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Broader CEPA a Mixed Blessing

Changes may have emboldened plaintiffs to file baseless claims

By **Alix R. Rubin**

In 2006, both the New Jersey Legislature and the Judiciary broadened the scope of the Conscientious Employee Protection Act (CEPA). But have these changes truly enhanced protection for whistleblowers in the state, or have they simply emboldened plaintiffs to file lawsuits under the statute with no real basis?

The Legislature broadened CEPA's protection in January 2006 when it amended the statute to include protection against retaliation of employees who disclose, threaten to disclose, object to or refuse to participate in employer "deception of, or misrepresentation to, any shareholder, investor, client, patient, customer, employee, former employee, retiree or pensioner of the employer or any governmental entity..." N.J.S.A. § 34:19-3. The amendment also strengthens the enforcement of CEPA by making the following remedies mandatory upon a finding of a violation of the statute:

- an injunction to restrain any contin-

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uing violation of CEPA;

- reinstatement of the plaintiff-employee to the same or an equivalent position;
- reinstatement of full fringe benefits and seniority rights;
- compensation for all lost wages, benefits and any other remuneration; and
- payment of reasonable attorneys' fees and costs of suit.

In addition, the amendment increases maximum civil fines — which are still discretionary — to \$10,000 for the first violation and \$20,000 for each subsequent violation. There is no longer a cap on punitive damages that may be awarded. N.J.S.A. §§ 34:19-5, 2A:15-5.14(c).

By defining CEPA's protections broadly, the Legislature has effectively created a conflict between at least one federal law and CEPA, such that CEPA may be pre-empted as applied to certain entities. In *Fasano v. Federal Reserve Bank of New York*, 457 F.3d 274 (3d Cir. 2006), cert. denied, 127 S.Ct. 977 (2007), the Third Circuit held that CEPA was pre-empted as applied to the 12 Federal Reserve Banks governed by the Federal Reserve Act. The court reasoned that the state statutes at issue — CEPA and the New Jersey Law Against Discrimination

(NJLAD) — "impose substantive and procedural burdens well beyond those imposed by federal law, and thereby frustrate Congressional intent to provide the Federal Reserve Banks with relatively unfettered employment discretion." The Third Circuit reversed the district court on this ground and instructed the district court to dismiss the complaint.

The Third Circuit held that both CEPA and NJLAD were pre-empted as applied to the Federal Reserve Bank of New York because the statutes "go far beyond what is permitted by the Federal Reserve Act" as implicitly amended by the Americans With Disabilities Act (ADA) and the federal banking whistleblower statute.

With respect to CEPA, such provisions as unlimited punitive damages and protection against employer retaliation for disclosing suspected wrongdoing to a supervisor or to any public body about virtually any topic conflict with a Federal Reserve Bank's power — granted by the Federal Reserve Act — to dismiss its employees at will, limited only by the ADA and the federal banking whistleblower statute. Thus, the Third Circuit reasoned, because CEPA's protection is more expansive than its federal counterpart — the federal banking whistleblower statute, which protects a Federal Reserve Bank

employee from retaliation for disclosing suspected wrongdoing only to the Bank itself, a federal banking agency or the Attorney General — CEPA is pre-empted by the Federal Reserve Act and cannot be applied to the Federal Reserve Banks.

Just one month after the Legislature broadened the scope and enforcement of CEPA, the State Judiciary expanded what constitutes an employee for purposes of the statute. In *D'Annunzio v. Prudential Insurance Company of America*, 383 N.J. Super. 270 (App. Div. 2006), the Appellate Division held that the definition of "employee" under CEPA could include independent contractors under certain circumstances. The court ruled that a chiropractor hired by an insurance company to review medical records may be an employee entitled to CEPA protection, despite the fact that he might be classified as an independent contractor under common law. This determination would turn on the extent of the insurance company's control and direction of the chiropractor's work. The Appellate Division therefore reversed the summary judgment that had dismissed the plaintiff's CEPA claim.

