U.S. Chamber of Commerce

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Congress Fixes The Vail Letter: The Good, Bad and the Ugly

Before leaving for Thanksgiving break, Congress passed the Fair and Accurate Credit Transactions Act (FACT Act)[1], a bill which amends the Fair Credit Reporting Act (FCRA). The President has indicted support for the legislation and is expected to sign it. Although provisions of the bill primarily address credit and identity theft issues, Section 611 of the bill pertains to workplace investigations. More specifically, Section 611 contains a partial fix to problems created by a 1999 Federal Trade Commission (FTC) opinion letter, known as the Vail letter. Although not intentionally, the bill also affects FCRA's regulation of criminal background and reference checks.

The Vail Letter: Employers Hiring Experienced Third Party to Investigate Workplace Misconduct Must Comply with FCRA's Notice and Disclosure Requirements On April 5, 1999, the FTC, which enforces FCRA, issued a staff opinion letter stating that organizations that regularly investigate allegations of workplace sexual harassment, such as private investigators, consultants or law firms, are "consumer reporting agencies" (CRA) under FCRA; and that, if the employer hires such an organization to conduct an investigation, both the employer and the CRA must comply with FCRA's notice and disclosure requirements.[2] While the Vail letter only addresses whether FCRA applies to sexual harassment investigations, a subsequent FTC opinion letter states that FCRA applies to any investigation of employee misconduct.[3] FCRA's notice and disclosure requirements include:

- **Notice** the employer must notify to the employee prior to the investigation;
- **Consent** the employer must obtain the employee's consent prior to the investigation;
- **Disclosure** the employer must disclose a description of the nature and scope of the proposed investigation, if the employee requests it and release a full, un-redacted investigative report to the employee once the investigation is complete;
- **Reinvestigation** the CRA must reinvestigate the matter free of charge and record the status of the disputed information within 30 days, if the individual disputes the accuracy or completeness of the information obtained in the initial investigation.[4]

Although Vail Deterred Employers from Using Experienced Outside Investigators,, FTC Refuses to Rescind Letter Because it is virtually impossible to conduct an investigation while complying with FCRA's notice and disclosure requirements, and because employers and investigators face unlimited liability, including punitive damages, for failure to comply, the Vail letter effectively deterred employers from using experienced and objective outside organizations to investigate workplace

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[1] Full text of the bill is available at http://frwebgate.access.gpo.gov/cgi-bin/useftp.cgi?IPaddress=162.140.64.21&filename=h2622enr.pdf&directory=/diskb/wais/data/108_cong_bills.

[2] *See* April 5, 1999 letter from Christopher Keller, Attorney, Division of Financial Practices, to Judi Vail, Esq., available at http://www.ftc.gov/os/statutes/fcra/vail.htm.

[3] *See* August 31, 1999 letter from David Medine, FTC Associate Director Division of Financial Practices, to Susan Meisinger, available at http://www.ftc.gov/os/statutes/fcra/meisinger.htm; *see also* Statement of Federal Trade Commission before the House Banking and Financial Services Committee, May 4, 2000.

[4] 15 U.S.C. § 1681 *et seq.*

misconduct.[5] Yet, in many cases, employers must use outside investigators in order to comply with obligations under other laws.[6] And, even where outside investigators are not explicitly required, they are generally preferred.[7] Simply put, the Vail letter placed employers in the untenable position of having to choose between two legal obligations; the obligation to use outside experts to thoroughly investigate a matter or, the obligation to comply with FCRA as interpreted by FTC. Although the FTC recognized this conflict, it denied the Chamber's repeated requests to rescind the letter, claiming that a legislative fix was necessary.[8]

FTC Proposed Legislative Solution Would Have Codified Vail and Provided Only Limited Exceptions Although the Chamber advocated for legislation which completely removed employment investigations from FCRA's purview, the FTC proposed much narrower bill, which would have codified Vail and provided only limited exceptions. Set forth below are the talking points we provided to legislators, which outline the FTC proposal and the problems with it.

- **Requirement of illegality –** The proposal would only apply to investigations into misconduct that "constitute" or "could lead to" a violation of law, a rule of a self-regulatory organization, or breaches of business ethics or confidential business information. Thus, any violation of a workplace rule that does not itself meet one of those standards would presumptively still be covered by the Vail letter. For example, investigations into many types of harassment that are not specifically prohibited law, such as harassment based sexual orientation, would continue to fall within FCRA's purview. Similarly, Vail would continue to govern investigations into employer safety rules that are more stringent than those mandated by law. Such rules range from prohibiting firearms in the workplace to wearing safety equipment.

- **Non-workplace behavior –** For the proposal to apply, the investigation could not include information about non-workplace behavior. Yet, many employers have restrictions on off-the-job drug abuse, alcohol consumption, or violent behavior, particularly in safety-sensitive jobs. Investigations into workers' compensation fraud or similar investigations also may involve non-workplace behavior.

