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Employer Update

In Case of Nationwide First Impression, Court Approves Use of "Predictive Coding" in Discovery

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In This Issue

In a decision likely to have a significant impact on any litigation involving sizeable volumes of electronic data, a federal court has for the first time approved of the use of a computer-assisted document review methodology known as "predictive coding." The New York federal court's decision in *Da Silva Moore v. Publicis Groupe et al.*, No. 11-cv-1279(ALC)(AJP), 2012 WL 607412 (S.D.N.Y. Feb. 24, 2012) was one that was being closely watched by lawyers and clients alike, and may reshape the manner in which parties assess and proceed with litigation.

The Court's Opinion in *Da Silva Moore*

The issue of using predictive coding arose in the context of a putative collective and class action alleging systemic gender discrimination. As the parties prepared for the commencement of discovery, the parties' agreed-upon custodian list from the defendants generated a massive number of documents – approximately three million in total – that the defendants wanted to substantially winnow for production. Fortunately for the defendants, in seeking to resolve their e-discovery burden, they were in the right courthouse.[1] In October 2011, Magistrate Judge Peck had authored an article in the *Law Technology News* describing the potential advantages of an automated document review process known as "predictive coding" over the more traditional electronic discovery process involving keyword searching and manual review.[2] As a result, Judge Peck was receptive to the defendants' proposal to use predictive coding in the *Da Silva Moore* matter. Over Plaintiffs' objections to various aspects of the use of predictive coding,[3] Judge Peck not only issued what "appears to be the first [Opinion] in which a Court has approved of the use of computer-assisted review[,]" but also authored a trenchant analysis of the topic and concluded that "[c]omputer-assisted review appears to be better than the available alternatives, and thus should be used in appropriate cases."[4]

In reaching its conclusion, the Court observed that while "computer-assisted review is not perfect, the Federal Rules of Civil Procedure do not require perfection."[5] Instead, what they require is "'the just, speedy, and inexpensive determination' of lawsuits[,]" an aim that is "further reinforced by the proportionality doctrine" under which discovery must be limited when its burden or expense would outweigh its likely benefit.[6]

What Is Predictive Coding?

In both his article and *Da Silva Moore*, Judge Peck explained that predictive coding is a process by which the use of sophisticated algorithms enables computers to determine the likely relevance of an electronic document. The objective in using predictive coding is to substantially reduce the amount of manual document review required and enhance the accuracy of that review. The process typically begins with a senior attorney manually reviewing and coding a random subset of documents to create the important baseline set or "seed set." This "seed set" – both the documents coded as "relevant" and as "not relevant" by the senior attorney in his or her manual review – is the core element of predictive coding, as it provides the computer program with a basic "training" on how to make relevancy determinations of the thousands or millions of additional documents remaining to be reviewed. The use of seasoned lawyers to develop the "seed" is the lynchpin of the process, as attorneys with a breadth and depth of experience are typically best positioned to make the initial, critical determinations regarding relevance to the claims and defenses in the case.

While the senior attorney's review of the seed set begins the process of "training" the computer, the training does not end there; rather, it is an iterative process that hones the "seed set" upon multiple rounds of review and testing. After using algorithms to analyze the seed set, the computer will predict the relevancy of other random subsets of documents based on what it has learned thus far, sometimes producing a numerical "relevance" score for each coded document (the higher the score, the more likely the document is to be relevant). The senior attorney will then manually review the computer's coded documents, thus providing feedback to the computer on how accurate its relevancy determinations were, which the computer uses to train itself even further. Multiple back-and-forth rounds between the computer's predictions and the attorney's manual review will ensue, continuing until "'the system's predictions and the reviewer's coding sufficiently coincide'" such that the computer can confidently predict the relevance of any given document.[7] "'Typically, the senior lawyer (or team) needs to review only a few thousand documents to train the computer.'"[8] The volume of documents manually reviewed by the senior attorney at the outset, in order to train the computer effectively, is likely to be a fraction of the volume of documents that would otherwise have to be reviewed over the course of many months by teams of junior associates, staff attorneys, and paralegals in a completely manual (and traditional) electronic document review.

Reports indicate that "technology-assisted reviews require, on average, human review of only 1.9% of the documents, a fifty-fold savings over exhaustive manual review."

In *Da Silva Moore*, defendants initially proposed the use of predictive coding, and while Plaintiffs objected (at first to the concept in its entirety, and then to its application), the parties ultimately agreed to a protocol for the use of this methodology.[9] Under this protocol, a random sample of 2,399 documents would be manually coded by a senior attorney to create the initial seed set, with additional documents thereafter added to the seed set through senior attorney review of top hits from keyword searches (using terms provided by both parties) and other "judgmental sampling."[10] Following the creation of the seed set would come seven back-and-forth training rounds of 500 documents each between the computer and a senior attorney, followed by a manual review of a random sample of 2,399 documents coded by the computer as not relevant, to ensure the accuracy of these determinations.[11]

In *Da Silva Moore*, *all* documents reviewed by defendants' counsel in order to create the seed set and during the ensuing iterative rounds, whether they were deemed relevant or not, except for any privileged documents, were to be produced to plaintiffs' counsel for their review.[12]

Advantages of Predictive Coding

First and foremost, predictive coding can drastically reduce the cost associated with large-scale document reviews. Companies used to paying for junior associates, staff attorneys, or paralegals to spend countless hours over many months reviewing thousands, even millions, of documents can frontload the process by having a senior attorney review a few thousand documents at the outset of discovery in order to train the computer to do the rest of the review, thereby slashing overall costs. A recent journal article touting the benefits of automated document review, quoted by Judge Peck in *Da Silva Moore*, found that "'[t]he technology-assisted reviews require, on average, human review of only 1.9% of the documents, a fifty-fold savings over exhaustive manual review.'"[13]

Moreover, predictive coding may actually produce far more accurate results than the traditional method of keyword searches followed by manual review of documents. The Court in *Da Silva Moore* was particularly critical of keyword searching, calling it "over-inclusive" and "not very effective" while analogizing the process of lawyers choosing keywords to the children's card game of "Go Fish" in which one party guesses at keywords without knowing the other party's "cards (*i.e.*, the terminology used by the responding party's custodians)."[14] The Court also dismissed as a "myth" the notion that manual review is the "gold standard" of e-discovery, observing that "statistics clearly show that computerized searches are at least as accurate, if not more so, than manual review[,]" and pointing to an Electronic Discovery Institute study which concluded that "'[o]n every measure, the performance of the two computer systems was at least as accurate (measured against the original review) as that of human re-review[,]'" which suffers from such factors as fatigue, differences in strategic judgment, and simple human error.[15] By replacing the often ineffective keyword search process and substantially eliminating the human error and other limitations of manual review, predictive coding can generate a more accurate set of relevant documents than traditional methods tend to produce.

Predictive Coding Not a Panacea

The Court was careful to note that computer-assisted review should only be used in appropriate cases, as it is "not a magic, Staples-Easy-Button, solution. . . ."[16] In *Da Silva Moore*, "the Court determined that the use of predictive coding was appropriate considering: (1) the parties' agreement, (2) the vast amount of ESI to be reviewed (over three million documents), (3) the superiority of computer-assisted review to the available alternatives (*i.e.*, linear manual review or keyword searches), (4) the need for cost-effectiveness and proportionality under Rule 26(b)(2)(C) [of the Federal Rules of Civil Procedure], and (5) the transparent process proposed by [Defendants]."[17] In cases with small volumes of ESI, the time and money spent on having a senior attorney reviewing thousands of documents in order to train the predictive coding software may not be justified.

