

Labor and Employment Law

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Harassment

Affirmative Defense Against Claim Of Sexual Harassment Is Upheld

Leslie McPherson worked for the City of Waukegan. According to her, a supervisor not only engaged in verbal sexual harassment, he deliberately put his hand on her breast and then put his hand down her pants. McPherson asked him to stop and left his office. She then reported the incidents to a City attorney. That same afternoon, the supervisor was given the option of a suspension pending an investigation or immediate resignation. The supervisor agreed to resign. McPherson was given 30 days of paid leave to "recover" from this improper sexual touching. McPherson took the leave, and then demanded an additional 90 days of paid leave. When the City declined to provide this additional paid leave, McPherson's attorney tendered McPherson's resignation. McPherson then filed suit in the U.S. District Court for the Northern District of Illinois, alleging unlawful sexual harassment in violation of Title VII and a violation of state law for the assault.

The lower court judge found in favor of the City on the Title VII claim, holding that the affirmative defense allowed by the Supreme Court in *Faragher* and *Ellerth* precluded liability in this case. The judge also dismissed the state law claim, finding that it was preempted by the Illinois Workers' Compensation Act. On appeal, the Seventh Circuit (which covers Illinois, Indiana and Wisconsin) agreed. *McPherson v. City of Waukegan*, No. 03-2738.

In affirming the judgment for the City based on the *Faragher/Ellerth* affirmative defense, the

Seventh Circuit noted that to establish this defense the City must prove that there was no "tangible employment action" taken against McPherson. McPherson argued that she was subjected to a tangible employment action, because she was constructively discharged. The

Seventh Circuit disagreed, noting that McPherson did not resign until months after the supervisor had left. Because the hostile environment did not exist at the time of her resignation and the City had encouraged McPherson to return to work, the Seventh Circuit concluded that the resignation did not constitute a

constructive discharge. Furthermore, the court noted that: the City was not aware of the physical assault until McPherson's complaint; upon learning of the misconduct it promptly took steps to correct and prevent future incidents; the City had maintained and disseminated its sexual harassment policies; and McPherson failed to avail herself of the City's policies.

This case is a good example of the importance of having a comprehensive harassment policy and being able to prove that the employer is following its policy. The Seventh Circuit's holding that a constructive discharge cannot occur if the alleged harasser has been (constructively) discharged before the victim of the harassment resigns is also an important development.

The holding that a constructive discharge cannot occur if the alleged harasser had been discharged before the victim of the harassment resigns is an important development.

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Harassment

California Passes Mandatory Harassment Training Law

California leads the nation again in passing an innovative employment law. The State's newest twist is a law requiring employers with 50 or more employees to provide sexual harassment training to all supervisory employees. Effective January 1, 2006, employers *must* provide at least two hours of classroom or other effective training to all supervisors who are employed as of July 1, 2005, and to every new supervisor within six months of his or her date of hire. The training must be repeated to all supervisors every two years.

The California law specifies the information that must be conveyed in the mandatory training. The training must provide information and practical guidance regarding federal and state law pertaining to harassment, must explain the remedies available to victims of harassment, and must include practical examples. The training must be given by individuals with expertise in the preven-

tion of discrimination, harassment, and retaliation. Presumably, regulations will be in effect by mid-2005 so that employers will know who qualifies to perform the training. However, the mere fact that an employer conducts the mandatory training in accordance with the law

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does not automatically insulate the employer from liability for harassment.

Although the California law is significant in that it contains specific mandatory training requirements, it has long been important for all employers throughout the country to provide harassment training—particularly since the Supreme Court's 1998 *Ellerth* and

Faragher decisions. In *Ellerth* and *Faragher*, the Supreme Court created an affirmative defense to harassment liability for employers who take steps to prevent and correct workplace harassment, and numerous courts have found that employee training is essential to establishing such an affirmative defense. By conducting and documenting training of employees in accordance with the California statute, an employer will not only be in compliance with this new state law, the employer should also be well on the road to establishing an affirmative defense under *Ellerth* and *Faragher*—which, as shown in the *McPherson* case discussed above, can be extremely important to an employer defending against a harassment claim.

