

Internal Investigations Update: Employer’s Right to Terminate Employees Who Refuse to Cooperate with Internal Investigation Upheld

In a June 16 decision (available [here](#)), the U.S. Court of Appeals for the Second Circuit affirmed a lower court’s decision to dismiss a lawsuit filed by two executives at a New York insurance company who claimed they were wrongfully terminated for their refusal to cooperate in the company’s internal investigation. The decision affirmed the principle that employers may terminate employees for cause if they fail to cooperate in an internal investigation.

In September 2004, the New York Attorney General (“AG”) began investigating an alleged bid-rigging scheme. During a defendant’s guilty plea in connection with the AG’s investigation, that defendant alleged that two executive employees of one of the relevant companies, William Gilman and Edward McNenney, Jr., were co-conspirators in the scheme. Shortly thereafter, the employees were suspended and company counsel requested that they consent to be interviewed as part of the company’s internal investigation, warning that failure to comply with the request would result in their termination.

A short time later, the AG issued a press release concerning the investigation in which the AG announced that criminal prosecutions arising out of the wrongdoing would be limited to individuals. This announcement was, according to the Court’s decision, “widely understood” to mean the AG would indict Gilman and McNenney. As a result, the two executives refused to be interviewed for the internal investigation, and they were fired.

As executives, Gilman and McNenney earned, among other things, stock options and stock bonus units, but many of those benefits were forfeited under their contracts because they were terminated “for cause.” Gilman and McNenney filed suit for lost benefits, arguing that their terminations were not for cause. The trial court granted a motion for summary judgment against Gilman and McNenney, finding that the interview requests were reasonable and the refusal to participate gave cause for termination.

Under Delaware law, which governed the employment contracts at issue, “cause” for termination includes the refusal to “obey a direct, unequivocal, reasonable order of the employer.” The plaintiffs maintained that the orders were unreasonable.

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On appeal, the Court of Appeals concluded that the orders were reasonable, and the plaintiffs' refusal to comply gave cause for termination. The Court explained that the company "was presumptively entitled to seek information from its own employees about suspicions of on-the-job criminal conduct." Moreover, the company could take measures to "protect its standing with investors, clients, employees, and regulators," and it had a duty to shareholders to investigate potentially criminal conduct by employees.

The Court acknowledged that the interview demands "placed [the plaintiffs] in the tough position of choosing between employment and incrimination," but it found that the personal right to not sit for interviews "does not immunize [them] from all collateral consequences that come from [those] act[s]." According to the Court, the company had to use the threat of discharge, "because in the absence of exculpatory explanation, [the company] needed to assume the worst: that the . . . allegations were true and that [it] was vicariously liable for their criminal conduct." In sum, the company "did what any other company would do, and (arguably) what any company should do."

The plaintiffs also argued that their employer's interview demands were unreasonable because they constituted "state action" in violation of their Fifth Amendment right against self incrimination. In support of this position, the plaintiffs urged the adoption of a categorical rule under which a private company's actions amount to state action when they are taken in response to government action, and at least one purpose in taking the actions is to obtain better treatment from the government. Again, the Court of Appeals disagreed, stating that a rule that deems all companies who cooperate with a governmental investigation to be state actors "would be incompatible with corporate governance and modern regulation." There is no state action when the company "had independent regulatory interest and motives for making [its] inquiries and for cooperating with [a] parallel investigation[] being conducted by the government." Because the company had a "supremely reasonable, independent interest" in conducting an internal investigation, its requests for interviews were not a state action.

This ruling follows other U.S. Courts of Appeals that have upheld an employer's right to terminate employees for failing to cooperate or lying in an internal investigation.¹ In the wake of this decision, companies investigating allegations of wrongdoing should take additional comfort that that they may terminate employees for cause if they fail to cooperate in an internal investigation.

¹ See *E.E.O.C. v. Total Sys. Servs., Inc.*, 221 F.3d 1171 (11th Cir. 2000) (finding that an employer can properly discharge an employee based on its good faith belief that the employee lied in an internal investigation into sexual harassment allegations); see also *Wood v. Summit County Fiscal Office*, 377 F. App'x 512 (6th Cir. 2010) (finding that the county's reasons for terminating an employee, including failure to cooperate in an internal investigation, were proper and not retaliatory); *Redd v. Nolan*, 663 F.3d 287 (7th Cir. 2011) (finding that a public employer did not retaliate by terminating an employee who refused to cooperate in an investigation in violation of the department's regulations).

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