Moreover, for predictive coding to be effective, counsel for all parties must be willing to proceed in a collaborative and cooperative manner, and the senior attorneys must be willing to spend significant time on the front end of this process. Additionally, parties should consider whether they are comfortable with the transparency that is likely to be required at the initial stages of computer-assisted review, especially insofar as defendants' counsel might view the production of documents deemed *not* to be relevant (instead of just the documents deemed relevant) as an intrusion on their thoughts and mental impressions about the case. In *Da Silva Moore*, Judge Peck emphasized that the transparency of the proposed predictive coding protocol "made it easier for the Court to approve the use of predictive coding[,]" and noted that "[t]his Court highly recommends that counsel in future cases be willing to at least discuss, if not agree to, such transparency in the computer-assisted review process."[18]

Finally, using predictive coding requires a court that is willing to stage the discovery process. The Court in *Da Silva Moore* noted that "[i]f staging requires a longer discovery period, most judges should be willing to grant such an extension."[18] However, if a particular judge is not inclined to alter his or her usual discovery schedule to accommodate the iterative rounds necessary to train the computer, then predictive coding may not be an option.

Key Takeaways

While predictive coding has many potential advantages, it is important to remember that it is not a panacea for all that ails litigants about electronic discovery. Predictive coding has inherent limitations and challenges that need to be considered before it is deployed in litigation. That said, when confronted with the prospect of voluminous documents to be reviewed, parties would be wise to consider the use of predictive coding, as doing so could ultimately make the document review process more accurate and less costly. Should the parties go down this path, they should consider inviting their electronic discovery vendors to participate in the relevant court hearings, a practice that the Court commended as "very helpful" in *Da Silva Moore*.[20]

With this Southern District of New York decision on an issue of nationwide first impression, predictive coding has officially arrived, and is very likely here to stay. At this point, it is unclear as to how to determine whether the use of predictive coding in a given case would be appropriate – in other words, what's the tipping point regarding when predictive coding makes economic sense? The answer to this question will turn on various qualitative, quantitative, and strategic factors. However, now that *Da Silva Moore* has given the green light for computer-assisted review, counsel in other sizeable litigations will likely attempt to utilize this technology in the months and years to come, and the plaintiffs' and defendants' bars alike will be watching these developments closely.

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1 In response to defendants' counsel's proposing the use of predictive coding, Magistrate Judge Peck remarked, "'You must have thought you died and went to Heaven when this was referred to me[.]'" *Da Silva Moore* at *3, n.3.

2 Andrew Peck, *Search, Forward*, L. Tech. News, Oct. 2011, at 25, 29.

3 On February 22, 2012, two days before Judge Peck issued his written Opinion approving of the use of predictive coding, Plaintiffs filed a Rule 72(a) objection to Judge Peck's rulings at a February 8, 2012 status conference regarding discovery protocol. The rulings at the status conference reflect issues that overlap with items addressed in Judge Peck's February 24, 2012 Opinion, including the use of predictive coding. Plaintiffs' Rule 72(a) objection is still pending before the District Judge.

4 *Da Silva Moore* at *11, *12.

5 *Da Silva Moore* at *11.

6 *Id.* (citing Fed. R. Civ. P. 1, 26(b)(2)(C)).

7 *Id.* at *2 (quoting *Search, Forward*).

8 *Id.*

9 *Da Silva Moore* at *3. In fact, Plaintiffs' objections appear to be ongoing, as they have requested Judge Peck's recusal from the case based on his purported connection to the defendants' e-discovery vendor, as he explained in an Order requiring plaintiffs to advise the Court whether they wish to file a formal motion for his recusal (ECF No. 158, April 2, 2012). Clearly taken aback by plaintiffs' request, Judge Peck notes in this Order that his "favorable view of computer assisted review technology in general was well known to plaintiffs" and he has never "endorsed [the vendor's] methodology or technology, nor received any reimbursement from [the vendor]…." Accordingly, he concluded the Order by "strongly suggest[ing] that plaintiffs rethink their 'scorched earth' approach to this litigation." On April 13, 2012, Plaintiffs formally moved for Judge Peck's recusal from the case. Plaintiffs' objections and subsequent request for Judge Peck's recusal highlight one inherent problem in the use of predictive coding: the plaintiffs' bar, as they do not usually bear the costs of massive document reviews and, in fact, would often prefer to heighten the burden on defendants in order to induce settlement.

10 *Da Silva Moore* at *5.

11 *Id.* at *6.

12 *Id.* at *5-6. Since the time of the Opinion, the parties jointly submitted a proposed schedule calling for defendants to produce more than 13,500 "seed set" documents to plaintiffs over a two-week period, which Judge Peck so ordered. *See* ECF No. 153 (March 30, 2012).

13 *Da Silva Moore at* *9 (quoting Maura R. Grossman & Gordon V. Cormack, *Technology-Assisted Review in E-Discovery Can Be More Effective and More Efficient Than Exhaustive Manual Review*, Rich. J.L.& Tech., Spring 2011, at 43).

14 *Id.* at *10.

15 *Id.* (citing Herbert L. Roitblatt, Anne Kershaw & Patrick Oot, *Document Categorization in Legal Electronic Discovery: Computer Classification v. Manual Review*, 61 J. Am. Soc'y for Info. Sci. & Tech. 70, 79 (2010)).

16 *Id.* at *8.

17 *Id.* at *11.

18 *Id.*

19 *Id.* at *12.

20 *Id.*

Emerging Issues Concerning Social Media and the Workplace

By Courtney Fain

Every day seems to bring new developments for employers trying to navigate the limits on their ability to regulate their employees' use of social media in the workplace. Recent media coverage has focused on employers who ask employees and prospective employees for Facebook log-in and password information or otherwise require employees to "friend" someone in human resources or management. The Maryland state legislature acted quickly to prohibit an employer from "request[ing] or requir[ing]that an employee or applicant disclose any user name, password or other means for accessing social media accounts, and similar legislation is in the pipeline in several other states, including Washington, Illinois, New York, and California, as well as in Congress. While the legislative response has focused on the need to protect employees' right to privacy and ensure that employers are not violating any discrimination laws in demanding access to their current and potential employees' Facebook pages, employers should be mindful that such policies may also be deemed unlawful under the National Labor Relations Act (the NLRA).

As discussed in more detail below, under recent guidance provided in a report (the Report) issued by the Office of the General Counsel of the National Labor Relations Board (the NLRB), policies that demand access to employees' Facebook pages, Twitter feeds, or other social media forums could be construed as chilling workers' willingness to exercise their rights under Section 7 of the NLRA. While the Report does not explicitly address such policies, it provides valuable guidance as to how social media policies in the workplace may implicate the rights of both unionized and non-unionized employees and is indicative of the NLRB's clear interest in monitoring social media issues in the workplace.

Social Media and Section 7 Rights

The Report, which was issued on January 24, 2012, and follows upon a similar report issued in August, illustrates that the NLRB will carefully examine social media policies, and any adverse employment actions taken pursuant to such policies, to determine whether the policies violate Section 8(a)(1) of the NLRA. Section 8(a)(1) prohibits employers from engaging in conduct that "interfere[s] with, restrain[s], or coerce[s] employees in the exercise of" Section 7 protected activities.[1] Section 7 grants covered private-sector employees, including non-unionized employees, "the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection."[2] A rule that doesn't explicitly restrict Section 7 activities may still be in violation of Section 8(a)(1) if it is shown that (1) employees would reasonably construe the language to prohibit Section 7 activity; (2) the rule was promulgated in response to union activity; or (3) the rule has been applied to restrict the exercise of Section 7 rights.[3]

Importantly, while a social media policy might be deemed to be overbroad and in violation of Section 7, an employee who suffers an adverse employment action pursuant to that policy will not necessarily have been unlawfully impacted unless it is also determined that the employee was engaging in Section 7 protected activity.[4] Unfortunately, the decisions show that the line between an employee simply "venting" and one seeking to initiate a collective action is not easily drawn, and some cases turn in part on whether an employees' Facebook posting actually elicited a response from co-workers, regardless of what the poster actually intended.

