

Message from Our Managing Partner

In this *Update*, Matthew DeIDuca and Maureen Q. Dwyer report on the repercussions of a recent New Jersey Supreme Court ruling that holds that employers, under specific policies, can view most “private” e-mails their employees send using company-owned computers.

We’re also pleased to announce these new enhancements to Pepper services:

- our Independent Contractor Compliance Practice Group, which can advise and assist clients on an interdisciplinary basis, as Congress moves to make employee misclassification a federal labor law violation
- our Italian Desk, part of Pepper’s International Practice Group, to serve as a bridge between Italian and U.S. businesses.

In addition, we note recent and upcoming events and webinars, and highlight an episode of The Deal and Pepper Hamilton’s Legal Roadmap to Success podcast series: “Distressed Debt.”

As always, we welcome your comments, questions and suggestions.

Michael J. Mann, Partner

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NJ Supreme Court: Employers May Reserve Right Via Specific Policies To View Most ‘Private’ Employee E-Mails Sent on Company-Owned Computers

MATTHEW V. DELDUCA | DELDUCAM@PEPPERLAW.COM

MAUREEN Q. DWYER | DWYERM@PEPPERLAW.COM

The New Jersey Supreme Court recently handed down a landmark decision dealing with the vexing question of when an employer has the right to monitor and access personal e-mails and other electronic communications by employees using computers owned by their employers. The court ruled that employers may implement policies prohibiting or limiting personal communications on company computers, and employers may discipline employees for violating those policies. The court also ruled that employers may review the substance of most private e-mail and computer communications, but only if the employer has implemented and communicated a detailed policy that effectively eliminates any reasonable expectation the employee may have that his or her computer communications are private. Finally, the court held that employers are never free to review the substance of certain communications, in particular an employee’s confidential communications with his or her lawyer.

In *Stengart v. Loving Care Agency, Inc., A-16-09, 2010 N.J. LEXIS 241* (Mar. 30, 2010), Marina Stengart used her company-issued laptop to exchange e-mails with her lawyer relating to an employment discrimination lawsuit she was contemplating filing against her employer. Although she used the company-issued laptop,

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Stengart sent these e-mails via her personal Yahoo account, which was protected with a password. After Stengart quit her job and filed a lawsuit against her employer, the company hired an expert in computer forensics to recover all the files stored on Stengart's company laptop. Among the e-mails recovered were Stengart's communications with her lawyer. Stengart's lawyer asserted that the attorney-client privilege applied to these e-mails and demanded their return. Loving Care refused to return them, relying on the company's written policy that any communications made on a company computer belong to the company.

In *Stengart*, the court was faced with two issues: (1) the extent to which employers may access personal e-mails sent by employees on company computers via password-protected accounts, and (2) whether the employer may, via a policy, reserve the right to view communications that would otherwise be protected by the attorney-client privilege. Ultimately, the court found that no matter what the employer's policy provides, an employer may never access the substance of employee communications protected by the attorney-client privilege. This ruling is based on the strong public policy concerns supporting the privilege. An important point for New Jersey employers, however, is that the *Stengart* decision also provides specific guidance to employers and courts on two much broader issues: (1) whether employers may implement and enforce policies governing personal use of company computers, and (2) when employers may access the substance of personal communications on company computers.

The *Stengart* decision clearly provides that employers are free to implement policies that prohibit or limit personal use of company computers. Employers are also free to monitor the extent of employees' personal computer use and to discipline employees whose use violates company policy.

Stengart also provides helpful guidance on the issue of when employers may review the *substance* of an employee's personal e-mails and other computer usage. The court noted that New Jersey, like many states, recognizes a cause of action for intrusion into privacy. Unlike most states, New Jersey's state constitution also gives employees in the private sector a right of privacy in the workplace. Under both legal theories, the employee's right to privacy extends to those areas where the employee has a "reasonable expectation of privacy." As a result, employers have always been well-advised to eliminate any "reasonable expectation of privacy" by adopting policies informing employees that they should not expect communications they make on company computers, servers or networks to be private.

In *Stengart*, the Supreme Court focused extensively on the adequacy of the notice provided by the employer's electronic communications policy. The *Stengart* employer's policy was similar to policies implemented by many New Jersey employers and employers around the country. The employer's policy stated that communications on company computers belong to the company and that such communications are not private. The policy also provided that "occasional personal use" of computers was permitted. Like most employer policies, the company's policy provided no detail about the various ways in which the employer could access personal communications, including password-protected communications. The Supreme Court found that the employer's policy did not provide enough detail about the employer's ability to access communications to remove the employee's reasonable expectation of privacy, particularly when using a password-protected account.

