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Employment Law Practice Group

If you have any questions or comments about this Newsletter, please feel free to contact any of the attorneys in our Litigation Group listed below via telephone at (212) 574-1200 or via e-mail generally by typing in the attorney's last name @sewkis.com.

Partners:
M. William Munno
Michael J. McNamara
Mark D. Kotwick
Anne C. Patin

Associates:
Julia C. Spivack
Benay L. Josselson
Michael B. Weitman
Celinda J. Metro

SEWARD & KISSEL LLP

One Battery Park Plaza, NY, NY 10004
Tel: 212 574 1200 | Fax: 212 480 8421
sknyc@sewkis.com
www.sewkis.com

Fifth Circuit Court of Appeals Holds That Internal Reporting Is Not Protected Activity under Dodd-Frank, But District Courts Continue to Hold Otherwise

■ *Summary:* The debate over whether internal reporting, as opposed to reporting securities laws violations directly to the U.S. Securities and Exchange Commission ("SEC"), is protected activity under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank") is continuing to heat up. This summer, in *Asadi v. G.E. Energy (USA), L.L.C.*, 720 F.3d 620 (5th Cir. 2013), the Fifth Circuit Court of Appeals became the first federal appellate court to decide the issue, concluding that internal reporting is not protected activity under the statute. In so holding, the Fifth Circuit deviated from several prior district court opinions which have held that internal reporting alone qualifies as protected activity. Last month, two district court judges (including Judge Shira Scheindlin in the Southern District of New York), came to the opposite conclusion that internal reporting is protected and followed their brethren from various other districts. To date, the Second Circuit Court of Appeals has not addressed this issue, but it appears ripe for a determination.

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U.S. Supreme Court Defines "Supervisor" Under Title VII

■ *Summary:* This summer, the U.S. Supreme Court resolved a question left open by its previous decisions, *Faragher v. City of Boca Raton*, 524 U.S. 775 (1998) and *Burlington Industries v. Ellerth*, 524 U.S. 742 (1998): who is a "supervisor" for Title VII purposes that can create vicarious liability for an employer? While the Court narrowed the definition to a person who has the authority to effect a "significant change in the employment status, such as hiring, firing, failing to promote, reassignment with significantly different responsibilities, or a decision causing a significant change in benefits," there no doubt will continue to be sharp factual disputes over who constitutes a "supervisor."

Full article on page 3.

Year-End Reviews – What to Do, What to Avoid

■ *Summary:* In this edition, we take a moment to provide our clients and friends with some practical guidance for year-end performance appraisals. When handled properly, year-end appraisals can be a valuable management tool for employers and employees alike. Please take a moment to remind yourself of these general principals and reach out to your Seward & Kissel LLP attorney if you have any additional questions or concerns.

Full article on page 5.

Fifth Circuit Court of Appeals Holds That Internal Reporting Is Not Protected Activity under Dodd-Frank, But District Courts Continue to Hold Otherwise

On July 17, 2013, the United States Court of Appeals for the Fifth Circuit held that employees who internally report alleged securities laws violations cannot maintain a private right of action against their employer under the anti-retaliation provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank") unless they also report the alleged violations to the Securities and Exchange Commission (the "SEC"). *See Asadi v. G.E. Energy (USA), L.L.C.*, 720 F.3d 620 (5th Cir. 2013). The *Asadi* decision marks the first time a federal appeals court has addressed this question, and goes against a trend among federal district courts (noted in our Summer 2013 Newsletter) to interpret the statute broadly to cover internal reporting even absent a report to the SEC. After *Asadi*, two additional district court opinions were rendered holding that internal reporting is protected and confirming that this issue is far from resolved. *See Rosenblum v. Thomson Reuters (Markets) LLC*, 2013 U.S. Dist. LEXIS 153653 (S.D.N.Y. Oct. 25, 2013); *Ellington v. Giacoumakis*, 2013 U.S. Dist. LEXIS 148939 (D. Mass. Oct. 16, 2013). Another case which was expected to deal with the issue was decided in favor of the employer on the grounds that Dodd-Frank does not apply extraterritorially, but did not reach whether internal reporting was protected activity. *See Liu v. Siemens A.G.*, 2013 U.S. Dist. LEXIS 151005 (S.D.N.Y. Oct. 21, 2013) (stating that there was "no need for the court to wade into this debate.").