NLRB Guidance

The NRLB's finding in the 14 reported cases show that social media policies should specify the precise types of communications that are prohibited, and not rely on vague or subjective terms such as "unprofessional," "inappropriate," or "disrespectful," because such terms could be understood to implicate Section 7 rights. For example, in one case, the NLRB found that the employer's code of conduct, which prohibited "insubordination or other disrespectful conduct" and "inappropriate conversation," was overbroad. In another case, even the existence of a "savings clause," which provided that any limitations should not be interpreted so as to interfere with employee rights, could not cure a policy that limited employees to "appropriate" communications. The NLRB reasoned that even with the "savings clause" employees could reasonably determine that criticism of the employer's policies were prohibited as inappropriate, and the policy was therefore overbroad.

Further, blanket prohibitions on an employee's ability to identify as an employee or otherwise prohibit any use of the employer's name or logo without approval may also violate employees' Section 7 rights. Similarly, general prohibitions on discussions of "confidential" information may also be unlawfully overbroad, because such policies could reasonably be construed to extend to protected communications of such topics as wages and working conditions.

Finally, broad non-disparagement policies are likely in violation of the NLRA where they prohibit employees from making *any* disparaging or defamatory statements in the electronic media about the employer. But, where a prohibition on disparagement was included within a list of other prohibited activity, including sexual harassment and discrimination, it was determined that such a policy was not so overbroad as to be construed to implicate Section 7 rights.

The NLRB's January 24, 2012 Report illustrates that the NLRB will carefully examine social media policies, and adverse employment actions based upon them, for potential violations of Section 8(a)(1) of the NLRA.

Implications for Employers

The issuance of a second report relating to social media in less than six months signals that the NLRB is closely monitoring the interactions of social media and the workplace, and indeed the report recognizes there are many "emerging issues" in this area. Employers must walk a fine line in crafting social media policies that are not so overbroad such that an employee would "reasonably construe" it as prohibiting Section 7 activity and would be well advised to consider the NLRB's reasoning outlined above in carefully crafting any policies encompassing social media, including any policies requiring access to employees' private social media accounts.

Specifically, because undefined terms might be read broadly to encompass Section 7 protected activity employers should consider providing examples of the specific types of prohibited behavior. Further, because a "savings clause" expressly protecting Section 7 activity may not be enough to cure an otherwise overbroad policy, including such a clause should not be done at the expense of drafting a narrowly crafted policy. Finally, employers should consider that any policy demanding access to employees' social media sites arguably, under the reasoning outlined above, could be construed as chilling Section 7 rights, and is potentially unlawful under the NLRA. Whether the NLRB is considering this precise issue remains to be seen. But, in light of the NLRB's recognition that social media is a "hot topic" for employers and the extensive media coverage of these practices and subsequent response by Congress and state legislatures, such policies are probably on the NLRB's radar as well, and it is likely that the benefits to such policies are outweighed by the risks.

1 National Labor Relations Act § 8(a)(1), 29 U.S.C. § 158.

2 National Labor Relations Act § 7, 29 U.S.C. § 157.

3 *See Lutheran Heritage Village-Livonia*, 343 NLRB 646, 647 (2004).

4 *See The Continental Group, Inc.*, 357 NLRB No. 39, slip op. at 4 (2011).

Arbitration and Class Action Waivers after *Concepcion* and *Horton*

By Jeffrey S. Klein, Nicholas J. Pappas and Celine J. Chan

Almost a year ago, the Supreme Court decided *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011), regarding the enforceability of arbitration agreements with provisions that waived employees' right to assert their claims as class actions. In *Concepcion*, the Court held that the Federal Arbitration Act (the FAA) preempted a state-law rule that prohibited, as unconscionable, the enforcement of such "class action waiver" provisions in arbitration agreements because the state rule impermissibly interfered with accomplishing the FAA's objectives.

Concepcion arose in the context of a consumer's challenge to a sales tax charge on a cell phone that had been advertised as "free," and the case did not address how the FAA might apply to class action waiver provisions in arbitration agreements covering employment disputes. After *Concepcion*, the National Labor Relations Board (the NLRB) in *D.R. Horton, Inc.*, 2012 WL 36274 (N.L.R.B. Jan. 3, 2012) invalidated an agreement that required all employees individually to arbitrate employment claims as contrary to Sections 7 and 8 of the National Labor Relations Act (the NLRA). The NLRB found that the waiver violated Section 7 because it restricted group association by prohibiting employees from bringing collective or class claims in any forum. The NLRB found *Concepcion* inapplicable because it did not address the NLRA or employment disputes.

Both before and after *Horton*, courts have reached divergent conclusions regarding how *Concepcion* affects the enforceability of class action waivers in employment cases. In this article, we analyze these cases and address whether and how employers may modify their arbitration programs in light of *Concepcion* and its progeny.

Concepcion and *Horton*

In *Concepcion*, the Supreme Court held, in the context of a consumer arbitration agreement, that the FAA preempted a state law that invalidated, as unconscionable, class action waivers in private arbitration agreements. 131 S. Ct. at 1753. Because the state law at issue targeted and disfavored arbitration agreements, the Court found that the FAA preempted the state law. The Court also noted that because class arbitration, as "manufactured by" the state law, is fundamentally different from bilateral arbitration, the state law was "inconsistent with the FAA," and impermissibly imposed procedures that were not agreed to in the parties' arbitration agreement.

Some employment law practitioners initially believed that *Concepcion* supplied employers with a tool to require all employees individually to arbitrate employment disputes. However, in *D.R. Horton*, the NLRB provided employees with grounds to argue against universal application of *Concepcion* to employment claims. In *Horton*, the NLRB examined the enforceability of a home builder's Mutual Arbitration Agreement (the MAA) that employees were required to sign as a "condition of employment." *See* 2012 WL 36274, at *1. The MAA provided, in part, that: (1) all employment claims will be determined only by final and binding arbitration; (2) the arbitrator may hear only individual claims; and (3) the employee waives the right to file a civil proceeding.

Michael Cuda, a superintendent with Horton, the home builder company, notified his employer of his intent to initiate arbitration on behalf of himself and a class of superintendents, alleging that they were misclassified as exempt under the Fair Labor Standards Act (the FLSA). After Horton challenged Cuda's notice based on the MAA's restrictions on collective claims in arbitration, Cuda filed an unfair labor practice charge, and the NLRB's General Counsel issued a complaint alleging that the MAA violated Section 8(a)(1) of the NLRA because the waiver provision violated employees' Section 7 rights under the NLRA.

The NLRB held that the class action waiver did violate Section 8(a)(1) because it "clearly and expressly" barred employees from exercising "substantive" Section 7 rights by prohibiting class or collective claims in any forum. The NLRB also determined that its finding would not conflict with the FAA, but that even if it did, the FAA's intent was always "to leave substantive rights undisturbed."

The NLRB identified two limitations on *Horton*. First, *Horton* is limited to "agreements applicable to 'employees' as defined in the NLRA," so it does not apply to supervisors[1] and managers[2] who are excluded from NLRA coverage. Second, only agreements that would "reasonably [be] read" to bar concerted activity are vulnerable. Thus, the NLRB ruled that an agreement requiring individual arbitration, "but not precluding a judicial forum for class or collective claims, would not violate the NLRA . . . ."

