

## employment & employee benefits developments focus on recent decisions — summer 2006



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### Supreme Court Broadens Title VII Retaliation Protections

The U.S. Supreme Court has broadened the standard for determining whether employer actions constitute retaliation under Title VII of the Civil Rights Act of 1964. The Court held that anti-retaliation provisions pertain to any employer action that is “materially adverse to a reasonable employee” — including those that occur outside the workplace or are unrelated to employment conditions. The Court’s June decision in *Burlington No. & Santa Fe Ry. Co. v. White* reconciled a split in the circuit courts over the appropriate standard.

The case involved Sheila White, a forklift operator for Burlington Northern & Santa Fe Railway Co. In September 1997, White complained to Burlington management that her immediate supervisor sexually harassed her when he stated that women were unfit to work in Burlington’s Maintenance and Ways Department. Thereafter, Burlington suspended White’s supervisor for ten days and ordered him to attend sexual harassment training. At the same time, management demoted White from the forklift operator position and returned her to the track laborer position she had held earlier.

White filed a complaint with the Equal Employment Opportunity Commission (“EEOC”) claiming that her demotion resulted from gender discrimination and that it was in retaliation for her discrimination complaint to Burlington management. Several days later, Burlington suspended White without pay after a superior reported her for insubordination following a supposed argument over logistical matters. Ultimately clearing her of any misconduct, Burlington reinstated White with back pay, and White consequently reported the incident to the EEOC.

White filed a Title VII suit in federal district court, and the case was tried before a jury. The jury concluded that Burlington retaliated against White when it demoted her to her former track laborer position and then suspended her without pay. On appeal, the Sixth Circuit Court of Appeals *en banc* affirmed the jury’s \$43,500 compensatory damages award based on a strict construction of the Title VII anti-retaliation provision. The Sixth Circuit stated that, to prove retaliation under Title VII, the plaintiff must show that the defendant took an “adverse employment action” against him or her, which the court defined as a “materially adverse change in the terms and conditions of employment.”

The Supreme Court upheld the judgment in White’s favor but disagreed with the Sixth Circuit’s definition of actionable retaliatory acts. The Court held that the two main provisions of Title VII, the discrimination clause and the anti-retaliation clause, are not coterminous. While the discrimination clause prohibits discriminatory behavior solely in the

workplace and in conditions of employment (such as termination, hiring, and demotion), the anti-retaliation clause contains no such limitation. The Court explained that any limitation on the language of the anti-retaliation clause would inhibit employees from reporting discriminatory employer behavior, undermining the very purpose of the clause.

The Supreme Court also formulated a “reasonable employee” standard to determine actionable retaliatory behavior. Accordingly, employer retaliation is actionable if it would cause a reasonable employee material adversity sufficient to discourage him or her “from making or supporting a charge of discrimination.” Actionable retaliatory acts need not occur in the workplace and need not be discriminatory in and of themselves. This broader approach is also a marked shift from the Second Circuit’s standard, which governed Title VII cases in New York

federal courts. Like the Sixth Circuit, the Second Circuit had held that to be actionable the employer must take “adverse employment action against the employee.” As a result of the Supreme Court’s decision, it will be easier to plead and prove employee retaliation claims in New York federal courts.

Although the Supreme Court’s decision in *Burlington* definitively loosened the requirements for a Title VII retaliation claim, the Court did not provide trial courts with free rein to send every dispute to a jury. Indeed, the Court emphasized throughout its opinion that “context matters,” and the reasonable employee standard will still allow some cases to be dismissed on summary judgment. Nevertheless, employers should be especially vigilant about taking adverse action against employees who have complained of discrimination. •

## Supreme Court Clarifies Subrogation Rights for Health Plans

A health insurance plan can recover medical expenses it has paid on behalf of a plan beneficiary injured in an accident who subsequently receives monetary damages from third parties, the U.S. Supreme Court has ruled. In *Sereboff v. Mid Atlantic Medical Services, Inc.*, the Court issued a decision that gives new life to the enforceability of health plan subrogation provisions.

Until *Sereboff*, the enforceability of such provisions was in serious doubt. A subrogation provision (also known as an “Acts of Third Parties” provision) generally provides that when a plan beneficiary is injured as a result of a third party’s acts or omissions, the plan will provide coverage in connection with the injury, but requires the beneficiary to reimburse the plan from any recovery he or she receives from the third party. The Supreme Court refused to enforce a subrogation provision in *Great-West Life & Annuity Insurance Co. v. Knudson* and thus opened the question whether any subrogation provision would be enforceable under ERISA.