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[5] *See* May 24, 2000, letter from Howard Price, U.S. Department of Commerce Contracting Officer, to Jane Juliano and June 14, 2000, letter from Jane Juliano to William M. Daley, Secretary of Commerce, both stating that the Department has stopped hiring outside contractors to conduct discrimination investigations. Several Chamber members also have expressed concern with the Vail letter.

[6] *See* Statement of United States Chamber of Commerce Before the House Subcommittee on Financial Institutions and Consumer Credit, June 17, 2003 at 15, available at *http://www.uschamber.com/NR/rdonlyres/e2spo5rer6f2cw7oei6nunumr4rrcgzffv25rvufhjpxhpidiboeooodteuscqbfmuapdgerxkgeqf/ReynoldsTestimonyFCRA.pdf*.

[7] *See* Id.

[8] *See, e.g.*, January 3, 2002, letter from Stephen A. Bokat, Senior Vice President and General Counsel, U.S. Chamber of Commerce, and Randel Johnson, Vice President for Labor and Employee Benefits, U.S. Chamber of Commerce to The Honorable Timothy J. Muris, Chairman, Federal Trade Commission; March 31, 2000, letter from Robert Pitofsky, Federal Trade Commission Chair, to Congressman Pete Sessions; October 16, 2002, letter from Joel Winston, Associate Director, Division of Financial Practices, Federal Trade Commission, to Stephen A. Bokat, Senior Vice President and General Counsel, U.S. Chamber of Commerce, and Randel Johnson, Vice President for Labor and Employee Benefits, U.S. Chamber of Commerce.

- **Notice requirements** –

    - **90-Day period** Although the proposal would not require the employer to provide prior notice, the employer would have to notify the subject within 90 days of when the investigation began, unless the matter has been referred to a government enforcement agency. Yet, some highly complex matters, such as alleged violations of SEC or IRS rules may take more than 90 days and providing the subject with notice may jeopardize the investigation (e.g., subject could destroy evidence, intimidate witnesses, concoct stories, etc.) or open the door to potential retaliation.

    - **Notice regardless of adverse action** The proposal also requires that the employer notify the subject after the investigation is complete even where there has been no adverse action taken against the employee. However, doing so invites retaliation against accusers. For example, an employee suspected of workplace violence may act out against those he or she suspects reported the alleged incident after learning of the investigation. Similarly, a supervisor accused of sexual or racial harassment could learn of a sexual or racial harassment investigation and retaliate against suspected accuser. In either case, employees and others in the workplace are placed in danger and the employer is exposed to liability.

- **"Good faith" requirement** – To fall within the exception, an investigation must be "conducted in good faith and in a prompt, thorough and impartial manner so as to reasonably ensure the accurate and unsubstantiated determination of the facts." In addition, the employer must request the investigation and take action upon it "in good faith." These standards do not even apply under the current Vail letter. The result would be that every single investigation and/or adverse employment action resulting from an investigation would be subject to a thorough, top-to-bottom review by the FTC and/or a court.

Chamber Led Coalition Squashes Support for FTC Proposal Although the FTC offered its proposal in 2000, it did not gain any traction until this past summer when the agency, supported by consumer groups and labor unions, pushed their proposal as the House version of the FACT Act went to full Committee mark-up. The Chamber led a coalition of interested parties who, through heavy lobbying, squashed support for the proposal during the Committee mark-up. Among other things, the Chamber alerted an employee rights group about the FTC proposal and how it would lead to inadequate employee protections. That group, in turn, was able to convince key Democrats to withdraw support for the FTC proposal. The coalition then met with the FTC, providing them detailed explanations as to why their solution was inadequate. At that point, the FTC moved away from their position. Unfortunately, during the House Senate conference on the FACT Act, Sen. Paul Sarbanes (D-MD), again with support of consumer groups and labor unions, attempted to replace the Sessions fix (detailed below) with the FTC proposal. Thanks other conferees, in particular, Rep. Pete Sessions (R-TX) and Sen. Mike Enzi (R-WY), Sarbanes was unsuccessful.

The Sessions Compromise Shortly after the FTC issued the Vail letter, Rep. Pete Sessions (R-TX) set about providing an alternative legislative fix. It was quickly realized that any fix aimed at supplanting the FTC proposal would need bi-partisan support. Rep. Sheila Jackson-Lee (D-TX) joined the process and a compromise bill was drafted. The compromise exempted from FCRA's notice and disclosure requirements investigations of suspected violations of laws, regulations, rules of self regulatory agencies and pre-existing employer policies, as long as they were not made for the purpose of investigating the subject's credit worthiness, credit standing, or credit capacity. It also, however, required that employers disclose a summary containing the nature and substance of any investigative

report if the employer took adverse action based on the investigation. While the Chamber vigorously opposed the adverse action disclosure, it became clear that without it the legislation would not garner any support. As one legislator put it, "you can't put the whole genie back in the bottle."

