2014 LEGAL UPDATES FOR CALIFORNIA EMPLOYERS

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Table of Contents

TABLE OF AUTHORITIES

Page(s)

FEDERAL CASES

CALIFORNIA CASES

FEDERAL STATUTES

CALIFORNIA STATUTES

OTHER AUTHORITIES

The following materials are offered to highlight recent developments in the law. Please read these highlights with an understanding that particular judicial and legislative developments may be challenged at a future date. Further, only portions of case and statutory law are discussed in this paper. These materials do not consist of legal opinions or advice. If you have a particular question concerning a labor or employment matter, please consult with your legal counsel.

I. MEDICAL ISSUES IN THE WORKPLACE

A. Leaves of Absence

1. Employers May Terminate an Employee's Employment for Failure to Return from Leave on Time, Even Though Employee Was Eligible for FMLA/CFRA Leave.

In Escriba v. Foster Poultry Farms, Inc., 743 F.3d 1236 (9th Cir. 2014), the United States Court of Appeals held that an employer did not violate the Family and Medical Leave Act ("FMLA") and California Family Rights Act ("CFRA") when it terminated an employee's employment for violating its three-day no-show/no-call policy and the employee expressly decided not to take protected FMLA/CFRA leave, even though the employee's need for time off would have been covered by the FMLA/CFRA.

Escriba worked at a Foster Farms processing plant. She requested two weeks of vacation to visit her sick father in Guatemala, which her supervisor approved. The supervisor asked her whether she needed additional unpaid time off, and the employee responded that she did not. Escriba did not return to work until sixteen days after the expiration of her approved time off. During her absence, the employee made no effort to contact her employer to seek additional time off. As a result, the employer discharged the employee pursuant to its no-show/no-call policy. Under this policy, an employee is automatically terminated if he or she is absent for a period of three work days without notifying the company or without requesting a leave of absence. The employee later sued her employer for interference with her rights to a leave of absence under FMLA/CFRA.

On appeal, the court held that employers are not required to designate an employee's time off as protected FMLA/CFRA leave if the employee "expressed a desire *not* to take FMLA leave." Accordingly, an employee can choose not to use FMLA/CFRA leave, even if the underlying reason for her leave would have been covered under FMLA/CFRA. In Escriba, the employee would have been qualified for FMLA/CFRA leave because she was caring for an immediate family member with a serious health condition, but she expressly declined to utilize FMLA/CFRA leave at least twice. Moreover, Escriba had previously sought FMLA/CFRA leave fifteen times, which demonstrated her knowledge of FMLA/CFRA and suggested that she had an incentive to decline leave in order to preserve it for future use.

When an employee requests a leave of absence and is eligible to take FMLA/CFRA leave, employers should obtain express written confirmation from the employee regarding whether he or she intends to use (or decline to use) such leaves. By doing so, employers will be able to prove that they were not interfering with such rights but rather abiding by the employee's wishes. Employers are encouraged to consult with counsel if they are unsure whether an employee is attempting to reserve FMLA/CFRA leave.

B. Fitness-for-Duty

1. Under Limited Circumstances, Employers May Require Fitness-for-Duty Examinations After an Employee Returns from FMLA/CFRA Leave.

In White v. County of Los Angeles, 225 Cal. App. 4th 690 (2014), a California Court of Appeal held that an employer may require a fitness-for-duty ("FFD") examination after restoring an employee to her position upon return from FMLA/CFRA leave (even though it previously received a certification from the employee's health care provider clearing her for work). However, the employer must have a reasonable basis for requiring the exam, and the exam must be job-related and consistent with business necessity.

In White, an employee worked as an investigator for the Los Angeles County District Attorney's Office. Her position enabled her to make arrests, serve warrants, interrogate suspects, book prisoners, and carry a weapon. When she began acting erratically at work, her colleagues questioned her ability to safely perform her job. For example, during a "tactical training," she "continuously point[ed] her fake weapon at other team members." During a meeting with her supervisor, the employee acknowledged experiencing extreme highs and lows and even described herself as a "whack job." Several months later, she requested FMLA/CFRA leave. After four months of leave, the employee's physician cleared her to return to work. Upon her return, the employer placed her on a leave of absence and required that she complete an FFD examination, which she refused. The employee filed a lawsuit, alleging interference with her rights to a leave of absence under FMLA/CFRA.

On appeal, the appellate court ruled in favor of the employer, holding that although an employer cannot require a second opinion as to the health care provider's certification that an employee may return to work, an employer may require a FFD examination after an employee returns from leave, as long as the inquiry is *job-related and consistent with business necessity*. Accordingly, the court held that the employer did not interfere with the employee's FMLA/CFRA rights because she had already been properly restored to her position after exhausting her 12-week FMLA/CFRA leave.

Although the court ruled in favor of the employer in this case, employers should consult with counsel to ensure that they have a proper basis for requesting that employees complete FFD examinations given implications under various privacy and medical laws.

2. Employers May Terminate Employment for Refusing to Undergo a Fitness-for-Duty Examination.

The California Fair Employment and Housing Act ("FEHA") allows an employer to require a medical examination of an employee if the employer establishes that the inquiry is *job-related and consistent with business necessity*. A California Court of Appeal in Kao v. University of San Francisco, 229 Cal. App. 4th 437 (2014), recently held that the University of San Francisco ("USF") properly terminated a professor's employment for refusing to undergo a FFD examination when workplace safety was a major concern.

Kao, a professor at USF, began to exhibit bizarre and threatening behavior in front of his colleagues. After a series of verbal and physical confrontations, Kao's colleagues became fearful for their safety and avoided interactions with him. USF hired an expert to determine how to handle Kao's behavior. Based on the expert's assessment, USF informed Kao that he would be placed on a leave of absence unless he agreed to undergo a FFD examination. Following several failed attempts to have the employee

evaluated, USF terminated Kao's employment. Kao sued USF for disability discrimination, failure to accommodate, and failure to engage in the interactive process in violation of FEHA.

The FEHA requires employers to engage in a good faith interactive process to provide reasonable accommodations for an employee's disability, unless doing so would result in undue hardship. Accordingly, Kao argued USF was required to engage in the interactive process with him before requiring the FFD examination and failed to do so. The appellate court disagreed with Kao and held that USF was not required to engage in the interactive process before it could require Kao to undergo an FFD examination because he "never acknowledged having a disability or sought any accommodation for one." Ultimately, Kao's termination was proper because obtaining an FFD examination became vital to USF's business after Kao's frequent outbursts created "fear and confusion" in his academic department.

Kao's threat to workplace safety played an important role in the court's decision that Kao's termination for refusing an FFD examination was proper. If workplace safety is not an issue, employers should exercise caution and seek the advice of legal counsel before terminating an employee's employment for merely refusing to undergo a FFD examination.

C. Interactive Process

1. Employers Should Exercise Caution in Requiring Certain Schedules and Timeliness as Essential Job Functions.

In McMillan v. City of New York, 711 F.3d 120 (2d Cir. 2013), the federal Second Circuit Court of Appeals held that, as a matter of law, physical presence at or by a specific time is *not* an essential job function for all positions. Under McMillan, an employer might be discriminating against a disabled employee for refusing to allow the employee to come to work late, unless the tardiness interferes with the employee's work and presents an undue hardship for the employer.

McMillan was a case manager for the Human Resources Administration for the City of New York. The City has a flex-time policy allowing employees to arrive anytime between 9:00 a.m. and 10:00 a.m. McMillan had schizophrenia and took daily medication in the morning that made him drowsy. As a result, he often arrived to work around 11:00 a.m. Management began taking issue with his constant tardiness. McMillan requested accommodations for his disability, including a later start time that would permit him to arrive at work between 10:00 a.m. and 11:00 a.m. and then leave later in the evening. His supervisor concluded this later start time was not reasonable because there was no supervisor at the office after 6:00 p.m. and denied the request. McMillan sued the City for failure to accommodate under the Americans with Disabilities Act ("ADA"). The employee prevailed at the trial court level.

On appeal, the issue was whether McMillan was qualified to perform the essential functions of his job with a reasonable accommodation. The City's flex-time schedule permitted employees to arrive anytime within a one-hour window, which implied that punctuality and presence at a precise time was not essential to the position. Also, McMillan's supervisor explicitly or implicitly approved his late arrivals for years without issue. This was sufficient evidence that the City did not consider arriving at a specific time an essential function of McMillan's position.

Further, the City did not present adequate evidence that McMillan's requested accommodations would impose an undue hardship. Some of McMillan's job duties were unsupervised, so those duties could have been performed after 6:00 p.m. when his supervisor left the office. Also, McMillan offered to work

through his lunch (because New York does not have meal period requirements as California does) and "bank time" to be used when he would have to arrive late to work. This would allow him make up any missed time due to tardiness.

Because the specific arrival time was not an essential job function and the employee's proposed alternatives did not impose an undue hardship on the City, the court found that the City had not engaged in a good faith interactive process and had failed the accommodate the employee.

When making accommodations for disabled employees, determining the essential job functions is a critical first step. Ensure that job descriptions are regularly updated to assist with this process. Failure to do so could result in claims for disability discrimination, failure to accommodate, and failure to engage in the interactive process.

D. Workers' Compensation Preemption

1. Workers' Compensation Statutes Preempt Claims for Intentional Infliction of Emotional Distress.

California Labor Code section 3202(a) provides that an employee's right to recover workers' compensation benefits is the "sole and exclusive" remedy against the employer, with limited exceptions, for injuries occurring in the workplace (known as the "workers' compensation exclusivity rule"). Pursuant to section 3202(a), employees are generally prohibited from filing separate lawsuits against their employers for personal injury claims already covered by workers' compensation laws.

In Yau v. Santa Margarita Ford, Inc., 229 Cal. App. 4th 144 (2014), a California Court of Appeal recently held that the workers' compensation exclusivity rule applies to a claim of intentional infliction of emotional distress. Yau, a service manager at a car dealership, sued his employer for wrongful termination in violation of public policy and intentional infliction of emotional distress. He claimed that his employment was terminated because he complained that his colleagues were submitting fraudulent warranty repair claims to Ford Motor Company. In its defense, the employer argued that the workers' compensation exclusivity rule preempted Yau's claim for intentional infliction of emotional distress.

On appeal, the court concluded that Yau had a cause of action for wrongful termination in violation of public policy because he was terminated for complaining about possible fraud in the workplace. However, the court also held that there is no independent cause of action for intentional infliction of emotional distress separate from the wrongful termination claim. The court further held that physical and emotional injuries from workplace discipline or termination could not support a separate claim for emotional distress. Relying on the California Supreme Court decision in Miklosy v. Regents of Univ. of California, 44 Cal. 4th 876 (2008), the appellate court stated that even severe emotional distress caused by an employer's outrageous conduct "falls within the exclusive province of workers' compensation."

II. DISCRIMINATION, HARASSMENT, RETALIATION, AND WRONGFUL TERMINATION

A. Same-Sex Harassment

1. Supervisor's Conduct Sufficiently to Support Same-Sex Harassment Claim.

To establish a hostile work environment harassment claim under the FEHA, an employee must show that the conduct is based on a protected category and is sufficiently severe or pervasive so as to alter the terms and conditions of employment and create an abusive work environment. Under the FEHA, sexual harassment can occur between members of the same gender as long as the plaintiff can establish the harassment was "because of sex." As of 2014, harassing conduct "need not be motivated by sexual desire to support an inference of discrimination on the basis of sex." Several recent California cases have illustrated these developments.

In Lewis v. City of Benicia, 224 Cal. App. 4th 1519 (2014), Lewis (a homosexual intern) worked at the City of Benicia's water treatment plant. Lewis alleged that he experienced same-sex harassment by his supervisor, Hickman. Specifically, Lewis alleged that Hickman sexually harassed him by showing him sexually explicit images on an office computer, telling him risqué jokes, giving him approximately 30 gifts (including tuxedo underwear with ruffles and a bowtie, hats, T-shirts, wine, shot glasses, and backpacks), frequently buying him lunch, asking him for a kiss, and asking him to visit Hickman's home. Lewis also asserted that after he complained to his employer about the harassment and participated in the investigation of Hickman, the City retaliated against him by terminating his paid internship, prohibiting him from continuing to work at the water treatment plant, and falsely accusing him of workplace misconduct. Lewis sued his supervisor and the City for hostile work environment sexual harassment and retaliation under the FEHA. At trial, the City and Hickman prevailed through a combination of a successful motion for summary judgment (sexual harassment claim) and jury verdict (retaliation claim).

On appeal, the court reversed both the motion for summary judgment and the jury verdict in favor of the employer and supervisor. Specifically, the court held that Hickman's comments, jokes, and gifts could permit an inference that Hickman was interested in pursuing a romantic or sexual relationship with Lewis. Thus, the conduct could constitute unlawful harassment "because of sex." Further, the pattern of conduct could be sufficiently severe or pervasive under applicable law. As such, disputes of material fact existed that warranted reversal of the motion for summary judgment. Further, because the trial court excluded evidence of Lewis's sexual harassment claim from the trial, the court ordered a retrial because the jury was not permitted "a fuller understanding of the context in which Lewis's protected activity and City's adverse actions occurred."

In light of the Lewis case, employers are reminded to do the following: (1) consult with counsel to ensure that they have comprehensive unlawful harassment, discrimination, and retaliation policies in place, (2) properly train employees in order to prevent such unlawful conduct in the workplace and remind them that it is not limited to conduct motivated by sexual desire, and (3) immediately document and investigate every complaint of such unlawful conduct.

