TORT TRIAL AND INSURANCE PRACTICE

Committee News

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EMPLOYER-EMPLOYEE RELATIONS COMMITTEE

NLRB "WATCH LIST": DECISIONS AND ISSUES THAT COULD RECEIVE ATTENTION AND MORE PRO-EMPLOYER TREATMENT FROM THE NEW BOARD

By Derek G. Barella[1]

Over the last ten years, the National Labor Relations Board ("NLRB" or "Board") has resembled the National Football League in at least two respects. First, after a round of litigation before the Clinton Board, many employers have attested to feeling like a NFL quarterback on Monday morning. Second, in the NLRB, like the NFL, momentum has proven to be critical. Looking forward in 2003 to the first Republican-dominated Board since 1993, employers and industry groups are sensing a momentum shift they hope will lead to the Board's reversal of a number of Clinton-era, pro-labor decisions.

This anticipated shift may have already begun. On July 17, 2002, a Board majority consisting of recess appointees Hurtgen, Barlett, and Cowen (all Republicans), over the dissent of Democratic Member Liebman, overturned *St. Elizabeth's Manor*, 329 NLRB 341 (1999), which had held that an incumbent union was entitled to a reasonable period of time to bargain with a successor employer, during which time the union's majority status could not be challenged. In *MV Transportation*, 337 NLRB No. 129 (2002), the Board reinstated the standard that *St. Elizabeth's* had modified -- in a successorship situation an incumbent union is entitled only to a rebuttable presumption of continued majority support. The *MV Transportation* decision is unusual from the standpoint that most recess appointees are often reticent to overrule existing precedent. What is perhaps more extraordinary about the decision, however, is its tone. Not content simply to reverse *St. Elizabeth's*, the *MV Transportation* majority decried that decision's analysis as "faulty and . . . plainly insufficient to warrant such an abrupt departure from long standing Board precedent." *Id.* at *1.

I. Rights of Nonunion Employees to "Representation" During Investigatory Interviews

If *MV Transportation* is, in fact, a harbinger of things to come, the precedent at the top of the "watch list" of other candidates for possible reversal is the Board's 2000 decision in *Epilepsy Foundation of Northeast Ohio*, 331 NLRB 676 (2000), *enf'd in pertinent part*, 268 F.3d 1095 (D.C. Cir. 2001). In *Epilepsy Foundation*, the Board returned to the "pro-labor" side of the fence on an issue that has spawned varying decisions over the past 20 years.

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NOTES FROM THE CHAIR-ELECT

This year and next, the TIPS Employer-Employee Relations Committee would like to expand its membership. You probably receive this newsletter because you are already a member of the TIPS Employer-Employee Relations Committee. Why, then, would we be talking to you about increasing membership? Because service to our members is what keeps you coming back – and what will convince you to invite your colleagues to join our Committee.

Even though you are already a member, you may not know all the benefits of Committee membership. For many Committee members, receiving the Newsletter is a key reason to keep coming back. Through our Newsletter, we are able to deliver a wide variety of high caliber articles. We regularly have articles discussing recent developments in employment law, employment trial tips, and articles that enhance your practice by covering a broad spectrum of employment counseling issues. Our books, which cover a wide range of employment law topics, are relied upon by employment lawyers across the country.

Being active in the Committee only increases your membership benefits. By becoming involved, you can gain national exposure through writing and speaking opportunities. Perhaps the easiest way to become involved, and published, is to write a newsletter article. An article that you have already published in your firm's newsletter might be just the piece our Newsletter Editor, Tom Deer, is looking for.

The Committee has numerous other writing opportunities. For example, we anticipate publication of a new book, *The Practitioner's Guide to Defense of EPL Claims*, before the ABA Annual Meeting in August 2003. Ellis Murov is serving as editor and will be working with eleven different authors on this project. We have been asked to write books on two other topics in the next year. Contributing a chapter to a well-respected ABA publication is certainly a plus on any résumé.

The Committee also provides its members a variety of speaking opportunities. The Committee typically puts on a meeting at the American Bar Association Annual Meeting. We have attracted outstanding speakers who are leaders in their fields. In addition, many Committee members have served as speakers and have, as a result, earned recognition for their own expertise.

Finally, you should know that Committee membership is not all work. We certainly have many opportunities to socialize with our colleagues in wonderful venues. We are already planning social events for the 2003 ABA Annual Meeting in San Francisco and the Spring 2004 TIPS meeting in beautiful Napa Valley, California. Certainly, no one will come to Napa without sipping a glass of wine or two, taking a bike ride through the countryside, or playing a round of golf at one of the first class resorts in the area.

The Committee wants to increase its membership, not just in size, but also in the diversity of our members. We would like to have our membership reflect the entire spectrum of attorneys who practice employment law, including gender and ethnic diversity, geographic diversity, and areas of practice. (Yes! We have a place for Plaintiffs' counsel). Please take a moment to think about which of your colleagues -- or even your opposing counsel -- could benefit by joining us. Pass along this Newsletter and invite them to consider joining us.

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NOMINATIONS SOUGHT FOR 2003 EDMUND MUSKIE PRO BONO SERVICE AWARD

Nominations are open for the 2003 Edmund Muskie Pro Bono Service Award conferred annually by the American Bar Association Tort Trial and Insurance Practice Section (TIPS) to recognize section members who exemplify the attributes of Senator Edmund Muskie: his dedication to justice for all citizens, his public service, and his role as a lawyer and distinguished leader of TIPS.

Nominations should be submitted to: The Edmund Muskie Award, TIPS Law in Public Service Committee, Section of Tort Trial and Insurance Practice, 750 N. Lake Shore Drive, Chicago, IL 60611-4497. The deadline is February 15, 2003.

THE ABC'S FOR THE TAXATION OF SETTLEMENT PAYMENTS

By Jedd B. Vertman[1]

Depending upon which party to an employment dispute that you are representing, the tax consequences of a settlement payment are quite different. Therefore, a well-prepared attorney will be familiar not only with the tax consequences of a settlement payment to his or her client, but also the tax consequences of the same settlement payment to the opposing party. Importantly, understanding the taxation of settlement payments allows an attorney representing the plaintiff to know in advance the "net" settlement payment that his or her client will receive and allows an attorney representing the defendant to be cognizant of any taxes that the defendant will have to pay in addition to the negotiated settlement payment.[2] Moreover, by understanding both sides of the equation, an attorney not only protects his or her client's own best interests and bottom line, but may also be able to find creative solutions or acceptable compromises to tax-related stalemates. Rest assured, one need not be a seasoned tax attorney to understand the basic concepts related to the taxation of settlement payments.

