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WHISTLEBLOWER PROVISIONS OF SARBANES-OXLEY: WHAT HR AND EMPLOYMENT COUNSEL MUST KNOW

Last summer Congress passed the Sarbanes-Oxley Act, aimed at preventing the type of accounting and corporate governance abuses and management self-dealing alleged in the ENRON, Arthur Andersen, and Adelphia debacles. "Covered companies" under the Act are corporations that are publicly held, whether U.S. or foreign, if the non-U.S. public company is registered with the Securities and Exchange Commission ("SEC").

Sarbanes-Oxley addresses many matters that employment counsel and HR management will probably not be directly involved in or primarily responsible for, such as the make-up of the board of directors' audit committee; developing a code of ethics for senior financial officers; CEO and CFO certifications of financial statements; internal controls regarding audits; enforcement provisions, including bonus forfeitures for CEOs and CFOs; creation of a five-member board to oversee the accounting industry; and as to attorneys who appear before the SEC, reporting evidence of violations of securities laws, breaches of fiduciary duty or similar violations.

Whistleblower Provisions

Section 806 (18 U.S.C. § 1514A) prohibits retaliation by employers against "whistleblowers," *i.e.*, employees of covered companies who claim they were retaliated against because they provided information or participated in a proceeding addressing alleged violations of federal securities or antifraud laws, such as the mail fraud statutes. This provision applies not only to SEC-registered companies, but to their officers, employees, contractors, subcontractors and agents. Thus, businesses that are not registered with the SEC may be brought in through the "back door" and the statute may provide liability for individual executives and managers.

The no-retaliation protection is available, however, only if the employee provides information, causes information to be provided, or otherwise assists in an investigation regarding conduct that the employee reasonably believes is a violation of mail/wire fraud, bank fraud or securities fraud laws. (Many states have laws protecting whistleblowers. Sarbanes-Oxley does not prevent the application of other whistleblower laws, but instead provides protection in addition to those laws.)

However, whistleblowing is not a generalized matter. Specifically, the information must be provided to, or the investigation must be conducted by:

IN THIS ISSUE

- A federal regulatory or law enforcement agency;
- A member of Congress or any committee of Congress; or
- A person with supervisory authority over the employee (or such other person working for the employer who has the authority to investigate, discover or terminate misconduct).

Also protected is an employee's filing, causing to be filed, testifying, participating in or otherwise assisting in a proceeding filed, or (if the employer knows about it) about to be filed regarding any SEC rule or regulation or any federal law relating to fraud against shareholders.

Procedural Matters

Complaints must be lodged with the Secretary of Labor within 90 days of the alleged retaliatory conduct. The Secretary investigates and, within 180 days, issues a decision that is final, subject only to review by the Circuit Courts of Appeal under an abuse of discretion standard. However, if the Secretary does not issue a decision within 180 days, and the delay is not caused by the employee's bad faith, the employee may file suit in U.S. District Court, which will decide the matter *de novo*.

Remedies

Sarbanes-Oxley's remedies are not entirely clear. On the one hand, reinstatement, back pay and special damages such as attorney fees, litigation costs and expert witness fees are expressly allowed, and punitive damages are expressly excluded. On the other hand, the Act recites that remedies should include "all relief necessary to make the employee whole." Arguably, this could include damages for pain/suffering/emotional distress/humiliation/and the like, and front pay in lieu of reinstatement.

Criminal Provisions

Section 1107 of Sarbanes-Oxley (18 U.S.C. § 1513) provides criminal penalties of fines and/or imprisonment for up to ten years for anyone who, intending to retaliate, takes "any action harmful to any person, including interference with the lawful employment or livelihood of any person, for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any Federal offense..." Note that this provision is not limited to "covered companies." It applies to everyone. There is no ambiguity here as to whether there is individual liability for violations, as this is obviously addressed to individuals as well as to corporations. However, there is great ambiguity about the meaning of "law enforcement officer"—*e.g.*, does it include EEOC intake personnel?—and equal ambiguity about the meaning of "any Federal offense."

