



**I. An FCRA Primer**

Duties of Employers Who Intend to Use Employee Background Checks

The Disclosure Form

The Applicant's or Employee's Written Authorization

Dealing With A Derogatory Report

Taking An Adverse Action

**II. The Devil Is In The Details: Lessons From Lawsuits**

A. The Government Is Watching

B. Teachings From A Retrospective View

**III. A Self-Audit Checklist for FCRA Compliance**

**IV. About Kilpatrick Stockton's Class Action Team**

The use of background checks for the process of hiring and promoting employees is on the rise. The HireRight Employment Screening Benchmarking Report (2009) found that 93 percent of the employers questioned conducted criminal records background checks on job applicants. As the use of employment-related background checks increases, so does the number of lawsuits, including class actions, arising out of the use of employee background checks. Whether your company outsources its employee screening process or performs that function in-house, recent litigation in the area teaches that no entity can afford to ignore or take lightly its legal obligations with respect to employment-related background checks.

The Fair Credit Reporting Act (“FCRA”) outlines detailed procedures that must be followed when consumer reports, including credit reports and criminal background checks, are used for employment purposes. Adherence to these procedures is important because the FCRA provides for statutory damages of \$100 to \$1,000 for *each* willful violation of the statute, making the exposure for a company potentially catastrophic. Indeed, recent settlements of FCRA class actions involving employee background checks have numbered in the tens of millions of dollars. This Special Report provides a primer on the FCRA’s requirements for employee background checks, discusses lessons from recent case developments involving employee background checks, and provides a self-audit checklist that may be used, in counsel with an attorney, to assess a company’s FCRA compliance.

## **I. An FCRA Primer**

The FCRA requires that certain procedures be followed when a “consumer report” is used for employment purposes. 15 U.S.C. § 1681 *et seq.* Under the FCRA, a consumer report is a written, oral or other communication of information by a consumer reporting agency that bears on a consumer’s credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living that is used or expected to be used or collected for establishing the consumer’s eligibility for personal credit or insurance, employment, or other purposes authorized by the FCRA. 15 U.S.C. § 1681a(d). Thus, a consumer report is much broader in scope than just a credit report or a background check—it includes criminal and civil records, driving records, civil lawsuits, reference checks and other information obtained by a consumer reporting agency.

### **Duties of Employers Who Intend to Use Employee Background Checks**

An employer’s duties vary at each stage of the hiring and employment process when a background check or other consumer report is used.

#### **The Disclosure Form**

The FCRA requires that a company disclose to the applicant or employee that a background check will be obtained for employment purposes. This disclosure must be made in a document that consists *only* of the disclosure. 15 U.S.C. § 1681b(2)(A)(i). In other words, the disclosure form should be a single page consisting of only the text necessary to inform the applicant or employee that the employer intends to obtain his criminal background check or other consumer report.

#### **The Applicant’s or Employee’s Written Authorization**

The FCRA also requires that the employer obtain the applicant’s or employee’s written authorization to procure a background check or consumer report. The FCRA allows the employer to include this written authorization, typically a signature line confirming that the consumer report has been authorized, on the disclosure form described above. [FTC Opinion Letter](#), Steer, October 21,

1997, <http://www.ftc.gov/os/statutes/fcra/steer.shtm>. Nothing more than the disclosure and written authorization may be on the form. 15 U.S.C. § 1681b(2)(A)(ii).

### **Dealing With A Derogatory Report**

When a report contains information that could negatively impact an individual's eligibility for hire or promotion, the FCRA requires that certain steps be taken by users of background checks or other consumer reports in the employment context. It is of the utmost importance that these steps be completed *before* any "adverse action" is taken with respect to the applicant or employee. An "adverse action" is defined broadly under the FCRA and includes, among other things, an employment denial, termination, or any unfavorable change in employment. *See* 15 U.S.C. § 1681a(3)(k).

An entity considering taking adverse action based in whole or in part on a background check must do the following, before taking the adverse action:

1. Provide the applicant or employee with a copy of the background check or other consumer report.
2. Provide the applicant or employee with a summary of his rights under the FCRA, as prescribed by the Federal Trade Commission. *See* [FCRA Summary of Right, http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre35.pdf](http://www.ftc.gov/bcp/edu/pubs/consumer/credit/cre35.pdf)

15 U.S.C. § 1681b (3)(A). The purpose of this pre-adverse action notice is to provide the consumer with an opportunity to dispute and correct any inaccurate information in the background check and thereby avoid the adverse employment action that the employer might take based on the report.

### **Taking An Adverse Action**

After providing the pre-adverse action notice described above, the employer must wait a reasonable period of time before taking any adverse action – typically declining to hire or promote the individual – based in whole or in part on information in a background check. Upon taking an adverse action, the employer must provide notice to the consumer of the action. This is a second, distinct notice from the pre-adverse action notice described above. Such notice may be provided orally, in writing or electronically and must contain or include the following:

1. The name and contact information for the consumer reporting agency that provided the background check on which the adverse employment decision was based. The contact information provided should include the name, address, and phone number for the consumer reporting agency. If a toll-free telephone number is available for the consumer reporting agency, it should be provided to the applicant or employee.
2. A statement advising the individual that the consumer reporting agency did not make the adverse employment decision and cannot, therefore, provide any reasons why the adverse action was taken.
3. Notification that the applicant or employee is entitled to receive a free copy of the background check or consumer report on which the adverse action was based. The applicant or employee has a 60-day period in which to obtain his free report, and the employer's notice to the applicant or employee must so state.

