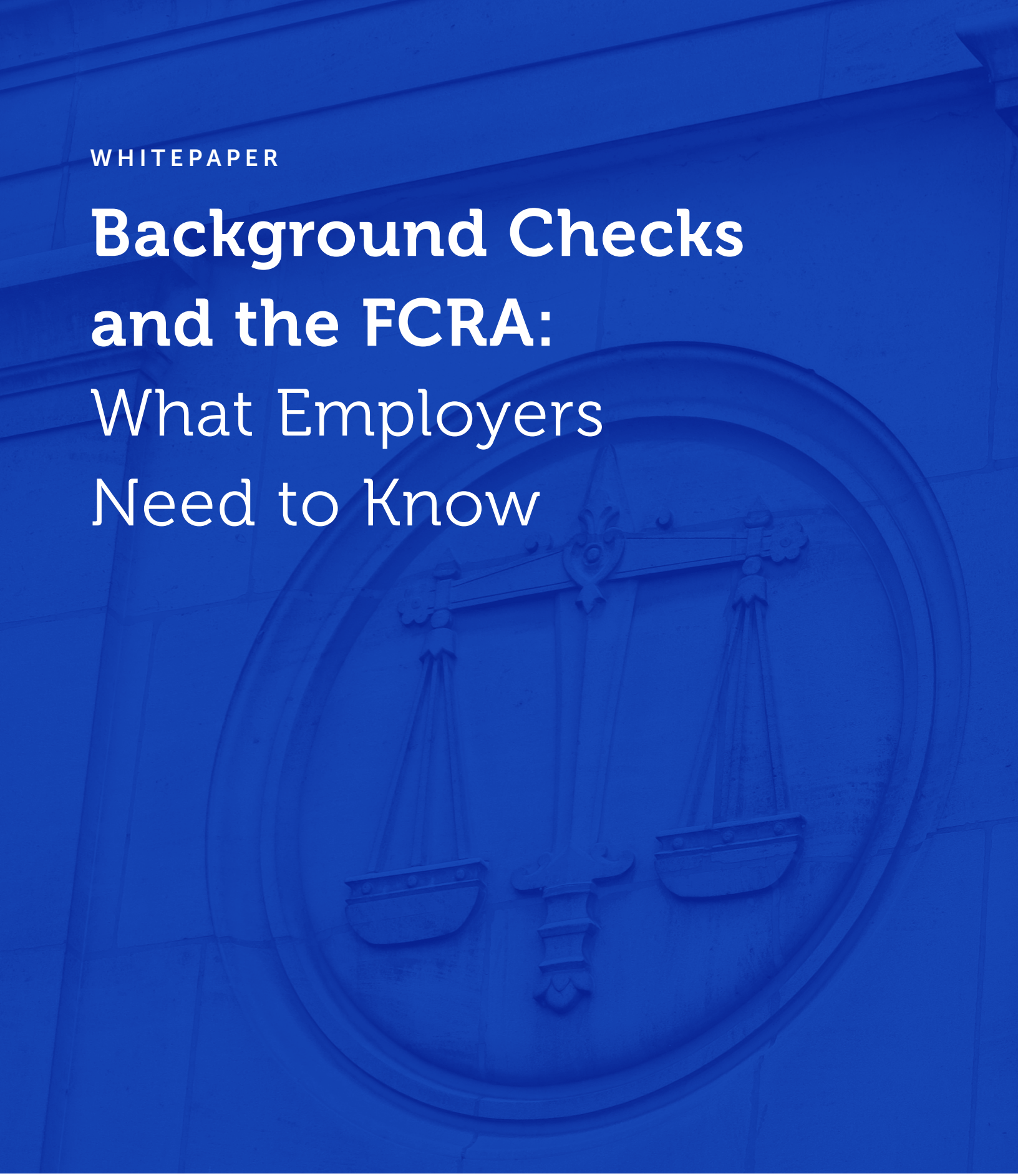
WHITEPAPER

Background Checks and the FCRA: What Employers Need to Know



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Introduction

Employers that engage a third-party background check provider (or "consumer reporting agency") to assist with their employment screening processes must be mindful of the various technical obligations under the Fair Credit Reporting Act ("FCRA").