In both *Sereboff* and *Knudson*, the Court’s consideration of subrogation provisions involved an examination of whether the plans’ efforts to enforce the provisions were equitable. In each case, the health plan sought to recover monies associated with benefits provided to beneficiaries who were injured by third parties, if the beneficiaries recovered damages from the third parties. Both plans sought recovery from the beneficiaries under ERISA Section 502(a)(3), which allows a plan fiduciary to obtain equitable relief to enforce the terms of a plan. Thus, in order for a plan to recover under ERISA Section 502(a)(3), a plan must seek a remedy which had been available in traditional courts of equity. In *Knudson*, although the plan beneficiary had recovered damages from the third party for her injury, this recovery was allocated to a special needs trust under California law. If the health plan were to recover for the monies it had expended for the care of the plan beneficiary, she would have to have repaid the health plan from her general assets. Based on this fact, the *Knudson* Court ruled that the claim for recovery would essentially be a claim of personal liability for a contractual obligation to pay money and thus would not be considered equitable. In contrast, when the *Sereboff* beneficiaries recovered from the third parties who caused their injuries, the monies were placed in an investment account to be preserved until the dispute between the Sereboffs and the health plan was resolved. Recognizing that a constructive trust was a remedy available in equity, the Court found that, in this instance, a constructive trust had arisen and could be enforced because there were specifically identifiable funds that were in the possession of the plan beneficiaries.

The key to the *Sereboff* Court’s allowing the health plan to recover under its subrogation provision was twofold. First, as discussed above, the monies the plan beneficiaries recovered were identifiable and in their possession and control. Second, the *Sereboff* Court found that the subrogation provision had imposed a constructive trust upon the beneficiaries’ recovery, *even before the beneficiaries had actually recovered their damages from*

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the third parties. Specifically, the Court recognized that the health plan's subrogation provision specifically identified a particular fund, as opposed to a beneficiary's general assets, upon which the plan would place a constructive trust (i.e., all recoveries from a third party) and the share of the constructive trust to which the plan would be entitled (i.e., that portion of the recovery which is due the health plan for coverage provided to the beneficiaries in connection with the injury).

Under the Court's reasoning, the *Sereboff* decision will allow a plan to recover subrogation monies and recoup other overpayments or erroneous payments, provided the payments can be specifically identified and traced to the beneficiary's possession (and are not mixed in the beneficiary's general assets).

In light of this decision, we recommend plans take the following actions:

- Plans which had eliminated subrogation provisions in response to *Knudson* or which never had subrogation provisions should amend their plans to allow for recovery of benefits paid to beneficiaries injured by third parties, when the beneficiaries recover damages from the third parties;
- Plan subrogation provisions should be revised to provide that any beneficiary's recovery from a third party will be held in trust for repayment of benefits to the plan; and
- Plans should intervene in pending plan beneficiary tort actions and file injunctive actions under ERISA Section 502(a)(3) to preserve the plan's rights of recovery once a plan beneficiary recovers from a third party for third party injuries. •

## Second Circuit Raises Standard for Workers Claiming Disparate Impact Under the ADEA

Laid-off workers claiming disparate impact under the Age Discrimination in Employment Act ("ADEA") must now meet a higher standard, following the U.S. Court of Appeals for the Second Circuit's recent decision in *Meacham v. Knolls Atomic Power Laboratory*. Reversing an earlier age discrimination decision, the court held that laid-off workers claiming disparate impact must establish that the decision to terminate them was unreasonable.

The plaintiffs in *Meacham* were laid off by Knolls Atomic Power Laboratory in an involuntary reduction in force ("IRIF"). They sued the Laboratory and other defendants under the ADEA and the New York Human Rights Law. A jury awarded the plaintiffs a multi-million dollar judgment under a disparate impact theory. On appeal by the defendants, the Second Circuit affirmed the judgment, holding that (i) the plaintiffs had established a prima facie case of disparate impact under the ADEA based on the subjective decision-making involved in the IRIF, and (ii) "notwithstanding defendants' facially legitimate business justification for the IRIF and its constituent parts, there was sufficient evidence of an equally effective alternative to the subjective components of the IRIF to support liability."

The defendants appealed to the Supreme Court, which vacated the decision and remanded the case to the Second Circuit for reconsideration in light of its decision in *Smith v. City of Jackson*. In *Smith*, the Supreme Court held that an employer will not be liable under the ADEA under a disparate impact theory "so long as the challenged employment action, in relying on specific non-age factors, constitutes a reasonable means to the employer's legitimate goals." The Court further held that the "business necessity" test — which permits plaintiffs in Title VII cases

to rebut an employer's legitimate business justification by establishing "that another practice would achieve the same result at a comparable cost without having a disparate impact on the group" — does not apply in the ADEA context. The Court reasoned that the narrower scope is justified because "age, unlike race or other classifications protected by Title VII, not uncommonly has relevance to an individual's capacity to engage in certain types of employment."