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OFCCP

OFCCP Gets Bank To Pay \$5.5 Million For Pay Discrimination

As we have noted in previous articles regarding the Office of Federal Contract Compliance Programs (“OFCCP”) (the agency that enforces the federal government’s affirmative action requirements for government contractors), the OFCCP is now focused on class action-type relief. A good example of their current orientation is a settlement that the agency recently negotiated with Wachovia Corp.

Based on a review of First Union National Bank’s corporate headquarters in 2001, the OFCCP determined that First Union had discriminated against female employees with respect to compensation. Approximately one month after a complaint was issued against First Union, the bank merged with Wachovia. In September 2004, the DOL announced that Wachovia has agreed to pay 2,021 current and former female employees a total of \$5.5 million in backpay and interest, as well as agreeing to undertake “extensive self-monitoring meas-

ures” over the next three years and to correct any statistically significant disparities in the compensation of its female employees. In announcing the settlement, Labor Secretary Elaine Chao said the \$5.5 million settlement “should put all federal contractors on notice that the Labor Department is serious about eliminating systemic discrimination against women.”

It is not only government contractors who are well-advised to do an analysis of their employees’ compensation to ensure that there is no statistical disparities between employees of different races or genders. In order to minimize any vulnerability to litigation for discrimination it is a good practice for all employers subject to federal and/or state anti-discrimination laws to periodically do a confidential wage review.

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ALJ Says Confidentiality Clause In Handbook Violates NLRA

For the past two years, UNITE HERE (a merger of the Union of Needletrades, Industrial and Textile Employees and the Hotel Employees and Restaurant Employee International Union) has been attempting to organize Cintas Corporation, a nation-wide supplier of uniforms. As a result of this long-running battle, the Union has filed numerous unfair labor practice charges. Recently, an Administrative Law Judge (“ALJ”) for the National Labor Relations Board (“NLRB”) ruled against Cintas on an issue that has implications for many other employers. *Cintas Corp.*, Case No. 13-CA-40821.

The Complaint charging Cintas with unfair labor practices involved a number of issues, including claims that the Company had unlawfully threatened employees if they brought in the Union. On most of the issues, the ALJ determined that the testimony from Cintas’ management employees was more credible than the testimony of the employees involved in the union organizing drive. However, the ALJ recommended a decision against Cintas with respect to a statement in the Company’s employee manual (entitled “Cintas Corporation Partner Reference Guide”). The manual stated that the Company recognizes and protects the confidentiality of information concerning the company and its employees and that “violating a confidence or otherwise releasing confidential information. . . could result in disciplinary action.” According to the ALJ, this provision violates the National Labor Relations Act because the employees could reasonably construe it as restricting their right to discuss their wages and terms and conditions of employment with their fellow employees or with the Union.

Cintas claimed that this interpretation of its manual is much broader than the Company’s intent, and that it had never disciplined any employee for having discussed his/her wages or terms and conditions of employment. Nevertheless, the ALJ ruled that any ambiguity in the employee manual must be interpreted in the employee’s favor and against the Company—even if the rule is not enforced. Although the ALJ stopped short of requiring Cintas to deliver individual written notices to all of its 27,000 workers in North America (as requested by the Union), the ALJ did recommend that the NLRB order Cintas to amend its manual to take out the offending language and to attach a letter to each of the amended manuals notifying employees of the changes in the manual. Also, he recommended that Cintas post notices of employees’ rights at *each* of the Company’s more than 300 U.S. facilities.

It is expected that the Union will challenge the ALJ’s findings in favor of Cintas, while Cintas will challenge the finding against it. Eventually, the NLRB will have to rule on whether Cintas’ manual violates the NLRA. In the meantime, employers would be well-advised to review their handbooks to eliminate provisions which may be interpreted as prohibiting employees from discussing their wages and terms and conditions of employment with their co-workers—or risk having to deal with an unfair labor practice charge.