As a premise, every settlement agreement should include an express allocation of the settlement payments to be received by the plaintiff, as well as a discussion of the expected tax treatment of such payments by the defendant, including the appropriate federal and state income tax and employment tax withholdings that the parties intend and agree upon when structuring the agreement. This is of particular importance because an express allocation contained in a settlement agreement will generally be respected by the Internal Revenue Service (the "IRS") and state tax authorities if the agreement was negotiated at arms-length and in good faith by adversarial parties.[3] Thus, explicitly addressing and providing for an allocation of settlement payments and the related tax consequences helps not only to avoid future disputes and inconsistencies between the parties as to the characterization of the settlement payments, but also helps protect against future scrutiny by the IRS and state taxing authorities. Settlement payments without express allocation provisions are often treated as entirely taxable (often as wages) by the IRS and state taxing authorities.

The following discussion is intended to provide attorneys settling employment litigation disputes with a general understanding of the federal and state income tax and employment tax consequences of most payments made pursuant to settlement agreements. Issues to be covered herein include:

- Distinguishing between taxable and non-taxable income, including the proper tax treatment of damages for "emotional distress (Section I)";
- Whether all, or a portion, of a settlement payment should be characterized as "wages," including the proper characterization of back pay and front pay (Section II);
- Determining the proper treatment of attorneys' fees (Section III); and
- Model language to be considered when drafting settlement agreements (Section IV).

While this discussion provides a good starting point (especially for non-tax lawyers) with respect to the federal and state income tax and employment tax consequences of entering into a settlement agreement, it does not purport to address every issue or contention that may arise. Therefore, it is usually a good idea to consult with a tax lawyer prior to finalizing any settlement agreement. Nonetheless, the basic concepts presented herein should prove most useful in negotiating, drafting and understanding the tax consequences of settlement payments.

I. Taxable vs. Non-Taxable Settlement Payments

In determining the proper federal and state income tax and employment tax treatment of amounts paid pursuant to a settlement agreement, the threshold inquiry should be whether such payments constitute taxable or non-taxable income to the plaintiff. Taxable income is just that -- income that is subject to federal and state income tax in the hands of the plaintiff. Taxable income generally must be reported by the defendant to the IRS and to the plaintiff. Non-taxable income is not taxable to the plaintiff and is not reported by the defendant to the IRS or to the plaintiff. This results in a

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[2] For purposes of this discussion, it is assumed that the employee or former employee is the plaintiff and the employer or former employer is the defendant.

[3] *See, e.g., Robinson, Edward,* 102 T.C. 116 (1994), *aff'd on this issue*, 70 F.3d 34 (5th Cir. 1995); *Gross, Ronald M.*, T.C. Memo 2000-342 (2000); *Burditt, Allen II*, T.C. Memo 1999-117 (1999).

common friction. Logic dictates that the plaintiff wants the entire settlement agreement to be non-taxable; however, most settlement payments arising in the employment context are taxable and, consequently, the employer is exposed to potential tax liability (including penalties and interest) for failing to withhold on, and report to the IRS and to the plaintiff, the amount of taxable payments made to the plaintiff (*see* Sections II and III below). Thus, it is imperative that counsel understands what is and is not taxable income to the plaintiff.

Code Section 104(a)(2)[4] provides that the amount of any damages (other than punitive damages) received, whether by suit or agreement and whether as lump sums or as periodic payments, on account of (i) personal physical injuries or (ii) physical sickness, are excluded from gross income (*i.e.*, non-taxable).[5] The statute specifically provides that "emotional distress" is not considered a physical injury or physical sickness.[6] For this purpose, "emotional distress" includes physical symptoms (*e.g.*, insomnia, headaches, stomach disorders) that may result from emotional distress.[7] Accordingly, most damages received for emotional distress (including the physical symptoms of emotional distress) may not be treated as damages on account of a personal physical injury or physical sickness, except to the extent amounts paid for medical care attributable to such emotional distress were not otherwise deducted by the plaintiff on his or her current or previous income tax returns.[8] However, "[i]f an action has its origin in a physical injury or physical sickness, then all damages (other than punitive damages) that flow therefrom are treated as payments received on account of physical injury or physical sickness whether or not the recipient of the damages is the injured party."[9] Thus, damages received for emotional distress and other non-physical injuries or sickness remain excludable from gross income under Code Section 104(a)(2) only to the extent that they are directly attributable to a personal physical injury or a physical sickness.

For example, the exclusion from gross income under Code Section 104(a)(2) does not apply to the amount of damages received that are based on a claim of employment discrimination or injury to reputation accompanied by a claim of emotional distress. However, the exclusion from gross income under Code Section 104(a)(2) would apply to the amount of damages received based on a claim of emotional distress attributable to physical sickness or personal physical injury.[10] The IRS has privately ruled that payments for damages properly attributable to direct unwanted or uninvited physical contact are treated as personal physical injuries under Code Section 104(a)(2) only if the contact results in observable bodily harm, such as bruises, cuts, swelling, or bleeding.[11] Conversely, taxable payments (*i.e.*, those not attributable to personal physical injuries or physical sickness excludable under Code Section 104(a)(2)) generally include wage payments, liquidated damages, punitive damages (whether or not attributable to personal physical injuries or physical sickness), and interest.

In order to characterize settlement payments as taxable or non-taxable income, attorneys settling employment related cases should look to: (i) the claims made by the plaintiff in any pleadings; (ii) the causes of action raised by the plaintiff; (iii) the types of relief available to the plaintiff under the statute; (iv) the types of relief available to the plaintiff under common law; and (v) any other documents or evidence supporting those (or other) claims, including correspondence between the parties and contract formulas for allocating damages.[12] In most employment discrimination cases, however, the key issue is not whether the settlements are taxable to the plaintiffs (which they usually are), but, rather, the extent to which such payments constitute "wages," upon which the defendant must withhold for federal and state income taxes and employment taxes. Thus, the pertinent inquiry in most employment-related cases is whether the settlement payments represent "wage" or "non-wage" payments, both of which are subject to federal and state income

[4] All "Code Section" references are to the Internal Revenue Code of 1986, as amended, or to the Treasury Regulations ("Treas. Reg. § ___") promulgated thereunder.

