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In *Rea v. Federated Investors*, No. 10-1440 (3d Cir. Dec. 15, 2010), the U.S. Court of Appeals for the Third Circuit held that the anti-discrimination provision in the Bankruptcy Code does not prohibit a private employer from refusing to hire an individual because he or she previously filed for bankruptcy. In so holding, the Third Circuit endorsed the view adopted by the vast majority of district courts – and became the first appellate court – to clarify a timely issue for employers that use credit history information to screen job applicants.

## Third Circuit Clarifies that Bankruptcy Code Does Not Prohibit Employers from Considering Previous Bankruptcies in Hiring Decisions

By Rod Fliegel and William Simmons

### Introduction

In *Rea v. Federated Investors*, No. 10-1440 (3d Cir. Dec. 15, 2010), the U.S. Court of Appeals for the Third Circuit weighed in on a timely issue for private sector employers: whether Section 525 of the Bankruptcy Code prohibits a private employer from rejecting job applicants based on a bankruptcy filing. The Third Circuit held that the statute's reach does not extend to the hiring process, and it affirmed the district court's order dismissing the case on the pleadings. The court's decision is plainly favorable to private sector employers with operations in the Third Circuit,<sup>1</sup> but employers still should be mindful of several related legal considerations.

### Background

Plaintiff Dean Rea applied through a placement firm for employment with Federal Investors in 2009. Although he thought that he would be hired after his initial interview, Rea was informed that he would not be hired because he had filed for bankruptcy in 2002. Rea sued, claiming that Federated Investors' refusal to hire him violated a provision in the Bankruptcy Code that prohibits private employers from engaging in certain actions regarding individuals who have claimed bankruptcy. The district court dismissed Rea's claims on the pleadings, finding that Section 525(b) of the Bankruptcy Code does not provide Rea with a cause of action for discriminatory refusal to hire. Rea appealed.

### Holding

In affirming the district court's ruling, the Third Circuit focused on the language and structure of Section 525 in its decision. The court pointed out that Section 525(a) includes broad provisions preventing a *governmental unit* from, among other things, "deny[ing] employment to, terminat[ing] the employment of, or discriminat[ing] against, a person that is or has been a debtor . . . or another person with whom such bankrupt or debtor has been associated." Section 525(b), however, is narrower in terms of the

restrictions imposed on private sector employers, requiring that they refrain only from “terminat[ing] the employment of, or discriminat[ing] with respect to employment against, an individual who is or has been a debtor under this title . . . or an individual associated with such debtor or bankrupt.”

Although Rea argued that Section 525(b) should be read broadly to also include a prohibition on private sector employers refusing to hire a person because of his or her bankruptcy history, the court held that the plain language of Section 525 should be respected, stating that it would not “contravene congressional intent by implying statutory language that Congress omitted.” The court noted the otherwise parallel structure of Section 525(a) and (b), and it found that the omission of the phrase “deny employment to” in Section 525(b) expressed an “abundantly clear” congressional intent to lessen the obligations placed on private sector employers as compared to the government. The court rejected the view of one federal judge in the Southern District of New York that Section 525(b) should be given the expansive reading that Rea suggested, and it chose to follow what it called the “overwhelming” authority provided by other rulings by both bankruptcy and district courts supporting its conclusion that Section 525(b) does not prohibit private sector employers from refusing to hire a job applicant due to a bankruptcy.

## Despite Third Circuit’s Ruling, Employers Must Continue to Exercise Caution in Using Credit History Information

Although the court’s decision is plainly favorable to employers with operations in the Third Circuit, employers, especially multi-state employers, should be mindful of several related considerations.

To begin with, the decision only applies to hiring decisions. Private sector employers are still prohibited by the Bankruptcy Code from relying on bankruptcy filings to make adverse personnel decisions concerning, and otherwise discriminating against, incumbents.

Employers also should be aware that, based on the fair credit reporting laws, background reports usually will not include bankruptcy filings after a certain amount of time has passed since the date of entry of the order for relief or the date of adjudication. In other words, the fair credit reporting laws may prevent an employer from learning about a prior bankruptcy filing in the first instance.

Of course, employers must continue to comply with all of the procedural requirements that the federal Fair Credit Reporting Act (FCRA) and its state law equivalents place on employers who rely on background reports (known as “consumer reports”) procured from a background check company (known as a “consumer reporting agency”). These requirements include, but are not limited to, the obligation to secure advance authorization from job applicants to order background checks and to mail the required “adverse action” notices whenever job applicants are rejected based, in whole or in part, on derogatory information in background reports (e.g., derogatory credit history information).

Additionally, the U.S. Equal Employment Opportunity Commission (EEOC) has long held (and recently reaffirmed) the view that the indiscriminate use of credit history information by employers will violate Title VII of the Civil Rights Act of 1964 if the employer’s screening practices have a disparate impact on protected class members. Earlier this year, the EEOC posted a related letter on its website, and it just recently held a hearing for public comment on the general topic. Just this week, the EEOC filed a putative nationwide Title VII race discrimination case in federal court in Ohio that alleges disparate impact based on the employer’s use of credit reports.

Finally, state laws restricting the use credit history information by employers have been gaining momentum. Four states – Washington, Hawaii, Oregon and Illinois – prohibit by statute the use of such information unless it is specifically job related. More states are currently considering such legislation, and a bill was introduced in Congress that would similarly amend the FCRA.

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<sup>1</sup> The Third Circuit Includes Pennsylvania, New Jersey, and Delaware.