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Section 703

Federal Income Taxation Of Employment Law Costs/Attorney’s Fees Curtailed

Effective October 22, 2004, Section 703 of the American Jobs Creation Act of 2004 will make employment law settlements somewhat easier and cheaper. Essentially, the new law eliminates federal income taxation of claimants’ receipt of attorneys fees and costs, whether awarded in a judgment or agreed to in a settlement. Under Section 703, the complicated situation caused by the application of the Alternative Minimum Tax—which in some situations meant paying more in taxes than the amount actually received by the claimant—will no longer be an

obstacle to settlement. Instead, an employee can deduct the full amount of attorneys’ fees and court costs paid in connection with most employment-related cases, up to the amount of income received as a result of the claim.

The new statute explicitly covers claims under Title VII, the NLRA, the FLSA, the ADEA, the Rehabilitation Act of 1973, ERISA, Title IX, the Employee Polygraph Protection Act, the FMLA, USERRA, and the ADA, among others. The statute also broadly covers claims under “[a]ny provision of Federal law (popularly known as

whistleblower protection provisions) prohibiting the discharge of an employee, the discrimination against an employee, or any other form of retaliation or reprisal against an employee for asserting rights or taking other actions permitted under Federal law.” and “[a]ny provision of Federal, State, or local law or common law claims. . . (i) providing for the enforcement of civil rights” or “(ii) regulating any aspect of the employment relationship. . . .”

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Employee Arbitration Agreements

Illinois Appellate Court Sets Tough Standard For Enforcement Of Employee Arbitration Agreements

On September 22, 2004, the Fifth District Appellate Court of Illinois affirmed a lower court's refusal to dismiss an employee's Workers' Compensation retaliation suit and to enforce the arbitration clause of an employment agreement entered into several years after the employee had been hired. In doing so, the Appellate Court imposed a new "knowing and voluntary" standard for such arbitration employment agreements and perhaps, more disturbingly, opined that the "voluntary" piece of the standard could only rarely be met. *Melena v. Annheuser-Busch Inc.*, No. 5-03-0805.

Exploring the tension between the strong public policy favoring the enforcement of arbitration agreements and the strong public policy in favor of enforcing Workers' Compensation retaliatory discharge claims, the Appellate Court began with a review of the Illinois Supreme Court case of *Midgett v. Sackett-Chicago, Inc.*, then quickly turned to federal precedent.

In reviewing federal law, the Appellate Court closely analyzed two Ninth Circuit cases, several Seventh Circuit cases and a few marginally-relevant U.S. Supreme Court cases to conclude:

We find the Ninth Circuit's knowing-waiver analysis persuasive. We acknowledge that this approach has not garnered universal support. Although the First and Seventh Circuits have endorsed the Ninth Circuit's approach without adopting it... the Third and Eighth Circuit Courts of Appeals have both expressly rejected it...

Applying the new "knowing and voluntary" standard that it had just created to the facts at hand, the Appellate Court found that the evidence was insufficient to determine whether the "knowing" standard was met, but held that the arbitration agreement was in no way "voluntary":

We have serious reservations regarding whether an agreement to arbitrate

offered as a condition of employment is ever voluntary. See *Gibson*, 121 F.3d at 1132 (Cudahy, J., concurring) (explaining that "we are dealing in most cases with a contract of adhesion: agree to arbitrate or lose your job")... When a job applicant is presented with an arbitration agreement as a condition of employment, the prospective employee is faced with a choice between accepting the arbitration agreement or continuing to search for a position that does not include such a requirement. That is a troubling enough scenario in its own right, but in the instant case, the plaintiff had even less volition in the matter than the typical job applicant. Her "choices" were to continue her employment, thereby automatically agreeing to the dispute resolution policy, or resign. Counsel for the defendant admitted at oral argument that the plaintiff would have been terminated had she refused to accept the policy. This left her with no viable options. The Court then concluded with a minor sop to employers:

We do not hold that employers and employees may never prospectively agree to arbitrate statutory claims. Where, for example, a highly skilled employee is genuinely in a position to negotiate the terms of an employment contract that contains an arbitration agreement, we might find that the employee's consent was knowing and voluntary. However, where an employee is told to "agree" to arbitrate statutory claims or be fired, any agreement so obtained is not voluntary and violates the public policy of this state.