4. Notice to the employee or applicant of his right to dispute the information in his background check with the consumer reporting agency that furnished it.

15 U.S.C. § 1681m.

## **II. The Devil Is In The Details: Lessons From Lawsuits**

While the FCRA sets the framework for employers that use background checks or other consumer reports for employment purposes, significant lessons can be learned from case developments.

### **A. The Government Is Watching**

The Federal Trade Commission (“FTC”) is responsible for administrative enforcement of compliance with the FCRA. In this capacity, the FTC has recently demonstrated an increased interest in cracking down on employers who fail to follow the FCRA’s guidelines for using consumer reports and background checks for employment purposes. This shift is important because the FTC need not be motivated by the potential to recover statutory damages or attorneys fees, and instead can pursue companies who commit “technical” violations of the FCRA that do not cause applicants and employees any tangible or significant damage. In contrast, plaintiff’s attorneys may be motivated to pursue only entities or retailers that hire or screen large numbers of applicants. Such motivation may be underscored by the fact that the FCRA provides for recovery of statutory damages of \$100 to \$1,000 *per violation* and allows prevailing parties to seek punitive damages and recover their attorneys’ fees. This statutory scheme makes class actions attractive to attorneys seeking to sue employers who do not comply with the FCRA in using background checks.

Recently, the FTC’s focus on the use of background checks resulted in financial penalties and rulings against two entities who failed to give employees the FCRA-required pre-adverse action and adverse action notices when hiring and firing decisions were made based on background checks. In separate complaints, the FTC alleged that Quality Terminal Services LLC and Rail Terminal Services contracted with a consumer reporting agency to conduct background checks, including criminal records checks, for employees and applicants. The FTC alleged that both companies made hiring and firing decisions based on those background checks, but failed to provide the employees and applicants with the pre-adverse action notices and adverse action notices mandated by the FCRA. To resolve these cases, the companies consented to final judgments requiring them to pay \$53,000 and \$24,000 in civil penalties. The settlements also include record keeping and reporting provisions to allow the FTC to monitor the companies’ compliance with the FCRA in the future.

While this Special Report focuses on the FCRA’s requirements for using employee background checks, another potential issue for consideration is the effect such use may have on minorities. The Equal Employment Opportunity Commission (“EEOC”) has taken a keen interest in the use of credit reports and criminal background checks for employment purposes. The EEOC has stated that the use of criminal records and credit reports in this context are presumed to have a disparate impact on racial minorities and “are significantly disadvantaging applicants and employees on the basis of race and color.” Against this backdrop, in September 2009, the EEOC brought an action against Freeman, a Texas based convention and events planning company, alleging that the company violated Title VII by using “a selection criterion for hiring, namely, credit history information, that has had, and continues to have a significant disparate impact on Black job applicants.” The FTC’s and EEOC’s recent enforcement action efforts underscore that employers should regularly assess their procedures to ensure compliance with the FCRA, state laws and anti-discrimination laws.

## **B. Teachings From A Retrospective View**

Some of the most instructive cases on the FCRA's requirements for the use of background checks for employment purposes will be familiar to those who regularly deal with the use of background checks in the employment context. They demonstrate that employers may find themselves "on the hook" with the background check companies they use when it comes to FCRA compliance.

In the related cases of *Beverly v. Wal-Mart*, 2008 WL 149032 (E.D. Va. 2008) and *Beverly v. Choicepoint*, 2008 WL 582622 (W.D.N.C. 2008), the plaintiffs alleged that ChoicePoint and Wal-Mart violated the FCRA when using and running employee background checks. The plaintiffs made two allegations: (1) they alleged that ChoicePoint failed to comply with its FCRA obligations as a consumer reporting agency when it sent public record reports to Wal-Mart and Target Corporation that may have contained information that likely would have a negative effect on the consumer's ability to obtain employment, without, at the same time, notifying the consumer that the report was issued and (2) they alleged that Wal-Mart took adverse action on employment applications based on consumer reports provided by ChoicePoint and that, although ChoicePoint (on Wal-mart's behalf) mailed a copy of the report and a statement of rights under the FCRA, that was not done within a "reasonable" period of time before the adverse action was taken. Specifically, the pre-adverse action letter containing the report and statement of rights was dated five days prior to the actual adverse action letter. However, the plaintiff received both letters at the same time, and therefore, alleged that he had no opportunity to correct his allegedly inaccurate background report. The court denied the defendants' motions for summary judgment in the case, and the parties later settled. For the ChoicePoint Class, ChoicePoint agreed to create a settlement fund of \$2,890,000. For the Wal-Mart Class, ChoicePoint and Wal-Mart agreed to create a settlement fund of \$4,000,000. The settlement received final court approval on May 1, 2009.