[5] Code Section 104(a)(2) generally applies to amounts received after August 20, 1996, unless amounts are received after August 20, 1996, pursuant to a written binding agreement, court decree, or mediation award in effect on (or issued on or before) September 13, 1995. P.L. 104-188, § 1605(b), (d)(2).

[6] Code Section 104(a)(flush language).

[7] Staff of the Joint Comm. on Taxation, 104th Cong., 2d Sess., General Explanation of Tax Legislation Enacted in the 104th Congress, 222-24 (hereinafter, the "Bluebook at ___").

[8] Code Section 104(a)(flush language); Bluebook at 222-23.

[9] Bluebook at 223.

[10] Bluebook at 223-24.

[11] *Priv. Ltr. Rul.* 200041022 (Oct. 13, 2000).

[12] *See, e.g., Robinson, Edward*, 102 T.C. 116 (1994), *aff'd on this issue*, 70 F.3d 34 (5th Cir. 1995); *Miller, Bonnie,* T.C. Memo 1993-49 (1993), *aff'd*, 76 AFTR 2d ¶95-5718 (1995 CA4) (unpublished).

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taxes in the hands of the plaintiff, but only "wage" payments are subject to upfront income and employment tax withholdings by the defendant.

II. Wage vs. Non-Wage Payments

On the portion of the any settlement payment treated as "wages," the defendant must withhold applicable federal and state income and employment taxes. For this purpose, "wages" are generally defined as all remuneration for services performed by an employee for his or her employer.[13] Treas. Reg. § 31.3121(a)-1(i) further provides that remuneration for employment is considered wages "even though at the time paid the relationship of employer and employee no longer exists between the person in whose employ the services were performed and the individual who performed them." Employees include former employees receiving settlement payments in connection with their current or previous employment, but it is unclear whether wages may be paid to a person with whom an employment relationship was never established (*e.g.*, a person who was not hired).[14] Additionally, it is the IRS' clear position that back pay and front pay constitute taxable wage payments.[15] On the other hand, "taxable non-wage payments" generally consist of all payments paid to a plaintiff that do not constitute (i) payment on account of personal physical injuries or physical sickness under Code Section 104(a)(2) or (ii) "wages."

(A) Tax Treatment of Wage Payments

Once a settlement payment is characterized as wages, the defendant may withhold federal income tax at a flat 27 percent rate on such wage payments, or if the settlement amount is very large, the defendant may consider allowing the plaintiff to reduce the amount of federal income tax withholding by filing a new Form W-4 claiming additional exemptions and determining the income tax withholding based on tables published by the IRS.[16] If the latter alternative is chosen, careful scrutiny under Treasury Regulations must be given to Form W-4s claiming more than ten exemptions.[17] Wages payments are also subject to state (and local where applicable) income tax withholding.

In addition to federal and state income tax withholdings, the defendant is required to withhold from any wage payments the employee's share of FICA taxes and must also pay from their own funds a matching amount to cover the employer's share of FICA taxes. For this purpose, wage payments are treated as being paid in the year received by the plaintiff, notwithstanding that they may represent back pay, front pay, or otherwise relate to a year other than in which they are being paid.[18] Wage payments are subject to current year tax rates and FICA caps.[19] For wage payments made in 2003, a defendant must withhold 7.65 percent from the first $87,000 of wage payments paid to a defendant and 1.45 percent on wages in excess of $87,000, and must also pay a matching amount from their own funds.[20] The employer must also pay (but not withhold) the employer's portion of federal unemployment taxes ("FUTA") and any state unemployment taxes. Wage payments are reported by the defendant to the IRS and to the plaintiff on a Form W-2 in the year in which such wages are paid to the plaintiff.[21]

Importantly, the appropriate federal and state income tax and FICA withholdings on the portion of the settlement amount constituting taxable wages will be deducted

[13] *See* Code Sections 3121(a), 3401(a).

[14] *See, e.g.*, Newhouse v. McCormick & Co., Inc., 157 F.3d 582 (8th Cir. 1998), *aff'g* 910 F. Supp. 1451 (D. Neb. 1996) (back pay and front pay awarded under an ADEA claim were not "wages" for income tax and employment tax purposes where the plaintiff was not hired for the position sought); *but see,* Rev. Rul. 78-176, 1978-1 C.B. 303 (payments received in settlement of a suit brought under Title VII by job applicants who allegedly were wrongfully refused employment were "wages" for purposes of FICA, FUTA, and income tax withholding, although no actual or previous employment relationship existed).

[15] *See, e.g.*, Rev. Rul. 96-65, 1996-2 C.B. 6 (which indicates in holding number 3 that back pay in an employment discrimination case under Title VII constitutes "wages" for federal income tax and FICA purposes); Johnson v. U.S., 85 AFTR 2d ¶2000-619; No. 99-S-1840 (April 11, 2000) (back pay and front pay received under an ADA claim are "wages" subject income tax and employment tax withholding); Associated Electric Cooperative Inc. v. United States, 42 Fed. Cl. 867 (1999) (certain termination payments paid pursuant to a voluntary separation program were "wages" subject to employment tax withholding); Gerbec v. United States, 164 F.3d 1015 (6th Cir. 1999) (portion of award for back pay and front pay constituted "wages" subject to employment taxes); Abrahamsen v. United States, 44 Fed. Cl. 260 (1999) (downsizing payments received by former employees were "wages" subject to income tax and employment tax withholding).

[16] *See* Treas. Reg.§ 31.3402(g)-1.

[17] *See* Treas. Reg. §31.3402(f)(2)-1(g).

[18] United States v. Cleveland Indians Baseball Co., 121 S.Ct. 1433 (2001).

[19] *See* Treas. Reg. §§ 31.3101-2(c), -3; 31.3111-2(c), -3.

