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Lessons from Arthur Andersen's Recent Troubles:

Why You Should Care About Document Retention and Destruction Policies

By Janice Procter-Murphy & Mary Beth Phillips

Implementing a document retention and destruction policy or reviewing your existing policy may not have seemed like a high priority a few months ago. In the wake of Arthur Andersen's recent indictment for obstruction of justice for the way it handled Enron's accounting documents, however, companies around the country are, or should be, turning their attention to this issue. If your business does not have a document retention and destruction policy, if your policy has not been reviewed lately, or if compliance with your policy is not evaluated regularly, a careful examination of your document storage and destruction practices is in order.

Arthur Andersen's Dilemma

For those of you who have not been following Andersen's recent troubles, this is how, according to published media reports, that company found itself facing prosecution.

In May of 2000, when the Securities and Exchange Commission ("SEC") was investigating accounting services Andersen had provided to another client, Andersen adopted a policy requiring destruction of documents that were no longer necessary to its business. In early 2001, Andersen reduced its staff responsible for document destruction. As a result, by June of 2001, documents had begun to pile up.

After Enron, another Andersen client, announced huge losses on October 15, 2001, the SEC commenced a preliminary inquiry into Enron's business practices. Andersen learned that same week of the SEC's inquiry as well as the SEC's plans to request information regarding the accounting services that Andersen had provided to Enron. David B. Duncan, head

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of Andersen's Enron team, then had urgent e-mails sent out reminding Andersen employees of the company's document destruction policy and urging compliance with it. Over the next three days, Andersen employees shredded 26 trunks and 24 boxes of documents. During the same time period, the deletion of e-mails at Andersen increased threefold. On November 9, Andersen learned that the SEC had served it with a subpoena for its documents regarding Enron. That day, Duncan instructed Andersen employees to stop shredding.

The SEC did not appreciate Andersen's distinction between knowing an investigation was coming and being served with a subpoena. Even though Andersen stopped destroying documents upon receipt of a subpoena, its perceived selective destruction of documents until that time was not well received by the government. It is for this conduct, destroying records seemingly in reaction to the SEC's looming investigation, that Andersen has been indicted.

Lessons to be Learned

What lessons can businesses learn from Andersen's mistakes? If your business has documents relevant to a threatened investigation or lawsuit, your handling of these documents likely will be subject to special scrutiny and so must be beyond reproach. Having a clear policy in place and requiring employees to adhere to it will discourage any unauthorized destruction of information and provide employees with precise guidance on how to conduct themselves in such situations. Moreover, if your company has destroyed relevant documents, but did so pursuant to a policy that was uniformly followed, the existence and conformance with such policy can go far in proving that the company was acting legitimately and not engaging in any shady cover-up tactics. Finally, if an investigation or lawsuit has been threatened, a document management system will help ensure that all potentially relevant documents are preserved. Your duty to preserve documents when litigation is expected overrides any document management system you have in place.

Federal Record-Keeping Requirements

The avoidance of these and other problems should be sufficiently compelling to convince you to adopt guidelines on retention of records. In determining the policy most appropriate for your business, however, you must be careful not to run afoul of federal regulations regarding retention of documents. Federal law mandates a variety of record-keeping requirements for employers. The following is a brief summary of some of the most important requirements.

The Equal Employment Opportunity Commission's ("EEOC") regulations interpreting the Age Discrimination in Employment Act require employers to keep, for three years, records for each employee containing his or her name, address, date of birth, occupation, rate of pay and compensation earned each week. Employers also are required to keep personnel records for one year relating to all job applications, resumes, promotions, transfers, demotions, layoff, discharges, job orders, advertisements and notices, test papers, and the results of any physical examinations. 29 C.F.R. § 1627.3(a). Employee benefit plans, such as pension and insurance plans, and written seniority systems must be maintained for one year after the plan is terminated.