The companion class actions, *Williams v. Telespectrum, Inc.*, 2007 WL 2439463 (E.D. Va. 2007) and *Williams v. Lexis-Nexis*, 2007 WL 678641 (E.D.Va. 2007), demonstrate that a plaintiff frequently sues both the employer and the background check company. The plaintiffs in these cases claimed that Telespectrum negligently and willfully violated the FCRA by failing to provide the required pre-adverse and post-adverse action notices. The plaintiff alleged that Telespectrum brought candidates into the office, handed them a copy of their background checks, and then terminated the candidates on the spot. The court denied Telespectrum's summary judgment motion because the company did not provide notice of the adverse action before it terminated the employees. Employees were thereby denied an opportunity to dispute the background checks, the court said. The repetitiveness of Telespectrum's conduct also led the court to hold that punitive damages might be available. However, Telespectrum ultimately defeated the plaintiff's effort to certify the case as a class action. The court reasoned that, because actual damages were available under the plaintiffs' negligence claim, and those damages would vary for each class member, a class action was not appropriate. Telespectrum later entered a confidential settlement with Plaintiffs. In the companion case, the Plaintiff alleged that LexisNexis failed to send its FCRA required notification as the consumer reporting agency that provided the background reports. That case was settled for more than \$20 million. Following *Telespectrum*, plaintiffs' attorneys in class actions have been less likely to seek actual damages, and instead pursue statutory damages, together with punitive damages and attorney's fees. This strategy change makes class certification less difficult and avoids the concerns expressed by the court in its denial of class certification in *Telespectrum*.

These cases teach that the devil is indeed in the details and that the stakes of FCRA compliance are high. Pre-adverse action letters should be sent more than five days prior to adverse action letters, so that an applicant or employee has an opportunity to dispute any inaccuracies. Intervening holidays should be considered (In *Beverly*, Labor Day may have delayed the plaintiff's receipt of his letters).

### III. A Self-Audit Checklist for FCRA Compliance

As discussed above, the FCRA's provisions for using consumer reports and background checks in the employment context are the focus of enforcement agencies and eager plaintiff's lawyers alike. With the potential for such high-stakes litigation, a self audit, conducted in consultation with counsel, is a good starting place to ensure FCRA compliance. Below is a checklist to guide such a self-audit.

- ❑ Have you engaged an FCRA-knowledgeable vendor for providing your background information?
- ❑ Is your disclosure form more than one page or more than a line or two in length? The disclosure form used to inform applicants that a background check will be procured should consist of only the disclosure, or alternatively, only the disclosure and a signature line for the applicant/employee to authorize the background check in writing.
- ❑ Do you have a pre-adverse action letter? Is a copy of the consumer's report and the FCRA statement of rights enclosed with the letter?
- ❑ Is responsibility for FCRA compliance properly allocated in your contracts with pertinent entities or vendors?
- ❑ Is your company taking any adverse action with respect to an applicant/individual *before* the individual has been provided with a copy of his report, the FCRA summary of rights and a reasonable amount of time (more than five days) to dispute the contents of the report? Recall that an adverse action is broadly defined to include any unfavorable change in employment.
- ❑ Are the individuals who handle your background check process, whether they are human resources professionals or vendors, following the same policies and guidelines with respect to their oral communications of adverse employment decisions? Are they trained in the basics of the FCRA and do they know who to consult with regarding questions that are not clearly addressed by the statute?
- ❑ Is your company making the appropriate disclosures and providing appropriate notices, not only with new hires, but with existing employees, such as those being considered for promotion, on whom a background check is procured? If the employee signed a blanket authorization at the time of hire, you may not need to obtain separate authorization to procure an additional background check. See [FTC Opinion Letter](http://www.ftc.gov/os/statutes/fcra/steer.shtm), Steer, October 21, 1997, <http://www.ftc.gov/os/statutes/fcra/steer.shtm>
- ❑ Is your company using employee background checks and other consumer reports in a manner that does not have a disparate impact on groups that are protected by anti-discrimination laws and in a manner that is justified by the positions being filled?
- ❑ Does your organization have procedures for continuous, proactive monitoring of your employment decisioning process, including monitoring of statistical "red flags" to ensure compliance and protection? Such processes could be helpful in defending against allegations of willful statutory violations.

The Class Action Team at Kilpatrick Stockton is happy to assist with or lead such audits. Kilpatrick Stockton has handled over 100 cases against the plaintiff's law firm that has litigated the best known FCRA cases involving employee background checks.

#### **IV. About Kilpatrick Stockton's Class Action Team**

Kilpatrick Stockton has a wealth of experience handling consumer class actions and FCRA individual and class action lawsuits. The team has successfully defended some of the largest FCRA class actions in jurisdictions throughout the country, including courts in California, Illinois, Florida, Georgia, and Virginia. Kilpatrick Stockton has handled FCRA cases in 87 of the 92 federal district courts.

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