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L&E Newsletter

A publication of the Labor and Employment Law Section
of the New York State Bar Association

A Message from the Section Chair

Robert Kingsley (Kayo) Hull

Section Performance and Opportunities

I'll pick up where I left off in the previous issue of the *L&E Newsletter*: with NYSBA President Kathryn Grant Madigan's pledge to focus the Association on "the basics of service to its members" and Section accountability.

Ours is a voluntary bar association, and the 23 substantive law Sections within NYSBA are even more voluntary: you can join the Association and pass on the Sections. Everyone receiving this publication has made an affirmative choice to increase his or her annual dues by $25 and join the Labor and Employment Law Section. For that we are grateful.

Surveys tell us that you join the Section to support and access cutting-edge CLE and to network with colleagues. The Section's Fall Meeting on the Cornell campus in Ithaca in late September did not disappoint. The informal feedback during the meeting was very positive: one attendee's comment to CLE Co-Chair Alan Koral—"Others promise, you deliver"—put it nicely. The anonymous evaluations collected by NYSBA staff after each session were consistent with that comment. (On page 7, CLE Co-Chair Stephanie Roebuck reports in detail on the Fall Meeting program.)

Attendance at our January and September meetings in 2007 was near all-time highs, and the proportion of our members attending Section meetings is on the high end among NYSBA Sections. Thanks to Alan and Stephanie, their colleagues on the CLE Committee, and their predecessors, the Section is known for the relevance and immediacy of its CLE topics and the skill and preparation of its CLE presenters.

Help Wanted: CLE; Section Website; Publications

Which takes me to my next subject: opportunities to become more involved in the Section's activities.

(1) **CLE**. Alan and Stephanie would be delighted to have your ideas for subjects and programs. The many new faces among our Fall Meeting presenters (at least 30 of the 39 speakers, by my count)

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testify to the fact that the door is wide open to your participation. Alan's and Stephanie's addresses and e-mail addresses appear on p. 61 of this *L&E Newsletter*.

(2) **Website**. The Section's website needs to be reimagined. It is not particularly user friendly or intuitive. We would like to offer our members an inviting, accessible website that can be a frequently consulted resource for all of our constituencies: counsel for unions, employers, individual plaintiffs, and government agencies. Is there a member (or a prospective member whom you know and could send our way) who could help lead that effort? Beyond the redesign, the Labor and Employment Law Section's website needs regular updating to stay fresh; a webmaster team needs to be assembled for that ongoing task. Now, if ever there was an opportunity to make your mark in the Section . . .

Do you have a favorite website you feel would serve as a good model for ours? (One of mine, in terms of simplicity of design and resulting ease of navigation, is the IRS website.) All suggestions are welcome. Website volunteers can get in touch with me by e-mail at kayo@arbit.com, and website ideas can be forwarded there as well.

(3) ***L&E Newsletter***. In a Section survey conducted by the Association a few years ago, this publication was one of our members' most popular Section benefits. Janet McEneaney, its editor, always welcomes articles and will be happy to discuss your nascent ideas and provide you with guidance and encouragement along the way.

This publication may need a new name, since with its emphasis on practical scholarly writing it has become more of a *Journal* than a *Newsletter*. If there is a Section member who would be interested in producing a monthly or semimonthly Section newsletter for e-distribution (perhaps serving as a gateway to our website), please get in touch with me.

Robert Kingsley (Kayo) Hull

Request for Articles

If you would like to have an article considered for publication, please telephone or e-mail me. When your article is ready for submission, you can send it to me by e-mail in WordPerfect or Microsoft Word format.

Please include a letter granting permission for publication and a one-paragraph bio.

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From the Editor

Janet McEneaney

At the end of September, the Fourth Department issued a decision in *Hauzinger v. Hauzinger* concerning mediator confidentiality. I asked Brett Peter Linn to write an article about the case, which has broad implications for almost all of us in New York. Keith Gutstein and Troy Kessler submitted an Albany Update, dealing with issues ranging from changes at the Human Rights Division to misclassification of workers. We have a report from CLE Committee Chair Stephanie Roebuck about the recent Fall Annual Meeting. Don Dowling writes another great column about practicing international employment law, and Diane Pfadenhauer enlightens us about successfully meeting WARN Act requirements. We have an article about the duty of loyalty within business organizations by David Morris and a note about supervisory liability by Andrew Schatkin. In addition, there are articles about labor and employment law in China, illegal immigrant workers and the mysteriously named GASB 45. This issue also includes the Third-Place winner in the Section's 2006 Dr. Emanuel Stein Writing Competition. I believe there is something for everyone here.

Finally, it has been several issues since I thanked the two people without whom this *Newsletter* would never appear in your mailbox: Lyn Curtis and Wendy Harbour of the NYSBA Publications Department.

NLRB Changes Course on Hiring At-Will Permanent Replacement Workers

A recent decision by the National Labor Relations Board makes it easier for employers to hire at-will permanent replacement workers. In *Jones Plastics and Engineering Co.*,[1] the Board revisited its 1997 *Target Rock* decision, in which it ordered the reinstatement of replaced striking employees.[2]

The employer in *Target Rock* had its replacement employees sign a boilerplate at-will statement providing, "I understand that the employer follows an employment-at-will policy in that I or the employer may terminate my employment at any time, or for any reason consistent with applicable state or federal law." The Board held that this statement violated Section 8(a)(3) of the National Labor Relations Act because it did not support the employer's position that the replacements were permanent.

In *Jones Plastics*, the Board found that the employer had shown proof of permanent status because it had the replacement workers sign statements before beginning employment which said they were permanent replacements for employees presently on strike. In the absence of other evidence that the replacements were temporary, the employer established that the replacement workers were permanent even though there was an at-will disclaimer in the statement they signed. The Board cautioned, however, that it would continue to examine job advertisements and other communications with replacement workers to determine their status.

NLRB Finds Some New York Graduate Students Are Employees

In two recent companion cases, decided on the same day, the National Labor Relations Board found that some graduate students employed by private research foundations affiliated with universities are employees, and thus entitled to representation.[3]

Unions petitioned to represent Research Assistants employed by the Research Foundations of the State University of New York and City University of New York Graduate Center. The Regional Director found that these Research Assistants were within the meaning of Section 2(3) of the National Labor Relations Act.

The Research Foundations argued that the Board's decision in *Brown University*[4] precluded a finding that the Research Assistants in dispute were employees. The Regional Director, however, found that *Brown University* did not apply under the facts of these cases, and the Board agreed. It found that, unlike the circumstances in *Brown*, the Research Foundations are not educational institutions. The Research Assistants' primary relationship with their employers is economic rather than educational.

Here We Go Again! California, Circuit City and Predispute Arbitration Agreements

In another round of what seems to be the unending karmic relationship of Circuit City Stores and its employees concerning predispute arbitration agreements, the California Supreme Court found that predispute arbitration agreements barring class actions are unenforceable if the class action would more effectively vindicate employee rights.[5]

In 2002, Robert Gentry filed a claim on behalf of himself and other salaried customer service managers whom he said had been illegally misclassified as exempt employees. When he was hired by Circuit City in 1995, Gentry received a packet that included a predispute arbitration clause. The arbitration agreement prohibited consolidation of claims and class arbitration, and it limited damages and recovery of attorney fees proceeding. The packet included a form by which Gentry could opt out of the agreement, but he declined to do so.

At the time Gentry filed his claim, the California courts were split as to the enforceability of class action waivers in predispute agreements. When Circuit City moved to compel arbitration, the court, citing various precedential decisions, ordered Gentry to arbitrate his individual claim and abide by his previous class action waiver. It did, however, find that the provisions for cost splitting and limitation of remedies were unconscionable.

In 2005, the California Supreme Court found some class action waivers to be unconscionable in the context of consumer litigation and stated:

> [w]e do not hold that all class action waivers are necessarily unconscionable. But when the waiver is found in a consumer contract of adhesion in a setting in which disputes between the contracting parties predictably involve small amounts of damages, and when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money, then, at least to the extent the obligation at issue is governed by California law, the waiver becomes in practice the exemption of the party "from responsibility for [its] own fraud, or willful injury to the person or property of another."[6]

The statutory right to receive overtime pay cannot be waived, the court found. In previous cases, the California Supreme Court held that when an employee is bound by a predispute arbitration agreement to adjudicate unwaivable statutory employment rights, the arbitration will be subject to certain minimal requirements:[7] Citing the U.S. Supreme Court's holding in *Gilmer* that a party compelled to arbitrate such rights does not waive them but merely "submits to their resolution in an arbitral, rather than a judicial, forum,"[8] it found that arbitration cannot be used to accomplish a de facto waiver of these rights. It concluded that under some circumstances, a predispute agreement could create a de facto waiver that would interfere with an employee's ability to enforce the overtime laws.

European Court of Justice Finds Public Policy Trumps Age Discrimination Rights

In an important European Union (EU) case just decided, the European Court of Justice (ECJ) held that a compulsory retirement age does constitute direct age discrimination but that it may, in some circumstances, be justified by public policy.[9]

Unionwide laws are formulated in Brussels as directives, but the EU does not directly enact or enforce national laws, and a directive does not take effect directly in Member States. Instead, the European Commission issues deadlines for the Member States to enact legislation to conform with the directives. This means that laws will vary from state to state as to standards and enforcement, although the underlying principles should be the same.[10] It is only recently that all of Europe has become subject to age discrimination laws, and many have been waiting to see how widely the ECJ would apply the somewhat vague wording of the directive.

Directive 2000/78 deals with age discrimination in, among other things, labor and employment. It states, in relevant part:

> *(4) The right of all persons to equality before the law and protection against discrimination constitutes a universal right. . . .*
>
> *(6) The Community Charter of the Fundamental Social Rights of Workers recognizes the importance of combating every form of discrimination, including the need to take appropriate action for the social and economic integration of elderly and disabled people.*
>
> *(8) The Employment Guidelines for 2000 . . . stress the need to foster a labor market favorable to social integration by formulating a coherent set of policies aimed at combating discrimination . . . They also emphasize the need to pay particular attention to supporting older workers, in order to increase their participation in the labor force.*
>
> *(9) Employment and occupation are key elements in guaranteeing equal opportunities for all and contribute strongly to the full participation of citizens in economic, cultural and social life and to realizing their potential.*
>
> *(11) Discrimination based on religion or belief, disability, age or sexual orientation may undermine the achievement of the objectives of the EC Treaty, in particular the attainment of a high level of employment and social*

protection, raising the standard of living and the quality of life, economic and social cohesion and solidarity, and the free movement of persons.

(12) To this end, any direct or indirect discrimination based on religion or belief, disability, age or sexual orientation as regards the areas covered by this Directive should be prohibited throughout the Community. . . .

(13) This Directive does not apply to social security and social protection schemes whose benefits are not treated as income within the meaning given to that term for the purpose of applying Article 141 of the EC Treaty, nor to any kind of payment by the State aimed at providing access to employment or maintaining employment.

(14) This Directive shall be without prejudice to national provisions laying down retirement ages.

(25) The prohibition of age discrimination is an essential part of meeting the aims set out in the Employment Guidelines and encouraging diversity in the workforce. However, differences in treatment in connection with age may be justified under certain circumstances and therefore require specific provisions which may vary in accordance with the situation in Member States. It is therefore essential to distinguish between differences in treatment which are justified, in particular by legitimate employment policy, labor market and vocational training objectives, and discrimination which must be prohibited.

(36) Member States may entrust [labor and management], at their joint request, with the implementation of this Directive, as regards the provisions concerning collective agreements, provided they take any necessary steps to ensure that they are at all times able to guarantee the results required by this Directive.[11]

A Spanish law passed in 2001 provides for mandatory retirement under collective bargaining agreements. The complainant, Mr. Palacios de la Villa, was employed by the Spanish company Cortefiel Servicios SA. His employment was subject to a collectively bargained agreement which stated that employment would be terminated once a worker reached retirement age, as long as the employee qualified for pension benefits.

In July 2005, Mr. Palacios de la Villa reached mandatory retirement age and the employer notified him that employment was automatically terminated. Mr. Palacios de la Villa brought suit in the Spanish courts, claiming that the company violated his right not to be discriminated against on the grounds of his age because the termination was based solely on his attaining the age of 65. The Spanish court referred the matter to the ECJ, asking for an interpretation of Council Directive 2000/78 and a preliminary ruling on the following questions:

- whether the prohibition on age discrimination precludes a national law under which compulsory retirement clauses are lawful where the only factors taken into account are the worker reaching the normal retirement age and conditions in the social security legislation being met; and
- if such national laws are prohibited, whether the Spanish court should apply its national law permitting compulsory retirement under these circumstances.

In his preliminary opinion issued in February 2007, the Advocate General referred to a provision in the Directive which states that "the Directive is to be without prejudice to national provisions laying down retirement ages." The Advocate General construed this to mean that the Directive does not apply to national retirement ages and, as a result, the compulsory retirement age in the Spanish collective agreement is lawful. He found, in addition, that even if the Directive does apply to retirement ages, the compulsory retirement age in this case was justified because it serves a legitimate employment and labor market policy, achieved by appropriate and necessary means; therefore, he asserted, it would not be unlawful.

The ECJ disagreed with the Advocate General on the application of the Directive to national retirement ages. It said that the only effect of the provision in the Directive stating that it was without prejudice to national retirement ages was that member states could determine their own retirement ages. It did not in any way preclude the application of the Directive to national retirement measures. Therefore the prohibition on age discrimination still applied.

The Court held that Directive 2000/78 does not affect the competence of the Member States to determine retirement age. It does, however, apply to national legislation on termination of employment contracts where the retirement age has been reached. Since legislation such as the disputed Spanish law directly imposes less favorable treatment for workers at retirement age, as compared with the rest of the workforce, it creates disparate treatment based on age, which is prohibited by articles 2(1) and (2)(a) of the Directive.

The Court went further and found that the compulsory retirement clause in the contract was part of a national policy seeking to promote better access to employment by distributing work more equitably among the generations. Although this objective was not expressly stated in the Directive, there is enough contextual material to demonstrate that it exists. This public policy—distributing work among the generations—is legitimate, appropriate and necessary, and thus falls within article 6(1) of the Directive. Thus, because the company's compulsory retirement policy was the means to achieving a legitimate social aim, it overrides the fact that automatic termination of employment upon reaching a mandatory retirement age is direct discrimination.

The upshot of this decision is that, although age discrimination in employment is prohibited, an employee will in the future have no grounds to claim unfair dismissal based on age unless he or she can show that the employer failed to comply with statutory retirement procedures.

U.S. Justice Department Files USERRA Claim in Florida on Behalf of Army Reservist

The Department of Justice filed a lawsuit against a county clerk in Florida to defend the rights of a member of the U.S. Army Reserve. The Justice Department claims that the Clerk of the Circuit Court for Hillsborough County violated the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA) by refusing to reinstate the reservist to her civilian employment position, which she would have retained had she not been called up for full-time military duty.

Under USERRA, a reservist called to active duty must be reemployed by the civilian employer in the same position the reservist would have held had he or she not been called to active duty. The complaint also alleges that the County retaliated against the reservist for filing a USERRA claim by transferring her to a different job at a lower rate of pay. The USERRA provides that the Department of Justice may appear on behalf of, and act as attorney for, persons whose complaints are referred to DOJ by the Department of Labor.

Janet McEneaney

Endnotes

1. 351 NLRB No. 11 (2007).
2. *Target Rock*, 324 NLRB 373 (1997).
3. *Research Foundation of City University of New York*, 350 NLRB No. 19, 2007 WL 1946621 (6/29/07); *Research Foundation of State University of New York*, 350 NLRB No. 18, 2007 WL 1946626 (6/29/07).
4. *Brown University*, 342 NLRB 483 (2004).
5. *Gentry v. Superior Court*, 42 Cal. 4th 443, 165 P.3d 556 (Cal. S. Ct. 8/30/07).
6. *Discover Bank v. Superior Court*, 36 Cal. 4th 148, 113 P.3d 1100 (2005).
7. *Armendariz v. Foundation Health Psychcare Services, Inc.*, 24 Cal. 4th 83, 6 P.3d 669 (2000); *Little v. Auto Stiegler, Inc.*, 29 Cal. 4th 1064, 63 P.3d 979 (2003).
8. *Gilmer v. Interstate Johnson/Lane*, 500 U.S. 20 (1991).
9. Case C-411/05, *Palacios de la Villa v. Cortefiel Servicios SA* [2007].
10. If a Member State fails to implement a directive, or implements it incorrectly, an individual might have a cause of action against the State. *See, e.g.*, Case C-6/90 & 9/90, *Francovich and Bonifaci and Others v. Italian Republic* [1991] ECR I-5357; Joined Cases C-46 & C-48/93, *Brasserie du Pecheur v. Bundesrepublik Deutschland* and *R. v. The Secretary of State for Transport, ex parte Factortame* [1996] 1 CMLR 889.
11. Council Directive 2000/78/OJ.

Annual Fall Meeting Report

By Stephanie Roebuck

The Labor and Employment Law Section of the New York State Bar Association held its annual Fall Meeting at the Statler Hotel on the campus of Cornell University in Ithaca on September 28 and 29, when a gathering of 146 attorneys attended continuing legal education programming, socialized with their colleagues and enjoyed the beauty of autumn in the Finger Lakes region.

The Section was honored by the presence of three of the top-ranking state officials in the labor and employment arena. Commissioner of Labor Patricia Smith and Commissioner of Human Rights Kumiki Gibson presented at the meeting's first plenary session which was chaired by David Raff (Raff & Becker, LLP). Both Commissioners discussed the changes in state law specific to their respective jurisdictions, their mandates for the upcoming year and the changes they are making in their Departments. Among the many changes announced by Commissioner Smith are the creation of a new office dealing with labor issues faced by immigrants, community outreach among immigrant population and other groups to identify violations of the labor laws, and active participation on the Governor's Task Force identifying employees who are misclassified as independent contractors. Commissioner Gibson stressed that the ratio of the number of proceedings resulting in a "probable cause" determination has changed under her jurisdiction from one in ten to one in three, and that she has issued a mandate to her staff to handle complaints in a more expeditious manner. That evening, Jennifer Brand, the Head of the Labor Bureau of Attorney General Andrew Cuomo's office, addressed the meeting attendees as the keynote speaker at dinner. Ms. Brand also emphasized the various changes to the State's Labor laws and how her office plans on enhanced enforcement activity through the next year.

Another area of concentration during the meeting was advocacy skills for labor and employment law practitioners. To that end, a plenary spotlighting how to present cases to various types of fact finders was chaired by Section Chair Robert Kingsley (Kayo) Hull. The panel, consisting of Federal Magistrate Andrew Peck; Judge Deborah Karalunas, Supreme Court, Onondaga County; arbitrator Melissa Biren; and jury consultant David Perrott (Trial-Graphix) provided valuable information as to how to maximize arguments to various triers of facts. At another plenary, chaired by Stewart Schwab, Dean of the Cornell Law School; Professor Bradley Wendel of Cornell Law School; and John Gaal (Bond Schoeneck & King LLP) informed the attendees about ethical pitfalls when preparing witnesses for depositions, hearings and trials. In an intimate presentation chaired by William Frumkin (Sapir & Frumkin, LLP), Judge Rosemary Pooler, of the Second Circuit Court of Appeals, and her former law clerk, Professor Kate Griffith of the Cornell University School of Industrial and Labor Relations (IRL), provided insights into how to effectively present appellate arguments to the federal bench.

The meeting attendees had two opportunities to choose among workshops to further enhance their continuing legal education. Professors Risa Lieberwitz and Michael Gold, both of ILR, presented on panels discussing recent Supreme Court decisions. Professor Lieberwitz, who was joined by Beth Bourassa (Whiteman Osterman & Hanna LLP) and Katherine Levine (New York State United Teachers) on a panel chaired by Seth Greenberg (Greenberg, Burzichelli & Greenberg, PC) presented on public sector discipline after the *Garcetti* decision. Professor Gold chaired a panel on the impact of the *Ledbetter* decision on employment law practice with presenters Darrell S. Gay (DLA Piper) and Kathryn E. White (Sapir & Frumkin, LLP). The meeting attendees also had the benefit of hearing from Louis Graziano on the newly developing area of "family obligations" discrimination, as he presented on a panel with Miriam F. Clark (Ritz & Clark) and Allan S. Bloom (Paul Hastings, LLP), chaired by Patricia Ann Cody (Heller, Erhman LLP). Mark Pearce (Creighton, Pearce, Johnsen & Giroux, LLP) chaired a panel on domestic violence in the workplace, which had presentations by experts in the field, including Buffalo City Court Judge Jeannette Ogden, Susan M. Corcoran (Jackson Lewis) and Laurel Eisner (Executive Director, Sanctuary for Families). Those attendees who practice in the area of employee benefits, international law and traditional private sector labor law were treated to updates on hot topics in their areas of concentration. The Employee Benefits Committee presented a workshop on Fiduciary Issues in 401(k) Plans chaired by Mark Brossman (Schulte Roth & Zabel LLP) with presenter Brent Glading (Glading Group). The International Law Committee offered a workshop on issues relating to assignments abroad, chaired by Wendi Lazar (Outten & Golden LLP) with presenters Robert Lewis (Baker & McKenzie LLP), Jeffrey Goodman (Heenan Blaikie, SR/LLP), Paul Callaghan (Taylor Wessing LLP) and R. Scott Jones (Goldstein Jones, LLP). Peter Conrad (Proskauer Rose, LLP) chaired a workshop on Private Sector Labor Relations Developments with Roy Galewski (Harris Beach PLLC) and Nathaniel Lambright (Blitman & King) presenting.

Along with the Friday night dinner reception, the meeting attendees were invited to two cocktail parties to meet their colleagues in a more relaxed atmosphere. Additionally, there was a golf tournament, chaired by Louis DiLorenzo (Bond Schoeneck & King, LLP), and a self-guided wine tour of the Cayuga Lake wineries. The Section also held committee meetings for planning of upcoming events. The Fall Meeting was co-chaired by Alan Koral (Vedder, Price, Kaufman & Kammholz) and Stephanie Roebuck (Keane & Beane, PC). The Section will meet again on February 1, 2008, in New York City for its Annual CLE program.

Confidentiality in Private Mediation: *Hauzinger v. Hauzinger*

By Brett Peter Linn

A. Introduction

In the case of *Richard M. Hauzinger v. Aurela G. Hauzinger*,[1] the Appellate Division, Fourth Department affirmed a trial court's refusal to quash a subpoena directed to a nonparty mediator, notwithstanding the existence of a confidentiality agreement made between the parties during the mediation process. As this is one in a relatively small line of cases addressing mediator privilege and confidentiality, *Hauzinger* has generated a great deal of interest among members of the mediation and Alternative Dispute Resolution (ADR) communities.[2] The intent of this article is to view *Hauzinger* in the context of both mediation and judicial concerns, and to suggest that the case reflects a common interest between the two; i.e., that of balancing confidentiality with other mutually accepted values such as voluntariness of agreements, self-determination, and impartiality of neutrals.[3]

B. Factual and Procedural Background

Hauzinger dealt with a pending divorce action in which the plaintiff-husband and defendant-wife had, prior to commencement of the action, entered into a mediated separation agreement. As part of the mediation process, a confidentiality agreement had also been executed by the then-unrepresented parties. However, during subsequent judicial proceedings, the wife challenged the underlying separation agreement as not being "fair and reasonable at the time of the making of the agreement."[4] In furtherance of this claim she served a subpoena *duces tecum* on the nonparty mediator, seeking to compel the production of records generated in connection with the mediation process as well as the mediator's appearance at a deposition.

Upon being served with this subpoena, the mediator moved to quash. Supreme Court, Cattaraugus County, denied this application, and the resulting order was appealed. Among other things, the mediator argued on appeal that the trial court abused its discretion by refusing to enforce the parties' confidentiality agreement.[5] Alternatively, asserted the mediator, the court should apply the confidentiality provisions of the Uniform Mediation Act (UMA), which has not been enacted into law by New York State.[6]

The Appellate Division, Fourth Department affirmed, holding in pertinent part as follows:

> Inasmuch as defendant seeks to establish the circumstances surrounding the execution of the separation agreement, and the court must determine in this action whether the terms of the separation agreement "were fair and reasonable at the time of the making of this agreement" (Domestic Relations Law §236 [B] [3]), we reject appellant's contention that the court abused its discretion in refusing to enforce the confidentiality agreement entered into by the parties as part of the mediation process (*cf. Lynbrook Glass & Architectural Corp. v. Elite Assoc.*, 238 AD2d 319, 656 N.Y.S. 2d 291), and in refusing to quash the subpoena as a matter of public policy. Although appellant urges this Court to apply the confidentiality provisions in the Uniform Mediation Act as a matter of public policy, New York has not adopted that Act and we decline to do so.[7]

This holding reflects a growing tension between evolving ethical standards in the field of private mediation, specifically those relating to confidentiality of process, and the statutory obligation of courts to protect the integrity of matrimonial agreements. While there are no easy answers, it may be of assistance to examine the multiple issues involved in more detail.

C. Privileges and Confidentiality in General

In seeking to quash the subpoena served upon him, the mediator in *Hauzinger* was in one sense effectively invoking a perceived evidentiary privilege created by the parties' confidentiality agreement.[8] The history behind privileges has been outlined by the Court of Appeals in *Lightman v. Flaum*, as follows:

> The common law insulated certain confidential information from disclosure at trial, such as interspousal communications made during the course of a marriage (*see,* 1 McCormick, Evidence § 78, at 323-324 [5th ed 1999]). Eventually, special categories of confidential communications were deemed by statute to be entitled to a privilege against disclosure. *See*, Prince, Richardson on Evidence § 5-101, at 225 [Farrell 11th ed 1995]. CPLR article 45 codifies rules of evidence that restrict the admissibility of information obtained in specified confidential contexts, such as that which exists between

> spouses (CPLR 4502), attorney and client (CPLR 4503), physician and client (CPLR 4504), psychologist and client (CPLR 4507) and social worker and client (CPLR 4508). In general, these statutes protect special relationships akin to fiduciary bonds, which operate and flourish "in an atmosphere of transcendent trust and confidence". *Aufrichtig v. Lowell,* 85 NY2d 540, 546.[9]

Once a matter is categorized as privileged, it is generally immune from disclosure,[10] and under CPLR 3101(b) the privilege may be invoked by a nonparty as well as a party.[11] Given the historical evolution discussed in *Lightman*, however, it is now generally considered that "[a] privilege is a matter of statute, and there is no privilege in the absence of a statute."[12] As no statutorily recognized private mediator/client privilege exists in New York,[13] it was not there for the mediator in *Hauzinger* to assert.