Under the Fair Labor Standards Act and Equal Pay Act, employers are required to keep records containing the following information for each non-exempt employee for three years from the last date of entry on the record: (1) name and Social Security number; (2) home address; (3) date of birth if under 19; (4) sex and occupation; (5) time of day and day of week on which employee's workweek begins, which may be a single notation for the entire workforce; (6) regular hourly rate of pay for any workweek in which overtime compensation is due, with an explanation of the basis of pay and amount of payments that are excluded from the regular rate of pay; (7) hours worked each workday and total each week; (8) total daily or weekly straight-time earnings; (9) total premium pay for overtime; (10) total additions to or deductions from wages paid each pay period; (11) total wages paid each pay period; and (12) date of payment and pay period covered by each payment. 29 C.F.R. §§ 516.2, 516.5(a). Employers must retain collective bargaining agreements and individual written contracts for three years, and all basic time cards, wage rate tables and order, shipping and billing records for two years.

Under the Family and Medical Leave Act ("FMLA"), employers must keep the following records for three years: (1) basic payroll records identifying each employee's name, address, occupation, rate or basis of pay, daily and weekly hours worked per pay period, additions to or deductions from wages, and total compensation paid; (2) dates FMLA leave is taken by eligible employees; (3) if FMLA leave is taken in increments of less than one full day, the hours of the leave; (4) copies of employee notices of leave furnished to the employer and copies of all notices given to employees as required under FMLA (copies of these records may be maintained in personnel files); (5) any documents describing employee benefits or employer policies regarding the taking of paid and unpaid leaves; (6) premium payments of employee benefits; and (7) records of any dispute between the employer and an employee regarding designation of leave as FMLA leave. 29 CFR § 825.500.

Title VII and the Americans with Disabilities Act require that if an employer makes any personnel or employment record, it shall preserve the record for one year from the date of the making of the record or the personnel action involved, whichever occurs later. 29 C.F.R. § 1602.14. In the case of a terminated employee, this requires keeping the personnel records of the individual terminated for one year from the date of termination, but the regulation also applies to records like requests for reasonable accommodation and application forms. If a charge of discrimination is filed with the EEOC, the employer must preserve all personnel records relevant to the charge.

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The Immigration Control and Reform Act requires that employers retain I-9 forms for one year after separation or three years from date of hire, whichever is later. 8 C.F.R. § 274a.2.

Employers with 100 or more employees are required to file annually with the EEOC a Standard Form 100, otherwise known as Employer Information Report EEO-1. Employers also must maintain a copy of their most recently filed EEO-1. 29 C.F.R. § 1602.7.

Not all of the above requirements apply to every business, and some additional requirements may apply to your business. For example, government contractors have additional requirements under Executive Order 11246, the Rehabilitation Act of 1973 and the Vietnam Era Veterans Readjustment Act. Companies subject to OSHA must follow additional guidelines for record retention, especially those companies whose employees may be exposed to toxic substances. If you have specific concerns about the guidelines applicable to your business, consult your attorney.

Recommendations

As evidenced by Andersen's experience in the Enron scandal, a document retention and destruction plan is only beneficial if it complies with the law and is followed uniformly. We recommend that you take five steps in implementing a document management system. First, investigate your current practice, including any regular purging of documents and e-mail performed by your information systems department. This allows you to identify any programs that may need to be overridden in case of anticipated litigation. Second, verify that the policy you adopt meets the record retention requirements applicable to your business. Third, implement a monitoring plan to ensure compliance with the policy and identify specific individuals as the people responsible for compliance so it is clear where "the buck stops." Fourth, disseminate the policy to all persons who might have documents or e-mail affected by the policy. Identifying these individuals also gives you a list of persons to notify if there are any changes or the policy needs to be suspended. Finally, audit your document retention and destruction practices periodically to make sure they are being followed uniformly, lest you be faced with an accusation of selective enforcement of the policy or with the problem of employees making their own determinations of when to get rid of old documents and e-mails.

Possible consequences if you are found to have improperly destroyed documents include an instruction to the jury that it may draw an adverse inference from the destruction and the possibility of a tort claim being made against you for spoliation of evidence. There also may be criminal sanctions for obstruction of justice under 18 U.S.C. § 1505, although such sanctions are usually imposed only in extreme circumstances.