The Second Circuit overturned the jury verdict in a 2-1 decision on August 14, 2006. The court affirmed its previous determination that the Laboratory satisfied its burden of establishing "that a legitimate business justification motivated the challenged component of [the decision to fire the workers]," but concluded that the plaintiffs "failed to carry their burden of demonstrating that the challenged employment practice was unreasonable." In so holding, the Second Circuit determined that the *Smith* decision rendered its previous decision untenable.

Employers often face difficult decisions when the need for an IRIF arises. The *Meacham* decision, however, permits employers to base their termination decisions, at least in part, on reasonable subjective judgments of management, without fear of liability for disparate impact under the ADEA. Nevertheless, employers are reminded that employees claiming disparate impact on *other* discriminatory grounds — i.e., those protected by Title VII, such as race, color, religion, sex or national origin — can still prevail by rebutting the employer's legitimate business justification for the decision. •

# Multiemployer Pension Funds Can Require Participants To Demonstrate Work Performed Was in Covered Employment

A multiemployer pension fund can shift the burden to a plan participant to demonstrate that the participant worked in covered employment and is eligible for benefits under the pension fund, the Second Circuit has ruled in *Wilkins v. Mason Tenders District Council Pension Fund*. The court cautioned, however, that because such a policy could result in participant disqualification, ineligibility, or denial or loss of benefits, a pension fund must disclose this policy in its summary plan description (“SPD”).

## Background

The case involved Abraham Wilkins, a participant in the Mason Tenders District Council Pension Fund (“MTDCPF”). Wilkins received a lump sum benefit based on the pension credits reported to the MTDCPF by his seven employers. However, Wilkins argued that his employers underreported his work in “covered employment” (work for an employer pursuant to a collective bargaining agreement that requires the employer to contribute to the fund in return for the participant accruing a pension benefit in the fund). Therefore, Wilkins claimed he was entitled to additional benefits. Although the MTDCPF had a policy of randomly auditing contributing employers, none of Wilkins’ employers had been audited during the years when the underreporting allegedly occurred, and the MTDCPF had no record of Wilkins’ performance of covered employment for these employers during this period. Wilkins produced Social Security Administration statements of earnings demonstrating that he had worked for these employers during the periods in question, but could not produce evidence, such as pay stubs, to demonstrate that the work performed for these employers constituted work in covered employment. The MTDCPF had adopted a policy pursuant to which participants bore the burden of proving that work for an employer constituted work in covered employment. Because Wilkins could not produce evidence demonstrating that the work constituted covered employment, the MTDCPF refused to include his work performed during the periods in question in calculating his pension benefit. Among other claims, Wilkins brought suit asserting that the MTDCPF breached its fiduciary duties by failing to advise participants that it had shifted to them the burden of maintaining proof of working in covered employment.

## SPD Disclosures to Participants Regarding Burden Shifts

Although the court upheld the MTDCPF’s basic policy of shifting to a participant the burden of demonstrating that work performed for a contributing employer constituted work in covered employment, it ruled that a pension fund does not have unfettered discretion to impose such a policy. Because the Employee Retirement Income Security Act of 1974 (“ERISA”) requires a pension plan

to disclose in its SPD situations which could result in a participant’s disqualification, ineligibility, or denial or loss of benefits, the court ruled that such a policy must be disclosed in the SPD. The SPD need not, however, describe every idiosyncratic contingency that might affect a plan participant’s benefit. The court suggested that the import of the pension fund’s policy should be disclosed in the SPD as well. For example, the court suggested that, in this case, the MTDCPF’s SPD should have explained that participants should maintain records of their work in covered employment.

The court ruled that a pension fund’s failure to make the proper SPD disclosure would not automatically subject the pension fund to liability. Rather, the court held that a participant could only recover if he or she could show that he or she was likely to have been harmed by the SPD’s deficiency. In this case, the court held that Wilkins would have to show that, if the SPD had disclosed the policy, he would have kept and safeguarded his records and that these records would be sufficient to demonstrate that he worked in covered employment. The court remanded the case for a factual determination of whether the plaintiff had in fact been prejudiced by the MTDCPF’s deficient SPD.

