former customers to transfer their business away from the former employer to the employee's new business but a court may enjoin *tortious* conduct (as violative of either the Uniform Trade Secrets Act and/or the Unfair Competition Law) by banning the former employees from using trade secret information to identify existing customers, to facilitate the solicitation with such customers, or to otherwise unfairly compete with the former employer.

Id., at 1238 (emphasis in original). Thus, the court that decided *The Retirement Group* was unwilling to enforce *any* non-solicitation agreement, even one that is narrowly tailored to protect trade secrets. The court would require that the employer rely upon other sources of law to protect those interests.

In *Dowell v. Biosense Webster*, 102 Cal. Rptr. 3d 1 (Cal. App. 2d, 2009), the Court of Appeals discussed *The Retirement Group* before stating in dicta that the court "doubt[s] the continued viability of the common law trade secret exception to covenants not to compete." *Id.*, at 11. However, in *Dowell*, the court did not answer the question of whether the trade secret exception continues to exist. That is because the court found the non-competition and non-solicitation clauses at issue to be overly broad, and not narrowly tailored or carefully limited to the protection of trade secrets. *Id.* A more recent decision from the Northern District of California adopted the restrictive view that *Edwards* prohibits all non-statutory exceptions to the prohibition against non-competition agreements, but did so without specifically considering the trade secret exception. *SriCom, Inc. v. eBislogic, Inc.*, 2012 WL 4051222, at *5 (N.D. Cal. Sept. 13, 2012) (also dismissing a breach of contract claim based on the alleged violation of a non-solicitation/no-hire provision based on *Edwards*' rejection of the "rule of reasonableness").

Conclusion

The trade secret exception to California's prohibition against employee non-competition/solicitation agreements has never been expressly overruled or invalidated by the California Supreme Court. Accordingly, California employers may argue that they continue to have at their disposal employee non-competition/solicitation agreements to use when entering into agreements with employees, if drafted so as to protect the employer's trade secrets. There are California state appellate courts which have suggested in dicta that they might refuse to enforce employee non-competition/solicitation agreements even if narrowly drafted to protect trade secrets. However, federal courts (including the Ninth Circuit) have made comments that appear to favor enforcement.

Putting aside what courts may do in litigation, employers in California appear to believe there is a valid basis for including customer non-solicitation agreements in their executive employment agreements. Our research of publicly available senior executive employment agreements entered into after *Edwards* reflects that public companies continue to include non-solicitation provisions aimed at protecting trade secrets.

Although the trade secret exception will continue to be the subject of future litigation, we anticipate that employers in California will continue to enter into and enforce non-competition/solicitation agreements on the grounds that such agreements are necessary to protect the employers' trade secrets. Employers who wish to implement such non-competition/solicitation agreements based on the trade secret exception should define their trade secrets with as much precision as possible and ensure their definitions are supportable both legally and factually. For example, to the extent factually supportable in specific cases, employers may seek to include within the scope of trade-secret information their customer lists, vendor lists, product information, financial information and strategic business information. Employers should be aware that California law defines trade secrets as information that "derives independent economic value … from not being generally known to the public" and information that "is the subject of efforts that are reasonable under the circumstances to maintain its secrecy." Cal. Civ. Code § 3426.1(d).

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

If you have questions concerning the contents of this issue, or would like more information about Weil's Employment Litigation and Executive Compensation and Employee Benefits practices, please speak to your regular contact at Weil, or to the editors or practice group members listed below:

Editor:

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

Practice Group Members:

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

Frankfurt

Stephan Grauke
+49 69 21659 650
stephan.grauke@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

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

Amy M. Rubin
+1 212 310 8691
amy.rubin@weil.com

Paul J. Wessel
+1 212 310 8720
paul.wessel@weil.com