

The Enemy Within

Companies fear employee lawsuits more than any other legal threat. To prevent them, experts advise looking in the mirror.

Kris Frieswick - CFO Magazine

February 1, 2007

o

Emily Grothe was floored when she heard that a former partner at her energy consulting firm was suing her and the company for, among other things, violation of the Family and Medical Leave Act and the Americans with Disabilities Act. The partner had left Natural Resource Group Inc. (NRG) under what CEO Grothe believed was a mutually agreed-upon separation.

Another company might have settled rather than let the case go to court. But Grothe rejected that option. "It's my opinion that if you haven't done anything wrong, you need to fight so you don't set up a culture of mediocrity and signal to your employees that you're afraid of litigation," says Grothe, whose company amassed \$43 million in revenue last year. "There was no evidence that we had discriminated against [the former partner] in any way."

Turns out Grothe was right. A year after the claims were filed, the case was dismissed by the judge.

NRG's success came at a price — \$250,000 in legal fees to be exact. Still, Grothe considers her company lucky. NRG has suffered through only one employee lawsuit in its 14 years. Larger companies like Wal-Mart and Coca-Cola face hundreds of employee lawsuits a year, and the cost can be staggering. Coca-Cola paid \$192 million in a racial-discrimination settlement in 2000. Last year, Verizon Communications was informed by the Equal Employment Opportunity Commission that it must pay \$49 million to settle pregnancy-discrimination claims filed against its predecessors, Nynex and Bell Atlantic.

Aside from the financial impact of these settlements, which must be disclosed to shareholders if they involve material amounts, the public-relations impact is significant. Witness Wal-Mart's recent media campaigns to burnish its image in the face of the current class-action sex-discrimination suit pending against it. Little wonder that labor and employment disputes are the top litigation concern of corporate counsels at 54 percent of U.S. corporations, according to a survey conducted by law firm Fulbright & Jaworski LLP in New York.

Preventing such suits is not easy. Most companies now mandate some form of training on

ways to avoid and investigate sexual harassment, workplace discrimination, and other employment quagmires. But those efforts aren't always as effective as companies would like — and are easy to forget or misunderstand. "Employers screw up the nuances and details of the employment laws and regulations," says Jeffrey Oberman, a partner in law firm Oberman Thompson & Segal in Minneapolis. He's not advising that companies stop providing comprehensive rules-based training to human-resource specialists, but he has found that the best defense against employee lawsuits is to provide such instruction to executives, managers, and supervisors (who are the target of most factual allegations) while also creating a workplace geared toward avoiding lawsuits in the first place. "If the employees trust the employer, technical violations almost never lead to litigation," says Oberman, adding that in those situations, parties almost always work things out. And in larger, more complex organizations, where it may be harder to create that environment, says Cynthia Jamison, national director of CFO Services with Tatum LLC, it is still possible in any individual case for "a boss and an employee to get to that trust."

Look in the Mirror

There is no typical employee lawsuit. Complaints can range from discrimination (age, sex, race, religion, national origin, pregnancy) to safety and health violations to a hostile workplace, wage and hour violations, harassment, wrongful termination, and retaliation, as well as breach of fiduciary duty.

While it is easy to blame the litigious nature of our society for the proliferation of such lawsuits, experts contend that employers should first look in the mirror. Most employment-related charges come down to an interaction between an employee and a manager that has gone horribly wrong. "We promote people to managerial roles because of their operational successes or financial skills," says Robert Gilmore, an employment and labor attorney with Kohrman Jackson & Krantz PLL in Cleveland, "but those skills don't translate into good management of people."

Sometimes, says Gilmore, managers sugarcoat issues with problem employees because they fear conflict, don't want to be the bearer of bad news, or want employees to like them. When problems escalate to the point where an employee must be terminated, lack of documentation or disciplinary history can leave the company vulnerable to litigation.

Other times, managers fail to properly listen to employee complaints, act on them, or pass them along to superiors. This often happens because a manager is so overwhelmed with operational demands that he or she overlooks the seriousness of an accusation. "When a company or manager is under stress," says Gilmore, "they're trying to hit numbers and they close down communication. They don't want to hear a complaining employee. In some companies, if an employee comes forward with a problem, they cut off his head. It's really a culture issue."

But it's crucial to encourage employees to come forward with complaints — not punish

them when they do — because "just being open and listening to employee complaints can give managers information about potential problems," says Ralph Dawson, a partner at Fulbright & Jaworski. Agrees Michael N. Sheetz, a partner with Nixon Peabody LLP: "The best time to resolve a case is right when it begins," and that's often at the complaint stage.

At Pelco Inc., one of the largest video-security-camera manufacturers in the world, the 2,400 employees and their complaints are taken very seriously. The Clovis, California-based company has an active suggestion/complaint system in which employees send notes directly to a designated representative in their division.