New Developments

Since *Concepcion* and *Horton*, one circuit court has enforced an arbitration agreement that it construed to include a class action waiver, while other district courts have reached varying conclusions on the issue. In *Quilloin v. Tenet HealthSystem Philadelphia Inc.*, 2012 WL 833742 (3d Cir. Mar. 14, 2012), the Third Circuit granted an employer's motion to compel arbitration. When Janice Quilloin commenced her employment as a registered nurse, she "voluntarily agree[d]" "to submit to final and binding arbitration" any and all employment claims, acknowledging that "arbitration will be the sole and exclusive remedy . . . ." However, Quilloin later brought a collective action under the FLSA.

Since *Concepcion* and *Horton*, one circuit court has enforced an arbitration agreement that it construed to include a class action waiver, while other district courts have reached varying conclusions on the issue.

In opposing the employer's motion to compel arbitration, plaintiff asserted that the agreement was unconscionable. On the issue of unconscionability, and specifically, the "potential inclusion of a class action waiver," the Court first recognized that the agreement contains no "express class action waiver," that this "[s]ilence . . . generally indicates a prohibition against class arbitration, but the actual determination . . . is a question . . . for the arbitrator."

Among the federal trial courts to assess the enforceability of class action waivers applicable to employment disputes, two Southern District of New York cases, *Sutherland v. Ernst & Young*, 2012 WL 130420 (S.D.N.Y. Jan. 17, 2012), and *LaVoice v. UBS Financial Services, Inc.*, 2012 WL 124590 (S.D.N.Y. Jan. 13, 2012), particularly illustrate the split in authority post-*Concepcion* and under the law of unconscionability.

In *Sutherland*, plaintiff Stephanie Sutherland agreed, as a condition of her employment, to "binding arbitration" "on an individual basis only." But, she later brought a collective action under the FLSA. In the Court's original decision on the employer's motion to compel arbitration – pre-*Concepcion* and -*Horton* – Judge Kimba Wood invalidated the agreement because plaintiff "substantial[ly] demonstrate[d]" that the waiver amounted to her inability to assert her claims. *See* 768 F. Supp. 2d 547, 553 (S.D.N.Y. 2011). Post-*Concepcion*, the employer moved for reconsideration, but Judge Wood denied the motion. *See* 2012 WL 130420 at *1, *9. The Court stated that the applicability of *Concepcion* was a "close question," but still determined that Sutherland was unable to vindicate her rights on an individual basis.

In contrast to *Sutherland*, in *LaVoice* Judge Barbara Jones granted an employer's motion to compel individual arbitration because plaintiff, a financial advisor, had signed an agreement waiving "any right to commence . . . any class or collective action . . . ." However, plaintiff later asserted collective and class claims under the FLSA, and state law. The Court "read [*Concepcion*] as standing against any argument that an absolute right to collective action" is consistent with the FAA and found that LaVoice's "circumstances differ[ed] drastically" from Sutherland's because LaVoice would still be able to exercise his statutory rights on an individual basis in arbitration.

Finally, in an unpublished order in *Johnmohammadi v. Bloomingdale's, Inc.*, No. 11-cv-06434 (GW)(AJW) (C.D. Cal. Feb. 29, 2012), a California district court granted an employer's motion to compel individual arbitration, and enforced an employee's waiver of his right to bring class claims in *both* arbitration and in court. Bloomingdale's obtained the waiver as part of its dispute resolution program, Solutions inSTORE (SIS), a pre-dispute program expressly permitting employees to opt out of arbitration and avoid waiving the right to bring employment class claims in all forums.

By accepting employment, the employee agrees to be covered by SIS, a four-step program, with the final step being binding arbitration. But, an employee can "opt out of the step-four arbitration by submitting an opt-out form within 30 days" of his hire date. If an employee does *not* opt out, "final and binding arbitration" covers all employment claims, and the employee waives any right to class claims in any forum.

Fatemeh Johnmohammadi was hired as a sales associate, and did not opt out of step-four arbitration, so when she brought a class action under state wage and hour laws, Bloomingdale's moved to compel arbitration. In its ruling, the Court recognized that of particular concern in *Horton* "was the fact that the waiver . . . was compelled by the employer as a condition of employment." Indeed, because the NLRB expressly did not address agreements that are "*not a condition of employment*," the Court stated that it "would find that a *voluntary* waiver . . . [that] does not function as a condition of employment would not run afoul of the NLRA." Plaintiff also did not argue that "an employee could never voluntarily and consciously agree to waive his or her section 7 rights, here in the form of a representative action." Thus, in the Court's February 29, 2012 "Order of Dismissal," the Court held that plaintiff "voluntarily entered" into the SIS to individually arbitrate, and that the class action waiver does not violate the NLRA.

The most critical decision is whether the employer will mandate arbitration as a condition of employment, or allow employees permissively to choose to opt out of the arbitration program.

Practical Considerations

In light of *Concepcion* and *Horton* and their progeny, employers may wish to review their arbitration programs to assess whether they comply with current precedent regarding questions of enforceability of class action waivers. Employers need to decide whether to structure arbitration programs to avoid legal disputes, or to create programs that may comply with *Concepcion*, but potentially be subject to challenges based on the theories described above.

The most critical decision is whether the employer will mandate arbitration as a condition of employment, or allow employees permissively to choose to opt-out of the arbitration program. Employers may consider that at least one federal court has enforced a *permissive* pre-dispute resolution program that allows employees to opt out. If this court is correct, employees who do not opt out may be deemed to have voluntarily submitted to individual arbitration of all employment claims.

Alternatively, if employers opt for a *mandated* pre-dispute arbitration program, they may consider first whether the program will be applicable only to "employees" as defined by the NLRA, or also include supervisors and managers who are not covered by the NLRA. For employees covered under the NLRA, *Horton* provided that "an agreement requiring arbitration of any individual employment-related claims, but not precluding a judicial forum for class or collective claims, would not violate the NLRA[.]" Thus, if *Horton* is not reversed on appeal, an employer may wish to require that its employees covered by the NLRA assert only individual claims in arbitration, but also inform such employees that if they wish to assert class action claims, both individual and class claims must be asserted only in court.

On the other hand, employers may argue that a program applicable to managerial or supervisory staff should not be analyzed under the NLRA. Rather, managerial or supervisory staff who do not meet the criteria for NLRA coverage would not have rights under Sections 7 or 8, and, therefore, class action waivers in arbitration agreements with such employees would arguably avoid the result in *Horton*.

Finally, as illustrated by *Quilloin*, *Sutherland* and *LaVoice*, courts may continue to apply the law of unconscionability to evaluating class action waivers. To avoid the substantive unconscionability arguments employees have made, employers may wish to incorporate, as a part of their agreements, provisions that cover cost-shifting and reimbursement of fees, that grant an arbitrator the authority to award any ultimate relief under applicable law, and that retain all statute of limitations. To avoid procedural unconscionability arguments, employers should clearly spell out all terms of any agreement, and for permissive opt-out programs, give employees ample time to opt out of arbitration on a confidential basis.

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1 § 2(3) of the NLRA provides that "employee" excludes "any individual . . . employed as a supervisor . . . ." *See also* NLRA § 2(11)(defining "supervisor").

2 *See NLRB v. Bell Aerospace Co. Div.*, 416 U.S. 267, 289 (1974)(stating that managerial employees are not covered by NLRA).