[20] FICA taxes are divided between social security and Medicare taxes. The social security tax rate is 6.2 percent each for both an employer and an employee for a total rate of 12.4 percent on the first $87,000 of wages paid in 2003 (this amount is indexed annually for inflation). The Medicare tax is 1.45 percent each for both an employer and an employee for a total rate of 2.9 percent of all wages paid in 2003.

[21] *See generally* Code Section 6051.

from the settlement payment. Accordingly, the amount of any settlement constituting wages will be received by the plaintiff "net" of taxes, which means that the plaintiff will generally receive only about 65 percent of the amount of wages agreed upon pursuant to the settlement agreement.[22] Additionally, the defendant will be required to pay an additional 6.2 percent of the amount of wages paid to the plaintiff up to $87,000 and an extra 1.45 percent of all wages paid above that amount. Thus, counsel should factor in these costs when a structuring settlement agreement that contain a wage component.

(B) Tax Treatment of Taxable Non-Wage Payments

Other taxable settlement payments (*i.e.*, "taxable non-wage payments") will be received by the plaintiff in their full amounts with no income or employment taxes being withheld by the defendant (unless income tax withholding is requested by the plaintiff and agreed upon by the defendant), although such amounts will generally be subject to federal and state income taxation and need to be reported on the plaintiff's federal and state income tax returns. For this purpose, "taxable non-wage payments" generally consist of all payments paid to a plaintiff that do not constitute (i) payment on account of personal physical injuries or physical sickness excludable under Code Section 104(a)(2) or (ii) wages. These payments include, among other items, punitive damages, liquidated damages, attorneys' fees, and interest. Taxable non-wage payments will be reported by the defendant to the plaintiff and the IRS on a Form 1099.

III. Attorneys' Fees

There is a split of authority on whether contingency fees paid directly to attorneys are included in a client's gross income as such fees are in essence income to the attorney and not to the client. The Fifth, Sixth and Eleventh Circuits exclude contingency fees from a client's gross income while the Third, Fourth, Seventh, Ninth, Tenth and Federal Circuits include contingency fees in a client's gross income.[23] The Second Circuit has not yet decided this issue, although a Vermont district court (whose holding is appealable the Second Circuit) recently held that a contingency fee paid directly to a client's attorney was not included in the client's gross income.[24] While a detailed analysis of this split in authority is beyond the scope of this discussion, a brief explanation of the tax consequences of including or excluding attorneys' fees from a plaintiff's gross income is nonetheless warranted.

Specifically, counsel representing a plaintiff should keep in mind that if attorneys' fees are included in a plaintiff's gross income that the plaintiff will generally have to pay income tax on some portion of such fees, notwithstanding that they may never in fact receive any of the proceeds under the fee agreement with the attorney. This is the case because the attorneys' fees, which are an itemized deduction for federal income tax purposes, are deductible by a plaintiff only to the extent that they exceed 2 percent of the plaintiff's adjusted gross income for the taxable year,[25] and are not deductible at all in determining alternative minimum tax (if applicable to the plaintiff).[26] If the attorneys' fees are included in a plaintiff's gross income, the defendant will generally report such fees to both the plaintiff and plaintiff's counsel on a Form 1099. On the other hand, excluding the attorneys' fees from a plaintiff's gross income involves no tax cost to the plaintiff on the portion of the settlement payment that is allocated as attorneys' fees and paid directly to the attorney and, in such a case, the fees are generally reported only to plaintiff's counsel on a Form 1099.

Regardless of whether the attorneys' fees are includable in, or excludable from, a plaintiff's gross income, such fees should be expressly identified in the settlement agreement to avoid the risk that some portion of the attorneys' fees will be improperly characterized by the parties. Thus, while plaintiff's counsel does not always want to disclose its fees to the opposing party, such disclosure is generally necessary to both properly exclude the attorneys' fees from a plaintiff's gross income in Circuits where such treatment is appropriate and, in Circuits where the attorneys' fees are included in a

[22] Depending on the plaintiff's tax situation, the plaintiff may recoup some of these taxes in connection with the filing of his or her federal and state income tax returns for the year of payment. Plaintiff's counsel may wish to consult a tax attorney or accountant to better understand a plaintiff's tax situation prior to finalizing the settlement agreement containing a wage component.

[23] *See* Campbell v. Comm'r, 274 F.3d 1312, 1314 (10th Cir. 2001), *cert. denied*, 122 S. Ct. 1915 (2002); Kenseth v. Comm'r, 259 F.3d 881, 885 (7th Cir. 2001); Young v. Comm'r, 240 F.3d 369, 379 (4th Cir. 2001); Coady v. Comm'r, 213 F.3d 1187, 1191 (9th Cir. 2000), *cert. denied*, 532 U.S. 972 (2001); Davis v. Comm'r, 210 F.3d 1346, 1347 (11th Cir. 2000) (per curiam); Estate of Clarks v. United States, 202 F.3d 854, 858 (6th Cir. 2000); Baylin v. United States, 43 F.3d 1451, 1454 (Fed Cir. 1995); O'Brien v. Comm'r, 319 F.2d 532, 532 (3rd Cir. 1963) (per curiam); Cotnam v. Comm'r, 263 F.2d 119, 126 (5th Cir. 1959).

[24] Raymond v. United States, 91 AFTR 2d 2003-535 (2002 D.C. VT).

[25] *See* Code Section 67 (relating to the two-percent floor on miscellaneous itemized deductions).

[26] *See* Code Section 56 (relating to adjustments in computing alternative minimum tax).

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plaintiff's gross income, to properly allocate the settlement payments between the various payment components, including attorneys' fees (this is especially true where there is a wage component in the settlement). In this respect, plaintiff's counsel may have to "fall on their sword" in order to protect their client's best interest.

IV. Model Language for Settlement Agreement

As discussed above, every settlement agreement should include an express allocation of the payments to be received by the plaintiff, as well as a discussion of the expected tax treatment of the settlement payments. Below is some simple, yet very decisive and powerful, language that counsel should consider including when drafting settlement agreements:

- Allocation of Settlement Payments:

"$ _____ shall be allocated and paid as non-taxable income under Code Section 104(a)(2)." [Very unusual in employment disputes]

"$ _____ shall be allocated and paid as back and/or front pay."