2. Employers Beware of No-Sex Harassment.

Similarly, in Taylor v. Nabors Drilling USA, LP, 222 Cal. App. 4th 1228 (2014), a California Court of Appeal recently reiterated that sexual desire not a prerequisite for sexual harassment under the FEHA. In Taylor, male workers on an oil rig subjected a male coworker to homophobic epithets (such as "queer,"

"faggot," "homo," and "gay porn star"). The employees knew that Taylor was heterosexual, yet their attacks were unmotivated by sexual desire. Nevertheless, the appellate court held the employees' actions constituted unlawful sexual harassment. The court concluded that the employee only needed to prove that gender was a substantial factor in the harassment. Thus, under the Taylor ruling, when verbal attacks on the heterosexual identity of an employee are used as a tool of harassment, this can constitute unlawful sexual harassment under the FEHA regardless of whether the attacks are motivated by sexual desire.

As public policy and law continue to expand what constitutes same/opposite-sex harassment, it is more important than ever for employers to take a proactive role in training employees—emphasizing that sexual harassment need not involve sexual motive or interest but can appear also in various forms of bullying, *e.g.,* making homophobic remarks.

B. Franchisor Liability for Sexual Harassment

1. Franchisor May Not Be Vicariously Liable for the Wrongful Acts of a Franchisee's Employees.

A recent California Supreme Court decision, Patterson v. Domino's Pizza, LLC, 60 Cal. 4th 474 (2014), offers good news for franchisors by holding that they are not automatically liable for the wrongful conduct of a franchisee's employees. Liability depends on whether the franchisor has the characteristics of an "employer" under California law.

Patterson, a female employee at a Domino's franchise, resigned from her employment after her male supervisor allegedly made lewd comments and groped her whenever they worked together. She filed a lawsuit for sexual harassment, failure to prevent harassment, and retaliation. The supervisor, the franchisee, and the franchisor (Domino's) were named as defendants in the lawsuit. Patterson claimed that Domino's was a joint employer of the individuals working for the franchisee, and as such, Domino's could be held vicariously liable for the sexual harassment because the franchisee was an agent of Domino's. Domino's argued that, in its position as a franchisor, it was not liable because it did not satisfy the criteria to be deemed Patterson's employer under applicable law. Domino's moved for summary judgment on this issue and prevailed.

On appeal, the Court agreed that Domino's was not Patterson's employer and, therefore, could not be held vicariously liable for any wrongdoing. In its analysis, the Court set forth a traditional employer/principal analysis to determine who retained the general right of control over factors such as the day-to-day decisions involving the supervision, hiring, and disciplining of the employees. Based on these factors, it determined the franchisee was the "employer." The Court used the franchise agreement between Domino's and the franchisee to further support its decision that no employment relationship existed between Patterson and Domino's. Specifically, Domino's had no contractual right or duty to control the operations in any of its stores, including any acts that might involve sexual harassment. The agreement stated that the franchisee, not Domino's, was responsible for "recruiting, hiring, training, scheduling for work, supervising and paying" the employees.

Franchisors should ensure that agreements with franchisees clearly delegate these duties and relinquish day-to-day control of employees to minimize finding of an employment relationship in the event of such a lawsuit.

C. Sex Discrimination (Bona Fide Occupational Qualification)

1. Employers Seeking to Establish a "BFOQ" Defense to Sex Discrimination Bear a Heavy Burden.

Under section 2000e-2(e)(1), part of Title VII of the Civil Rights Act, employers may permissibly engage in sex discrimination if sex is a *bona fide* occupational qualification ("BFOQ") reasonably necessary to the operation of the employer's business. For instance, an employer may require that an employee be female to qualify for a particular position. Given the wide public policy against employment discrimination, courts narrowly apply the BFOQ defense.

Although employers are in the best position to determine the needs of their businesses, Ambat v. City and County of San Francisco, 757 F.3d 1017 (9th Cir. 2014), illustrates that courts do not automatically defer to an employer's claim that being female is a BFOQ. In 2006, the San Francisco Sheriff's Department ("SFSD") implemented a new policy prohibiting male deputies from supervising female inmates in the County jails. The head of the SFSD adopted the policy for two main reasons: (1) to protect the safety of female inmates from sexual misconduct perpetrated by male deputies and (2) to protect the privacy of female inmates. A group of 35 deputies—mostly female—filed suit under Title VII and the FEHA, alleging the policy constituted sex discrimination. The plaintiffs claimed that the staffing restrictions deprived them of opportunities for overtime, preferred shifts, and regular days off previously earned by seniority. In its defense, the County asserted being female was a BFOQ for supervising female inmates. The trial court granted considerable deference to the County's claim that the policy was necessary to protect the safety and privacy of female inmates and ruled that being female was indeed a BFOQ under the limited circumstances when it granted the employer's motion for summary judgment.

However, the federal Ninth Circuit Court of Appeals gave the County no such deference. The court made it clear that deference to an employer asserting the BFOQ defense is "not automatic." Rather, courts should defer to an employer's judgment only if the employer's decision to implement a sex discriminatory policy is "reasoned and well-informed." The court gave no deference to the SFSD's decision-making process because it implemented the new policy based on a few incident reports about sexual misconduct without consultation of experts or outside sources about the necessity of the policy. The court held employers seeking to establish a BFOQ defense bear a "heavy burden," as implementation of a discriminatory policy is an "extraordinary response to a workplace problem."

Employers should be cautious about implementing a policy where sex is a BFOQ. The Ninth Circuit stressed that employers asserting a BFOQ defense are expected to make "commensurate efforts to determine that a discriminatory policy is a *necessary response and the only viable response*."

D. Age Discrimination

1. Making Mistakes on the Job Does Not Always Constitute Unsatisfactory Job Performance Warranting Termination.

In Cheal v. El Camino Hospital, 223 Cal. App. 4th 736 (2014), a California Court of Appeal held that an employer's implied policy of allowing mistakes to be made on the job precluded its argument that an employee was incompetent and could be terminated because she was prone to making errors.

Cheal was a diet technician for El Camino Hospital from 1987 until her employment was terminated in 2008, at the age of 61. During her long-term employment with the Hospital, Cheal consistently received the highest category of performance rating. However, in mid-2007, Cheal was assigned a new supervisor, who began accusing her of various mistakes, including incorrectly preparing menus for patients on restricted diets. A Hospital manager told Cheal that she was no longer competent to perform her duties as a diet technician and could take another position within the department, accept a severance package, or be terminated. Shortly thereafter, the Hospital terminated Cheal's employment. Cheal sued the Hospital for age discrimination, wrongful termination, failure to prevent age discrimination, and retaliation. The trial court granted the employer's motion for summary judgment because Cheal failed to establish evidence that she was performing her job competently and substantial evidence of discriminatory animus regarding her termination.

On appeal, the appeals court disagreed, holding that the lower court's finding of substandard performance was contradicted by the consistently high performance ratings Cheal received over the past two decades, which indicated that her performance satisfied her employer's own norms. Even though the Hospital's records showed that Cheal made various errors between prior to her termination, such errors by dietary employees were inevitable and expected due to the volume of patient meals prepared per day. In fact, the Hospital had a system in place where multiple employees would check the accuracy of the meal before it was delivered to the patient. Further, the Hospital's own printed evaluation form for Cheal's position prescribed an acceptable rate for certain types of errors, which contradicted the trial court's finding that errors necessarily constituted unsatisfactory performance. As such, the Hospital's reasons for Cheal's termination could constitute pretext.

Employers are reminded to give employees accurate performance evaluations and consistently enforce policies and procedures so that an employee's termination is not challenged for bias or discrimination.

E. Association Discrimination

1. FEHA Protections Further Expanded to Include an Employee's Association with a Disabled Individual.

In Rope v. Auto-Chlor System of Washington, Inc., 220 Cal. App. 4th 635 (2013), a California Court of Appeal reiterated that employees associated with disabled persons are a protected class of individuals under the FEHA. The court's decision demonstrates the broad reach of California's FEHA beyond the ADA. This decision allows an employee to maintain an action against his or her employer for termination or other adverse employment action on the basis of the employee's relationship with a disabled individual (*e.g.,* immediate family member, significant other, roommate).

Auto-Chlor hired Rope in September 2010. At the time of hiring, Rope notified Auto-Chlor that he would require leave to donate a kidney to his ailing disabled sister. In November 2010, Rope requested 30 days paid leave for this procedure, in accordance with a new law called the Donation Protection Act ("DPA"). However, the recently passed law was not scheduled to take effect until January 1, 2011. Despite Rope's repeated inquiries, Auto-Chlor was unresponsive to his leave requests and subsequently terminated his employment on December 30, 2010 (two days before the DPA was set to take effect), citing "poor performance." Rope had received satisfactory performance reviews and had no disciplinary issues during

his employment. Rope filed a lawsuit for association disability discrimination, among other claims. The employer moved to dismiss for failure to state a claim, which the trial court granted.

In its decision, the appellate court disagreed and allowed Rope to proceed with his association disability discrimination claim. The California Legislature's intent was to protect a broader class of individuals in California than under the ADA, namely individuals *associated* with disabled persons.

Rope stands for the proposition that the FEHA's protection of individuals from employment discrimination is broad in scope. Employers should update their employee handbooks to reflect this broader protection under the FEHA and train their human resources staff and supervisors accordingly.

F. Religious Garb and Grooming

1. The EEOC Clarified an Employers' Responsibilities Regarding Religious Dress and Grooming Practices in the Workplace.

Title VII protects all aspects of religious observance, practice, and belief and defines religion very broadly to include not only traditional, organized religions but also religious beliefs that are new, uncommon, not part of a formal church or sect, only subscribed to by a small number of people, or that may seem illogical or unreasonable to others. Title VII applies to any practice motivated by religious belief, even if other people may engage in the same practice for secular reasons. If an employer questions whether an employee's belief is sincerely held, and an employee requests an accommodation, the employer may ask for information reasonably needed to evaluate the request. However, employers may not automatically refuse to accommodate an employee's request, even if it violates the employer's dress code policy.

On March 6, 2014, the U. S. Equal Employment Opportunity Commission ("EEOC") issued a guidance regarding "Religious Garb and Grooming in the Workplace: Rights and Responsibilities." The example-based guide clarifies several important and complex issues regarding how Title VII applies to any practice motivated by religious belief in the workplace, including religious garb and grooming practices. Examples of tough situations and permissible actions are described to help clarify how federal discrimination law applies, including questions such as:

- What it means for a religious practice to be "sincerely held";
- What an employer should do if an applicant or employee's religious garb violates an employer's appearance policy or dress code;
- Examples of appropriate accommodations for an employee's religious dress or grooming practice;
- What constitutes retaliation against an employee for requesting a religious accommodation; and
- What constitutes religious harassment under Title VII, and what obligations an employer has to stop it.

The EEOC's guide also discusses various types of reasonable accommodations, such as covering the religious attire or item at work if permitted by the religious belief. It indicates that, in some instances, an

employer's reliance on a company's "image" or marketing strategy to deny a requested religious accommodation may be insufficient to demonstrate that making an exception would be an undue hardship. It makes clear, however, that an employer may bar an employee's religious dress or grooming practice based on workplace safety, security, health concerns or if the practice actually poses an undue hardship on the operation of the business.

G. Procedure

1. Employers May Not Shorten Certain Statutes of Limitation in an Employment Agreement.

In Ellis v. U. S. Security Associates, 224 Cal. App. 4th 1213 (2014), a California Court of Appeal held that an employment agreement limiting the statute of limitations to six months for all claims brought by an employee against his or her employer was unreasonable and contrary to public policy.

Ellis was subjected to repeated episodes of sexual harassment by her supervisor while working as a security guard at one of her employer's field offices. The employer terminated the supervisor's employment after numerous complaints were filed with the company. Simultaneously, the employer informed Ellis that she would be given a substantial raise and a promotion. Ellis was promoted, but the promise of a raise went unfulfilled, and shortly thereafter, she voluntarily resigned. Ellis filed a lawsuit, alleging violations of the FEHA and other related torts.

The employee timely exhausted her administrated remedies with the appropriate state agency and timely filed her lawsuit according to the statutes of limitation for all causes of action. Her employment agreement, however, contained a provision limiting the time frame within which she could sue her employer to six months after the date of the employment action from which the lawsuit arose. In response, the employer moved to dismiss the case because Ellis had waited longer than six months to file. The trial court granted the employer's motion.

On appeal, the court strongly disagreed. Although in some circumstances the parties may agree to shorten a statute of limitations period so long as the shortened period is reasonable (as in, gives sufficient time to effectively pursue a judicial remedy), courts generally only recognize shortened limitations periods in the context of simple transactions, such as a breach of contract, where the triggering event for the statute of limitations is immediate and obvious. However, the court held that they are not generally recognized in employment discrimination claims. The FEHA's strong public policy in favor of protecting employees against discrimination prevents an employer from asking its employees to waive their rights under that same statute. The six-month window within which to file a claim, as provided under the agreement, was simply an insufficient remedy when compared to the FEHA's statutory grant of one year to exhaust administrative remedies followed by an additional one year to file the lawsuit.

Employers should first consult with counsel prior to changing or adding terms to their employment agreements that could be perceived by a court as limiting an employee's rights under California law.