Background of *Asadi*

From 2006 through 2011, Khaled Asadi was employed by G.E. Energy (USA) L.L.C. ("GE") as its Iraq Country Executive, based in Amman, Jordan. In June 2010, GE was in the process of negotiating a joint venture agreement with the Iraqi Minister of Electricity. Around the same time period, GE hired a woman closely associated with a senior Iraqi official, allegedly to curry favor with that official in connection with the negotiation of the joint venture agreement. Asadi internally reported this issue to his supervisor, believing that, if true, this conduct would violate the Foreign Corrupt Practices Act (the "FCPA"). Shortly thereafter, Asadi allegedly received a negative performance review, and was pressured by GE to step down from his current position and accept a reduced role at GE. Asadi refused, and approximately one year later, GE terminated his employment.

Asadi filed a complaint in the United States District Court for the Southern District of Texas, alleging that GE violated the anti-retaliation provisions of Dodd-Frank when it terminated his employment following his internal complaints of a possible FCPA violation. GE moved to dismiss the complaint, arguing that (1) Asadi did not qualify as a "whistleblower" under Dodd-Frank because he did not report the alleged violation to the SEC, and (2) the anti-retaliation provisions of Dodd-Frank do not apply extraterritorially, and Asadi was based overseas. The district court declined to address whether Asadi qualified as a "whistleblower," but nevertheless dismissed the complaint, holding that Dodd-Frank's anti-retaliation provisions "*per se* do[] not apply extraterritorially." 2012 U.S. Dist. LEXIS 89746, at *32 (S.D. Tex. June 28, 2012). Asadi appealed the district court's decision to the United States Court of Appeals for the Fifth Circuit.

Fifth Circuit Holds That Reporting to the SEC Is Required For Whistleblower Protection

On appeal, the Fifth Circuit did not address the extraterritoriality issue on which the district court based its decision. Instead, the Court focused on whether Asadi qualified as a "whistleblower" under the statute. GE argued that Asadi did not so qualify, because Dodd-Frank plainly defines "whistleblower" as "any individual who provides . . . information relating to a violation of the securities laws *to the Commission*." 15 U.S.C. § 78u-6(a)(6) (emphasis added). Asadi conceded that he did not provide any information to the SEC. Asadi, however, argued that he was nonetheless covered because he engaged in certain protected activity that is contained in Dodd-Frank's anti-retaliation provisions, and he was allegedly fired as a result.

Dodd-Frank's anti-retaliation provisions provide whistleblowers with a private right of action against employers who take retaliatory actions against whistleblowers who engage in any one of three enumerated categories of protected activity. *Id.* at § 78u-6(h)(1)(A). The third category of protected activity – on which Asadi based his argument – does not necessarily require reporting information to the SEC. That provision (15 U.S.C. § 78u-6(h)(1)(A)(iii)) covers disclosures that are "required or protected" under the Sarbanes-Oxley Act of 2002 ("SOX"), the Securities Exchange Act of 1934, 18 U.S.C. § 1513(e), or any other law, rule, or regulation subject to the jurisdiction of the SEC.

Asadi argued that because he engaged in protected activity (*i.e.*, made a disclosure that is protected under SOX), and GE allegedly terminated his employment as a result, he was covered by Dodd-Frank. Asadi's argument was supported by the only five district court cases to have addressed the issue at the time, as well as an SEC regulation. *See UBS v. Murray*, 2013 U.S. Dist. LEXIS 71945 (S.D.N.Y. May 21, 2013) (Furman, J.); *Genberg v. Porter*, 2013 U.S. Dist. LEXIS 41302 (D. Colo. Mar. 25, 2013); *Kramer v. Trans-Lux Corp.*, 2012 U.S. Dist. LEXIS 136939 (D. Conn. Sept. 25, 2012); *Nollner v. Southern Baptist Convention*, 852 F. Supp. 2d 986 (M.D. Tenn. 2012); *Egan v. TradingScreen*, Inc., 2011 U.S. Dist. LEXIS 47713 (S.D.N.Y. May 4, 2011) (Sand, J.); *see also* SEC Rule 21F-2(b)(1) (defining a whistleblower

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for purposes of the anti-retaliation protections of Dodd-Frank to include an individual who provides information "in a manner described in [15 U.S.C. § 78u-6(h)(1)(A)]," which would cover internal reporting in certain circumstances).

The Fifth Circuit was not persuaded. Relying on the "plain language and construction of the whistleblower-protection provision," the Court concluded that "the whistleblower-protection provision unambiguously requires individuals to provide information relating to a violation of the securities laws *to the SEC* to qualify for protection from retaliation under [Dodd-Frank]." 720 F.3d at 629 (emphasis supplied). The Court ignored the district court cases that held otherwise, as none were binding on the Fifth Circuit. The Court also declined to rely on the SEC regulation "[b]ecause Congress has directly addressed the precise question at issue," and the regulation is "inconsistent" with the terms of the statute. *Id.* at 630.