"$ _____ shall be allocated and paid as liquidated damages."

"$ _____ shall be allocated and paid as [insert other damages – *e.g.*, emotional distress]."

"$ _____ shall be allocated and paid as interest."

"$ _____ shall be allocated and paid as attorneys' fees payable to _____."

- Federal, State and Local Income and Employment Tax Reporting and Withholding:

"The [defendant] will report as wages on Form W-2 and will withhold applicable federal, state and local income taxes and the plaintiff's share of FICA taxes (based on rates as currently in effect) with regards to the payment of wages, including the payment of back pay and/or front pay."

"The [defendant] will report on Form 1099 the balance of the settlement payment, including any attorneys' fees, as non-taxable wages, with the exception of any amounts designated as non-taxable income under Code Section 104(a)(2)."

"The [defendant] will provide the [plaintiff] and [plaintiff's counsel] with the appropriate federal and state tax forms reporting the settlement payments and any taxes withheld as required by law."

"The [plaintiff] acknowledges and represents that neither the [defendant], nor [counsel for the defendant], has made any representations regarding the income tax treatment of these settlement payments and that, except for withholding, reporting and payment of FICA taxes and federal, state and local income tax withholdings, the [plaintiff] is responsible for reporting and paying any taxes associated with these payments under relevant law."

- Additional Language to Consider:

"The [plaintiff] and/or [plaintiff's counsel] agrees to indemnify and hold the [defendant] harmless for any taxes, penalties, interest, and legal fees incurred by the [defendant] as a result of not withholding federal, state and local income taxes and/or FICA taxes on the settlement payment." [Pro-Defendant]

"No payment provided for and paid pursuant to this settlement agreement shall be treated as wages for purposes of any employee benefit plan of the [defendant]." [This provision may be dependant upon the terms of the defendant's employee benefit plan or collective bargaining agreement.]

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Ever since the Supreme Court's 1975 decision in *NLRB v. J. Weingarten, Inc.*, 420 U.S. 251 (1975), it has been established law that a union-represented employee is entitled upon request to the presence of a union representative during any investigatory interview that the employee reasonably believes could result in discipline. What has rested on far more unstable footing, however, is the question whether a nonunion employee enjoys a corresponding "*Weingarten* right" to have a co-worker present during such an interview.

For a period of time in the early 1980's, the NLRB held that a nonunion employee's request for representation fell within the Act's broad protection of "concerted protected activity." *See Material Research Corp.*, 262 NLRB 1010 (1982). From 1985 until the *Epilepsy Foundation* decision, however, the Board took a contrary view, concluding that *Weingarten* principles did not apply in nonunion settings because the Act's protection of concerted protected activities of union employees is broader than its protection of the actions of nonunion employees. *See Sears, Roebuck & Co.*, 274 NLRB 230 (1985); *E.I. DuPont & Co.,* 282 NLRB 627 (1988). Additionally, the Board considered the extension of *Weingarten* rights in such circumstances to be an unwarranted intrusion upon an employer's right to deal individually with its nonrepresented workforce. *Id.* The Clinton Board's decision in *Epilepsy Foundation* embraced, once again, the view that the Act broadly protects, on an equal level, concerted protected activity by union and nonunion employees. As a consequence, nonunion employees currently possess *Weingarten* rights; a fact that management groups have complained unduly interferes with workplace investigations, and could result in employers simply issuing discipline without the benefit of investigatory interviews.

While *Epilepsy Foundation* was enforced on appeal by the United States Court of Appeals for the D. C. Circuit, the court considered the point "debatable." However, given the relatively lenient standard of review, the court affirmed. The newly constituted Board could be prompted to revisit this issue, particularly in light of the dissenting opinions filed in *Epilepsy Foundation* by Republican Members Hurtgen and Brame and the circuit court's less than enthusiastic endorsement of the majority view.

II. Combined Bargaining Units of "Regular" and "Contingent" Workers

Another decision on the watch list for possible reversal is *M.B. Sturgis, Inc.*, 331 NLRB 1298 (2000), which reversed decades of NLRB precedent concerning the circumstances under which "temporary" or "contingent" workers can be included in the same bargaining unit with an employer's "regular" workforce. Before *M.B. Sturgis*, the Board sanctioned such a combined workforce only in those cases where both affected employers consented. *See Lee Hosp.*, 300 NLRB 947 (1990); *Greenhoot, Inc.*, 205 NLRB 250 (1973). *M.B. Sturgis* reversed this policy, holding that temporary workers could be included in an employer's regular bargaining unit even over one or both employers' objections if the temporaries shared a sufficient "community of interest" with the bargaining unit employees.

The Board's recent decision in *Outokumpu Copper Franklin, Inc.*, 334 NLRB No. 39 (2001), illustrates this policy change. In *Outokumpu Copper,* a manufacturer of light wall copper tubing employed a workforce of 238 regular full-time employees and 34 temporary employees obtained from three different staffing agencies. Considering "traditional community of interest factors," the Board observed that the staffing agencies hired the temporary employees and paid them substantially lower wages than the employer paid its regular workers. Further, the temporary workers were ineligible for certain employer benefits and seniority and were subject to a different attendance policy than the regular employees. Nevertheless, the Board concluded these different terms and conditions of employment were substantially outweighed by the common terms shared by the regular and temporary employees. The temporaries and the regular production workers worked side-by-side, performed the same work, and were supervised by the same supervisors. They worked the same shifts, in the same plant areas, and were part of the same production process. Finally, nearly all their terms and conditions of employment, including job assignments, directions, discipline and wages were ultimately controlled by the employer. On balance, the Board held the temporaries were appropriately included in the same bargaining unit as the regular employees, a result that would have occurred pre-*M.B. Sturgis* only with the consent of the manufacturer and all three temporary agencies. As the contingent workforce continues to grow in the coming years, employers and temporary agencies can be

expected to urge the new Board to reconsider this issue.