2. Court of Appeal Expands Mixed Motive Defense to Wrongful Termination Claims.

Historically, employers have heavily relied on the "mixed motive" defense in discrimination cases, which asserts that the employer may have had both legitimate and discriminatory reasons for taking an

adverse action against an employee. Using this defense, employers argued that because the employment decision was partially motivated by legitimate business reasons, the employer should not be held liable. In Harris v. City of Santa Monica, 56 Cal. 4th 203 (2013), the California Supreme Court agreed, in part, with an employer asserting this "mixed motive" defense and issued a ruling that made jury instructions permissible with such language. The language of the instruction was changed from requiring a jury to find that discrimination was "a motivating factor" in its employment decisions to requiring that it find discrimination to have been "a substantial motivating factor." While this holding was limited to statutory claims under the FEHA as opposed to common law claims, a California Court of Appeal in Mendoza v. West Medical Center Santa Ana, 222 Cal. App. 4th 1334 (2014), extended the California Supreme Court's ruling to the common law claim of wrongful termination in violation of public policy (a claim frequently asserted by employees).

Mendoza worked as a nurse at a hospital for many years and performed very well by all accounts. The employee reported that he was sexually harassed by a supervisor. The employer determined that both the employee and his supervisor had been complicit in the sexual conduct and terminated their employment. The employee sued for wrongful termination, and the trial court presented the jury with a causation instruction identical to that overturned in Harris ("a motivating factor"). The jury awarded the employee nearly $240,000 in damages, and the employer subsequently appealed.

On appeal, the court held that employers are entitled to allege a "mixed motive" defense and present such Harris jury instructions for a wrongful termination claim. If the employer prevails on this theory, the employer can avoid liability for certain damages, such as reinstatement, backpay, and other compensatory damages (here, about $240,000). This case represents a big win for employers in that the Harris decision is continuing to be upheld and even extended by lower courts.

H. After-Acquired Evidence

1. Misleading Behavior of Immigrant Employee May Reduce Damages on Discrimination Claim.

Under California law, an employee may be completely or partially barred from pursuing employment claims based on the doctrines of after-acquired evidence and unclean hands. In the former, the employer terminates an employee's employment for an allegedly unlawful reason and then later learns of wrongdoing by the employee that would have inevitably resulted in the employee's termination. This generally only provides a partial defense. In the latter, the employee must engage in inequitable conduct in connection with the matter in controversy. This generally provides a complete defense.

In Salas v. Sierra Chem. Co., 59 Cal. 4th 407 (2014), the California Supreme Court held that neither doctrine bars relief under the FEHA for an undocumented immigrant who misrepresents immigration status to an employer. The Court did hold, however, that both doctrines could limit the extent of the employee's remedies under the FEHA.

The employer in Salas was a chemical manufacturer who terminated large numbers of employees seasonally. Salas was an undocumented immigrant who used another individual's Social Security Number to obtain the position with the employer. The employee claimed that the employer was aware of the Social Security Administration's doubt about his immigration status but did nothing in response. Over the course of his time with the company, Salas was subject to the seasonal workforce reduction multiple times. During

one stint with his employer, Salas suffered two back injuries. He was placed on limited duty and filed a workers' compensation claim, but he otherwise continued his work. He was again laid off the winter after his second injury due to the seasonal change in demand. When Salas sought to return to work the subsequent year, he was unable to do so. He then filed a lawsuit failure to accommodate under FEHA and retaliation for filing a workers' compensation claim.

On appeal, a notable issue addressed by the Court was the effect of the doctrines of after-acquired evidence and unclean hands on an undocumented immigrant's ability to obtain relief under the FEHA. The Court held that to prevent the undocumented employee's ability to challenge an unlawful employment decision as a result of either of these doctrines would violate the FEHA's statutory scheme, which is to protect all employees from such harm by their employers. The Court also held, however, that the employee's ultimate relief should be limited to compensation for the injury prior to the employer's actual knowledge of undocumented status. This limitation would serve to prevent the employee from obtaining relief based on time during which he would not likely have been employed.

This decision, while not the most favorable to employers, does serve to limit the damages an employer would have to pay as a result of an undocumented employee's misrepresentation of his or her immigration status during the hiring process or on the job.

2. Employers May Rely on After-Acquired Evidence to Defeat a Discrimination Claim If Employee Not Qualified for Position.

In Horne v. District Council 16 International Union of Painters and Allied Trades, 221 Cal. App. 4th 1132 (2013), a California Court of Appeal held that evidence of a job applicant's disqualification for a position may be used to deny the applicant relief under the FEHA despite the prospective employer's ignorance of such evidence.

The prospective employer in Horne was a group of 16 local unions comprised of painters, drywall finishers, floor coverers, and glaziers ("District Council 16"). Horne (an African-American male) was a member of the glazer's union. In addition to his status as a member of the Glazers Local No. 718, the applicant was also on the union's executive board and was one of its officers. His interest in employment with the District Council 16 prompted him to apply twice for one of its organizer positions. Both times, a white male was hired over him. Horne was also a convicted felon and unable to carry a firearm as a result, arguably a disqualifying factor for employment as a union organizer. Horne sued the District Council 16 for race discrimination under the FEHA. While the District Council 16 was unaware of Horne's inability to carry a firearm at the time of his application, they relied on this fact in their motion for summary judgment as evidence of his failure to establish that he was actually qualified for the position for which he applied. The trial court granted the District Council 16's motion for summary judgment on this basis.

The Court of Appeal affirmed the lower court's decision. The Court clarified California's adoption of the McDonnell Douglas three-step approach in analyzing discrimination claims: (1) demonstration of a *prima facie* case; (2) articulation of legitimate business reasons for the adverse employment action; and (3) discussion of whether substantial evidence proves that the stated reason for the adverse employment action is in fact a mere pretext to mask a discriminatory motive. Horne tried to assert the after-acquired evidence doctrine and argued that the court could not consider this evidence in the first step. The court disagreed and held that the employee must prove, as part of the first step, that he or she is qualified for the position and the employer could use such evidence, even if after-acquired.

This ruling is a success for those employers who might otherwise be vulnerable to claims during their employment decision-making processes. However, employers should cautiously rely on after-acquired evidence in arguing qualification for the position given the current state of the law. On August 27, 2014, the California Supreme Court remanded this case back to the Court of Appeal to reconsider the decision in light of Salas, 59 Cal. 4th 407.

3. Employee Cannot Use Certain After-Acquired Evidence to Resuscitate a Discrimination Claim.

In Serri v. Santa Clara Univ., 226 Cal. App. 4th 830 (2014), a California Court of Appeal held that after-acquired expert evidence demonstrating that an employee's failure to perform important job functions that had no negative effect on her employer was not relevant to the employee's discrimination claim.

Serri (a female Puerto Rican) worked many years for Santa Clara University as the Director of Affirmative Action. Her tasks included the yearly preparation of the University's Affirmative Action Plan. During the last three years of employment, Serri failed to produce the Affirmative Action Plan and misrepresented her failure to do so to her superiors at the University. Serri's employment was ultimately terminated after numerous investigations into her conduct. She subsequently filed a lawsuit alleging various claims of discrimination. Defendants moved for summary judgment, which the trial court granted because the University sufficiently articulated legitimate business reasons for the termination by showing that Serri failed to competently perform her job duties when she did not complete the Affirmative Action Plan.

On appeal, the appellate court affirmed. Serri attempted to argue that preparation of the Affirmative Action Plan was not an important aspect of her job, and as such, her failure to complete was pretext for her termination. In support of this argument, she relied heavily on after-acquired expert evidence demonstrating the University suffered no detriment as a result of her actions. However, before she was terminated, she was told that her failure to complete the Affirmative Action Plan could result in adverse consequences for her employment. The court held that, regardless of the effect of her actions, her behavior was sufficiently improper to warrant termination, and the relevant inquiry was not the after-acquired expert evidence but rather the employer's motive at the time of the termination. "We conclude that the University met its burden of establishing that it acted in good faith and had reasonable grounds for believing Serri engaged in gross misconduct when it decided to terminate her and that its decision was based on 'fair and honest reasons.' . . . It cannot be reasonably asserted that termination for misrepresenting the status of an important report that impacted the work of other university departments was 'trivial, arbitrary or capricious' or unrelated to the university's business needs or goals."

This case stresses the importance of communicating each employee's specific job requirements, both verbally and in writing, so that expectations are unambiguous in the event of discipline or termination.

I. Damages

1. Ninth Circuit Wrestles with Formula for Calculating Employer's Punitive Damages.

In Arizona v. Asarco, LLC, 733 F.3d 882 (9th Cir. 2013), the United States Court of Appeals held that a $300,000 punitive damages award against an employer for sexual harassment violated constitutional notions of fairness when no actual damages and only nominal damages were awarded.

The female employee in this case was hired by a mining company and soon thereafter began to experience sexual harassment by her supervisor. The port-a-potty placed onsite for her was vandalized with pornographic imagery. She even experienced harassment from a different supervisor upon transferring locations within the company. The company largely ignored her claims regarding each of these experiences. Both the employee and the State of Arizona filed a lawsuit against the company, alleging sexual harassment under Title VII. At trial, the jury awarded her nominal damages of $1 but punitive damages of $868,750. The lower court reduced this award to $300,000 in accordance with the Title VII statutory limit on punitive damages.

On appeal, the Ninth Circuit used the balancing test adopted by the U. S. Supreme Court in BMW of North America, Inc. v. Gore, 517 U.S. 559 (1996). The appellate court weighed the following factors to determine whether an award of punitive damages is unconstitutional: (1) "degree of reprehensibility of the defendant's conduct;" (2) "ratio to the actual harm inflicted on the plaintiff" (*i.e.,* the dollar value of compensatory and nominal damages awarded); and (3) "civil or criminal penalties that could be imposed for comparable misconduct."

The court held that the first factor favored the $300,000 award because the employer's conduct was repeated and particularly egregious for its sexual connotation. The court determined that the second factor did not favor the $300,000 award because the ratio of the punitive damages to the actual harm inflicted (*i.e.,* 300,000 to 1) far exceeded the next highest ratio (125,000 to 1) that it could locate in its own survey of discrimination cases. The court stated that the third factor supported a limit of $300,000, commenting that the Title VII's damages cap to be a "legislative judgment" appropriate for benchmarking the reasonableness of a punitive award and weighing in favor of damages "at least on the order of the statutory cap." In balancing all of these factors, the court ultimately held that "a 300,000 to 1 ratio raise[d] [its] judicial eyebrows," but a 125,000 to 1 ratio did not. As such, it vacated the $300,000 award and remanded the case with instructions to order a new trial if the employee rejected the $125,000 award.

This case serves as a grim reminder to employers about the cost of ignoring egregious workplace misconduct by supervisors. In such circumstances, even a nominal compensatory award can result in significant punitive damages. Although reduced on appeal, the employer still endured substantial attorneys' fees to appeal this issue to the Ninth Circuit, which has decided to rehear this case *en banc*. This could result in a different judicial outcome.

2. A Longer Commute May Render a Higher Paying Job in the Same Business Inferior and Hinder Reliance on the Mitigation of Damages Doctrine.

Under the mitigation of damages doctrine, the damages suffered by an employee will be reduced by the amount of wages the employee has earned, or might have earned with reasonable effort, from other employment. However, the employer has the burden of proving that the other employment was comparable, or substantially similar, to the employment from which the employee was terminated. If the new job is inferior, the wages may not be used to mitigate damages. The location of the new job may be considered when determining whether the new job is inferior. In Villacorta v. Cemex Cement, Inc., 221 Cal. App. 4th 1425 (2013), a California Court of Appeal held that the damages of the employee could not be reduced, even when he had obtained employment in the same industry at a higher salary, because his new position was inferior based on the geographic location.

Villacorta worked as a maintenance planner for his employer in Victorville, California, earning an annual salary of $65,699. Due to economic difficulty, the employer made hundreds of layoffs from 2007 to 2009; Villacorta was laid off in 2008. He alleged that he was laid off because he is Filipino and that he was more qualified than many Venezuelans who were not laid off. Villacorta was unemployed for eight months and suffered anxiety and depression during that time. In October 2008, Villacorta began working for a different cement company as a maintenance supervisor, earning an annual salary of $69,300. The employee's commute was two to three hours each direction, so he rented an apartment closer to his job, and went home to Corona on the weekends.

Villacorta subsequently sued his former employer for wrongful termination. During closing arguments, Villacorta's attorney asserted his client suffered $44,000 in lost wages for the eight months that he was unemployed. Nonetheless, after clarification (or lack thereof) on their instructions, the jury returned a verdict for $198,000 in lost wages from the date of his termination through the trial date. The appellate court upheld the verdict, reasoning that the 120-mile commute was sufficient to render the employee's new job "inferior," and therefore, the employer could not rely on the mitigation of damages doctrine.

The effect of this case is that an employee can receive significant lost wages, even if he or she finds employment in the same field at a higher salary. Due to California's strict and ever-changing employment laws, employers are encouraged to seek counsel when making employee layoff decisions. Additionally, employers effectuating large layoffs should consider offering job assistance services to employees in an effort to mitigate damages.

J. Attorneys' Fees

1. Employees May Be Awarded Significant Attorneys' Fees Even When Achieving Very Limited Success.

In Muniz v. United Parcel Service, Inc., 738 F.3d 214 (9th Cir. 2013), the U. S. Ninth Circuit Court of Appeals affirmed an award of nearly $700,000 in attorneys' fees despite the plaintiff's limited success in achieving a jury verdict amount of $27,280 on a single discrimination claim.