Recent District Court Opinions

As with earlier district court opinions holding that internal reporting is protected under Dodd-Frank, the courts in *Rosenblum* and *Ellington* held that the definition of "whistleblower" that requires reporting to the SEC was not controlling. Instead, these courts held that the definition of "protected activity" in Dodd-Frank includes making disclosures that are "required or protected under the Sarbanes-Oxley Act of 2002." Specifically, 15 U.S.C. § 78u-6(h)(1)(A) of Dodd-Frank provides:

> No employer may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower
>
> (i) in providing information to the Commission in accordance with the section;
>
> (ii) in initiating, testifying in, or assisting in any investigation or judicial or administrative action of the commission based upon or related to such information; or
>
> (iii) in making disclosures that are required or protected under the Sarbanes-Oxley Act of 2002 (15 U.S.C.

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U.S. Supreme Court Defines "Supervisor" Under Title VII

On June 24, 2013, the U.S. Supreme Court resolved a question left open by its previous decisions in *Faragher v. City of Boca Raton*, 524 U.S. 775 (1998) and *Burlington Industries v. Ellerth*, 524 U.S. 742 (1998): who is a "supervisor" for Title VII purposes? In *Vance v. Ball State University*, _U.S._, 133 S. Ct. 2434 (2013) the Supreme Court held that an employee is a "supervisor" for Title VII purposes only when that employee has been empowered to take a tangible employment action against the alleged victim; that is, when the employee can effect a "significant change in employment status, such as hiring, firing, failing to promote, reassignment with significantly different responsibilities, or a decision causing a significant change in benefits."

Maetta Vance, an African-American woman, alleged that a fellow employee, Saundra Davis, who is white, created a racially hostile work environment. The United States District Court for the Southern District of Indiana had held that employer Ball State University could not be held vicariously liable for Davis' actions because Davis was not a "supervisor." The United States Court of Appeals for the Seventh Circuit affirmed, reasoning Davis was not a "supervisor" because she did not have the authority to hire, fire, demote, promote, transfer or discipline Vance. The Seventh Circuit went on to conclude that Ball State could only be liable if Vance established the university was negligent in discovering or remedying the harassing conduct, but that Vance failed to establish such negligence. 133 S. Ct. at 2440. Vance appealed, and in a 5 to 4 decision, the Supreme Court affirmed.

Vance had lodged numerous complaints of racial discrimination and retaliation during her employment as a catering assistant with the Ball State University Banquet and Catering division of Dining Services. The facts alleged in the complaint in *Vance* revolved around the actions of Davis, a catering specialist. Specifically, Vance complained that Davis "glar[ed] at her… intimidating her," that Davis blocked Vance on an elevator "and stood there with her cart smiling…" *Id.* at 2439. The university attempted to address the problem, but Vance initiated a lawsuit claiming "she had been subjected to a racially hostile work environment in violation of Title VII." Vance alleged in her complaint that Davis was her supervisor, and that the university was liable for Davis' actions.

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> 7201 et seq.), the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), including section 10A(m) of such Act (15 U.S.C. 78f(m)), Section 1513(e) of Title 18, United States Code, and any other law, rule or regulation subject to the jurisdiction of the Commission.

15 U.S.C. § 78u-6(h)(1)(A).

Accordingly, the *Rosenblum* and *Ellington* courts concluded that a person is protected from retaliation under Dodd-Frank for engaging in protected activity, which is broader than only reporting to the SEC. *See Rosenblum,* 2013 U.S. Dist. LEXIS 153635, at *16; *Ellington*, 2013 U.S. Dist. LEXIS 148939, at *9-10.

What Does *Asadi* Mean For Employers?

While the Fifth Circuit's decision in *Asadi* would appear to signal a victory for employers by narrowing the statute's reach, this is far from the end of the debate. The Fifth Circuit decision is binding only on district courts sitting in Texas, Louisiana, and Mississippi. As noted above, district judges in New York, Connecticut, Massachusetts, Colorado, and Tennessee have refused to adopt the statutory construction embraced by the Fifth Circuit (although a district judge in Colorado has since done so, *see Wagner v. Bank of Am. Corp.*, 2013 U.S. Dist. LEXIS 101297 (D. Colo. July 19, 2013)). It remains unknown how other appellate courts will decide this issue.

