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Annual California Roundup: Legislative (Not Much) and Judicial (A Lot) Developments

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Employment Law Commentary, October 2007

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It's time once again for our annual California legislative wrap-up. For California employers, however, there is little to report out of Sacramento this year; few labor and employment bills made it past Governor Arnold Schwarzenegger's veto power. Yet as we all know, the state legislature is not the only game in town. The judicial branch has been particularly active in the employment law context this year. The purpose of this legal update thus is twofold: to bring employers up to date on what the Governor did and did not sign into law this year, as well as to review a number of notable legal decisions that promise to shape employer-employee relations in the years to come.

Legislative Lookback

In October, Governor Schwarzenegger vetoed the majority of labor and employment legislation that crossed his desk. Since many of the bills the Governor nixed would have imposed greater restrictions on employers, this is a welcome development for businesses across California. Moreover, the few pieces of legislation that did become law are not particularly onerous for employers and, in terms of new wage laws that soon will take effect, actually can be construed as business--friendly. First, we will look at those bills that managed to run the full gauntlet and get signed into law. Next, we will review a sampling of the bills that died on the Governor's desk, to give employers a sense of what might be resurrected during next year's session—an election year, no less. Unless otherwise noted, all new laws will become effective January 1, 2008.

Aye: Bills Signed Into Law

Leave for Military Spouses (A.B. 392)
Section 395.10 of the Military and Veterans Code has been amended. ***Effective immediately***, employers with 25 or more employees must allow a spouse of certain members of the Armed Forces, National Guard, or Reserves deployed during military conflict to take up to 10 days of unpaid leave when the service member is home on leave. Employees are qualified for this leave provided they work for their employers at least 20 hours a week. Note, however, that independent contractors are not eligible for this leave.

Employees must notify their employers of their intent to take the leave within two days of receiving official notice that their spouse will be home. They also must submit written documentation certifying that their spouse will be home during the days for which leave from work is requested. Military spousal leave under this new law will not affect an employee's right to take any other kind of leave and will not affect other employee benefits.

Interestingly, the language of this new leave law only references "spouses" and not domestic partners. Yet because the California Domestic Partnership Act (effective January 1, 2005) extends the rights and duties of spouses to couples registered as domestic partners with the California Secretary of State, employers are advised to apply spousal military leave equally to qualified employees whose registered domestic partner is in the military.

Hourly Rate of Pay Requirement for Computer Professional Exemption Is Lowered (S.B. 929)
California Labor Code section 515.5, which sets forth the requirements for a computer professional to qualify as exempt from overtime wage laws, has been amended. Specifically, the hourly rate of pay requirement has been decreased from $41 per hour (adjusted for inflation, it currently is approximately $49) to not less than $36 per hour. Accordingly, a computer professional who earns an income that ultimately amounts to $36 per hour or more, can lawfully be classified as an exempt employee, provided all other requirements have been met. This is a pro-employer development that makes it easier to classify highly compensated computer professionals as exempt employees.

Prevailing Wage Determinations (S.B. 929)
California Labor Code section 1773.9 has been amended with respect to the allocation of prevailing wage payment. In general, contractors and subcontractors performing labor on public works costing more than $1,000 are required to pay their workers the general prevailing rate of per diem wages, as determined by the Director of Industrial Relations. Per diem wages include both hourly wage rates and employer payments for employee benefits. As amended, section 1773.9 authorizes contractors and subcontractors—whenever the Director's prevailing wage determination contains a predetermined change but does not specify how the change will be allocated—to allocate payments equal to that change to either hourly wages or benefits for up to 60 days following the Director's publication of the specified allocation. The law ensures that contractors are not subject to liability or litigation based on technical or unintentional noncompliance with the prevailing wage law regarding allocation of an employee's wages or benefits.

Notification of EITC Credit Eligibility (A.B. 650)
The Revenue and Taxation Code has been amended by adding various new sections, commencing with section 19850. Section 19850, *et seq*., requires employers to notify employees that they may be eligible for the federal earned income tax credit ("EITC") within one week (before or after) of providing employees with their annual wage summary, such as a W-2 form or form 1099. Section 19854 of the Revenue and Taxation Code provides the exact language that must be included in each employee notice, which can be either mailed to an employee's last-known address or hand-delivered to the employee. An employer may not satisfy the new EITC notice provisions by posting the notification on an employee bulletin board or sending it through office mail.