Muniz claimed her employer's decision to demote her was unlawfully motivated by her gender and age. The trial court dismissed all of the employee's claims except for a sole discrimination claim. At trial, the jury awarded her $27,280, including $9,900 for lost earnings, $7,300 for past medical expenses, and $9,900 for past noneconomic losses. Although both parties claimed victories and sought attorneys' fees, the trial court determined that Muniz was the prevailing party and was entitled to recover fees. Muniz requested more than $1.9 million, which the trial court graciously reduced to $696,162.78 based on a variety of permissible factors (hourly rates, standards in the industry, geographic norms, degree of success, etc.).

On appeal, the employer argued that the fees awarded to Muniz should have been substantially reduced based on her limited success. She only prevailed on one claim and for less than $30,000. However, the court disagreed and held that the deferential standard of review permits the trial court to have broad discretion to set the amount of fees awarded. The court also considered the employee's success to be a significant victory because she proved that her demotion was discriminatory.

This case is a reminder to employers about the challenges of litigation: the risk of being financially responsible for the employee's attorneys' fees, even if the employee only has limited success on damages.

It is essential to consult with counsel if there are concerns about the legal consequences of demoting or terminating an employee.

2. In Some Circumstances, Employers May Recover Attorneys' Fees for Frivolous and Vexatious Claims.

In Robert v. Stanford Univ., 224 Cal. App. 4th 67 (2014), a California Court of Appeal finally awarded attorneys' fees to an employer for a frivolous FEHA lawsuit by a former employee.

In this rare decision, the employer received complaints that Robert was harassing a coworker. Thereafter, the employer conducted an investigation, which revealed that Robert had become obsessed with another employee and had been stalking her for a long period of time. In response, the employer issued an order directing Robert to stay away from the complaining employee. Robert was told that if he did not comply, his employment would be terminated. After Robert's harassment persisted, the employer terminated his employment.

Thereafter, Robert sued his employer, claiming the investigation and restraining order were actually pretexts for race discrimination. In discovery, Robert admittedly could not identify any evidence of race discrimination other than his own opinion. After the close of evidence at trial, the employer successfully moved for nonsuit based on a lack of evidence. However, at that point, it had spent over $235,000 in fees defending the case, so it filed a motion to recover those fees. The trial court awarded the employer $100,000, "I am finding that the FEHA claim was without merit and was frivolous and vexatious. It was a legal theory in search of facts. There were none that were presented." The award was upheld on appeal.

Although recovering attorneys' fees from employees still remains a difficult legal battle, this case gives employers hope that the rare and unusual case may allow an avenue of recovery for such frivolous and vexatious claims.

K. Conflicts of Interest

1. In-House Attorneys Jointly Representing the Employer and the Employee Must Obtain Written Conflict Waiver or Risk Malpractice.

In Yanez v. Plummer, 221 Cal. App. 4th 180 (2013), a California Court of Appeal held that an in-house counsel had a conflict of interest when he represented both the employer and the employee during a deposition. Consequently, counsel's failure to obtain a written conflict waiver before representing the employee at his deposition was deemed to be potential malpractice.

In this case, an employee was hurt on the job, and another employee who witnessed the accident was deposed and represented by the employer's in-house counsel. The attorney never obtained a conflict waiver. The witness subsequently told the employer's in-house counsel that he was concerned that his testimony would not be favorable for the employer. The attorney ensured the witness that he would be fine and to just tell the truth. However, during the witness's testimony, the attorney essentially worked against him to demonstrate his seemingly contradictory statements. The witness was later terminated and subsequently sued the attorney for legal malpractice, claiming that he "set him up" at the deposition. The trial court granted the attorney's motion for summary judgment.

On appeal, the court reversed, explaining that a jury could decide that the attorney's failure to obtain a conflict waiver, combined with his questioning the employee at deposition, played a substantial role in the company's decision to terminate the former employee's employment.

This decision serves as an important reminder about assessing potential conflicts of interest prior to joint representation during litigation. Even in-house counsel must follow these procedures and obtain written conflict waivers when appropriate and permissible before agreeing to represent an employee at his or her deposition—or potentially risk malpractice.

L. Whistleblowers

1. Whistleblowing Employees Are Still Protected Even If They Are Not the First to Report the Misconduct.

California Labor Code section 1102.5(b) prohibits an employer from retaliating against an employee for reporting a workplace violation of a state or federal statute or for disclosing information during an investigation. Even if no actual violation occurred, employees are protected as long as they reasonably believe a violation of state or federal law occurred. In Hager v. County of Los Angeles, 228 Cal. App. 4th 1538 (2014), a California Court of Appeal held that section 1102.5(b) protects employees who disclose potential violations *already known by or disclosed to the employer*. Hager is the first California case to address whether section 1102.5 only protects first reports of violations or whether the statute also extends to secondary reports.

Hager, a deputy sheriff for the Los Angeles County Sheriff's Department, worked on a task force that investigated drugs in Antelope Valley. After another sheriff mysteriously disappeared, a detective for the Department asked Hager to speak with an informant about the disappearance. The detective previously learned that Engels (another deputy sheriff) might have been involved in the murder and disappearance. The informant told Hager that Engels was a dirty cop and possibly involved in the disappearance, affirming what the detective already knew. Hager reported this information. Ultimately, the Department concluded Engels was not involved in the murder and terminated Hager's employment for making false statements.

In a suit for whistleblower retaliation pursuant to section 1102.5, the Department argued that Hager did not "disclose information" within the meaning of the statute because the Department was already aware of the allegations against Engels. The court rejected the notion that only "first reports" are protected from whistleblower retaliation, stating that "a report does not necessarily reveal something hidden or unknown."

As a result, employers should be cautious about dismissing "secondary" reports of discrimination, harassment, or other violations that have already been disclosed to the employer. Hager makes clear that secondary reports are protected activities—any adverse action against an employee could result in a whistleblowing retaliation claim.

M. Teacher Tenure

1. California Laws Regarding School Teacher Tenure Unconstitutionally Deprive Students of Their Right to Equal Education.

In the landmark case, Vergara v. State of California, No. BC484642, 2014 WL 2598719 (Cal. Super. Ct. June 10, 2014), a California Superior Court judge issued a decision striking down five provisions of the California Education Code, holding school teacher tenure procedures as unconstitutional. The trial court found that these statutes adversely affected the quality of education of many students by continuously employing ineffective teachers, which is a violation of students' right to equal education.

In Vergara, nine California public school students brought a lawsuit challenging the constitutionally of five laws related to teacher tenure, including the permanent employment statute, three dismissal procedure statutes, and the last-in-first-out statute. The students claimed that the challenged statutes resulted in grossly ineffective teachers obtaining and retaining permanent employment and that these teachers were disproportionately situated in schools serving predominantly low-income and minority students. In response, the State presented evidence that competent teachers are a critical, if not the most important, component of success of a child's in-school education experience. Both sides also presented evidence of the specific effect of ineffective teachers on the future success of students. In the end, both sides agreed that grossly ineffective teachers substantially undermine the ability of that child to succeed in school and into the future.

The trial court found that the permanent employment statute, also referred to as the "two-year" statute, unfairly and unnecessarily disadvantaged both students and teachers. Under the current law, schools are forced to determine whether a probationary teacher is going to be offered tenure within the first two years of their employment. The trial court determined that this does not provide sufficient time for the school to make an informed decision. As a result, teachers are being reelected who would not have been if the school had more time to evaluate the teacher. Conversely, the time constraints also result in non-reelection based on a small sliver of doubt, thus depriving teachers of an adequate opportunity to establish their competence and students of potentially competent teachers.

The court entered judgment in favor of the students and enjoined enforcement of the challenged statutes. However, the court decided not to enforce the injunction until the appeal process has run its course or the legislature has responded with new legislation. This decision will very likely be appealed to the California Court of Appeal and beyond.

N. New Legislation and Regulations

1. New Immigration Retaliation Bill Provides Additional Protections for Employees and Employers.

Assembly Bill 2751 clarifies previous measures enacted to protect immigrant employees against unlawful retaliation and expands the bases and remedies for immigrant retaliation claims. The Bill amends California Labor Code sections 98.6, 1019, and 1024.6 and will take effect on January 1, 2015.

The Bill expands protections for employees. Current law prohibits employers from engaging in various "immigration-related practices," including threatening to file or filing a false police report. Under the new law, this definition is expanded to include any complaint with any state or federal agency. Further,

courts are authorized to suspend the business licenses of parties who violate immigration-retaliation laws. Suspended licenses are "specific to the business location or locations where the unfair immigration-related practice occurred," rather than state-wide.

The Bill also expands some protections for employers. Current law prohibits employers from discharging or retaliating against an employee for updating personal information. Under the new law, this definition is narrowed to only include a lawful change of name, social security number, or a federal employment authorization document. As a result, employers will no longer be prohibited from taking action against an employee for updating previous misrepresentations about personal information, such as educational qualifications or criminal records.

2. New Law Protects Unpaid Interns from Unlawful Harassment and Discrimination.

The FEHA prohibits employers from discriminating against or harassing employees on the basis of certain protected characteristics. Assembly Bill 1443 extends the FEHA's unlawful harassment and discrimination protections to unpaid interns.

As a result, employers will be liable for the unlawful harassment of unpaid interns by employees and non-employees if the employer "knows or should have known of the conduct and fails to take immediate and appropriate corrective action." Further, employers will be required to make certain accommodations for interns. For instance, under the new law, employers must provide unpaid interns reasonable accommodations for religious observance or engage in a good faith interactive process to determine reasonable accommodations for interns with disabilities.

Employers with unpaid interns should plan to update harassment training and employee handbooks before Assembly Bill 1443 becomes effective on January 1, 2015.

3. Employers Must Train Supervisors on Bullying in the Workplace.

Effective January 1, 2015, employers with 50 or more employees will be required to train supervisors on "abusive conduct," or bullying, as part of their mandatory sexual harassment training. Assembly Bill 2053 amends California Government Code section 12950.1 to define abusive conduct as that "with malice, that a reasonable person would find hostile, offensive, and unrelated to an employer's legitimate business interests."

The Bill describes types of abusive conduct, which includes, but is not limited to, repeated verbal abuse, "use of derogatory remarks, insults, and epithets, verbal or physical conduct that a reasonable person would find threatening, intimidating, or humiliating, or the gratuitous sabotage or undermining of a person's work performance." Note that the list of abusive conduct created by the Bill covers conduct not based on a protected characteristic, such as race or gender. Thus, the scope of employers' training on what constitutes "abusive conduct" must be broad.

Employers should update their sexual harassment training to cover "abusive conduct" before the new legislation becomes effective on January 1, 2015.

4. Prohibition of Employment Discrimination Extended to Victims of Stalking.

Senate Bill 400 became effective on January 1, 2013, and prohibits employers from discharging, discriminating against, or retaliating against employees who are victims of stalking. Senate Bill 400 legislation amends California Labor Code sections 230 and 230.1, which previously only protected victims of sexual assault and domestic violence.

Under the new law, employers may not take any adverse action against employees for taking time off for activities related to the stalking, such as filing a complaint or appearing in court. Furthermore, the Bill also added a provision to section 230, requiring employers to provide reasonable accommodations to victims of sexual assault, domestic violence, or stalking. Types of reasonable accommodations include transfer to another position, modifying the employee's schedule, changing work telephone numbers, installing locks, and assistance in documenting sexual assault, domestic violence, or stalking that occurs in the workplace.

The list of reasonable accommodations for stalking victims is non-exhaustive—employers should assess measures to accommodate victims of stalking on a case-by-case basis. At a minimum, employers should revise policies against discrimination, harassment, and retaliation to include victims of stalking. Employers should also create internal protocols for accommodating victims of domestic violence, sexual assault, and stalking that are consistent with the reasonable accommodations provided in section 230.

III. PRIVACY AND ELECTRONIC ISSUES

A. Background and Credit Checks

1. The EEOC and the FTC Issue Joint Guidances on Background Checks.

In 2012, the EEOC issued a guidance regarding the consideration of arrest and conviction records in employment decisions under Title VII. The guidance advised that an employer's use of such criminal history information may constitute unlawful discrimination if it creates a "disparate impact" on minorities or other protected categories. The EEOC recommended that employers engage in an individualized assessment of the specific criminal conduct at issue and any risks inherent in the duties of a particular position, rather than adopt a blanket policy of excluding applicants or employees with certain criminal convictions. The EEOC warned employers that it would aggressively seek to enforce this guidance.

On March 10, 2014, the EEOC and the Federal Trade Commission ("FTC") issued two joint guidances on the use of criminal conduct in employment decisions. Although neither seems to cover new substantive ground, both serve as reminders that this issue is a top enforcement agenda item for both agencies.

The first guidance advises employers on their existing legal obligations under the federal Fair Credit Reporting Act ("FCRA") and Title VII when conducting background checks on applicants and employees and then using such information to take adverse action. The second guidance advises employees on their rights under these same laws when their employers conduct background checks.

Although the EEOC in particular has faced some challenges in its agenda to challenge employers' background procedures, these guidances should caution employers to consult counsel on these issues.

2. U. S. Census Bureau Could Face Class Action Liability Under a Disparate Impact Theory of Discrimination Because of Screening Practices.

