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(c) The term *any political subdivision of a State or local government* means any entity which is either.

(1) Created directly by a state or local government, or

(2) Administered by individuals who are responsible to public officials (i.e., appointed by an elected public official(s) and/or subject to removal procedures for public officials, or to the general electorate.

(d) This exclusion from the Act applies only to the Federal, State, and local government entity with respect to its own public employees. Except as provided in sections 7 (b) and (c) of the Act, and § 801.11 of the regulations, this exclusion does not extend to contractors or nongovernmental agents of a government entity, nor does it extend to government entities with respect to employees of a private employer with which the government entity has a contractual or other business relationship.

§ 801.11 Exemption for national defense and security.

(a) The exemptions allowing for the administration of lie detector tests in the following paragraphs (b) through (e) of this section apply only to the Federal Government; they do not allow private employers/contractors to administer such tests.

(b) Section 7(b)(1) of the Act provides that nothing in the Act shall be construed to prohibit the administration of any lie detector test by the Federal Government, in the performance of any counterintelligence function, to any expert, consultant or employee of any contractor under contract with the Department of Defense; or with the Department of Energy, in connection with the atomic energy defense activities of such Department.

(c) Section 7(b)(2)(A) provides that nothing in the Act shall be construed to prohibit the administration of any lie detector test by the Federal Government, in the performance of any intelligence or counterintelligence function of the National Security Agency, the Defense Intelligence Agency, or the Central Intelligence Agency, to any individual employed by, assigned to, or detailed to any such agency; or any expert or consultant under contract to any such agency; or any employee of a contractor to such agency; or any individual applying for a position in any such agency; or any individual assigned to a space where sensitive cryptologic information is produced, processed, or stored for any such agency.

(d) Section 7(b)(2)(B) provides that nothing in the Act shall be construed to prohibit the administration of any lie detector test by the Federal Government, in the performance of any intelligence or counterintelligence function, to any expert, or consultant (or employee of such expert or consultant) under contract with any Federal Government department, agency, or program whose duties involve access to information that has been classified at the level of top secret or designated as being within a special access program under section 4.2 (a) of Executive Order 12356 (or a successor Executive Order).

(e) Section 7(c) provides that nothing in the Act shall be construed to prohibit the administration of any lie detector test by the Federal Government, in the performance of any counterintelligence function, to any employee of a contractor of the Federal Bureau of Investigation of the Department of Justice who is engaged in the performance of any work under a contract with the Bureau.

(f) *Counterintelligence* for purposes of the above paragraphs means information gathered and activities conducted to protect against espionage and other clandestine intelligence activities, sabotage, terrorist activities, or assassinations conducted for or on behalf of foreign governments, or foreign or domestic organizations or persons.

(g) Lie detector tests of persons described in the above paragraphs will be administered in accordance with applicable Department of Defense directives and regulations, or other regulations and directives governing the use of such tests by the United States Government, as applicable.

§ 801.12 Exemption for employers conducting investigations of economic loss or injury.

(a) Section 7(d) of the Act provides a limited exemption from the general

prohibition on lie detector use in private employment settings for employers conducting ongoing investigations of economic loss or injury to the employer's business. An employer may request an employee, subject to the conditions set forth in sections 8 and 10 of the Act and §§ 801.20, 801.22, 801.23, 801.24, 801.25, 801.26, and 801.35 of this part, to submit to a polygraph test, but no other type of lie detector test, only if—

(1) The test is administered in connection with an ongoing investigation involving economic loss or injury to the employer's business, such as theft, embezzlement, misappropriation or an act of unlawful industrial espionage or sabotage;

(2) The employee had access to the property that is the subject of the investigation;

(3) The employer has a reasonable suspicion that the employee was involved in the incident or activity under investigation;

(4) The employer provides the examinee with a statement, in a language understood by the examinee, prior to the test which fully explains with particularity the specific incident or activity being investigated and the basis for testing particular employees and which contains, at a minimum:

(i) An identification with particularity of the specific economic loss or injury to the business of the employer;

(ii) A description of the employee's access to the property that is the subject of the investigation;

(iii) A description in detail of the basis of the employer's reasonable suspicion that the employee was involved in the incident or activity under investigation; and

(iv) Signature of a person (other than a polygraph examiner) authorized to legally bind the employer; and

(5) The employer retains a copy of the statement and proof of service described in paragraph (a)(4) of this section for at least 3 years and makes it available for inspection by the Wage and Hour Division on request. (See § 801.30(a).)