Since CEPA's definition of "employee" includes "any individual who performs services for and under the control and direction of an employer," the court reasoned, the primary focus of the parameters of this definition "is on the 'control and direction' of the worker's performance of services for the employer," and not on factors that define the term "employee" in other contexts, that is, the terms of compensation, provision of benefits and whether the individual works a full week or only part of a week. Thus, the Appellate Division rejected the 12-part test it used in *Pukowsky v. Caruso*, 312 N.J. Super. 171 (App. Div. 1998), under which it had determined that independent contractors were not entitled to protection as employees under the NJLAD. The court held in *D'Annunzio* that "the term 'employee' should not be diluted by the *Pukowsky* test" because many of the *Pukowsky* factors, particularly those related to compensation, have no relevance to CEPA's goal of protecting employees from retaliation when they blow the whistle on illegal

activities in the workplace.

The court therefore selected four of the *Pukowsky* factors it felt germane to CEPA to "provide an appropriate guide for identifying those workers who fit" CEPA's definition of the term employee:

- the employer's right to control the means and manner of the worker's performance;
- whether the worker was supervised;
- the furnishing of equipment and a workplace; and
- the manner of termination of the relationship.

Based on these factors, the court concluded that questions of fact existed as to whether the chiropractor was an employee for CEPA purposes.

In March 2006, the Appellate Division reached a similar result in *Stomel v. City of Camden*, 383 N.J. Super. 615 (App. Div. 2006). In *Stomel*, the plaintiff, a public defender for the city of Camden, alleged that he was dismissed in retaliation for reporting an extortion attempt and for providing testimony that implicated the mayor in unlawful activity. The court stated that it was employing the control test used in *D'Annunzio* as well as the "relative nature of the work" test, which focuses on the extent of the worker's economic dependence on the business and the relationship of the nature of the work to the operation of that business and may be particularly applicable to professionals like attorneys.

However, it appears that the court used control-like factors when it held that the plaintiff, a public defender, was an employee of the city under CEPA. Although he maintained his own private business with his own support staff and exercised independent judgment in his representation of clients on behalf of the city, he was not free to choose those clients, he was required to submit written reports detailing his representation, the city paid him with a monthly check based on an annual salary, he could not be paid until the city law department certified that his work had been done satisfactorily and the municipal court made appointments for him to meet with indigent clients. More significantly, the Appellate Division

noted that "plaintiff's whistle-blowing about the extortion attempt benefited the public and deserves CEPA's broad protection." Thus, it appears that the nature of the CEPA claim — that is, whether it impacts on public health, safety or welfare — may play an important role in the court's determination of employer versus independent contractor status, particularly in cases involving professionals.

This might explain why, in late 1995, the Law Division held that an in-house counsel whose sole law office was located in defendant's building, whose support staff and other services and equipment were provided or paid for by the defendant and who received annual raises in the form of increases to his hourly rate was an independent contractor for purposes of CEPA. While acknowledging that some factors weighed in favor of employee status, the court in *Perlowski v. Elson T. Killam Associates*, 384 N.J. Super. 467 (Law Div. 2005), held that the following factors tipped the balance in favor of independent contractor status:

- plaintiff was not solely dependent on defendant for his income, as he was authorized to perform work for other clients;
- plaintiff did not participate in defendant's pension plan;
- defendant did not deduct income or Social Security taxes from plaintiff's pay; and
- plaintiff did not receive medical or vacation leave from the defendant.

Tellingly, unlike in *D'Annunzio* and *Stomel*, the CEPA claim at issue in *Perlowski* concerned compliance with corporate law and procedure and therefore arguably did not impact on public health, safety or welfare.

In a case of first impression, the New Jersey Supreme Court declined to further expand the definition of "employee" under CEPA to include a shareholder-director of a physician's association. In *Feldman v. Hunterdon Radiological Associates*, 187 N.J. 228 (2006), the court adopted the fact-intensive approach used by the United States Supreme Court in *Clackamas Gastroenterology Associates v. Wells*, 538 U.S. 440 (2003), and focused on "the professional association's direction and con-

trol over the shareholder-director and the true power and vulnerability of the shareholder-director within the association" to determine whether she was an employee for CEPA purposes.

The plaintiff in *Feldman*, a physician and one of six shareholder-directors of an association of radiologists who shared in the management and control of the association, had concerns about the competence of one of the association's members. The plaintiff used her power and influence in the association and as chairperson of medical imaging at the hospital to focus the association's attention on this member's performance. However, the association members soon split over the appropriate handling of this member. Plaintiff resigned from the association and filed a complaint against it alleging, among other things, a violation of CEPA.