In Houser v. Pritzker, No. 10CV3105, 2014 WL 2967446, __ F. Supp. 2d. __ (S.D.N.Y., July 1 2014), the trial court granted partial class certification to a group of applicants who alleged the U. S. Census Bureau's applicant screening process disproportionately affected African-Americans and Latinos, in violation of Title VII. The plaintiffs brought the class action under the disparate impact theory of liability and claimed that the Census Bureau's neutral screening practice disparately impacted African-American and Latino applicants.

After applicants submitted an application and completed a written exam, the Census Bureau used the FBI database to determine whether applicants had arrest records or criminal convictions. If the FBI database returned a "hit," staff members reviewed the information to assess whether the applicant was "immediately available for hire" or whether the Census Bureau should send a "30-day letter" to the applicant. The letter required applicants to send official court documentation on all arrests or convictions within 30 days of receiving the letter. According to the plaintiffs, the review of criminal background information did not consider whether the arrest resulted in a conviction, the amount of time that passed since the arrest, and whether the applicant sought a position that involved interaction with the public, as suggested by the EEOC in its 2012 guidance.

The plaintiffs also alleged that the 30-day letter was ambiguous and did not contain basic information, such as the arrests for which documentation was requested. As a result, 93% of the applicants with arrest records were not considered for temporary employment with the Census Bureau and less than 1% of African-American and Latino applicants who received the letter were hired. Thus, the plaintiffs asserted that the Census Bureau's screening practices were neither job-related nor consistent with business necessity (as set forth in the 2012 EEOC guidance) and disproportionately precluded African–Americans and Latinos from obtaining employment with the Census Bureau because these groups have higher arrest and conviction rates than Caucasians.

Both sides presented experts to discuss whether the screening process was job-related or consistent with business necessity. The Census Bureau argued that the hiring procedures were "necessary to gain public trust and minimize public safety risks." While the court did not consider the merits of the experts' analyses, the court determined the class member's claims raised the common question of whether the Census Bureau's hiring process was "racially biased" and allowed the case to proceed as a class action.

The case illustrates the importance of reviewing criminal background check policies to ensure that they are precise and continue to comply with developments in the law. Importantly, employers should not implement blanket policies but instead use individualized assessments based on criteria that are job-related and consistent with business necessity.

B. Social Media

1. Court Offers Guidance on Ownership of Company-Affiliated Social Media Accounts.

There has been an increase in the number of lawsuits brought between employees and employers disputing the ownership of social media accounts. Given that the implication is frequently federal law,

cases in other jurisdictions offer practical guidance as to what employers should include in social media policies to ensure maximum protection and defenses.

In Maremont v. Susan Freedman Design Group, Ltd., 2014 WL 812401 (N.D. Ill. Mar. 3, 2014), a director of marketing sued her employer, a design firm, for taking over her Facebook and Twitter accounts to conduct company business while she was on a leave of absence. In furtherance of her duties, the employee created a blog, a company Facebook page, and a Twitter account. The employee also had a personal Facebook page and claimed she was required to set up and access the company Facebook page through her personal Facebook page. The employer alleged that it required her to create the Twitter account, but the employee claimed it was personal, although she occasionally used it to promote company business. Regardless, she kept a spreadsheet on a company computer with all of her login information, including usernames and passwords. The employee claims that she restricted access to the spreadsheet, but a coworker alleged that she was provided access. The employee was seriously injured in a work-related car accident and began a leave of absence. While on a leave, the company maintained her social media activities. Specifically, while the employee was on a leave, 17 posts were made to her Twitter account and five friend requests were accepted on her *personal* Facebook page.

As a result, the employee filed a lawsuit against her employer in violation of the Stored Communications Act ("SCA"), which prohibits unauthorized, unintentional access to electronic communications. The court denied the employer's motion for summary judgment and allowed the employee's claim to proceed because there was a dispute over whether the employer was authorized the access the accounts. Although she kept the login information on a company computer, it was arguably restricted. Moreover, the accounts were personal.

This case offers critical guidance as to what should be included in social media policies for employees. If employers want employees to set up work-related social media accounts (Twitter, Facebook, LinkedIn, etc.), then the policy should state that the employer owns, operates, and manages the account. Employers should require employees to provide IT with the usernames and passwords to these accounts. Here, the employer might have prevailed if it required the employee to set up a company account (rather than a personal one) and had policies in place about usernames and passwords for social media accounts that are owned, operated, and controlled by the company. Social media policies should establish that employees have no reasonable expectation of privacy when using company-owned or personal devices to conduct business. Moreover, they should establish that employees are prohibited from using such devices for unauthorized company business.

2. Court Holds that Facebook Report of Unlawful Harassment Is Not a Report to Employer.

In Debord v. Mercy Health Systems of Kansas, Inc., 737 F.3d 642 (10th Cir. 2013), the federal Court of Appeals held that a Facebook posting regarding unlawful harassment in the workplace was an insufficient "report" to put the employer on notice under applicable law.

The employee in this case worked as a hospital technician and was supervised by the director of radiology, who allegedly touched the employee inappropriately many times over the course of five years. The employer finally became aware of the potentially unlawful harassment when it noticed a Facebook post on the employee's page that mentioned "creepy" touching by the director. When confronted, though, the employee denied having written the post. Regardless, the employer conducted an investigation into the

conduct. Ultimately, it terminated her employment for the dishonest post about a supervisor as well as disruptive text messages to other employees about the investigation. The employee brought a lawsuit against her employer alleging retaliation for reporting sexual harassment, among other claims.

On appeal, the appellate court upheld dismissal of the employee's claims, holding that the Facebook post was insufficient to constitute reporting of unlawful harassment to her employment. Although somewhat similar to an oral complaint (which is sufficient), the court distinguished it by stating that it did not come through the *official reporting system* of the employer nor could the employer have been put on sufficient notice of its existence. Further, the court stated that the employee's misconduct regarding the text messages was also sufficient legitimate business reasons to warrant her termination because the employer's policies required her to keep such investigations confidential.

Although the employer in this case was very successful in countering its former employee's electronic media claims, employers should still cautiously investigate each and every allegation of unlawful conduct, regardless of the source. A California court might decide this case differently.

3. Employer Could Be Liable for Employee's Disclosure of Her Co-Worker's Confidential Medical Information on Facebook.

Under the ADA, employers have a duty to protect the private medical information of their employees. To establish a claim for violation of this provision, an employee must prove that the employer obtained employment-related medical information, the information was disclosed by the employer rather than treated as confidential, and the employee was somehow injured by the disclosure. In Shoun v. Best Formed Plastics, Inc., No. 14-CV-463, 2014 WL 2815483, __ F. Supp. 2d. __ (N.D. Ind., June 23, 2014), a trial court ruled that an employer could be liable for a violation of the ADA when one of its employees posted a co-worker's confidential medical information on Facebook.

Shoun injured his shoulder while working at Best Formed Plastics ("BFP") and spent several months recovering from his injury. Stewart processed Shoun's workers' compensation claims and monitored his medical treatment for BFP. In doing so, Stewart learned about the nature and extent of Shoun's injury. Five days after Shoun filed a lawsuit against BFP, Stewart posted the following on her *personal* Facebook page: "Isn't [it] amazing how [another employee] experienced a 5 way heart bypass just one month ago and is back to work, especially when you consider George Shoun's shoulder injury kept him away from work for 11 months and now he is trying to sue us."

Under the ADA, all medical information gathered by BFP and Stewart in the context of Shoun's injury was required to be treated as a "confidential medical record." Shoun argued that Stewart's Facebook post was a "deliberate disclosure of [his] medical condition to other persons" in violation of the ADA. BFP argued that it was not liable because Shoun voluntarily disclosed the medical information in his public lawsuit against BFP five days prior to the Facebook post. According to BFP, when Stewart posted her comment, it was nothing more than a "mere recitation of facts" previously disclosed to the public by Shoun's lawsuit. The employer moved to dismiss, but the court denied the motion and allowed Shoun's claim to proceed.

Shoun serves as an important reminder for employers to train their employees on the use of social media during and outside of work hours. In Shoun, the employer faced liability even though the employee

posted the information on her *personal* Facebook page. Employers should also have clear company policies to help employees understand the importance of keeping medical information confidential.

4. FFIEC Issues Final Social Media Guidance for Financial Institutions.

On December 11, 2013, the Federal Financial Institutions Examination Council ("FFIEC") issued final guidance entitled, "Social Media: Consumer Compliance Risk Management Guidance" ("Guidance"). The Guidance addresses the applicability of federal consumer protection and compliance laws to activities conducted via social media by banks, savings associations, and credit unions, as well as by nonbank entities supervised by the Consumer Financial Protection Bureau ("CFPB"). The purpose of the Guidance is to help financial institutions understand potential consumer compliance and legal risks associated with the use of social media, along with expectations for managing those risks. The Guidance covers three primary areas: (1) it defines "social media"; (2) it identifies the minimum contents of a social media risk management plan for financial institutions; and (3) it identifies possible legal, operational, and reputational risks of using social media to interact with customers and suggests ways for institutions to manage the risks.

The Guidance defines social media as a "form of interactive online communication in which users can generate and share content through text, images, audio and/or video." Social media can be distinguished from other online media in that the communication tends to be more interactive. While traditional email or text messages do not constitute social media under the Guidance, messages sent through social media channels are subject to the Guidance. The FFIEC provided a non-exhaustive list of specific examples channels that are considered social media under the Guidance, which includes Facebook, Google Plus, MySpace, Twitter, Yelp, Flickr, YouTube, LinkedIn, Second Life, FarmVille, and CityVille.

The Guidance recommends that a financial institution have a risk management program allowing it to "identify, measure, monitor, and control the risks related to social media." The risk management program should be proportionate in size and complexity to the level of the institution's involvement in social media. Even financial institutions that do not actively use social media are expected to have a risk management program to address employee use of social media and protocol for responding to negative comments or complaints arising within social media platforms. The Guidance recommends financial institutions design the program with input from specialists in compliance, technology, information security, legal, human resources, and marketing.

Furthermore, the Guidance discusses several risk areas associated with the use of social media and identifies ways to manage such risk. The potential risk areas covered by the Guidance are compliance and legal risks, reputation risks, and operational risks. Compliance and legal risks arise from potential violations of laws, regulations, and internal policies regarding social media use, and can result in enforcement actions or civil lawsuits against the financial institution. The Guidance provides a non-exhaustive list of laws and regulations relevant to a financial institution's social media activities and recommends financial institutions periodically evaluate use of social media to ensure compliance with federal, state, and local laws, and the Guidance. Reputational risks may arise from negative public opinion in connection with social media. The Guidance provides methods for minimizing specific reputational risks, which include fraud and brand identity risks, risks associated with allowing third parties to monitor a financial institution's social media site, privacy risks, consumer complaints and inquiries, and employee use of social media. Lastly, operational risks can arise from a financial institution's use of information

technology, which includes social media. Financial institutions that use social media are particularly vulnerable to malware and account takeover. Accordingly, the Guidance recommends financial institutions include social media in their incident response protocol for security breaches. The Guidance also provides a list of FFIEC and federal agency publications which address operational risk associated with information technology.

Employers covered by this Guidance are strongly encouraged to revisit their social media policies to ensure that they are in compliance.

C. Right to Privacy

1. Court Makes It Easier for Employee to Sue Employer for Digital Invasion of Privacy.

As technology becomes more popular and employees want to integrate personal devices with work devices, many employers struggle with the employee's expectation of privacy in a mixed-used device upon separation of employment. There are many factors to consider in a privacy analysis, and the law is constantly evolving in light of the ongoing technology evolution.

In Lazette v. Kulmatycki, 94 F. Supp. 2d 748 (N.D.Oh. 2013), an employee turned in her company BlackBerry on her last day of employment. The device contained access to her personal Gmail account (which was permitted under the company's policy), which she neglected to delete from the device prior to turning in. Upon retrieving the device, a coworker accessed, read, and shared with others nearly 48,000 emails in her personal Gmail account over the course of 18 months. Many communications related to her family, health, career, finances, and other personal matters.

The former employee sued under the SCA and for invasion of privacy. The employer moved to dismiss, alleging that the employee consented to access by using a personal account on a company device and not deleting the account upon separation of employment. The court strongly disagreed, allowing the employee's claims to proceed, stating that simply using a company device to access a personal account does not amount to authorization to access and that the employee had a reasonable expectation of privacy in "highly personal and private" emails. "Indeed, the precise terms of the warning matter. With regard to what one might from a warning of the possibility of occasional, random monitoring is one thing, total absorption is another."

This decision highlights that employers must have clear policies about use of and access to electronic devices, whether it is for personal or business use. Specifically, employers must clearly and conspicuously warn employees that they have no expectation of privacy, even if they use company devices for personal activities.

IV. EMPLOYER LIABILITY

A. Course and Scope of Employment

1. Common-Sense Decision Prevents Employer Liability for Employee's Outrageous Conduct.

In Montague v. AMN Healthcare, Inc., 223 Cal. App. 4th (2014), a California Court of Appeal held that a staffing company was neither vicariously liable for the fact that an employee whom it had placed on a job intentionally poisoned a coworker nor liable for negligent training of that employee.

The plaintiff in the case was an employee of a medical treatment facility with a coworker who was placed at the facility by a staffing agency. The plaintiff and her coworker had two arguments at work, and the coworker poured acid into the plaintiff's bottle of water in retaliation. The plaintiff then filed a lawsuit against her coworker as well as the staffing agency.