Finally, although employers may welcome the *Asadi* court's narrow construction of the Dodd-Frank whistleblower provisions, it may cause employees who suspect securities law violations to bypass internal compliance and go straight to the SEC. And, even if an employee reports an alleged violation internally, employers will not necessarily know whether or not the employee has also spoken with the SEC. Thus, employers should always think carefully and seek legal advice before taking any adverse action against an employee who alleges wrongdoing by the company. While the Fifth Circuit's decision in *Asadi* is instructive, until the issue is reconciled by the courts or Congress, employers should seek legal counsel when they receive an internal complaint and before taking any employment action. ◆

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Notably, both parties agreed that Davis "did not have the power to hire, fire, demote, promote, transfer or discipline Vance." *Id.*

Pursuant to the Supreme Court's earlier decisions in *Faragher* and *Ellerth*, an employer's vicarious liability for harassment under Title VII may depend on the status of the alleged harasser. If the harasser is the victim's co-worker, the employer will only be vicariously liable if it was negligent in controlling working conditions. If, however, the harasser is a "supervisor," and the supervisor's harassment culminates in a tangible employment action, the employer is strictly liable. *See Ellerth*, 524 U.S. at 762. However, if no tangible employment action is taken, the employer can avoid liability for the supervisor's actions by affirmatively establishing that (1) the employer exercised reasonable care to prevent and correct the harassing behavior, and (2) that the plaintiff unreasonably failed to take advantage of the preventive or corrective opportunities provided by the employer.

In *Vance*, the Supreme Court observed that lower courts "have disagreed about the meaning of the concept of a supervisor in this context." 133 S. Ct. at 2443. While "[s]ome courts, including the Seventh Circuit below, have held that an employee is not a supervisor unless he or she has the power to hire, fire, demote, promote, transfer or discipline the victim," others, including the Second Circuit, "have substantially followed the more open-ended approach advocated by the EEOC's Enforcement Guidance" which correlates supervisor status with the ability to exercise significant discretion over the employee's daily work. *Id*.

In affirming the Seventh Circuit's decision, the majority rejected the approach taken by the EEOC and the Second Circuit, and limited an employer's vicarious liability to where the employer has empowered the employee to take tangible employment actions against the victim, rejecting "the nebulous definition of 'supervisor' advocated in the EEOC Guidance…" *Id.* Notably, the term "supervisor" is not one used by Congress in Title VII, but rather was adopted by the Supreme Court in *Faragher* and *Ellerth* "as a label for the class of employees whose misconduct may give rise to vicarious employer liability." The Supreme Court reasoned "[i]t is because a supervisor has that authority [to inflict direct economic injury] – and its potential use hangs as a threat over the victim – that vicarious liability (subject to the affirmative defense) is justified." In reaching its conclusion, the majority explained the workability of this specific definition of "supervisor": "[i]n a great many cases, it will be known even before litigation is commenced whether an alleged harasser was a supervisor, and in others, the alleged harasser's status will become clear to both sides after discovery." *Id.* at 2449.

Conclusion

Even under the narrowed definition of "supervisor" adopted by the Supreme Court in *Vance*, whether an employee is a supervisor will remain an issue of fact. But one thing does remain clear: having a clearly defined mechanism for employees to report complaints of harassing or discriminatory behavior and resolving complaints promptly as and when they occur can help avoid or reduce liability for alleged harassment perpetrated by co-workers and supervisors alike. ◆

Year-End Reviews – What to Do, What to Avoid

As the calendar year draws to a close, many employers are thinking about conducting performance reviews of their employees in connection with year-end procedures. Such reviews can be a valuable tool for employers and employees alike. However, if a review is not conducted properly, it can do more harm than good.

This article provides some basic tips for conducting performance appraisals which can help employers maximize the benefits of the performance review process to the employer, and the employee.