As a result, the *Stengart* case drives home that employers that wish to reserve the right to access the substance of employees' personal computer communications in the workplace must have clear policies that provide employees with details about what communications are prohibited and what communications may be monitored. It is essential to implement and communicate those policies to employees in advance. Unfortunately, very few New Jersey employers have policies that would pass muster under the stringent standard articulated in *Stengart*.

Following the *Stengart* decision, New Jersey employers should review their electronic communications policies. Policies must clearly articulate whether personal use of company computers is permitted, and if so, any limitations on such usage should also be clearly defined. In addition, employers that wish to reserve the right to review the substance of personal employee communications on company computers or servers should implement policies that provide significant detail on the ways that access may occur. Finally, company personnel or outside contractors who are asked to monitor or access an employee's personal e-mails should be trained on the scope of the employer's and the employee's rights relating to those communications.

For any questions regarding electronic communications policies and the right of privacy, please contact the authors.

Pepper Hamilton Announces Formation of Italian Desk as Bridge Between Italian and U.S. Businesses

Continuing its long history of assisting Italian companies and individuals in their business endeavors in the United States, and American companies and individuals investing and conducting business in Italy, Pepper Hamilton LLP has formed its Italian Desk, part of the firm's continued development of its International Practice Group.

The Italian Desk, a multi-disciplinary team of attorneys and professionals, has strong credentials and experience in a variety of practice areas and in many industries, including fashion and retail, manufacturing, food and beverage, pharmaceuticals and life sciences, financial services, technology and energy.

Pepper Hamilton partners Joseph V. Del Raso and Frank J. Cerza, co-chairs of Pepper Hamilton's Italian Practice Group, co-announced the creation of the Italian Desk. "We are very excited about the Italian Desk as a way to provide value to companies in both countries by bringing to bear our legal and business skills, client experience and relationships, and deep understanding of the similarities and differences between the Italian and American cultures," Del Raso said. "This effort is part of Pepper Hamilton's commitment to providing a bridge between Italian business and U.S. opportunities, and vice versa."

Cerza said the members of Pepper Hamilton's Italian Desk are uniquely positioned to serve not only as business lawyers, but also as business advisors. "We certainly have the depth of knowledge of real estate; corporate and securities matters; commercial litigation, arbitration and other forms of dispute resolution; tax; mergers and acquisitions; trade; intellectual property; and regulatory, labor and other matters that Italian companies will encounter as they establish or expand their business in the United States," he added. "In addition, Joe and I also had experience in business, before we were lawyers. So, with the help of a deep Pepper Hamilton bench, the Italian Desk also offers strategic and business planning advice on corporate formation, site selection, distribution, licensing and franchising approaches, tax planning and other areas."

The Italian Desk also advises clients about:

- entry and growth in the U.S. market
- venture capital and private equity

- cross border transactions, such as investments, joint ventures and dispositions of assets or businesses
- facilitating access to private investment funding
- sales of goods and services
- establishment of business operations in Italy
- Foreign Corrupt Practices Act and related compliance and enforcement issues.

Both Del Raso and Cerza pointed out that the benefits the Italian Desk offers to clients are enhanced by the firm's strong relationships with Italian law firms and key commercial and financial institutions as well as federal, state and regional governmental and regulating bodies in the United States and Italy.

Del Raso, a Pepper Hamilton commercial partner, also is president of the National Italian American Foundation and chairman of the board of trustees of The American University of Rome. Cerza, a member of the Board of the Italy-America Chamber of Commerce, Inc. and Honorary Representative of the American Chamber of Commerce in Italy for the State of New York, has lived in Italy and is fluent in Italian.

For more information about Pepper Hamilton's Italian Desk, contact Frank Cerza at 212.808.2741 or cerzaf@pepperlaw.com, or Joseph Del Raso at 215.981.4506 or delrasoj@pepperlaw.com.