Andersen's indictment should serve as a powerful wake-up call to businesses across the country. A company's obligations concerning its records do not arise only after a subpoena has been served. In order to guard against potential problems, controls on document retention and destruction is essential, as is monitoring compliance with those controls. If you would like assistance in evaluating your current document handling practices and identifying changes needed to help protect your business from liability, please contact any member of Fennemore Craig's labor and employment section. We can help craft a policy that is right for you. ■

Recent Developments In Employment Law

By Celeste J. Helms

U.S. Supreme Court Prevents the ADA from Trumping Seniority Systems

***US Airways, Inc. v. Barnett*, 2002 WL 737494 (U.S. April 29, 2002)**

When deciding whether to provide a disabled employee with an accommodation that violates the company's seniority policy, employers can rest reasonably assured that "the seniority system will prevail in the run of cases." In *Barnett*, the Supreme Court addressed the issue of whether a requested accommodation that conflicts with the employer's seniority rules is "reasonable." In a slim majority ruling, the Supreme Court held that under the Americans with Disabilities Act of 1990 ("ADA"), such an accommodation will not be deemed reasonable.

The ADA prohibits an employer from discriminating against an individual with a disability who, with "reasonable accommodation," can perform the essential functions of the job. Robert Barnett hurt his back in a cargo-handling position at US Airways and then transferred to a less physically demanding position in the mailroom. Under US Airways' seniority system, the mailroom position later became open to seniority-based employee bidding. In response to several senior employees bidding for the mailroom position, Barnett requested that US Airways accommodate his disability by making an exception to the seniority system and allowing him to

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remain in the mailroom. US Airways decided not to make an exception and Barnett lost his job. Barnett then brought a lawsuit under the ADA claiming that he was an individual with a disability, the mailroom job amounted to a "reasonable accommodation" of his disability, and US Airways unlawfully discriminated against him by refusing to assign him the mailroom job.

The Supreme Court held that a proposed accommodation that violates the rules of a company's seniority system normally means that the accommodation is not a "reasonable" one. However, the Court acknowledged that employees remain free to show special circumstances that justify a finding that, despite the seniority system, the requested accommodation is reasonable on the particular facts. The employee has the burden of showing special circumstances and must explain why, in the particular case, an exception to the seniority system can constitute a reasonable accommodation even though in the ordinary case it cannot.

U.S. Supreme Court Determines That Employers Need Not Prospectively Designate FMLA Leave

***Ragsdale v. Wolverine Worldwide, Inc.*, 122 S. Ct. 1155 (2002)**

In *Ragsdale*, the country's highest court reviewed a case under the Family and Medical Leave Act ("FMLA") for the first time since the Act's inception in 1993. The FMLA guarantees qualifying employees twelve weeks of unpaid leave each year.[1] Before the Supreme Court's decision, employers were sure to prospectively designate company leave as FMLA leave due to a Department of Labor ("DOL") regulation providing that if an employer fails to designate an absence as FMLA leave, it will not count against an employee's FMLA entitlement.[2] Resolving a split of authority in the federal courts of appeal as to the validity of this regulation, the Supreme Court found the regulation invalid and contrary to the remedial purposes of the FMLA.

Adopting a more generous leave policy than that required under the FMLA, Wolverine Worldwide, Inc. ("Wolverine"), allowed Tracy Ragsdale thirty weeks of leave when cancer kept her from working. Wolverine refused Ms. Ragsdale's request for additional leave or permission to work part time and terminated her when she did not return to work after thirty weeks. Ms. Ragsdale brought suit against Wolverine under the FMLA alleging that Wolverine was in technical violation of the DOL regulations. Ms. Ragsdale alleged that, because Wolverine never formally designated any of the thirty weeks of company leave as FMLA leave, pursuant to the DOL regulation, the clock never began to run on her FMLA leave and, thus, she was entitled to twelve additional weeks of leave.

The Eighth Circuit, rejecting the DOL regulation, held that employers do not need to give prospective notice to an employee that company leave is also FMLA leave. FMLA only requires that an employer provide a minimum of twelve weeks of leave, regardless of how designated. Thus, if an employer's leave policy provides twelve weeks of leave, FMLA requires no more. The U.S. Supreme Court agreed. The Court found that the DOL regulation requiring the company to grant Ms. Ragsdale twelve more weeks of leave because it had not informed her that the thirty week absence would count against her FMLA entitlement was contrary to the FMLA and was beyond the Secretary of Labor's authority. Under the FMLA, Ms. Ragsdale was entitled to twelve, not forty-two weeks of leave.