(Approved by the Office of Management and Budget under control number 1225–0170)

(b) For the exemption to apply, the condition of an ''ongoing investigation'' must be met. As used in section 7(d) of the Act, the ongoing investigation must be of a specific incident or activity. Thus, for example, an employer may not request that an employee or employees submit to a polygraph test in an effort to determine whether or not any thefts have occurred. Such random testing by an employer is precluded by the Act. Further, because the exemption is limited to a specific incident or activity, an employer is precluded from using the exemption in situations where the so-called ''ongoing investigation'' is continuous. For example, the fact that items in inventory are frequently missing from a warehouse would not be a sufficient basis, standing alone, for administering a polygraph test. Even if the employer can establish that unusually high amounts of inventory are missing from the warehouse in a given month, this, in and of itself, would not be a sufficient basis to meet the specific incident requirement. On the other hand, polygraph testing in response to inventory shortages would be permitted where additional evidence is obtained through subsequent investigation of specific items missing through intentional wrongdoing, and a reasonable suspicion that the employee to be polygraphed was involved in the incident under investigation. Administering a polygraph test in circumstances where the missing inventory is merely unspecified, statistical shortages, without identification of a specific incident or activity that produced the inventory shortages and a ''reasonable suspicion that the employee was involved,'' would amount to little more than a fishing expedition and is prohibited by the Act.

(c)(1)(i) The terms *economic loss or injury to the employer's business* include both direct and indirect economic loss or injury.

(ii) Direct loss or injury includes losses or injuries resulting from theft, embezzlement, misappropriation, industrial espionage or sabotage. These examples, cited in the Act, are intended to be illustrative and not exhaustive. Another specific incident

which would constitute direct economic loss or injury is the misappropriation of confidential or trade secret information.

(iii) Indirect loss or injury includes the use of an employer's business to commit a crime, such as check-kiting or money laundering. In such cases, the ongoing investigation must be limited to criminal activity that has already occurred, and to use of the employer's business operations (and not simply the use of the premises) for such activity. For example, the use of an employer's vehicles, warehouses, computers or equipment to smuggle or facilitate the importing of illegal substances constitutes an indirect loss or injury to the employer's business operations. Conversely, the mere fact that an illegal act occurs on the employer's premises (such as a drug transaction that takes place in the employer's parking lot or rest room) does not constitute an indirect economic loss or injury to the employer.

(iv) Indirect loss or injury also includes theft or injury to property of another for which the employer exercises fiduciary, managerial or security responsibility, or where the firm has custody of the property (but not property of other firms to which the employees have access by virtue of the business relationship). For example, if a maintenance employee of the manager of an apartment building steals jewelry from a tenant's apartment, the theft results in an indirect economic loss or injury to the employer because of the manager's management responsibility with respect to the tenant's apartment. A messenger on a delivery of confidential business reports for a client firm who steals the reports causes an indirect economic loss or injury to the messenger service because the messenger service is custodian of the client firm's reports, and therefore is responsible for their security. Similarly, the theft of property protected by a security service employer is considered an economic loss or injury to that employer.

(v) A theft or injury to a client firm does not constitute an indirect loss or injury to an employer unless that employer has custody of, or management, or security responsibility for, the property of the client that was lost or stolen or injured. For example, a cleaning contractor has no responsibility for the money at a client bank. If money is stolen from the bank by one of the cleaning contractor's employees, the cleaning contractor does not suffer an indirect loss or injury.

(vi) Indirect loss or injury does not include loss or injury which is merely threatened or potential, e.g., a threatened or potential loss of an advantageous business relationship.