EEOC Issues Final Rule Concerning Disparate Impact and Reasonable Factors Other Than Age Under the Age Discrimination in Employment Act

By Alex M. Solomon

On March 30, 2012, the Equal Employment Opportunity Commission (EEOC) issued a final rule (Final Rule) amending its Age Discrimination in Employment Act (ADEA) regulations regarding disparate impact and reasonable factors other than age (RFOA).[1] The Final Rule comes into effect on April 30, 2012, and addresses issues related to the United States Supreme Court's 2005 holding in *Smith v. City of Jackson*.[2] Specifically, the Final Rule codifies the holding in *Smith* that an employer may avoid liability if a disparate impact is attributable to a RFOA, but states, per the Court's 2008 holding in *Meacham v. Knolls Atomic Power Laboratory*,[3] that the burden of production and persuasion for such a defense rests with the employer. Additionally, the Final Rule provides a non-exclusive list of considerations intended to clarify whether an employer has established a RFOA defense.

The Final Rule Codifies *Smith v. City of Jackson* and *Meacham v. Knolls Atomic Power Laboratory*

The EEOC has long maintained that individuals could bring a disparate impact claim under ADEA. Some courts, however, after the Supreme Court's decision in *Hazen Paper Company v. Biggins*,[4] held that such a cause of action was not cognizable. The Supreme Court resolved the split in authority in *Smith v. City of Jackson*, which concerned whether salary increases that favored police officers under age 40 violated ADEA.[5]

The US Court of Appeals for the Fifth Circuit held that the plaintiffs could not bring a disparate impact claim, but the Supreme Court reversed. Along with its holding that a disparate impact claim is cognizable under ADEA, the Supreme Court also held that an employer could defend against such a claim "where the differentiation is based on reasonable factors other than age," which is embodied in Section 4(f)(1) of ADEA.[6] Prior to *Smith*, the EEOC regulation on disparate impact under ADEA stated that an employer could avoid liability only if its policy was justified as a business necessity, which is the standard under Title VII.[7] The Final Rule dispatches with the "business necessity" standard, and codifies *Smith*'s RFOA standard. Accordingly, newly revised 29 C.F.R. Section 1625.7(c) states that, in relevant part, "Any employment practice that adversely affects individuals within the protected age group on the basis of older age is discriminatory unless the practice is justified by a 'reasonable factor other than age.'"[8]

Post-*Smith*, a split developed on what burden the employer carries in asserting a RFOA defense – with certain courts holding that the employer only had a burden of production, and others maintaining that the employer additionally held the burden of persuasion. *Meacham v. Knolls Atomic Power Laboratories* resolved the split. The Supreme Court held that an employer "must not only produce evidence raising the defense, but also persuade the factfinder of its merit."[9] The Final Rule codifies this holding in newly revised 29 C.F.R. Section 1625.7(d), which states, "Whenever the 'reasonable factors other than age' defense is raised, the employer bears the burdens of production and persuasion to demonstrate the defense."[10]

Final Rule Aims to Clarify Application of RFOA Defense

In addition to "conform[ing] existing regulations to recent Supreme Court decisions," the EEOC states that the Final Rule is "to provide guidance about the application of the RFOA affirmative defense." To this end, the EEOC provides its guidance through a list of non-exclusive "considerations that [the EEOC contends] are manifestly relevant to determining whether an employer demonstrates the RFOA defense."[11]

As an initial matter, under the new regulations, the RFOA must be "objectively reasonable when viewed from the position of a prudent employer mindful of its responsibilities under the ADEA under like circumstances." This "reasonableness" determination

Under the new regulations, the RFOA must be "objectively reasonable when viewed from the position of a prudent employer mindful of its responsibilities under the ADEA under like circumstances."

"must be decided on the basis of all the particular facts surrounding each individual situation." An employer must show that the challenged "employment practice was both reasonably designed to further or achieve a legitimate business purpose and administered in a way that reasonably achieves that purpose in light of the particular facts and circumstances that were known, or should have been known, to the employer."[12]

After couching the RFOA in terms of objective reasonableness, the Final Rule proceeds onto the list of the five relevant, but non-exclusive, considerations. To summarize, the five considerations are:

(1) whether the factor is related to the employer's stated business purpose;

(2) whether the employer accurately defined and applied the factor (including how managers were provided guidance or training about the factor's application);

(3) the extent to which the employer curtailed supervisors' subjective assessment of employees;

(4) the extent to which an employer evaluated whether the challenged practice would have a disparate impact; and

(5) the extent of the harm – in terms of injury and number affected – that is a result of the practice.[13]

The revised regulations promulgated by the Final Rule provide that the RFOA defense may be established even if no single one, or a specific combination, of the above five considerations are shown. Alternatively, proving just one of the five considerations does not "automatically establish the defense," such as to bar liability.[14]

Employers are advised to carefully review and consider the Final Rule, and to remain apprised of developments concerning its application – especially application of the five considerations, as the EEOC will consider them in determining whether an employer has successfully established a RFOA defense. Whether an employer chooses to take action to satisfy any one of the five considerations, however, will depend on individualized operational and legal considerations, which should be discussed with counsel.

1 Disparate Impact and Reasonable Factors Other Than Age under the Age Discrimination in Employment Act, 77 Fed. Reg. 19080 (Mar. 30, 2012) (to be codified at 29 C.F.R. pt. 1625).

2 544 U.S. 228 (2005).

3 554 U.S. 84 (2008).

4 507 U.S. 604 (1993).

5 In order to provide competitive compensation, police officers with less than five years of tenure were provided proportionately greater salary increases than those officers with greater tenure.

6 29 U.S.C. § 623(f)(1).

7 29 C.F.R. § 1625.7(d) (2004).

8 77 Fed. Reg. at 19095 (Revised Regulation 29 C.F.R. § 1625.7(c)).

9 554 U.S. at 87.

10 77 Fed. Reg. at 19095 (Revised Regulation 29 C.F.R. § 1625.7(d)).

11 *Id.* at 19081.

12 *Id.* at 19095 (Revised Regulation 29 C.F.R. § 1625.7(e)(1)).

13 *Id.* (Revised Regulation 29 C.F.R. § 1625.7(e)(2)(i)-(v) ("Considerations that are relevant to whether a practice is based on a reasonable factor other than age include, but are not limited to: (i) The extent to which the factor is related to the employer's stated business purpose; (ii) The extent to which the employer defined the factor accurately and applied the factor fairly and accurately, including the extent to which managers and supervisors were given guidance or training about how to apply the factor and avoid discrimination; (iii) The extent to which the employer limited supervisors' discretion to assess employees subjectively, particularly where the criteria that the supervisors were asked to evaluate are known to be subject to negative age-based stereotypes; (iv) The extent to which the employer assessed the adverse impact of its employment practice on older workers; and (v) The degree of the harm to individuals within the protected age group, in terms of both the extent of injury and the numbers of persons adversely affected, and the extent to which the employer took steps to reduce the harm, in light of the burden of undertaking such steps.").

14 *Id.* (Newly Revised Regulation 29 C.F.R. § 1625.7(e)(3)).

California Implements Wage Theft Prevention Act, Which Will Impose Significant New Burdens on Employers

By Jonathan Sokotch

Following on the heels of New York's 2011 mandate to provide new hires and incumbent employees with detailed notices of their pay rates, pay dates, and other information,[1] California has imposed its own significant notice requirements on employers with California-based employees. Specifically, the California Wage Theft Prevention Act (the CWTPA), which became effective January 1, 2012, requires, among other things, that employers provide notices to designated California employees "at the time of hire," disclosing each employee's pay rate, pay date, and various other information concerning the employment relationship.[2] As contrasted with the New York law, the CWTPA does not require disclosure to incumbent employees.