One possible area of privilege available to private mediators under New York Law relates to the confidentiality of settlement and settlement negotiations recognized by CPLR 4547, codifying "the common law rule . . . that the settlement of a disputed claim or an offer to settle the claim is inadmissible to prove either the liability of the alleged wrongdoer or the weakness of the claimant's cause of action."[14] This rule is limited, however, in that the "exclusion of settlement evidence is required only when the purpose of admission is to prove the validity or weakness of a claim or the amount of damages. The usual rules of relevance apply when settlement-related evidence is offered for some other purpose."[15] Under circumstances such as those involved in *Hauzinger*, where the integrity of the agreement itself has been questioned, this exclusion would most likely be inapplicable to the pertinent issues.

Courts have also recognized a somewhat broader public policy of protecting "[a]ctions taken and observations made for the stated purpose of arriving at a settlement agreement, and expressly not for litigation, which actions would not have been accomplished except in a mutual attempt to reach a settlement. . . ."[16] This public policy of encouraging attempts at settlement is especially pertinent under circumstances where the negotiating parties expressly agree to keep certain matters confidential, as in many private mediation contexts.[17] Confidentiality agreements are viewed as a right possessed by parties in a civil dispute to "chart their own . . . course."[18]

Contractual confidentiality is not, however, absolute. In applying this policy, "'[c]ourts must have the discretion to balance the competing interests of the parties, the public, and the justice systems. When this balance favors confidentiality, confidentiality should be provided'"[19] On the other hand, where there is a strong interest favoring disclosure of agreed-upon confidential material in conjunction with a showing of materiality, discovery may be warranted.[20] With specific relevance to the issues involved in *Hauzinger,* "given a showing of cause sufficient to invalidate a contract, such as fraud, collusion, mistake or some such similar ground, a court may relieve a party from the consequences of his or her stipulation."[21] "The mere fact that . . . information may have been communicated in confidence does not create a privilege since '[n]o pledge of privacy nor oath of secrecy can avail against demand for the truth in a court of justice.'"[22]

D. Confidentiality in the Mediation Process

"It is widely perceived that the cornerstone to an effective mediation is that communications shared in the process will be kept strictly confidential."[23] The importance of confidentiality cannot be underestimated, as it fosters essential trust in the mediation process and encourages "full, frank, and open participation."[24] Accordingly, confidentiality is one of the critical standards included within the respective sets of voluntary ethics promulgated by various ADR organizations. For the private mediation community, a very real concern exists that this cornerstone may be eroded if *Hauzinger* is read so broadly as to abrogate confidentiality merely because a challenge to the underlying agreement, no matter how perfunctory, has been raised. As discussed below, such a broad reading would not be warranted under existing case law.

This concern is somewhat amplified because mediation in New York is largely an unregulated field. With the exception of community dispute resolution centers (CDRCs),[25] and perhaps a small number of other statutorily enabled programs, there is no comprehensive statutory scheme regulating mediator qualifications, standards or discipline.[26] Akin to clerics, for example, mediators "are free to engage in [mediation] activities without the State's permission, they are not subject to State-dictated educational prerequisites and, significantly, no comprehensive scheme regulates the [mediator-client] . . . relationship."[27] Given this lack of regulation, as with clerics, the private mediation field is unable to identify any source of legally recognized confidentiality outside of the sources discussed above.[28] For the most part, protection of confidentiality in private mediation is relegated to the use of participant agreements.

Equally as important is the lack of codified public accountability. Without such accountability, it is at best questionable whether a mediator's breach of any perceived fiduciary duty, including confidentiality, could give rise to a private cause of action on the part of the mediation participant.[29] Therefore, notwithstanding the existence of several sophisticated sets of voluntary ethical standards, such precepts may be virtually unenforceable. While the vast majority of mediators are highly scrupulous, the mediation process is not always perfect and, worse yet, there are no legislated means to enforce standards or to prevent unqualified mediators from privately practicing.

E. Judicial Role in Divorce Cases

In divorce actions, one or both of the parties frequently seek incorporation of a settlement stipulation or separation agreement into the judgment. If so incorporated, the agreement actually becomes *part of* the judgment, subjecting both parties to the possibility of subsequent postjudgment enforcement and contempt proceedings if issues of noncompliance arise. Accordingly, in the interests of all involved, courts have a statutory obligation to ascertain that the terms of the agreement "were fair and reasonable at the time of the making of the agreement and are not unconscionable at the time of entry of final judgment."[30]

Any party seeking to set aside a separation agreement or settlement stipulation, however, bears a decidedly heavy burden. As set forth in *Rodriguez v. Rodriguez:*

> To successfully set aside an agreement, it should be shown that no reasonable and competent person would accept its terms, which are so unconscionable as to shock the conscience. *See, Lounsbury v. Lounsbury* [300 AD2d 812, 814 (2002)]. Moreover, if a party can demonstrate duress that deprived him or her of the ability to act in self-interest or exercise free will, then the agreement may be set aside, *see Morand v. Morand*, 2 AD3d 913, 914 [2003]; *Lyons v. Lyons,* 289 AD2d 902, 904 [2001], *lv denied sub nom. Anonymous v. Anonymous,* 98 NY2d 601 [2002]. Where varying versions of events are presented regarding these issues, deference is afforded the trial court's determination of witness credibility. *See, Broer v. Hellerman*, 2 AD3d 1247, 1248 [2003].[31]

Although this ultimate burden is substantial, when a trial court is presented with significant indicia that an agreement may not have been the product of free will, a duty of investigation is imposed. Once this duty is triggered, "[a] stipulation of settlement should be closely scrutinized and may be set aside upon a showing that it is unconscionable or the result of fraud, or where it is shown to be manifestly unjust because of the other spouse's overreaching."[32] Accordingly, where there are allegations truly sufficient to create an inference of duress or intimidation exercised by one party, or that one party did not adequately disclose financial assets, a court should direct appropriate disclosure of the circumstances surrounding the making and execution of the agreement, "followed by a hearing 'to test the validity of the [stipulation of settlement].'"[33]

Disclosure from a nonparty requires a showing that the testimony or other discovery is "material and necessary."[34] Subpoenas duces tecum and depositions, such as those involved in *Hauzinger*, are standard disclosure tools used to procure material and necessary information from a nonparty.[35] While under certain circumstances an operative interest may be satisfied through less-invasive discovery than a nonparty deposition, e.g., by simple production of the written agreement itself,[36] where there is a serious challenge to the integrity of the underlying agreement, full disclosure is warranted with appropriate protective measures as deemed necessary.

In this regard, it is important to note that *Hauzinger* cannot be viewed as disregarding confidentiality and authorizing the blanket use of subpoenas against mediators. The Appellate Division merely held that, in this particular matter, the trial court did not abuse its discretion by allowing a subpoena to stand where confidentiality concerns were outweighed by countervailing public policy and party interests.[37] For the most part, "[j]udicial review of separation agreements [and settlement stipulations] is to be exercised sparingly, with the goal of encouraging parties to settle their differences by themselves"[38] Unsupported and conclusory allegations of fraud, duress, overreaching, or unconscionability are therefore insufficient as a matter of law to create the inference necessary to implicate intrusive judicial scrutiny.[39]

This balancing analysis is significant in that confidentiality is only one of several generally recognized mediation precepts. Most mediator standards also include, e.g., provisions relating to voluntariness of the mediation process, party self-determination, and mediator impartiality. In any given context, these varying standards must all be balanced and, to the extent possible, harmonized with one another. Presumably, therefore, as mediators grapple with their own intrinsic ethical dilemmas, they undertake an analysis similar to that enunciated by the courts. Given the high deference afforded to parties who resolve their own differences, most unwarranted judicial scrutiny of mediated agreements can be dissuaded by the type of meticulous care to detail practiced by good mediators, thus avoiding any ostensible inferences of fraud, duress, overreaching, or unconscionability.

F. Summary

Through my association with various ADR organizations, I have many friends and colleagues in the mediation community. The vast majorities of mediators take their chosen discipline very seriously and possess the highest of ethical standards. Courts must be sensitive to the fact that the private mediation community is safeguarding one of its most valued standards, that of confidentiality, in the best way it presently can—generally through the use of private agreements. *Hauzinger* cannot be read to absolve courts from assuring that an adequate basis exists before intruding upon this confidential relationship.

By the same token, courts have a concomitant duty to fulfill a need that the private mediation community, as any unregulated field, cannot adequately fulfill; i.e., enforceable public accountability. In my more than 20 years in the judicial system, it has become painfully clear that decisions made by parties who are going through stressful and emotionally charged times are often influenced by such things as the deliberate misrepresentations or omissions of others, extreme duress, and sometimes physical or emotional abuse. A confidentiality agreement, even one reached within the mediation process, should not be used as an absolute shield against good faith judicial inquiries into equally valid concerns such as free will and party empowerment.

Regulation of any field is necessary to protect both public and private interests. Until there is some type of uniform regulatory scheme governing mediation, the operative decisions must be made by courts on a case-by-case, discretionary basis. In the final analysis, the issues raised by *Hauzinger* involve respect for all stakeholders and the balancing of often competing interests; concerns which we hopefully all share.

Endnotes

1. 43 A.D.3d 1289, 842 N.Y.S.2d 646 (4th Dep't 2007).
2. A potential concern is that if *Hauzinger* is construed to be a case of first impression, under *stare decisis* principles it may bind trial courts until either the remaining Appellate Divisions or the Court of Appeals speaks on the issue (*see* David D. Siegel, New York Practice [4th Ed.], § 449, p. 758).
3. It is not the intent of this article to take any position as to whether or not *Hauzinger* was correctly decided on its facts. The facts recited in the case are rather sparse, and thus this article merely attempts to give a general overview of the various issues involved.
4. Domestic Relations Law § 236(B)(3).
5. The mediator's argument that the subject subpoena and notice failed to comport with the procedural requirements of CPLR 3101(a)(4), which was rejected by the Appellate Division, is not addressed in this article. In essence, the court held that the requisite information was adequately provided in motion papers.
6. Senator Dale M. Volker presently sponsors a bill (S1967 [2007]) which would establish the Uniform Mediation Act.
7. 842 N.Y.S.2d 646.
8. As set forth below, the assertion of this privilege is in keeping with a mediator's ethical obligation to protect confidentiality of process.
9. 97 N.Y.2d 128, 133 (2001), *cert. denied*, 535 U.S. 1096 (2002).
10. *See, generally,* David D. Siegel, New York Practice (4th Ed.), § 346, p. 556; CPLR 3101(b).
11. *Id*. As *Hauzinger* did not deal with issues of waiver, this article will not discuss such issues.
12. 58A NY Jur 2d, Evidence and Witnesses, § 854.
13. The designation "private" is used to refer to mediators who are not operating under the auspices of a community dispute resolution center (CDRC) or other statutorily enabled program (*see* Section D, *infra*).
14. Alexander, Practice Commentaries, McKinney's Cons Laws of NY, Book 7B, CPLR 4547, at 842.
15. *Id*. at 843; *see American Re-Insurance Co. v. United States Fidelity & Guaranty Co.,* 19 A.D.3d 103, 104 (1st Dep't 2005).
16. *Gordon v. Village of Bronxville,* 5 Misc. 3d 1030(A) (Sup. Ct., West. 2004).
17. *See, e.g., Lynbrook Glass & Architectural Metals Corp. v. Elite Assoc., Inc.,* 238 A.D.2d 319 (2d Dep't 2007) (cited by the Appellate Division, Fourth Department in *Hauzinger*). The court in *Lynbrook Glass* recognized that certain reports prepared expressly for mediation were protected from disclosure due to the parties' confidentiality agreement.
18. *Trump v. Trump,* 179 A.D.2d 201, 204 (1st Dep't 1992), *appeal dismissed,* 80 N.Y.2d 892 (1992), *leave to appeal denied,* 80 N.Y.2d 760 (1992).
19. *Gordon v. Village of Bronxville, supra, quoting New York County Data Entry Worker Product Liability Litigation v. A.B. Dick Co.,* 162 Misc. 2d 263 (Sup. Ct., N.Y. Co. 1994), *aff'd,* 222 A.D.2d 381 (1st Dep't 1995).
20. *See, e.g., Masterwear Corp. v. Bernard,* 298 A.D.2d 249, 250–251 (1st Dep't 2002). The court in *Masterwear* noted that party confidentiality may be protected by appropriate limitations on discovery, if warranted (298 A.D.2d at 250–251).
21. *Trump v. Trump, supra,* 179 A.D.2d 204.
22. *Pickard & Anderson v. Young Men's Christian Ass'n and Women's Educational and Industrial Union of Auburn, New York, Inc.,* 119 A.D.2d 976, 977 (4th Dep't 1986), *quoting* 8 Wigmore, Evidence § 2286 (McNaughton rev. ed. 1961).
23. 6 Bruner & O'Connor on Construction Law, § 20:155.
24. *People v. Snyder,* 129 Misc. 2d 137, 138 (Sup. Ct., Erie Co. 1985).
25. In 1981, the New York State Legislature enacted Judiciary Law Article 21-A, which established the Community Dispute Resolution Centers Program (N.Y. Judiciary Law §§ 849-a *et seq.*). Community dispute resolution centers (CDRCs) are separate not-for-profit organizations overseen by the New York State Court System's Office of Alternative Dispute Centers Programs, which serve as community resources for the discussion and resolution of interpersonal disputes. Pursuant to N.Y. Judiciary Law § 849-b(6), all CDRC mediator memoranda, work products and case files, as well as all communications relating to the subject matter of the resolution made during the process, are confidential and nondiscoverable in any judicial or administrative proceedings.
26. Because mediators serving CDRCs are governed by a statutory confidentiality provision, *Hauzinger* should have little direct bearing on such entities. At the very least, as the issue in *Hauzinger* involved the effect of a confidentiality agreement rather than interpretation of a statute, any analysis would necessarily be somewhat different. This reflects a very important distinction. While private agreements are subject to close judicial scrutiny, "[t]he wisdom of a particular statute is beyond the scope of judicial review . . . and [courts] should not substitute [their] judgment for that employed by the Legislature in enacting the statute in question" (*Nettleton Co. v. Diamond,* 27 N.Y.2d 182 [1970], *reargument denied,* 28 N.Y.2d 539 [1971]). The judicial deference given to the statutory privilege created by Judiciary Law § 849-b(6) has been clearly expressed (*see, e.g., United States v. Gullo,* 672 F. Supp. 99 [W.D.N.Y. 1987]; *People v. Snyder, supra,* 129 Misc. 2d 137).
27. *Lightman v. Flaum,* 97 N.Y.2d 128, 136 (2001).
28. *Id*.
29. *Id*. at 137.

30. Domestic Relations Law § 236(B)(3).

31. 11 A.D.3d 768, 769–770 (3d Dep't 2004).

32. *Cruciata v. Cruciata*, 10 A.D.3d 349, 350 (2d Dep't 2004); *see also Chapin v. Chapin*, 12 A.D.3d 550 (2d Dep't 2004). Although *Cruciata* dealt with a settlement stipulation, the general principles enunciated therein also apply to separation agreements (*see* Domestic Relations Law § 236[B][3]).

33. *Cruciata v. Cruciata*, *supra*, *quoting Berkman v. Berkman*, 287 A.D.2d 426, 427 (2001); *compare*, *Rodriguez v. Rodriguez*, 11 A.D.3d 768, 769–770 (3d Dep't 2004).

34. *Webdale v. North General Hosp.*, 7 Misc. 3d 947, 956 (Sup Ct., N.Y. Co. 2005, *aff'd*, 24 A.D.3d 153; *see, generally*, *Lutz v. Goldstone*, 31 A.D.3d 449, 450 (2d Dep't 2006); *Matter of Diehr*, 13 A.D.3d 150 (1st Dep't 2004). The prior CPLR 3101(a)(4) "special circumstances" test was eliminated in 1984 (*see Catalano v. Moreland*, 299 A.D.2d 881 [4th Dep't 2002], and the requirement now only applies to nonparty expert witnesses (*see* CPLR 3101 [d][1]).

35. *See*, *e.g.*, CPLR 3106, 3107, 3111 & 3120 (1).

36. *See*, *e.g.*, *Matter of Gordon v. Village of Bronxville*, *supra*, 5 Misc. 3d 1030(A).

37. It must be remembered that in *Hauzinger*, neither party was represented by counsel when it participated in the mediation process. Although lack of legal representation, in itself, is insufficient to warrant vacatur of an agreement or stipulation, it is one factor to be considered (*cf. Korngold v. Korngold*, 26 A.D.3d 358, *leave to appeal dismissed*, 7 N.Y.3d 861 [2006]).

38. *Korngold v. Korngold*, *supra*, 26 A.D.3d 358 (2d Dep't 2006).

39. *Id*. at 359.

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The Duty of Loyalty and Its Implications for Employers and Employees

By David J. Morris

Many people are familiar with noncompete and nonsolicit agreements between employers and employees. In contrast, the duty of loyalty that an employee owes an employer is less well known. Yet this duty, which applies even in the absence of a written agreement, has substantial implications for employers and employees not unlike noncompete and nonsolicit agreements. For employers, the duty offers some measure of protection to guard their interests and help ensure that their employees remain loyal even, in some instances, once they leave their position. For employees, knowing the existence and reach of this duty can help them conduct themselves lawfully during the term of their employment and when they contemplate moving to another position. The following discussion should prove useful to employers by alerting them to their rights under Illinois law regarding the duty of loyalty, and to employees by providing them with a list of problematic conduct which could give rise to substantial liability.

Under Illinois law, the duty of loyalty requires that an employee act solely for the benefit of the employer in all matters connected with his or her employment.[1] What this concept means has been the subject of numerous lawsuits. As a starting point, through what has come to be known as the "preliminary stages" doctrine, courts agree that the duty of loyalty does not prevent an employee from taking certain preliminary steps which may be seen as competing with such employee's employer.[2] This duty does not prohibit an employee from planning, forming, and outfitting a competing corporation while still working for the employer, or even informing a client of the employee's intention to leave the employer, so long as the employee does not engage in competition with the employer.[3] For example, a court has allowed an employee who served as the vice-president of manufacturing at his employer's manufacturing company to obtain financing, design a production plant, and purchase equipment and supplies, all while still employed.[4] In contrast, when an employee's activities extend beyond what courts deem "preliminary" competitive activities and "commence[] business as a rival concern while still in his employer's service," such as in the case of active solicitation of clients or employees, a court may find a violation of the duty of loyalty.[5]

Beyond the "preliminary stages" doctrine, the reach of the duty of loyalty depends on whether the employee at issue is an officer or nonofficer employee. This is because the duty of loyalty imposes more restrictions on officers than nonofficer employees. Before discussing the prohibited and permissible actions of each type of employee, it is important to note how Illinois courts distinguish an officer from a nonofficer employee. Rather than focusing on an employee's title, Illinois courts analyze an employee's everyday activities.[6] An officer is an employee who performs "significant managerial and supervisory responsibilities for the operation of the . . . office"[7] or otherwise has significant autonomy and discretion in the performance of her duties for the employer.[8]

A. Officers

Corporate officers, as agents of their employer, are held to a higher duty of loyalty standard than regular employees.[9] The duty of loyalty specifically prohibits corporate officers from (1) actively exploiting their positions within the corporation for their own personal benefit or (2) hindering the ability of a corporation to continue the business for which it was developed.[10] Further, for corporate officers, the duty of loyalty imposes affirmative obligations upon them to disclose information which falls within the scope of the fiduciary relationship and to refrain from profiting, without permission from the one who is owed the fiduciary duty, from property or information which is considered as belonging to the beneficiary.[11]

Conduct which is likely to trigger liability for corporate officers under the duty of loyalty includes:

1. using corporate assets without compensating the corporation to develop a new entity;[12]
2. appropriating the office space of the corporation to help another corporation or business in which the officer has an interest;[13]
3. taking advantage of a corporate opportunity[14] without first disclosing it and tendering the opportunity to the corporate employer;[15]
4. taking advantage of a corporate opportunity where officer's private interest would conflict with that of the corporation;[16]
5. using corporate assets to usurp corporate opportunity for employee's own venture;[17]
6. pretermination solicitation of one or more customers of the employer;[18]
7. soliciting or contracting with fellow employees of employer prior to terminating employment relationship;[19]

8. voting for and accepting bonuses without disclosure that officer is leaving the company or firm;[20] and

9. using firm's confidential information such as credit, billing, or other financial information of the company or company's records for the benefit of employee's new venture.[21]

It is also important to note that resigning does not automatically relieve a former officer of a corporation from her duty of loyalty to that former corporation where transactions which were initiated during the tenure of the officer's employment relationship are concerned. For those transactions which commenced during the officer's employment with her former employer or which were based upon information obtained during that relationship, the corporate officer, even after she resigns or is terminated, cannot utilize essential information from those transactions or contact the parties involved without subjecting herself to liability under the duty of loyalty doctrine.[22]

B. Nonofficer Employees

The duty of loyalty does not impose as many restrictions on employees who are not officers of a corporation. Under the more lenient standard for nonofficer employees, Illinois law holds that once an employee leaves his position with an employer, he ceases to owe that employer a fiduciary duty.[23] Further, where there is no fraud, no contractual restrictive covenant, and there has been no improper taking of a customer list, former employees may, without fear of breaching the duty of loyalty, compete with their former employers and solicit former customers provided there is no evidence of this kind of business activity prior to the employee's termination of his employment.[24]

In general, the duty of loyalty prohibits nonofficer employees from:

1. competing with the employer while still in the employ of that employer;[25]

2. taking employer's customer list or soliciting customers away from employer while still in the employ of that employer;[26] and

3. appropriating the employer's personal property.[27]

C. Employer's Remedies for Employee's Breach of Duty of Loyalty

An employer has a wide array of remedies that it may seek in charging an (former) employee with a breach of the duty of loyalty. These remedies include:

1. recovery of an employee's total compensation paid during the time that the employee was breaching the fiduciary duty owed to his employer;[28]

2. the imposition of a constructive trust to collect the profits reaped by the employee as a result of his breach of his fiduciary duty;[29]

3. recovery of bonuses paid during the same period in which the employee breached his fiduciary duty;[30]

4. the imposition of punitive damages if the breach was intentional and without just cause;[31] and

5. injunctive relief.[32]

D. Conclusion

By identifying prohibited and permitted conduct, the foregoing discussion is intended to make both employers and employees aware of their rights and obligations under the doctrine of the duty of loyalty and to apprise them of some of the more serious implications of violating that duty.

Endnotes

1. *Riad v. 520 Michigan Ave. Assoc.*, 2000 WL 680217, *3 (N.D.Ill. 2000) (applying Illinois law).
2. *Id*. (finding no evidence that general manager of hotel actively solicited hotel's clients or employees prior to general manager's termination).
3. *E.g., Riad*, 2000 WL at *3. *See also Smith-Shrader Co., Inc. v. Smith and R.S. Valve Corp.*, Ill. App. 3d 571, 578 (1st Dist. 1985) (distinguishing Smith's pretermination solicitation of clients from employee's actions in *Ellis and Marshall Assoc., Inc. v. Marshall*, 16 Ill. App. 3d 398 [1st Dist. 1974], where employee's pretermination notice to clients of intention to leave employer constituted "mere commentary on future plans").
4. *Lawter Int'l, Inc. v. Carroll*, 116 Ill. App. 3d 717, 733–34 (1st Dist. 1983).
5. *Riad*, 2000 WL at *3; *Dowd and Dowd, Ltd. v. Gleason*, 352 Ill. App. 3d 365, 372 (1st Dist. 2004).
6. *Aon Risk Serv., Inc. of Illinois v. Shetzer*, 2002 WL 1989466 at *4 (N.D.Ill. 2002) (applying Illinois law) (finding that employee with the title of "senior vice president" was not an officer because he only performed the duties of an account broker, salesman and service representative and did not supervise any employees); *Foodcomm Int'l v. Barry*, 328 F.3d 300, 304 (7th Cir. 2003) (applying Illinois law) (finding that while employees were not titled "officers," employees with exclusive charge over purchasing decisions of employer constituted "officers" subject to higher duty of loyalty).
7. *Id.*
8. *Foodcomm Int'l*, 328 F.3d at 304.
9. *Veco Corp. v. Babcock*, 243 Ill. App. 3d 153, 160 (1st Dist. 1993).
10. *E.g., Foodcomm Int'l*, 328 F.3d at 303.
11. *Graham v. Mimms*, 111 Ill. App. 3d 751, 761 (1st Dist. 1982).
12. *Levy v. Markal Sales Corp.*, 268 Ill. App. 3d 355, 369 (1st Dist. 1994), *cert. denied*, 516 U.S. 861 (1995).
13. *Id.* at 369.
14. A corporate opportunity "exists when a proposed activity is reasonably incident to the corporation's present or prospective business and is one in which the corporation has the capacity to engage." *Lindenhurst Drugs, Inc. v. Becker*, 154 Ill. App. 3d 61, 67 (2d Dist. 1987).

15. *E.g., Markal Sales*, 268 Ill. App. 3d at 366.
16. *Comedy Cottage, Inc. v. Berk*, 145 Ill. App. 3d 355, 359 (1st Dist. 1986) (noting officer's duty of loyalty to corporation includes obligation to disavow any corporate opportunity where officer's private interest would conflict with those of the corporation).
17. *Graham*, 111 Ill. App. 3d at 763 ("a corporation's fiduciary will not be permitted to usurp a business opportunity which was developed through the use of corporate assets.").
18. *E.g., Gleason*, 352 Ill. App. 3d at 372.
19. *E.g., Radiac Abrasives, Inc. v. Diamond Tech., Inc.*, 177 Ill. App. 3d 628, 633 (2d Dist. 1988).
20. *Gleason*, 16 Ill. App. 3d at 376–77.
21. *Id.* at 765–766.
22. *See Veco*, 243 Ill. App. 3d at 161 (finding that transfer of multiple clients from executive's former employer to new venture within days of executive's termination required prior careful planning and therefore must have commenced pretermination in violation of executive's duty of loyalty).
23. *Jostens, Inc. v. Kauffman*, 842 F. Supp. 352, 354 (C.D. Ill. 1994) (applying Illinois law).
24. *E.g., Gleason*, 352 Ill. App. 3d at 374.
25. *E.g., Aon Risk Serv.*, 2002 WL 1989 466 at *4.
26. *E.g., Dowel v. Bitner*, 273 Ill. App. 3d 681, 691 (4th Dist. 1995).
27. *ABC TransNational Transport, Inc. v. Aeronautics Forwarders, Inc.*, 62 Ill. App. 3d 671, 683 (1st Dist. 1978).
28. *See, e.g., Gleason*, 352 Ill. App. 3d at 386 (Illinois law allows for a complete forefeiture of compensation earned during the period covering the breach of the fiduciary duty).
29. *Hill v. Names & Addresses, Inc.*, 212 Ill. App. 3d 1065, 1083 (1st Dist. 1991) (constructive trust may be imposed even when it more than compensates plaintiff for injury resulting from breach of loyalty, because the right to recover from one who exploits his fiduciary position for his personal benefit is triggered by gain to agent rather than loss to principal).
30. *Gleason*, 352 Ill. App. 3d at 386.
31. *Id.* at 388.
32. *See Foodcomm Int'l*, 328 F.3d. at 304–05.

