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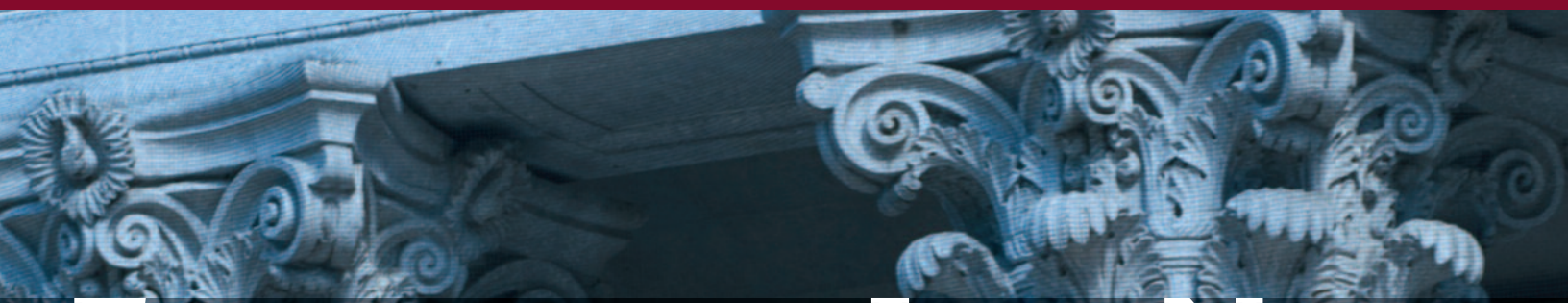

EMPLOYMENT LAW NEWS

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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:
Jennifer J. Pearson
Julia C. Spivack
Benay L. Josselson

SEWARD & KISSEL LLP

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

New York's Highest Court to Determine What Constitutes Improper "Solicitation" Under the *Mohawk* Doctrine

- *Summary:* The Second Circuit has certified these questions to be answered by the New York Court of Appeals: What is improper solicitation of clients when a business is sold? What is the scope of New York's "*Mohawk* doctrine," which provides that the seller of a business has a perpetual duty not to solicit former clients or customers? The answers will shed light on whether "improper solicitation" requires that the seller actually initiate contact with former clients.

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WARN Act Liability for Private Equity Firms

- *Summary:* Private equity firms and investment management companies with fewer than 100 employees should beware: they may be subject to liability under the federal Worker Adjustment and Retraining Notification Act (the "WARN Act") if their portfolio company violates the WARN Act. Under the "single employer" theory, even a distant parent company that is sufficiently linked with, and/or in control of, a subsidiary is deemed to be a "single employer" with that subsidiary. Thus the employees of both entities - the private equity firm and the portfolio company - may be counted to determine WARN Act coverage and liability. Accordingly, private equity firms must pay close attention when portfolio companies close plants or have mass layoffs.

Full article on page 2.

New York Court Finds Compliance Officer is Not Entitled to an Exception From the At-Will Employment Doctrine

- *Summary:* On December 21, 2010, the Appellate Division, First Department held that a Chief Compliance Officer ("CCO") of an investment manager was *not* entitled to an exception to the at-will employment doctrine. Consequently, the CCO could be terminated for investigating his boss's alleged front running activities. While the case is favorable for employers, investment managers and other employers located in New York should nevertheless encourage employees to report regulatory violations. At the same time, however, employers should specify that any non-retaliation policy does *not* limit the firm's at-will policy.

Full article on page 4.

New York's New Domestic Workers' Bill of Rights

- *Summary:* On November 29, 2010, the Domestic Workers' "Bill of Rights" took effect, providing domestic workers, such as nannies and housekeepers, with workplace protections under New York State's anti-discrimination, wage and hour and Workers' Compensation laws. Under the new law, domestic workers are afforded protection against harassment in the workplace, and are entitled to overtime pay, one day of rest per week, three days of paid time off after a full year of employment, and expanded disability coverage.

Full article on page 5.

New York's Highest Court to Determine What Constitutes Improper "Solicitation" Under the *Mohawk* Doctrine

The Second Circuit has certified to the New York Court of Appeals the question of what constitutes improper solicitation of clients in the context of a sale of a business and the scope of New York's "*Mohawk* doctrine," which provides that the seller of a business is considered to have sold his "good will" and thus has a perpetual duty not to approach former clients or customers to solicit their business. *Bessemer Trust Co., N.A. v. Branin,* Nos. 08-2462-cv(L), 08-2677-cv (XAP), 2010 U.S. App. LEXIS 17662 (2d Cir. 2010); *see also Mohawk Maintenance Co. v. Kessler*, 52 N.Y.2d 276 (1981).