III. Employer Withdrawals of Union Recognition

The new Board might also take aim at the Clinton Board's 2001 decision in *Levitz Furniture of the Pacific*, 333 NLRB No. 105 (2001), which abandoned the Board's long-standing position on employer withdrawals of union recognition. Prior to *Levitz*, before making such withdrawals, employers needed to show *either* that the union had actually lost majority support or that the employer at least had "a good-faith doubt, based on objective considerations, of the union's continued majority status." *Id*. at *1, *citing Celanese Corp.*, 95 NLRB 664 (1951). On the same showing of good-faith doubt, an employer was likewise permitted to test its union's majority support by petitioning for an RM election, or polling its employees to ascertain their union sentiments.

In *Levitz*, the Board overruled *Celanese* and held that "an employer may unilaterally withdraw recognition from an incumbent union only where the union has actually lost the support of a majority of the bargaining unit employees." Thus, employers may no longer assert a good-faith doubt as to a union's continuing majority status as a basis for withdrawing recognition. Rather, under the new standard, "an employer can defeat a post-withdrawal refusal to bargain allegation [only] if it shows, as a defense, the union's actual loss of majority status." *Levitz*, 333 NLRB No. 105 at *2. In other words, "an employer with objective evidence that the union has lost majority support — for example, a petition signed by a majority of the employees in the bargaining unit — withdraws recognition at its peril." *Id*. at *11.

Responding to the argument that its new standard puts employers in a bind vis-à-vis their obligations under Section 8(a)(2), the *Levitz* majority explained, "an employer violates Section 8(a)(2) only by continuing to recognize a union that it knows has actually lost majority support, not one whose majority status is merely in doubt." *Id*. at *10. Therefore, even if an employer has evidence of actual loss of majority status, it will not run afoul of Section 8(a)(2) if it "plays it safe" and files an RM petition while continuing to recognize the union, rather than withdrawing recognition "at its peril." To that end, the Board purported to ease the standard under which an employer can petition for an RM election, holding that such is permissible whenever an employer demonstrates "good-faith reasonable uncertainty (rather than disbelief) as to unions' continuing majority status." *Id*. The Board claimed this new standard would enable employers seeking to test a union's majority status to use the Board's procedures, which it believed to be the "most reliable measure of union support," rather than the "more disruptive process of unilateral withdrawal of recognition." *Id.* From an employer's standpoint, however, the delay caused by resorting to the Board's election procedures, particularly when the employer has objective evidence that the union no longer enjoys majority support, is less than appealing.

IV. Employer Private Property Rights and Ability to Exclude Nonemployees

The new Board may also revisit a line of authority highlighted by a recent Clinton Board decision that purports to limit an employer's ability to exclude non-employees from engaging in union activities on its property. In *Lechmere, Inc. v. NLRB*, 502 U.S. 527 (1992), the Supreme Court held that an employer can lawfully exclude non-employees from engaging in union organizing activities on its private property unless the non-employees can make the difficult showing that they have no other means of access to their target audience. The Board has applied the *Lechmere* standard to situations involving non-employees seeking to engage in area standards or consumer boycott activities on an employer's private property. *See Leslie Homes*, 316 NLRB 123 (1995); *Gallaria Joint Venture*, 317 NLRB 1147 (1995).

Despite this authority, employers still may run afoul of the Act by exercising their private property rights in a disparate manner. In *Albertson's, Inc.*, 332 NLRB No. 104 (2000), *enf. denied*, 301 F.3d 441 (6th Cir. 2002), for instance, the employer barred two unions from gaining access to the immediate exterior of its retail grocery stores for purposes of engaging in solicitation and handbilling. One union sought to handbill consumers, asking them not to purchase a product carried by Albertson's that was produced by a company with whom the union was involved in a labor dispute. The other union sought to organize Albertson's employees. The General Counsel established that Albertson's allowed various organizations to have "regular and frequent access to the immediate exterior of its stores to solicit both employees and customers in fund-raising endeavors . . . ." *Id*. at *6. On these facts, the Board held that

Albertson's violated the Act, explaining that since *Lechmere*, it has "consistently found that an employer that denies a union access to its property while regularly allowing other individuals, groups and organizations to use its premises for various activities unlawfully discriminates against union solicitation." *Id.*

As the *Albertson's* decision illustrates, the Board does not alter its disparate treatment analysis based on the identity of the union's target audience, be they employees or consumers. Nor does the Board vary its analysis based on whether the allowed solicitations are charitable, political or otherwise. Several factors could lead the Board to reconsider these policies in the coming term. First, the Board's General Counsel has anticipated that employers, charitable organizations and the general public will exhibit a heightened sensitivity to this issue following the terrorist attacks on September 11, 2001, and the ensuing increase in nationwide fundraising activities by charitable organizations. On September 28, 2001, the General Counsel issued a Guidance Memorandum confirming that "an employer may lawfully permit a small number of isolated beneficent acts as exceptions to a valid no-solicitation/no-distribution rule" and explained that "in determining whether certain beneficent acts fall within this exception, the Board evaluates the 'quantum of . . . incidents' involved." *See* Gen. Couns. Memorandum GC 01-06. This Guidance Memorandum may suggest an expansion, albeit slight, of the "small number" of exceptions that at least the General Counsel's office may allow before finding discrimination.

Beyond the General Counsel's clarification, former Republican Board Member Hurtgen, who dissented in *Albertson's*, has called for the Board's precedent in this area to be reworked. As Member Hurtgen explained in his dissenting opinion, the "line" that Albertson's had drawn with respect to allowable solicitations on its property separated well known charitable groups on the one side from political, commercial and unknown charitable groups on the other. As this was not an "anti-union" line, Member Hurtgen would have concluded that it was lawful.

Several circuit courts have agreed with Member Hurtgen's analysis. For instance, in *Be-Lo Stores v. NLRB*, 126 F.3d 268 (4th Cir. 1997), the employer obtained state court injunctions to remove nonemployee union picketers from sidewalks and parking lots outside its stores. The Board noted that the employer had previously granted access to Muslims selling oils on a "pretty constant" basis outside some Be-Lo stores, an "occasional" Jehovah's Witness distributing magazines outside another, cookbook sales inside another, and Girl Scout cookie sales inside yet another. Accordingly, the Board concluded the employer violated the Act by discriminating against the union. The Fourth Circuit disagreed, stating:

> we seriously doubt, as do our colleagues in other circuits, that the [disparate treatment exception] applies to nonemployees who do not propose to engage in organizational activities. . . . If it does, we further doubt that an employer's approval of limited charitable or civic distribution while excluding union distribution constitutes discrimination.
>
> *Id.* at 284.