(2) Economic losses or injuries which are the result of unintentional or lawful conduct would not serve as a basis for the administration of a polygraph test. Thus, apparently unintentional losses or injuries stemming from truck, car, workplace, or other similar type accidents or routine inventory or cash register shortages would not meet the economic loss or injury requirement. Any economic loss incident to lawful union or employee activity also would not satisfy this requirement. It makes no difference that an employer may be obligated to directly or indirectly incur the cost of the incident, as through payment of a ''deductible'' portion under an insurance policy or higher insurance premiums.

(3) It is the business of the employer which must suffer the economic loss or injury. Thus, a theft committed by one employee against another employee of the same employer would not satisfy the requirement.

(d) While nothing in the Act prohibits the use of medical tests to determine the presence of controlled substances or alcohol in bodily fluids, the section 7(d) exemption does not permit the use of a polygraph test to learn whether an employee has used drugs or alcohol, even where such possible use may have contributed to an economic loss to the employer (e.g., an accident involving a company vehicle).

(e) Section 7(d)(2) provides that, as a condition for the use of the exemption, the employee must have had access to the property that is the subject of the investigation.

(1) The word *access*, as used in section 7(d)(2), refers to the opportunity which an employee had to cause, or to aid or abet in causing, the specific economic loss or injury under investigation. The

term ''access'', thus, includes more than direct or physical contact during the course of employment. For example, as a general matter, all employees working in or with authority to enter a warehouse storage area have ''access'' to unsecured property in the warehouse. All employees with the combination to a safe have ''access'' to the property in a locked safe. Employees also have ''access'' who have the ability to divert possession or otherwise affect the disposition of the property that is the subject of investigation. For example, a bookkeeper in a jewelry store with access to inventory records may aid or abet a clerk who steals an expensive watch by removing the watch from the employer's inventory records. In such a situation, it is clear that the bookkeeper effectively has ''access'' to the property that is the subject of the investigation.

(2) As used in section 7(d)(2), *property* refers to specifically identifiable property, but also includes such things of value as security codes and computer data, and proprietary, financial or technical information, such as trade secrets, which by its availability to competitors or others would cause economic harm to the employer.

(f)(1) As used in section 7(d)(3), the term *reasonable suspicion* refers to an observable, articulable basis in fact which indicates that a particular employee was involved in, or responsible for, an economic loss. Access in the sense of possible or potential opportunity, standing alone, does not constitute a basis for ''reasonable suspicion''. Information from a co-worker, or an employee's behavior, demeanor, or conduct may be factors in the basis for reasonable suspicion. Likewise, inconsistencies between facts, claims, or statements that surface during an investigation can serve as a sufficient basis for reasonable suspicion. While access or opportunity, standing alone, does not constitute a basis for reasonable suspicion, the totality of circumstances surrounding the access or opportunity (such as its unauthorized or unusual nature or the fact that access was limited to a single individual) may constitute a factor in determining whether there is a reasonable suspicion.

(2) For example, in an investigation of a theft of an expensive piece of jewelry, an employee authorized to open the establishment's safe no earlier than 9 a.m., in order to place the jewelry in a window display case, is observed opening the safe at 7:30 a.m. In such a situation, the opening of the safe by the employee one and one-half hours prior to the specified time may serve as the basis for reasonable suspicion. On the other hand, in the example given, if the employer asked the employee to bring the piece of jewelry to his or her office at 7:30 a.m., and the employee then opened the safe and reported the jewelry missing, such access, standing alone, would not constitute a basis for reasonable suspicion that the employee was involved in the incident unless access to the safe was limited solely to the employee. If no one other than the employee possessed the combination to the safe, and all other possible explanations for the loss are ruled out, such as a break-in, the employer may formulate a basis for reasonable suspicion based on sole access by one employee.

(3) The employer has the burden of establishing that the specific individual or individuals to be tested are ''reasonably suspected'' of involvement in the specific economic loss or injury for the requirement in section 7(d)(3) to be met.

