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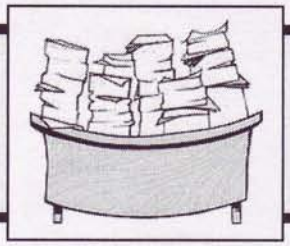

Preventing Identity Theft: Must Employers Shred Employee Background Reports?

by Paul J. McCue

Employers conducting background checks on job applicants and current employees must now comply with a new regulation that is part of a federal initiative to prevent identity theft under the Fair Credit Reporting Act ("FCRA").[1] Unlike the longstanding FCRA requirements that deal with the mandatory disclosures to job applicants and employees, the new federal rule governs how employers should dispose of the information obtained in employee background reports. This regulation, which took effect on June 1, 2005, requires all employers to shred or otherwise effectively destroy information obtained on applicants and employees.

This article reviews the existing requirements under the FCRA for conducting background checks on employees and penalties for violations of the FCRA. It also describes the new regulation concerning disposal of information and offers practical tips for complying with the new regulation.

General Requirements of the FCRA

Employers might have a variety of reasons for seeking a report concerning the background of a job applicant or a current employee. For example, an employer might want to know the financial status of an employee who controls or has spending authority over large amounts of money or, more typically, employers want to be sure an applicant does not have a criminal record. If handled properly, background checks on employees can assist employers, including law firms, in their decision-making and minimize the risk of negligent hiring or negligent retention claims.

Although the FCRA repeatedly refers to "consumers,"[2] that term is defined to mean any "individual."[3] The law specifically governs "background reports" obtained for employment purposes, which are defined as reports "used for the purpose of evaluating a consumer for employment, promotion, reassignment or retention as an employee."[4] One of the permissible purposes for which a reporting agency can lawfully furnish a report to a third party is that it believes the report will be used for employment purposes.[5]

There are two types of consumer reports, and they have different disclosure requirements. The first type is a general "consumer report" that contains information, either written or oral, obtained from a reporting agency bearing on an individual's creditworthiness, character, general reputation, personal characteristics, or mode of living.[6] The second type of report defined in the FCRA is an "investigative consumer report," which also contains information that reflects on an individual's character, general reputation, personal characteristics, or mode of living. However, the investigative consumer report differs from the consumer report in that it includes information gathered from personal interviews with neighbors, friends, associates, or "others with whom he is acquainted or who may have knowledge concerning" the individual.[7]

Disclosure Requirements

The FCRA mandates that an employer comply with the following procedures for obtaining and using either a consumer report or an investigative consumer report on a job applicant or an existing employee:

1. The employer must provide the individual with a clear and conspicuous disclosure in writing that it may obtain a consumer report on the individual. This disclosure document must consist solely of the disclosure,[8] and therefore cannot be included within an employment application form.
2. The individual must give written authorization for the employer to obtain the report.[9] However, the employer need not make the disclosure and obtain the individual's authorization immediately preceding every consumer report that it obtains on the employee. At the start of employment, an employer can make a single, blanket disclosure and obtain a single authorization that covers the entire period of the individual's employment.[10]

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3. Before taking any adverse action based on the report, such as denying employment to an applicant, the employer must provide the individual a copy of the report and a written description of his or her rights under the FCRA.[11] The notice of rights can be obtained on a form provided by the U.S. Federal Trade Commission ("FTC").[12]
4. After providing a copy of the report and the FTC notice, if an employer takes an adverse action based in whole or in part on the report, the employer must provide the following to the individual: (a) notice of the adverse action taken, such as the decision not to hire or to terminate employment; (b) the name, address, and phone number of the reporting agency from which the report was obtained; (c) a statement that the reporting agency did not make the decision to take the adverse action and cannot provide specific reasons the action was taken; (d) notice of the individual's right to obtain a free copy of his or her report from the reporting agency within sixty days; and (e) notice of the individual's right to dispute the accuracy or completeness of the information in his or her report with the reporting agency.[13]

Specific Investigative Report Requirements

When obtaining an *investigative* consumer report, in which information is obtained by a consumer-reporting agency through personal interviews, an employer also must comply with additional requirements under the FCRA. The employer must provide a written notice to the individual within three days of initiating the investigation by the reporting agency.[14] The notice must inform the individual of his or her right to request complete and accurate information from the employer concerning the nature and scope of the investigation.[15] The notice also must include a written summary of the individual's rights under the FCRA.[16]

If the individual requests information on the nature and scope of the investigation, the employer must provide a complete and accurate response in writing within five days of receiving the request, or five days after the report has been requested from the reporting agency, whichever is later.[17] The employer's response should describe the nature and scope of the investigation,[18] such as the topic of the investigation or the questions asked, the number and types of people interviewed, and the name and address of the investigating agency.