The Supreme Court employed a variation of the control test used in *D'Annunzio* and *Stomel* to determine whether plaintiff was an employee under CEPA. However, the court reached the opposite conclusion the Appellate Division had reached in *D'Annunzio* and *Stomel*, finding the plaintiff was not an employee of the association because "her power over the direction of [the association] was at least as significant as that of any other member." The court reasoned that CEPA was not intended to address power struggles among equals. Moreover, the court noted, if a shareholder-director has the power to "root out wrongdoing," she does not need to "blow the whistle" and therefore is not an employee under CEPA. Even when, as in *Feldman*, the shareholder-director is subject to an employment agreement, unless the plaintiff is a shareholder-director in name only — that is, without any real power — he or she will not be deemed an employee for purposes of CEPA.

Despite the flux in 2006, CEPA has retained its essential constraints. Under *Colon v. Prudential Insurance Company of America*, 2006 WL 507732, at *6 (App. Div. March 3, 2006), cert. denied, 187 N.J. 80 (2006), to prove a violation

of CEPA, a plaintiff still must show:

- he has "an objectively reasonable belief that his employer violated a law or rule or regulation promulgated by law, or committed a fraudulent or criminal act, or acted in a manner incompatible with a clear mandate of public policy concerning the public welfare;"
- he disclosed or threatened to disclose such activity to a supervisor or to a public body or objected to or refused to participate in such activity;
- he suffered an adverse employment action; and
- a causal connection existed between his whistle-blowing activity and the adverse employment action.

The plaintiff in *Colon*, a vice president of the defendant company, reported to management his concerns about another vice president's noncompliance with company policy with respect to a particular third-party vendor contract. However, the plaintiff failed to assert — either during his employment or in the litigation — that the other vice president or the company had violated any law, rule, regulation or public policy or had committed a fraudulent or criminal act. Since a key element of plaintiff's prima facie CEPA claim was missing, the Appellate Division held that the trial court had properly dismissed the claim. While the Appellate Division found plaintiff's internal complaint to be reasonable, it held that purely private disputes do not rise to the level of a clear mandate of public policy and CEPA actions should not "devolve into arguments between employees and employers over what is, and is not, correct public policy." Thus, "[w]hen an employee simply disagrees with the lawful practices of his employer he cannot seek protection under the CEPA."

Moreover, the court found that the plaintiff in *Colon* had been dismissed for something other than his objection to another vice president's noncompliance with company policy; namely, he was dismissed for attempted interference with an internal investigation into a sexual

harassment claim against him. As such, there was no causal connection between plaintiff's whistle-blowing activity and his employment termination, and his CEPA claim was properly dismissed.

Likewise, the plaintiff in *Carmichael v. Pennsauken Township Board of Education*, 462 F.Supp.2d 601 (D.N.J. 2006), did not establish a prima facie CEPA claim because he could not show that his complaints and inquiries regarding the discipline of students for harassing him were causally related to the school board's failure to rehire him as track coach. Significantly, neither the school's athletic director, who had interviewed plaintiff for the position, nor the committee that made the hiring decision was aware of the harassment incident. The District Court noted that, "[i]n order to draw a causal connection between the protected activity and the alleged retaliation, Plaintiff must demonstrate more than his 'myopic interpretation of events wherein retaliatory motives permeated the [D]efendants' every move.'"

Although the elements of the prima facie case under CEPA have not substantially changed and both the *D'Annunzio* and *Stomel* cases are currently on appeal before the New Jersey Supreme Court, employers should take certain precautions, particularly due to the fact-intensive nature of the inquiries in *Feldman*, *D'Annunzio* and *Stomel*. Employers who use independent contractors in their businesses but do not control or direct their performance should state so in their contracts. They also should not treat their independent contractors like employees with respect to performance, supervision, the furnishing of equipment and a workplace and termination of the relationship. In addition, employers should be clear that their retaliation complaint procedures apply to independent contractors and shareholder-directors as well as employees and should seek to have their employment practices liability insurance policies cover claims by independent contractors and shareholder-directors. ■