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NEW DEFERRED COMPENSATION LEGISLATION REQUIRES ACTION BY MANY EMPLOYERS

The American Jobs Creation Act of 2004 will significantly change how nonqualified deferred compensation will be taxed. As a result, all employers will need to review their nonqualified deferred compensation plans prior to January 1, 2005, to ensure they will continue to operate as intended after that date.

WHAT PLANS ARE SUBJECT TO THE NEW REQUIREMENTS?

Generally, all nonqualified deferred compensation plans are subject to the new requirements. A nonqualified deferred compensation plan (an "NQ Plan") is any plan that provides for the deferral of compensation, other than a "qualified employer plan" or a bona fide vacation leave, sick leave, compensatory time, disability pay, or death benefit plan. A qualified employer plan is:

- ♦ A qualified retirement plan described in Section 401(a) of the Internal Revenue Code (the "Code");
- ♦ An annuity plan described in Code Section 403(a);
- ♦ A plan established by the United States for its employees, or by a state or political subdivision or by an agency or instrumentality of any of the foregoing;
- ♦ An annuity contract described in Code Section 403(b);
- ♦ A simplified employee pension;
- ♦ Any simple retirement account;
- ♦ An eligible deferred compensation plan for state and local employees and tax-exempt organizations maintained under Code Section 457(b); or
- ♦ A qualified governmental excess benefit arrangement under Code Section 415(m).

A nonqualified stock option is not covered by these new rules if the exercise price is at least equal to the fair market value of the stock on the date of grant and the option does not have a deferral feature other than the right to exercise the option in the future. Qualified or incentive stock options, qualified employee stock purchase plans, or annual bonuses or other amounts paid within two and one-half months after the end of the taxable year in which services are performed are also not subject to these new rules.

The new rules are not limited to employees. Deferred compensation paid to a director, consultant or other independent contractor will also be subject to these new rules.

WHAT ARE THE NEW REQUIREMENTS?

There are three specific requirements that must be met to

avoid an acceleration of taxation. These are a distribution requirement, an acceleration requirement, and an election requirement. If any of these requirements is not met, the deferred compensation will be taxed as soon as it is vested.

Distributions

The distribution requirement is met if the NQ Plan provides that compensation deferred under the plan may not be distributed to a participant earlier than:

- ♦ The date the participant separates from service;
- ♦ The date that the participant becomes disabled;
- ♦ The date of the participant's death;
- ♦ A time (or times) specified under the NQ Plan at the date of the deferral (e.g., the participant's 65th birthday);
- ♦ To the extent provided by the Secretary in future guidance, a change in the ownership or effective control of the corporation, or in the ownership of a substantial portion of the assets of the corporation; or
- ♦ The occurrence of an unforeseen emergency.

In the case of a "specified employee" of a public corporation, the separation from service requirement will be met only if distributions may be made no earlier than six months after the date of a separation of service (or, if earlier, the date of the death of the employee). A "specified employee" is any employee who is an officer of the corporation having an annual compensation greater than \$130,000, a five percent owner of the corporation, or a one percent owner of the corporation having annual compensation from the employer of more than \$150,000.

An unforeseen emergency is defined as a severe financial hardship to the participant resulting from an illness or accident of the participant, the participant's spouse, or a dependent of the participant, loss of the participant's property due to casualty, or other similar or extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant. A distribution will meet the unforeseeable emergency exception only if the amounts distributed with respect to an emergency do not exceed the amounts necessary to satisfy such emergency and pay any taxes reasonably anticipated as a result of the distribution, after taking into account the extent to which such hardship is or may be relieved through reimbursement or compensation by insurance or otherwise, or by liquidation of the participant's assets (to the extent the liquidation of such assets would not itself cause severe financial hardship).