Congress Moves to Make Employee Misclassification a Federal Labor Law Violation

In Response, Pepper Creates Independent Contractor Compliance Practice Group

RICHARD J. REIBSTEIN | REIBSTEINR@PEPPERLAW.COM

On April 22, 2010, a long-awaited bill addressing the issue of misclassification of employees as independent contractors was introduced by the House (Rep. Lynn Woolsey, D-CA) and Senate (Sen. Sherrod Brown, D-OH). The bills, H.R. 5107 and S. 3254, are called the Employee Misclassification Prevention Act (EMPA). They would amend the federal Fair Labor Standards Act to impose strict recordkeeping and notice requirements on businesses with respect to workers treated as independent contractors, and expose such businesses to fines from \$1,100 up to \$5,000 per employee for each violation of the law.

The purpose of EMPA is to curtail and penalize the practice of many businesses in the United States of misclassifying employees as independent contractors. This practice has reportedly contributed to the “tax gap” at both the federal and state level, as well as a loss of federal and state labor protections for those workers that, by law, should be classified as employees instead of as independent contractors.

EMPA does not prohibit businesses from continuing to use properly classified independent contractors; it only prohibits companies from misclassifying workers as independent contractors when such workers are really employees.

Nonetheless, all businesses would be affected by EMPA, because it imposes upon every company that uses either employees or independent contractors a recordkeeping and a notice requirement. Any business that fails to provide the required notice would be subject to fines, even if its independent contractors are properly classified.

Briefly, if enacted into law as drafted, EMPA would:

- require every company covered by the law to provide a written notice to all workers who perform labor or services informing them that they have been classified as either an employee or “non-employee,” directing them to a Department of Labor Web site for further information about the rights of employees under the law, and informing them to contact the Department of Labor if they have any questions about whether they have been misclassified

PEPPER HAMILTON ATTORNEYS’ NEW BLOG ADDRESSES INDEPENDENT CONTRACTOR COMPLIANCE

Pepper Hamilton’s Independent Contractor Compliance Practice Group leaders have launched a blog at www.independentcontractorcompliance.com, which includes a comprehensive set of legal resources for companies and lawyers seeking information about independent contractor misclassification, and which will track and comment on developments in the law. Richard Reibstein, Lisa Petkun and Andrew Rudolph have been handling worker classification matters for more than 20 years. As part of Pepper’s interdisciplinary practice in this field of law, they address this issue from the labor, tax and employee benefits law perspectives.

- require companies which are now required to keep records of the hours of work and wages of employees to keep comparable records for “non-employees” providing labor or services to the business
- add a new provision making it a “prohibited act” under federal law to fail to accurately classify a worker as an employee (i.e., to misclassify a worker as a non-employee)
- impose upon businesses a penalty from \$1,100 to \$5,000 per worker for a violation of the notice or recordkeeping requirements or for misclassifying an employee as a non-employee, and
- impose triple damages for willful violations of the minimum wage or overtime laws where the employer has misclassified the affected employee.

In addition, EMPA would direct the Secretary of Labor to:

- establish a misclassification Web site that would enable workers to file complaints online and notify them that employees may have greater rights under state or local laws than under federal law
- amend the Social Security Act to establish penalties for misclassifying employees or for paying unreported wages to employees for unemployment compensation purposes
- authorize the Department of Labor to report misclassification information to the IRS, and
- direct the Department of Labor to conduct “targeted audits” of certain industries “with frequent incidence of misclassifying employees as non-employees.”

The proposed legislation also seeks to pierce the corporate veil of corporations, partnerships, and LLCs owned in whole or part by the worker and used to avoid the issuance of Form 1099s.

EMPA is one of two bills introduced in this legislative term that deal with misclassification of employees. In 2009, the House and Senate introduced the Taxpayer Responsibility, Accountability, and Consistency (TRAC) Act of 2009 (S. 2882 and H.R. 3408). If enacted, the TRAC Act would limit the availability of the so-called “safe harbor” provisions in Section 530 of the Revenue Act of 1978, which has been relied on by many businesses to designate workers as independent contractors for federal employment tax purposes. The TRAC Act also would afford workers the right to petition the IRS for a determination of the worker’s status, and increase penalties of up to \$1 million to \$3 million for intentional disregard by taxpayers filing incorrect Form 1099s. Both houses of Congress are expected to reintroduce TRAC Act bills in 2010 that are similar or identical to those bills introduced in 2009.

The introduction of EMPA is consistent with the national labor policy of the Obama administration. The recently released Budget for Fiscal Year 2011 authorized \$25 million to the Department of Labor to target employee misclassification through the hiring of 90 additional investigators and 10 additional lawyers to pursue “a joint proposal that eliminates incentives in law for employers to misclassify their employees” and “enhances the ability of both agencies to penalize employers who misclassify.”