The Sixth Circuit went one step further in *Cleveland Real Estate Partners v. NLRB*, 95 F.3d 457 (6th Cir. 1996), holding "discriminat[ing] in the enforcement of a no-solicitation policy cannot mean that an employer commits an unfair labor practice if it allows the Girl Scouts to sell cookies, but is shielded from the effect of the Act if it prohibits them from doing so. . . . [W]e hold that the term 'discrimination' [in this context] means favoring one union over another, or allowing employer-related information while barring similar union-related information." *Id.* at 465. Following its opinion in *Cleveland Real Estate Partners*, the Sixth Circuit denied enforcement to the Board's decision in *Albertson's. Albertson's, Inc. v. NLRB*, 305 F.3d at 455.

In addition to former Member Hurtgen and the courts, the Board's discrimination analysis has received attention from members of Congress. In May 2001, Senator Tim Hutchinson (R-AR) introduced the Preserve Charitable Giving Act to amend the NLRA to allow employers to permit charitable solicitations without risk that doing so would undermine the validity of their no-solicitation policies as applied to unions. Senator Hutchinson's bill was referred to the Senate Committee on Health, Education, Labor and Pensions. 147 Cong. Rec. § 5438. A corresponding bill has been introduced in the House of Representatives by Representative William Asa Hutchinson (R-AR).

V. Employer Lawsuits Based on Union Activities That are Believed to be Unlawful

Beyond these recent NLRB decisions, the new Board can be expected to deal with issues left open by the Supreme Court's decision last year in *BE&K Constr. Co. v. NLRB*, 536

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U.S. 516 (2002). *BE&K* involved a steel mill's lawsuit against several unions based on the unions' allegedly unlawful activities in conjunction with a corporate campaign against the mill. Among other things, the mill claimed the unions violated various federal and state laws by lobbying for irrelevant environmental controls on the mill, engaging in unlawful handbilling and secondary strike and picketing activities, and initiating litigation against the mill in bad faith. Ultimately, the mill lost or withdrew all of its claims. In the meantime, two of the unions filed unfair labor practice charges with the Board, claiming the mill's lawsuit was unlawful retaliation for their members' protected concerted activities. Under the guise of the Supreme Court's decision in *Bill Johnson's Restaurants, Inc. v. NLRB*, 461 U.S. 731 (1983), the Board upheld the unions' charges. The Board concluded that the mill's lawsuit was unmeritorious because its claims were dismissed or withdrawn, and was retaliatory because the mill admitted it was aimed at stopping union activity the mill believed to be unprotected. As a remedy, the Board ordered the mill to cease and desist from prosecuting such litigation, to post a notice acknowledging its violation, and to pay the unions' legal fees and expenses in defending against the lawsuit. Also relying on *Bill Johnson's*, 461 U.S. 731, the Sixth Circuit enforced the Board's decision. 246 F.3d 619 (6th Cir. 2001). A divided Supreme Court reversed.

The Court majority held that the Board's view -- that a lawsuit is unlawfully retaliatory if it was brought with "ill will" or "a motive to interfere with the exercise of Section 7 rights" -- is overbroad because it would cover a lawsuit filed by an employer to stop union conduct that the employer reasonably (but wrongly) believed to be illegal. Relying on its decision in *Professional Real Estate Investors, Inc. v. Columbia Pictures Indus., Inc.*, 508 U.S. 49 (1993), the Court instructed that "[a]s long as a plaintiff's *purpose* is to stop conduct he reasonably believes is illegal, petitioning is genuine both objectively and subjectively." *Id*., slip op. at 16 (emphasis in original). What the Court did not decide, and thus, what the new Board may be expected to determine in future decisions, is whether an employer violates the Act by pursuing "unsuccessful but reasonably based suits that would not have been filed but for a motive to impose the costs of the litigation process, regardless of the outcome, in retaliation for NLRA protected activity . . . ." *Id*., slip op. at 19. The Court's opinion also leaves room for further NLRB refinement of the parameters for determining when litigation is "baseless."

VI. Two Last Issues: E-Policies and NLRB Deferral of Information Request Charges

Two final issues that could merit attention from the new Board include employee access to e-mail and the willingness of the Board to defer information request disputes to arbitration. In a series of Advice Memoranda to the NLRB's various Regional Offices, the General Counsel during the Clinton Administration opined that where employees regularly utilize their employer's e-mail system for business purposes, the e-mail system constitutes a "virtual work area." As a result, an employer may not, through the promulgation of a "business-use-only" policy, absolutely prohibit its employees from utilizing the e-mail system (at least during non-working time) for union-related purposes. *See, e.g., Pratt & Whitney*, Case No. 12-CA-18466, Gen. Couns. Adv. Mem. (Feb. 23, 1998); *TU Electric*, Case No. 16-CA-19810, Gen. Couns. Adv. Mem. (Oct. 18, 1999); *American Publishing Co. of Ill.*, Case No. 13-CA-38098, Gen. Couns. Adv. Mem. (Feb. 4, 2000). That said, the General Counsel's office has sanctioned some employer-imposed limitations on non-work-related e-mail use where the limitations are reasonable and narrowly tailored. *See, e.g., TXU Electric*, Case No. 16-CA-20576, Gen. Couns. Adv. Mem. (Feb. 7, 2001).

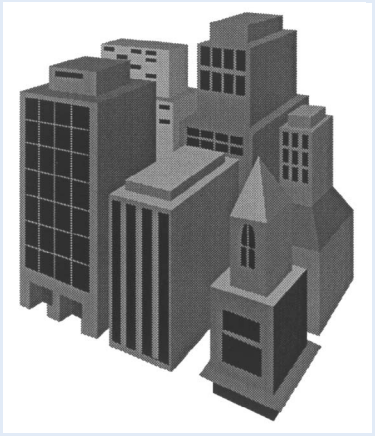
These inquiries -- whether an employer's e-mail system is a virtual work area, and whether the limitations imposed by an employer's e-policy are reasonable -- are fact-intensive, and as a result, have yielded seemingly incongruous results in several unreviewed ALJ decisions. *Compare Guard Publishing Co*., Case No. 36-CA-8743-1 (Feb. 21, 2002) (upholding employer's business-use-only e-policy as a valid limit on the use of its communications equipment, but finding violation based on employer's discriminatory enforcement against union-related communications), *with Rockaway Bedding*, Case No. 4-CA-30386-2 (Mar. 6, 2002) (striking down similar business-use-only e-policy as facially overbroad). As with contingent workers, the ever-increasing use of e-mail in the workplace will undoubtedly create many opportunities for the Board to weigh in on this topic.