Acceleration of Benefits

This requirement is met if the NQ Plan does not permit the acceleration of the time or schedule of any payment under the plan, except as may be provided in future regulations.

Elections

The new requirements include rules for initial elections and for changes in elections. The initial election requirement will be met if the NQ Plan provides that compensation for services performed during a taxable year may be deferred only if the election to defer such compensation is made no later than the close of the preceding taxable year, or at such other time as may be provided in the regulations. For the first year in which a person becomes eligible to participate in the NQ Plan, an election must be made within 30 days after the date the person becomes eligible to participate in the plan.

For performance-based compensation based on services performed over a period of at least 12 months, the election must be made no later than six months before the end of the period. For example, if a participant is entitled to a bonus depending upon the performance of the employer over a 24-month period starting on January 1, 2005, the participant can elect to defer a portion of the bonus as long as the election is made no later than six months before the end of the 24-month period, or July 1, 2006.

For an NQ Plan that allows a subsequent election to delay a payment or change the form of payment, the plan must require that the deferral election not take effect until at least 12 months after the date on which it is made. In the case of an election related to a payment other than by reason of disability, death, or unforeseen emergency, the NQ Plan must require that the first payment with respect to which the deferral election is made be deferred for at least five years from the date such payment would otherwise have been made. Lastly, with respect to any payments to be made at a specified time or pursuant to a fixed schedule, the NQ Plan must require the deferral election to be made no less than 12 months prior to the date of the first scheduled payment.

WHAT HAPPENS IF THESE REQUIREMENTS ARE NOT MET?

If at any time during a taxable year an NQ Plan fails to meet any of the three requirements described above, or is not operated in accordance with those requirements, then all compensation deferred under the plan for the taxable year and all preceding years is includable in gross income. However, inclusion is not required if the deferred amounts are subject to a substantial risk of forfeiture, or if they were previously included in gross income. Also, the inclusion in income only applies to the participant to which the failure applies.

If compensation is required to be included in gross income

because of a failure to comply with these requirements, the tax imposed on that income is increased by both interest and an amount equal to 20 percent of the amount required to be included in income. With a current maximum individual tax rate of 35 percent, this latter provision could impose a federal tax of 55 percent on the taxable amounts. Interest is determined at the underpayment rate (currently five percent) plus one percent, and it applies to the underpayment in tax that would have occurred had the deferred compensation been includable in gross income for the year in which first deferred, or if later, the first year in which such deferred compensation is not subject to a substantial risk of forfeiture.

WHEN ARE THESE NEW RULES EFFECTIVE?

These new rules apply to deferrals after December 31, 2004. Therefore, it is necessary for every sponsor of an NQ Plan to review the plan to ensure that it will meet the new requirements. Amounts deferred under a plan prior to January 1, 2005, are not subject to these rules unless the NQ Plan is materially modified after October 3, 2004. Thus, an NQ Plan that does not meet these requirements but under which no additional amounts will be deferred, will not be subject to these new rules as long as the plan is not materially modified. However, if the sponsor wishes to continue the NQ Plan, then it will be necessary to amend the plan, effective as of January 1, 2005, to meet these new requirements.

Will a modification of an NQ Plan to meet the new requirements be treated as a material modification? The Act provides that no later than 60 days after the date of enactment, the Secretary of the Treasury is to issue guidance providing a limited period during which an NQ Plan adopted before December 31, 2004, may, without violating the three new requirements, be amended to conform to the new requirements for amounts deferred after December 31, 2004.

WHAT SHOULD YOU DO IF YOU HAVE AN NQ PLAN?

If you have an NQ Plan that you wish to continue after 2004, it needs to be reviewed to determine whether it satisfies the new requirements. If not, it will be necessary to amend the plan to do so. However, before any such amendment is made, you should await issuance of guidance by the Treasury to ensure that the changes that are made do not constitute a material modification that could result in the new rules being applicable to prior deferrals. Also, if at any time you desire to make a change to your NQ Plan, you should obtain qualified counsel that such change will not constitute a material modification that could result in an acceleration of tax consequences.

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