The California Division of Labor Standards Enforcement (the DLSE) – the agency charged with administering and enforcing California's wage and hour laws – intending to clarify employer obligations under the CWTPA, has promulgated a template form of notice and a guidance in the form of an FAQ.[3] The DLSE, however, rather than clarifying or simplifying employer obligations through its interpretation of the CWTPA, has instead muddied the water for employers, leaving them vulnerable to potential non-compliance and perhaps civil claims.

Scope of Coverage

Unlike the New York employee-notification laws, which cover virtually all New York-based employees, California excludes from its notice requirements government employees, employees who are exempt from the payment of overtime wages under California law, and unionized employees, if the applicable collective bargaining agreement expressly sets forth the employee's wages, hours of work, working conditions, premium wage rates for overtimes hours, and if the regular rate of pay is at least 30 percent more than the California minimum wage.

Timing of Notice

While New York requires employers to distribute notices to new hires and incumbent employees (on an annual basis), California only requires distribution of the notice "at the time of hire."[4] However, in the event of any change to information set forth in the notice, the CWTPA requires employers to issue a supplemental notice within seven days of such change, unless those changes are reflected on a timely wage statement or disclosed to the employee in another writing required by law within seven days of the change. As an example, an employer should not issue a supplemental notice every time it increases an employee's pay rate, as long as it discloses all pay rate changes in its wage statements as required under California Labor Code Section 226. As there is overlap between the information employers are required to provide in wage statements and in these notices, employers should take steps to ensure that such information is consistent in both statements.

Information Employers Must Disclose to Their New Hires

The CWTPA mandates disclosure of eight different categories of information on the notice to employees, and the DLSE, through its template, requires disclosure of several additional categories of information. The eight categories of information referenced in the statute are as follows:

- The rate or rates of pay and basis thereof, whether paid by the hour, shift, day, week, salary, piece, commission, or otherwise, including any rates for overtime.
- Allowances, if any, claimed as part of the minimum wage, including meal or lodging allowances.
- The regular payday designated by the employer.
- The name of the employer, including any "doing business as" names used by the employer.
- The physical address of the employer's main office or principal place of business, and a mailing address, if different.
- The telephone number of the employer.
- The name, address, and telephone number of the employer's workers' compensation insurance carrier.
- Any other information deemed material and necessary by the DLSE.

The DLSE has authority to require disclosure in the notice of additional information it deems "material and necessary,"[5] although some employers contend that the DLSE has exceeded the legislative intent via its substantial "add-on" requirements to the CWTPA. The DLSE has advised that even if an employer chooses not to use the DLSE's template form of notice, any notice must include "all the information requested on the DLSE's template."[6]

The additional information requested on the DLSE template includes the following:

The DLSE's interpretation of the CWTPA has muddied the water, leaving employers vulnerable to potential non-compliance and perhaps civil claims.

- the identity and contact information of "any other business or entity" that the "worksite employer" uses to "hire employees or administer wages or benefits";
- whether an employee's "employment agreement" is "oral" or "written";
- the employer's business type (*i.e.*, a sole proprietor, corporation, LLC, partnership, etc.);
- the employer's workers' compensation policy number or certificate number for permissible self-insurance;
- the employee's hire date;
- the name and signature of an employer representative; and
- the date the notice is provided to the employee and the date signed by the employee.

Challenges and Traps for the Unwary

Filling out the above-discussed categories of information on the

DLSE's template notice presents challenges and some possible traps for employers. The following will discuss several of the more difficult and confusing elements of that task.

Written or Oral Agreement? The requirement in the DLSE's template notice that employers check a box to indicate whether the employee's "employment agreement" is "oral" or "written," is problematic, as it incorrectly assumes that all employees enter into an "employment agreement" that is either "oral" or "written." In fact, many employers do not enter into formal "employment agreements" with their at-will employees, and the terms of employment might not be all written or all oral, but rather may be a mixture of both. For instance, employee handbooks and benefit plans are often provided in written form, while certain work-shift information may be provided only orally. So how should an employer fill out this section if the terms of employment are both oral and written? One option is to check both boxes. Another option is to respond by stating in writing (which can be accomplished via an attachment or by customizing the form) that the terms of employment are both oral and written. It is also advisable that employers state on the notice that the employee's employment is at all times "at will" and that the notice creates no contract of employment. While the DLSE has clarified in its guidance that checking the box acknowledging a written employment agreement will not affect the presumption of "at will" employment, communicating the "at will" status clearly on the face of the notice and with emphasis has the added benefit of eliminating any possible ambiguity and ensuring that all employees (or others who review the notice document) have complete clarity that the employment is "at will."

The DLSE's template notice is problematic because it requires that employers check a box that incorrectly assumes that all employees enter into an "employment agreement" that is either "oral" or "written."

Rate(s) of Pay: The DLSE has clarified in its guidance that all rates of pay that are "fixed or ascertained by calculation" must be disclosed in the CWTPA notice, and not just rates that are "time-based" or "piece-based." For each rate disclosed, the employer must provide the monetary value and basis for earning such rate (*i.e.*, $10.00 per hour). Thus, for example, if an employee is paid by the hour and also receives supplemental commissions, the DLSE provides the following example as an appropriate description of that employee's "Rate(s) of Pay": "$10.00 per hour, plus commissions of __% of sales closed during prior month." In addition, if a separate document of the employer contains formulas or calculations for a relevant "rate" of pay, the employer must reference that document in the notice. (DLSE FAQ #18).

Overtime Rate(s) of Pay: The DLSE has clarified that employers cannot disclose the "Overtime Rate(s) of Pay" by merely providing the multiplier for overtime (*e.g.*, 1.5 times the regular rate after 8 hours and/or double the regular rate after 12 hours) but must provide the actual dollar amounts (*e.g.*, $15 per hour after 8 hours and $20 per hour after 12 hours). The DLSE notes that if an employee receives pay other than just from an hourly rate – such as via supplementary commissions, bonuses, or piece rates – that additional pay must be included in determining the "regular rate of pay" for purposes of overtime compensation. In cases where variable supplemental compensation on top of a fixed hourly rate may cause overtime rates to vary by week, the DLSE has clarified that an employer need only disclose the minimum overtime rates based on the hourly rate, if it also notes that such overtime rates are subject to upward adjustment when other forms of wages are earned during the applicable pay period.

Entities that Hire or Administer Wages/Benefits: The DLSE requires on its template that employers disclose various information regarding "any other business or entity" that the "worksite employer" uses to "hire employees or administer wages or benefits," but does not require disclosure if such entity is a "recruiting service" or "payroll processing service." In so doing, it appears that the DLSE intends to require identification of entities that could qualify as "joint employers," to make it easier for employees or the government to take action against those entities for wage and hour violations, for which joint employers can share liability. The language used by the DLSE here, however, is ambiguous and subject to interpretation. For instance, the terms "worksite employer" and "recruiting service" are undefined, and have no specific meaning under applicable employment law. Furthermore, the DLSE's instruction on its template that employers must identify "temporary services" agencies and "employee leasing" companies, but not "recruiting service" entities will cause uncertainty, as the line between a typical "recruiting service" and a staffing agency that administers wages and benefits can be blurry, and some entities will not fall neatly into either category. In addition, while it is unclear whether the request to disclose entities that "administer wages or benefits" is intended to include third-party administrators of benefit plans, such a requirement would arguably be preempted by ERISA with respect to ERISA-governed benefit plans, as ERISA regulates disclosure of such information. Given the DLSE's vague and imprecise language, determining which third parties to disclose may be unclear, and employers should seek advice from counsel on grey area determinations.