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Beyond the WARN Notice: Getting to the Tipping Point and Beyond

By Diane M. Pfadenhauer

In addition to the technical requirements of closing work facilities, such closings are often fraught with significant emotional tolls. Most turnaround experts and bankruptcy professionals are experts at unwinding the operation and closing the doors. They perform these tasks with a seemingly strong stomach so that they can go beyond the emotional issues facing employees and focus on the tasks at hand. Others, unfortunately, view the task of closing the plant in its raw, simplified form: give the notice, terminate the employees, and shut the doors. While certain business considerations may necessitate this chopping block approach to downsizing, for the sake of the employees and ultimately for the good of the organization, there are a myriad of technical considerations, legal issues, and human issues, all within the context of an extremely difficult environment, that any employer should consider when closing a facility.

Particularly where there is a remaining ongoing entity in some form, management has a significant opportunity when planning and carrying out a plant closing. This includes building or retaining the good will necessary among employees to move the organization forward, thereby helping it to meet its strategic objectives with minimal disruption and waste of resources.

Basic WARN Requirements

The Worker Adjustment and Retraining Notification Act (WARN) generally requires certain employers to provide notice to workers 60 days in advance of a plant closing or mass layoff.[1] Covered employers include those with 100 or more employees.[2] A plant closing refers to the permanent or temporary shutdown of a single site of employment or one or more facilities or operating units within a single site of employment.[3] Alternatively, a mass layoff refers to a workforce reduction, not the closing of a plant, which results (during any 30 day period) in the loss of employment for: (1) at least 33% of the active employees (excluding part time employees), and (2) 50 employees. This 33% requirement does not apply where 500 employees or more are reduced.[4] Notably, ". . . plant closings involve employment loss which results from the shutdown of one or more distinct units within a single site or the entire site, [whereas] a mass layoff involves employment loss, regardless of whether one or more units are shut down at the site."[5]

The employer is required to provide notice to affected employees or their representatives, the particular state dislocated worker unit, and the chief elected official of the local government.[6] In the context of the sale of the business (or part thereof), it is generally the seller who is responsible for providing the notice.[7] Should the buyer intend to conduct a plant closing or mass layoff it is obviously prudent for the buyer and seller to work together to determine who will provide the required notices.

Generally, the notices must be provided 60 days prior to any plant closing or mass layoff, and a worker's last day is considered the date of his/her layoff.[8] Anyone who is terminated beyond the issuance of the first layoff is still entitled to the full 60-day notice period.

WARN provides three exceptions to the requirement that the notice be provided 60 days in advance. Notwithstanding these exceptions, the notices to employees and other required parties must still be issued. The exception relates to the timeliness of the notice. The first, the "faltering company" exception, applies only to plant closings, not mass layoffs and is intended to be narrowly construed. It applies in instances where the employer is actively seeking to obtain capital or business at the time the notice should have otherwise been given. There must have been a realistic possibility of obtaining the financing or business. The financing or business sought by the employer must have been sufficient to enable it to avoid or postpone the plant closing. Lastly, the employer must have believed that providing the required notice would have prevented it from obtaining the capital or business sought.[9]

The second exception refers to "unforeseeable business circumstances" and applies to both mass layoffs and plant closings. It refers to situations that were not reasonably foreseeable at the time the notice would have been otherwise required.[10] An example of this might be the sudden cancellation of a major contract by a client or some other sudden event out of the employer's control.

The last exception, the "natural disaster" exception, applies to both mass layoffs and plant closings which occur as a result of any natural disaster. These include, among others, floods, earthquakes, and storms and the employer must be able to show that there is a direct relationship between the disaster and the plant closing or mass layoff.[11]

Beyond the Notice

The WARN 60-day notice is often considered the pivotal moment in time in a plant closing or mass layoff. This issuance of the notice is often the beginning of the implementation of a sophisticated and detailed transition plan, which has hopefully been undertaken as far as possible in advance of the notice. Operationally, however, there is another point—the tipping point—which can be more pivotal to the success or failure of the plant closing or layoff.

The tipping point refers to the moment in time during the notice period to which the employer must keep employees or a group of employees in order to meet its business demands. An employer's inability to keep certain employees up until the tipping point could be detrimental to its operations. Employers obviously struggle with this issue once the notice is given. Employees likely begin looking for employment opportunities elsewhere and they often become disengaged. This results in a loss of productivity and the potential for costly errors.

Ideally, the employer wants the employees to stay up until their respective tipping points and no longer. If an employee is no longer required, the employer may let the employee go and continue to provide salary for the remainder of the notice period. Ideally, the employer would like to see the employee resign for another position thereby relieving the employer of future salary or severance obligations.

Communication, Communication, Communication

Communication is often touted as the answer to most employee problems. However, communicating can either be done in a productive and positive manner that helps retain employees and enables them to transition with dignity or it can be done in a manner that fosters ill will not only among those affected, but also among remaining employees, outside constituents and the community at large. A communications plan must be carefully orchestrated with specific roles and responsibilities assigned.

An effective communication plan must go well beyond the notice and include the following elements:

1. **A Review of Notice Documents:** This will ensure that they reflect not only the legal and technical requirements of compliance but that they reflect the culture and management style of the organization. Indeed, at times the boiler plate notice can be most effective. However, when considering future relationships with the affected employees, those employees that remain, business relationships, and the impact on other stakeholders, this simple notice can take on far more meaning than initially thought.

2. **Preparation of Speeches to Various Stakeholders:** This includes employees, business relationships, and other relevant stakeholders. Who will deliver the news? Will it be done in person? Will there be smaller meetings? Will there be one large meeting? Will it be conducted offsite? What written materials will be provided to employees beyond the required notice? How will questions be handled?

3. **Creation of Talking Points and Answers:** When conducting a plant closing, mass layoff or other strategic event with significant employee impact, it is always recommended that the organization prepare a list of talking points with the appropriate answers. Ideally, this list will anticipate many of the questions that will be posed by employees during the meeting *and* will provide approved answers. This will clearly demonstrate to employees that the employer has not only complied with minimal requirements but has given thought to the impact of the transition on employees. Some of the topics addressed in the talking points range from the reason for the closure or layoff, preliminary timelines, the effects on benefits and pay, how day-to-day job duties may be affected, and how layoff decisions were made.

4. **The Day of the Announcement:** The employer should be prepared to communicate quickly and effectively both internally and externally. Included in this phase of the communications plan is the need to ensure that appropriate personnel are assigned to receive and answer questions from their appropriate constituents. All stakeholders, particularly employees, must be made aware of whom these "go to" people are. And those charged with answering questions and communicating must have the appropriate training and information to ensure that the message is delivered clearly, consistently, and as intended. Ideally, the organization will recognize those questions that it cannot answer as of the date of the announcement and be prepared with appropriate responses.

5. **After the Announcement:** Once the employer is in the midst of the commotion associated with the announcement, it must quickly act to meet with individual employees to discuss the individual effect of the plant closing or mass layoff. Another speech needs to be written, a series of talking points and answers prepared and documents and other materials need to be compiled and distributed—all of which must be evaluated for legal compliance and to ensure they reflect the appropriate tone and style desired.

Management Education and Support

The organization should plan to discuss the plant closing or mass layoff with appropriate management personnel just prior to announcing it to the general employee population. While some may disagree with this philosophy, it will help to alleviate the "sandwich effect." This occurs when a general meeting is held with employees and management together. A carefully scripted speech is delivered, everyone goes back to work and the employees go immediately to their manager to ask questions. The manager, having no more or less information and no direction from senior management about how to handle such inquiries, can do greater damage than initially imagined. Where should a manager go with his/her own questions or those posed by employees?

The meeting with management should take place on the same day as the general meeting. At times, organizations wish to conduct a meeting a day or two prior. Be forewarned that the farther away in time the two communications are the greater likelihood of word getting out and rumors spreading like wildfire. Topics to be addressed with management should include the same general items described above. In addition, however, managers must be made aware of how they are to respond to questions. This is the time to address the talking points, who is responsible for certain questions that will be posed, what authority they will have to make promises, or to provide guidance to employees. One of the worst things that can happen is for an employer to demoralize the very managers it needs to keep employees engaged during the transition.

Further, the organization needs to address what changes in roles and responsibilities will occur upon the announcement. Is an outsider being brought in? How will this influence existing management authority? How will it influence individual employee job duties and responsibilities? Even if the answers to some of these questions are not known at the outset, they must be considered, anticipated and a response crafted.

Policy Issues Often Overlooked

While every organization has certain policies in place, they may have fallen to the wayside over time, may be minimally enforced or not be adequate to address a plant closing or mass layoff. Therefore, employers should review and revise, where appropriate, the following policies.

1. **Security:** The organization will need to address security concerns in order to be prepared for the transition and throughout the notice period. Ideally, the employer should consider security concerns beyond the location in question. A detailed review of financial, capital, information technology, and other areas is required. Failure to address these issues and prepare well in advance of the announcement can result in events as simple yet catastrophic as an employee tossing a wrench into a multi-million dollar machine, theft of trade secrets and loss of competitive advantage, and other sabotage. Again, the security implemented must be consistent with the spirit of the organization yet balanced against the risks of loss.

2. **Company Property:** Company property appears to have a way of disappearing at a much more accelerated rate during a plant closing or mass layoff. A solid inventory at the outset is vital for preventing and/or tracking the loss of materials, equipment, office supplies, computers, customer information/lists, etc. Related to this is the establishment of a process to recover property in the possession of employees, including intellectual property.

3. **Ongoing Communications with the Media, Government Officials, and Various Stakeholders:** The contemplated transition may require that employers change the contact persons or approved persons who can communicate on behalf of the organization not only to the media but to government officials. Giving thought to these well in advance will help to minimize uncertainty and the communication of misinformation.

4. **Paid Absence Time:** The closing of a facility or mass layoff may be the first time that an organization must deal with the decision about how to handle paid absence time upon separation. Regardless of existing policies, employers must review WARN requirements and state laws for guidance on dealing with all forms of paid absence time.

5. **Bumping Rights and Other Polices Relating to Job Posting, etc.:** Where there is a collective bargaining agreement in place, it is typical for the union and management to discuss the method of bumping if not clearly laid out in the agreement and to negotiate over the effects of the plant closing or mass layoff. The mere significance and magnitude of such a transition may push the envelope of the most predictable union-management relationship.

6. **Job Elimination, Return to Work:** These policies, sometimes considered separate policies and sometimes buried within other major policies, require review in the context of the transition. Employees may assert rights contained in a specific policy buried in an outdated handbook that the employer failed to consider.

Getting to the Tipping Point

Wise employers will carefully review their workforces and determine the tipping point for each employee or groups of employees. In doing so, calculate the potential damage or risk to the organization if the employee(s) depart earlier. Focus on those employees where the impact is most significant (such as when their skills are unique and not transferable to others) and put a plan into place to keep them until they are no longer needed. Such a plan may include individual communication with employees regarding their job searches in order to remain abreast of how close their departure may be to the desired time. Employers may also wish to plan the implementation of any job search assistance initiatives at a time when it is closer or farther from the tipping point, depending upon the circumstances. In other words, evaluate when, during the 60-day notice period, the tipping point is. If the risk of loss of a group of employees is significant and the tipping point is at the end of the notice period, provide these employees with enhanced job search support later in the notice period rather than earlier. Included in this assessment is the likelihood of employees finding other employment in light of their skills and market conditions.

In addition, discuss with employees any notice they might give upon resigning. These are often negotiable and employees may be willing to agree to provide more or less than the standard two-week notice.

Be sure to determine where cross training can be done. As fewer and fewer staff members are required, cross training can allow critical employees who may have time on their hands to be retained to their tipping point.

Enhanced severance is often a technique that employers use to motivate employees to stay until the tipping point. For example, employees may be eligible for severance based upon a standard formula. The employer may offer enhanced severance if an employee stays to achieve some milestone or reach some particular date in the future. This dissuades employees from finding employment elsewhere and leaving while the employer still needs their skills. While enhanced severance is often an effective solution, there are many instances in the case of plant closings or mass layoffs where the employer does not have the resources to provide it.

Beyond the Tipping Point

Once the tipping point is reached for an employee or group of employees, all bets are off. The employer no longer needs them, and there is often opportunity for idle time and mischief in the workplace as both the employer and the employees wait for the 60 days to expire. Some employers may consider letting some of these employees go early. However, this must be balanced with the notion that the employer may be giving a free "vacation" to those employees who figure out how to play their cards correctly.

The effective employer will want to again evaluate each employee or group of employees against the risk of them remaining in the workplace as the notice period winds down. What will be the effect on other employees who are still vitally needed? Will there be a decline in morale? What will be the effect on operations? Will idle time result in abuse of policies? Will there be sabotage of equipment? These questions are particularly important when some form of the entity will remain after the mass layoff or plant closing. Ultimately, the employer wants to remove those employees as soon as possible after the tipping point. Hopefully, this is done at the employee's volition as he/she moves proudly on to a new job.

As Employees Depart

The following are just a few areas that should be addressed well in advance in order to help employees and the organization adequately transition.

1. **Unemployment Issues:** A variety of logistical issues will need to be addressed. While notices will be given to local authorities and the requisite state unemployment service, many of these offer sophisticated services beyond simply processing unemployment claims. Resume writing, providing job leads, interview preparation, and the like can be conducted onsite at the facility. These services are often quite robust and free of charge. For an organization in distress, they provide the difference between a layoff that is cold and inhumane and one that is perceived as empathetic and professional. Remember, however, that these services should be timed in conjunction with the appropriate tipping point described above.
2. **Community Outreach:** The breadth of support available in local communities is often an enormous untapped resource. Charitable institutions, religious groups, business groups and the like can often provide a multitude of services to the departing employee.
3. **Outplacement:** while many firms rely on local state employment services to provide job service assistance to employees, many others consider outplacement services provided by a professional services firm. These can by quite costly and are offered at different levels of service depending upon the level of employee. Often these are included as part of any severance given to employees and are, therefore, often subject to a waiver and release.
4. **Benefits Continuation:** Health benefits continuation issues, including COBRA, will be of particular concern to employees especially in the case of a plant closing. Will the plan exist after the plant is closed? Will employees be eligible for benefits continuation under the existing plan or will they be eligible under the plan of a related entity? Will continuation rights not exist at all? Sadly, these questions are often not addressed until the first employee leaves and the organization is forced to determine the appropriate course of action. Always remember that the nature of the underlying transaction, if any, can influence benefits continuation rights.
5. **Retirement Plans:** Also high on the employees' list of concerns is their retirement plan. Again, the nature of the underlying transaction will affect pension and retirement issues. Who will be responsible for distributions? Will any plans need to be

amended to be brought into compliance in order to avoid disqualification issues or to address the contemplated transaction?

6. **Relocation:** Will employees be offered relocation to another facility? How will tax implications be communicated to employees? What level of assistance will be provided? What information will be provided about the new location to employees to review and consider when deciding whether to relocate?

7. **Employees on Disability or Medical Leave of Absence:** All too often an employer fails to provide notice to employees who are on an approved leave of absence. Typically, employees who are on family or medical leave will be forgotten when the notices are issued. At some point long after the notice was required the employer must deal with the fact that it has not provided the required 60 days of notice. The employer must also give consideration to and educate employees as to how disability issues, including workers' compensation claims, will be handled going forward after the party responsible for administration is gone or duties reassigned elsewhere.

8. **Categorization of Pay as Severance or Wages and Other PTO Issues:** Careful thought must be given to the tax and benefit consequences of pay given to employees after they depart. Are these wages for time worked or severance? Are they to be included as wages for the purpose of calculating unemployment benefits? Will these payments affect retirement calculations or benefits? Will these payments be considered wages or salary for the purposes of calculating future workers' compensation premiums? These issues are just a sampling of those that must be addressed with legal and tax guidance.

After Everyone Is Gone

The closing of a facility poses logistical considerations with regard to how necessary activities will take place once the doors have been closed. Assuming there is no trustee in bankruptcy to take care of the affairs of the closed organization, someone else in the organization, typically in another location, must assume responsibility for taking care of many details. Changes in staff and a lack of knowledge of local practices may make these tasks even more difficult. The tip of the iceberg when it comes to these issues includes, but is certainly not limited to:

1. **Paying Out of Benefits:** Retirement plans, COBRA Notices, final paychecks, W-2s, and the winding down of other benefit plans must be taken care of. The simple act of obtaining forwarding addresses or reminding employees to keep a responsible person apprised of their addresses will make the job of winding things down that much easier.

2. **Proper Reporting to the State:** Each state has its own requirements with regard to notification that must be made, tax filings and other reporting.

3. **Record Retention Issues:** What happens to the box of employee files? What about all of the records that were retained for specific periods time in order to comply with regulations? The information that was treated as confidential and locked in a secure location? Lastly, what will happen to information relevant to the distribution of benefits sometime in the future, perhaps decades away?

Conclusion

As one can see, the planning for an effective plant closing or mass layoff requires the organization to go well beyond the creation of the required notice. In reality, the notice is just a small piece of a highly sophisticated plan to retain and secure organizational resources, minimize risk, and ensure the continuation or proper closing down of a business or facility. This plan must be balanced with the need to ensure that employees are treated fairly and equitably, that they remain engaged with the employer until they are no longer needed and that their affairs are addressed in a thoughtful and professional manner.

Endnotes

1. 20 CFR § 639.1(a).
2. 20 CFR § 639.3(a).
3. 20 CFR § 639.3(b).
4. 20 CFR § 639.3(c).
5. 20 CFR § 639.3(c).
6. 20 CFR § 639.4.
7. 20 CFR § 639.4(c).
8. 20 CFR § 639.5(a)(1).
9. 20 CFR § 639.9(a).
10. 20 CFR § 639.9(b).
11. 20 CFR § 639.9(c).

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Legislative Update

By Keith Gutstein and Troy L. Kessler

Introduction

Recent changes in Albany will have long-lasting effects on the landscape of labor and employment law in New York State. As discussed herein, a change in leadership at the New York State Division of Human Rights, paired with various proposals in the New York State Legislature, will undoubtedly impact the rights and remedies available to employees, and the potential liabilities of employers.

> *"Recent changes in Albany will have long-lasting effects on the landscape of labor and employment law in New York State."*

Changes at the New York State Division of Human Rights

At The New York State Division of Human Rights ("The Division"), *the times, they are a changin'*.

When Kumiki Gibson stepped into the role of Commissioner, she promised an overhaul of the Division, and she is living up to her word. Since her appointment in early 2007 by New York State Governor Eliot Spitzer, Commissioner Gibson has significantly transformed key percentages for the Division. According to the Division's website, whereas under the prior commissioner's administration just one in ten investigations resulted in a favorable finding for the complainant, that ratio now has increased to almost one in every three cases.[1] The percentage of complainants who have prevailed in hearings has also increased from 27% to 47% through the first half of 2007.[2] However, these statistics only reveal a part of the transformation currently under way at the Division. Commissioner Gibson has combined some basic initiatives with some significant measures in an effort to reinforce and reflect the original intent of the Human Rights Law. Understanding these changes at the Division is critical for both plaintiff's and defendant's counsels practicing in the area of labor and employment law.

Easier. Faster. More Proactive.

A marked difference between the Division under Commissioner Gibson and her predecessors is her goal of making the process more efficient. The Division's website has been updated to reflect the new philosophy and mission of the commissioner, as well as to offer greater ease of use for potential complainants.

Another strategy she is employing is to spearhead changes in the law that will make it easier for complainants to file a complaint with the Division or proceed to court. The Division is also moving to eliminate the backlog of pending cases. Commissioner Gibson has established a clear goal for tackling the backlog: to resolve each case in 465 days or less, which is the statutory target.[3]

Initiating Investigations

Beyond these basic tactics, the Division under Commissioner Gibson has initiated several investigations of its own, and like the EEOC, has assumed a prosecutorial role. Some of these Division-initiated investigations have already captured media headlines for their pro-human rights stance. Chief among them was a Division-prompted investigation into the East Meadow Union Free School District's (UFSD's) policy of not allowing students to use guide, hearing, and service dogs while in school.[4] The Division's authority to conduct investigations into potential discriminatory practices, which had been challenged by the East Meadow UFSD based on a federal court's prior dismissal of a student's claim under the Americans with Disabilities Act, was affirmed by a recent Supreme Court decision.[5] Similarly, it is anticipated that the Division's initiative will extend to situations involving potential discrimination by employers in the context of the workplace. Note, too, that the Division's actions on behalf of the disabled resulted in its securing the passage of legislation which expanded the rights of persons with disabilities and provided broader avenues for disabled individuals to assert their human rights.[6]

In another Division-initiated investigation, a Wal-Mart motion to enjoin the Division from investigating alleged discriminatory employment practices, which was based on the prior criminal records of three employees, was denied by the Appellate Division, Fourth Department. [7] The Court affirmed the Division's right to investigate Wal-Mart's potential violation of the New York State law in order to assist ex-felons to reenter the workplace. The Appellate Division recognized the Division's role in fulfilling its statutory mandate to prevent and eliminate discrimination and affirmed Commissioner Gibson's position that the Division should serve as an active law enforcement agency.[8]

Legislative Changes

As the Division has been transforming itself by becoming more efficient and by increasingly initiating investigations, there has been a simultaneous push in the New York State Legislature to expand the available remedies under the Human Rights Law. While the Legislature has yet to implement the proposed bills, the mere fact that they have been proposed reveals the desire of many legislators, which is to expand the scope of the Human Rights Law. The following are two examples of bills proposed in the State Legislature which reflect the trend toward expanding the Human Rights Law:

- A2575, sponsored by Assemblyman Jacobs and comparable to the Senate's S1013, seeks to allow the award of punitive damages whenever a case of discrimination is established under the Human Rights Law.
- A2836, sponsored by Assemblyman Morelle, would require the Commissioner of Human Rights to establish a comprehensive management and training plan inclusive of plans for staffing, preservation of evidence, and the establishment of an ombudsperson and permanent training advisory committee as well as the award of attorneys' fees and costs, prejudgment and postjudgment interest, and punitive damages in actions brought for unlawful discriminatory practices.

Such legislation and those of its kind would give the Division broader ammunition in its role to enforce the Human Rights Law.

Awarding Damages and Ordering Training

When Commissioner Gibson recently signed an order finding that the New York State Department of Corrections (DOC) had engaged in egregious sexual harassment of and retaliation against a gay corrections officer, she awarded the plaintiff $850,000 in damages and ordered the DOC to train its employees and enforce policies to prevent discrimination.[9] In her ruling, Commissioner Gibson expressed outrage, noting that, "[t]his case shocks the conscience. This women's life was placed in danger because of her sex and sexual orientation. It is vital that the Department of Corrections take immediate steps to end such horrific discriminatory conduct. In New York, an employer cannot permit, condone, or facilitate discriminatory abuse against an employee."[10]

This order is indicative of the passion the new Commissioner has for the State's Human Rights Law and those it seeks to protect. As the Division, under Commissioner Gibson, gains greater recognition for its strong stance in favor of human rights, it is likely that those whose rights have been denied or jeopardized will come forward in increasing numbers. The Commissioner's extreme sense of urgency in facilitating the role of protecting and affording human rights is evident as the number of new complaints filed between January 2007 and August 2007 rose to 4,252; up 15% from the same period in 2006.[11] Furthermore, probable cause determinations have increased to a rate of one in almost three instances versus the one in ten under the previous administration.[12] How does all of this bode for employers and employees?

Effects on Employers and Employees

With the Division's more user-friendly website, higher profile, and aggressive pro-human rights stance, it is logical to expect an increase in the number of charges filed with the Division, particularly if the Legislature expands the available remedies under state law. Consequently, it is likely that an increasing number of claims will be issued "Probable-Cause" findings and advance to hearings. As such, employers can expect to incur increased expenses in defending these claims than they had previously. This is true even if an employer prevails, because the cost of a hearing exceeds the costs that previously would have been incurred in investigating a claim, drafting and submitting a position statement, and attending the occasional fact-finding conference.

Employers will also experience a change in the way the Division resolves cases. Previously, if an employer showed a desire to discuss a resolution at the early stages, the deadline for submitting a position statement was usually held in abeyance with the cost of preparing a position statement used as leverage by the Division to encourage a settlement. Now the Division is less likely to allow a position statement to be held in abeyance while discussions are going forward. The net result is that the window of time available in which to discuss an early resolution has been essentially closed, thereby forcing employers to make their decisions more rapidly.

Employees are likely to view the new and improved Division as more responsive and focused on human rights and, therefore, a more attractive agency for filing a complaint. They may elect to go to the Division in higher numbers, rather than retain counsel, and choose to file a lawsuit directly in state court, as is their option under New York State law. Of course, the potential increase in complaints filed with the Division and the number of cases referred to hearings could, conceivably, cause a new backlog for the Division. In view of the proposed legislation (e.g., A2575 and S1013) which seeks to allow the award of punitive damages whenever a case of discrimination is established under the Human Rights Law, as well as attorney's fees (A2836), there may be even greater incentive to make the Division a popular forum for claims.

Task Force on Employee Misclassification

Along with a more proactive role of the New York State Division of Human Rights under Commissioner Gibson, Governor Spitzer is also advancing his agenda in the employment law arena. One example is his issuance of an Executive Order to establish a task force to investigate the misclassification of employees as independent contractors.[13] The Joint Enforcement Task Force on Employee Misclassification ("Task Force") was created to address several findings, including:

- An increasing number of New York employers are improperly classifying individuals they hire as "independent contractors";
- Employers sometimes engage in employee misclassification to avoid their legal obligations under federal and state labor, employment and tax laws;
- Employee misclassification has a significant adverse impact on New York's residents, businesses and economy due to its depriving workers of protections and benefits to which they are legally entitled, reduces compliance with employment and safety standards, gives employers who misclassify employees a competitive advantage over law-abiding businesses, deprives the state of substantial revenues, and imposes indirect costs on the State from decreased legitimate business activity and increased demand for social services; and
- Up to 10% of employees covered by audits of New York employment records from 2002 to 2005 may have been misclassified.