On appeal, the court held that the injured plaintiff could not maintain a claim against the staffing agency because the employee it had placed acted outside the course and scope of her employment in poisoning her coworker. The appellate court stated that there must be some element of foreseeability to the tortfeasor's behavior as it relates to the work of her employer (here, the staffing company). The court held that the evidence of foreseeability was insufficient in this case because the plaintiff failed to attribute her assailant's attack in the work environment as distinct from a personal problem between the two. The court also held that the staffing agency could not be held liable for failure to adequately train the intentional tortfeasor. The plaintiff did not provide sufficient evidence from which it would be reasonable to conclude that the staffing agency failed to adequately train the tortfeasor and that the failure caused the plaintiff's injury.

This decision is a straightforward repudiation by the court of any attempt to impute such extreme actions by an employee to their employer.

V. WAGE AND HOUR

A. Class Certification and Related Issues

1. Employers Using Staffing Companies Should Adopt a Uniform Policy Informing Their Employees of Rights to Meal and Rest Periods or Risk Class Certification.

In Benton v. Telecom Network Specialists, Inc., 220 Cal. App. 4th 701 (2013), a California Court of Appeal held that evidence of employees working under a variety of conditions is not sufficient to deny class certification where a joint employer lacks a uniform, lawful meal and rest period policy.

An employee of Telecom Network Specialists ("TNS") filed a class action complaint against TNS on behalf of 750 cell tower technicians. Most of the proposed class (85%) consisted of technicians hired and paid by third party staffing companies that provided employees to TNS. TNS directly hired and paid the remaining putative class members. The complaint included allegations that TNS was a *joint employer* that failed to pay overtime and provide meal and rest periods for its technicians. TNS did not have uniform meal and rest period policies, and the staffing companies that it used had a "variety of different policies."

On appeal, the appellate court analyzed whether evidence of diverse employee experiences with different staffing companies is a sufficient basis to deny class certification for a lack of common issues in the class. Relying on three recent cases—Brinker Restaurant Corp. v. Superior Court, 53 Cal. 4th 1004 (2012); Bradley v. Networkers Intl., LLC, 211 Cal. App. 4th 1129 (2012); and Faulkinbury v. Boyd & Associates, Inc., 216 Cal. App. 4th 220 (2013)—the court noted that class certification is appropriate where employer liability could be determined with *facts common to all class members*, regardless of whether a class member was co-employed by a staffing agency with lawful meal and rest period policies. Thus, TNS's unlawful lack of uniform meal and rest period policies was "susceptible to common proof" on a class-wide basis.

The court did not accept TNS's argument that, because technicians worked under diverse conditions, determining liability would require individualized inquiries inappropriate for class treatment. TNS presented evidence showing that technicians performed different types of work under varying levels of supervision, some staffing companies had lawful meal and rest period policies, and some technicians chose to forego meal and rest periods in order to complete their work more quickly. As the court explained, evidence that some employees were able to take meal and rest periods is only relevant to calculating individual damages and is not a sufficient basis to deny class certification.

Benton emphasizes the importance of adopting uniform, lawful meal and rest period policies in the joint employer context because failure to do so could result in liability for the unlawful meal and rest period practices of a staffing agency.

2. Employer Memorandum Stating That Pre-Shift Time Was Not Compensable Results in Class Certification.

In Jones v. Farmers Ins. Exch., 221 Cal. App. 4th 986 (2013), a California Court of Appeal focused on the plaintiffs' theory of liability when it determined that common issues among the class predominated. The putative class in Jones included claims representatives who alleged that Farmers failed to pay them for time spent synchronizing their computers prior to the start of their workday. The claims representatives received their field assignments via work laptops and spent most of the day in the field inspecting automobiles and meeting with claimants. Prior to the lawsuit, Farmers issued a "Work Profile" memorandum to each claims representative, which established that computer sync time was not compensable.

On behalf of their motion for class certification, plaintiffs submitted 51 declarations detailing the various uncompensated tasks performed by employees prior to the start of the workday. Farmers argued that it had no uniform policy requiring unpaid pre-shift work, and "absent such a policy individual issues predominated and class treatment was inappropriate." Specifically, Farmers asserted that the Court would need to determine what tasks each employee performed before the beginning of their shifts, whether the tasks were trivial, and whether the employees' supervisors were aware of any off-the-clock work.

Rejecting the employer's focus on the individual experiences of each employee, the court evaluated the plaintiffs' *theory of recovery*—that Farmers applied a uniform policy to all putative class members denying compensation for "computer sync time" performed before the plaintiffs' scheduled shifts. Evidence that putative class members would need to prove individualized damages did not destroy commonality. The court relied on the Brinker decision, which held that "[c]laims alleging that a uniform

policy consistently applied to a group of employees is in violation of wage and hour laws are the sort routinely, and properly, found suitable for class treatment."

Jones illustrates how seemingly harmless policies, such as a work memorandum, can provide a basis for class certification. Although the employer in Jones had no written policy requiring unpaid pre-shift work, the "Work Memorandum" issued by Farmers was enough to create a theory of liability sufficient to demonstrate commonality. Employers should have employment handbooks and other policies reviewed by counsel to ensure compliance with wage and hour laws and to prevent future liability.

B. Statistical Sampling

1. California Supreme Court Issues Long-Awaited Decision About Trial of Class Actions.

In the California Supreme Court's much anticipated decision of Duran v. U. S. Bank National Assn., 59 Cal. 4th 1 (2014), the Court makes it clear that before a trial court certifies a class, it should require the plaintiff to present a trial plan that will permit the case to be tried manageably on a class-wide basis. As the Court stated in the opening line of the opinion, this case was "an exceedingly rare beast: a wage and hour class action that proceeded through trial to verdict." Duran represents a major step in bringing California's standards on class certification more in line with those set forth by federal courts, relying on key decisions such as Wal-Mart Stores, Inc. v. Dukes, 131 S. Ct 2541 (2011), and Comcast v. Behrend, 133 S. Ct. 1426 (2013). Significantly, the Court also offered critical guidance on California's standard for certifying class actions in exempt misclassification cases.

This class action was brought on behalf of hundreds of current and former business banking officers, claiming that the bank misclassified them as outside sales employees. The trial court certified the class based on evidence from a randomly selected group of 21 out of the 260 class members and prohibited the employer from introducing evidence regarding the experiences of other class members who were not part of the sample. The trial court eventually concluded that the banking officers were, in fact, misclassified as outside salespersons and entered a $15 million judgment against the employer for unpaid wages.

The Court unanimously held that a court should not certify a class without a manageable trial plan, a court must continually reevaluate certification issues and decertify if individual issues later predominate, and the employer has a right to present its affirmative defenses. Significantly, the Court determined that trial court's statistical sampling method was invalid and violated the employer's due process right to present such defenses.

The Duran opinion cannot be overstated in importance. By requiring a manageable trial plan prior to certification, plaintiffs and the trial court will be forced to foresee the litigation through trial and not overzealously move to certify and re-certify classes. Although Duran certainly will not curb the filing of class actions, it could significantly impact settlement negotiations given that it provides employers with more due process defenses.

C. Reimbursements

1. Employers Must Reimburse Employees for All Cell Phone Expenses.

Employers should think twice about requiring employees to use personal cell phones at work. California Labor Code section 2802 requires an employer to reimburse an employee for "all necessary expenditures or losses incurred by the employee in direct consequence of the discharge of his or her duties." In Cochran v. Schwan's Home Service, Inc., 228 Cal. App. 4th 1137 (2014), a class of 1,500 customer service managers alleged that Schwan's Home Service violated section 2802 by failing to reimburse employees for the work-related use of their personal cell phones.

The trial court denied class certification due to a lack of commonality, reasoning that determining liability would require a review of the plaintiffs' individual cell phone plans and their payment of cell phone expenses. On appeal, the court reversed the decision and held that, under section 2802, the employer must reimburse a "reasonable percentage" of the employees' cell phone bills. As a rule of thumb, if an employer requires an employee to make work-related calls from a personal cell phone, the employee is "incurring an expense for the purposes of section 2802."

What if the employee has a plan with unlimited minutes and incurs no additional expense from the work-related calls? Always reimburse. The court made clear that reimbursement for work-related calls is "always required," even in the absence of any actual or additional expense to the employee. The court's unforgiving interpretation of section 2802 seeks to prevent employers from receiving a windfall by "passing its operating expenses onto the employee." Cochran's decision requires reimbursement even if an employee does not pay for his or her own cell phone bill or has an unpaid bill. In light of the broad implications of the Cochran decision, reviewing and updating cell phone policies is crucial to maintain compliance with section 2802.

D. Inside Sales

1. California Supreme Court Limits Inside Sales Exemption.

In the landmark decision of Peabody v. Time Warner Cable, Inc., 59 Cal. 4th 662 (2014), the California Supreme Court unanimously decided that an employer may not attribute commission wages paid in one pay period to other pay periods in order to satisfy the compensation requirement for the inside sales exemption.

Time Warner paid its commissions about once a month. The question before the Court was whether Time Warner could allocate the monthly commission payments over the course of the month in which they were paid, *i.e.,* across the time period during which the commissions were "earned." The Court emphatically said no, explaining why satisfaction of the exemption should be difficult: "Making employers actually pay the required minimum amount of wages in each pay period mitigates the burden imposed by exempting employees from receiving overtime. This purpose would be defeated if an employer could simply pay the minimum wage for all work performed, including excess labor, and then reassign commission wages paid weeks or months later in order to satisfy the exemption's minimum earnings prong."

To satisfy the inside sales exemption the employee must receive in each pay check at least 1.5 times the minimum wage for the hours worked during the applicable workweeks covered by that paycheck

(that means $13.50 per hour worked, effective July 1, 2014). An employer who pays commissions less frequently than semimonthly or biweekly must pay a sufficient hourly rate to ensure the 1.5 times minimum wage threshold is met.

The decision has the effect of increasing the hourly pay required to maintain the exemption. This will result in an increase in non-commission earnings. As a result, payroll expenses will increase unless commission rates are reduced. Also, because the inside sales exemption requires the employee to make more than 50% of wages from commission, it will be harder to meet that 50% threshold (because of the higher hourly rate now required).

The only good news from the Court in this decision was its recognition that commissions are earned when conditions are met, even if there is a delay between when a sale occurs and when commissions are earned: "[A]n employment agreement may require receipt of a client's payment before any commissions on sold advertising are earned. If a client routinely pays its bills on the 15th of each month, commissions will be earned and owed once a month. Yet this does not create a monthly pay period in contravention of section 204(a). To summarize, section 204 establishes semimonthly pay periods, but there is no obligation to pay unearned commission wages in any pay period. Commissions are owed only when they have been earned, even if it is on a monthly, quarterly, or less frequent basis."

Employers are strongly encouraged to review classifications of their sales employees as well as commission agreements to ensure compliance with Peabody or risk jeopardizing the inside sales exemption. This could create exposure to claims for unpaid overtime, waiting time penalties, and related claims.

E. Deductions from Exempt Employees' Salaries (Partial Day Absences)

1. Employers May Require Salaried Employees to Use Accrued Vacation or Paid Time Off for Partial Day Absences.

Rhea v. General Atomics, 227 Cal. App. 4th 1560 (2014), offers welcome news for employers and settles the dispute over whether employers may require exempt employees to use accrued vacation, sick, or paid time off for partial day absences of less than four hours. The issue was previously addressed in Conley v. Pacific Gas & Electric Co., 131 Cal. App. 4th 260 (2005), which upheld an employer's policy requiring exempt employees to use their accrued vacation time to offset partial day absences of at least four hours. The Conley court refused to address whether the same policy would be lawful if applied to absences of less than four hours. The DLSE also addressed the issue and the Conley decision in a lengthy 2009 opinion letter and stated that an employer could do so for absences shorter than four hours. DLSE O.L. 11.23.2009. In Rhea, the Court affirmed Conley and held that employers may require exempt employees to use accrued vacation, sick, or paid time off for partial day absences in any increment, *including increments less than four hours*.

The plaintiff filed a class action lawsuit against General Atomics challenging its policy of requiring exempt employees to use accrued paid time off to cover partial day absences from work. Exempt employees at General Atomics were paid a salary and allowed to accrue paid time off that could be used to take time off for any reason, including vacation, sickness, and family obligations. General Atomics adopted a policy in which it deducted from employees' accrued paid time off banks for partial day absences of *any* length of time. Employees who worked more than 40 hours in a week were not required to use their paid

time off to cover full or partial day absences. The plaintiff alleged that such a practice violated the salary basis test and, thus, risked the exempt classification. On appeal, the court agreed with the employer and cited Conley with approval, holding that there was nothing in Conley to suggest that a policy requiring exempt employees to use accrued paid time off for partial day absences of less than four hours should be prohibited.

Employers should review their policies regarding vacation, sick, paid time off, leaves of absence, and punctuality/attendance to ensure that they require exhaustion of such accrued banks for partial day absences.

F. Working "Off the Clock"

1. Employers Do Not Have to Compensate Employees for "Off the Clock" Work Performed Without the Employer's Actual or Constructive Knowledge.