Every comment is reviewed once a month by CEO David McDonald and the company's executive board, logged by the human-resources manager, and assigned for resolution the same day. Two days later, the resolutions are explained at group meetings. "It keeps everyone honest," says McDonald. Systems like this, often taking the form of telephone hotlines, have become standard in the wake of recent financial scandals, but usually focus on reports of fraud or malfeasance rather than the managerial or interpersonal issues that can escalate into employee lawsuits.

Pelco's "say anything" system, however, is just one reason why the company, in its 20-year existence, has had only one employee lawsuit filed against it — which it settled for \$1,000. McDonald attributes the company's litigation-averse employment culture to creating an environment in which "the line between management and employees is so blurred that no one even uses those terms any more." In his opinion, however, "this culture isn't an antilitigation plan or a profit plan, it's a do-the-right-thing plan." In addition to a companywide open-door policy, McDonald says that Pelco's active volunteer program (since 1993, Pelco and its employees have donated more than 1 million toys to Toys for Tots) levels the managerial hierarchy and creates a common bond between employees and managers.

•

Hire to Fit

Litigation deterrence starts with good hiring practices at all levels. Many companies seeking to limit lawsuit exposure use preemployment screening, including several rounds of interviews, drug tests, and personality tests to ensure that potential employees will fit in with their co-workers. McDonald uses an "integrity" test, a type of personality screening to make sure that employees will complement Pelco's corporate culture, a culture McDonald likens to a family.

Rigorous hiring practices at Geil Enterprises, a California-based firm that specializes in cleaning and security services, are part of the reason that it has never had a successful employee lawsuit filed against it in its 20 years of existence, says president Sam Geil. Using Predictive Index System, a personality-assessment tool, the company creates a

desired-personality profile for each job, then evaluates potential hires according to that profile. Similarly, NRG uses a tool it created itself to match the personality traits of successful employees to those of applicants for similar jobs.

Both Pelco and Geil then leverage those "right" hires to create an open communication system bent on avoiding conflict. At Pelco, for example, 360-degree performance reviews are used for supervisors. Everyone two levels below each manager answers anonymous questionnaires about his or her performance. Supervisors' raises are based largely on their scores. "If we can't get a supervisor into the right range, we move them into a position where they're not supervising others. That forces everyone to keep their eyes on the ball," says McDonald.

Those supervisors are also rigorously schooled not just in employment law but in basic conflict resolution as well. McDonald puts all his supervisory employees through a 12-week management communication workshop taught by professors from Fresno State University's Craig School of Business that focuses on conflict resolution, motivating employees, and fair treatment. Meanwhile, Geil, who was an HR manager at another company before taking over the reins of his family's business, employs a more hands-on approach by going to the manager's location and "walking around with them, talking about the real issues they face, and figuring out how to work things out."

Above All, Be Fair

Still, there will always be litigious employees who will find something to sue about no matter how much trust and communication a company has fostered. When that happens, it's important to have a comprehensive discussion with counsel, the CEO, the CFO, and other relevant senior executives to evaluate all options. Knowing when to fight, when to settle, and when to arbitrate or mediate can mean the difference between an inconvenient legal scuffle that costs a few thousand dollars and a court order to pay millions in punitive damages.

First, say experts, executives must evaluate their true legal position. Brutal honesty will directly affect the bottom line: Does the company have a defensible case and a credible explanation for its decisions? (Oberman says that even the appearance of lies and cover-ups can lead to the worst possible results.) Does the company have thorough and consistent documentation of all actions relating to the case? Did the company act as soon as the matter was brought to management's attention? Did the company have a formalized process to do so? If an employee is accused of harassment or discrimination, was a thorough investigation done even if the accused employee was a senior-level or high-revenue-generating employee? Most important, were all matters handled in a truly honest, fair, and impartial way? If the answer to these questions is yes, the company probably has a strong case. If a company chooses to go to court, it had better have deep pockets to pay for litigation expenses, though that may be less expensive in the long run

than paying off weak claims just to get rid of them. According to Oberman, quick settlements with undeserving plaintiffs often lead to "me too" claims by others.

If it looks like the firm has made mistakes that cannot be fixed short of litigation, then a quick settlement might not be a bad idea. Oberman says that, in addition to incurring legal exposure and expenses, protracted litigation of cases with weak defenses undermines workplace morale and productivity. When a company has ignored a problem, failed to properly document, or treated an employee in a patently unfair manner, that is not the strongest position in which to enter a courtroom. Settlements don't just involve cash, though. Be aware that plaintiffs may seek substantive changes to company policies, procedures, and maybe operations, and that courts have been very aggressive about upholding all the terms of out-of-court settlements, which themselves are legally binding.