In establishing the Task Force, the governor's intent is to address these problems (i.e., inefficiencies stemming from a division of enforcement responsibility with multiple agencies) by creating greater efficiency with enhanced interagency cooperation and enforcement through the joint prosecution of serious violators. In practice, the Task Force will be composed of the Commissioner of Labor, Attorney General, Commissioner of Taxation and Finance, chair of the Workers' Compensation Board, the Workers' Compensation Fraud Inspector General, and the Comptroller of the City of New York. The Commissioner of Labor was designated to serve as the chair of the newly formed Task Force.

Through his executive order, Governor Spitzer has afforded broad power to the Task Force to investigate claims of misclassified employees, initiate enforcement actions and solicit for possible violators through a public hotline. Establishing protocols through which individual Task Force agencies investigating potential misclassification of employees can refer a matter to other participating agencies is also directed in the executive order. So as not to overtly alienate businesses, the governor also mandates that the Task Force consult with business, labor, and community groups to reduce employee misclassification, for instance, through educational materials and measures to prevent misclassification. The order goes on to state that the Task Force should take from its liaison with these groups recommendations for "appropriate administrative, legislative or regulatory changes to:

(i) reduce or eliminate any barriers to the Task Force's operations;

(ii) prevent employee misclassification from occurring;

(iii) investigate potential violations of the laws governing employee misclassification; and

(iv) improve enforcement where such violations are found to have occurred."[14]

The Task Force is clearly charged with identifying successful measures to prevent employee misclassification and thus reduce the need for greater enforcement. Employers should be cognizant of the Task Force and the likelihood that its existence will prompt a significant amount of audits and/or lawsuits. Following the thought, "an ounce of prevention is worth a pound of cure," attorneys representing management would be well advised to counsel their clients on the benefits of conducting a self-audit to make certain that all of their individual workers are properly classified.

Amendment to Labor Law § 191(c)—Commissioned Salespersons

Labor Law § 191(c) has been amended in a manner which has broad implications for commissioned salespersons and their employers. The amendment, effective October 16, 2007, requires commission agreements between salespersons and their employers to be in writing, subject to the following requirements:

> The agreed terms of employment shall be reduced to writing, signed by both the employer and the commission salesperson, kept on file by the employer for a period of not less than three years and made available to the commissioner [of Labor] upon request. Such writing shall include a description of how wages, salary, drawing account, commissions and all other monies earned and payable shall be calculated. Where the writing provides for a recoverable draw, the frequency of reconciliation shall be included. Such writing shall also provide details pertinent to the payment of wages, salary, drawing account, commissions and all other monies earned and payable in the case of termination of employment by either party. The failure of an employer to produce such written terms of employment, upon request of the commissioner, shall give rise to a presumption that the terms of employment that the commissioned salesperson has presented are the agreed terms of employment.[15]

The amendment has significant ramifications for commissioned salespersons and their employers not only by requiring that commission agreements be in writing, signed by both parties, but by requiring that the employer maintain the agreement for three years or risk a presumption that the terms of employment presented to the Department of Labor (or in a lawsuit) by the salesperson are the agreed-upon terms.[16] Moreover, the statute is explicit in delineating the requirement that the commission agreement contain the following provisions: a description of how the commissions, wages, salary and/or drawing account are to be calculated; the requirement that the agreement must contain a statement as to the frequency of the reconciliation if the commissioned salesperson receives a recoverable draw; and a description of the manner in which payments will made to the commissioned salesperson in the event of her termination from employment.[17]

"By placing the onus for compliance on employers, counsel and their respective clients must pay close attention to the new statutory requirements in order to avoid a minefield of potential liability."

A "commissioned salesman [salesperson]" is defined as "any employee whose principal activity is the selling of any goods, wares, merchandise, services, real estate, securities, insurance, or any article or thing and whose earnings are based in whole or in part on commissions."[18] The amendment does not affect the prior portions of the statute which required employers to furnish commissioned salespersons, "upon written request . . . with a statement of earnings paid or due and unpaid."[19] Further, the amendment does not affect the prior portion of the statute which addresses the frequency of payment of commissions, i.e., commissions cannot be paid at a frequency of less than once a month.[20]

By placing the onus for compliance on employers, counsel and their respective clients must pay close attention to the new statutory requirements in order to avoid a minefield of potential liability. The failure of employers to retain such written agreements will lead to significant problems for them. The statute creates a presumption in favor of the terms alleged by the employee if the employer fails to maintain the fully signed agreement (setting forth the required terms). In the event the Department of Labor, prompted by a complaint or audit, requests the production of such an agreement, an employer's failure and/or inability to comply will likely prejudice the outcome of the investigation.

A potential and significant unintended consequence of the amendment may arise in the drafting of these agreements. Specifically, the employer who seeks to address the requirements of the amended statute without the benefit of proper counsel may accidentally create a contract for a fixed term when one was not intended, thereby nullifying the "at will" status of the employee.[21] Accordingly, counsel for both employees and employers must pay specific attention to these agreements.

Proposed Amendment to the Workers' Compensation Law—New York State "Caregiver" Leave

In June 2007, the New York State Assembly passed A9245, which amends the Workers' Compensation Law to provide for the "payment of disability benefits to employees who take family leave, either to bond with a child under the age of one, or to care for a sick relative."[22] The bill entitles an employee to paid leave, funded through disability insurance benefits, for up to 12 weeks.[23] However, the bill does not provide "job protection" for those employees who choose to take the leave referenced in the bill.[24] As of the date this article was drafted, the bill has been "delivered" to the New York State Senate Rules Committee.

"Disability," as used in the Workers' Compensation Law, is defined as:

> the inability of an employee, as a result of injury or sickness not arising out of and in the course of an employment, to perform the regular duties of his employment or the duties of any other employment which his employer may offer him at his regular wages and which his injury or sickness does not prevent him from performing . . . . disability also includes disability caused by or in connection with a pregnancy.[25]

If enacted, the bill would broaden the definition of the term "disability" under the Workers' Compensation Law § 201(9), to include "family leave."

Currently, there is no New York State family leave law, and the federal Family Medical Leave Act (FMLA) is available only to employees who work for employers that employ 50 or more employees.[26] Under the FMLA, employees are entitled to 12 weeks of unpaid leave. Moreover, employees who take FMLA leave are "protected" in that employers must return those employees to their original position, or an equivalent, upon returning from leave.[27] Thus, under the FMLA, unlike A9245, there is a strong element of "job protection."

The Assembly's focus in passing the bill was clearly to grant employees an element of income security if they opt to take leave. A statement issued by the Assembly in support of A9245 cited a national study which revealed that "seventy-seven percent" of employees refrained from taking FMLA leave, to which they were entitled, due to the fact that the FMLA provides only for unpaid leave.[28] In response, A9245 provides for paid leave in the form of disability benefits (up to $170 a week) to employees who opt to take leave. However, it remains unclear as to how many employees would choose to take leave if they knew that the law failed to provide them with "job protection."

The New York State Assembly's version of the leave law, which has a clear emphasis on employees who act as "caregivers," is in conformity with recent Enforcement Guidance promulgated by the United States Equal Employment Opportunity Commission (EEOC). As of May 22, 2007, the EEOC issued Enforcement Guidance regarding improper treatment of "workers with caregiving responsibility."[29] The Enforcement Guidance was issued because "changing workplace demographics, including women's increased participation in the labor force, have created the potential for greater discrimination against working parents and others with caregiving responsibilities."[30]

In light of the evolving trend at the EEOC towards protecting employees who act as "caregivers," together with the fact that the FMLA covers only those employers with 50 or more employees, the progress of A9245 must be kept under close watch by practitioners, as well as employees and their employers, as it brings New York closer to having a family leave law. However, unlike the FMLA, which makes it unlawful to take adverse employment action against an employee who takes FMLA leave, A9245 does not "confer [any] job protection [to] employees who would take leave under the proposed bill."[31] As the Statement in Support of A9245 declares, "only employees covered by FMLA . . . would have job protection under this bill."[32] Accordingly, if A9245 passes the Senate and is signed into law by the governor, it is unclear whether the bill will have the Assembly's desired effect of increasing the number of employees who opt to take leave to care for family members, as the bill fails to provide any guarantee to workers about the safety of their jobs should they choose to take leave.

Proposed Amendment to the "Whistleblower" Law

In June 2007, the New York State Assembly passed A9247, which provides for "protection to employees from retaliatory actions by employers where such employees report illegal business activities."[33] If the bill eventually becomes law, it would have dramatic implications for practitioners in the area of labor law, as it would substantially expand whistleblower protections for individuals employed within New York State and would likely increase the amount of litigation by employees who are whistleblowers. The bill has been "delivered" to the New York State Senate and has been referred to the Rules Committee.

Currently, whistleblower protections are limited to employees who "disclose or threaten to disclose to a supervisor or to a public body an activity, policy or practice that is in violation of the law, rule or regulation which violation creates and presents a substantial and specific danger to the public health or safety or which constitutes health care fraud."[34] In order to obtain whistleblower protection, the employee must first bring the "activity, policy or practice in violation of law, rule or regulation to the attention of a supervisor of the employer and has afforded such employer a reasonable opportunity to correct such activity."[35] Further, whistleblower protections are also currently available to employees in the health care field who "disclose" or "object" to a "practice or policy" which constitutes "improper quality of patient care."[36]

The key phrases with respect to the current whistleblower laws are that the "policy or practice" at issue must either relate to "danger to the public health or safety" or "improper quality of patient care." If the disclosure by the employee relates to any other kind of malfeasance on the part of the employer, and the employer then retaliates against the employee, current New York law does not provide for a whistleblower cause of action by an employee against their employer.[37] Additionally, under current New York law, even if the malfeasance relates to activities which present a substantial and specific danger to the public health, employees must still comply with the requirement that the same must be reported to their supervisor, and the employer must be provided with a reasonable opportunity to correct the activity in question.[38]

Thus, A9247 would serve to substantially alter the landscape of whistleblower liability by creating a cause of action for those employees who are retaliated against by their employers for the disclosure of "illegal business activities."[39] This would serve to increase the extent litigation, as for example, the disclosure of illegal financial activities by an employee would now entitle them to protection under the amended statute. The amendment would serve to foster the Assembly's stated goal of encouraging employees "who wish to report violations of law by their employers."[40] For practitioners, as well as employees who face adverse employment action, the bill would also have the effect of creating a potential cause of action for employees against their employers.

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What Is International Employment Law Practice?

By Donald C. Dowling, Jr.

In the beginning there were lawyers who practiced labor law in front of the National Labor Relations Board and its Administrative Law Judges. Then an offshoot practice evolved for the nonunion sector: employment law. In the last few decades, the subconcentrations of labor and employment law practice multiplied: Occupational Safety and Health Act. Workers' Compensation. Wage-Hour and Fair Labor Standards Act litigation. Employment counseling. Antidiscrimination litigation. Employment class actions. Employee benefits and its "sub-subconcentrations," ERISA counseling, ERISA litigation, and executive compensation.

The most recent labor and employment law subconcentration to emerge is international labor and employment law. Although new, this practice is already so evolved that its practitioners now get selectively listed. *PLC Which Lawyer*? ranks lawyers practicing USA International Labor and Employment Law. In 2007 a publisher released the first-ever international employment law school casebook for the U.S. market, *The Global Workplace—Cases and Materials*.

As the newest subconcentration of labor/employment practice, international employment law may be the least understood. Not everyone knows exactly what international employment practitioners do—and don't do. Let's answer the most common questions about this practice.

Q Why would a multinational client retain a U.S. international employment lawyer rather than an expert local practitioner licensed in the foreign country at issue?

A Let's distinguish *international* employment law from *local foreign* employment law. An employment law problem that arises in a single foreign country is of course best handled locally. For a strike in Brazil, hire a Brazilian labor lawyer. For a dismissal in China, engage a Chinese employment lawyer. To draft an independent contractor agreement in Turkey, retain a Turkish lawyer.

"International" means "among nations." *International* employment lawyers quarterback multicountry projects, advising on *cross-jurisdictional* questions that simultaneously implicate the employment laws of two or more countries. On these matters, foreign local lawyers are generally competent to advise on only the slice of the project that affects their local country.

Q U.S. lawyers are licensed state by state. How can U.S. state-licensed employment lawyers possibly practice in Canada or Mexico—let alone New Zealand or Uruguay?

A They don't. When necessary, international employment lawyers get opinions from foreign local counsel. This is exactly what international lawyers of other disciplines do—international mergers and acquisition lawyers, international antitrust lawyers, international banking lawyers.

Imagine, hypothetically, a multinational launches some new product in 24 countries and needs to secure global trademark/copyright protection for its logo and slogan. That company would turn to an international intellectual property lawyer who, coordinating with foreign local IP counsel, oversees the 24-country trademark/copyright compliance project. From a process standpoint, that is exactly what an international employment lawyer does when a multinational with employees in 24 countries launches a global stock option plan or carries out a global reduction in force or globally aligns its pre-employment screening procedures.

Q I'm representing a German company in a sexual harassment case that arose in their Dallas office. Separately, I'm defending a nationality discrimination EEOC charge filed by an Iraqi immigrant working in Austin, and I'm advising a Houston employer with a lot of Mexican workers on its English-only policy. Am I practicing international employment law?

A No. These are domestic U.S. law matters. The *parties* may have some links to foreign countries, but the *legal questions* implicate U.S. domestic employment law only, not foreign law. By contrast, international employment law involves cross-border facts and cross-jurisdictional employment law questions.

We can distinguish *inbound* from *outbound* international employment practice. From the point of view of a U.S. practitioner, advising an incoming foreign-owned employer (or an incoming foreign-citizen expatriate) on U.S. domestic employment law issues is inbound, whereas advising a U.S.-based multinational on employment matters overseas is outbound. Inbound international employment practice is vital. The issues and skills involved, however, are largely (although not completely) the same as in a domestic labor/employment practice. Outbound matters tend to be the ones that implicate foreign laws.

Q What's the difference between international employment practice and immigration practice?

A These are two distinct areas. Immigration is a vital practice, but it is distinct from "international employment law" as we are defining it here. Immigration lawyers get government permissions for clients to stay in a country. Many visas are not linked to employment status, and many immigration clients are not employed. While immigration matters often arise in the employment context, U.S. immigration is an inbound practice, and it is not substantively employment law—the immigration Title of the U.S. Code is structurally separate from U.S. Code titles on labor and employment. That said, international employment law projects may have an emigration component—securing foreign host-country visas for outbound expatriates. Also, U.S. and foreign immigration law issues arise in global workforce restructurings and cross-border mergers and acquisitions.

Q Speaking of immigration, do all the global workforce mobility and migration these days feed the international employment law practice?

A Less than it may seem. The rise of the international employment practice is more a function of business pressure to globalize operations (globally align workforces) than any spike in expatriate postings. Expats have always been a key piece of the international employment practice, and expat work remains as thriving as ever. But because of the upswing in international matters addressing foreign local employee populations, as the international employment practice pie gets bigger, the expat slice might be, if anything, shrinking.

At those Fortune 500 multinationals with thousands of employees outside the U.S., usually just 1 to 3% of the overseas employee population are expats. International employment law practice involves those expats as well as the other 97 to 99% of employees abroad—the foreign locals. On a per-employee basis, expats need more "care and feeding" (legal attention) because of their involved "secondments" (foreign assignments), benefits, and terminations. But many of the complex projects in an international employment practice tend not to be expat driven.

Q Then what kinds of client matters do international employment lawyers work on?

A Globalization means certain human resources issues that a decade ago would have been relegated to overseas control now get driven from U.S. headquarters. As such, corporate headquarters now tend to seek international employment law advice on 15 types of matters:

1. Global employee contract documents, handbooks, codes of conduct, ethics codes, discrimination/harassment/diversity policies, other global human resources policies, affinity groups—and global training
2. Global whistleblower hotlines (compliance with Sarbanes-Oxley § 301 and foreign data privacy and labor laws)
3. Global reductions-in-force and workforce restructurings
4. Global compensation, benefits, commission, bonus, equity, and severance pay plans
5. Global human resources information systems (compliance with foreign data privacy laws)
6. Global employee communications (compliance with labor and language laws)
7. Human resources in international mergers and acquisitions (due diligence and contract drafting through postmerger integration)
8. Cross-border labor representation strategy (union/works council alignment, foreign negotiations over headquarters' global mandates, response to global "corporate campaigns," and secondary boycotts)
9. "Sweatshop" (supplier) codes of conduct and monitoring (compliance with local laws and corporate policies on human rights)
10. Human resources issues in "offshoring" and international outsourcing
11. Overseas independent contractors (avoiding de facto employee liability)

12. Global applicant background checks/screening and global employee surveillance (video, computer)

13. Headquarters-driven global oversight of local employment law compliance

14. Duty of care/managing exposure to employee personal injury claims arising abroad (terrorism, pandemics, dangerous assignments, employee security)

15. Expatriates (secondment arrangements, benefits, terminations, repatriation)

Q Since international employment lawyers are not licensed in foreign jurisdictions, their chief role on these projects would seem to be collecting up and packaging advice from foreign lawyers. Right?

A No. When international employment lawyers get together and "talk shop," their biggest frustration is the misunderstanding that their practice means shuttling back and forth as intermediaries between U.S. clients and foreign counsel. Like other types of international lawyers (international business lawyers, international arbitration lawyers, international tax lawyers), international employment practitioners advise clients on cross-border legal strategies and principles that apply across jurisdictions. Gathering advice on specific foreign local rules, like all legal research, can be critical. But local advice gathering is not necessarily the main "value-add" of an international law practice, and in fact—like domestic legal research—is often efficiently delegated to junior lawyers.

American employment at will is unique in the world. The other side of that coin is that the labor/employment law principles arising outside the U.S. are radically different from our doctrines stateside. To advise U.S.-based clients on outside-U.S. human resources strategies, an international employment lawyer needs to understand foreign employment law principles well enough to discuss them in a cold phone call from a client or prospective client. This means being ready to distinguish, for example:

- unfair dismissal damages vs. wrongful dismissal damages vs. statutory severance pay vs. payment in lieu of notice
- collective redundancies for an ETO (economic, technical, or organizational) reason vs. unjustified redundancies
- vested rights vs. acquired rights in the transfer of undertakings context
- individual consultation vs. collective information and consultation vs. worker participation
- works councils in member states of the European Union vs. European Works Councils vs. Asian worker committees
- white unions vs. enterprise unions vs. independent trade unions vs. trade union confederations vs. trade union political parties
- sectoral collective bargaining agreements vs. enterprise-level agreements
- transposition of social directives vs. direct effect
- model contractual clauses vs. binding corporate rules vs. safe harbor
- statutory termination procedures vs. mandated employer-issued DDPs (dismissal and disciplinary procedures)
- mandatory profit sharing vs. *aguinaldo*
- employment services companies vs. foreign operating subsidiaries
- dual employer liability vs. PE (permanent establishment) liability
- positive action vs. victimization
- bullying and mobbing vs. moral and psychosocial harassment
- end-of-service gratuities vs. superannuation

Expect in-house employment lawyers and human resources professionals at multinational clients already to understand the terms on this list. Sophisticated clients seek outside international employment law advisors who have mastered these concepts well enough to offer creative strategies—not go-betweens who need to call foreign lawyers to clarify terms.

Beyond addressing these foreign law principles, international employment lawyers also advise U.S.-based clients on why and how, overseas, they need to replace or radically restructure many American-made human resources tools tailored for the unique U.S. employment-at-will environment, such as:

- employment-at-will clauses and handbook disclaimers
- detailed employee handbooks
- mandatory applicant and employee consents/acknowledgements
- union avoidance strategies
- applicant drug testing and credit checks
- diversity plans/metrics, race/ethnicity tracking, affirmative action plans and affinity groups

- fraternization/nepotism policies and employee dating restrictions
- expressly anonymous, mandatory whistleblower hotlines
- adverse impact analysis
- health care benefits and other benefits restricted to regular full-time employees
- vacation and retirement benefits that increase with job tenure

Q I attended a bar association program, "International Employment Law," where the speakers focused on the extraterritorial reach of U.S. discrimination laws and on the trend to invoke the Alien Tort Claims Act (ATCA) in U.S. court class actions on behalf of foreign workers. Aren't these issues at the core of U.S. international employment practice?

A Not necessarily, although these issues are important. In daily practice, the extraterritorial reach of U.S. discrimination laws seems to arise most often as one among several issues in U.S. expatriate postings and terminations. But as already discussed, expats are just one slice of the international employment law practice pie, and so the extraterritorial reach of U.S. discrimination law is just a piece of that slice.

ATCA and other theories grounding purported class actions in U.S. courts on behalf of foreign employees may not have been widely successful, but there have been a number of very large and important cases over the years. However, there is probably not enough of a "critical mass" of these lawsuits or of extraterritorial reach of U.S. discrimination law claims to ground a practice for many international employment litigators.

Q Is international employment law purely a management-side practice?

A No. Labor/employment lawyers other than those representing employers also have international practices:

- Some lawyers who represent individual employees handle expatriate "secondments" and expat terminations that implicate laws in two or more jurisdictions.
- Some class action lawyers have handled claims in U.S. courts on behalf of allegedly victimized workers abroad.
- Some lawyers who represent labor unions get involved in international "corporate campaigns" and cross-border secondary boycotts against multinationals.
- Some employment lawyers work for the International Labour Organisation, the World Trade Organization, and the U.S. agencies administering labor-side agreements to trade treaties like NAFTA.

Q What is the future of the international employment law practice?

A Corporations' focus on compliance, together with the globalization trend, push multinationals to take a global approach to many (if not all) aspects of human resources and employment law compliance. Multinationals in the global information age increasingly wrestle with cross-border talent problems and increasingly demand counselors even more fluent in international employment law concepts as they are themselves. This demand will spur growth in the practice of international employment law in coming years.

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Chinese Employment and Labor Law: Current Status and Future Developments

By Junlu Jiang

I. Introduction

This article gives an overview of the current labor laws in the People's Republic of China and provides a brief analysis of the latest developments. The article consists of two parts: The first part deals with legal regulations and policies currently in force; the second part introduces the proposed legislation on employment contract law, where some comments are also put forward for discussion.

II. Status Quo

The Labor Law of the People's Republic of China (hereinafter referred as the "Labor Law"),[1] adopted by the Standing Committee of the National People's Congress in 1994, serves now as the basic system of rules in the area of employment and labor law. Its position and stipulations on some important issues are summarized below.

A. Termination of Employment Contracts

In China it is difficult for an employer to terminate an employment contract before expiry. Under the Labor Law, an employer may terminate an employment contract before its expiry in the following four situations:

- **Article 24:** An employment contract may be terminated upon agreement of parties concerned through consultation.
- **Article 25:** An employer may terminate an employment contract if one of the following cases occurs: 1) a worker is proved to be not up to the employment standards within the probationary period; 2) an employee has seriously violated labor discipline or the rules and regulations laid down by the employer; 3) an employee is in serious dereliction of duty or has resorted to deception for personal gains and caused serious losses to the interests of the employer; 4) an employee has been affixed with criminal responsibility.
- **Article 26:** In one of the following cases, an employer may terminate an employment contract, but must give a written notice to the employee thirty days in advance: 1) an employee, after a treatment of disease or non-job-related injuries, is unable to do the job assigned by the employer; 2) an employee is not competent for the job assigned to him and still falls short of the standards even after being trained or given other jobs; 3) an employment contract can no longer be performed due to major changes in the objective conditions of the employer and a revision cannot be reached through consultation by both parties.
- **Article 27:** When an employer needs to cut employment due to near bankruptcy and in a period of legal rectification or due to difficulties in its production or business operations, the trade union or all the workers are to be informed of the true situation, with their opinions heard and conveyed by the employer to the labor administration department. If an employer who has cut employment according to the provisions of this article recruits workers again within six months, priority is to be given to the employees who were formerly discharged.

However, the right of the employer to dismiss an employee under certain of the above provisions is restricted under the following circumstances. Thus, according to Article 29 of the Labor Law, the employer is prohibited from terminating the employment contract in accordance with Articles 26 and 27 where any one of the following circumstances arises: 1) an employee has been confirmed to have lost totally or partially the capability to work due to occupational disease or a job-related injury; 2) an employee is in the period of treatment for diseases or injuries; 3) a woman employee is in the pregnancy, lying-in or breast-feeding period; 4) certain other cases as provided for by law or administrative decrees.

Of course a resignation by an employee can as a matter of law be accepted.

B. Overtime and Work Hours

1. Standard Working Hours

The term "standard working hours" refers to the working hour system implemented by employers under normal conditions, as stipulated by the laws and regulations, and is divided into daily and weekly working hours. "Standard daily working hours," also called a working day, are the working hours arranged by an employer for each 24-hour period, from morning to evening. "Standard weekly working hours," also called a working week, are the working hours arranged by an employer for each seven-day week. According to the standards for working hours currently implemented by the Chinese Government, a working day consists of eight hours and a working week consists of forty hours over a five-day week.

An employer that cannot satisfy the above requirements mandated by Articles 36 and 38 of the Labor Law because of special production circumstances may implement other measures for work and rest time in accordance with the requirements of Article 39 of the Labor Law and with the approval from the labor administration department. For example, it may adopt flexible measures for arranging work and rest time. More specifically, an enterprise may implement a system of non-fixed working hours or a system of comprehensive calculation of working hours according to the enterprise's special production circumstances, the special nature of the work involved, or the individual employee's position.

Note that a "non-fixed working hour system" is a system whereby working hours are not calculated according to a fixed-length working day. Following approval from the labor administration department of the People's Government, employers which adopt a non-fixed working hour system will not be subject to the restrictions set out in Article 41 of the Labor Law relating to extended standard daily working hours and extended standard monthly working hours. However, such an employer must adopt flexible working hours and other suitable work and rest time options so as to guarantee the right of its employees to take rest and holidays as well as fulfill their production and work assignments.

An enterprise may implement a system of non-fixed working hours for any of the following employees:[2]

- Senior managerial personnel, field personnel, sales personnel, some shift employees and other employees of an enterprise whose standard working hours cannot be assessed owing to the nature of their work.
- Long-distance transport personnel of an enterprise, taxi drivers, some railroad, port and warehouse personnel engaged in loading and unloading of cargo, and other employees who are required to work on an ad hoc basis due to the special nature of their work.
- Other employees for whom the system of non-fixed working hours is suitable due to the special circumstances of production, special work requirements, or the scope of their job duties.