Employers must be prepared for complaints that every alleged EEO, wage-hour, NLRA or OSHA "retaliation" has potential criminal implications for companies and managers.

Practical Considerations

All employers affected by this statute should immediately review their internal complaint procedures. Most companies already have in place detailed policies dealing with sexual and other forms of harassment that undoubtedly include provisions for reporting perceived policy violations, for investigating complaints and for preventing retaliation. And some companies have wisely extended these policies to discrimination in general. However, few, if any, have in place similarly detailed policies for whistleblowers. While individual corporate cultures will determine whether such policies will be expanded narrowly, to assure protection only of behavior covered by the Sarbanes-Oxley Act, or broadly, to protect whistleblowing generally, some modification of policy will be essential to almost all employers. Along with the obvious (and immediate) impact of Sarbanes-Oxley on personnel policies, covered employers should be aware of (and may well want to coordinate their HR efforts with) Section 301 of the statute (18 U.S.C. § 78f) requiring the board's audit committee to establish a procedure providing for the receipt, retention and effective investigation and resolution of accounting and auditing complaints, including anonymous complaints.

With all additions or expansions of policy must go training for supervisors and managers, as well as all HR personnel. Clearly, the policy behind Sarbanes-Oxley

and the reasons for adding special whistleblowing emphasis to corporate personnel policies should be explained, and a positive endorsement by senior management should be obtained. All employees should understand that the company endorses whistleblowing complaints, if it does not positively solicit them.

Unanswered Questions

A number of unresolved issues are noted above, such as whether the civil sections of the statute provide for individual liability, the scope of the Act's civil remedies and criminal provisions, the meaning of "investigation" in the context of disclosures to members of Congress, and the scope of the "reasonably believes" criterion. Other unanswered questions include the applicability of binding arbitration to complaints brought to the Secretary of Labor and/or to the U.S. district courts, the extraterritorial application (if any) to non-U.S. based employees of U.S. companies and covered non-U.S. SEC-registered companies, and the interaction of the whistleblower provisions of Sarbanes-Oxley with other provisions, such as those addressed to board audit committees. While clearly much of this transcends the scope of human resources counsel and executives, their input and understanding will be essential to employers' successful compliance with the statute.

If you have any questions about Sarbanes-Oxley, or wish to discuss, or need any assistance in, developing your company's policies or procedures regarding whistleblowers, please call Alan Koral in New York (212/407-7750), George Blake in Chicago (312/609-7520), or any other Vedder Price attorney with whom you have worked.

FIRING DISGRUNTLED EMPLOYEE FOR POOR PERFORMANCE NOT DISCRIMINATORY, SAYS SEVENTH CIRCUIT

The United States Court of Appeals for the Seventh Circuit reviews appeals from decisions of federal district courts located in Illinois, Wisconsin and Indiana. Because many of our readers conduct business in those states, we frequently report on opinions of the Seventh Circuit dealing with employment law issues. Two recent opinions have drawn our attention: *Koski v. Standex International Corporation* (No. 01-3505 decided 10/15/02), and *Herrnreiter v. Chicago Housing Authority* (No. 01-3202 decided 12/30/02). Each case involved a previously satisfactory employee in a protected class whose job performance deteriorated after his attitude toward management soured. This situation presents a touch-and-go decision for human resources managers. In both cases the employee was fired . . . and in both cases the Court found no discrimination and ruled for the employer.

Koski (303 F3d 672). Let go for unsatisfactory job performance after 28 years of service during which he had received promotions and merit increases, Koski sued, claiming that his employer's reasons for firing him were pretexts for age discrimination. The district court granted summary judgment to the employer (Spincraft, a unit of Standex International Corporation in Wisconsin). On appeal, the Seventh Circuit affirmed the judgment.

For the purpose of summary judgment, Spincraft conceded that Koski was a member of a protected class and could establish a *prima facie* case of age discrimination. It countered that he was terminated for legitimate reasons unrelated to age: his growing introspection and moodiness caused job performance problems; he was failing to communicate with coworkers as required by his position; and he had inappropriately made disparaging remarks about Spincraft management.