Alternative Workweek Schedules: Pharmacists (S.B. 812)
Depending on the nature of their work, pharmacists may be regulated by Wage Order 7, relating to the mercantile industry, or Wage Order 4, relating to professional, technical, clerical, mechanical, and similar occupations, including employees in the health care industry. Whereas both wage orders permit the adoption of alternative workweek schedules by agreement, Wage Order 7 requires that any such agreement provide not less than two consecutive days off within a workweek, but Wage Order 4 has no such restriction. Section 1186.5 thus has been added to the Labor Code and permits pharmacists employed in the mercantile industry pursuant to Wage Order 7 to adopt the alternative workweek schedules allowed by Wage Order 4, including alternative workweeks that can be adopted by employees working in the health care industry.

Workers' Compensation
Section 90.3 of the Labor Code has been amended to provide that employers found by the Labor Commissioner to be illegally without workers' compensation insurance may be included as a statistic in an annual report published on the Labor Commissioner's website (S.B. 869). The Governor also signed various other bills into law that will slightly adjust the state's workers' compensation scheme. Among other things, these new laws will extend the time period during which an injured worker can receive aggregate disability payments, from two to five years (A.B. 338); prohibit the limit on the number of chiropractic, occupational therapy, and physical therapy visits an injured employee may have, from applying to visits for post-surgical physical medicine and post-surgical rehabilitative services (A.B. 1073); require the Administrative Director of the Division of Workers' Compensation to adopt and revise an official medical fee schedule for burn cases on at least a biennial basis (A.B. 1269); and delete workers' compensation insurance from the requirement that insurers maintain certain minimum reserves for outstanding losses and loss expenses for various coverages (S.B. 316).

Reminder: Hands-Free Law and Itemized Wage Statement Amendment Takes Effect July 1, 2008
Don't forget! The hands-free legislation signed by Governor Schwarzenegger in 2006 goes into effect on July 1, 2008 (S.B. 1613, 2006 Legislative Session). This law prohibits the use of a cell phone in a moving vehicle unless the driver is using a hands-free device. Commercial drivers are exempted from this law until July 1, 2011. Employers should require their employees to abide by this new law to help prevent vicarious liability in the event a worker acting within the course and scope of employment is involved in an auto collision caused by the worker's negligence (such as cell-phone distraction).

Additionally, an amendment to Labor Code section 226(a)(7) signed by the Governor in 2005 kicks in on January 1, 2008 (S.B. 101, 2005 Legislative Session). Under this amended section, which delineates the type of information required to be shown on an employee's itemized wage statement, *i.e.,* pay stub, only the last

four digits of an employee's social security number or an employee identification number other than a social security number may be displayed.

Minimum Wage Tickler
Also note that, beginning July 24, 2007, the federal minimum wage rose to $5.85. It will rise again next year, to $6.55, on July 24, 2008. Effective January 1, 2008, the minimum wage in California will increase from $7.50 per hour to $8.00 per hour.

Nay: Bills Vetoed

Wage and Job Classification Record Retention (A.B. 435)
An effort to amend section 1197.5 of the California Labor Code, which prohibits payment of unequal wages to members of the opposite sex performing equal work, was vetoed. Under the proposed statute, the time frame for retaining employee wage and job classification records would have been expanded, and the statutes of limitations governing various wage actions would have been extended.

Family-Related Legislation
California's Family Rights Act ("CFRA") and Paid Family Leave insurance program ("PFL") remain unchanged thanks to a pair of vetoes issued by Governor Schwarzenegger. The CFRA requires employers with 50 or more employees to allow up to 12 weeks of unpaid leave for personal illness, bonding with a new child, or serious illness of a parent, dependent child under the age of 18, or spouse. The vetoed legislation would have expanded the CFRA's protections to include care for a seriously-ill child (regardless of whether the child was a minor dependent), parent-in-law, grandparent, sibling, grandchild, or domestic partner (A.B. 537). Under another vetoed bill, California's PFL program would have been expanded to include the same group (S.B. 727). The Governor declined to usher these bills into law because he felt it would have increased confusion about leave requirements.

Additionally, a bill that would have entitled employees to take up to four days off for bereavement leave upon the death of a spouse, child, parent, sibling, grandparent, grandchild, or registered domestic partner has died (S.B. 549).