2. Extension of Working Hours

The term "extension of working hours" is referred to in Article 41 of the Labor Law and includes overtime worked during normal working days and also overtime worked on rest days and legal holidays. Specifically, the total amount of overtime worked on normal weekdays, rest days and legal holidays is not to exceed thirty-six hours per month. Until such time as the legislative arm of the PRC enacts legislation providing further interpretation of this regulation, it is to be enforced accordingly.

According to Article 44 of the Labor Law, when arranging the overtime pay for a worker's overtime, the enterprise is to pay not less than one hundred fifty percent of the normal wage. When arranging for employees to work overtime during rest days, the employer should first consider making arrangements for employees to take alternative rest days, but when such alternative rest days cannot be arranged, the employer is to pay such employees no less than two hundred percent of their normal wage. Alternative rest time should be provided in the same time period as the overworked time. When arranging for employees to work during a legal holiday, the employer should pay no less than three hundred percent of their normal wage, and in general alternative rest days may not be used to substitute legal holidays.

C. Vacation and Holidays

1. Holidays

According to the stipulations of the Labor Law and the *Measure Regarding National Standards for Annual and Commemorative Holidays* (revised by the State Council on 18 September 1999), employees are entitled to two days of rest per work week. Each employee is entitled to a total of ten legal holidays every year as follows:

- New Year's Day (1 January)—one day
- Chinese New Year/Spring Festival (the first, second and third days of the first month of the lunar calendar)—three days
- Labor Day (1, 2 and 3 May)—three days
- National Day (1, 2 and 3 October)—three days

In addition to the above, there are certain holidays which are eligible for certain employees, but not all. For example, there is Women's Day (8 March), which is a half-day off for all female employees. And there are those traditional holidays observed in accordance with the customs of ethnic minorities that are stipulated as holidays by the People's Government at the provincial level of the relevant ethnic minority regions.

Should any of the above national holidays fall on weekends (i.e., Saturday or Sunday), employees are eligible for additional day(s) off on the following work day(s). Those holidays which are observed by certain group of ethnic minorities, but not all, which are not stipulated by the People's Government, are not to be carried over and taken on the next workday, should they fall on a weekend.

2. Leave

(i) Annual Leave

Employees who have worked for longer than one year continuously are entitled to annual leave with pay. Specifically, Article 45 of the Labor Law stipulates that:

> The State shall implement a system of paid annual leave. Employees who have

> worked continuously for at least one year are entitled to annual leave, the detailed measures for which shall be stipulated by the State Council.

However, the State Council has not promulgated the detailed measures. Until the State Council promulgates those measures, enterprises should continue to adhere to the Notice on Issues concerning Employees' Annual Leave, jointly promulgated on 15 June 1991 by the Central Committee of the Chinese Communist Party and the State Council. This notice stipulates that:

> When determining the amount of annual leave to be given to employees, the enterprise shall differentiate among various factors, such as the work obligations, qualifications and work experience and position of the different types of employees as well as other factors. However, in any event, annual leave may not exceed two weeks.

Therefore, although employees are entitled to annual leave, the management personnel of the enterprise has the discretion to grant the appropriate amount of time for annual leave to employees according to their qualifications, work experience and position in the enterprise, subject to the legally mandated two-week limit.

(ii) Family Leave (Covering Employees in State-Owned Enterprises)

According to the Regulations Regarding Family Leave for Employees,[3] an employee who has worked for more than one year, who does not live with his or her spouse, and who is unable to visit the spouse on public rest days (weekends), is entitled to take leave in order to visit his or her spouse. An employee who has worked for more than one year, and does not live with his or her parents and is unable to visit the parents on public rest days (weekends), is entitled to take leave in order to visit the parents.

The term "parents" here includes the adults who raised the employee as a child and relatives whom the employee is currently supporting. It does not, however, include parents-in-law. The family leave regulations for married and unmarried employees are as follows:

- Married employees are given one thirty-day period per annum to visit their spouses.
- Married employees are given one twenty-day period for every four years to visit their parents.
- Unmarried employees should, in principle, be given one twenty-day period per annum to visit their parents. If, due to work requirements, the employer is unable to give family leave, or if the employee agrees to do so, family leave may be taken as one forty-five-day period every two years.

The period of family leave consists of the time for the employee visiting his or her spouse or parents and, in addition, the time period of leave granted for traveling, as the actual circumstances require. The aforementioned leave periods all include public legal holidays and legally stipulated holidays within the period granted.

D. Social Insurances

In China social insurances are regulated by the Labor Law, which covers pension, medical care, work injury and unemployment as well as maternity.

1. Basic Pension

Pursuant to the Labor Law, both employer and employee are required to pay basic pension insurance premiums, and should make full payment on time. Where premiums are not paid in full and on time, the corresponding amounts will not be credited to the employees' individual accounts, and the pension fund will not cover the cost of such retired employees. The employer has the duty to withhold such payments from the employee's salary.

2. Enterprise Supplementary Pension Insurance

The term "enterprise supplementary pension insurance" refers to a type of social insurance provided in addition to basic pension insurance, which the Chinese Government encourages enterprises to establish on behalf of their employees, in accordance with the financial status of the enterprise, after basic pension contributions have been promptly made in full. It is a second "tier" of the pension insurance system and plays a complementary role to the basic pension insurance: Employers often provide supplementary pension insurance to their key or outstanding employees as an incentive, in order to retain such employees and increase morale.

Social insurance and commercial insurance are different from each other. The social insurance is implemented by the state in accordance with the laws and administrative regulations and is therefore mandatory: Such social insurance aims to provide fair and reasonable welfare and basic protection for the livelihood of employees and is not intended to make a profit. On the other hand, commercial insurance establishes a relationship on the principles of mutual consent and fairness between the insurance company, whose intention is to make profit, and the insured.

E. Medical and Maternity Leave

1. Medical Leave Period for Enterprise Employees for Illness or Non-Work-Related Injuries

According to the *Regulations for the Medical Leave Period for Enterprise Employees for Illness or Non-*

Work-Related Injuries, when an enterprise's employees must stop work due to illness or non-work-related injuries and must undergo medical treatment, a medical leave period of between three and twenty-four months is to be provided for the employee, according to the employee's actual number of years of employment with the prior employer and the number of years of employment with the current employer.

Employees who have actually worked for fewer than ten years in total, including prior employment, and fewer than five years with the current employer, are eligible for up to three months of medical leave, and those who have worked for more than five years with the current employer are eligible for up to six months of medical leave.

Employees who have actually worked for more than ten years in total, including prior employment, but fewer than five years with the current employer, are eligible for up to six months of medical leave, and those who have worked for more than five years with the current employer are eligible for up to nine months of medical leave. Those who have worked with the current employer for between ten and fifteen years are to be given twelve months of medical leave, those who have worked with the current employer for between fifteen and twenty years are to be given 18 months of medical leave. Finally, those who have worked with the current employer for more than twenty years are to be given twenty-four months medical leave.

The foregoing is set out in the following chart.

Entitlement to medical leave period		
Total years worked	**Employment with the enterprise**	**Medical treatment period (months)**
Fewer than 10 years	Fewer than 5years	3
	More than 5years	6
More than 10 years	Fewer than 5 years	6
	5-10 years	9
	10-15 years	12
	15-20 years	18
	More than 20 years	24

Employees entitled to three months of medical leave are allowed to take a total period of six months medical leave; those entitled to six months are allowed to take a total period of twelve months medical leave; those entitled to nine months are allowed to take a total of fifteen months medical leave; those entitled to twelve months are allowed take a total of eighteen months of medical leave; those entitled to eighteen months are allowed to take a total of twenty-four months medical leave; those entitled to 24 months are allowed to take a total of thirty months medical leave.

Medical leave period (months)	Total period allowed for medical leave (months)
3	6
6	12
9	15
12	18
18	24
24	30

During an employee's medical leave period, the employees' sick pay, illness relief funds and medical treatment will be implemented in accordance with the relevant regulations.

In addition, employees who have serious illness (such as cancer, mental illness or paralysis) and fail to recover within twenty-four months are entitled to extend the medical treatment period upon approval by the enterprise and the supervisory labor department.[4]

2. Maternity Leave

Female employees who have not violated the relevant state regulations on family planning are entitled to the following maternity leave.[5]

- Female employees are eligible for no fewer than ninety days of maternity leave, including fifteen days before childbirth and seventy-five days afterward.
- For female employees who experience a difficult childbirth, fifteen extra days may be added. If the female employee gives birth to more than one child, fifteen extra days may be added for each additional child in one delivery.
- For female employees who have a miscarriage, the enterprise is to grant maternity leave based upon documentation from the medical department. Female employees are entitled to fifteen to thirty days of maternity leave after a miscarriage in the first four months of pregnancy and forty days maternity leave for a miscarriage after four months of pregnancy.

F. Work Injury Benefits

All types of enterprise and individual industrial and commercial business operators who hire workers in the PRC are to participate and purchase work injury insurance stipulated in the *Regulation for Work Injury Insurance* and pay premiums for work-related injury insurance for all staff and workers hired.

An employee who suffers a work-related injury or from an occupational disease and requires temporary absence from work in order to receive treatment during the paid medical leave period will receive the original salary and benefit and be paid by the employer monthly.

An employee who suffers from a work-related injury may request termination of the employment relationship with the employer, and the employer will make a one-time payment of a medical subsidy for the work-related injury and an employment subsidy for the injured employee. The specific amount will be determined by the appropriate governmental authority of the province, autonomous region or centrally-administered municipality.

The benefits available for employees injured in the course of work in Beijing are prescribed in accordance with Article 15 and Article 18 of the *Regulation for Work Injury Insurance for People Working for Enterprises in Beijing*.

G. Retirement / Pension Benefits

Article 73 of the Labor Law stipulates that employees are to receive the following social insurance benefits in accordance with the law:

- Pension benefits following retirement (male employees who have reached the age of sixty or female employees who have reached the age of fifty (blue collar workers) or the age of fifty-five (white collar workers) whose continuous time worked totals ten years.
- Medical treatment benefits for persons suffering from an illness or non-work-related injury.
- Work-related injury benefits for persons who are disabled as a result of a work-related injury or who suffer from an occupational disease.
- Unemployment benefits for persons who are unemployed.
- Maternity benefits for females who give birth to children.

Employers should provide social insurance for their employees through the local insurance organizations, in accordance with the type of social insurance and contribution standards stipulated in the Labor Law and other laws. Enterprises should promptly make contributions in full payment to the corresponding insurance funds.

H. Housing Allowance

The development of housing funds has been beneficial to managers and employees of FIEs (Foreign Invested Enterprises) in a number of ways. By contributing a relatively small amount, the employer can participate in the housing fund system without penalty.

Foreign enterprises and their employees in Beijing are to contribute to the social insurance funds and the Housing Fund as follows:

Contribution Rates in Beijing

Fund \ Contributor	Employer	Employee (Percentage of individual wage)
Basic Pension	19%	7%
Basic Medical Insurance	9%	1%
Unemployment Insurance	1.5% of total payroll	0.5%
Work-related Injury Insurance	0.2%-1.9% of total payroll	Does not contribute
Maternity Insurance	Not Applicable	
Housing Fund	10% employee's actual wage	10%

I. Restrictions on Confidentiality Agreements and Non-Compete Agreements

A "trade secret" refers to proprietary technical information and business information relating to production, sales and operations that is unknown to the public, is of economic benefit to employer, has a practical application, and for which reasonable protective measures have been adopted by the employer (regardless of the type of medium on which the trade secret is stored or recorded). If the above information has fallen into the public domain, the company cannot list them as its own secret information.

Under Chinese Law, the term of the non-compete obligation may not exceed three years and the company must pay the employee the agreed-upon amount of monetary compensation in consideration of his/her performance of the non-compete obligations, failing which the employee can not be legally obligated to adhere to such obligation.

III. Proposed Developments

In November 2005, the proposed draft Employment Contract Law was approved by the State Council for submission to the NPC Standing Committee for its ratification. The first deliberation has already been finished, and the second began in October 2006. As another principal law in this area, it is expected to promote greatly the development of Chinese labor law. This part of this article deals with some problems emerging in the course of the discussions concerning the draft. The answers set forth below to these questions represent only personal opinions and may deviate from the official Employment Contract Law finally promulgated.

A. Enterprises that Fail to Sign Employment Contracts with their Employees

China's current Labor Law requires an employer to enter into a written employment contract with each employee when an employment relationship is established between the two. The legitimacy of oral employment contracts is generally not recognized by law, unless the employer and the employee have no disagreement on the content of the contract. In normal cases, the supervisory body[6] of the Ministry of Labor and Social Security will impose an administrative penalty on the entities or individuals who fail to sign an employment contract with their employees upon the establishment of an employment relationship.

The Employment Contract Law draft also stipulates the duration of employment contracts and imposes heavier legal obligations on employers who fail to sign employment contracts with their employees. Where the employer fails to sign a contract with the employee, the duration of the employment relationship is deemed to be for an indefinite period, or a long-term employment contract. (Some academics recommended that it should default into a three-year contract.) Considering the strict restrictions of the current Labor Law on the termination of employment contracts, such long-term contracts are likely to impose substantial pressure on employers in terms of the flexibility of their recruitment.

Enterprises should pay great attention to the concern and attitude of the Employment Contract Law draft toward enterprises that fail to enter into employment contracts with their employees. They should enter into fixed-term employment contracts with their employees according their actual needs.

B. Employers' Obligation to Compensate Employees upon the Termination of Employment Contracts

China's current Labor Law does not require employers to compensate their employees when an employment contract is terminated upon expiration. However, some provinces or municipalities, such as Fujian province, have local regulations or rules that require employers to do so.

Compensation refers to money received by the employee from the former employer for purposes of the employee's living and job hunting expenses after the contract termination. This is remuneration paid in another form to reward the employee for his or her contribution to the employer. Under the current Labor Law, employees whose employment contracts are terminated due to their incompetence may still receive compensation. However, the employees whose contracts are terminated upon the expiration of the contract (where no mistakes are made) are not entitled to such compensation. Such a practice has been considered inequitable. More importantly, the fact that employees are not entitled to compensation upon the expiration of the employment contract has resulted in the prevalence of short-term employment contracts, and the tendency of employers to favor shortening the contract duration. This phenomenon has attracted the attention of the whole society.

Since China's Labor Law sets stringent restrictions on the rescission of employment relationships but overlooks the imposition of restrictions on the termination of employment contracts, a large number of enterprises choose to sign one-year contracts with their employees to get around the labor law's restriction on prematurely rescinding employment contracts.

In the discussions about the draft Employment Contract Law, the issue of appropriate measures to combat the tendency of shortening employment contract durations attracted a lot of attention. One suggested measure is to require enterprises to deem employment contracts automatically renewed twice as long-term contracts; another is to require enterprises to compensate their employees upon the expiration of the contract. For each year the employee served in the organization, the employee should receive one or two months' pay as compensation. The latter measure has received more widespread support.

Pursuant to these views, it is crucial for enterprises to make adjustments to their human resources policies and systems and to decide on the duration of employment contracts, modify staff handbooks, establish or revise performance appraisals and punishment criteria according their situation and needs. This way, enterprises can keep the people they need and let go of the ones they don't need.

C. Statutory Requirements on Enterprises' Internal Labor Rules

The concept of "internal labor rules" of an enterprise refers to the system of day-to-day human resources management, including documents setting forth the specific rights and obligations of the employees. Enterprises may manage their staff according to their internal labor rules, but, thus far, the law is silent on such internal labor rules. The draft Employment Contract Law sets forth various provisions to fill this gap.

The draft requires employers to create internal labor rules in areas such as security and hygiene, workplace discipline, leave and vacation, and employment contract management. This is done to provide security to the employees' rights and certainty in regard to obligations of employment.

The draft provides that employers are to solicit the opinions of their employees' union when drafting and modifying their internal labor rules. Where no employees' union has been established in the enterprise, the employer is to hold hearings among the employees.

The draft also stipulates that the internal labor rules created by employers are to be effective on the day that employees are officially given notice and are to be binding on both the employer and the employee. Internal labor rules may be invalidated by the Ministry of Labor and Social Security, the Labor Dispute Arbitration Commission, and the courts.

When a dispute arises between an employer and employee where an employee claims an internal labor rule to be invalid, the employer is to bear the burden of producing evidence to show that the relevant internal rule(s) complies with the requirements of the draft Employment Contract Law. If the employer fails to meet its burden, the penalty that the employer has imposed on the employee pursuant to such rule(s) may be revoked. In practice, an employer's most effective way of providing notice is still to ask the employees to sign a written confirmation. Employers should be very wary about notifying employees via email.

D. Employees of "Labor Dispatch Agencies"

The hiring of workers from so-called "labor dispatch agencies" has attracted considerable attention. The draft Employment Contract Law is especially concerned about the potential detrimental effects such a phenomenon may have on workers' rights.

Labor dispatch agencies differ from employment agencies and headhunting firms. The former employ and enter into employment contracts with the laborers themselves, dispatching the laborers to enterprises in need of the laborers. The enterprises where the laborers actually work (the so-called "end employer") only need to pay the labor dispatch agency a commission and do not have an obligation to pay the laborers' wages, or contribute to the laborers' social security or housing funds. Rather, these obligations are fulfilled by the labor dispatch agencies themselves. Employment agencies and headhunting firms do not establish contractual labor relations with the referred employees, nor do they contribute to laborers' social security or housing funds.

The draft confirms the legitimacy of labor dispatch agencies, but requires that such companies obtain certification before conducting business and entering into the employment contract with the employee. In addition, the draft requires labor dispatch agencies to enter into a labor dispatch agreement with the "end-employer" enterprise where the employee will be working. Such agreement must specify the following terms:

– the name of the dispatched laborer;

– the role of the dispatched laborer;

– the place of work;

– the duration of dispatch;

– the end-employer's detailed expectations of the laborer; and

– the breakdown regarding which obligations to the laborer are to be fulfilled by the labor dispatch agency and which are to be performed by the end-employer. (The laborer is to be informed of the content of such agreement.)

The draft also requires the end-employer to refrain from using the laborer in a manner not contemplated by the labor dispatch agreement and prohibits such an entity from dispatching the laborer to other entities.

The draft further provides that, if the dispatch agency seeks to alter or terminate the employment contract, the laborer can communicate directly with the end-employer. In such an event, the end-employer bears the obligation of facilitating the negotiations between the laborer and labor dispatch agency.

The draft stipulates that the end-employer is responsible for ensuring that the labor dispatch agency does not take any illegal actions, such as docking the laborers' wages. The end-employer is jointly and severally liable for such acts.

The latest news is that, because of strong disagreement from the labor dispatch companies, the draft eliminates the restriction on a maximum one-year dispatched period.

E. The Representative Offices of Foreign Companies

At present, the representative offices of foreign companies in China do not have the right to hire employees directly and may only recruit staff through foreign enterprise service institutions that enter into employment contracts with personnel. Such an arrangement is irreconcilable with the labor reforms contemplated by the Employment Contract Law and is likely to complicate labor relations if left standing.

The draft leans towards permitting representative offices to enter into contractual labor relationships as employers and deems that the Employment Contract Law be applicable to such situations.

F. Specific Provisions on Non-Compete Clauses

The operation of non-compete clauses was a hotly debated issue during the drafting deliberations of the Employment Contract Law. The current labor law does not include provisions regulating non-compete clauses, despite the fact that such clauses are widely employed in certain industries, including IT for example. How the Employment Contract Law should deal with non-compete clauses was an issue that drew a lot of attention.

The draft Employment Contract Law permits employers to include non-compete clauses in their employment contracts vis-à-vis employees with knowledge of trade secrets or to sign separate non-compete agreements with such employees. Pursuant to such an agreement, the subject employee is prohibited from working for other employers that manufacture the same type of products or operate the same kind of business as the employer, and from starting his or her own business that manufactures similar products, or provides similar services that may be in competition with the employer, for a certain period after the termination or rescission of the employment contract. In the event of breach, the employee is liable to the employer for damages. The draft also requires non-compete clauses to include a provision obligating the employer to compensate the employee for such restrictions upon the termination or rescission of the contract. The compensation for a non-compete clause/agreement is to be no less than the annual pay that the employee would receive from the employer under the employment contract, regardless of the duration of the restriction. Some experts oppose the implementation of such a requirement on the ground that the amount of compensation given should relate to the duration of the non-compete restriction. They propose that the compensation should be one-third of the pay that the employee would receive from the employer during the non-compete period. The damages imposed for breach of a non-compete clause are to be no more than twice the compensation the employer must pay the employee in consideration for such restriction.

The draft provides that the geographic scope of non-compete clause/agreements must be limited to cover only regions where the actual competition with the employer may occur. The duration of non-compete clause/agreement may not be longer than two years, which is one year shorter than the current duration of such clauses /agreements in practice.

In addition, the draft provides that non-compete clauses will be held invalid in the following situations:

- Where the trade secrets of the employer have already been published or no longer have an impact on the employer's interests.
- Where the employer fails to compensate the employee for the non-compete clause/agreement as agreed upon after the termination or rescission of the employment contract.

G. The Principle of Employee Protection

Although the principle of employee protection was not expressly included in the draft Employment Contract Law, that principle is embodied in specific clauses.

For instance, where the employee and the employer dispute the interpretation of the clauses of the employment contract, the draft provides that such clauses are to be interpreted in a way that is favorable to the employee. This follows the principle of *contra proferentum*, in that the language of an employment contract is normally drafted by the employer.

In terms of the renewal of employment contracts, the draft requires employers to perform employment renewal formalities before the expiration of the contract. If an employee continues to work for the employer after the expiration of the employment contract, the contract will be deemed automatically renewed if the employer failed to negotiate a new contract.

The draft also requires employers to remunerate employees for work already performed where the employment contract is invalidated or rescinded, except in circumstances where the employee is engaged in malicious collusion or such remuneration would impair the public policy interests of the nation, collectives or third parties. The amount of the remuneration may be negotiated by the employer and the employee. If such negotiation fails, the remuneration of employees recruited by the enterprise in similar roles may be used as a benchmark.

Where the employment contract conflicts with collective contracts or state regulations, the employer and employee may renegotiate if (i) the remuneration or labor conditions, etc. agreed upon in the employment contract fail to comport with the minimums set by the state or the relevant collective contract; or (ii) if the existence of an employment contract is ambiguous and the labor dispute arises from the failure to use a written contract. If such negotiations fail, the relevant provisions in the collective contract will be applied, but if no relevant provisions are available in the collective contract, the relevant state regulations will be applied, and if relevant provisions are available in both the collective contract and the state regulation, those that are more favorable to the employee will be applied.

The principle of employee protection will be widely adopted in arbitral and judicial practice.

IV. Conclusion

As embodied in the draft discussed above, the forthcoming Employment Contract Law may cause extensive changes to labor relations. Consequently, corporate human resources management must adapt to the requirements of the new law. HR managers must amend their letters of appointment, employment contracts, internal labor rules, and various other documentations in order to satisfy the requirements of the Employment Contract Law.

Endnotes

1. It was adopted at the Eighth Session of the Standing Committee of the Eighth National People's Congress on 5 July 1994 and became effective from 1 January 1995.
2. According to the stipulations of Article 4 of the *Measures for Examination and Approval of the Implementation of the System of Non-fixed Working Hours and Comprehensive Calculation of Working Hours by Enterprises,* promulgated by the Ministry of Labor on 14 December 1994 and effective on 1 January 1995 ("Examination and Approval Measure").
3. It was adopted by the 17th Session of the Standing Committee of the 5th National People's Congress on 6 March 1981 and promulgated by the State Council on 14 March 1981.
4. *See* Article 2 of the *Notice for Implementing the Regulations for the Medical Leave Period for Enterprise Employees for Illness or Non-Work-Related Injuries*, promulgated on 23 May 1995.
5. *See Regulations of People's Republic of China for the Protection of Female Employees*, promulgated on 21 July 1988 and implemented on 1 September 1988 by the State Council; the *Response to Questions Regarding the Regulations for the Protection of Female Workers*, promulgated by the Ministry of Labor on 20 January 1989; and the *Notice Regarding Several Questions on Maternity Leave for Female Employees,* promulgated on 4 September 1988 and effective from 1 September 1988.
6. The labor supervisory bodies are established at all administrative levels of the labor and social security ministries and are in charge of the administrative supervision and management of the labor law.

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Tomka: A Comment on Supervisory Liability

By Andrew J. Schatkin

This article proposes to set forth an analysis of the seminal and landmark case of *Tomka v. Seiler Corp*.[1] and to offer an evaluation and criticism of its reasoning and holding, and offer, in addition, an alternative.

The facts in *Tomka* were that a female employee brought suit against her former employer and three male co-employees asserting claims of a Hostile Environment, Sexual Harassment, and Retaliatory Discharge, in violation of Title VII and the New York State Human Rights Law (HRL). The plaintiff also asserted an unequal pay claim, under the Equal Pay Act (EPA) and the HRL, as well as common-law Assault and Intentional Infliction of Emotional Distress claims. The United States District Court for the Western District of New York granted the defendants' Motions for Summary Judgment and the plaintiff appealed.

The Court of Appeals for the Second Circuit held that the evidence raised genuine issues of material fact, precluding Summary Judgment on the Sexual Harassment claims, under Title VII and the HRL; and that the evidence raised genuine issues of material fact, precluding Summary Judgment on the claim of Retaliatory Discharge. The Court also ruled that the plaintiff's EPA claim as to four of seven named male employees could not be resolved on Summary Judgment; that the claim of unequal pay for equal work under Title VII and the HRL was properly dismissed on the ground that the plaintiff presented no evidence that the employer acted with discriminatory intent in paying the plaintiff less than male employees; that the individual defendants could be sued in their personal capacities for sexual harassment under the HRL; that the employer could not be held liable under New York Law, on the basis of Respondeat Superior, for alleged sexual assaults committed by male co-employees and the emotional distress stemming from those acts; and that the employer could not be held liable under New York Law for negligence in retaining or supervising male employees alleged to have sexually harassed the plaintiff absent evidence that the employer had notice of prior assaults or sexual misconduct.

Most important, the Circuit Court held that the individual defendants, with supervisory control over the plaintiff, could not be held personally liable under Title VII. Thus, the United States Court of Appeals affirmed in part and reversed in part.

This article will consider discretely and exactly the holding and analysis of the Second Circuit in *Tomka* that the individual defendants, with supervisory control over the plaintiff, could not be held personally liable under Title VII.