In Jong v. Kaiser Found. Health Plan, Inc., 226 Cal. App. 4th 391 (2014), a California Court of Appeal held that employers are not liable for "off the clock" work by an employee performed without the employer's *actual or constructive knowledge*. Jong, a former pharmacy manager, brought a class action suit against his employer for unpaid overtime for alleged off the clock work performed by pharmacists classified as non-exempt. Prior to the events giving rise to the lawsuit, the pharmacists were classified as exempt employees. After the pharmacists were reclassified as non-exempt, Kaiser adopted a written policy indicating all managers should be clocked in when performing any work. Kaiser also required employees to sign a form attesting they were aware that off the clock work was prohibited.

Jong alleged that although the Kaiser had a policy against working off the clock, he was still compelled to work off the clock because he was responsible for ensuring the pharmacy stayed within a predetermined budget. According to Jong, an inability to stay within budget by incurring excessive overtime would be deemed a failure to perform his job. He claimed that he was reprimanded for incurring too much overtime. Jong also claimed that the employer had actual or constructive knowledge of his off the clock work because deposition testimony by fellow pharmacy managers established that it required more than 40 hours per week to perform their required tasks when they were previously classified as exempt employees. Jong also submitted alarm code data from his pharmacy and cross-referenced the data to his time records to demonstrate that he disarmed the alarm and worked prior to clocking in.

The court explained that although the deposition testimony may have put the employers on notice that the pharmacy managers worked more than 40 hours per week as exempt employees, it did not put the employer on notice that they were working overtime when they were specifically directed not to without prior approval *via an express written policy*. The alarm code data was not particularly compelling because Jong was unable to demonstrate what he was doing during the time between disarming the alarm and clocking in. Lastly, Kaiser presented evidence that it paid Jong for every hour he worked, even overtime hours. There was never an occasion where Jong requested to work overtime and his request was denied. In light of the above evidence, the court held that it was reasonable for the employer to rely on the times reported by the employees.

This case is a prime example of the importance of implementing a clear written policy prohibiting non-exempt employees from working off the clock. Moreover, employers should ensure that they have evidence showing that employees have acknowledged receipt of such a policy.

G. Independent Contractor

1. California Supreme Court Reiterates Proper Test for Independent Contractor Status.

One of the most important factors that courts and enforcement agencies use to analyze whether an individual is properly classified as an independent contractor is whether the individual has the "right to control" the work and the manner and means in which the work is performed. An individual's right to control the manner and means of the work is usually indicative of independent contractor status. In Ayala v. Antelope Valley Newspapers, Inc., 59 Cal. 4th 522 (2014), the California Supreme Court reaffirmed the test for determining whether an individual is properly characterized as an independent contractor, holding that the question is whether the hirer of services has the legal *right to control* the activities of the individual.

In Ayala, four individuals brought a class action lawsuit against the newspaper publisher, alleging that they were misclassified as independent contractors. The plaintiffs moved to certify a class, contending that the central question to liability was whether putative class members were misclassified and that this question could be answered with common proof—namely the standard agreements between the plaintiffs and the publisher. The publisher argued that the case was not suitable for class treatment because of the variations in how the individuals performed their work. Ultimately, the trial court denied certification, finding that the analysis would require heavily individualized inquiries into the publisher's level of control over the employee's work.

On appeal, the Court disagreed, pointing out that the trial court had used the incorrect standard for whether an individual is properly classified as an independent contractor. The main difference between an "employee" and an "independent contractor" is not how much control a business exercises, but how much the business *retains the right* to exercise control over the individual. At the class certification stage, the relevant inquiry is not whether the business has the right to control the work. Rather, the proper inquiry is whether the business's right to control the work was sufficiently uniform to permit adjudication on a class-wide basis.

In considering the publisher's right to control the workers, the Court emphasized that the relationship was governed by the form agreements. These agreements uniformly addressed the publisher's control over what was delivered, when and how deliveries were made, and the publisher's right to terminate the agreement without cause. Because the trial court relied on the incorrect standard for independent contractor classification, the Court reversed the denial of class certification and remanded the case for further proceedings regarding the question of class certification.

This case serves as an important reminder that independent contractor classifications are fact-specific inquiries that should be guided by counsel. Moreover, agreements documenting these relationships should be carefully drafted in light of applicable law.

2. Ninth Circuit Holds Appliance Delivery Drivers Are Misclassified as Independent Contractors.

In Ruiz v. Affinity Logistics Corp., 754 F.3d 1093 (2014), the U. S. Ninth Circuit Court of Appeals held that the appliance delivery drivers were misclassified as independent contractors under the primary and secondary factors outlined in S. G. Borello & Sons, Inc. v. Department of Industrial Relations, 48 Cal. 3d 341 (1989), one of the seminal cases on this issue.

In Ruiz, the company required its drivers to sign "Independent Truckman's Agreements" documenting an independent contractor relationship. The company also required the drivers to obtain a fictitious business name, a business license, and a commercial checking account, but the company helped the drivers complete the forms. The company also exercised significant control over the drivers, including requiring them to attend a meeting each morning to pick up their route schedule, wear a specific uniform, cover all tattoos and refrain from wearing earrings, and return their truck to the company's office at the end of their shift, among other things. Ruiz sued on behalf of himself and other putative class member alleging that they were misclassified as independent contractors. The trial court sided with the employer, concluding that the drivers were properly classified as independent contractors.

On appeal, the court disagreed and reiterated that both the primary and secondary factors outlined in Borello should be used to determine whether an individual is properly classified as an independent contractor. The primary and most significant factor is the company's right to control work details. The secondary factors include the following: (1) whether the one performing services is engaged in a distinct occupation or business; (2) the kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the principal or by a specialist without supervision; (3) the skill required in the particular occupation; (4) whether the principal or the worker supplies the tools and the place of work for the person doing the work; (5) the length of time for which the services are to be performed; (6) the method of payment, whether by the time or by the job; (7) whether the work is part of the regular business of the principal; and (8) whether the parties believe they are creating the relationship of employer-employee.

Based on these factors, the federal appellate court concluded that the drivers were misclassified as independent contracts. The company had the right to control and retained all necessary control over the details of the drivers' work. The company completely controlled the drivers' rates, schedules, routes, and even their grooming habits. The secondary factors also supported classifying the drivers as employees because the drivers' work was closely monitored, their jobs did not require substantial skill, trucks were provided, the pay arrangement resembled an hourly pay arrangement, and drivers often stayed with the company for years.

This case offers yet another example of the increasing importance for employers to reexamine current independent contractor relationships and agreements in light of continuing scrutiny by courts. In addition to the cost of defending misclassification claims, employers who are found liable for misclassifying employees are subject to an array penalties, including reimbursing employees for unpaid wages (overtime, missed meal and rest periods, reimbursements), civil fines from state agencies, and fines from the Internal Revenue Service. Even a well-drafted independent contractor agreement will not protect employers from misclassification liability as the agreement must comport with the actual nature of the relationship.

3. Ninth Circuit Finds FedEx Drivers Are Improperly Classified as Independent Contractors.

In Alexander v. FedEx Ground Package Sys., 765 F.3d 981 (9th Cir. 2014), applying California law, the federal Ninth Circuit Court of Appeals held that FedEx improperly misclassified a class of 2,300 delivery drivers as independent contractors.

FedEx, which classified its drivers as independent contractors, required them to pay for their own trucks and expenses. The independent contractor agreements provided the drivers with some discretion in

their work and stated that no employee or agent of FedEx had the authority to direct manner in which the drivers performed their work. However, the court looked beyond the language of the agreement and determined that several factors indicated FedEx had the right to control the manner in which drivers performed their work, supporting the employees' claim that FedEx improperly misclassified them as independent contractors. For instance, FedEx had mandatory appearance guidelines for employee uniforms, truck color, and truck dimensions; all drivers had to use FedEx logos; and FedEx dictated when the drivers could leave and return to the terminals. The court concluded that although FedEx's right to terminate its drivers' relationships at-will supported its classification of the drivers as independent contractors, other secondary right to control factors favored classification as employees. Most importantly, the FedEx drivers were not involved in distinct occupations or businesses—the drivers looked and acted like FedEx employees.

Such a decision has an impact on any employer engaging independent contractors for driving or delivery purposes. Businesses with such relationships should promptly review the relationships to ensure compliance with this new decision.

H. Waiting Time Penalties

1. Court's Broad Interpretation of the California Labor Code Makes No Distinction Between Employees "Who Quit" and Who Retire for Purposes of Waiting Time Penalties.

California Labor Code section 202 requires employers to pay the final wages to an employee "who quits" within 72 hours of the employee's termination of employment. Employers are subject to waiting time penalties under section 203 for failure to pay final wages within the time mandated by section 202.

In McLean v. State of California, 228 Cal. App. 4th 1500 (2014), a California Court of Appeal recently held that the California Labor Code's 72-hour time frame to pay the final wages of an employee "who quits" also applies to a *retired* employee. McLean, a former deputy attorney general, filed a class action on behalf of retired state employees who were not promptly paid their final wages by the State. The State argued that retired employees are not entitled to waiting time penalties under section 203 because the 72-hour requirement only applies to an employee "who quits," which is different from an employee who "retires." The trial court agreed with the State.

On appeal, the Court disagreed, holding that the plain language of section 202 did not establish whether an employee "who quits" includes an employee who "retires." Accordingly, the court considered the purpose and intent of section 202—to protect employees. The court concluded that the policy of protecting employees is not furthered by excluding retired employees from the definition of employees "who quit" under section 202.

In light of the McLean decision, employers takes step to ensure that they pay final wages to retiring employees within the time mandated by section 202. Failure to do so could expose the employer to waiting time penalties under section 203.

I. Wrongful Termination

1. Failing to Reimburse Employees for Work-Related Expenses May Result in Constructive Discharge Claim.

In Vasquez v. Franklin Management Real Estate Fund, Inc., 222 Cal. App. 4th 819 (2013), the California Court of Appeal held that an employee who was required to use his own vehicle for extensive work-related errands without reimbursement resulted in pay below minimum wage and eventually his constructive discharge.

In Vasquez, the employee worked as a maintenance technician for the employer and was paid $10 per hour for his services. During his employment, his supervisors instructed him to drive his own vehicle for work-related tasks. The employee estimated that he drove a minimum of 30 miles every day for work-related errands and that the employer failed to reimburse him for gas or mileage. As such, the employee claimed the employer "passed on a portion of its normal operating expenses to a low waged worker," causing him to be paid less than the minimum wage. The employee emphasized these conditions created an intolerable work environment in violation of California public policy.

To establish constructive discharge, an employee must prove that the employer "either intentionally created or knowingly permitted working conditions that were so intolerable or aggravated at the time of the employee's resignation that a reasonable employer would realize that a reasonable person in the employee's position would be compelled to resign." Here, the court acknowledged that an employer's failure to reimburse an employee for work-related expenses would not ordinarily create intolerable working conditions leaving the employee with no option but to resign. However, this case illustrates unusual circumstances where an employee was paid less than the minimum wage and was unable to afford basic living expenses, which rose to the level of constructive discharge. The court emphasized that under these conditions, the employee was wearing out the vehicle on which he relied for his own livelihood and could have been potentially left both jobless and carless. Therefore, the court determined that the employee had been constructively discharged from his job and reversed the dismissal of his complaint.

To avoid liability, employers should have a written policy and procedure in place that promptly reimburses employees for all reasonably work-related expenditures.

J. Arbitration Agreements

1. California Supreme Court Finally Clarifies Enforceability of Class and Representative Action Waivers.

Following conventional wisdom, many California employers have adopted the practice of requiring their employees to sign mandatory arbitration agreements. For such employers, the advantages of arbitration include the following: (1) reduced publicity because arbitration is closed to the public and the press; (2) less exposure to punitive damages or runaway verdicts (juries tend to be more emotional and oftentimes award larger punitive verdicts than do arbitrators); (3) more expeditious and streamlined discovery; (4) speedier resolution of the litigation as compared with the economically challenged and overburdened court system; (5) ability to select an arbitrator with employment expertise; and (6) protection from potential class actions. To benefit from such advantages, however, employers must diligently review their arbitration agreements with competent employment counsel to ensure that such agreements remain enforceable in light of the rapidly evolving body of law pertaining to arbitration agreements.

By way of background, California and federal courts have rendered a series of key decisions in recent years that affect the enforceability of employment arbitration agreements in both the individual and class (or representative) contexts. In 2000, the California Supreme Court upheld the concept of mandatory, pre-dispute employment arbitration agreements in Armendariz v. Foundation Health Psychcare Services, Inc., 24 Cal. 4th 83 (2000). The Court stated that employers could require employees to sign arbitration agreements as a condition of employment, so long as they are not unconscionable. The Court set forth a variety of factors to consider when determining whether such an agreement is conscionable, including, but not limited to, whether the agreement is bilateral (meaning that both employer and employee are bound to arbitrate claims against one another), is fair, and requires the employer to pay costs unique to arbitration.

In 2005, the California Supreme Court decided the case of Discover Bank v. Superior Court, 36 Cal. 4th 148 (2005). The Court held that arbitration agreements waiving the right to bring class action lawsuits (in the consumer context) were unconscionable and, thus, unenforceable in California. Several years later, in Gentry v. Superior Court, 42 Cal. 4th 443 (2007), the California Supreme Court further held that arbitration agreements waiving the right to bring class action lawsuits (in the employment context) were unconscionable and, thus, unenforceable in California if "class arbitration would be a significantly more effective way of vindicating the rights of affected employees than individual arbitration." The Court set forth a four-factor test to make this determination. However, six years later, in AT&T Mobility, LLC v. Concepcion, 131 S. Ct. 1740 (2011), the U. S. Supreme Court held that the Federal Arbitration Act ("FAA") preempts state laws that disallow class action waivers in arbitration agreements (and consequently, preempts Discovery Bank and Gentry).