In anticipation of this proposed legislation on employee misclassification, Pepper has created its Independent Contractor Compliance Practice Group (http://www.pepperlaw.com/PracticeArea_preview.aspx?PracticeAreaKey=72). This practice team focuses on the interrelated legal issues involving independent contractors by using an interdisciplinary approach along with unique proprietary tools and techniques to diagnose and enhance compliance with independent contractor laws.

We also have prepared an article (available online at http://www.pepperlaw.com/publications_article.aspx?ArticleKey=1769) that explains steps employers should take now to minimize the risks posed by the use of independent contractors.

Pepper’s Independent Contractor Compliance Practice Group includes more than 25 employment, tax, and employee benefits attorneys working collectively. We have a dual approach: first, to assist organizations that currently use independent contractors to do so in a permissible manner under applicable employment, tax and employee benefits laws and to minimize exposure to liability from such laws; and second, to defend organizations that are subject to misclassification challenges brought in judicial and administrative proceedings and audits by governmental agencies and private lawyers.

Our team members understand that an audit by an unemployment or workers’ compensation agency of a company’s use of independent contractors may also lead to legal challenges in the tax and employee benefits areas, and vice versa. When asked by clients to enhance their legal compliance with independent contractor laws, we examine the issues and propose compliance measures from all three related legal disciplines – tax, employee benefits, and labor/employment law – using our proprietary tools, including “IC diagnostics” based on continually updated legal research.

More information about Pepper’s Independent Contractor Compliance Practice Group may be obtained by contacting any of the group’s co-chairs: Richard J. Reibstein (employment/labor matters) at 212.808.2722 or reibsteinr@pepperlaw.com; Lisa B. Petkun (tax matters) at 215.981.4385 or petkunl@pepperlaw.com; or Andrew J. Rudolph (employee benefits matters) at 215.981.4749 or rudolpha@pepperlaw.com.

Recent and Upcoming Events

FINANCIAL RESEARCH ASSOCIATES' 11TH ANNUAL TAX PRACTICES FOR PRIVATE EQUITY FUNDS

May 17-18, 2010 | New York, NY

On May 18, Steven D. Bortnick spoke on "Tax Efficient Private Equity Exit Options: LP Secondary Market Sales/Transfers and Public Market Strategies."

NEW JERSEY BANKERS ASSOCIATION'S 2010 COMPLIANCE UNIVERSITY

June 1, 2010 | Monroe Township, NJ

Travis P. Nelson presented a "Federal/State Legislative/Regulatory Update."

INSTITUTE FOR INTERNATIONAL RESEARCH'S 9TH ANNUAL PRIVATE EQUITY TAX & COMPLIANCE PRACTICES

June 23-24, 2010 | The Hyatt Harborside | Boston, MA

Steven D. Bortnick, on "Basics of Private Equity Regulations and Reporting and International Update: Cross Border Issues and Trends."

INDEPENDENT CONTRACTOR COMPLIANCE (ICC) BREAKFAST BRIEFING SERIES

July 22, 2010 | Pepper Hamilton's Princeton Office

7:30 a.m. Registration and Breakfast | 8:00-11:00 a.m. Panel Presentation and Question & Answer Session

Pepper Hamilton's ICC Practice and Marcum LLP are pleased to present a series of Breakfast Briefings highlighting the legal and legislative challenges facing employers that use independent contractors, and focusing on ways businesses can continue to use independent contractors in compliance with applicable labor, tax, and employee benefit laws. To register for this event, visit

www.regonline.com/ICC_Princeton.



The Deal and Pepper Hamilton's Legal Roadmap to Success - Distressed Debt

There are a number of hot-button legal topics interesting to dealmakers at the moment. What key legal issues should you be thinking about in the coming months? Hear thoughtful perspectives in this series of incisive podcasts from The Deal and Pepper Hamilton LLP.

EPISODE 5: PEPPER HAMILTON ON DISTRESSED DEBT

In this 2010 Legal Roadmap to Success podcast sponsored by Pepper Hamilton, partners William R. Wagner and John P. Duke discuss distressed debt with The Deal's Maria Woehr.

Listen today by visiting <http://www.thedeal.com/knowledge/legal-roadmap-to-success/pepper-hamiltons-wagner-and-duke-on-distressed-debt.php>.

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