



PRIVACY & SECURITY LAW



REPORT

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Incipient Legislative Trend Toward ‘Credit Privacy’ Compels Restraint in the Use of Credit Checks for Employment Purposes



BY PHILIP L. GORDON

Introduction

The collision of two tectonic trends is spawning a new form of employee privacy right with potentially significant implications for every business that handles personally identifiable information (PII). On the one hand, privacy and human resources professionals, seeking to implement legislative and regulatory directives to safeguard PII and otherwise mitigate risk,

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are subjecting their organizations’ own employees and the employees of vendors who access PII to increasingly rigorous background checks. By way of illustration, one recent study reported that 70 percent of respondents conducted background checks on more than 80 percent of new hires,¹ and another recent study found that 60 percent of respondents conducted credit checks on at least some job candidates.² On the other hand, the Foreclosure Crisis and the Great Recession have left millions of Americans—many of whom are desperately searching for employment—with a materially damaged, if not destroyed, credit history.

State legislators around the nation appear to be hearing from constituents who believe that their wrecked credit—revealed, directly or indirectly, through infor-

¹ Employee ScreenIQ, “Trends in Employment Background Screening 2010 Results” at 1 (June 22, 2010).

² Society For Human Resource Management, “Background Checking: Conducting Credit Background Checks” (Jan. 22, 2010).

mation contained in background check reports—has caused them to have their employment application rejected or to lose their job. On July 1, 2010, Oregon joined Hawaii and Washington as the third state in less than two years to impose tough restrictions on conducting credit checks for employment purposes (9 PVL R 954, 6/28/10). Notably, this legislative ferment is not a quirk of the Pacific Northwest. Bills containing similar restrictions have recently been proposed in the following one dozen states: Connecticut, Illinois, Maryland, Michigan, Missouri, New Jersey, New York, Ohio, Oklahoma, South Carolina, Vermont, and Wisconsin.

On the federal level, Sen. Diane Feinstein (D-Calif.) unsuccessfully attempted to insert restrictions on credit checks by employers into the financial reform bill. House and Senate conferees have approved a conference report on the bill that was subsequently cleared by the House June 30 and is awaiting Senate consideration. In 2009, a bill (H.R. 3149) was introduced in the House of Representatives to amend the Fair Credit Reporting Act to restrict the use of credit checks for employment purposes (8 PVL R 1153, 8/3/09).

Given that the impact of the economic downturn on creditworthiness likely will continue for many years to come, it is highly likely that many bills eventually will be enacted into law and that other states and perhaps the federal government will follow suit.

Until this incipient legislative trend comes to fruition, the degree to which an organization should rely on credit history for employment decisions and to vet vendors' employees will be a business decision. Consequently, before delving into the details of the new laws and proposed bills, we will briefly examine the following question: Do millions of Americans, having lost their homes, their credit cards, or both, now have a heightened proclivity to engage in dishonest, unethical, or even criminal conduct? Put another way, how can organizations smartly use credit history in light of the country's recent economic turmoil?

Examining the Posited Link Between Credit History and Trustworthiness

Our research has found only two published studies, both relatively dated, which seek to draw an empirical connection between financial difficulties and work-related problems. Both studies reach the unsurprising conclusion that certain financial problems could lead to decreased productivity or dishonest conduct, but, both studies at the same time concede that such occurrences are the exception rather than the rule.

A 1991 report by the Defense Personnel Security Research and Education Center ("Report") identifies a link between financial irresponsibility and certain compulsive behaviors — e.g., drug or alcohol abuse, compulsive gambling, compulsive shopping — that could have an adverse impact on performance and even lead to criminal conduct. The Report, however, does not identify specific profiles of, or parameters for, financial irresponsibility that make the link with adverse conduct more or less likely. Instead, the Report emphasizes the importance of significant investigation before drawing from any particular piece of negative financial information an adverse inference about the subject's propensity for misconduct:

Experience suggests that financial difficulties may increase temptation to commit illegal or unethical

actions. *One must remember, however, that many such acts are committed out of simple greed, not need, and that the great majority of those with financial difficulties are not inclined to commit illegal acts at all.* When investigating and adjudicating financial issues, it is important to look beyond the obvious facts of an individual's financial obligations. *Investigators need to examine the causes of financial problems and how the individual has reacted to these problems.*³

The second report, from 1996, lists thirty-five "poor financial behaviors" (see Appendix A) which could result in heightened stress and have an adverse impact on an employee's productivity. At the same time, however, this report emphasizes that most individuals who experience one or more of these "poor financial behaviors" do not suffer an adverse effect on their work:

It is crucial for individuals, families, and employers to understand that most people go through their lives effectively "handling" all the stressors of modern life, occasionally exhibiting poor financial behaviors. Most families struggle with change, adapt, and utilize creative techniques to manage the demands of life.⁴

This study also points out that poor financial behaviors resulting in productivity-lowering stress typically are combined with other personal issues, such as marital problems, drug or alcohol abuse, or significant personal or family health issues. Interestingly, neither report attempts to examine the potentially motivational effects of financial difficulties, i.e., that individuals with an apparently adverse credit profile might be willing to work harder and longer hours so that they can earn salary increases, bonuses, and/or overtime to relieve financial strains.