Despite the fact that the Supreme Court invalidated the DOL regulation at issue here, we advise employers to continue to follow the notice provisions outlined in the regulations and provide employees notice that their company leave is also being counted as FMLA leave.

A Title VII Charge Need Not Be Verified When Filed

***Edelman v. Lynchburg College*, 122 S.Ct. 1145 (2002)**

Title VII of the Civil Rights Act of 1964 requires that a charge of employment discrimination be filed with the Equal Employment Opportunity Commission ("EEOC") within 180 days after the alleged unlawful practice occurred before an employee may file a Title VII action in court.[3] While employers seek to preclude Title VII claims on the basis that the employee belatedly filed a discrimination charge with the EEOC, the EEOC has long been striving to accommodate late filings. Through its *Edelman* decision, the U.S. Supreme Court has now boosted the EEOC in its endeavor. The U.S. Supreme Court resolved a conflict among the federal courts of appeals by upholding an EEOC regulation permitting an otherwise timely filer to verify a charge after the time for filing has expired.

Leonard Edelman, a white Polish-Jewish biology professor, claimed that Lynchburg College denied him tenure in violation of Title VII. He wrote the EEOC a letter, not verified under oath, within the 300-day time limit alleging that he had been subject to "gender-based employment discrimination, exacerbated by discrimination on the basis of [his] family's national origin and religion." Edelman did not, however, file a verified charge with the EEOC until 313 days after the alleged discrimination, thirteen days past the time limit.

The District Court dismissed Edelman's Title VII claim because Edelman failed to file his verified discrimination charge within the applicable 300-day period. The Fourth Circuit Court of Appeals affirmed, holding that the EEOC regulation allowing a later oath to relate back to an otherwise timely filed charge is invalid because it permits a charge of discrimination to be verified after the expiration of the statutory limitations period.

The U.S. Supreme Court reversed, finding that the EEOC's relation-back regulation is a sound interpretation of § 706 of the Civil Rights Act of 1964, as amended, 42 U.S.C. § 2000e-5. The Court reasoned that § 706(b) merely requires the verification of a charge, without saying when it must be

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verified; § 706(e)(1) provides that a charge must be filed within a given time period, without indicating whether it must be verified when filed. Since neither provision incorporates the other, the Court found the Fourth Circuit's assumption that § 706(b) and (e)(1) must be read as one, a doubtful structural and logical leap. The Court concluded that a charge must be verified only by the time the employer is obliged to respond to the charge, not at the time an employee files the charge with the EEOC.

Ninth Circuit Insists That Circuit City's Arbitration Agreement is Unenforceable

***Circuit City Stores v. Adams*, 279 F. 3d 889 (9th Cir. 2002)**

The fate of arbitration agreements in the employment context has been hanging in the balance for some time. For many employers, the U.S. Supreme Court's decision in *Circuit City Stores v. Adams*, 532 U.S. 105 (2001), in which the Court held that the Federal Arbitration Act ("FAA") applies to agreements to arbitrate employment disputes, appeared to put the issue to rest. Despite the Supreme Court's pronouncement in *Circuit City* that arbitration is an appropriate forum for resolving employment discrimination claims, the Ninth Circuit's decision on remand calls into question the benefits conferred upon employers by the Supreme Court's decision. Employers relying on arbitration for protection from costly lawsuits may need to reevaluate their arbitration agreements.

In *Circuit City Stores v. Adams*, the Supreme Court reversed the Ninth Circuit's reading of the FAA, and held that the FAA is in fact applicable to arbitration agreements in the employment context. On remand from the U.S. Supreme Court, the Ninth Circuit held that Circuit City's arbitration agreement still was unenforceable. This time, the Ninth Circuit struck down the agreement on different grounds; namely, that the agreement was unconscionable under California contract law rather than on grounds involving the Federal Arbitration Act ("FAA").

In assessing whether the agreement was procedurally and substantively unconscionable, the court considered the balance of bargaining power between the parties to the contract and the extent to which the contract clearly disclosed its terms. The Circuit City agreement failed this test because it was a "standard-form" contract, drafted by the party with the superior bargaining power, relegating to the other party (the employee) the option of either adhering to the terms of the contract without modification or rejecting the contract (and a job) entirely. In essence, employees were required to take the contract or leave it. Further, the court found that while the agreement bound employees to arbitrate all of their claims, Circuit City was free to litigate its disputes with its employees in court.