- **Stick to the Schedule.** Employee handbooks may indicate that performance reviews are conducted at least annually. As such, employers should be sure to conduct reviews at least that often. Prioritize and make time in your busy schedule to conduct reviews in a timely manner.
- **Be Prepared.** Do not wait until just prior to the review to think about what points you want to cover. An annual review covers the entire year – not just the month or two prior to the review. Know what key points need to be discussed, and have a clear vision of what you would like the employee to take away from the discussion. While you may prepare notes for yourself, do not let the employee who is being reviewed see, or have a copy, of your personal notes.
- **Be Honest.** It can be difficult to openly criticize others, but it is imperative that any supervisor conducting a performance review understand the importance of being honest and accurate during the review. Supervisors or managers conducting the reviews should be trained to offer constructive criticism, along with praise. We often encounter situations where an employer wants to terminate an employee for poor performance, but when we refer to past performance reviews they are overwhelmingly positive because the supervisor "felt bad" about mentioning or discussing negatives. Protect yourself, and help employees improve, by being honest.
- **The Setting.** Reviews should be conducted in a private, quiet place. Be certain to allow enough time for the discussion. Do not make the employee feel rushed. Unless there is an unavoidable emergency, do not take calls or check emails during the review. Creating the right environment encourages a civil discourse.
- **Avoid Surprises.** Any instances of poor performance that arise during the year should be brought to the employee's attention as they happen, and you should establish a clear path for improvement. You should ideally write down contemporaneous notes documenting the key facts of the incident, and save those notes in the employee's personnel file. If there are incidents from the year, remind the employee of such incidents at the annual review.
- **Be Positive.** The year-end review should contain a mix of constructive criticism and encouragement. Any outstanding achievements that the employee made during the year should be recognized. Mention a few key areas where the employee has succeeded and encourage him or her to keep up the good work in those areas.
- **Be Professional and Respectful.** The employee being reviewed is likely anxious. Conduct the meeting in a business-like tone. Even if the subject matter gets challenging, or the employee is not receiving criticism well, do not demean or belittle the employee, and do not raise your voice. If the employee becomes unusually emotional or upset, stop speaking, take a moment, and resume the conversation when the employee has calmed down.
- **Encourage a Dialogue.** Reviewers should not be doing all of the talking in the review. Ask the employee for feedback on his or her experiences working at the company during the past year. Encourage the employee to share ideas and goals for making the relationship better and the workplace more productive.
- **Outline a Clear Path for Improvement.** During the review, focus on what was expected of the employee during the year, what he or she achieved, and outline some key areas for improvement. Give clear examples where appropriate and avoid making overly general statements without giving the employee a clear path to succeed. (*i.e.*, "you should communicate better with the group" vs. "you can improve your communication with the group by doing x, y and z"). End the discussion by giving the employee a clear vision of what is expected in the coming year. If possible, set concrete goals. If there are specific areas where the employee needs to improve, explain why you believe there was a failure, and what you would like the employee to do to rectify the failure going forward.
- **Written Appraisals.** If a written form is being used to evaluate an employee, make sure the form is appropriate for the position being reviewed. Generally, a form based on numerical rankings in broad categories without further color is unhelpful. If no written form is being used, make some notes on the factual points made during the discussion and the goals established for the employee, and keep the notes in the employee's personnel file.

One of the primary objectives of a performance appraisal is to improve performance. One of the best ways to achieve improved performance is by taking the time to implement a solid year-end appraisal process which engages the employee in a dialogue and fosters the creation of collaborative solutions to make the workplace a better and more efficient place for both employer and employee. ◆

Seward & Kissel's employment lawyers are experienced practitioners who possess the tenacity and legal skills needed to win difficult disputes, the sound judgment required to help clients avoid expensive and unnecessary fights and the drafting and negotiating skills to fully protect the interests of our clients. As a result, we have an enviable record of success in this area. We handle all types of employment disputes in federal and state courts and also represent clients in proceedings before administrative and regulatory agencies, including the Equal Employment Opportunity Commission ("EEOC") and state divisions of human rights, and in arbitrations before the Financial Industry Regulatory Authority ("FINRA"), and other arbitration tribunals, such as the American Arbitration Association and JAMS. We also represent our clients, including major financial institutions, in unfair competition, breach of contract and employee raiding cases that have involved applications for injunctive relief. We have considerable experience and success in litigating all aspects of employment cases, from motion practice to trial, and in taking on the most well-known firms of the plaintiff's bar.

Our practice also includes representing executives, portfolio managers and other senior personnel in negotiations with their employers as well as in disputes that may arise. Additionally, we offer highly responsive and seasoned counsel with judgment and perspective in employment matters and regularly advise our clients on compliance with the law and strategies to avoid litigation. We are equally proud of our accomplishments in mediating sensitive and potentially very expensive and distracting employment disputes arriving at positive outcomes for our clients. We represent a wide range of principal players in the financial industry, including domestic and foreign banks, investment banks, broker-dealers, investment companies, investment advisers, publicly-held corporations and individuals. We have expertise in all areas of employment law and monitor and analyze all significant developments in the area. Our experience and the depth of the Firm's practice in the securities industry and regulatory issues provide us with a unique edge in employment matters facing the industry. We are a leading adviser to hedge fund managers in the employment issues they encounter, including those who are building their businesses and others who are more established.