The Court of Appeals opined that the courts in the Second Circuit are divided over whether an employer's agent may be held individually liable. The Court went on to analyze the meaning of Title VII's definition of an employer. The Court stated that some courts have held that the meaning of "agent" in Title VII includes "employers," who may be held individually liable for discriminatory acts. The Court went on to state that at least three Circuits and a number of District Courts have interpreted this section as not creating individual liability but as a simple expression of Respondeat Superior. The Court concluded that the term agent was not a statutory employer under Title VII, analyzing and considering the statutory scheme and Title VII's remedial provisions.[2]

This writer and lawyer finds the holding in *Tomka* disturbing, if not shocking. Judge Parker, in his strongly worded dissent in *Tomka*, stated that, "The express language of the statute permits individual liability under Title VII and . . . sound jurisprudence counsels giving that statutory language that full effect."[3] Furthermore, Judge Parker saw no basis, "in the statute, or elsewhere for reading the agent clause to impose only Respondeat Superior liability, to the exclusion of joint and several liability, between an employer and his or her agent . . . under Title VII."[4]

In addition, the meaning of "agent" in the Title VII definition of employer, as the *Tomka* Court pointed out, has engendered a significant split of views and opinions among the federal courts. Some courts have held that the plain meaning of the statute means supervisory personnel and others that agents of the employer are statutory "employers" who may be held individually liable for their discriminatory acts.[5]

This writer believes that the dissent of Judge Parker, and the views of other federal courts on this issue, point to a better rule than that articulated in *Tomka*. *Tomka* shields malefactors from their maledictions and malefactions. There would have been no Nuremberg Trials if Hitler were the only defendant and his agents were excused as nonemployers. Workers are at the mercy, on the basis of the at-will employment doctrine, of their employers. To shield individuals who wreak harm and vengeance on helpless employees on the basis of their not being employers, serves little or no purpose but to protect wrongdoers from paying for their wrongdoing, at least out of their pockets.

Clearly these supervisors are not mere puppets but are doing the will and carrying out the dictates of the behemoth corporate Goliath employer, which crushes individuals that stand in its way, like checkers on a checkerboard.

There are other policy considerations that can be articulated and argued here. The United States District Court for the District of Rhode Island, in *Iacampo v. Hasbro, Inc.*,[6] set forth a different view of this matter, opposing the *Tomka* holding entirely. In *Iacampo*, an employee brought state and federal claims against her employer and others for gender and disability discrimination. The defendants moved to dismiss, or alternately, for a more definite statement of the claims. The United States District Court held that plaintiff's immediate supervisor and her supervisor's supervisor could be held individually liable under the Americans with Disabilities Act (ADA) and Title VII. The Court further held that plaintiff stated prima facie claims for violations of the Rhode Island Fair Employment Practices Act; the ADA; and Title VII; and for simple assault, battery, and second-degree sexual assault. The Court also held that common-law discrimination claims against defendant, as a third-party beneficiary of contracts between defendant and state government, could not be decided on a motion to dismiss in light of factual disputes over whether the employer signed agreements of which the plaintiff was the intended beneficiary. Finally, the District Court held that the plaintiff failed to state a claim of the Negligent Infliction of Emotional Distress and that the Rhode Island Workers' Compensation Act shielded the employer from the Intentional Infliction of Emotional Distress claim.

More specifically, the Rhode Island District Court engaged in extensive analysis of the question of supervisory/individual liability under the Americans with Disabilities Act and Title VII. The Court noted that there had been a division of authority among the circuits and districts on the issue of individual liability and supervisory employees under Title VII, citing a number of cases for this particular proposition.[7]

The Court then went on to state, over the impassioned dissent of Judge Parker, that in *Tomka*, the majority held that supervisor employees are not individually liable under Title VII. The Court then noted that they were persuaded as to the reasoning of Judge Parker's dissent and found that supervisory employees could be individually liable under Title VII and the ADA. The Court reasoned that,

> The imposition of individual liability on supervisory employees under Title VII and the ADA promotes judicial restraint while providing greater redress for victims of discrimination. Courts ignore their constitutional role when they peer beyond the clear language of the statute in search of ascribed congressional purpose, thus to rewrite the law. As Judge Parker notes, title VII is unambiguous, and a literal reading of the agent clause does not do such violence to the statutory scheme as to justify inquiry into legislative intent. To ignore the plain language of the Title VII (and the ADA) is set forth on uncertain, unmarked, and forbidden judicial waters. . . . Moreover, threatening supervisory employees with individual liability under Title VII and the ADA deters those who would use their positions and power to discriminate, and guarantees that victims of discrimination will receive redress not only from amorphous corporate entitles, but from their very present oppressors.
>
> Clearly, Booth, as Iacampo's immediate supervisor, and Godfrin, Booths's supervisor, are Hasbro's agents. Thus, the Court opines that Booth and Godfrin may be found individually liable under Title VII and the ADA.[8]

Kramer v. Windsor Park Nursing Home[9] also sheds a great deal of light in its reasoning as to why the *Tomka* holding is inappropriate, if not incorrect. In *Kramer*, an employee who was formerly employed by a nursing home, brought an employment discrimination action against the nursing home and the co-owner of the home. The nursing home and co-owner moved for Summary Judgment. The United States District Court for the Southern District of Ohio, Western Division, held in pertinent part, that the nursing home, which was named in the Equal Employment Opportunity Commission Complaint, and co-owner, shared an identity of interest sufficient to excuse the employee's failure to name the co-owner in the caption of her EEOC Complaint. The Court further held that the co-owner could be held individually liable for violations of Title VII, the Rehabilitation Act, and the American's With Disabilities Act (ADA), and that material issues of fact precluded Summary Judgment for the employer in the employee's ADA and Rehabilitation Act claims. The *Kramer* Court proceeded, more specifically, to analyze the question of individual liability under federal discrimination statutes. The Court initially noted that Ms. Kramer had sued Mr. Byars in his individual capacity as owner/administrator of Windsor Park. Mr. Byars argued that he could not be held individually liable under Title VII. The Court went on to state that although it recognized that the majority of circuits disagreed with it, the Court stated that it continued to adhere to the view that Title VII does provide for individual supervisory liability, citing *Johnson v. University Surgical Group Associates of Cincinnati*.[10] The Court stated that in *Johnson* it identified three reasons why Title VII provides for individual supervisors' liability.

First, the Court stated the prior holdings of the Sixth Circuit gave at least tacit approval of co-employee supervisor liability.[11] The Court went on to state, as a second reason, that individual liability promotes the purposes of Title VII, referencing the Civil Rights Act of 1991, PL 102-66, Section 3(1). Third, the Court stated agency principles are followed throughout Title VII, and that these principles support shared liability on the part of both the employer and the agent referencing Restatement (2d) of Agency, Section 359 C(1) (1957). The Court concluded that it would continue to adhere to the conclusion that Title VII does provide for individual liability until the Sixth Circuit or the Supreme Court decided otherwise.

In short, both *Kramer* and *Iacampo* point in a different direction on the issue of individual supervisory liability, and it is urged that their view is the right and correct view.

Conclusion

This brief critical analysis of the *Tomka* holding offers the following view. Clearly the holding of *Tomka*, in effect, is to shield management from liability in Title VII actions. Title VII gives the definition of employer as a person engaged in an industry effecting commerce that has 15 or more employees . . . and any agent of such a person.[12] The issue is, What is an agent? The fact of the matter is that it is stretching the point to say that corporate management is not in an agency relationship with the corporate entity. *Tomka* says they are not within the Title VII definition of an employer. The reality of the *Tomka* holding is that corporate officials are shielded from their wickedness, indifference, callousness, and the pain they cause others. They act badly and are excused and shielded. They fire the worker, at will, who must support his wife and children, and in light of this, *Tomka* says that they are immune from suit. On the plain meaning of agent in the Title VII definition of employer, it surely cannot be said that a corporate supervisor is not an agent. He is doing the will of his fictional boss and should not be allowed to escape. It is no excuse that United States soldiers killed and tortured civilians in Iraq on the ground that they were following orders. If those more humble citizens should be subject to the rule of law, how much more so should well-heeled, prosperous corporate officials be brought to task for their violations and malicious actions? *Tomka* is wrong in the view of this writer, legally and morally, and should be changed. *Tomka,* in the view of this writer, is a step back rather than a step forward. A democratic society places worth on each and every individual irrespective of race, sex, sexual orientation, class, height, or weight. The prosperous should no more be excused than the powerless and weak should be prosecuted.

Endnotes

1. 66 F.3d 1295 (2d Cir. 1995).
2. *See Tomka v. Seiler Corp.*, *supra* at 1313–1317.
3. *See id*. at 1318.
4. *See id*. at 1320.
5. *See*, *e.g.*, *Jones v. Continental Corp.*, 789 F.2d 1225 (6th Cir. 1986) (individuals may be held liable as "agents" of an employer under Title VII); *Paroline v. Unisys Corp*. 879 F.2d 100, 104 (4th Cir. 1989), *rev'd in part, aff'd in relevant part*, 900 F.2d 27 (4th Cir. 1990) (en banc) (individual liability under Title VII for supervisory positions); *Bridges v. Eastman Kodak Co.*, 800 F. Supp. 1172, 1179–80 (S.D.N.Y. 1992) ("agents" includes supervisors and other individuals who participate in discriminatory decision-making process); *Cheng v. Tams Consultants, Inc*., 1991 U.S. Dist. LEXIS 6095, at *4-7 (S.D. N.Y. May 2, 1991) (supervisory employees are agents of the actual employer for purposes of Title VII liability); *Goodstein v. Bombardier Capital, Inc*., 889 F. Supp. 760, 763–65 (D.Vt. 1995) (agents may be personally liable under Title VII.).
6. 929 F. Supp. 562, 572 (D.R.I. 1996).
7. *See Paroline v. Unisys Corp*., 879 F.2d 100, 104 (4th Cir. 1989), *rev'd in part, aff'd in relevant part*, 900 F.2d 27 (4th Cir. 1990) (supervisory individuals may be liable under Title VII) with *Miller v. Maxwell's Intern. Inc.*, 991 F.2d 583, 587–588 (9th Cir. 1993), *cert. denied*, 510 U.S. 1109, 114 S. Ct. 1049, 127 L. Ed. 2d 372 (1994) (no individual liability), and *Grant v. Lone Star Co*., 21 F.3d 649, 651–653 (5th Cir. 1994), *cert. denied*. *See also Caldwell v. Federal Express Corp.*, 908 F. Supp. 29, 36 (D.Me. 1995); *Ruffino v. State Street Bank and Trust Co.*, 908 F. Supp. 1019, 1047–48 (D.Mass. 1995); and *Miller v. CBC Companies, Inc.*, 908 F. Supp. 1054, 1064–1065 (D.N.H. 1995). *See Iacampo v. Hasbro, Inc., supra* at 571–572.
8. *Iacampo, supra* at 572.
9. 943 F. Supp. 844 (S.D. Ohio 1996).
10. 871 F. Supp. 979, 986 (S.D. Ohio 1994).
11. The Court cited in support of this proposition *Jones v. Continental Corp*. 789 F.2d 1225, 1231 (6th Cir. 1986); *Romain v. Kurek*, 772 F.2d 281 (6th Cir. 1985).
12. 42 U.S.C. § 2000e(b).

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The Perplexing Case of GASB 45

By Kenneth W. Bond

One of the most complex and difficult to understand financial issues facing states and local governments now and in the near future is compliance with Statement 45 issued by the Governmental Standards Accounting Board in 2004 ("GASB 45").[1] Municipal attorneys, who often would rather leave budget and financial issues to the accountants, need to become familiar with GASB 45 if for no other reason than that it is, in effect, in the nature of a substantial "unfunded mandate"[2] established by a national non-governmental or regulatory entity whose standards of financial accounting are followed by the accounting profession in preparing audited financial statements.[3] Resort to the Legislature for "mandate relief" is probably unavailable, practically speaking, while resort to the Legislature for mandate compliance is probably a necessity.

Much has been written about the mechanics of GASB 45.[4] In a nutshell, by the end of 2008, every state and local government entity that prepares financial statements must disclose therein its estimate of unfunded health benefit costs for retired employees.[5] The resulting number, by any measure, is staggering and must be reported as an unfunded actuarial accrued liability.[6] There are no safe harbors from compliance. Failure to comply may be a "scarlet letter" with the national credit rating agencies so that access to capital markets may be more expensive.[7] Accountants, actuaries, bond attorneys, financial advisors, underwriters and bond insurers are now jockeying for position to present bond financing solutions to meet GASB 45 requirements.

How GASB 45 was born is a product of three (if not more) trends in government financial accounting. The first trend is the movement in the private sector in the 1990s to require financial reporting of accrued health benefits for private corporations. This was a period when mounting pension and health benefits were identified as raising the cost of manufacturing in the United States, making U.S.-based production uncompetitive to the rest of the world rising from the fall of the Iron Curtain, the advent of the Internet, and the opening of markets in China and India. If an American manufacturer was going to close shop or move it to Shanghai, for example, shareholders needed to know the accrued pension and health benefits owing to former employees. The response from the Financial Accounting Standards Board ("FASB"), GASB's sibling, was Statement 106 which requires the reporting of accrued health benefits as a balance sheet liability. GASB largely borrowed from FASB Statement 106[8] in producing GASB 45. Second, in 1999 GASB issued Statement No. 34[9] which requires the valuing of major capital assets (roads, water and sewer facilities, etc.) imposing a balance sheet approach to governmental financial reporting. GASB 45 advances the balance sheet approach by requiring accounting for retirees health benefits as an actuarial accrued liability. Finally, GASB 45 is justified as another step in the direction of full disclosure and transparency in financial reporting. GASB 45 is not so much a reaction to Sarbanes-Oxley disclosure requirements, as a prophylactic against potential securities fraud highlighted recently by Securities and Exchange Commission no action enforcement.[10]

> *"[B]y the end of 2008 every state and local government entity which prepares financial statements must disclose therein its estimate of unfunded health benefit costs for retired employees."*

The municipal securities market's reaction to GASB 45 has until recently been muted. Since GASB 45's effectiveness is phased in over three years, only the states and largest, and presumably most sophisticated, local governments have been required to comply with it beginning in 2007. However, as the effective date for intermediate and small local governments draws nigh, a somewhat radical response from the bond issuer community has emerged. In Texas, the legislature adopted legislation which would require municipalities to account for retiree health benefits on a pay-as-you go basis, in an attempt to remove the concept of an actuarial accrued liability from state law and thereby side step the application of GASB 45.[11] This maneuver has been criticized as disrupting the uniformity of accounting rules on a national basis, making it more difficult for underwriters and rating agencies to price and evaluate the debt of bond issuers from state to state. Likewise, the Connecticut legislature has adopted a bill which would permit the State Comptroller to "select" which GASB standards (i.e., elect to not follow GASB 45) the state should follow to comply with GAAP for financial accounting purposes.[12] A more aggressive, and somewhat surprising, negative reaction to GASB 45 has emanated from the Government Finance Officers Association ("GFOA"), the premier trade association for state and local government bond issuers. In December 2006, GFOA blasted GASB as unfit to continue in its role as the authoritative accounting standard-setting body for states and local governments, and called for GASB to be dismantled and its functions transferred to FASB.[13] GFOA asserted that after 20 years of standard setting, GASB's mission is complete with nothing to do but find an accounting solution to every perceived financial problem, seeking new outlets for its standard-setting energies, taking on non-financial "accountability" issues (a role traditionally assigned to the SEC and the MSRB[14]), and generally frustrating GFOA members with seemingly endless projects which complicate financial reporting without adding information of real value for decision makers.[15]

"New York, a strong municipal union state with a plethora of local governments, many in a state of economic decline, is disadvantaged by GASB 45 compared to states with growing economies, weak or no municipal unions and fewer units of local government."

Texas, Connecticut and GFOA have a point; in fact several points. GASB 45 is the stepchild of FASB 106 applicable to corporate financial accounting. The asset/accrued liability balance sheet approach of recent GASB statements for governments suggests corporate financial accounting standards are being imposed on governments without taking into consideration the uniqueness of municipal finance. Hence, everyone's frustration. For example, requiring disclosure of accrued retiree health benefits for a major corporation on the brink of bankruptcy (as was the case of General Motors reported in 2006) makes sense. Shareholders and employees (active and retired) want to know that there is a funded trust sufficient to pay benefits if business operations cease—"pay-as-you go" would not necessarily provide future benefits since there may be no future revenues. But municipal finance is different (even the rules of Chapter IX of the Bankruptcy Code[16]). Governments possess the sovereign police power which includes the power to tax and assess. It doesn't matter if the government makes a profit to "stay in business" (including several in New York which operate with an annual deficit). The government may expand and merge but absent a hurricane or nuclear war, it's not going anywhere: it will always be taxing and assessing its residents. Here, pay-as-you-go works well. Yet while GASB 45 requires disclosing the actuarial accrued health benefit liability, it does not recognize the obvious: an actuarial accrued asset of government tax or other revenues to be raised in the future. If the actuarial accrued asset were recognized in the GASB standard-setting process, the financial accounting problem would not exist: an actuarial accruing asset would correspond to an actuarial accrued liability.

Likewise, GASB appears to have largely ignored state law issues in drafting Statement 45. For example, GASB 45 requires annual payments beyond pay-as-you go to be placed in a trust, just like FASB 106 for corporations.[17] However, GASB 45 ignores that local governments generally do not have the power to create "trust funds" absent special state enabling authority or exercise of home rule power (not available to school districts). Governments can create reserve funds, and the Legislature has made an effort to address GASB 45 by authorizing a reserve fund for retiree benefits,[18] but moneys in a reserve are restricted to low-yielding "secure" investments applicable to public funds which would make the rate of return inadequate to liquidate the UAAL GASB 45 requires governments to recognize.[19] Further, it is unclear whether government trust funds for which federal tax law treats income as exempt from income taxation apply to the purpose which GASB 45 requires.[20]

Unlike provisions in the Internal Revenue Code dealing with the exclusion of interest on municipal bonds from income taxation,[21] and Rule 15c2-12 dealing with disclosure requirement for municipal bonds sold to the public,[22] GASB 45 applies to all governments regardless of size—there are no safe harbors from its application. This will be particularly frustrating for small or infrequent bond issuers which require certified financial statements in their disclosure documents to enter the capital markets. Both the federal tax laws and federal securities laws contain "safe harbors" for small issues so as to not overburden local government.[23] Thus, a small upstate village with a once-in-a-decade financing may find exemptions from arbitrage and rebate tax rules and continuing disclosure requirements, yet would need to perform the actuarial valuation of its accrued health benefits owing to retired employees in order to sell bonds. If the village is one which has declined in population and economic productivity in the past several years (there may be hundreds of them), disclosing the UAAL may appear to distort the village's future fiscal viability.

Indeed, New York, a strong municipal union state with a plethora of local governments, many in a state of economic decline, is disadvantaged by GASB 45 compared to states with growing economies, weak or no municipal unions and fewer units of local government.[24] Although retiree health benefits are not guaranteed under the State Constitution like pension benefits,[25] and indeed must be provided through collective bargaining,[26] the Legislature is under pressure to sustain retiree benefits equal to those of active employees.[27] FASB 106 may have had the effect on corporations to convert retiree benefit plans from "defined benefit" to "defined contribution" types in the aspiration to reduce employer health benefits costs. But it would be a long and hard struggle with the municipal unions to effect the same result in New York.[28]

The plenary application of GASB 45 calls for smaller local governments to band together in compliance. Efforts in this direction are already underway from government trade associations.[29] Indeed, the issue of "shared municipal services" and consolidation of local governments is an active pursuit by the Legislature and the

Governor.[30] But none of the current activity in this area specifically addresses GASB 45 compliance. As to fiscal inability of some local governments to fund the actuarial accrued liability imposed by GASB 45, state aid in some form would appear necessary. Indeed, the state is in a better position to take over GASB 45 compliance responsibility than most upstate local governments.

Stronger local governments may have the fiscal ability and the will to fund additional payments beyond pay-as-you go to account for the actuarial accrued liability GASB 45 requires to be recognized. But for most, should GASB 45 be fully implemented, resort to borrowing to fund the liability may be inevitable. Even those governments making the extra ARC payments may be scrutinized by rating agencies should their future administrations decide to discontinue ARC payments and resort to financing. At some point in the business cycle interest rates for borrowing become lower than the rate of return on invested bond proceeds. That is when governments issue bonds to finance actuarial accrued pension liabilities and will issue bonds to finance actuarial accrued retiree health benefits. But New York law is deficient in providing a statutory regime for this purpose. The *Hurd* case and its progeny[31] discourage attempts to finance the UAAL under any provision of the Local Finance Law. Bond proceeds as "public funds" have nowhere to go to be invested in high-yielding securities necessary to liquidate the UAAL.[32] Constitutional debt limits make it impossible for almost any local government to issue tax-supported bonds in a principal amount sufficient to fund the UAAL (it's not just another "settled claim" that can be funded with non-voted debt).[33] The Comptroller has developed a working group to look into statutory changes. However, a set of comprehensive statutory amendments is required in New York to make GASB 45 financing clearly "legal and valid."

As for a state attempting to opt out of GSB 45 compliance through a change in state accounting rules, Texas and Connecticut are likely to encounter the same result as South Carolina 25 years ago when it asserted its constitutional right ("intergovernmental tax immunity") to issue long-term municipal bonds in bearer form in the face of Internal Revenue Code amendments requiring tax-exempt bonds to be issued in registered form.[34] In an increasingly "flat world"[35] it is unrealistic for states and local governments which require access to public markets to consider excluding themselves from accepted rules applicable to the market—whether federal tax law or GAAP financial accounting standards. This principle may be illustrated by the U.S. Supreme Court's action in the near future in *Kentucky v. Davis*[36] in the context of permissible state economic protection where a state appeals court upheld taxpayers' allegation under a "dormant Commerce Clause"[37] theory that a municipal bond exempt from state income taxation in the state of issue should also be exempt from state income taxation in the state of the taxpayer/bondholder. Only if the Supreme Court should reverse and remand (no Commerce Clause violation)[38] or should GFOA muster safe harbor protections, might the application of GASB 45 be limited.

"[A] comprehensive plan to address financing GASB 45 obligations has yet to be considered seriously by New York's legislative leaders—and the GASB 45 compliance clock is ticking."

But where does GASB's standard setting end and at what point are state lawmakers compelled to modernize 19th century laws prescribing local government finance powers to address 21st century market standards? As to GASB, the trend toward recognizing actuarial accrued financial liabilities is at odds with the traditional income statement approach to municipal accounting. What's to stop a standard setter from requiring, for example, an accrued liability of recurring highway expenses to maintain transportation infrastructure? Because states and local governments are ongoing entities irrespective of business conditions, any accrued expense necessarily has a companion accrued revenue.[39] Yet at least one state court has renounced treating accrued revenues under its laws as an "asset" which can be financed.[40]

Modifying New York's debt financing laws around state constitutional constraints on incurring state debt has not been a serious policy concern in recent years. For any project which the New York Constitution may prohibit the state to finance directly, there has been a legislatively created public benefit corporation to finance the project indirectly—all upheld by the Court of Appeals on various challenges.[41] Thus, financing GASB 45 requirements through a state-sponsored entity may be the most practical solution. But state agency financing of local government projects tends to diminish local government control and undermine the vitality of local government finance laws. Addressing the funding of GASB 45 requirements at the local level may require changes to the New York Constitution so that a discreet stream of revenues can be pledged to special non-tax-supported bonds similar to "tax increment bonds" which may be issued for municipal redevelopment purposes.[42] Encouraging, or compelling, local governments to act jointly or through regional agencies would minimize the costs of borrowing and maximize investment returns. However, a comprehensive plan to address financing GASB 45 obligations has yet to be considered seriously by New York's legislative leaders—and the GASB 45 compliance clock is ticking.

Endnotes

1. GASB was organized in 1984 by the Financial Accounting Foundation to establish financial accounting and reporting standards for state and local governments, including school districts.

2. The term is used in the context of the State requiring local government expenditures to be funded with locally derived revenues. Its meaning applies aptly to GASB 45 compliance.

3. The American Institute of Certified Public Accountants requires audited financial statements to note departures from GASB standards, sometimes with adverse credit rating implications.

4. *See* "Testimony from First Deputy Comptroller Regarding GASB 45 Accounting Change," www.nysocs3.osc.state.ny.us/press/releases/jan07/013007.htm, January 30, 2007; Fingar, "GASB 43 and GASB 45: The End of Public Sector Retirement Benefits as We Know Them?" Journal of Compensation & Benefits, November/December 2006; Wiener, "State and Local Government's Options for Complying with GASB 45's OPEB Reporting Requirement," Section on State and Local Government Law, American Bar Association, www.abanet.org/statelocal/lawnews/winter06/Stateand Local.htm.

5. GASB 45 refers to the accrued liability of retiree health benefits (and other retiree benefits, such as life insurance) as "other post employment benefits" or OPEB. GASB 45 compliance phases in over three years: public sector entities with annual revenues in excess of $100 million are required to comply as of December 15, 2006; those with annuals between $100 million and $10 million as of December 15, 2007; and those with annual revenues less than $10 million as of December 15, 2008.

6. This is the "unfunded actuarial accrued liability" or UAAL which GASB 45 requires be disclosed in financial statements and its payment addressed by the issuer. GASB 45 requires that the UAAL be paid at least in the amount of the ARC (*see* note 17).

7. Moody's, Standard & Poor's and Fitch, the national municipal bond rating services, have each written reports to the effect that a failure to fund OPEB liabilities or otherwise manage them will be viewed as a negative rating factor.

8. Statement 106 of the Financial Accounting Standards Board (December 1990) addresses financial accounting of post-retirement benefits other than pensions of private sector employers.

9. GASB Statement 34 (June 1999) requires public sector entities to report the value of major infrastructure capital assets like roads, water and sewer facilities.

10. *See In re City of San Diego*, SEC el Nos. 33-8751, 34-54745 (November 14, 2006), affirmed on appeal to the D.C. Circuit Court of Appeals. The SEC was concerned that San Diego did not disclose in its prior bond offering statements that its fiscal condition might require an election by the city in the future to pay bondholders or pension obligations, but not both.

11. New Chapter 2264 of Subtitle F, Title 10 of the Texas Government Code establishes an alternative basis of accounting for Texas governments since "GASB 45 could lead to inaccurate and inappropriate reporting of OPEB obligations in Texas."

12. Not surprisingly, GASB has urged the governor to veto the bill: Leone, "FAF to Governor: Veto the Bill," www.cfo.com, June 20, 2007.

13. *See* www.gfoa.org/gsb.shtml.

14. U.S. Securities and Exchange Commission or SEC; Municipal Securities Rulemaking Board, or MSRB, under the supervision of the SEC which sets standard for underwriters and financial institutions participating in the municipal securities industry.