In sum, these reports suggest, at best, that credit information should be used, if at all, in employment decision making only (a) in combination with other information which suggests that an applicant's or employee's financial difficulties may be a manifestation or cause of other significant stressors; (b) only where the applicant or employee will hold a position that could be exploited for personal financial gain, and even then (c) only with substantial caution.

In addition to the difficulties of gauging the predictive value of credit history with respect to any one candidate, using credit information to make employment decisions also raises the challenge of consistent treatment across a group of job applicants or candidates for promotion. More to the point, given the wide range of potentially adverse credit information, an organization could face difficulty explaining why one applicant's credit history justified rejection while another applicant's credit history did not, raising the risk of a failure-to-hire claim. For example, a policy that establishes a loan default as a disqualifying or negative factor might be difficult to justify if the rejected applicant defaulted on a relatively small loan while the accepted applicant is precariously in debt for a much larger sum.

In light of the points discussed above, organizations should consider several factors in evaluating whether to

³ Report at 30 (emphasis supplied).

⁴ T. Garman, I. Leech, J. Grable, "The Negative Impact of Employee Poor Personal Financial Behaviors on Employers," *Financial Counseling and Planning*, Vol. 7, at 160 (1996).

use credit checks for employment purposes. Those factors include the following: (a) an assessment of the predictive value of credit history; (b) the applicant's or employee's job responsibilities; (c) the organization's potential exposure under laws restricting the use of credit checks (discussed below) and for failure-to-hire and other discrimination claims; (d) the risk of disqualifying individuals capable of superior performance; and (e) the administrative burden, if any, on the organization of evaluating credit history and, where appropriate, obtaining additional information from or about the candidate to put the credit history into fuller context.

The Existing and Pending Restrictions on Credit Checks for Employment Purposes

None of the enacted or proposed legislation in this area imposes an outright ban on the use of credit history for employment purposes. Instead, these laws and bills substantially circumscribe the use of credit history to situations where legislators, at least implicitly, have determined that credit history has sufficient relevance to employment decision-making. Unfortunately, these laws and bills generally provide only limited guidance in identifying appropriate subjects for a credit check.

Washington's law, the first of the three to be enacted, generally bars employers from obtaining any information from a consumer reporting agency (*i.e.*, a background check or employment screening company) concerning an applicant's or employee's credit history. The law permits procurement of credit history only if the information is "substantially job-related" or "required by law." In addition, the employer must provide the individual with prior, written notice of "the employer's reasons for use of such information." An employer can satisfy the notice requirement with respect to current employees through a statement in its employee handbook.⁵ The law does not define the circumstances in which credit history would be "substantially job-related".

Hawaii generally prohibits any form of discrimination based upon credit history.⁶ Hawaii permits an employer to inquire into, and consider, credit history after making a conditional job offer, but only if "the credit history or credit report is directly related to a bona fide occupational qualification."⁷ The general prohibition on "credit discrimination" also does not apply when the employer is permitted or required by law to inquire into credit history, or to "managerial or supervisory employees."⁸ These terms encompass (a) "individuals who formulate and effectuate management policies by expressing and making operative" the employer's decisions, and (b) individuals who are authorized to exercise independent judgment in making employment-related decisions.⁹

Oregon's law—which, as noted above, went into effect on July 1, 2010—generally prohibits an employer from obtaining or using credit history for employment decisions.¹⁰ The prohibition does not apply to federally insured banks or credit unions, employers who are required by law to use credit history for employment pur-

poses, or to the employment of certain law enforcement officers.¹¹ Like Washington's law, Oregon's law also permits an employer to obtain and use credit history if the information would be "substantially job-related" and the employer provides prior, written notice of its "reasons for the use of such information." Oregon's law, like Washington's, does not define the term "substantially job-related".¹²

However, Oregon's Bureau of Labor and Industries recently promulgated regulations that define "substantially job-related" in two different ways. Credit history meets that standard if (a) an essential function of the position sought requires access to financial information other than information related to the exchange of cash, a check, or a credit or debit card number in a retail transaction; or (b) the position sought is one for which the employer is required to obtain credit history as a condition of obtaining insurance or a surety or fidelity bond.¹³

Like the Hawaii, Oregon and Washington laws, all of the proposed bills generally prohibit inquiries into credit history for employment purposes with an exception for situations where credit history bears a substantial relationship to the job in question. Also like those laws, most of the proposed legislation provides virtually no guidance on the types of circumstances that would satisfy the "substantially job-related" standard.