To avoid summary judgment, Koski had to create a genuine issue of fact as to whether Spincraft's reasons were pretextual, *i.e.*, a cover-up for discrimination. Koski had to present evidence that Spincraft's reasons were factually baseless, or not the actual motivation for his discharge, or insufficient to motivate the discharge.

Koski offered deposition testimony from coworkers who believed he was performing his job well. However, the Court considered the relevant inquiry to be whether management decision-makers, not fellow employees, genuinely believed that he had problems. Koski pointed out that Spincraft had changed its reasons for firing him, first emphasizing his lack of teamwork and then stressing his moodiness and failure to take criticism. The Court agreed that Spincraft had used different language to

describe Koski's shortcomings but considered the underlying message consistent. "A reasonable jury could not find that these discrepancies support an inference that Spincraft's justification is a lie," the Court said.

Koski argued that Spincraft's documentation of his deficiencies was suspicious; negative performance reviews were not in his personnel file, supporting notes were missing, and the review principally relied on by Spincraft was dated after his termination. However, Koski admitted that he had been orally informed of most of the negative comments in the contested documents, thus supporting Spincraft's position that it believed Koski's performance was poor.

Although Koski denied making disparaging comments about management, he conceded that management considered his remarks disrespectful. Thus, he was unable to show that management did not believe he made the remarks and had simply used this as an opportunity to fire him for the impermissible reason of age.

Finally, the Court dismissed as unspecific the statements of other employees that younger workers were generally treated more favorably than older workers, and numerical evidence that the majority of employees recently terminated by Spincraft were over the age of 40. The Court concluded: "As we have said numerous times, employers may terminate competent employees because they do not like them, or, as in this case, because the employee does not respect the employer's authority."

Herrnreiter (315 F3d 742). Employed as an accountant in the auditing division of the CHA's Office of the Inspector General, Herrnreiter was transferred to the investigation division. He found his new job more interesting and challenging, and he had the use of a car and no longer had to sign in and out of the office. However, after 6 months Herrnreiter was transferred back to auditing by Inspector General, Leonard Odom. A few months later, Odom fired Herrnreiter for unsatisfactory performance of the reassigned auditing tasks.

Herrnreiter is a white, naturalized U.S. citizen of German origin. Odom is black. Herrnreiter sued, alleging his transfer back to auditing and subsequent termination were motivated by race and national origin. The district court granted summary judgment to the CHA. Again the Seventh Circuit affirmed.

As to Herrnreiter's transfer back to auditing, the Court concluded that this was not a significant enough change in employment status to be actionable under Title VII. The Court listed the three groups of cases that satisfy the statutory criterion:

1. the employee is terminated or his compensation, fringe benefits, or other financial terms of employment are diminished; or
2. the employee's career prospects are reduced by a nominally lateral transfer that prevents him from using the skills in which he is trained and experienced; or
3. the employee's job is changed in a way that injures his career without a lateral transfer.

Herrnreiter's case was merely one of subjective preference for one position over another. The auditor's job was not inferior to the investigator's job, and it allowed Herrnreiter to use the accounting skills for which he was trained. The Company car and not having to sign in or out of the office were minor perks. The Court concluded:

> The two jobs were equivalent other than in idiosyncratic terms that do not justify trundling out the heavy artillery of federal antidiscrimination law; otherwise every trivial personnel action that an irritable, chip-on-the-shoulder employee did not like would form the basis for a discrimination suit.

Although Herrnreiter's transfer back to the audit division was not actionable under Title VII, had it been motivated by race or national origin it could have been used as evidence that his subsequent firing was the second step of a two-step discriminatory plan. However, the Court found no evidence that the transfer or the firing was invidiously motivated. As to the firing, Herrnreiter claimed that he had been set up by Odom after being transferred back to the audit division by being given impossible deadlines on assignments and then fired when he failed to meet the deadlines. However, the evidence showed that his assignments were standard auditing tasks and that the deadlines were not rigid. The Court found that Herrnreiter "was sulking because of having

been transferred back to the audit division, losing the car and the freedom of an investigator." He had admitted in a deposition that after the transfer "he probably gave up" trying to satisfy his superior's demands.