15. GFOA's and certain states' frustration with GASB can be illustrated and perhaps measured by standards for disclosure established by Robert Amdursky and Clayton Gillette over 15 years ago. They measured the cost of disclosing, the amount of loss if the risk materialized, and identified the party in the best position to disclose to determine whether a fact was "material" (should be disclosed) and who should be responsible for the disclosure. *See*: "Municipal Debt Finance Law—Theory and Practice," § 6.1.1, R. Amdursky and C. Gillette, Little, Brown and Company, 1992, Boston. Using the Amdursky/Gillette analysis, given that (i) calculating the UAAL and ARC is very costly, (ii) the risk of default on account of the UAAL is minimal (governments keep assessing and collecting taxes), and (iii) financial institutions are in a better position to determine the information GASB 45 requires than most governments, it is arguable that the UAAL is not a material fact and that, far from being a government financial accounting mandate, the bond underwriter should provide it in its discretion and at its expense.

16. Municipal bankruptcy contemplates only the financial reorganization of an ongoing entity (e.g., Chapter II) not liquidation and winding up business in bankruptcy proceedings (*i.e.*, Chapter X).

17. This is the ARC (annual required contribution) payment consisting of the "normal cost" per annum of retiree health benefits plus the per annum portion of the UAAL (unfunded actuarial accrued liability) for future retiree health benefits amortized (over 30 years).

18. See A.71221 (New York Legislature, 2007).

19. Like all public funds, moneys in a reserve fund are limited largely to investments in bank certificates of deposit and U.S. government direct and guaranteed obligations (NYS General Municipal Law, § 11).

20. Government created trusts, the income from which the federal tax laws recognize as tax-exempt, are available under §§ 115, 401(b) and 501(c)(9) of the Internal Revenue Code of 1986, as amended (the "Code") but none of these provisions neatly apply to the trust prescribed in GASB 45.

21. Sections 103 and 141-151 of the Code and applicable U.S. Treasury Regulations.

22. Rule 15c2-12 promulgated under the Securities Exchange Act of 1934 regulates underwriters and broker/dealers in the underwriting and subsequent sale of municipal securities as to the disclosure of information available to the investing public.

23. For example, bond issues under $5 million principal amount are exempt from rebate of arbitrage profits on investment of bond proceeds; a bank may purchase municipal bonds of an issuer selling not more than $10 million per annum and exclude the interest income if so designated by the issuer; a bond issue under $1 million or maturing in not more than 9 months issued in minimum denominations of $100,000 is exempt from the disclosure and continuing disclosure provisions of Rule 15c2-12.

24. *See* "The Palisades Principals: Fixing New York's Fiscal Practices," Citizens Budget Commission, February 2004, which compares New York fiscal conditions to other Northeastern states and large urban states.

25. *See Lippman v. Sewanaka Central High School District*, 66 N.Y.2d 313, 496 N.Y.S.2d 987 (1985).

26. *See Handy v. County of Schoharie*, 244 A.D.2d 842, 665 N.Y.S.2d 708 (3d Dep't 1997); 1988 Opns. St. Comp. No. 88-5, p.1.

27. Ch 22, Laws of 2007 (New York) protects school district retirees from diminution of health benefits without diminution for active employees through May 2008.

28. *See* "Defusing New York's Pension Bomb," E.J. McMahon, Director, Empire Center for New York State Policy, June 2006.

29. S*ee* www.roberthjackson.org/documents/bond_newyork_102506.pdf. The Commission on Local Government Efficiency & Competitiveness ("CLGEC"), created by executive order in April 2007, is charged with finding ways to "streamline government at every level . . ." taking into account "the multiplicity of local governments that has evolved over centuries . . . ;" www.nyslocalgov.org.

30. *See* "Shared Services" on the CLGEC website: www.nyslocalgov.org/pdf/shared_service_brief.pdf.

31. S*ee Hurd v. Buffalo*, 41 A.D.2d 402, *aff'd*, 34 N.Y.2d 628 (1974) (an expense [pension contribution] that exceeds the constitutional tax limit may not be financed under the Local Finance Law).

32. *Id.*, note 19.

33. Financing of settled claims recognized in § 11.00(a), subd. 33 of the Local Finance Law are subject to debt limits in Article VIII, § 2 of the New York Constitution.

34. *See South Carolina v. Baker*, 485 U.S. 505 (1988), where the Supreme Court held that the Tenth Amendment did not prohibit Congress from requiring all state and local bonds in excess of $1 million be issued in registered form for the interest thereon to be tax-exempt holding that "states must find their protection from congressional regulation through the national political process . . ." Similarly, a state's legislative attempt to opt out of GASB 45 may encounter resistance from the "national market process" of the municipal securities industry which abhors diversions from nationally accepted and recognized norms.

35. *See* "The World Is Flat—A Brief History of the Twenty-First Century," T. Friedman, Farrar, Straus and Giroux, New York, 2005.

36. *See Kentucky v. Davis*, 197 S.W.3d 557 (2007), *cert. granted*, 127 S. Ct. 245 (May 21, 2007).

37. U.S. Const. art. 1, § 8, cl. 3.

38. In *United Haulers Association, Inc. v. Oneida-Herkimer Solid Waste Authority et. al*, __ U.S. __ (April 30, 2007), the Supreme Court found no Commerce Clause violation where the economic protection benefited a public enterprise rather than a private one in the context of a "flow control" ordinance.

39. *Id.*, note 15.

40. *See Lance v. McGreevey*, 180 N.J. 590 (2004), where the New Jersey Supreme Court did not recognize the proceeds of a securitization of future taxes as a "revenue" under the state constitution requiring a balanced budget.

41. *See LGAC v. STARC*, 2 N.Y.3d 524 (2004), where the Court of Appeals sanctioned numerous legislatively crafted assignments of public funds among various conduit entities sufficient to slip by state constitutional prohibitions on issuing debt, *citing* the *Wein* cases from the 1970s and the *Schulz* cases from the 1990s. *But see California et al. v. All Persons Interested in the Matter of the Validity of the California Pension Obligation Bonds to be Issued, etc*., Court of Appeals, 3d App Dist., filed July 2, 2007, where the court struck down the legislative authority for pension obligation bonds as violating the state constitutional restraint on issuing non-voted direct state debt because such authority was not within exceptions for (i) "special fund doctrine" bonds, *Rider v. City of San Diego*, 18 Cal. 4th 1035 (1998), (ii) bonds to finance contingent liabilities (*i.e.*, leases), *City of Los Angeles v. Offner*, 19 Cal. 2d 483 (1942), or (iii) bonds to finance obligations imposed by law, *County of Los Angeles v. Byram*, 36 Cal. 2d 694 (1951).

42. *See* NYS General Municipal Law, Art. 18-D (Municipal Redevelopment Law).

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Is Your Client Using Illegal Immigrant Workers?

By Elizabeth M. Hijar and Staci M. Jenkins

There are very few issues that are as divisive as immigration—illegal and legal. However, no matter where one stands on this issue, the law prohibits the hiring of illegal immigrant workers. Until a few years ago, the government's enforcement of the law was lax and far from routine. But since the events of September 11, 2001 and the emergence of illegal immigration as a hot-button issue, the government has been stepping up enforcement and investigations on businesses that employ unauthorized workers. Based on the investigations of Immigration and Customs Enforcement (ICE), the largest investigative arm of the Department of Homeland Security, many employers (including supervisors and executives) have either been sued, arrested, indicted, fined, and imprisoned for criminal and civil charges ranging from the unauthorized employment of illegal immigrants to engaging in fraud and falsification of documents, and harboring illegal immigrants for commercial advantage. Further, countless employees have been detained and deported for being in the United States illegally.

Some specific ICE investigations have resulted in the following:

- The detention of 1,282 workers for immigration violations employed at plants of Swift & Company, one of the nation's largest processors of fresh pork and beef;
- The guilty plea and payment of fines totaling $300,000 by two corporate executives of the Golden State Fence Company for the hiring of unauthorized alien workers; and
- The arrest of seven current and former managers of IFCO Systems North America, Inc. for conspiring to transport, harboring, encouraging and inducing illegal aliens to reside in the United States for commercial advantage and private financial gain, and other charges related to fraudulent documents.

An Employer's Obligation

These examples underscore the high stakes for employers who fail to comply—wittingly or unwittingly—with their obligations under the immigration laws. In 1986, the Immigration Reform and Control Act (IRCA) was passed into law. IRCA requires employers to verify the identity and work eligibility of all employees hired after the passage of IRCA. In order to fulfill the requirements of IRCA, employers and employees must fill out the Form I-9. Completing the Form I-9 requires that the newly hired employee provide the employer with documentation that confirms the employee's identity and authorization to work in the United States. Employment of illegal workers often results from the employer's exercising a less-than-careful eye over the completion of the I-9 Form.

Unfortunately, a properly completed Form I-9 does not ensure that an employer is not hiring an illegal immigrant worker because it cannot detect cases of stolen identity. Currently, the only indication an employer has from the government that an employee may have stolen the identity of an authorized worker is when it receives a letter from the Social Security Administration (SSA) indicating that the employee's name or social security number does not match the name or social security number on file with the SSA. Adding to the complexity of an employer's obligation, the government has not issued final guidance on how to respond to these "no-match" letters.

The Pitfalls of Using Temp Agencies and Contractors

Even if a company's own employees are properly authorized to work, a company can find itself in legal jeopardy because of its use of contractors or temporary workers. Part of ICE's enforcement strategy includes investigating the hiring practices of temp agencies and contractors that provide workers to other businesses. In many cases, these companies provide workers that are vital to other businesses' production and successes. Recently, ICE searched the Portland, Oregon offices of American Staffing Resources, Inc. ("ASR"), a commercial staffing firm, and Fresh Del Monte Produce, Inc. ("Del Monte"), the well-known fresh produce company. One of the ASR offices was located at the Del Monte plant. According to an ICE press release, warrants were issued to search for evidence of "hiring illegal aliens; harboring illegal aliens; encouraging illegal aliens to reside in the United States; identity theft; immigration document fraud; and Social Security fraud." More importantly, about 170 ASR employees who were production workers at the Portland Del Monte plant were detained for possible deportation hearings, and three managers from ASR were arrested and charged with knowingly hiring illegal workers. Undoubtedly, the searches and detentions caused great disruption to Del Monte's production and operations.

Fortunately for Del Monte, neither it nor any of its supervisors have been charged with knowingly employing illegal immigrants. Yes, it is not only the company that can be held liable, but individual supervisors also risk liability for having knowledge of employing unauthorized workers. Knowledge is defined broadly to include actual and constructive knowledge. Constructive knowledge is present where an employer is aware of circumstances in which he or she should have known that an employee was not authorized to work and failed to investigate. For example, it would be difficult to argue that no constructive knowledge exists where an employer is aware that an employee goes by two entirely different names (one at work and one socially), and yet fails to investigate.

The problems that a company can face because of the workers used by a contractor or employment agency are aggravated if there is a finding of joint employment. When determining who is the employer and who is the employee, ICE looks beyond payroll and applies the IRS guidelines for defining employment. According to the IRS, determining who is an employer is based on several factors. The most important one is control. The more control a business has over a worker (e.g., control over how, when, and where the worker performs services), the greater the likelihood that an employer-employee relationship exists.

Even when a business does not have an employer-employee relationship with its contract workers, it cannot knowingly use employment agencies or contractors that employ illegal immigrants. As a consequence, an employee or company cannot turn a blind eye to the work authorization of anyone working on its behalf. Wal-Mart knows this all too well. As a result of allegations that it knowingly contracted with janitorial companies that employed illegal aliens, Wal-Mart paid a record $11 million settlement to the government in March 2005. Additionally, part of the settlement directed Wal-Mart to establish a system that verifies that its independent contractors are taking reasonable steps to comply with immigration laws in their employment practices and to cooperate truthfully with any investigation of these matters.

How to Best Avoid Hiring Unauthorized Immigrant Workers

As the government continues to increase enforcement through the efforts of ICE, many companies find themselves asking what steps can be taken in order to avoid hefty fines and potential jail sentences. Large companies that use contract agencies to supplement their workforce ask how they can ensure that they will not be held responsible for the actions of these agencies. ICE has established a Hiring Guide for Employers that provides guidelines as to what steps employers can take to prevent the hiring of undocumented workers. Although some of these steps are somewhat simplistic—such as providing annual training on completion of the I-9 Form and detection of fraudulent documents, only allowing those trained to complete the I-9 Form, and requiring a secondary review of each employee's verification—other suggestions place serious responsibilities on the employer and cannot be taken lightly.

The most onerous suggestion by ICE in its Hiring Guide for Employers is that the employer should utilize the Basic Pilot Program for all hiring. The Basic Pilot Program is a voluntary program that involves verification checks of the Social Security Administration and the Department of Homeland Security databases. The program uses an automated process to verify the employment authorization of all newly hired employees. However, to utilize the Basic Pilot Program, an employer must enter into a Memorandum of Understanding ("MOU") that requires the employer's agreement to utilize this program for every new employee at the location and to grant the government the right to come on-site to review Basic Pilot documentation (including I-9 Forms) as well as interview employees. Many employers find that this agreement opens the door too wide for government oversight. The trade-off, though, is a rebuttable presumption that the employer did not knowingly hire unauthorized workers if all steps are followed in the Basic Pilot Program.

Employers must keep in mind that it is possible to take things too far in attempting to diminish the risk of hiring illegal workers. For example, requesting more documentation than allowed on the I-9 Form or refusing to hire individuals who have a foreign accent could easily result in national origin discrimination claims.

They Work for a Contractor; What Can I Do?

Although the above suggestions are acceptable when dealing with a company's own employees, exerting this much control over a contractor may push the company into a joint employer situation. In other words, if an employer were to train the employees of a contract agency on how to complete the I-9 Forms or to review all of the agency's I-9 Forms, the employer is heading towards establishing an employer-employee relationship with the contractor's employees. This would subject the employer to liability. Instead, when an employer utilizes contract or employment agencies, it should set policies or standards in place that the contractor must meet. This allows the employer to maintain a distance in terms of control. Some options could include that an employer require all contractors to:

- Provide training by an outside source for its employees completing the I-9 Forms;
- Guarantee that only trained employees will complete the I-9 Forms;
- Submit to a yearly review of a small portion of I-9 Forms from a random selection of workers placed at the employer's facility; and/or
- Participate in the Basic Pilot Program.

Any or all of these suggestions could be included in a company's contract with the contract or employment agency. By doing so, the company begins to protect itself from being considered the contractor or agency's employee's co-employer.

Changes on the Horizon for Employment Verification

The recent Comprehensive Immigration Reform Bill, referred to as the "Grand Bargain," and recent laws passed in a handful of states provide insight as to the direction that workplace enforcement is headed in the near future. The Grand Bargain proposed to require all employers to electronically verify all new hires within eighteen months of the enactment of the bill. The bill also proposed that all current employees would need to be verified in the system within three years. Although the electronic verification program proposed by this bill was not defined, many believe it would have had many similarities with the Basic Pilot Program.

In the past, employment verification was an area of law that was left to the federal government. Yet, several states are now stepping forward with laws of their own that will require companies to take additional steps to ensure that their employees are authorized to work. Some states that have already passed laws include Colorado, Georgia, and the most recent addition, Arizona. The Arizona bill that was signed into law by Governor Janet Napolitano on July 2, 2007 requires that all employers participate in the Basic Pilot Program by January 1, 2008 and imposes aggressive consequences to employers who knowingly or intentionally hire undocumented workers. For example, a second offense may result in a permanent revocation of the employer's licenses to do business in the State of Arizona. In a written statement from the Governor to the Arizona Speaker of the House, the Governor stated that "Because of Congress' failure to act, states like Arizona have no choice but to take strong action . . . [and] other states are likely to follow . . . [T]he United States Congress must act swiftly and definitively to solve this problem at the national level."

Increased enforcement by ICE, closer scrutiny of employers utilizing contractors, and the push towards electronic verification of employees on both the federal and state level leave employers no choice but to take a detailed look at their I-9 policies and employment practices. One way to do so is to have your immigration counsel perform an I-9 audit to identify any problem areas. A detailed audit will help companies and supervisors to best protect themselves from severe business consequences, such as permanent revocation of business licenses, fines and even imprisonment.

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On a Collusive Collision Course: Multiemployer Bargaining Units and Antitrust Law

By Joshua Fulop

I. Introduction

There is substantial dissonance between the aims of antitrust and labor laws. Antitrust laws endeavor to proscribe those combinations that restrict competition. Labor laws endeavor to foster the combination of similarly situated employees so that they may restrict labor market competition. Congress attempted to solve this contradiction by exempting from antitrust laws those independent union actions that were in pursuit of legitimate goals.[1] Unfortunately, the encouragement of unilateral union actions, such as strikes and boycotts, conflicted with the overarching National Labor Relations Act (NLRA) policy of promoting industrial harmony through collective bargaining.[2] The Supreme Court thus recognized that to secure the goals of the NLRA, some allowances must be made for competition-restricting agreements emanating from the collective bargaining process.[3]

Yet, rather than foster a proper reconciliation between the two laws, this Supreme Court only further entangled and confused their unique policy goals. It forbade employers from making agreements with competitors to restrict competition but encouraged them to make agreements with unions effecting the same result. This contradiction was amplified by the longstanding National Labor Relations Board (NLRB) policy of encouraging employers to bargain in multiemployer bargaining units (MEBUs).[4] When all companies in an industry are able to bargain as a single entity, they form an aggregate monopoly on the supply of the output product—precisely what antitrust laws seek to prevent.

While the Court's lenient construction of the collective bargaining exemption perhaps did some harm to the effectuation of antitrust policy, it also created profitable opportunities for unions to exploit their monopolies on the input of labor. The union and multibargaining employer unit constitutes a bilateral monopoly; i.e., one monopolist (the union) controls an input into another monopolist's (the employer's) output. In a bilateral monopoly, each monopolist attempts to leverage its position to capture the monopolistic profits from sale of the output good in the monopolistic market. The input monopolist's leverage comes from its ability to set an initial price for a necessary input, while the output monopolist's leverage comes from its ability to account for the initial price of the input monopolist by setting a final price above the competitive level.

Prior to the Supreme Court case of *Brown v. Pro Football*,[5] unions were able to capture a substantial majority of the monopoly profits by demanding higher wages. MEBUs, though monopolies themselves, were powerless to respond, as antitrust laws constrained their ability to exercise monopolistic power independent of unions. Thus, employers acted as participants in a competitive marketplace, passing on the union's higher labor costs in the form of higher prices but not themselves benefiting from such increases. *Brown* greatly expanded the ability of employers to make and implement mutual agreements related to the collective bargaining process. The result is a collective bargaining process far more closely resembling the traditional bilateral monopoly.

This article will examine the history of labor's exemption from antitrust laws in section II. In section III, it will argue that prior to *Brown v. Pro Football*, unions were able to leverage this exemption, in a multiemployer bargaining situation, to secure monopolistic wages. Finally, in section IV, this paper will argue that the Supreme Court decision in *Brown* marks a fundamental change in policy towards employers in multiemployer bargaining units. By removing the constraints that had previously prevented employers from making competition-restricting agreements independent of unions, *Brown* created substantial incentive for union and employers to collusively create a product market cartel, whereby output is restrained and monopoly profits result.

II. Brief History of the Labor Exemption to Antitrust Law

A. Origin of the Statutory Exemption

The regulation of unions and union activities is well within congressional power under the Commerce Clause. This follows from the natural ability of unions to engage in conduct that imposes substantial restraints upon interstate commerce. Thus, it is ironic that the first federal law to substantially regulate unions was not a labor law at all; rather, early regulation of unions first resulted from the Sherman Antitrust Act of 1890.[6]

Congress enacted the Sherman Act to illegalize business combinations operating "in restraint of trade" among the several states.[7] "Restraint of trade" is a term of art under common law used specifically to refer to restraints on free competition in the marketplace.[8] In *Loewe v. Lawlor* (hereinafter *Danbury Hatters*),[9] the Supreme Court found a union boycott of an employer restrained trade in such a way as to violate the Sherman Act. The Court drew no distinction between corporate combinations and combinations between "laborers acting in the interest of laborers."[10]

Because such a broad reading could have been interpreted as criminalizing almost every conceivable union action, Congress responded by passing the Clayton Act of 1914.[11] The Clayton Act provided labor unions with a limited statutory exemption from prosecution under the Sherman Act. Section 6 foreclosed application of the Sherman Act to labor unions, declaring that because "[t]he labor of a human being is not a commodity or article of commerce," laborers may carry out legitimate union activities without running afoul of the antitrust laws.[12] Section 20 removed certain union activities from the scope of judicial injunction, including strikes, boycotts, and pickets.[13]

Following the Clayton Act, judges were forced to reconcile an antitrust policy that sought "to preserve a competitive business economy" with a labor policy that sought to "preserve the rights of labor . . . to better its conditions through the agency of collective bargaining."[14] This required the Supreme Court to carefully balance "how far Congress intended activities under one of these policies to neutralize the results envisioned by the other."[15] In *Duplex Co. v. Deering*,[16] the Court found the exemption extended only to union activities directed against an employer by its own employees.

Congress again responded, this time with the Norris-LaGuardia Act.[17] Norris-LaGuardia was intended, in part, "to restore the broad purpose which [it] thought it had formulated in the Clayton Act but which was frustrated . . . by unduly restrictive judicial construction."[18] Following Norris-LaGuardia the Supreme Court finally acted to articulate a broad statutory exemption for labor from antitrust laws. In *United States v. Hutcheson*, the Court reinterpreted § 20 of the Clayton Act to protect all union actions from the Sherman Act, so long as a union was acting (1) in its self-interest and (2) independent of non-union groups.[19]

B. Origin of the Nonstatutory Exemption

The statutory exemption applied only to labor's wholly independent actions. This was an anathema to the fundamental purpose of labor law—the promotion of the joint, harmonious settlement of industrial disputes through collective bargaining.[20] Thus, as a means of encouraging labor to achieve its objectives through the collective bargaining process, the Supreme Court recognized "a limited nonstatutory exemption from antitrust sanctions" for certain union-employer agreements.[21] Although the breadth of this exemption was unclear in early Supreme Court decisions, certain policy goals did emerge shortly thereafter.

First, the purpose of the nonstatutory exemption was to effectuate "the strong labor policy favoring the association of employees to eliminate competition over wages and working conditions."[22] Thus, although the nonstatutory exemption protected agreements reached by unions with employers, it was to be entirely a protection for union interests. This comports with the view that the NLRA was union biased rather than an evenhanded statute.

Second, the breadth of the nonstatutory exemption was narrower than the statutory exemption. It exempted collective bargaining agreements only insofar as they concerned labor issues of import to public policy. For example, statutory requirements that employers and unions bargain over wages, hours and working conditions weighed "heavily in favor of antitrust exemption" for agreements on matters "intimately related" to these mandatory subjects.[23] Thus, in *Jewel Tea*, the Court found that unionized butchers could impose limits on the hours that their grocery store employers could sell self-service, prepackaged meat. Although the employers had not required union work during the off-hours operation, the Court accepted the butchers' argument that the hours that meat was sold affected the hours they would be required to work.[24]

Furthermore, the statutory exemption permitted unions to unilaterally effectuate certain restraints on competition in the output market that would have been illegal under the nonstatutory exemption.[25] For example, the nonstatutory exemption was forfeited when collective bargaining negotiations ventured outside the realm of the bargaining unit, whereby a union promised one employer to impose certain conditions on another employer.[26] Thus, in *United Mine Workers*, the Supreme Court found an agreement between the union and large mine operators whereby the union would impose certain conditions on small operators, violated the Sherman Act.[27] While the Court found it "beyond question" that the union could unilaterally "seek the same wages" from all employers, nevertheless it could not conspire with one set of employers to do the same.[28]

Using these guidelines, circuit courts established varying criteria governing application of the exemption. Perhaps the most cited decision was *Mackey v. National Football League*.[29] [30] There, the Eighth Circuit adopted a three-part test for application of the nonstatutory exemption. Specifically, it found that the nonstatutory exemption would apply only if: (1) the restraint at issue primarily affected only the parties to the collective bargaining agreement; (2) the agreement concerned a mandatory subject of bargaining; and (3) the agreement was a product of bona fide arm's-length bargaining.[31]

C. Brief Legal Analysis of Multiemployer Bargaining Units

Today, the use of multiemployer bargaining units (MEBUs) is widespread, comprising 40% of all major collective bargaining agreements.[32] A MEBU is a group of employers in an industry that combines to jointly negotiate a collective bargaining agreement with a union.

Though no statute explicitly permits the use of MEBUs,[33] both the Supreme Court and Congress have long recognized their importance to the furtherance of labor policy.[34] Thus, the Court has facilitated their certification through the NLRB.[35]

The NLRB has a strong interest in ensuring that multiemployer bargaining remains an instrument for promoting labor peace.[36] Therefore, the NLRB has recognized the importance of consent in the operation of MEBUs. Consent is required by both union and employer to certify a MEBU.[37] Furthermore, once contract negotiations begin, absent unusual circumstances, withdrawal is permitted only by consent of the parties.[38]

Interestingly, the Supreme Court sanction of MEBUs was based on policy goals quite different from those underlying the nonstatutory labor exemption. While the nonstatutory exemption was thought of as an instrument for unions to achieve better working conditions, the MEBU was an instrument for employers to achieve bargaining equality with a large union.[39] This "self-help" was necessary when employers and unions bargained over conflicting interests.[40] Indeed, the Court recognized the close tie between the expansion of MEBUs and passage of the NLRA, arguing that "employers have sought through group bargaining to match increased union strength."[41]

Yet, because union consent is required for their constitution, there clearly exists some unacknowledged utility of MEBUs to unions that compels this widespread union sanction. The next section will explore this utility in more depth.

III. The Union and Multiemployer Bargaining Unit as a Bilateral Monopoly

A. The Bilateral Monopoly Defined

A bilateral monopoly occurs when an "upstream" monopolist seller sells an intermediate product to a "downstream" monopsonist buyer,[42] who is also a monopolist seller of a final product.[43] In a bilateral monopoly, there exists a mutual interdependence between the parties that affects each one's ability to charge monopolist prices.[44] Economist predictions as to the effects of the bilateral monopoly on price and output are largely determined by the ability of the two monopolists to bargain.