This paper will discuss those that relate to the ordering of the background check report (or "consumer report") and the FCRA's requirements when an employer takes action based in whole or in part on information in the report.

In this whitepaper, we will cover:

- What is the FCRA
- FCRA coverages and jurisdictions
- Obtaining consent
- FCRA-related lawsuits
- Disclosures and authorization
- Adverse action
- And more ...

Please note that in addition to the FCRA there are a myriad of state and local laws that may also apply to disclosure and authorization forms of which you should be aware, and are not covered in this whitepaper.

What is the FCRA?

The FCRA is the primary legislation that regulates employers' ability to obtain and use background information on applicants or employees that meets the definition of a "consumer report." The FCRA imposes certain notice requirements on employers who obtain "consumer reports" or "investigative consumer reports" from a "consumer reporting agency" and attempt to use that information in the employment context.

The FTC has previously shared that the term "employment purpose" is often interpreted liberally, so the FCRA may also apply to individuals who are not technically employees, such as independent contractors, agents and volunteers.

Under the FCRA, a "consumer reporting agency" is defined as any person who, for monetary fees, dues, or on a cooperative nonprofit basis, regularly engages in whole or in part in the practice of assembling or evaluating consumer credit information or other information on consumers for the purpose of furnishing consumer reports to third parties. When an employer seeks any written, oral, or other communication (e.g., credit history, criminal records, driving records, etc.) from a consumer reporting agency about an applicant and employee for employment purposes, it must comply with certain notice requirements.

FCRA: Coverages and Jurisdiction

The FCRA defines two types of reports that employers may obtain from consumer reporting agencies: "consumer reports" and "investigative consumer reports."

- **Consumer reports** are defined as written, oral, or other communications by a consumer reporting agency which bear upon a consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living and which is used (or expected to be used) as a factor in establishing eligibility for employment purposes. This type of report is often obtained by employers in making hiring or promotion decisions.

- **Investigative consumer reports** are reports provided by a consumer reporting agency which include information on a consumer's character, general reputation, personal characteristics, or mode of living obtained through communications with neighbors, friends, or associates of the consumer or acquaintances of the consumer or others.

FCRA: Disclosures and Consent

Before an employer seeks to obtain a consumer report, the FCRA requires that it make a clear and conspicuous written disclosure to the applicant or employee that a consumer report may be obtained. This written disclosure must appear on a separate, stand-alone document, (which means that it cannot be incorporated into the employment application). This disclosure must also be made before the consumer report is obtained or caused to be obtained. In addition to this disclosure, before requesting the consumer report, an employer must obtain the written authorization of the applicant or employee.

The FCRA further requires that an employer disclose to the applicant or employee, also known as the consumer, that an investigative consumer report may be obtained. The employer must provide a written disclosure to the consumer no later than three days after the investigative consumer report has been first requested from the consumer reporting agency.

In addition, the disclosure must include the Consumer Financial Protection Bureau's "A Summary of Your Rights Under the Fair Credit Reporting Act," as well as a statement informing the applicant or employee of the right to request additional disclosures regarding the nature and the scope of the investigation.

If a consumer makes such a request within a reasonable time, the employer must provide a complete disclosure of the nature and the scope of the investigation that it requested. The disclosure must be in writing and must also be given to the applicant or employee no later than five days after the date on which the request was received or the investigative consumer report was first requested, whichever is later in time.

Under the FCRA, an aggrieved consumer can seek damages for willful or negligent violations.