In *Bessemer*, Plaintiff sued Francis Branin, a former principal of the investment management firm sold to Plaintiff, after several of Branin's clients followed him to his new firm, Stein Roe Investment Counsel, LLC ("Stein Roe"), a direct competitor. Branin did not have a contractual non-compete or non-solicit agreement with Plaintiff. But, he was subject to an implied, perpetual non-solicit under the *Mohawk* doctrine. Branin did not contact his former clients directly, but was involved in Stein Roe's strategy to attract his former clients, and responded to their questions about Stein Roe and participated in meetings between Stein Roe and his former clients. 2010 U.S. App. LEXIS 17662, at *9-13. Thereafter, several of Branin's former clients moved their accounts from Bessemer to Stein Roe. *Id.* at *2.

The District Court found that Branin had improperly solicited at least one of his former clients. *Bessemer,* at *29-30. In so holding, the District Court said it was irrelevant whether Branin or the client initiated contact. *Id.* at *31. The Second Circuit, however, expressly disagreed, noting that under the limited guidance provided by New York courts, the identity of the initiator has been "both relevant and important for courts that have applied the implied covenant." *Id.* at *32.

Noting the significance of New York law in the financial services industry, the Second Circuit asked the New York Court of Appeals to determine what constitutes improper solicitation under the *Mohawk* doctrine. *Id*. at *33-34. Specifically, the Second Circuit asked: "[w]hat degree of participation in a new employer's solicitation of a former employer's client by a voluntary seller of that client's good will constitutes improper solicitation?" *Id.* at *44. In certifying this question, the Second Circuit noted:

> We are particularly interested in how the following two sets of circumstances influence this analysis: (1) the active development and participation by the seller, in response to inquiries from a former client whose good will the seller has voluntarily sold to a third party, in a plan whereby others at the seller's new company solicit the client, and (2) participation by the seller in solicitation meetings where the seller's role is largely passive.

Id. at *44-45.

Where Does This Leave Sellers of Businesses and Employers?

The New York Court of Appeals should be issuing guidance in the upcoming months. Until then, what constitutes improper solicitation will remain unclear. Sellers of businesses can, however, use contractual non-solicitation agreements to ensure that the desired prohibited conduct is expressly defined until the guidance is issued.

WARN Act Liability for Private Equity Firms

Private equity firms and investment management companies with fewer than 100 employees should beware: they may be subject to liability under the federal Worker Adjustment and Retraining Notification Act (the "WARN Act") if their portfolio company violates the WARN Act. Under the "single employer" theory, even a distant parent company that is sufficiently linked with, and/or in control of, a subsidiary is deemed to be a "single employer" with that subsidiary. Thus the employees of both entities - the private equity firm and the portfolio company - may be counted to determine WARN Act coverage and liability. Accordingly, private equity firms must pay close attention when portfolio companies close plants or have mass layoffs.

What is WARN?

The WARN Act requires employers with 100 or more full-time employees to provide at least 60 days written notice to affected employees in advance of plant closings or mass layoffs. 29 U.S.C. §2101 *et seq.* If the covered employer fails to provide the required notice, the employer

is liable to each affected employee for 60 days of pay and benefits. *Id.* at §2104(a)(1).[1]

A parent company and its subsidiaries may be deemed a "single employer" for purposes of the WARN Act depending on the subsidiaries' degree of independence from the parent corporation. The federal Department of Labor ("DOL") regulations implementing WARN set forth a five factor test to evaluate whether the single employer concept applies, including: "(i) common ownership, (ii) common directors and/or officers; (iii) de facto exercise of control, (iv) unity of personnel policies emanating from a common source, and (v) the dependency of operations." 20 C.F.R. § 639.3(a)(2). However, the DOL has advised that these five non-exclusive factors do not trump applicable state corporate law (specifically, principles of piercing the corporate veil) and federal labor law (including the Labor Management Relations Act ("LMRA")) for determining whether affiliated entities comprise a single employer. 54 Fed. Reg. 16,045 (Apr. 20, 1989).

Whether multiple entities may be deemed a "single employer" impacts both the initial determination of whether the target employer meets the 100 employee threshold for WARN Act coverage, as well as whether plaintiffs may seek recovery from related entities for the target employer's WARN Act violations.

What is the Single Employer Test for Purposes of WARN?