## Implications for Multiemployer Pension Funds

The *Wilkins* case is important to multiemployer pension plans because it highlights both the pitfalls that pension funds face in determining whether an individual performed work in covered employment and the steps the fund may take to address these problems. As the court recognized, Social Security Administration earnings reports can be insufficient to demonstrate that work for an employer constitutes work in covered employment: such work could have been performed pursuant to a collective bargaining agreement between the employer and another union, requiring an employer to make contributions on behalf of the employee to another pension plan. (Indeed, the court observed that Wilkins was a member of three unions besides the Mason Tenders District Council during the period in question.) Thus, we recommend that a pension fund consider adopting a policy specifying that participants will bear the burden of demonstrating work performed for an employer constitutes work in covered employment. If a pension fund adopts such a policy, this policy must be disclosed to participants in the fund’s SPD. Finally, we recommend that a pension fund should review its policies, in general, to determine whether it has adopted any other policies which could result in participants’ disqualification, ineligibility, or denial or loss of benefits. If a pension fund has adopted policies with these effects, the pension fund should ensure that the policies are properly disclosed in the SPD. •

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## New York Labor Law: Unvested Stock Options Are Not Considered Wages

Unvested, contingent rights to equity-based compensation should not be considered wages, according to a recent ruling by the Appellate Division, First Department of the New York Supreme Court. In *Guiry v. Goldman, Sachs & Co.*, a 2-1 majority of the appellate panel held that, under New York's payment of wages law (Article 6 of the New York Labor Law), terminated employees do not have a right to receive the value of unvested stock options when those options are contingent on future employment.

Whether certain bonuses should be considered wages has been the subject of litigation in New York courts. New York's payment of wages law prohibits employers from making deductions from an employee's earned wages except in certain circumstances. New York Labor Law §190(1) defines wages as "the earnings of an employee for labor or services rendered, regardless of whether the amount of earnings is determined on a time, piece, commission, or other basis." If a particular payment is considered wages, then employees — including former employees — still have a right to receive that payment.

In 2001, the New York Court of Appeals held in *Truelove v. Northeast Capital & Advisory* that discretionary bonuses that depend on the employer's financial success, rather than the employee's personal productivity, are outside New York Labor Law §190's definition of wages. The payment of such bonuses, even in installments over time, could legally be made contingent on continued employment. Therefore, if an employee were fired or resigned, he or she would not thereafter have a right to the remaining installments of the bonus. The court's decision rested both on the discretionary nature of the bonus and its profit-sharing characteristics. However, the decision discussed only unpaid installments of bonuses — not unvested stock options.

*Guiry v. Goldman Sachs* addressed the issue left open in *Truelove*. Martin Guiry worked as an account executive in the Private Client Services Group at Goldman Sachs from May 1993 until June 2002. After 1999, Guiry's compensation was comprised of monthly commissions and equity-based compensation in the form of unvested, contingent rights to Restricted Stock Units of Goldman Sachs shares and unvested options to purchase Goldman Sachs stock. These rights were contingent on Guiry's continued employment with Goldman Sachs as of the scheduled vesting dates. When Guiry's employment was terminated in 2002, his options had not vested, and Goldman Sachs refused to honor them.

Guiry filed suit, arguing that his right to stock options constituted earned wages, which Goldman Sachs could not withhold under New York law. Goldman Sachs maintained that the equity-based component of Guiry's compensation was merely a discretionary bonus under an incentive compensation scheme, and therefore Guiry had no right to the unvested stock options after termination.

Drawing on *Truelove*, the appellate panel decided that Guiry's unvested stock options did not constitute wages under New York Labor Law §190(1). Rather, unvested stock options are considered incentive compensation because

they "serve the function of giving employees an incentive to stay with the firm and to maximize the value of the firm's business." The court focused closely on the factors that affect the value of the bonus to the employee. The court found that the "hallmark" of incentive compensation is that its "value to the recipient depends on the firm's overall financial success, not simply on the employee's personal productivity."

The court also clarified that whether a bonus should be considered wages does not depend on its discretionary nature. Although the discretionary nature of the bonus played a large part in *Truelove*, the court found that the *value* of the compensation is the factor that is truly dispositive. If the ultimate value of a bonus depends



"at least in part, on the financial success of the business enterprise," it will not constitute wages, whether or not such compensation is discretionary. Thus, because the compensation at issue in *Guiry* depended on the financial success of Goldman Sachs at the time the options vested, the stock options were not wages under New York Labor Law §190(1).

In coming to this conclusion, the court analyzed the purpose of Article 6 of the Labor Law, finding that it was intended to protect wages on which employees and their families depend, not "supplemental income that may prove worthless when ultimately received." Because the value of stock options depends on the financial success of the firm, their ultimate value is not known until they are exercised.

Under *Guiry*, unvested stock options that are contingent on future employment will not be considered wages under the Labor Law. The court's analysis of wages provides guidance for other forms of compensation. If compensation depends, at least in part, on the financial success of the business, it will not be considered wages. •

# employment & employee benefits developments

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