- To prove a willful violation, the plaintiff must show the employer acted with either malice or reckless disregard for the law. If successful, the plaintiff is entitled to either actual damages or statutory damages of not less than $100 and not more than $1,000, attorney's fees, and punitive damages. Most class actions under the FCRA allege willful violations because statutory damages are much easier to calculate than actual damages given that actual damages arguably involve a specific individualized inquiry into each potential class member's damage, which makes it difficult for the plaintiff to certify the case as a class action.

- The damages for negligent violations are actual damages and attorney's fees (no punitive damages and no statutory damages available). This means that a plaintiff must prove that the employer's violation caused some form of harm, which can be monetary or non-monetary (e.g., emotional distress, etc.).

The FCRA states that a claim for a violation must be brought (a) within two years of the plaintiff's discovery of the violation or (b) within five years of the date of the violation, whichever is earlier. Given the statute of limitations, exposure for getting these hyper-technical requirements of the law can be very high.

The Rise of FCRA-Related Class-Action Lawsuits

Employers have been the target of increased FCRA litigation in recent years. Many of these cases have been brought as class actions, thus exposing employers to significant damages. Much of the litigation has focused on the adequacy of the employer's disclosure and authorization forms, in particular, whether they meet the FCRA's requirement that the disclosure be "clear and conspicuous" and "in a document that consists solely of the disclosure."

For the most part, the claims usually point to the inclusion of what the Federal Trade Commission has referred to as "extraneous text," which courts have found to exist when the forms include a release of claims, a waiver of liability, at-will statements, state and local notices, and also when the disclosure is otherwise combined with or included in a separate notice or form (e.g., employment application, handbook, etc.). Additionally, with the popularity of online applications and applicant tracking systems, employers have found themselves facing new legal arguments throughout the country.

Disclosures and authorization

Given the challenges in this area, employers are advised to carefully review their disclosure and authorization forms for compliance on a regular basis. Employers should also consider eliminating any extraneous information from the disclosure form and ensure that it is in a stand-alone document. Certainly, any release of liability should be removed from the disclosure form itself.

The importance of separate forms

While the Federal Trade Commission has opined that combining the disclosure and authorization into one form is permissible, keeping the forms separate might allow an employer to include a liability release while minimizing the risk of a class action under the FCRA. Employers should carefully weigh the various options available to them in terms of the proper format and presentation of these forms.

Employers also should take notice of how their forms present as part of its online application process. Employers that utilize applicant tracking systems or online application processes should carefully review those systems to ensure that the disclosure is clear and conspicuous and appears as a separate and free-standing document.

To minimize risk, the process should not appear as though the disclosure form is simply another page of a larger job application. In sum, whether in paper or electronic format, the disclosure form must remain separate and apart from the employment application, and also must be prominent and distinct from other content.

Pre-Adverse and Adverse Action

You find the perfect candidate, make a conditional offer of employment, and eagerly await the results of the background check report (or "consumer report"). If the report is clear or contains non-job-related minor offenses, you will likely choose to onboard the person. But if the report reveals potentially disqualifying information, can you simply revoke the job offer?

The answer is no—not legally anyway. Any time an employer orders a background check report from a third-party background check provider (or "consumer reporting agency"), the FCRA regulates the process for both ordering the report and making decisions based on it. Please note in addition to the FCRA, there are a myriad of state and local laws that may have additional requirements for employers.

The FCRA defines "adverse action" to mean a ***denial of employment or any other decision that adversely impacts any current or prospective employee*** *(e.g., termination, denial of promotion, failure to hire, revoking a job offer, etc.). This definition is very broad and has been interpreted liberally by the courts.*

Taking action: What employers need to know

Before an employer takes any adverse action based in whole or in part on the background report, it must provide the consumer with a copy of the background check report obtained from the background check provider and the Consumer Financial Protection Bureau's "A Summary of Your Rights Under the Fair Credit Reporting Act." Additional notices may be required under state and local laws.