The three bills that provide some guidance parallel, and expand upon, the specific exceptions in the Hawaii law and the Oregon law and regulations. Illinois' bill permits credit checks on employees with signatory power over business assets exceeding \$100 per transaction or custody of, or unsupervised access to, cash or marketable assets worth more than \$1,000.¹⁴ The bills proposed in Connecticut and Vermont provide that a credit check is "substantially related" to a position that involves (a) "setting the direction or control of the business"; (b) "access to consumers', employees', or employer's personal information other than information customarily provided in a retail transaction"; or (c) a fiduciary responsibility to the employer, including, but not limited to, the authority to issue payments, transfer money or enter into contracts."¹⁵

These laws and bills suggest that if the incipient legislative trend towards "credit privacy" continues, the laws themselves, or the regulations and judicial decisions construing those laws, likely will permit employers to check credit history for the following categories of positions:

- ▶ Executives and management personnel with the authority to exercise significant discretion over a business or its assets;
- ▶ Employees with significant fiduciary responsibilities for a business' assets; and
- ▶ Employees authorized to access personally identifiable information that could be used to commit identity fraud (*e.g.*, Social Security number, driver's license number and/or financial account number with required security or access code) other than PII routinely exchanged in a retail transaction.

⁵ Rev. Code Wash. § 19.182.020(2).

⁶ See Haw. Rev. Sta. § 378-2(8).

⁷ *Id.* § 378-2.7(a)(1).

⁸ *Id.* § 378-2.7(a)(2)-(4).

⁹ *Id.* § 378-2.7(b).

¹⁰ Or. S.B. 1045 § 2 (eff. July 1, 2010).

¹¹ *Id.* § 2(a)-(c).

¹² *Id.* § 2(d).

¹³ Or. Admin. R. § 839-005-0080(2).

¹⁴ Ill. HB4658, § 10(b)(2), (3).

¹⁵ Ct. Raised Bill No. 5061, § 1(a); Vt. H. 522, § 1.

As a caveat, no case law to date has construed the Hawaii, Oregon, or Washington laws and all of the bills discussed above are subject to change. In addition, some states, like New Jersey, have proposed bills that appear to be more restrictive than the laws and bills discussed above.¹⁶ Consequently, were an organization currently to conduct credit checks on applicants or employees falling within the categories listed above, it would be prudent for the organization to survey continuously the legal landscape in this area for new statutes, regulations and case law that might permit only more limited use of credit history in employment decisions.

An Employer's Potential Exposure for Monetary Damages or Civil Penalties

The Hawaii, Oregon, and Washington laws each confer a private right of action on aggrieved individuals, but the remedies in Hawaii and Oregon are relatively limited.

Violation of the Washington statute is an unfair and deceptive trade practice. A plaintiff may recover her actual damages and a monetary penalty of \$1,000 in cases involving willful conduct, as well as reasonable attorneys' fees and costs.¹⁷

The permissible remedies under the Oregon and Hawaii laws are the same. While individuals are authorized to bring a private action for alleged violations, their remedies are limited to equitable relief, including hiring or reinstatement, up to two years of back pay and an award of attorneys fees and costs.¹⁸ There is no administrative exhaustion requirement.

Steps Employers Should Take to Comply With Applicable Law When Conducting Credit Checks

The Hawaii, Oregon, and Washington laws discussed above supplement existing federal laws regulating the use for employment purposes of credit checks and of information about bankruptcies. This section addresses these state and federal laws in turn.

From a substantive perspective, employers who are not required by law to check credit history for employment purposes should substantially restrict the categories of employees on whom they obtain credit information. The most conservative approach would limit credit checks in Oregon to employees falling within the categories delineated by the recently promulgated regulations; in Washington, to the same categories given the identical language of the Oregon and Washington laws; and in Hawaii, to managerial and supervisory employees as defined above. Employers in Hawaii and Washington willing to assume more risk could rely on the somewhat broader interpretation of the "substantially job-related" standard suggested above.

From a procedural perspective, an employer should conduct credit checks on Hawaiian job applicants only after making a conditional offer of employment. For job applicants in Oregon and Washington, employers should insert into their background check disclosure and authorization form or employment application and the employee handbook language similar to the follow-

ing: "Company will obtain information concerning your creditworthiness, credit standing, or credit capacity to assist in its evaluation of your suitability for employment only if (a) an essential function of the position which you seek involves access to financial information other than information related to the exchange of cash, a check or credit or debit card number in a retail transaction, or (b) the position which you seek is one for which Company is required to obtain credit history as a condition of obtaining insurance or a surety or fidelity bond."