Without definitive guidance from the DOL, federal circuit courts have expressed differing approaches in determining whether related entities should be deemed a single employer for both coverage and liability purposes under the WARN Act. For example, the Ninth Circuit uses a hybrid of the single employer test under the LMRA together with the DOL regulations under the WARN Act to determine liability. *See, e.g., Childress v. Darby Lumber, Inc.*, 357 F.3d 1000, 1005-6 (9th Cir. 2004) (considering both DOL and LMRA factors for WARN Act single employer test). The Third and Fifth Circuits, however, have determined that the DOL test alone is the most appropriate test because it was created with the situations underlying WARN in mind. *See, e.g., Pearson v. Component Technology Corp.*, 247 F.3d 471, 490 (3d Cir. 2001) (holding the DOL test should be used to determine WARN Act liability in the case of both a secured lender and parent/subsidiary relationship); *Administaff Cos., Inc. v. N.Y. Joint Board, Shire & Leisurewear Div.*, 337 F.3d 454, 457-58 (5th Cir. 2003) (applying DOL standards to determine WARN Act liability and declining to consider NLRA joint employer test to determine liability).

While the Second Circuit has not adopted a specific test for intercorporate WARN Act liability, case law indicates that the DOL factors should be considered. The closest the Second Circuit has come to addressing the appropriate standard for parent/subsidiary WARN Act coverage was in *Coppola v. Bear Stearns & Co., Inc.*, a case involving lender liability. There, the court declined to apply the DOL factors at all in determining whether a creditor would be held liable for the debtor's WARN Act violations, but suggested that the DOL factors "may be relevant to the question of whether the entities' relationship is in fact that of parent and subsidiary rather than debtor and creditor, or perhaps some combination of the two." 499 F.3d 144, 150 (2d Cir. 2007) (citing *Pearson*).

Two courts in the Southern District of New York have applied the DOL test to assess intercorporate WARN Act liability of investors, emphasizing the importance of a related entity's de facto control of the decision to trigger a mass layoff or plant closure. *See Guippone v. BH S&B Holdings LLC*, 09 Civ. 1029 (CM), 2010 U.S. Dist. LEXIS 50482, at *11 (S.D.N.Y. May 18, 2010) (granting several investors' motion to dismiss following finding that defendants were not a single entity); *Vogt v. Greenmarine Holding, LLC*, 318 F. Supp. 2d 136, 140-141 (S.D.N.Y. 2004) (granting several investors' motions to dismiss, but denying others' based on specific factual allegations regarding the relationships of the defendants to the underlying bankrupt company). Accordingly, an otherwise distant investment firm could risk liability for an affiliate's WARN Act violations if it is a decision-maker with respect to an office closing or layoff.

In *Guippone*, a former employee of Steve & Barry's, a clothing company that had filed for bankruptcy, sued Steve & Barry's investors and their investment vehicles for WARN Act liability. The court determined that the plaintiff sufficiently pled that the holding company that was the sole managing member of Steve & Barry's could be subject to WARN Act liability primarily because its board had exercised control over certain of Steve & Barry's employment decisions, including the decision to file for bankruptcy and impose mass layoffs. *Guippone*, 2010 U.S. Dist. LEXIS 50482 at *21. Plaintiff failed, however, to show that other related investment companies met the DOL test. The other

[1]The New York State Worker Adjustment and Retraining Notification Act ("NY WARN Act") took effect on February 1, 2009. The law is modeled after the federal WARN Act. The NY WARN Act, however, was designed to supplement the federal statute and is therefore both broader in scope and more stringent for employers in several respects. While the federal WARN Act covers businesses with either 100 or more full-time employees or 100 or more employees including part-time employees who work in the aggregate at least 4,000 hours per week, the NY WARN Act covers businesses with as few as 50 or more full-time employees or 50 or more employees including part-time employees who work in the aggregate at least 2,000 hours per week. Under the NY WARN Act, employers are required to provide written notice of any mass layoffs, relocations or plant closings at least 90 days in advance, as opposed to 60 days under the federal WARN Act. The NY WARN Act requires such notice to be sent to a broader group of individuals and agencies than required under the federal WARN Act. While we are not aware of any case law determining single employer liability for purposes of the NY WARN Act, New York employers should be aware that this theory could be applied to determine whether they have 50 or more full-time employees.

investment companies had no direct ownership interest, did not participate in the decision to declare bankruptcy or cause the mass layoff, operated separate businesses with separate staff and facilities, and had separate finances. *Id.* at *12-21. Thus, the court found that these other related entities did not constitute a single employer with Steve & Barry's, and were not liable under the WARN Act.

In *Vogt*, the court determined that based on the specific factual allegations, three of the eight defendant companies could be held liable for the employer's failure to provide advance notice of termination to approximately 6,500 employees located in thirteen different facilities that it simultaneously shut down. *Vogt*, 318 F. Supp. 2d at 138. After considering the five factors with respect to each of the defendants, the court found that three defendants could be liable because they were alleged to have specifically controlled the decisions leading to the employer's bankruptcy, plant closings and terminations. *Id.* at 145-146.