After providing these documents, the employer must wait a "reasonable period of time" before taking the adverse action. The Federal Trade Commission (FTC) has opined in an informal staff opinion letter that a five (5) business day waiting period might be reasonable. However, what is reasonable depends on the specific factual circumstances involved and, thus, the FTC advised that legal counsel should be consulted in order to judge the appropriate waiting period on a case by case basis.

The purpose of the waiting period is similar to due process; it is to allow consumers to advise the employer of any information the employer should consider before making a final decision, including evidence that the information in the report is inaccurate or incomplete or any other mitigating evidence the consumer would like to furnish. Some ban-the-box laws mandate employers wait longer than seven days (e.g., San Francisco and others).

Understanding an adverse action notice

After the waiting period, the employer must provide to the consumer an "adverse action" notice, which contains the following:

1. Notice of the adverse action taken
2. The name, address, and toll-free telephone number of the background check provider that furnished the background check report
3. A statement that the background check provider did not make the decision to take the adverse action and is unable to provide the consumer the specific reasons why the adverse action was taken
4. Notice of the consumer's right to obtain a free copy of the consumer report from the background check provider within 60 days
5. Notice of the consumers right to dispute the accuracy or completeness of any information in the background check report furnished by the background check provider

It should be noted that the pre-adverse and adverse action notice process is not limited to job applicants or candidates—it applies equally to employees. Thus, if an employer intends to take adverse action against a current employee, it must provide a pre-adverse action notice, wait a reasonable period of time, and provide the final adverse action notice.

The question in these situations is what to do with the employee during the waiting period. The answer will depend on the situation and what information was revealed in the check. One option is to allow the employee to continue working during the waiting period. If the background check report reveals something particularly concerning (e.g., serious criminal record), the employer might deem it necessary to remove the employee from the workplace during the waiting period. If the employer takes this approach, it should consider paying the employee while on "administrative leave" and work with employment counsel to ensure its process is compliant.

Where background checks and consumer reports diverge

Another consideration is that certain workplace investigations where a background check may be conducted may not be considered "consumer reports" under the FCRA. These investigations are defined as those done to:

- Investigate suspected misconduct relating to employment; or
- Ensure compliance with federal, state, or local laws and regulations, the rules of a self-regulatory organization, or any preexisting written policies of the employer.

However, to qualify as a workplace investigation, it must not involve investigation of an employee's credit worthiness, credit standing, or credit capacity, and arguably only applies to an employee and not an applicant.

An employer must still abide by modified adverse action requirements if it takes adverse action based on the investigation. The post-adverse action disclosure to the subject of these investigation need only summarize "the nature and substance" of any report, but does not need to identify sources of information.

Many FCRA lawsuits against employers have focused on employers alleged failure to follow this process. For instance, most claims center on the employer's alleged failure to provide a copy of the consumer's consumer report before taking adverse action on that individual. As it relates to taking action against someone due to background check report information, employers are well advised to ensure that their pre-adverse and adverse action notices are compliant and during the pre-adverse action stage, the consumer, is always provided a copy of their consumer report and given a reasonable opportunity to dispute the accuracy of the report before the adverse action is taken.

Some claims allege the employer took adverse action too soon or failed to include the most recent FCRA Summary of Rights document.

Training is critical

Many employers have compliant processes or policies in place, but then forget to train their managers, recruiters or other hiring personnel about the proper procedure. For example, managers may think they are being helpful if they call the consumer to let them know that their report revealed something problematic.

However, if the consumer has not yet received a pre-adverse action letter with the report and the FCRA Summary of Rights, the employer may face possible exposure because the manager might be viewed as having taken adverse action before the requisite "pre-adverse" steps were actually completed. Employers should also review with legal counsel if they attempt to rely on any exception to the FCRA, including the workplace investigations exception.

Given the dramatic increase in FCRA lawsuits, employers should re-evaluate their pre-employment and hiring practices at least annually. Employers and their legal counsel should give thought to developing a process that complies with the FCRA and the numerous state and local laws that impact their use of background check information, especially criminal or credit information, in making employment decisions.

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