In addition to these new state law requirements, employers conducting credit checks for employment purposes must comply with the federal Fair Credit Reporting (FCRA) as well as analogous state laws. The FCRA requires that employers provide notice that a credit check will be conducted and obtain the subject's prior authorization.¹⁹ If the employer will take adverse employment action based in whole or in part on the results of a credit check, the employer must provide the subject with a "pre-adverse action notice" that includes the credit check report and the Federal Trade Commission's summary of rights under the FCRA.²⁰ The employer must wait a reasonable time after sending this notice — generally, a minimum of five business days — before taking adverse action. If the employer does not timely receive information demonstrating that the credit check results were inaccurate or incomplete, the employer may take adverse action. The employer must then provide the applicant or employee with an "adverse action notice" that contains the information prescribed by the FCRA.²¹

Finally, private employers should note that an often overlooked provision of the Bankruptcy Code prohibits discrimination solely because an individual has filed for bankruptcy, has been insolvent before bankruptcy, or has failed to pay a debt discharged in bankruptcy.²² A significant majority of the courts to have addressed the question has construed the Bankruptcy Code's anti-discrimination provision to apply only to current employees and not to provide protection for job applicants.²³ However, because no appellate court has yet addressed the issue, employers should consult with counsel before taking adverse action against a job applicant whose credit history reveals a bankruptcy filing.

APPENDIX A

Table 2 from T. Garman, I. Leech, J. Grable, "The Negative Impact of Employee Poor Personal Financial Behaviors on Employers," *Financial Counseling and Planning*, Vol. 7, at 160 (1996).

¹⁹ 15 U.S.C. § 1681b(b)(2).

²⁰ *Id.* § 1681b(b)(3).

²¹ *Id.* § 1681m(a).

²² See 11 U.S.C. § 525(b).

²³ See, e.g., *Myers v. Toojay's Mgmt. Corp.*, 2009 U.S. Dist. LEXIS 97418, at **14-18 (M.D. Fla. Oct. 20, 2009); *In re Stinson*, 285 B.R. 239, 242 (Bankr. W.D. Va. 2002); *Pastore v. Medford Sav. Bank*, 186 B.R. 553 (Bankr. D. Mass. 1995) (holding that section 525(b) does not provide a cause of action for failure to hire). *But see Leary v. Warnaco Inc.*, 251 B.R. 656 (Bankr. S.D.N.Y. 2000) (holding that "discrimination with respect to employment" encompasses all aspects of employment, including hiring).

¹⁶ N.J. Assembly Bill No. 1519, § 1.1(r).

¹⁷ Rev. Code Wash. § 19.182.150.

¹⁸ Or. S.B. 1045, § 3; see also Or. Rev. Stat. § 659A.885(1), (2). Haw. Rev. State. §§ 378-5(b), (c).

POOR FINANCIAL BEHAVIORS

1. Regularly spending too much money
2. Regularly overusing credit
3. Regularly reaching the maximum limit on a credit card
4. Regularly running out of money
5. Regularly writing “bad checks” (e.g., ones with insufficient funds in the account which results in additional bank/vendor charges and perhaps other penalties)
6. Typically having a low or non-existent emergency fund savings
7. Regularly being unable to pay due bills (e.g., utilities, rent, child care, credit cards)
8. Regularly being unable to repay installment debts
9. Habitually receiving “overdue notices” from creditors
10. Regularly paying late some due bills and installment debts
11. Regularly relying on a second income to pay living expenses and debts
12. Being denied additional credit because of a poor credit history
13. Regularly borrowing, perhaps by obtaining a cash advance from a line of credit on a credit card or advance pay from an employer, to pay for living expenses and/or other debts
14. Regularly obtaining debt-consolidation loans
15. Typically having liabilities in excess of assets
16. Typically not contributing to a pension plan
17. Regularly losing money to ripoffs and frauds
18. Regularly losing money by gambling or buying lottery tickets and/or gambling in an attempt to “fix” one’s financial situation
19. Regularly allowing insurance to lapse (e.g., vehicle, renter’s/homeowner’s, medical, life)
20. Regularly making a request for welfare (e.g., cash grants, food stamps, subsidized housing)
21. Regularly feeling emotionally stressed about money matters
22. Regularly worrying about the security of one’s job
23. Regularly receiving communications from collection agencies
24. Being sued for financial reasons
25. Having property securing a debt repossessed
26. Having utility service cut off
27. Being evicted from rental housing or having one’s home foreclosed
28. Having a lien placed on one’s personal or real property
29. Having one’s tax refund intercepted by a government agency or court order
30. Having one’s wages garnished
31. Filing for personal bankruptcy
32. Being referred by an employer for credit and budget counseling because of poor job performance associated with poor financial behavior
33. Exhibiting unethical and/or criminal behavior (e.g., employee theft, embezzlement, check fraud, income tax evasion, expense account fraud, filing deceptive loan statements)
34. Being disciplined or fired by one’s employer for poor financial behavior
35. Being imprisoned for financial reasons