The *Koski* and *Herrnreiter* decisions reinforce the notion that workers whose negative attitudes about their jobs cause performance to drop below management's reasonable expectations need not be coddled just because they are in a protected class. Although letting such employees go creates a risk of litigation, in this day and age that risk is a cost of running a successful business.

If you have any questions about any of the issues in these cases, please call Jim Petrie (312/609-7660) or any other Vedder Price attorney with whom you have worked.

SEVENTH CIRCUIT FINDS ASKING SUBORDINATE FOR SEX THREE TIMES IN ONE CONVERSATION MAY BE ACTIONABLE HARASSMENT

The United States Court of Appeals for the Seventh Circuit recently decided a case that seems to broaden its previous readings of what harassing conduct is sufficiently "severe or pervasive" to warrant a trial. In *Quantock v. Shared Marketing Services, Inc.*, 312 F.3d 899 (7th Cir. 2002), the Seventh Circuit found that the plaintiff could take to a jury her claim that she was sexually harassed when her supervisor propositioned her three times in one conversation. Briefly, Cathey Quantock claims that she was subjected to unlawful sexual harassment when her boss asked her for sex, she reported it to a supervisor, and her employer did nothing about it. She sued her employer, Shared Marketing Services, Inc., for sexual harassment under Title VII and her boss, Rick Lattanzio, for intentional infliction of emotional distress.

Quantock's Claim of Sexual Harassment

Quantock was an account supervisor for Shared Marketing, Inc. She claimed that her supervisor, Rick Lattanzio, propositioned her for sex three times during a single meeting on January 24, 2001. According to Quantock, first Lattanzio asked her for oral sex, then to participate in a "threesome," and finally to have "phone sex." Quantock stated that she refused each request in turn. Quantock also alleged that Lattanzio had previously grabbed her breasts and forcibly kissed her, but admitted that these other incidents occurred three or four years prior to the meeting forming the basis of her lawsuit.

Shared Marketing transferred Quantock to an account executive position one week after the meeting. The account executive position received the same salary and benefits as the account supervisor position, but was responsible for three specific accounts instead of overseeing general company operations. Quantock alleged that, after her transfer, she reported Lattanzio's sexual propositions to one of her supervisors in accordance with Shared Marketing's sexual harassment policy. She stayed with Shared Marketing for about five or six weeks after the January 24 incident. She then resigned "... because the harassment and subsequent change in position left her shocked, devastated, and humiliated..."

Quantock sued Shared Marketing for sexual harassment under Title VII. She also sued Lattanzio for intentional infliction of emotional distress. However, the Seventh Circuit upheld the lower court's dismissal of the latter claim because it was preempted by the Illinois Human Rights Act, 775 ILCS 5/1-101, *et seq.* The district court found that there was no triable issue of fact for a jury and granted summary judgment to Shared Marketing. Quantock appealed to the Seventh Circuit.

Three Propositions by Supervisor Could Constitute Severe Harassment

On appeal, the Seventh Circuit analyzed Quantock's claim to determine whether she showed sexually harassing conduct sufficiently "severe or pervasive" to create a hostile work environment. The Court also examined Quantock's claim that she was subject to *quid pro quo* harassment because she had been transferred to the account executive position one week after refusing Lattanzio's advances. The Court held that there was no reason to "disturb" the lower court's dismissal of this claim because Quantock did not deny that her responsibilities were only changed, rather than significantly diminished, and her wages and benefits stayed the same, so she did not suffer an adverse employment action.

In determining whether a hostile work environment exists, the Court considers "the totality of the discriminatory conduct, its severity, whether it is physically threatening or humiliating or a mere offensive utterance, and whether it unreasonably interferes with an employee's work performance." The behavior must be severe and pervasive from both an objective standard (that of a hypothetical reasonable person) and a subjective standard (Quantock herself must have viewed the behavior as offensive). The Court noted that the conduct need not be both severe *and* pervasive. One or the other suffices.

