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Federal Courts Increase Scrutiny of Employer Compliance with the FCRA's Adverse Action Requirements

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In the last two years, the number of employment class actions under the federal Fair Credit Reporting Act (FCRA) has ballooned. Most of the cases reported in the media have involved challenges to an employer's compliance with the FCRA's disclosure and authorization requirements. However, recent class action filings show that the plaintiff's bar also is bringing class claims that call into question employer compliance with the FCRA's adverse action requirements, including allegations that the employer has failed to provide any pre-adverse action notice, or if notice has been provided, to wait an appropriate amount of time before taking final adverse action against an individual (holding the job open in the meantime). Two recent federal court decisions tackling "pre-adverse action" notices demonstrate that compliance with the FCRA is indispensable for all employers that use background reports to make hiring and employment decisions.

The FCRA Requires a Two-Step Adverse Action Process

Employers must follow certain requirements if they intend to take "adverse action" against an individual, including a job applicant or a current employee, based in whole or in part on the contents of a consumer report, before the adverse action is taken.[1]

In the context of a consumer report used for employment purposes, an adverse action includes "a denial of employment or any other decision for employment purposes that adversely affects any current or prospective employee."[2] The FCRA also defines the term "adverse action" to broadly extend to "any action taken or determination that is made in connection

1 *But* see 15 U.S.C. § 1861a(y) (relaxed rules for misconduct investigations). Separate state and local requirements are beyond the scope of this Insight.

2 15 U.S.C. § 1681a(k)(1)(B)(ii).

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with an application that was made by . . . any consumer" and that is "adverse to the interests of the consumer."[3] In prior guidance, the Federal Trade Commission (FTC) has expressed an expansive view of the FCRA's definition of the term "adverse action" and opined that the term extends beyond decisions to disqualify a job applicant from further consideration for an available position.[4]

Before the employer implements the adverse action against the applicant or employee, the employer must provide a "pre-adverse action" notice to the individual, which must include a copy of the consumer report and the Consumer Financial Protection Bureau's Summary of Rights.[5] This requirement affords the applicant or employee with an opportunity to discuss the report with the employer before the employer takes adverse action.

Once the employer is prepared to take the adverse action against the applicant or employee, it must then provide an "adverse action" notice to the individual.[6] The adverse action notice, which can be in writing or delivered orally or by electronic means, must contain the following information:

- The name, address and telephone number of the consumer reporting agency (CRA) that provided the report to the employer;
- A statement that the CRA did not make the adverse decision and is not able to explain why the decision was made;
- A statement setting forth the applicant's or employee's right to obtain a free disclosure of his or her report from the CRA if the applicant or employee makes a request for such a disclosure within 60 days; and
- A statement setting forth the applicant's or employee's right to dispute directly with the CRA the accuracy or completeness of any information contained in the report that the CRA provided to the employer.[7]

The text of the FCRA does not dictate the minimum amount of time an employer must wait between mailing the pre-adverse action and adverse action notices. One fairly accepted standard was five business days, although recent class action cases suggest that employers may want to wait more than five business days.

Recent Federal District Court Decisions Addressing Pre-Adverse Action Notices

In *Jones v. Halstead Management Company, LLC,* a property management firm conducted a criminal

3 15 U.S.C. § 1681a(k)(1)(B)(iv).

4 *See 40 Years of Experience with the Fair Credit Reporting Act: An FTC Staff Report with Summary of Interpretations* at https://www.ftc.gov/reports/40-years-experience-fair-credit-reporting-act-ftc-staff-report-summary-interpretations.

5 15 U.S.C. § 1681b(b). If an individual contacts the employer in response to the pre-adverse action notice to say there was a mistake (inaccuracy or incompleteness) in the consumer report, the employer may exercise its discretion whether or not to move forward with the hiring decision or engagement; the FCRA does not dictate a course of action. However, by law, the consumer reporting agency must within 30 days promptly investigate any dispute about the accuracy or completeness of the report from the individual. 15 U.S.C. § 1681i. If the consumer reporting agency updates the consumer report, both the individual and the employer will receive notice.