How Can Private Equity Firms Limit Their Exposure to WARN Liability?

While definitive guidance is lacking on the issue of intercorporate WARN Act liability, the DOL factors provide important guidelines that private equity firms and other investment companies should consider when assessing risk. Thus, we recommend our clients evaluate the following factors:

Common Ownership: Consider the relationship between the related companies. Stock ownership alone does not render a parent company liable for its subsidiary's actions, but it is a factor. *See, e.g., Guippone*, 2010 U.S. Dist. LEXIS 50482 at *13. However, the more remote the ownership interest, such as ownership through affiliated companies or entities, the more tenuous a claim of common ownership would be.

Common Directors and/or Officers: Consider whether the relevant companies have common directors, officers and manager-level employees, or have officers or directors of one entity play a management role in the related entity. *See, e.g., Guippone*, 2010 U.S. Dist. LEXIS 50482 at *13. Remember, it is appropriate for a parent to have common directors and/or officers with a subsidiary, so this factor alone is insufficient for finding liability. *Id.* at *15.

Unity of Personnel Policies Emanating From a Common Source: Consider whether the investment companies directly control the day-to-day personnel decisions and labor operations, by thinking about who hires and fires employees, pays wages, and maintains personnel records and benefits. *Id.*

Dependency of Operations: Consider whether there is overlap among the companies administrative functions, such as shared administrative staff, purchases and/or equipment, and commingled finances. *Id.* at *18.

De Facto Control: Consider the investment companies' level of involvement in decisions that could lead to bankruptcy, office closure or layoffs, or directly relate to filing for bankruptcy, closing offices or terminating employees. *Id.* at *19-20. If an investment company is alleged to have been a decisionmaker responsible for the bankruptcy or employment decision underlying the WARN violation, it will weigh heavily in favor of finding liability.

New York Court Finds Compliance Officer is Not Entitled to an Exception from the At-Will Employment Doctrine

On December 21, 2010, the Appellate Division, First Department held that a Chief Compliance Officer ("CCO") of an investment manager was not entitled to an exception to the at-will employment doctrine and consequently could be terminated for investigating his boss's alleged front running activities. *Sullivan v. Harnisch*, Index No. 115092/2008, 2010 NY Slip Op 09407 (1st Dep't Dec. 21, 2010) (modifying in part and affirming in part March 8, 2010 orders of the Supreme Court, New York County (Richard B. Lowe III, J.)).

Until October 2008, the plaintiff, Joseph W. Sullivan, worked as the CCO for Peconic Partners LLC and Peconic Asset Managers LLC ("Peconic"), institutional investment managers and registered investment advisors. In October 2008, Sullivan investigated what he believed to be "front running" by the firm's majority owner and president, William F. Harnisch. Peconic's written Code of Ethics requires an employee to clear in advance the purchase or sale of securities with the CCO, and to report all securities transactions in which an employee has a beneficial interest. As CCO, Sullivan was required "on pains of termination" to determine, upon learning of a potential violation, whether a member of Peconic had violated the code. Sullivan learned that Harnisch had sold most of his personal shares in Potash Corporation, a company in which Peconic had invested. Harnisch did not clear the

sale with Sullivan or otherwise report it to Peconic. After Harnisch sold two-thirds of his interest in Potash at $123 per share, the average price of Potash shares dropped to $103 per share. It was estimated that Peconic clients lost over six million dollars by not having their shares sold at the same time that Harnisch sold his.

Sullivan concluded that Harnisch had engaged in "front running," violated Peconic's Code of Ethics and acted contrary to Peconic's disclosures in its SEC Form ADV. When Sullivan questioned Harnisch about the sales, Harnisch allegedly refused to explain. Days later, Harnisch terminated Sullivan's employment, erased his computer data, as well as Peconic's trading logs, and kicked Sullivan out of Peconic's partnership.

The lower court held that language from Peconic's Handbook, prohibiting retaliation, and the Code of Ethics, specifically requiring the CCO to report complaints to the SEC, may give rise to an "express limitation" to the general at-will employment rule. The Appellate Division, however, disagreed. It reiterated that "absent a constitutionally impermissible purpose, a statutory proscription, or an express limitation in the individual contract of employment, an employer's right at any time to terminate an employment at will remains unimpaired." 2010 N.Y. Slip Op 09407, at *4 (internal quotation omitted). Further, the Appellate Division determined that nothing in the Peconic Handbook or Code of Ethics, expressly or otherwise, protected Sullivan from being terminated.