Because Lattanzio had a position of significant authority at Shared Marketing, worked in close quarters with Quantock and propositioned her for sex directly and repeatedly, a jury could find his behavior sufficiently severe to alter the terms of Quantock's employment. The Court found Lattanzio's alleged behavior "considerably more severe than the type of occasional vulgar banter, tinged with sexual innuendo" that it previously held not to be actionable harassment.

The Court also found that Quantock had produced enough evidence as to the remaining required elements of her claim to take the case to trial. First, because she claimed she had reported the incident to her supervisor and seen a psychologist, a reasonable jury could find that she found Lattanzio's conduct subjectively severe. Further, because her supervisor had asked her for sex, a jury could find that the harassment was "because of her sex." Finally, because Lattanzio was her supervisor, the company could be held liable for his actions under Title VII.

Because the Court found that Quantock had presented enough evidence that a jury could find severe or pervasive harassing conduct, it reversed the lower court's ruling and allowed her to proceed to trial.

Broader Reading of Hostile Work Environment

The Seventh Circuit's holding that three propositions could constitute severe sexual harassment under Title VII suggests that the Court may be more willing to send sexual harassment cases to trial than previous decisions have indicated. For example, the Court upheld summary judgment for a law firm where a legal secretary alleged that, over a six-month period, a firm partner asked her to show him pictures of herself wearing lingerie, commented to her about her undergarments and asked her whether she bought lingerie from Frederick's of Hollywood. *See Pryor v. Seyfarth, Shaw, Fairweather & Geraldson*, 212 F.3d 976 (7th Cir. 2000). And the Court found no actionable harassment where a plaintiff's supervisor had asked her out on dates, called her a "dumb blond," placed his hand on her shoulder several times, placed "I love you" signs in her work area, and attempted to kiss her on at least one occasion. *See Weiss v. Coca-Cola Bottling Co. of Chicago*, 990 F.3d 333 (7th Cir. 1993). Finally, two incidents of misconduct by the plaintiff's supervisor, including rubbing the plaintiff's upper thigh and kissing her, did not constitute a hostile work environment. *See Saxton v. American Tel. & Tel. Co.*, 10 F.3d 526 (7th Cir. 1993).

The Court's ruling in *Quantock*, then, seems to represent a potential opportunity for plaintiffs to take to a jury claims that previously might have been thought unactionable. It leaves employers with even more uncertainty in an already unpredictable area of the law. However, employers can still give themselves some degree of protection by instituting and enforcing strong policies against all forms of harassment, including multiple avenues for reporting harassment, and requiring anti-harassment training for all their employees, including their most senior managers and executives.

If you have any questions about this case or sexual harassment generally, or wish to discuss or desire assistance in developing harassment policies, please call Alison Maki (312/609-7720) or any other Vedder Price attorney with whom you have worked.

BE CAREFUL OUT THERE! MANDATORY PROGRESSIVE DISCIPLINE SYSTEM MAY TRUMP EMPLOYEE MANUAL DISCLAIMER

Though an employee manual contains a contract disclaimer and "at-will" statement, the Vermont Supreme Court in *Dillon v. Champion Jogbra, Inc.*, No. 2,000-560, Dec. 27, 2002, held that a mandatory progressive discipline system and practice of pre-discharge discipline support a wrongful termination suit. In *Dillon*, the manual given to all new hires stated:

> The policies and procedures contained in this manual constitute guidelines only. They do not constitute part of any employment contract, nor are they intended to make any commitment to any employee concerning how individual employment action can, should, or will be handled.
>
> Champion Jogbra offers no employment contracts nor does it guarantee any minimum length of employment. Champion Jogbra reserves the right to terminate any employee at any time 'at-will' with or without cause.

Later, the company established a progressive discipline system that, the court stated, "was mandatory in tone."