6 15 U.S.C. § 1681m(a).

7 *Id.* DOT-regulated motor carriers are not required to provide a "pre-adverse action" notice to applicants or employees if the applicant applied for employment by mail, telephone, computer or other similar means. 15 U.S.C. § 1681b(b)(3)(B). Rather, motor carriers must provide to the individual, within three days of taking adverse action, an oral, written or electronic notification that adverse action has been taken, which must include the same disclosures required in "adverse action" notices for non-trucking employers.

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background check on the plaintiff who had been offered a position as a doorman.[8] On July 16, after receiving the background report, the firm informed the plaintiff that his background report contained several criminal charges and that the plaintiff "did not meet the building's hiring criteria." That same day, a firm representative called the plaintiff and informed him over the phone that his background report contained criminal information. The plaintiff advised the firm that the report was inaccurate because he did not have a criminal history. (In fact, he was correct.) Regardless, the plaintiff received a "Pre-Adverse Action Notice" dated July 17. The notice advised the plaintiff that the firm had "decided to revoke [his] conditional offer of employment" based on the information in the background report.

In his lawsuit, the plaintiff claimed that the firm violated the FCRA because, among other reasons, the July 17 notice "revoked his offer of employment based upon" the background report—"a revocation that occurred before he received notice that [the firm] intended to take adverse action on the basis of the report, before he was provided with a copy of the report, and *before* he had a meaningful opportunity to dispute it." The firm, along with the background check company, filed a motion to dismiss, claiming the plaintiff did have an opportunity to dispute the information in the background report before it took adverse action against him.[9] The court denied the defendants' motion.

The crux of the defendants' argument favoring dismissal of plaintiff's pre-adverse action claim was that the firm did not take adverse action against the plaintiff "when it made an internal decision to revoke Plaintiff's offer of employment and stopped the onboarding process." Instead, they argued, "an adverse action does not occur until the decision is communicated or takes effect." They also argued that the firm "refrained from taking adverse action until [the background check company] informed [the firm] of the results of Plaintiff's dispute."

In rejecting the defendants' argument that the firm had not made a "final decision" to revoke the plaintiff's offer before he had an opportunity to dispute the report and that "stopping the onboarding process" did not constitute an "adverse action," the court pointed directly to the July 17 letter to the plaintiff that expressly stated the firm had "decided to revoke your conditional offer of employment." The court did, however, acknowledge the possibility that after discovery, the defendants "may well be able to demonstrate that there is a question of fact that the unequivocal language in the questionably-titled 'Pre-Adverse Action Notice' was simply infelicitous because no decision had been made." The court denied the defendants' motion.

On the other hand, the employer in *Ramos v. Genesis Healthcare, LLC*, received a more favorable ruling.[10] In that class action case, the plaintiff received an offer of employment that was conditioned on receipt of a satisfactory background investigation. Several days later, on July 18, the background report revealed three prior criminal convictions, including one felony conviction involving injury to a child. At this time, consistent with the employer's adjudication rules, the background check vendor adjudicated the plaintiff's background report as "Requires HR Review." After an internal review of the plaintiff's criminal record, on July 22, the employer graded the plaintiff's report as "Does Not Meet." That same day, the employer sent to the plaintiff a letter, which included a copy of the background report and a summary of rights. The letter also advised the plaintiff, in part, that the employer "has or will be completing [its] review of your application within the next few days, and may take action based on the enclosed report," and that the plaintiff had the right to contact the background check vendor to dispute the information contained in the report.

8 81 F. Supp. 3d 324 (S.D.N.Y. Jan. 27, 2015).

9 The firm filed a third-party complaint against the background check company alleging that by contract, the background check company rather than the firm had an obligation to manage the pre-adverse action notice process.

10 2015 U.S. Dist. LEXIS 133699 (E.D. Pa. Oct. 1, 2015).