An effort to amend the Fair Employment and Housing Act ("FEHA") to include "familial status" as an additional basis upon which employment discrimination would be prohibited also has met defeat (S.B. 836). In issuing his decision not to sign the proposed bill, Governor Schwarzenegger explained,

> "[e]xpanding workplace protections to include something as ambiguous as 'familial status' is not appropriate. This bill will not only result in endless litigation to try and define what discrimination on the basis of 'familial status' means, it will also unnecessarily restrict employers' ability to make personnel decisions."

Non-California Choice of Law/Choice of Venue Provisions (A.B. 1043)
The Governor vetoed a bill that would have rendered non-California choice of law and choice of venue provisions in employment agreements, handbooks, or "other statements of the employer's policies," void and unenforceable under public policy. The Governor explained his decision accordingly:

This bill appears to create a solution in search of a problem. California law currently ensures that employees cannot be subjected to unconscionable contract provisions that would force them to forgo the protections of California law or litigate their claims in an inappropriate out-of-state forum. Moreover, this bill creates unnecessary and unhelpful uncertainties for the employers and employees concerning issues of federal preemption. Lastly, I strongly support the right of parties to freely contract for the terms of their employment relationship. This bill fundamentally conflicts with that policy.

Employer-Provided Healthcare (A.B. 8)
A controversial bill opposed by employers likewise has been vetoed. Assembly Bill 8 would have required employers by January 1, 2009, to provide health care to employees and their dependents in an amount equivalent to 7.5% of the employer's total social security wages. Alternatively, under the bill, employers could elect to have health care coverage provided through a state program with a minimum payment and to set up a pre-tax cafeteria plan under IRS code section 125.

Other Miscellaneous Bills
Additionally, Governor Schwarzenegger vetoed legislation that would have permitted agricultural employees, as an alternative procedure, to select their labor representatives by submitting a petition to the Labor Board accompanied by representation cards signed by a majority of the bargaining unit (S.B. 180). He moreover

rejected a bill that would have prohibited willful misclassification of employees as independent contractors and authorized the Labor and Workforce Development Agency to assess specified civil penalties on persons or employers violating the bill (S.B. 622). The Governor also blocked efforts to subject employers to criminal penalties if they failed to maintain employment records for a specified time or did not provide inspection and copies of those records within a specified time to current and former employees (A.B. 1707). Likewise, he vetoed a bill that would have required employers convicted of a crime involving fraud, misrepresentation, or misconduct related to a lockout to make restitution to employees for lost wages and benefits (A.B. 504).

Federal Update

In the employment discrimination context, it should be noted that the Employment Non-Discrimination Act (H.R. 3685) sponsored by Representative Barney Frank (D-Mass) currently is winding its way through the United States House of Representatives. If passed, the Act would bar discrimination based on actual or perceived sexual orientation. Many gay rights groups contend the Act does not go far enough, however, and are pushing for it to include protections based on gender identity.

Recent Judicial Developments

California courts this year have issued a number of significant decisions in the employment and labor law context. Thus, while the 2007 legislative session was relatively quiet in this area, there is much to report in terms of case law developments.

Landmark Meal and Rest Break Decision
Without question, the case that made the biggest splash this year was the California Supreme Court's unanimous decision in *Murphy v. Kenneth Cole Productions.* The court in *Murphy* held that payments due to employees under Labor Code section 226.7 for missed meal and rest breaks are wages, not penalties, governed by a three-year statute of limitations. A more comprehensive digest of the *Murphy* decision can be found in our April 2007 *Employment Law Commentary*.

Class Action Waiver Provisions in Pre-Employment Arbitration Agreements
On August 30, 2007, the California Supreme Court in *Gentry v. the Superior Court of Los Angeles* held that a class action waiver provision in a pre-dispute arbitration agreement cannot be enforced where (a) the claims at issue cannot be waived as a matter of law (e.g., claims for unpaid wages, including overtime, which are unwaivable under California Labor Code section 1194), and (b) a class action would be a "significantly more effective means" of resolving the claims at issue in the case.

Although the *Gentry* court seemed to suggest that a class action would be a significantly more effective means of resolving employee wage-hour claims, it stopped short of reaching this blanket conclusion. The court stated, "[w]e do not foreclose the possibility that there may be circumstances under which individual arbitrations may satisfactorily address the overtime claims of a class of similarly aggrieved employees, or that an employer may devise a system of individual arbitration that does not disadvantage employees in vindicating their rights under section 1194."