Penalties and Damages for Violations of the FCRA

Violations of the FCRA can result in civil penalties of up to $2,500 in an action brought by the FTC.[19] Individuals can sue for willful violations of the FCRA to recover actual damages they suffer up to $1,000, plus punitive damages and attorney fees and costs awarded by the court.[20] Individuals also can sue for emotional distress and loss of reputation under the FCRA.[21] In 2004, the FTC filed suit against two casinos that allegedly denied employment to applicants without providing the proper disclosures. The casinos settled the suit by entering into a consent decree with the FTC and agreeing to pay $325,000 in civil penalties.[22]

Obtaining a consumer report under false pretenses or without a permissible purpose can make a company liable to a consumer-reporting agency for the greater of $1,000 or the actual damages sustained by the agency.[23] Knowingly and willfully obtaining information on an individual from a consumer reporting agency under false pretenses also is a crime that can subject a person to fines and up to two years in prison.[24]

New Requirements for Disposal of Consumer Reports

Effective June 1, 2005,[25] the new FCRA regulation related to background checks requires employers to take "reasonable measures to protect against unauthorized access to or use of" information obtained in consumer reports when disposing of it.[26] The regulation also provides examples of such "reasonable measures." One example would be to adopt policies and procedures that "require the burning, pulverizing, or shredding of papers containing consumer information, so that the information cannot practicably be read or reconstructed."[27]

The new rule on disposal of consumer information was issued by the FTC as part of the Fair and Accurate Credit Transactions Act of 2003 ("FACTA").[28] FACTA amended the FCRA in several ways to protect the confidentiality of information that businesses and reporting agencies maintain on individuals.[29] For example, FACTA enables identity theft victims to place "fraud alerts" on their credit files and to work with creditors and credit bureaus to block information in their credit reports resulting from identity theft.[30]

The FTC regards the rule as setting a flexible standard for the proper disposal of consumer information, so companies must determine what measures are reasonable based on the sensitivity of the information, the costs and benefits of different disposal methods, and the company's nature and size.[31] Because the FTC standard is flexible and not intended to address every type of business and every situation that might arise, the examples provided in the regulations "are illustrative only and are not exclusive or exhaustive methods for complying with the rule."[32] For example, the regulations recognize that the consumer information could be maintained in an electronic format, so that employers might need to implement special procedures for destroying or erasing electronic media.[33]

For companies that hire commercial shredding operations to shred large volumes of their documents, the new rule anticipates the company will exercise some due diligence to ensure that the commercial shredder is complying with the rule. For example, according to the FTC regulations, the due diligence exercised by a company to ensure a third party is properly disposing of its sensitive information could include:

- reviewing an independent audit of the disposal company's operations and its compliance with this rule
- obtaining information about the disposal company from several references or other reliable sources
- requiring that the disposal company be certified by a recognized trade association or similar third party
- reviewing and evaluating the disposal company's information-related security policies and procedures
- taking other measures to determine the competency and integrity of the disposal company.[34]

Record Retention Laws Unaffected

Although the FTC regulation imposes new requirements for employers to follow when disposing of protected information, it does not impact any existing laws or regulations that govern which documents employers should dispose of and which they should retain. The new regulations specifically do not "alter or

affect any requirement imposed under any other provision of law to maintain or destroy such a record."[35] Thus, the regulations only govern "how" the employee background reports should be disposed of, without requiring that the reports necessarily be disposed of and without impacting any record retention obligations on how long employers should retain records.[36]

Practical Advice for Compliance

Employers should become familiar with the new rule concerning the disposal of FCRA reports, and provide updated training to all individuals who deal with employee background checks and other private information concerning individuals. Although the rule does not require any particular method to be used, employers should consider taking advantage of relatively inexpensive shredding machines and software programs that wipe or erase electronic data.