The conventional model, called the price leadership model, assumes that the parties do not bargain, leading to sequential decision making. Under the Price Leadership Model, the upstream monopolist independently prices its goods; then, the downstream monopolist independently decides the quantity it will purchase at that price.[45] As the lead actor, the upstream monopolist attempts to set a price that captures the complete monopolistic profit of the downstream monopolist.[46] However, it is ultimately unsuccessful, because its monopolistic prices are met by decreased demand from the downstream monopolist.[47] Thus, a vicious cycle is formed, whereby output will, in theory, approach zero.[48] The profits of each party will be hurt until the upstream monopolist recognizes that it must allow the downstream monopolist to receive some portion of the monopolistic profits. This game will ultimately result in lower output, higher prices, and monopolistic rents split between downstream and upstream monopolists.[49]

The bargaining model assumes the ability for parties to bargain with minimal transaction costs. When parties can coordinate actions, they will effectively maximize joint profits by behaving as a single vertically integrated monopolist.[50] By treating the upstream monopolist's input as a controllable cost of production, the parties are able to set a final output and price that maximizes monopolistic profit. Once this Pareto Optimal outcome is achieved, the parties will then divide the gains between themselves through bargaining.[51]

B. Modeling the Union and Multiemployer Bargaining Unit

1. The Bilateral Monopoly

The concept of bilateral monopoly is not only applicable to monopolistic producers but is also applicable to labor-management relations. This article considers a common form of union-management bargaining that is also a modified form of bilateral monopoly. Specifically, it considers a situation where an upstream union monopolizes labor, while a downstream MEBU aggregately monopolizes both the purchase of labor and the sale of the ultimate product of that labor.[52]

This bilateral monopoly is unique because neither employee nor employer is a natural monopolist. However, while a group of employees can form a legal monopoly through constitution of a union, an employer is prohibited from such action by the Sherman Act. Instead, in the limited context of bargaining, employers may enter into a MEBU comprised of all employers in an industry. A MEBU differs substantially from a union in the degree to which it can leverage its monopoly. A union can exert substantial leverage because it can both act independently and enter into direct agreements with employers to limit labor competition. A MEBU, on the other hand, has little leverage, because it cannot act independently outside the collective bargaining agreement, nor can it enter into direct agreements with unions to limit output. Thus, the bilateral monopoly we consider differs somewhat from the traditional version.[53]

2. Criticism of the Bilateral Monopoly Model

Thomas Campbell, in his article "Labor Law and Economics,"[54] argues against application of the bilateral monopoly framework. He reasons that because a union's composition is based on the final product output of an employer as opposed to the input of an employee, the multiemployer bargaining unit will not have a monopsony on the purchase of labor.[55] Rather, an unhappy employee could always sell his services to an employer in a different product market.

While undoubtedly true that management lacks a total monopsony on labor, this does not negate the presence of a bilateral monopoly. First, an employee's options are far more limited than what Campbell suggests. Campbell's theory assumes not only a complete disconnect between employee and goods produced, but also the ready availability of other suitable employers in the employee's area. Yet, even were such employers to exist, Campbell's theory ignores the high costs of switching jobs, especially union jobs, where pay and benefits are governed by seniority.

Second, and perhaps most important, Campbell's analysis as it relates to individual employees is inapplicable when applied to union bargaining. While a dissatisfied employee can leave an untenable employment situation, a union cannot. The best a union can do is strike. But, by striking, a union risks losing its labor monopoly, as an employer may then hire replacement workers.[56] Thus, a union's limited exit options preserve the general framework of the bilateral monopoly.

Furthermore, Campbell neglects a much stronger argument against the union/MEBU bilateral monopoly; namely, the bilateral monopoly assumes the presence of a final output monopolist that is not truly present here, because antitrust restrictions limit the ability of employers in a bargaining unit to exercise monopolistic control over the output marketplace.[57] Part I of the next section will highlight some suggested scholarly analyses to reconcile these problems. Part II will present my view on the proper mode of analysis for the union/MEBU bilateral monopoly.

C. Proper Model for the Union and Multiemployer Bargaining Unit Pre-*Brown*

1. Scholarly Analysis of the Union and Multiemployer Bargaining Unit Bilateral Monopoly?

Friedman, in his article, "Antitrust Analysis and Bilateral Monopoly,"[58] undertook the most extensive application of bilateral monopoly to the collective bargaining relationship. The basis for his analysis is the price leadership model, which follows from his belief that a union's sole decision is the price it should charge for labor, while an employer's sole decision is the amount of labor to employ at that given price-point.[59]

Friedman contends that this situation is unlike the prototypical bilateral monopoly, because employers cannot make agreements to restrain output that are necessary to combat total monopolization of profit by the union.[60] Thus, they remain locked in a competitive marketplace for the output good.[61] This causes employers to bargain with unions for lower wages, so that they can reap more competitive profit by selling more goods at the competitive price. Friedman predicts that prices will rise past competitive levels, but not to the monopolistic profit-maximizing level, and that the union will capture the available monopolistic profits.[62]

Friedman's view is opposed by Maloney, McCormick, and Tollison in their article, "Achieving Cartel Profits through Unionization."[63] There, they argue that a union uses its ability to negotiate with firms industrywide to collude with management.[64] Such collusion causes the parties to behave as a single, vertically integrated monopolist, thus allowing them to maximize joint profits under the bargaining theory.[65] Under the authors' model, because employers cannot themselves limit output, the union uses strategic industrywide strikes to effect such limitations.[66]

Finally, in their article, "A Pedagogical Treatment of Bilateral Monopoly,"[67] Blair, Kaserman, and Romano make the point that the parties to a bilateral monopoly need not be in equal bargaining positions to achieve a joint profit-maximizing outcome. Although not specifically referencing labor-management relations, the authors find that a downstream monopolist will always produce and sell at the joint profit-maximizing outcome, even when the upstream monopolist has a dominant bargaining position.[68] Thus, the only variance will be the price of the intermediate good, which will vary by the relative bargaining powers of the parties.[69]

2. Proper Model for Pre-*Brown* Analysis

Blair, Kaserman, and Romano's model is the most intuitively correct as applied to the pre-*Brown*, union-MEBU bilateral monopoly. Their model deals with the operation of a bilateral monopoly in the presence of bargaining leverage disparities. Such disparities are readily observable in the leverage a union has in collective bargaining.

Both union and employer are legally required to bargain with each other.[70] A union nevertheless has a choice between two bargaining strategies. It can either collude with a MEBU in maximizing monopolistic profits or act belligerently by refusing such collusion. If the union eschews collusion, the parties' behaviors most closely replicate the sequential decision making of the price leadership model.[71] Under the price leadership model, the upstream monopolist union sets a price for labor that attempts to capture the entire monopolistic profits. Yet, unlike the textbook bilateral monopoly, the downstream monopolist MEBU here cannot respond by decreasing the purchase of labor and increasing prices. An agreement among employees to do so is illegal and can be accomplished only with union assistance in collusion. Without the possibility of agreement, no employer possesses the individual incentive to limit output. Rather, they behave as participants in a competitive marketplace by treating labor as a cost of production and then producing at a price sufficient to obtain a normal profit (i.e., some amount sufficient to discourage exit but insufficient to encourage entry).[72] The union obtains its monopolistic profits, and the employers obtain only competitive profits.

Presumably, the union will sacrifice such a favorable result only for an even better one. Because employers can obtain only a competitive profit without collusion, it is difficult to imagine that unions would offer employers more than a minimal share of the collusive monopolistic profits. Thus, as per Blair, Kaserman, and Romano, under the system that existed before *Brown* in 1996, it was irrelevant whether or not there was collusion. Either way, a union reaped the large majority of monopolistic profits, which consumers subsidized through higher output good prices.

This differs from Friedman's analysis in two significant ways. First, Friedman believes a profit maximizing outcome will not result because the MEBU will fight the union on wages to secure greater competitive profit. He asserts that with lower wages, an employer will be able to increase earnings by selling more products at the normal, competitive profit.[73] Of course, if normal profit is defined as that which is "sufficient, but just sufficient, to induce the firms in an industry to continue producing and offering the product in question,"[74] then a MEBU cannot earn greater profits by lowering the costs of production. Greater production will simply be met with lower gross margins on sales. Certainly an individual firm can still earn greater profits by lowering its costs of production, relative to its competitors, but this should have no effect on the negotiating position adopted by a MEBU.

Second, Friedman analyzes the union/MEBU negotiation under the price leadership model. This choice ignores the centrality of collective bargaining to the union-management relationship. Specifically, Friedman assumes that the illegality of direct union-management cooperation to restrict output effectively operates to wholly eliminate any such collusion between the two parties. Yet, as will be discussed in the next section, the union has many tools at its disposal to legally reduce an employer's output. Thus, even were a MEBU able to increase its profits through decreased wages, a union could respond by colluding and offering the MEBU a share of the monopolistic profits sufficient to compensate them for the decreased production.

IV. The Union and Multiemployer Bargaining Unit after *Brown v. Pro Football*

A. *Brown v. Pro Football*

The National Football League (NFL) bargained as a MEBU with the NFL Players Association ("Union"). While bargaining over a new contract, the NFL independently adopted a resolution that allowed owners to field a development squad of six players. These players would practice with and substitute for Union players but would be paid only a nonnegotiable $1,000 weekly salary. The Union vehemently opposed this, arguing players should be able to negotiate salaries. When bargaining between the NFL and Union over this proposal reached impasse, the NFL unilaterally imposed it, with obligatory penalties for individual teams that did not adhere to the $1,000 salary. Development squad players then challenged the NFL's unilateral implementation as a violation of the Sherman Act prohibition against agreements in restraint of trade.

The Supreme Court began consideration of *Brown* by recognizing the inherent conflict between antitrust and labor law, finding that "antitrust law often forbids or discourages the kinds of joint discussions and behavior that the collective-bargaining process invites or requires."[75] It then interpreted the nonstatutory labor exemption to grant the NLRB jurisdiction over the legal limits of the collective bargaining process, including where it conflicts with antitrust policy.[76] This was based on its finding that one objective of the nonstatutory exemption was to remove "from antitrust courts the authority to determine, through application of the antitrust laws, what is socially or economically desirable collective-bargaining policy."[77] Thus, although antitrust law may forbid "all agreements among . . . competing employers . . . that unreasonably lessen competition among or between them," labor law may permit anticompetitive agreements that are "conducive to industrial harmony."[78]

Applying this framework, the Supreme Court held the nonstatutory antitrust exemption applies to employer conduct that grows out of and is directly related to the collective bargaining process.[79] Thus, employers may make competition restricting agreements among themselves without the participation of labor[80] and may unilaterally implement those agreements following impasse.[81] Indeed, this framework applies to sports and nonsports employers equally.[82]

B. Effect of *Brown* on the Union and Multiemployer Bargaining Unit

Brown considers the exact situation with which we here deal—the bilateral monopoly. The NFL is a textbook example of a dual monopolist and monopsonist, as no real competitors exist for its product, nor is there an alternative venue through which NFL players can sell their talents.[83] Thus, it cannot be said that the Court was dealing only with situations of significant monopolistic disparities.

The *Brown* Court had the opportunity to sanction the three-part *Mackey* test, which explicitly considered the effects of the bargaining unit on nonparties. Instead, it effectively overturns *Mackey*,[84] and provides impetus for broader interpretations of the exemption.[85] Indeed, *Brown* marks the culmination of a fundamental change in Supreme Court policy towards labor.[86] Whereas early labor decisions emphasized the goals of promoting worker interests, *Brown* represents the Court's more close alignment with the view that labor laws are "essentially neutral," and that "vigorous collective bargaining [is] the most effective means of resolving labor-management disputes."[87] This view is not novel but is in substantial accord with the longstanding Supreme Court policy towards MEBUs, as articulated in *Buffalo Linen*.[88] It is the view that a MEBU can further the goals of labor policy by acting in its own interest, thereby preempting the antitrust laws that had previously constrained it.[89]

Brown "strengthens the position of employers involved in the collective bargaining process with unions."[90] Previously, labor had less incentive to collude with management, mainly because it could reap monopolistic profits by acting independently. *Brown* gave employers a substantial weapon to combat union belligerence—the ability to "implement employment terms without fear of antitrust liability" once impasse is reached.[91] This restores to employers the ability to punish union defection under the price leadership model. A MEBU faced with unreasonable and unyielding wage demands can now enter into legally enforceable agreements that unilaterally implement less favorable conditions. Because a union no longer possesses the independent leverage it had previously, it now must cooperate with employers to achieve maximum monopolistic profits.

C. Creation of a Product Market Cartel

With cooperation now necessary for each side to maximize joint monopolistic profits, both union and employer will create a product market cartel. A product market cartel is usually formed by a group of firms with the intention of reducing output to an extent necessary for all firms to reap monopolistic profits. Collusion between union and employer to create a product market cartel was proposed by Campbell. He argues that a union will act as an agent for management in establishing a product market cartel and is duly compensated with a share of the joint gains.[92] The formation of a product market cartel is made possible by the ability of union and MEBU to make enforceable agreements over mandatory subjects of bargaining. How this works is discussed below in more detail.

1. Mandatory Subjects of Bargaining

Employers cannot themselves limit their joint output, for MEBUs can only enter into agreements concerning the collective bargaining process. Thus, employers require union assistance in restricting production. Maloney, McCormick, and Tollison argued that labor could accomplish this by engaging in strategic striking across employers.[93] However, because an agreement between union and management to strike would likely fall well outside the boundaries of any nonstatutory antitrust exemption, this model seems to be unworkable in any practical sense. It would require employers to concede monopolistic level wages to union members based on an unenforceable and illegal promise. It would also be quite the risky collaboration, as it is based on assumptions that the union will be able to (1) persuade its members to strike without substantial cause and (2) communicate and coordinate the length and breadth of the strike with management of all firms in the industry.

Yet, the larger problem with the authors' argument is that it overlooks a union's ability to coordinate with management and achieve output reduction legally, through its nonstatutory exemptions. In *Jewel*, the Court strongly suggested that nonstatutory antitrust exemption extends to at least all mandatory subjects who are bargaining.[94] Because employer concessions on such mandatory subjects can cause subsequent constraints on production capabilities, Campbell recognized that a collective bargaining agreement can effectively constrain an employer's ability to set output.[95] Therefore, by negotiating a single agreement, with a single monitoring union, a MEBU can concede to a union the wages and terms of employment necessary to effectively limit industrywide output.

Mandatory subjects of bargaining include all those subjects that vitally affect terms and conditions of employment.[96] The most obvious means for controlling output is through wages. Assuming the inability of an employer to extract greater productivity efficiency, the greater the wages a union requests, the more costly the final good is to produce, the more expensive it is to purchase, the less it is demanded, and the less labor is required.

The union can also ensure uniform employee productivity by bargaining over mandatory subjects. First, it can require that employees work equivalent amounts of time for equivalent pay by negotiating over overtime,[97] holidays,[98] and vacation pay.[99] Next, it can require that employees work at only specific hours, by negotiating work hours,[100] work days,[101] compensatory time off for overtime hours worked,[102] and breaks.[103] Finally, once worker input is controlled, a union can negotiate to ensure that labor is not replaced by other inputs. To ensure that other, cheaper labor is not brought in, a union can negotiate subcontracting clauses.[104] To ensure that an employer does not substitute mechanical processes for labor, a union can negotiate production quotas and work rules.[105]

2. Monitoring

Because agreements between firms to restrain output are illegal under the Sherman Act, the pervasiveness of cheating strongly constrains the effectiveness of any industrywide attempt by employers to cartelize. Unions offer firms access to an otherwise unachievable benefit—the ability to sign output-limiting agreements that are legally enforceable and duly monitored.[106] These agreements are largely monitored by unions that can hold an employer that violates the terms of the agreement "subject to suit and even to job action."[107]

V. Conclusion

Although the labor laws were created to promote industrial cooperation and harmony through collective bargaining, antitrust problems emerge when such laws encourage union and employer to get too close. Campbell clearly recognized the potential for cartelization in his seminal article.[108] He suggested that neither the Supreme Court nor Congress would have enthusiastically supported MEBUs had they been aware that they obtain their benefits largely from the creation of cartels.[109]

Yet, at least for now, the Supreme Court has rejected this assertion. *Brown* was incredible for its scope. The Court there posited that agreements concerning mandatory subjects of bargaining were outside the scope of antitrust law, even if they imposed some restrictions on competition. Simply put, the Court found it unworkable for antitrust courts to determine how bargaining over wages, hours, and working conditions should properly proceed in an antitrust framework.[110] The Court was wary of allowing the nonstatutory exemption to turn on "amorphous" inquiries into an employer's subjective motivation.[111]

Thus, the Supreme Court has not ignored the opportunity for collusion that exists between MEBU and union. It has merely found, on balance, that such possibility is an acceptable cost of promoting greater freedom in the employer-union relationship.

Endnotes

1. 29 U.S.C. §§ 101-15.
2. Clyde W. Summers, *Comparison of Collective Bargaining Systems: The Shaping of Plant Relationships and National Economic Policy*, 16 Comp. Lab. L. 467, 470 (1995).
3. *Connell Constr. Co. v. Plumbers & Steamfitters Local Union No. 100*, 421 U.S. 616, 622 (1975).
4. *NLRB v. Truck Drivers Local Union (Buffalo Linen)*, 353 U.S. 87, 94–95 (1957).
5. 518 U.S. 231, 240 (1996).
6. 15 U.S.C. §§ 1-7.
7. 15 U.S.C. § 1.
8. *Apex Hosiery Co. v. Leader*, 310 U.S. 469, 493–94 (1940).
9. 208 U.S. 274, 308–09 (1908).
10. *Id.* at 302.
11. 15 U.S.C. §§ 12-27, 29 U.S.C. § 52.
12. 15 U.C.S. § 17.
13. 29 U.S.C. § 52.
14. Allen *Bradley Co. v. Local Union No. 3, International Brotherhood of Electrical Workers*, 325 U.S. 797, 806 (U.S. 1945).
15. *Id.*
16. 254 U.S. 443, 466 (1921).
17. 29 U.S.C. §§ 101-15.
18. *United States v. Hutcheson*, 312 U.S. 219, 235–36 (1941).
19. *Id.* at 232.
20. Summers, *supra* note 2, at 470.
21. *Connell Constr. Co. v. Plumbers & Steamfitters Local Union No. 100*, 421 U.S. 616, 622 (1975).
22. *Id*. *See also* Local Union No. 189, *Amalgamated Meat Cutters & Butcher Workmen v. Jewel Tea Co.*, 381 U.S. 676, 689–90 (1965) (stating the important consideration in whether there is a nonstatutory labor exemption is whether the union was acting in pursuit of its own labor union policies).
23. *Id.* at 689–90.
24. *Id.* at 696–97.
25. *Id.* at 622–23.
26. *United Mine Workers v. Pennington*, 381 U.S. 657, 668 (1965).
27. *Id.* at 666–67.
28. *Id.* at 664–66.
29. 543 F.2d 606, 614 (8th Cir. 1976).
30. *See* 9-72 Federal Antitrust Law § 72.7 n.184.
31. *Mackey*, 543 F.2d at 614.
32. *Brown v. Pro Football*, 518 U.S. 231, 240 (1996).
33. Robert H. Lande & Richard O. Zerbe, Jr., *Anticonsumer Effects of Union Mergers: An Antitrust Solution*, 46 Duke L.J. 197, 208 (1996).
34. *NLRB v. Truck Drivers Local Union* (*Buffalo Linen*), 353 U.S. 87, 94–95 (1957). Indeed, limitations on MEBUs were considered and rejected by Congress during passage of the Taft-Hartley Act. *Id.*
35. Lande & Zerbe, Jr., *supra* note 33, at 208 (1996). *See also* American *Fedn. of Labor v. NLRB*, 308 U.S. 401, 411 (finding NLRB representation certifications are generally outside the scope of judicial review).
36. *Charles D. Bonanno Linen Serv. v. NLRB*, 454 U.S. 404, 412 (1982).
37. *See* Lande & Zerbe, Jr., *supra* note 33, at 209; Thomas J. Campbell, *Labor Law and Economics*, 38 Stan. L. Rev. 991, 1048 (1986).
38. *Bonanno*, 454 U.S. at 410–11.
39. *Buffalo Linen*, 353 U.S. at 96.
40. *Id.*
41. *Id.* at 94–95.
42. An upstream seller is one whose product is an input into the production of the downstream purchaser.
43. Richard D. Friedman, *Antitrust Analysis and Bilateral Monopoly*, 1986 Wis. L. Rev. 873, 873 (1986).
44. *Id.*
45. *Id.* at 878.
46. *Id.*
47. *Id.*
48. *Id.*
49. *Id.*
50. *Id.* at 880.
51. *Id.* at 881.
52. *Id.* at 916.
53. *Id.*
54. Campbell, *supra* note 37.
55. *Id.* at 1020, n.154.

56. *NLRB v. Mackay Radio & Tel. Co.*, 304 U.S. 333, 345 (1938).

57. Friedman, *supra* note 43 at 916.

58. *See supra* note 43.

59. *Id.* at 916–17.

60. *Id.* at 916.

61. *Id.* at 916–17.

62. *Id.* at 917-18.

63. 46 S. Econ. J. 628 (1979).

64. *Id.* at 628.

65. *Id.* Although the authors do not discuss bargaining theory specifically, they follow the same line of reasoning.

66. *Id.*

67. 55 S. Econ. J. 831, 837 (1989).

68. *Id.* at 836–37.

69. *Id.* at 837.

70. 29 U.S.C. § 158(a)(5) and (b)(3).

71. Of course, union/MEBU behavior will not exactly replicate the price leadership model, because a union and MEBU must negotiate no matter the bargaining strategy adopted by the union. Thus, the sequential union action and MEBU reaction generally occurs at the bargaining table. The union will request a wage level, which the MEBU must then respond to strategically.

72. *See* Friedman, *supra* note 43 at 916–18.

73. *Id.* at 917.

74. Charles E. Mueller, *Glossary of Antitrust Terms*, 26 Antitrust L. & Econ. Rev. No. 4 (1995), *available at* http://www.metrolink.net/~cmueller/ii-03.html.

75. *Brown*, 518 U.S. at 242.

76. *Id.* at 236-37, 240–41.

77. *Id.* at 242.

78. *Id.* at 240–41.

79. *Id.* at 250.

80. *Id.* at 237.

81. *Id.* at 250.

82. *Id.* at 248.

83. Chris L. Dickerson, *Brown v. Pro Football, Inc—The Nonstatutory Exemption From Antitrust Liability Becomes a Management Weapon*, 1997 Wis. L. Rev. 1047, 1072-73 (1997).

84. *See California ex rel. Lockyer v. Safeway, Inc.*, 371 F. Supp. 2d 1179, 1185 n.5 (C.D. Cal. 2005) (finding *Mackey* does not survive *Brown*).

85. *See Clarett v. NFL*, 369 F.3d 124, 133–34 (2d Cir. 2004) (finding the nonstatutory exemption to be broader than the *Mackey* test).

86. Steven D. Buchholz, *Run, Kick, and (Im)passe: Expanding Employers' Ability to Unilaterally Impose Conditions of Employment After Impasse in Brown v. Pro Football*, 81 Minn. L. Rev. 1201 at 1225 (1997).

87. *Id.* at 1225.

88. *Buffalo Linen*, 353 U.S. at 94–96.

89. Buchholz, *supra* note 86 at 1226.

90. Joseph Covelli, *Brown v. Pro Football, Inc.: At the Intersection of Antitrust and Labor Law, Supreme Court's Decision Gives Management the Green Light*, 27 Stetson L. Rev. 257, 259 (1997).

91. *Id.* at 285.

92. Campbell, *supra* note 37 at 1009–10.

93. *See* Maloney, *supra* note 63, at 628.

94. *Jewel Tea*, 381 U.S. at 689.

95. Campbell, *supra* note 37 at 1049.

96. *Allied Chem. & Alkali Workers v. Pittsburgh Plate Glass Co.*, 404 U.S. 157, 178–179 (1971).

97. *NLRB v. Montgomery Ward & Co.*, 133 F.2d 676, 686-87 (9th Cir. 1943).

98. *Singer Mfg. Co.*, 24 NLRB 444, 470 (1940).

99. *Id.*

100. *Jewel Tea*, 381 U.S. at 691.

101. *Id.*

102. *Fall River Savings Bank*, 260 NLRB 911, 918 (1982).

103. *Nat'l Grinding Wheel Co.*, 75 NLRB 905, 910 (1948).

104. *Fibreboard Paper Prods Corp. v. NLRB*, 379 U.S. 203, 215 (1964).

105. *First Nat'l Maint. Corp. v. NLRB*, 452 U.S. 666, 676–77 (1981).

106. Campbell, *supra* note 33 at 1050.

107. *Id.*

108. *Id.* at 1041–42.

109. *Id.* at 1052–53.

110. *Brown*, 518 U.S. at 240–41.

111. *Id.* at 247.

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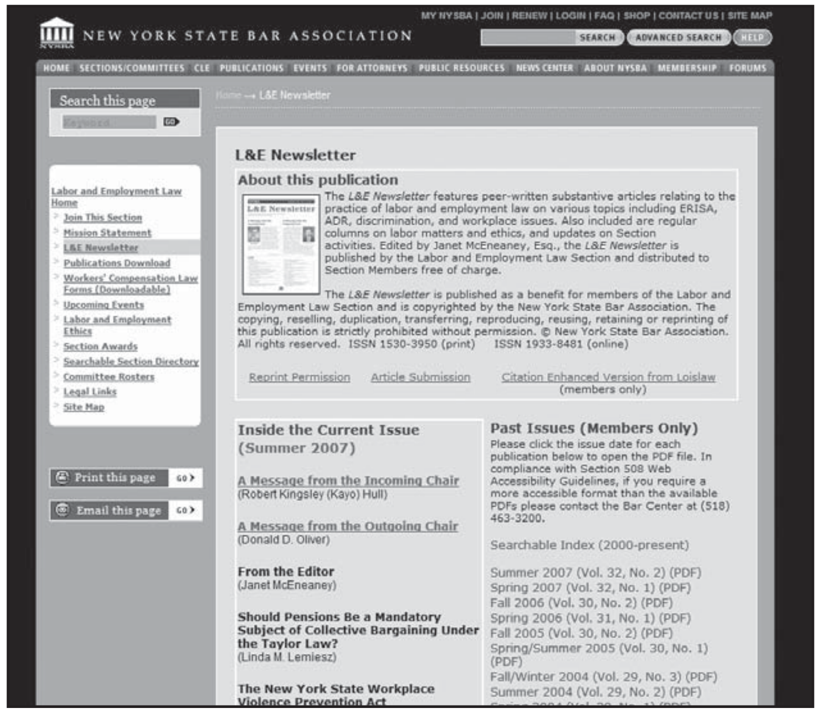

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