In a flurry of cases since the AT&T decision, California courts have grappled with the question of whether an employer may require employees to waive the right to file or participate in a class or representative action. Significantly, California courts have attempted to circumvent AT&T's holding by concluding that various employment arbitration agreements were unconscionable for a myriad of reasons. Finally, this year, the California Supreme Court reconciled the state of Gentry in its landmark decision of Iskanian v. CLS Transp. Los Angeles, LLC, 59 Cal. 4th 348 327 (2014). In Iskanian, the Court held that Gentry is preempted by the FAA and recent U. S. Supreme Court decisions: "Under the logic of [the United States Supreme Court's decision in] AT&T, the FAA preempts Gentry's rule against employment class waivers" because it frustrates the fundamental purpose of the FAA (*i.e.,* streamlined and quick proceedings). Iskanian now makes it clear that *class action waivers* are enforceable under California law. Significantly, though, the Court had an opposite ruling on *representative action waivers*, holding that they were not preempted by the FAA due to California public policy. As such, representative action waivers are not enforceable under California law.

Employers must promptly review and revise their arbitration agreements to carve out representative action waivers. There are several recommended approaches, including drafting a stay of representative action claims pending completing of all claims that must be arbitrated.

K. New Legislation and Regulations

1. New Legislation Expands "Liquidated" Damages for Minimum Wage Violations.

Actions for minimum wage violations are about to become more expensive for employers. Under California Labor Code section 1194.2, an employee is entitled to "liquidated" damages in "an amount equal

to the wages unlawfully unpaid and interest thereon." The liquidated damages are in addition to damages for unpaid wages and penalties.

A crucial question in a civil lawsuit is how far back an employee's damages claim stretches. California has a three-year statute of limitations for a claim of unpaid wages. However, there is currently no statute of limitations for a claim for liquidated damages under section 1194.2. Assembly Bill 2074 amends section 1194.2 to allow employees to recover liquidated damages for the entire three-year statute of limitations period for the underlying minimum wage action. The Bill was proposed in response to a recent California Court of Appeal decision holding that an employee can recover wages for three years of minimum wage violations and for only one year of liquidated damages. The new legislation goes into effect on January 1, 2015.

2. California Raises Minimum Wage in Two Steps.

Last fall, Governor Jerry Brown signed Assembly Bill 10 into law, which amended California Labor Code section 1182.12 to increase the minimum wage (from $8.00 per hour) in two increments. First, effective, July 1, 2014, the minimum wage increased to $9.00 per hour. Second, effective January 1, 2016, the minimum wage will again increase, to $10.00 per hour. The cumulative raise by 2016 will be 25%. This marks the first increase in California's minimum wage in six years. Employers should be aware of the broad implications of such a change.

First and foremost, employers must increase the hourly rate of employees earning below the new minimum wage. In addition, these employees' pay rates for overtime, vacation, sick leave, paid time off, and meal and rest period premiums must increase as well. Failure to do so may result in significant liability to employers for wage and hour violations.

Moreover, the minimum wage increase also affects exempt employees. To qualify for the administrative, executive, or professional exemption from overtime, employees must earn an annual salary of at least twice the minimum wage (previously, $33,280 per year). Employers must evaluate whether the salaries of their exempt employees meet the new salary requirements. As a result of the amendment, the minimum exempt employee salary increases to $37,440 per year, effective today, and to $41,600 per year, effective January 2016. Failure to pay such salaries may result in exemption misclassification claims, which could result in liability to employers for failure to pay overtime, failure to provide meal and rest periods, and other derivative claims.

Moreover, this increase will also affect the commissioned inside sales employee exemption. To qualify, these employees must earn more than 1.5 times the minimum wage for all hours worked (previously, $12.00 per hour; now $13.50, as of today, and $15.00 per hour as of January 2016). However, this increase will not affect the computer professional exemption as the Division of Labor Standards Enforcement independently determines the rate for this classification.

Employers are encouraged to review employees' compensation to ensure compliance with the minimum wage increases and their derivative requirements. Moreover, employers should review timekeeping and payroll procedures to ensure that rates for overtime, vacation, sick leave, paid time off, and meal and rest period premiums comport with the new law.

The minimum wage increase will also impact specific industries and select employer policies, including the construction industry, employers that provide meals and/or lodging to employees, employers

that require employees to provide hand tools, and employers that pay travel time at the minimum wage rate.

3. California Offers Paid Sick Leave to Employees.

Assembly Bill 1522 (the "Healthy Workplaces, Healthy Families Act of 2014") goes into effect on July 1, 2015. The Bill requires most employers to provide employees with paid sick leave. The accrual rates, maximums, and carryovers are determined by the Bill. An employer is covered under the Bill as long as it has at least one employee who works 30 or more days in California within a year from the commencement of employment, even if the employee is classified as part-time or temporary. The Bill excludes certain industry-specific employees from coverage.

Under the new law, employees will *accrue* paid sick leave at a rate of one hour for every 30 hours worked. However, an employer may *limit accrual* of paid sick leave to a maximum of 48 hours. Further, an employer may limit an employee's *use* of paid sick leave to 24 hours per year. An employer must allow the employee to carry over accrued paid sick leave from year to year. An employer may impose a 90-day waiting period to use accrued paid sick leave; however, accrual must begin immediately upon starting employment. Employers with policies offering the same or higher benefits are exempt from these requirements.

The new law also provides extensive guidelines for accrual of sick time, calculating rate of pay for paid sick leave, and notice to employees of the paid sick time available. For example, employers must meet record-keeping requirements for use of sick leave for at least three years. Further, employers must provide written notice to employees regarding the amount of paid sick leave available either in the employees'' wage statements or other notice on payday.

In light of the many provisions in the new legislation, employers should carefully review and update sick leave or paid time off policies as well as payroll practices regarding time off for sick leave.

4. Employers Will Be Required to Pay Employees for Time Spent on Heat-Related Recovery Breaks.

Senate Bill 1360 amends California Labor Code section 226.7 to clarify that employers must compensate employees for the time they spend on heat recovery breaks. The new legislation will take effect on January 1, 2015.

Under current law, employers with work environments where there is a high risk of heat-related illness and injury must allow employees to take recovery breaks throughout the day to prevent heat exhaustion. Current regulations do not expressly limit how many recovery breaks and employee may take throughout the day. Heat recovery periods are separate from the rest periods required under California law and will constitute fully compensable time under the new legislation. Thus, employers must not deduct time spent on recovery breaks from employees' wages.

VI. LEGISLATIVE AND BENEFITS

A. Unemployment Insurance Benefits

1. California Courts Shed New Light on the Meaning of "Misconduct" that Disqualifies an Employee from Eligibility for Unemployment Benefits.

California Unemployment Insurance Code section 1256 (and supporting regulations) disqualify an employee from receiving unemployment benefits if the employee was discharged for "misconduct." Because section 1256 does not define misconduct, courts have shaped the definition by considering the totality of the circumstances surrounding the employee's actions. Two recent cases shed light on employee actions that rise to the level of misconduct.

The California Supreme Court in Paratransit, Inc. v. Unemployment Ins. Appeals Bd., 59 Cal. 4th 551 (2014), recently held that a finding of "misconduct" under section 1256 requires that an employee acted with "wrongful intent." Further, the Court made clear that in the absence of prior discipline or warnings, a single act of disobedience does not constitute misconduct unless the act is substantially detrimental to the employer. The employee in Paratransit refused to sign a disciplinary notice arising from a customer complaint because he feared that his signature would be an admission of his wrongdoing. As a result, the employee's employment was terminated for insubordination, and he was disqualified from receiving unemployment benefits on the basis that his refusal to sign the notice constituted misconduct. The Court concluded the employee's refusal to sign was a *good faith error* in judgment that lacked the wrongful intent required to establish misconduct under section 1256.

In Irving v. Unemployment Ins. Appeals Bd., 229 Cal. App. 4th 946 (2014), a California Court of Appeal decided the issue of whether falsifying time records constitutes misconduct under section 1256. The employee in Irving was suspended and eventually discharged for exceeding his meal periods and falsifying his time records related to those meal periods. Irving testified that he falsified his time records because his supervisors instructed him to do so and that he took longer meal periods because other employees also did so. The trial court determined Irving's actions did not rise to the level of misconduct because the false timekeeping was a good faith misunderstanding of Irving's job duties. On appeal, the Court disagreed, finding Irving's excessive violation of meal periods and falsification of time records constituted misconduct within the scope of section 1256. Unlike Paratransit, the court in Irving handled the issue of dishonesty, which requires examining the actions from a reasonable person's perspective, rather than the perspective of the employee. Thus, the court rejected Irving's argument that his actions were a good faith misunderstanding, stating that a reasonable person would not have interpreted Irving's actions as honest.

Both of these cases offer employers guidance in deciding whether to challenge an employee's claim for unemployment insurance benefits.

B. Taxes

1. IRS Clarifies Taxability of Severance Payments.

On March 25, 2014, the U. S. Supreme Court issued its much anticipated decision in United States v. Quality Stores, Inc., 134 S. Ct. 1395 (2014). The issue before the Court was whether certain severance payments made to employees terminated against their will are taxable wages under the Federal Insurance

Contributions Act ("FICA"), 26 U.S.C. section 3101. The Court held that the FICA's broad definition of "wages" for "employment" necessarily included severance payments where such payments are made to employees on the basis of services provided and not linked to the receipt of state unemployment benefits.

In 2001, Quality Stores filed for bankruptcy relief. Prior to filing its bankruptcy petition, the company terminated thousands of employees as a means to downsize and prepare the proceedings. Quality Stores distributed to its former employees a severance package with variable rates on the basis of seniority and time served in the company. Pursuant to FICA, Quality Stores paid the employer's assumed share of taxes on the distribution and likewise withheld the employees' share as well. Subsequent to the distributions and bankruptcy filing, Quality Stores petitioned the Internal Revenue Service ("IRS") for a refund of the withheld amounts on the basis that FICA's definition of "wages" should be interpreted in a manner that exempts such severance payments from taxation. When the IRS declined to respond to Quality Store's petition, the company brought suit and prevailed at the district court and the Sixth Circuit Court of Appeals.

In an 8-0 decision, Justice Kennedy wrote the opinion of the Court holding that the severance payments at issue are taxable under FICA's definition of "wages." The Court focused on FICA's definition of "wages" that includes "any remuneration for employment" and highlighted that fact that "employment" includes any services rendered as well as the entire employer-employee relationship. Thus, although the severance payments issued by Quality Stores did not necessarily compensate directly for actual services rendered, the term "wages" necessarily includes the severance payments on the basis that such payments were made only to employees of the company.

Employers should be aware of this decision when processing severance payments for employees upon separation of employment.

2. Restaurant Owners Should Reconsider How They Handle Automatic Gratuities in Light of IRS Revenue Ruling.

Restaurants and catering services typically add an automatic gratuity of 18% or 20% to bills for large parties. Automatic gratuities help cover overhead and ensure patrons do not short change servers of large parties. This practice may soon be a thing of the past. On January 14, 2014, the IRS began to enforce Revenue Ruling 2012-18, which classifies automatic gratuities as *service charges*, rather than "tips." Long-standing industry practice has been to treat automatic gratuities as tips. The new classification of automatic gratuities as service charges means employers must report the automatic gratuities as part of their taxable income.

Other types of automatic gratuities that are considered service charges include: (1) bottle service charges; (2) room service charges; (3) contracted luggage assistance charges (hotel or resort); and (4) mandated delivery charges (food or retail deliveries). Service charges constitute *non-wage tips*, which are subject to social security tax, Medicare tax, and federal income tax. Importantly, service charges are considered as income to the employer regardless of whether the employer distributes the tips among employees.

The IRS's classification of automatic gratuities as service charges rather than tips has several significant implications for employers. First, employers will no longer be eligible to take the "tip credit" permitted by the Fair Labor Standards Act for employees who serve large parties where automatic

gratuities are customary. This means employers *must* pay employees who serve large parties at least the applicable minimum wage because they are technically performing non-tipped work. Second, employers face the difficult task of determining what wages to pay employees who split their time between performing tipped-work—serving a small group at a restaurant—and non-tipped work subject to service charges—serving a large restaurant party with an automatic gratuity added to the bill. Third, employers will need to recalculate overtime rates for employees who are paid a portion of automatic gratuities and work more than 40 hours in a week or more than 8 hours in a day. Again, this calculation is difficult when employees perform a combination of tipped and non-tipped work.

Lastly, whether an employer characterizes a payment as a "tip" rather than an automatic gratuity is not determinative for FICA tax purposes. The Revenue Ruling provides that the absence of any of the following four factors indicates a payment may be a service charge rather than a tip:

(1) The payment must be made free from compulsion;
(2) The customer must have the unrestricted right to determine the amount of the payment;
(3) The payment should not be the subject of negotiation or dictated by the employer's policy; and
(4) The customer generally has the right to determine who receives the payment.

In light of the recent changes, employers in the service industry should consult with counsel to discuss how the Revenue Ruling affects their business and whether they need to amend existing payroll and tax practices.