When a company contracts with another party to shred documents, including employee background reports, employers should consider stating in the company contract that the documents given to the vendor for shredding will include sensitive information subject to this federal rule. The company contract also should state that the shredding company will comply with the rule by making the information secure from unauthorized access.

NOTES

1. 15 U.S.C.A. §§ 1681a to 1681x. The statute is available online at the Federal Trade Commission website, http://ftc.gov. Under "Contents" on the home page, click on "Legal Resources," then "Statutes Enforced by FTC," then on "Consumer Protection Mission," and scroll down to "Fair Credit Reporting Act."
2. *Id.*
3. 15 U.S.C.A. § 1681a(c).
4. 15 U.S.C.A. §§ 1681a(d)(B) and 1681a(h).
5. 15 U.S.C.A. §§ 1681b(a)(3)(B) and 1681(b); *Comeaux v. Brown & Williamson*, 915 F.2d 1264, 1273-74 (9th Cir. 1990) (obtaining report on employee under false pretenses covered by FCRA and subjects employer to liability).
6. 15 U.S.C.A. § 1681a(d).
7. 15 U.S.C.A. § 1681a(e); *Belshaw v. Credit Bureau of Prescott*, 392 F.Supp. 1356, 1360 (D.Ariz. 1975) (§§ 1681d and 1681l apply only to investigative reports and not applicable where contested report was "consumer report" rather than "investigative consumer report").
8. 15 U.S.C.A. § 1681b(b)(2)(A)(i).
9. 15 U.S.C.A. § 1681b(b)(2)(A)(ii).
10. *Kelchner v. Sycamore Manor Health*, 305 F.Supp.2d 429, 434 (M.D.Pa. 2004).
11. 15 U.S.C.A. § 1681b(b)(3)(A).
12. A copy of the notice can be found in C.F.R., Title 16, Pt. 698, App. F, or by accessing http://ftc.gov. Under "Contents" on the home page, click on "Legal Resources," then "FTC Rules (16–999)," then scroll down to "Part 698—Model Forms."
13. 15 U.S.C.A. § 1681m(a).
14. 15 U.S.C.A. § 1681d(a).
15. *Id.*; 15 U.S.C.A. § 1681g(c).
16. *Id.*
17. 15 U.S.C.A. § 1681d(b).
18. *Id.*
19. 15 U.S.C.A. § 1681s(a)(2)(A).
20. 15 U.S.C.A. § 1681n(a).
21. *Dalton v. Capital Assoc. Indus., Inc.*, 257 F.3d 409, 418-19 (4th Cir. 2001); *Zamora v. Valley Fed. Savs. & Loan Ass'n*, 811 F.2d 1368, 1371 (10th Cir. 1987).
22. No. CV-S-04-0963 (U.S. Dist.Ct., Dist. of Nevada, July 13, 2004), Consent Decree.
23. 15 U.S.C.A. § 1681n(b).
24. 15 U.S.C.A. § 1681q.
25. 16 C.F.R. § 682.5.
26. 16 C.F.R. § 682.3(a).
27. 16 C.F.R. § 682.3(b)(1).
28. 15 U.S.C.A. § 1681w.
29. 15 U.S.C.A. §§ 1681c-1, c-2, s-3, w, and x; 20 U.S.C.A. §§ 9701 *et seq.*
30. 15 U.S.C.A. § 1681c-1 and c-2.
31. *Disposal of Consumer Report Information and Records*, 69 Fed. Reg. 68,690, 68,693 (Nov. 24, 2004) (Federal Trade Commission analysis of rules and discussion).
32. 16 C.F.R. § 682.3(b).
33. 16 C.F.R. § 682.3(b)(2).
34. 16 C.F.R. § 682.3(b)(3).
35. 15 U.S.C.A. § 1681w(b); 16 C.F.R. § 682.4.
36. Record retention requirements under state and federal laws and related common law causes of action are beyond the scope of this article. The U.S. Equal Employment Opportunity Commission ("EEOC") generally requires employers to keep payroll records for three years and other employment records for one year from the making of the record or the date of the personnel action involved. After the involuntary termination of an employee, the personnel records of the employee should be retained for one year from the date of termination. The filing of an EEOC charge requires the immediate preservation of records through the termination of any resulting litigation. *See* 29 C.F.R. §§ 1602.14 and 1627.3. ■

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