In 2003, the Chamber requested changes to the legislation that eliminated the requirement that the misconduct investigation be pursuant to a violation of laws, regulations, rules of self regulatory agencies and pre-existing employer policies. We argued that small employers often do not have written employer policies and, because of a lack of resources, they are often ones who need outside investigators the most. Our proposed changes would exempt any investigation into workplace misconduct as well as any investigation into compliance with laws, regulations, rules of self regulatory agencies and pre-existing employer policies. The Chamber also requested that the identification of witnesses be explicitly exempted from the adverse action notice. Both of these requests were granted. The Chamber also asked drafter include a provision which would have explicitly stated that the adverse action notice is not intended to abrogate the attorney-client or work-product privileges and a provision capping any damages stemming from the adverse action report. These suggestions were rejected as too controversial. There was also a fear that including the attorney client provision would do more hard than good if objectors secured its removal prior to final passage.

Bottom Line: The Good, the Bad and the Ugly – Less Limitations, An Adverse Action Disclosure and Some Possible Unintended Consequences The Sessions compromise eventually became Section 611 of the FACT Act . While the compromise is not an ideal fix, it is vast improvement over the FTC proposal. Below is a short synopsis of the good, the bad and the ugly in the bill.

- **The Good** – **Almost All Investigations Covered by the Vail Letter Are Exempt** The bill exempts from FCRA's notice and disclosure provisions all investigations into "suspected misconduct relating to employment" and any investigation of "compliance with Federal, State or local laws and regulations, the rules of a self regulatory organization, or any pre-existing written policies of the employer." Investigations are not exempt, however, if "made for the purposes of investigating a consumer's [or in this case, employee's or prospective employee's] credit worthiness, credit standing, or credit capacity." Under 611, employer is still free to argue that the investigation does not fall within FCRA's purview at all because the investigator does not meet the definition of a CRA or for other reasons.[9]

- **The Bad – Adverse Action Disclosure** The bill requires the employer disclose to the subject a summary containing the nature and substance of any investigative report if it takes adverse action based on the investigation. Under FCRA's scheme, employers face unlimited damages for any violation of this provision. The summary, however, need not identify sources. Also, the disclosure requirement obviously only applies to investigations that, but for the bill, would have fallen within FCRA's purview.

[9] *See e.g., Rugg v. Hanac,* 2002 WL 31132883 (S.D.N.Y. 2002); *Hartman v. Lyle Park District*, 158 F.Supp.2d 869, 876 (N.D. Ill. 2001); *Johnson v. Federal Express Corp.*, 147 F.Supp.2d 1268, 1272 (M.D. Ala. 2001); *Robinson v. Time Warner, Inc.*, 187 F.R.D. 144 (S.D.N.Y. 1999); 1999 U.S. Dist. LEXIS 14304 (S.D.N.Y. 1999); *Friend v. Ancillia Systems Inc,* 68 F. Supp. 2d 969 (N.D. Ill. 1999).

- **The Ugly – Outstanding Issues**

    - **Content of Adverse Action Disclosure** It's unclear exactly how much information an employer must reveal in the adverse action disclosure. The bill simply states the disclosure is a "summary containing the nature and substance of the communication," except sources need not be revealed. As the Chamber pointed out early in the debate when it argued against the disclosure requirement, this vagary promises to produce litigation. The FTC does not have rulemaking authority over Section 611, so will not be clarifying this issue via notice and comment rulemaking. The agency, however, still may issues interpretive guidance through opinion letters.
    - **Attorney-Client Privilege and Other Privacy Issues** Although there is no provision in the bill specifically stating that the adverse action disclosure is not intended to abrogate the attorney-client or work-product privileges or other confidentiality obligations or privileges , case law under the Vail letter suggest that the privileges will remain intact.[10] In addition, there may be language on confidential information in the soon to be released final conference report. In any case, this issue is certain to come up in litigation.
    - **Affect on Background Investigations and Reference Checks** The bill exempts from FCRA's notice and disclosure requirements "communications in connection with an investigation of (i) suspected misconduct related to employment; or (ii) compliance with Federal, State, or local laws and regulations, the roles of a self regulatory organization, or any pre-existing written policy… not made for the purpose of investigating a consumer's credit worthiness, credit standing, or credit capacity…." FCRA previously covered background investigations and reference checks performed on current employees and applicants when the employer hired an experienced third party to run the checks. While the bill clearly exempts background checks which are part of an investigation into misconduct, the awkward language "in connection with an investigation of . . . compliance with Federal, State, or local laws and regulations, the roles of a self regulatory organization, or any pre-existing written policy" leaves it somewhat unclear as to whether other reference and background checks are exempt. One reading of the language would exempt any background or reference check conducted pursuant to an employer's written policy.

[10] *Robinson.,*187 F.R.D. at 148 n.2 (lawyer's report was prepared to provide legal advice to the company, not for taking adverse action against Robinson and, therefore, did not fall within FCRA purview); *Hartman*, 158 F. Supp.2d at 876 ("[t]here is nothing in the FCRA or its history that indicates that Congress intended to abrogate the attorney-client or work-product privileges, as would be the effect of applying the FCRA's requirements (which include disclosure of the report) to reports of the type at issue in this case." Also, because of the special fiduciary relationship between attorney and client, a communication between them "qualifies as a 'report containing information solely as to the transactions or experiences between the consumer and the person making the report,' and, thus, is not a consumer report within the meaning of FCRA.")