Importantly, the *Gentry* decision is not a rebuke of pre-employment arbitration agreements. Rather, the court in *Gentry* suggested that class action waivers found to be unenforceable should be severed from an arbitration agreement and the parties allowed to proceed to arbitration as a class. *Gentry* therefore does not impact the overall enforceability of pre-dispute arbitration agreements in the employment context. Its effect instead is limited to whether and to what extent an employer may control how an employee's claims are brought in arbitration—as an individual claim or by class action vehicle.

Burden Change in Disability Discrimination Lawsuits
In *Green v. State of California*, the California Supreme Court resolved a split in the lower courts by holding that an employee alleging disability discrimination under the FEHA has the burden of proof to show that he can perform the essential functions of the job with or without reasonable accommodation. This holding aligns the FEHA with the ADA, which likewise burdens the employee, not the employer, with proving he is a "qualified individual with a disability."

The *Green* decision obviously is favorable to employers, but it is not a free pass. Under FEHA, employers still must explore all possible means of reasonably accommodating a person prior to rejecting the person for a job or making any employment-related decision.

Rejection of Business and Professions Code § 17200 Claim Regarding Bonus Plan Tied to Profits
In Prachasaisoradej v. Ralphs Grocery Co., Inc., store employee Eddy Prachasaisoradej claimed Ralphs'

profit-sharing plan violated California's longstanding prohibitions against deducting from employees' earnings the costs for routine breakages, cash shortages, loss of equipment, and workers' compensation. Because, the plaintiff alleged, the plan was illegal, it also constituted an unfair business practice under section 17200. The California Supreme Court disagreed, finding that applying statutes prohibiting direct deductions of costs from employees' wages to a plan whose purpose is to give employees an incentive to improve profits "would defy reason and common sense." It thus held that profit-sharing plans do not violate the law even if costs are deducted from revenue to determine the amount of profits on which the incentive compensation is based. Accordingly, because Ralphs' plan did not violate any underlying labor laws, the court ruled "[t]he derivative claim of liability under Business and Professions Code section 17200 thus also fails."

This decision gives a welcome green light to standard profit-sharing plans widely used by employers in California. Employers can feel free to adopt (or maintain) such plans without fear of liability.

At-Will Employment Provisions Given Plain Meaning

California appellate courts have issued conflicting decisions regarding whether an employment contract providing for termination "at any time," without more, can be interpreted as allowing an implied agreement requiring cause for termination. Happily, this conflict now is resolved.

In *Dore v. Arnold Worldwide, Inc.*, Arnold Worldwide, Inc. ("AWI") hired Brook Dore ("Dore") and sent him a letter confirming the terms of his employment which, among other things, provided that his employment was at will. The letter explained the phrase "at will" accordingly: "This simply means [AWI] has the right to terminate your employment at any time just as you have the right to terminate your employment with [AWI] at any time." When AWI terminated Dore's employment over two years later, Dore sued for various claims, including breach of contract and breach of the implied covenant of good faith and fair dealing. Among other things, he alleged the at-will statement in AWI's offer letter was ambiguous because it only addressed when his employment could terminate ("at any time") and was silent on the issue of cause. The California Supreme Court rejected this argument in a unanimous decision. The court held that the formulation "at any time" in a termination clause "is not per se ambiguous merely because it does not expressly speak to whether cause is required…. As a matter of simple logic such a formulation ordinarily entails the notion of 'with or without cause.'"

The court then proceeded to examine whether Dore's offer letter as a whole nonetheless could be considered ambiguous as to the at-will nature of his employment because it referenced a 90-day assessment period and annual reviews. Ultimately, however, the court ruled that these additional provisions did not expressly or impliedly confer on Dore the right to be terminated only for cause.

The moral of this story for employers is to make their at-will provisions clear and unambiguous so it is mutually understood that an employee can be terminated at any time, with or without cause or reason. Further, employers must take care not to include any provisions in offer letters or agreements that could be construed as negating the employment's at-will nature.