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On July 25, three days later, the employer called the plaintiff and explained that her application had been "flagged" due to her felony conviction. The plaintiff acknowledged that she had been charged with a felony, but stated that she pleaded to a lesser offense. After internal discussions, the employer notified the plaintiff on July 29 of the decision to revoke her job offer. That same day, the employer sent a letter to the plaintiff advising of the adverse decision.

In her lawsuit claiming the employer violated the FCRA's pre-adverse action notice requirement, the plaintiff claimed the July 22 letter and internal notes and emails, including her being graded as "Does Not Meet," prove the employer *actually* made the decision to revoke her offer before July 22. Thus, argued the plaintiff, she had "no real opportunity to contest the report forming the basis of this decision." The employer argued it did not take adverse action against the plaintiff until its July 29 letter informing her of the final decision.

At the outset, the court, citing prior federal court decisions, state that "a preliminary decision to take adverse action does not trigger the FCRA's notice obligation." According to the court: "The FCRA 'expressly allows for the formation of an intent to take adverse action before complying with §1681b(b)(3) because it states that 'the person intending to take' adverse action must provide the report and description of rights prior to taking the adverse action." In other words, "[t]he formation of intent, therefore, cannot be the adverse action itself."

In granting the employer's motion for summary judgment, the court found that "even if [the employer] formed an intent to revoke [the plaintiff's] offer, its internal decision to take an adverse action based on a consumer report does not violate [the FCRA] because an adverse action does not occur until the decision is communicated or takes effect." The employer presented undisputed evidence that it considered the plaintiff's information about her criminal record and made the final decision after the plaintiff had the opportunity to respond and provide that information. In fact, the plaintiff did so by explaining her position to the employer both by phone and email. According to the court: "She received notice and took advantage of the opportunity."

The court distinguished one decision holding to the contrary because in that case, the employer simply implemented its preliminary adverse decision without any further communication with the applicant or consideration of whether the applicant had filed a dispute once the adverse hiring decision had been made. By contrast, in Ramos, the employer presented undisputed evidence that it had conversations with the plaintiff and actually considered the plaintiff's information about her criminal record, which refuted the plaintiff's argument that the initial grade "Does Not Meet" was, in fact, a *final* decision. In sum, according to the court:

> [The employer's] internal decision on July 21 and 22, 2014 did not constitute a final decision. It is entitled to make an internal determination of "intent" to revoke the employment offer so long as it affords [the plaintiff] a real opportunity to challenge this internal determination. All of the evidence confirms [the plaintiff] took advantage of the opportunity and [the employer] evaluated her challenge, discussed it internally and only then reached a final decision. Accordingly, the July 22, 2014 pre-adverse action notice complied with the FCRA.

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Considerations for Employers

Now more than ever, it is advisable for employers that use background checks for employment purposes to take steps to ensure compliance with the applicable provisions of the FCRA. There is more FCRA litigation against employers for alleged willful violations of the FCRA than ever before, especially class action litigation against larger, national employers. In addition, because various other laws affect the use of background checks for employment purposes, such as Title VII of the Civil Rights Act of 1964 and state fair employment and fair credit reporting laws, employers should continue to be mindful of their obligations to comply with all of these laws.

Employers also should:

- Consider the potential significance of the FTC's position with respect to how they vet incumbents for promotions and lateral transfers (even ones without an increase or reduction in pay) and how, if at all, they use consumer reports to take disciplinary action against employees.
- Consider periodically auditing their background check policies and procedures to ensure that applicants and employees are being provided with an adequate amount of time to consider the information contained in their background check reports. It also would be prudent for employers to review the indemnity provision in their "subscriber agreements" with CRAs. Employers may outsource the process of mailing the notices, but the employer remains potentially liable under the statute.
- Take steps to ensure that they are providing applicants and employees with the most recent version of the Summary of Rights document.
- Consider how to best record personnel decisions such that, if necessary, the employer can prove that the reason an applicant was rejected was because of a poor interview, failure to provide requested follow-up information, drug test failure, etc., rather than based—even in part—on the background report.

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