To have a valid arbitration agreement, the court explained, some "modicum of bilaterality" is required so that arbitration does not appear to be a means of maximizing employer advantage. For instance, in *Circuit City Stores v. Ahmed*, 283 F.3d 1198 (9th Cir. 2002), the Ninth Circuit considered issues identical to those addressed in the remanded *Circuit City Stores v. Adams* case but arrived at a very different outcome, primarily because the arbitration agreement at issue in the *Ahmed* case allowed the employee a meaningful choice not to participate in arbitration. Under the arbitration agreement in *Ahmed*, Circuit City employees had the genuine possibility to opt-out of the arbitration program by mailing in a simple one-page form.

In contrast, the arbitration agreement in *Circuit City Stores v. Adams* was imbalanced because the agreement required only employees to arbitrate their claims, limited relief available to employees, required employees to split arbitration fees with Circuit City, and imposed a strict one-year statute of limitations, depriving employees of the benefit of the continuing violation doctrine. The Ninth Circuit found this agreement unconscionable under California law and, consequently, unenforceable. Employers, therefore, should be cautious in drafting and reviewing arbitration agreements to ensure that the agreements comply with the relevant state's contract law. ■

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[1] The Act provides that an employee is eligible for FMLA leave if she has worked for a covered employer for at least 1,250 hours during the preceding twelve months. The Act entitles an eligible employee to a total of twelve workweeks of leave during any twelve-month period when (1) the employee is giving birth to a child, (2) a child is placed with the employee for adoption or foster care, (3) the employee is taking care of certain relatives with "serious health condition[s]," and/or when the employee herself cannot "perform the functions" of her position because she suffers from a "serious health condition." 29 U.S.C. § 2612(a)(1).

[2] 29 C.F.R. § 825.700(a) (2001).

[3] However, § 706(e)(1) provides that "in a case of an unlawful employment practice with respect to which the person aggrieved has initially instituted proceedings with a State or local agency with authority to grant or seek relief from such practice..., such charge shall be filed...within three hundred days after the alleged unlawful practice occurred." 42 U.S.C. § 2000e-5(e)(1).

SAVE THE DATE

For the 2002 Labor & Employment Fall Seminar scheduled for October 8, 2002 in Phoenix October 9, 2002 in Tucson.

Labor & Employment Practice Group

AMY ABDO	602-916-5399
JOHN J. BALITIS, JR.	602-916-5316
SCOTT M. FINICAL	602-916-5300
DONALD R. GILBERT – Co-Chair	602-916-5306
JORDAN GREEN	602-916-5426
DAVID N. HEAP	602-916-5326
CELESTE HELMS	602-916-5432
LORI A. HIGUERA	602-916-5387
ALEC R. HILLBO	602-916-5385
BARNEY M. HOLTZMAN	*(T)* 520-879-6810
ERWIN D. KRATZ	*(T)* 520-879-6401
PAUL MOORE	602-916-5386
M. BRENT PEUGNET	602-916-5315
MARY BETH PHILLIPS	602-916-5380
JANICE PROCTER-MURPHY	602-916-5331
SAL J. RIVERA	602-916-5357
CYNTHIA L. SHUPE	602-916-5437
STEVEN R. SOLWAY	602-916-5374
RONALD J. STOLKIN – Co-Chair	*(T)* 520-879-6801 *(P)* 602-916-5321
JEAN M. SULLIVAN	602-916-5381
MICHELE L. TYLER	602-916-5391
PATRICK WALTZ	602-916-5424
ANNE WURTH	602-916-5474

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If you have comments concerning this issue, please contact:

Heide Rose
Marketing Administrator
Fennemore Craig
3003 N. Central Avenue
Suite 2600
Phoenix, AZ 85012
602-916-5290

FENNEMORE CRAIG
A HISTORY TO LEVERAGE

3003 North Central Avenue
Suite 2600
Phoenix, AZ 85012-2913

One South Church Avenue
Suite 1000
Tucson, AZ 85701-1627

1891 North Mastick Way
Suite A
Nogales, AZ 85621-1081

1221 N Street
Suite 801
Lincoln, NE 68508-2028

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