Civil Penalties

The CWTPA provides no specific civil remedy or penalty for violations of its notice requirements. Plaintiffs' attorneys, however, will undoubtedly attempt to sue for violations of the CWTPA under California's Private Attorney Generals Act of 2004 (PAGA), which creates a private right of action for violations of most sections of the California Labor Code and provides civil penalties of $100 for each aggrieved employee per pay period for the initial violation and $200 per employee per pay period for each subsequent violation. Defense attorneys, however, will argue that the CWTPA's notice provisions fall into a PAGA carve-out under California Labor Code Section 2699(g)(2), for certain notice and posting provisions. The question of whether CWTPA's notice provisions are covered by or excluded from PAGA will likely be resolved in court. Until such resolution, prudent employers should assume they face risk of considerable penalties for non-compliance.

Employers should also be cognizant of the relationship between the new law and the extant California wage statement penalties. Per California Labor Code Section 226, employers are required to disclose on employee wage statements "all applicable hourly rates in effect during the pay period," which overlaps with the rate information to be provided on the CWTPA notices. Violations of the wage statement provision carry penalties of $50 per employee for the initial pay period in which a violation occurs and $100 per employee for each violation in a subsequent pay period, not exceeding an aggregate penalty of $4,000. Given this overlap, failure to comply with the new law may cause incorrect information to be placed on employees' wage statements, and thus create civil liability for employers.

Conclusion

Given the issues and questions that remain unresolved under CWTPA – including whether PAGA penalties will apply, how to address ambiguities in the DLSE's template form and guidances, and whether a court will strike the DLSE's template for exceeding legislative intent – this is an important and evolving piece of legislation that California employers will need to follow closely. In the meantime, California employers should take a cautious and conservative approach, by devoting the time and resources necessary to comply with the template and guidance promulgated by the DLSE.

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1 *See* Section 195.1 of the New York State Labor Law.

2 These notice requirements are codified under California Labor Code Section 2810.5. In addition to these new notice provisions, the CWTPA crafted other changes to the California Labor Code that are beyond the scope of this article, such as, for example, requiring restitution to employees in addition to civil penalties for failure to pay minimum wages, criminalizing willful violations for non-payment of wages after a court judgment or final administrative order, extending the time for obtaining judgments on final orders for collection of penalties by the DLSE, and allowing employees to recover attorneys' fees and costs incurred to enforce a judgment for unpaid wages.

3 The DLSE's template notice and FAQ are both available online at http://www.dir.ca.gov/dlse/Governor_signs_Wage_Theft_Protection_Act_of_2011.html.

4 The DLSE has added in recent guidance that, while not required, "it would be a best practice" for employers to also provide notices to current employees as well. *See* DLSE FAQ #2.

5 *See* California Labor Code 2810.5.

6 If employers customize their own form of notice and do not use the DLSE's template, the DLSE requires that all requisite information be provided in a single stand-alone document. Employers can provide the notice electronically as long as the worker can print out and acknowledge receipt of the notice. DLSE FAQ #6, 7, 9.

The Fifth Circuit Finds that a Corporate Acquisition Agreement Amended an Employee Benefit Plan

By Daniel Birnhak

As a result of a recent Fifth Circuit decision, *Evans v. Sterling Chemicals*, 660 F.3d 862 (5th Cir. 2011), a review of the amendment provisions in benefit plan documents may be appropriate. In *Evans*, the Fifth Circuit concluded that the provisions of an asset purchase agreement regarding the buyer's retiree medical obligations to the seller's employees hired by the buyer constituted an amendment of the buyer's retiree medical benefits plan, notwithstanding the absence of any intent of the buyer and seller to treat the purchase agreement as a plan amendment. The court extended the reasoning it developed in a case involving a merger agreement, *Halliburton Co. Benefits Committee v. Graves*, 463 F.3d 360 (5th Cir. 2006), *i.e.*, any writing that satisifes the requirements of a plan amendment under the terms of the benefit plan document will be treated as a plan amendment. The Fifth Circuit's holdings in *Evans* and *Halliburton* present a trap for the unwary when drafting documents that include provisions relating to specific employee benefit obligations or drafting amendment provisions in benefit plan documents. The amendment provision in any benefit plan document should require an explicit statement of intent in any document to be treated as a plan amendment (and perhaps a specific reference to the amendment provision of the plan) in order to avoid unintended plan amendments with similarly unintended consequences.

In *Evans*, several affiliated entities (collectively, Cytec or sellers) were selling their interests in an acrylic fibers business to a subsidiary of Sterling Chemicals pursuant to an asset purchase agreement. The sellers provided retiree medical benefits to their employees and, with respect to their employees who were hired by the buyer, obtained the buyer's agreement to provide retiree medical benefits on the same terms as provided by sellers to their employees from time to time. The asset purchase agreement included an explicit provision against intended third-party beneficiaries.

Retiree medical coverage for the transferred employees was provided, after the closing date of the purchase transaction, under Sterling's retiree medical plan, but such plan was not formally amended to address the inclusion of sellers' transferred employees. Sterling's retiree medical plan and the accompanying summary plan description included a provision reserving to Sterling the absolute right to amend or terminate the plan.

The asset purchase agreement executed by sellers and buyer was approved by Sterling's board of directors and accordingly met the literal requirements in Sterling's retiree medical plan as to the form of plan amendments. The Fifth Circuit, following its decision in *Halliburton*, concluded that the provisions in the asset purchase agreement constituted an amendment of Sterling's retiree medical plan.

In *Halliburton*, a merger agreement between Halliburton and Dresser Industries contained a covenant requiring Halliburton to maintain the Dresser retiree medical plan as in effect on the closing date of the merger, except to the extent that any modifications were consistent with Halliburton's medical plans for its own similarly situated employees. Halliburton sought to modify the Dresser retiree medical plan to make retirees responsible for future premium increases in a manner inconsistent with the treatment of Halliburton's similarly situated employees.

The Fifth Circuit in *Halliburton* found that, consistent with the requirements set forth in the plan document (including the procedure for plan amendments and approval by the persons authorized to amend the plan), certain provisions in the merger agreement satisfied those requirements and thus constituted a plan amendment, even if the provision is not labeled as a plan amendment. In other words, the retiree medical benefits provision in the merger agreement constituted an amendment to Dresser's retiree medical plan.

Neither the asset purchase agreement in *Evans* nor the merger agreement in *Halliburton* included an express statement that the agreement was not intended to modify or amend any particular employee benefit plan. The Fifth Circuit declined to opine in *Evans* and *Halliburton* as to whether such a provision would have changed the outcome of the case. Note that the Fifth Circuit disregarded as inapplicable specific provisions in the relevant transaction agreements that explicitly disclaimed the creation of any third-party beneficiary rights under such agreements.

In view of *Evans* and *Halliburton*, to avoid unintended plan amendments, the amendment provisions in benefit plan documents should be written in a manner that requires a specific intent for any document to be treated as a plan amendment, *e.g.*, by requiring an explicit reference to the plan amendment provisions in the benefit plan document as part of any valid plan amendment.

Tiffin v. Lester Aldridge: Can a Fixed-Share Partner Be Held To Be an Employee in the UK?