Administrative Exemption Examined

This summer, California courts of appeals issued several decisions that appear to narrow the scope of the administrative exemption from overtime wage laws under California law. Applicability of the administrative exemption turns on five interrelated factors; however, in both *Eicher v. Advanced Business Integrators* and *Harris v. Superior Court*, the only factor at issue was whether the employee performed "office or non-manual work directly related to management policies or general business operations" of the employer or its customers. In each case, the appellate court held that the employer failed to prove this prong of the administrative exemption analysis because evidence showed the respective employees only engaged in core "day-to-day" business.

The more polemic of these two cases is *Harris*, which relied on *Eicher* to hold that insurance claims adjusters do not fit within the administrative exemption and thus are entitled to overtime wages. This holding is a significant departure from federal case precedent, Department of Labor opinion letters, and the federal regulation 29 C.F.R. § 541.205(c)(5), which is expressly incorporated into Wage Order 4-2001 and states that "claims agents and adjusters" are exempt administrative employees. Equally significant is the *Harris* court's pronouncement that "production work" (which does not qualify for the administrative exemption) may not have to actually involve producing the product or service that the employer sells. As a result, day-to-day activities necessary for the employer's business operations may be non-exempt work even if such activities are not producing the employer's product, and regardless of the level of individual judgment, discretion, or decision-making involved.

The *Harris* decision casts a confusing light on an already unclear area of law in California. As noted in Judge Vogel's vigorous dissent in *Harris*, there are two separate lines of cases here—one that supports the conclusion that claims adjusters are non-exempt, and the other supporting the opposite view. This dichotomy

is illustrated by comparing the outcome in *Harris* with the Ninth Circuit's 2006 holding in *In re Farmer's Exchange*. In *In re Farmer's Exchange*, the court ruled 29 C.F.R. § 541.203 (which it cited as being consistent with 29 C.F.R. § 541.205(c)(5)'s statement that claims adjusters qualify as administratively exempt) and Department of Labor opinion letters compel the conclusion that claims adjusters are exempt employees. In reaching this conclusion, it rejected many of the arguments the *Harris* court found persuasive, including the notion that claims adjusters are involved in disqualifying production work. Unlike in *Harris,* the Ninth Circuit's analysis also did not ignore claims adjusters' use of discretion and independent judgment—which is a necessary factor to balance when assessing whether an employee meets the administrative exemption.

The Supreme Court has declined to review the *Eicher* decision; however, it remains to be seen whether it will review the lower court's holding in *Harris*,which contained a strong dissent. Though these cases are outside the more mainstream analysis of the administrative exemption, they serve as added reminders to employers that employee classification is serious business that warrants careful consideration.

Statistical Evidence in Age-Discrimination Cases

A California intermediate appellate court recently reversed a lower court's granting of summary judgment, ruling a former Google employee can proceed with his claims of age discrimination under the FEHA. In *Reid v. Google, Inc.*, the court held that plaintiff Brian Reid ("Reid"), a former Google manager in operations and engineering who was fired at age 54, raised a jury issue of age discrimination through evidence showing that older employees statistically were more likely to receive poorer performance reviews and lower bonuses, and that company executives allegedly made ageist remarks. Moreover, the court ruled that Google's alleged shifting explanations for its decision to fire Reid created a triable issue of pretext for a jury to resolve.

Reid's statistical expert analyzed the links between age, performance evaluations, and bonuses among Google's employees in engineering and operations. Google did not offer any expert testimony of its own. Accordingly, the court stated:

> [T]he trial court clearly erred when it determined that there was no issue of material fact arising from [plaintiff's statistical evidence]. Importantly, *Google does not offer conflicting expert testimony to dispute Reid's statistical findings*; rather, Google's counsel offers arguments about why the findings are not sound. Such argument goes to the *weight* of the statistical evidence, a task reserved for the jury, not a court on summary judgment.

(Emphasis in original.) The court likewise found that alleged comments that Reid was "slow," "fuzzy," "sluggish," and "lethargic" and that his ideas were "obsolete" and "too old to matter" were not stray remarks "insufficient to avoid summary judgment" but, rather, remarks whosea weight should be judged by the jury.

Conclusion

Though few employment-related bills survived the Governor's veto, California courts filled in the gap by issuing many noteworthy opinions on a variety of employment and labor law topics. Take heed, however: next year stands to be a more active legislative session, given its election-year status. Many of the recently vetoed bills therefore may resurface in 2008.