Some companies, even if they know a case is weak, will use the legal system and their resources to stall the process as long as possible in the hopes of outspending or waiting out the plaintiffs until they abandon the case. This strategy may occasionally work for smaller individual cases, but it can also backfire, especially when established, well-funded plaintiff's attorneys are involved, as is the case with the Wal-Mart class-action suit. In such cases, there's little chance the plaintiffs will abandon their case unless a large settlement offer is made before going to court.

Arbitration agreements have had a mixed history as a litigation-avoidance tool. State law varies widely on the conditions under which they are binding and whether an employee may concurrently file a lawsuit while arbitration proceeds. Some courts have thrown out arbitration agreements signed by employees if they are found to be unfair, imposed a financial burden for arbitration on the employee, limited the number of awards, or were signed under duress. It was for this last reason that, in 2003, the 9th U.S. Circuit Court of Appeals in San Francisco invalidated an arbitration agreement used by Circuit City.

Whatever route a firm takes, experts say the best way to protect yourself is to document, document, document. At NRG, for example, CFO Roger Blomquist notes that careful documentation couldn't help the company avoid a lawsuit but did help it win. "We felt that we had all the necessary documents signed by both the company and the employee" in the matter, he says.

That's why it is vital to have processes in place to handle employee complaints, discipline, and termination. And documentation should cover actions taken after a problem arises, too. If a case does make it to trial, the first thing a jury will look at is what the company did when it found out about the problem. Often the answer spells the difference between winning and losing — or, in the case of a loss, the difference between paying back wages and reinstatement or paying compensatory or punitive awards. "The court wants to know what the company's procedures were, and did the company follow them once the problem was made known," says Fulbright & Jaworski's Dawson.

Above all, act with fairness. "In the final analysis, the main reason people decide to sue is because they don't think they were treated fairly," says Gilmore. "If you treat an employee unfairly, and that employee is a member of a protected group, you run the risk of being sued for discrimination."

Retaliation: Lawsuit du Jour

The fastest-growing area of employment litigation is retaliation. In 2004, Equal Employment Opportunity Commission settlements alone totaled \$90 million. And that's not likely to abate anytime soon, considering the U.S. Supreme Court's broadening of the definition of retaliation last summer.

That case involved a female employee of Burlington Northern Santa Fe Railway Co. who claimed the company retaliated against her after she filed a harassment claim against her manager. After the complaint, she was reassigned from her forklift-operator job to one involving more hard physical labor. The company denied the charge. It hadn't fired her or cut her pay, argued company attorneys, so its actions could not be deemed retaliatory.

The Supreme Court, however, sided with the worker. And its June 2006 ruling created a precedent that dramatically broadened the concept of retaliation to include management's alteration of an employee's status in ways other than outright termination or pay reduction. Now retaliation can include a transfer or a change in working hours, for example.

The EEOC is also broadening its definition of retaliation, says Constance M. McGrane, a litigation attorney with Conn Kavanaugh Rosenthal Peisch & Ford in Boston. Typically, as part of any employee-lawsuit settlement, a clause is added stipulating that the employee will not reapply for a job at the company. These so-called don't-darken-my-door clauses, however, may be "viewed by the EEOC in and of themselves as retaliation," says McGrane. — *K.F.*

So Many Ways to Sue

Determining the scope of employee lawsuits is problematic. For starters, there are no aggregate numbers for how many such suits are filed annually. After all, they can be filed in either federal or state court and can allege violations of a multitude of federal or state employment statutes.

For example, in 2005, the number of cases filed alleging only labor-law violations (relating to workplace conditions, union issues, and fair labor standards) and civil-rights violations (related to the Americans with Disabilities Act and the Civil Rights Act of 1991) in all U.S. district courts was 35,252. But this doesn't include the cases filed in state court alleging

violations of state labor and employment laws.

Adding up the vast economic toll isn't easy either. Statistics from the Equal Employment Opportunity Commission, the federal agency that oversees compliance with federal antidiscrimination laws, offer only a small glimpse, but it is staggering. In 2005, companies paid out more than \$378 million in discrimination-claim nonlitigated settlements with that agency alone. That's up from \$362 million the year before, but doesn't include the billions that companies pay out in legal costs or court-ordered judgments and settlements or the hundreds of mammoth class-action suits filed on allegations of such things as breach of fiduciary duty (filed by employees of Enron and AIG) and the massive sex-based discrimination suits filed in 2004 against large retailers like Wal-Mart and Costco.

The other cost, of course, is the disruption such suits cause. "In addition to the damages that companies pay, these lawsuits divert time, talent, and resources," says Ralph Dawson, a partner with Fulbright & Jaworski. And between the time spent preparing the lawyers, serving as witnesses, gathering evidence, and so on, says Michael Sheetz, a partner with Nixon Peabody, the "overall cost of executive downtime far outweighs the out-of-pocket costs." — *K.F.*

Kris Frieswick is a freelance writer based in Boston.