The only retreat from New York's employment at-will rule was expressed by the Court of Appeals, New York's highest Court, in *Wieder v. Skala*, 80 N.Y.2d 628 (1992), where a law firm associate alleged he had been fired for insisting his firm report another associate's unethical behavior. In finding that the associate stated a valid breach of contract claim, the Court of Appeals found a tacit "compact that in conducting the firm's legal practice, both Wieder and the firm would do so in compliance with the prevailing rules of conduct and ethical standards of the legal profession." In *Sullivan*, the Appellate Division cautioned that the *Wieder* exception "has not been applied to a business or profession other than the practice of law." *Sullivan,* 2010 N.Y. Slip Op 09407, at *5. Thus, the Appellate Division held that, regardless of Sullivan's job responsibilities, Sullivan "did not have either an express or implied right to continued employment." *Id.* at *6.

The Appellate Division, however, confirmed that an employment manual which specifically provides that an employee who reports wrongdoing "will be protected against reprisals," with no disclaimer as to express or implied contractual liability, can be the basis of a cause of action for breach of contract. *Id.* at *5-6 (citing *Mulder v. Donaldson, Lufkin and Jenrette*, 208 A.D.2d 301, 307 (1995)).

Investment managers and other employers located in New York should encourage employees in either Employee Handbooks or Codes of Ethics to report regulatory violations. However, if employers choose to include non-retaliation language, employers should ensure that any such manual contains a disclaimer regarding limitations on the at-will employment relationship and express and/or implied contractual liability.

New York's New Domestic Workers' Bill of Rights

On November 29, 2010, the Domestic Workers' "Bill of Rights" took effect, providing domestic workers, such as nannies and housekeepers, with workplace protections under New York State's anti-discrimination, wage and hour and Workers' Compensation laws, respectively.

Who is a Domestic Worker?

A domestic worker is "a person employed in a home or residence for the purpose of caring for a child, serving as a companion for a sick, convalescing or elderly person, housekeeping, or for any other domestic service purpose," excluding casual workers, companions employed by an outside employer or agency, and relatives. N.Y. Labor Law §2(16). Although the law does not define "casual workers," the federal definition of "casual basis" under the federal Fair Labor Standards Act refers to casual or intermittent babysitting services.

What Rights Do Domestic Workers Have?

Under the new law, domestic workers are afforded protection against harassment in the workplace, and are entitled to overtime pay, one day of rest per week, three days of paid time off after a full year of employment, and expanded disability coverage.

- **Harassment:** A domestic worker who works for an employer with three or fewer employees will now be protected from sexual harassment and harassment based on gender, race, religion or national origin. Previously, coverage was contingent on an employer having four or more employees. Notably, the amendments do not address disparate treatment in hiring, termination or compensation, or harassment based on age, disability, sexual orientation or marital status.
- **Overtime:** Unless a domestic worker qualifies for an exemption under the federal Fair Labor Standards Act, a domestic worker living outside of his or her employer's home will be entitled to payment of

overtime at the rate of one and one-half times the worker's regular hourly rate for all hours worked over 40 in one week (7-day period). A domestic worker living inside his or her employer's home will be entitled to payment of overtime for all hours worked over 44 in one week. A domestic worker will also be entitled to one day (24 hours) of rest each week. A domestic worker who works on his or her day of rest will be entitled to overtime for all hours worked that day, regardless of whether the worker met the requisite hour threshold for the week.

- **Paid Time Off:** A domestic worker is entitled to three paid days off after one full year of employment.
- **Disability:** A domestic worker working less than 40 hours a week is entitled to disability benefits coverage. Employers should ensure that the proper disability insurance policy is obtained.

What Should Employers of Domestic Workers Do?

Employers of domestic workers should be aware of these new requirements and should take steps to comply going forward. All new hires should be notified in writing of the payday and his or her hourly and overtime pay rates, if applicable, and employers should obtain a written acknowledgement of the receipt of such notice. On each designated payday, each employee should receive a breakdown of wages earned during the pay period then ending. Employers are not obligated to proactively provide an explanation for how the wages were computed, but should be prepared to provide an explanation in the event an employee has questions.

Employers also should redistribute policies on hours, sick leave, vacation, personal leave and holidays, updated to include the new overtime and paid time off regulations. With respect to recordkeeping, employers should maintain a daily log of hours worked by each employee, and payroll records showing for each employee his or her hours worked, gross wages, deductions and net wages for the payroll period. Finally, employers of domestic workers should be sure that they have proper insurance coverage for short term disability and Workers' Compensation.