By Ivor Gwilliams

Introduction

The Court of Appeal's recent judgement on *Tiffin v. Lester Aldridge* reaffirmed the Employment Appeal Tribunal's (EAT) decision on a matter which began in the Employment Tribunal (ET), and concerned a fixed-share partner of a limited liability partnership (an LLP), who argued (after he was dismissed) that he had, in fact, been an employee and was, therefore, entitled to bring a statutory employment claim in relation to his dismissal. The Court of Appeal agreed with the fundamental decision, reached by both tribunals, that despite the often marked discrepancies in terms of profit-sharing and decision-making power that can (and in this case did) exist between fixed-share partners and full equity partners, a fixed-share partner is, indeed, a partner and not an employee of the partnership provided that the parties enter into the membership agreement in the full knowledge of the terms of the partnership.

This ruling, which is summarised below, provides some comfort for professional services firms, private equity houses, and other firms in the financial sector that are established as partnerships or LLPs and that make use of the position of a fixed-share partner. It should be borne in mind that each case will be decided ultimately on its particular facts and, therefore, one cannot be absolutely certain that a so-called fixed-share partner will not be found to have employment status. It will also be appreciated that such claims tend to be brought not when an individual agrees to become a fixed-share partner but rather on their removal as a member of the partnership. Having said that, this summary will provide guidance as to how partnerships and LLPs in the UK can avoid their relationship with fixed-share partners being considered to be one of employer and employee.

Why Does the Distinction Between a Partner (or Member) and an Employee Matter in the UK?

There are a number of statutory rights that an employee will have that differ from those of a partner. In particular:

- partners, unlike employees, do not qualify for statutory employment protection, such as the right not to be unfairly dismissed and the right to receive a statutory redundancy payment on redundancy;
- partners do not have statutory parental rights, such as the right to maternity leave, paternity leave, or adoption leave;
- post-termination restrictive covenants may stand a better chance of being enforceable against partners, where, in theory at least, the bargaining power between the covenantor and the covenantee is on a more equal footing;
- there are likely to be tax advantages to the partnership in terms of the employers' national insurance contributions (*i.e.*, employer social security contributions) that employers must account for in respect of employees' pay (currently at 13.8 percent).

Having said that, in reality, the precise terms of a partnership/LLP agreement may narrow the distinctions between partner and employee rights. For example, a partnership/LLP agreement may provide partners with maternity/paternity rights as a matter of contract. Furthermore, whilst a partner may not qualify for statutory employment protection and, therefore, cannot bring a claim for unfair dismissal, partners do have discrimination rights, which are potentially more valuable than unfair dismissal rights. Unfair dismissal compensation is capped (approximately at £85,000) unless the reason for the dismissal is the employee having "blown the whistle" about, say, financial irregularities or breaches of health and safety legislation, whereas compensation for discrimination is not capped.

The absence of one or more factors indicating partner status does not prevent partner status from being found to subsist.

What Factors in the UK Make an Individual a Partner Rather Than an Employee?

It has been left to case law to determine, in practice, what distinguishes a partner from an employee. Although the name given to the relationship and, more importantly, the documentation that dictates the terms of the relationship are key considerations, a number of other factors pertaining to the substance of the arrangement need to be considered. These include:

- whether the individual participates in the partnership's/LLP's decision making and management;
- whether the individual makes a capital contribution;
- whether the individual is entitled to a share in the partnership's/LLP's surplus assets;
- the degree of control the individual has over the day-to-day operations of the partnership, including having authority to sign cheques on behalf of the firm and the right to hire and dismiss the firm's employees;
- whether the individual receives fixed remuneration notwithstanding the profits or losses of the partnership/LLP;
- whether the individual receives an express or implied indemnity against debts and liabilities to the firm from other partners, or merely a contribution towards those owed to third parties.

What were the relevant facts of the case?

Mr. Tiffin was promoted to the status of a fixed-share partner of the Lester Aldridge partnership in May 2006. Thereafter, he received monthly drawings based on an annual fixed share of profits instead of a salary and was entitled to receive a share of the overall profits equivalent to five "profit share points." He made a £5,000 capital contribution to the firm and became an authorised signatory on the firm's client and office bank accounts. On the day before Mr. Tiffin signed the partnership agreement, the firm issued him with a P45 (tax) form confirming the end of his employment contract. He became responsible for accounting for his income tax and, accordingly, the rate of his national insurance contributions changed. Mr. Tiffin received additional benefits from the firm, which he was not entitled to as an employee and could claim back various expenses which were incurred during the course of his work.

In April 2007, Lester Aldridge converted to LLP status and all of the equity partners and fixed-share partners of the firm signed the LLP agreement. Mr. Tiffin was required to contribute another £1,250 to the capital of the partnership, now an LLP. At the ET hearing, Mr. Tiffin claimed that he had been coerced into signing this agreement. However, this was rejected by the judge, who decided that he was a willing participant in this respect.

How Did *Tiffin v. Lester Aldridge* Advance the Law?

The case highlighted two key points, which were as follows:

- the absence of one or more factors indicating partner status does not prevent partner status from being found to subsist; and
- it does not matter that the degree to which a factor is present is small.

At the EAT hearing, Mr. Tiffin argued that he could not be considered a genuine partner as he did not participate in the LLP's key management decisions and his share of any equity profits was so small in comparison with the equity partners as to be an inconsequential factor in determining his status. In addition, he argued that the practical circumstances of his work relationship, such as the requirement that he work certain core hours and that he was reliant on others for work, as well as the circumstances of his dismissal, indicated that there was an employment relationship.

The EAT dismissed Mr. Tiffin's arguments on the basis that there is no minimum threshold of rights to profits and participation in management decisions that has to be attained before an individual can be considered to be a partner and no requirement that a partner must be able to act independent of the authority and direction of other partners.

The ruling does not offer a fait accompli that labelling an individual as a fixed-share partner will ensure that they are not afforded the status and rights of an employee.

Even though Mr. Tiffin had only limited rights in relation to attending and voting at partnership meetings, even though he contributed only £6,500 of capital to the partnership (a fraction of what its full equity partners had contributed) and even though he was entitled to a relatively small share of residual profits and losses in addition to his fixed share of profits, he was found to be a partner and not an employee. The essential characteristics – *i.e.*, the making of a capital contribution, the receipt of a share of profits (as opposed to a salary), the right to a share of the surplus profits on a winding-up of the partnership, and the right to participate in partnership meetings – were all consistent with Mr. Tiffin being a partner, as opposed to an employee.

Guidance

Whilst there is no doubt that the Court of Appeal's decision supports the notion that a fixed-share partner is a genuine partner, notwithstanding the discrepancies the may exist between the status of fixed-share partners and full equity partners, the ruling does not offer a fait accompli that labelling an individual as a fixed-share partner will ensure that they are not afforded the status and rights of an employee. Partnerships and LLPs still need to ensure that the practical realities of the relationship are such that a court will not consider the partnership agreement to be a sham.

Steps that can be taken to ensure this include:

- ensuring any appropriate documentation (*e.g.*, the partnership/LLP agreement) is in place and properly executed by all parties;
- ensuring that any documentation addresses the key factors attributable to true partner status (such as capital contributions, profit sharing, involvement in management decision making, rights to the surplus assets of the partnership/LLP on winding up, and the individual's rights to make decisions (such as signing cheques) on behalf of the partnership/LLP); and
- ensuring that the documentation accurately reflects the reality of the situation in order that it will not be seen as a sham.

Conclusion

Whilst there may be few differences, in practice, between a fixed-share partner and a senior employee or salaried partner, these few differences are likely to be decisive. Therefore, the greater the number of factors that indicate partner status that can be documented in any LLP agreement, even if (as was the case in *Tiffin v. Lester Aldridge*) only to a limited degree, the less likely the intended relationship between the parties will be called into question.

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