With regard to deferral, the Board's General Counsel recently announced his intention to argue in two pending cases that the Board should reconsider its policy of refusing to defer to arbitration

unfair labor practice charges that are based on alleged refusals to provide information. *See* Report of the General Counsel for the period June 2001 to August 2002, available at www.nlrb.gov/press/r2464.html. According to the General Counsel, "arbitration can often provide a more efficient and economical approach to refusal to furnish information disputes in established collective-bargaining relationships." Given that employers are usually on the receiving end of information requests, the outcomes in these cases are worthy of interest.

Following a year in which the NLRB was comprised largely of recess appointees, and for several months, only one active member, the new Board faces a large backlog of cases. *See Four New Labor Board Members Sworn in, Creating Full Complement After Long Delay*, DAILY LAB. REP. (BNA), No. 243 at AA-1 (Dec. 18, 2002). Current Chairman Robert Battista, a former management-side labor lawyer from Detroit, has announced his intention to reduce the backlog by "shorten[ing] the time required to reach a decision in each case." *Id*. As the new Board goes about this task, employers and industry groups hope to see many of the Clinton Board's more pro-labor decisions treated like a fifth-string quarterback and "put on waivers."

PROPERTY INSURANCE PROGRAM TACKLES THE COVERED CLAIM



March 2003, in New Orleans, the Property Insurance Law Committee will present a timely and informative program on one of the hottest issues in property insurance today – the measurement and payment of the admittedly covered claim. As the high profile lawsuits arising out of September 11th illustrate, the fact that the insurer and policyholder agree a first party loss is covered does not mean there are no coverage issues or potential disputes. The Property Insurance Law Committee's Mid-Year program is entitled "Property Insurance in the New Millennium: Measuring and Paying the Covered Claim." This program will take place March 13-15, 2003, at the Ritz Carlton Hotel, New Orleans, Louisiana. Nationally prominent property insurance attorneys will discuss the cutting edge developments in loss valuation, including actual cash value and replacement cost issues, diminished value as a measure of loss, valued policy laws, business interruption and extra expense, soft costs and claim preparation expenses, sue and labor, additional insureds, mortgagees and loss payees, claims involving tenants, the appraisal clause, bad faith claims resulting from payment disputes, and inter-insurer disputes. A panel of senior insurance company in-house claims counsel will also discuss the resolution of these disputes and their expectations regarding outside counsel.

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CASE LAW UPDATE: INEVITABLE DISCLOSURE and EMPLOYEE CHOICE DOCTRINES

By Thomas E. Deer[1]

In the past few months, the inevitable disclosure doctrine has been rejected by at least two prominent courts, one on each coast. In contrast, the "employee choice" doctrine has fared better, at least in two well-publicized cases.

In *Whyte v. Schlage Lock Company*, 101 Cal.App. 4th 1443, 125 Cal. Rptr.2d 277 (4th Dist. 2002), a California appellate court flatly rejected the inevitable disclosure doctrine as a theory of recovery. As forcefully stated by the court, "Lest there be any doubt about our holding, our rejection of the inevitable disclosure doctrine is complete." The court reasoned, "The chief ill in the covenant not to compete imposed by the inevitable disclosure doctrine is its after-the-fact nature: The covenant is imposed *after* the employment contract is made and therefore alters the employment relationship without the employee's consent." 101 Cal. App. 4th at 1462-63 (emphasis in original).

Although not quite as stinging, a New York appellate court rejected the application of the inevitable disclosure doctrine in *Marietta Corp. v. Fairhurst,* 2002 WL 31898398 (N.Y.A.D. 3 Dept. 2003). In the case, Marietta sued Fairhurst, its former senior vice president of sales and marketing, after he left and joined a competitor. Fairhurst had signed a confidentiality agreement with Marietta, and Marietta claimed he would inevitably breach it. Reversing a preliminary injunction, the appellate court rejected the claim. The court found that the inevitable disclosure doctrine is "disfavored" absent evidence of actual misappropriation, and that an employer should not be allowed to make an "end-run" around a confidentiality agreement by claiming the inevitable disclosure doctrine provided an independent basis for relief. The appellate court held that, upon the evidence presented, the injunction should be reversed, as there was no demonstrated showing of irreparable harm.

Employers have fared better with regard to the doctrine of "employee choice" in at least two recent cases. First, in *Tatom v. Ameritech Corp*., 305 F.3d 737 (7th Cir. 2002), the Court of Appeals for the Seventh Circuit ruled that an employer was within its rights to withhold incentive pay and cancel stock options that were contingent on the employee's refraining to work for a competitor. The court held the pertinent provisions did not constitute a "restraint on competition," and that the employer was correct in deeming Tatom's new employer a "competitor" for purposes of the pay awards. Second, in *Lucente v. International Business Machines Corp.*, 310 F.3d 243 (2nd Cir. 2002), the appellate court reversed summary judgment and an award of over 6 million dollars for the employee. In short, the court held that the former employee's restricted stock award could be subject to forfeiture under the non-compete restrictions in the company's incentive compensation plan.

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April		
8	Posttraumatic Stress Disorder in Personal Injury and Insurance Defense Cases	Teleconferece
12-16	TIPS National Trial Academy	Reno, NV
17-18	Transportation MegaConference VI	New Orleans, LA
May		
1-4	TIPS Spring Meeting	Austin, TX
7-10	FSLC Spring Meeting	Chicago, IL
13-14	Staff Counsel Meeting	New York, NY
August		
7-13	ABA Annual Meeting	San Francisco, CA
October		
TBA	Aviation Litigation Meeting	Washington, DC