Hired in 1997, Dillon was offered a sales administrator position in late July 1998 and told she would receive extensive training and it would take four to six months to feel comfortable in the new job. About a month later, she was told that things were not working out, that she would be reassigned to a temporary position, and that she should apply for other jobs that might open, but if nothing became available she would be terminated at the end of December. Unable to find a permanent position, she was terminated. Dillon sued for breach of contract, claiming her termination violated the progressive disciplinary procedures contained in the manual and followed in practice. A lower court ruled for the company. Dillon appealed.

In a 3-2 decision, the Vermont Supreme Court held that it was up to the court to decide if there is ambiguity in the manual. The court majority found ambiguity between the disclaimer and at-will statement and the progressive discipline system which it described:

> [t]he manual goes on to establish in Policy No. 720 an elaborate system governing employee discipline and discharge. It states as its purpose: "To establish Champion Jogbra policy for all employees." It states that actions will be carried out "in a fair and consistent manner." It provides that "[t]he Corrective Action Policy requires management to use training and employee counseling to achieve the desired actions of employees." It establishes three categories of violations of company policy and corresponding actions to be generally taken in each case. It delineates progressive steps to be taken for certain types of cases, including "[u]nsatisfactory quality of work," and time periods governing things such as how long a reprimand is considered "active." All of these terms are inconsistent with the disclaimer at the beginning of the manual, in effect sending mixed messages to employees.

The Vermont case is an example of the tightrope an employer walks in having a multi-tiered corrective action policy without setting itself up to be sued for breach of contract when the employer chooses to bypass or accelerate the system either intentionally or inadvertently. Although extreme on the facts presented, the Vermont case is not unique. Courts in other jurisdictions, including Illinois, have also held that mandatory progressive discipline systems may supersede at-will disclaimers, since the ambiguity must be resolved against the party who drafts the document — the employer.

This decision simply underscores the care to be taken when drafting a discipline, or, for that matter, any personnel policy. A mandatory, detailed policy allowing for no employer discretion or deviation may end up as Employee Exhibit One in a suit claiming treatment was not consistent with the policy, notwithstanding a contract disclaimer in the same document.

If you have any questions about this case or about the at-will doctrine in general and statements in your manual or other policies and procedures that may bear on the at-will doctrine, please call George Blake (312/609-7520), Bruce Alper (312/609-7890) or any other Vedder Price attorney with whom you have worked.

UNIONS WINNING MORE ELECTIONS, REDOUBLING ORGANIZING EFFORTS

Although union membership remains low, a recent *Daily Labor Report* (No. 4, January 7, 2003) shows that elections won by unions increased during the first six months of 2002 compared to the same period of 2001. According to NLRB data analyzed by BNA PLUS, AFL-CIO-affiliated unions (excluding the Teamsters) won 490 of the 823 elections in which they participated

(59.5%). The Teamsters, involved in the most elections (318), won only 145 (45.6%). The four other most active unions each won more than they lost: the UFCW won 56 of 110 elections (50.9%); the IBEW won 42 of 67 (62.7%); the Operating Engineers won 44 of 64 (68.8%); and the SEIU won 56 of 81 (69.1%).

National independent unions fared even better, winning 73% of 37 elections held. Labor's highest win rate was in services (63.4% of 692 elections); one of the lowest was in manufacturing (39.4% of 452 elections).

To improve their won-lost records, in 2002 the AFL-CIO entered into agreements with the national affiliates it supports setting specific organizing goals, and last month the AFL-CIO's first National Organizing Summit was held in Washington, D.C. with a goal of increasing organizing efforts in specific industries such as health care, manufacturing, construction, retail trade, food production, transportation and communication.

Several unions have successfully developed organizing strategies for specific categories of employees, or specific industries or regions. Since 1999 the SEIU has organized 145,000 home care workers. UNITE has quadrupled its laundry worker membership. HERE successfully recruited thousands of hotel workers in Las Vegas. And the CWA has organized 15,000 new members at Cingular Wireless under a card-check/neutrality agreement negotiated with Bell South.

If you have any questions about this topic, please call Jim Petrie (312/609-7660) or any other Vedder Price attorney with whom you have worked.

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