(g)(1) As discussed in paragraph (a)(4) of this section, section 7(d)(4) of the Act sets forth what information, at a minimum, must be provided to an employee if the employer wishes to claim the exemption.

(2) The statement required under paragraph (a)(4) of this section must be received by the employee at least 48 hours, excluding weekend days and holidays, prior to the time of the examination. The statement must set forth the time and date of receipt by the employee and be verified by the employee's signature. This will provide the employee with adequate pre-test notice of the specific incident or activity being investigated and afford the employee sufficient time prior to the test to obtain and consult with legal counsel or an employee representative.

(3) The statement to be provided to the employee must set forth with particularity the specific incident or activity being investigated and the basis for testing particular employees. Section 7(d)(4)(A) requires specificity beyond the mere assertion of general statements regarding economic loss, employee access, and reasonable suspicion. For example, an employer's assertion that an expensive watch was stolen, and that the employee had access to the watch and is therefore a suspect, would not meet the ''with particularity'' criterion. If the basis for an employer's requesting an employee (or employees) to take a polygraph test is not articulated with particularity, and reduced to writing, then the standard is not met. The identity of a co-worker or other individual providing information used to establish reasonable suspicion need not be revealed in the statement.

(4) It is further required that the statement provided to the examinee be signed by the employer, or an employee or other representative of the employer with authority to legally bind the employer. The person signing the statement must not be a polygraph examiner unless the examiner is acting solely in the capacity of an employer with respect to his or her own employees and does not conduct the examination. The standard would not be met, and the exemption would not apply if the person signing the statement is not authorized to legally bind the employer.

(h) Polygraph tests administered pursuant to this exemption are subject to the limitations set forth in sections 8 and 10 of the Act, as discussed in §§ 801.20, 801.22, 801.23, 801.24, 801.25, 801.26, and 801.35 of this part. As provided in these sections, the exemption will apply only if certain requirements are met. Failure to satisfy any of the specified requirements nullifies the statutory authority for polygraph test administration and may subject the employer to the assessment of civil money penalties and other remedial actions, as provided for in section 6 of the Act (see subpart E, § 801.42 of this part). The administration of such tests is also subject to State or local laws, or collective bargaining agreements, which may either prohibit lie detector tests, or contain more restrictive provisions with respect to polygraph testing.

§ 801.13 Exemption of employers authorized to manufacture, distribute, or dispense controlled substances.

(a) Section 7(f) provides an exemption from the Act's general prohibition regarding the use of polygraph tests for employers authorized to manufacture, distribute, or dispense a controlled substance listed in schedule I, II, III, or IV of section 202 of the Controlled Substances Act (21 U.S.C. 812). This exemption permits the administration of polygraph tests, subject to the conditions set forth in sections 8 and 10 of the Act and §§ 801.21, 801.22, 801.23, 801.24, 801.25, 801.26, and 801.35 of this part, to:

(1) A prospective employee who would have direct access to the manufacture, storage, distribution, or sale of any such controlled substance; or

(2) A current employee if the following conditions are met:

(i) The test is administered in connection with an ongoing investigation of criminal or other misconduct involving, or potentially involving, loss or injury to the manufacture, distribution, or dispensing of any such controlled substance by such employer; and

(ii) The employee had access to the person or property that is the subject of the investigation.

(b)(1) The terms *manufacture, distribute, distribution, dispense, storage,* and *sale,* for the purposes of this exemption, are construed within the meaning of the Controlled Substances Act (21 U.S.C. 812 et seq.), as administered by the Drug Enforcement Administration (DEA), U.S. Department of Justice.

(2) The exemption in section 7(f) of the Act applies only to employers who are authorized by DEA to manufacture, distribute, or dispense a controlled substance. Section 202 of the Controlled Substances Act (21 U.S.C. 812) requires every person who manufactures, distributes, or dispenses any controlled substance to register with the Attorney General (i.e., with DEA). Common or contract carriers and warehouses whose possession of the controlled substance is in the usual course of their