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Fenwick Employment Brief

September 9, 2009

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Ninth Circuit Defines Scope Of Protection For Whistleblowers Under Sarbanes-Oxley Act

In *Van Asdale v. International Game Technology*, the U.S. Court of Appeal for the Ninth Circuit issued its first decision defining the scope of protected conduct under the whistleblower protection provisions of the Sarbanes-Oxley Act of 2002 ("SOX"). SOX protects employees of publicly traded companies from retaliation for providing information related to possible violations of federal securities laws (*e.g.*, shareholder fraud) or for hindering an investigation by the U.S. Securities and Exchange Commission (SEC). The court held that to state a claim for protection under SOX, plaintiffs did not have to prove the existence of *actual* fraud, but rather, merely had to demonstrate they had an actual and objectively reasonable belief that shareholder fraud had occurred.

The plaintiffs in this case were former in-house attorneys at International Game Technology ("IGT") who were terminated shortly after allegedly telling senior executives to investigate whether the company inherited a flawed patent while acquiring another company. Rejecting the district court's finding that plaintiffs failed to engage in protected activity under SOX, the Ninth Circuit clarified that protected activity must "definitively and specifically" relate to one of the listed categories of fraud or securities violations" under SOX (mail fraud, wire fraud, bank fraud, securities fraud, shareholder fraud, or violation of a SEC regulation). A plaintiff, however, is not required to use any magic words such as "stock fraud" or "fraud on shareholders" or even reference "Sarbanes-Oxley" during communications with his or her employer in order to engage in protected activity under SOX. Further, a plaintiff must have had a subjective belief that the reported conduct amounted to fraud, and the belief must be objectively reasonable, that is, must approximate the basic elements of a securities fraud claim. Finding that Congress intended to protect all good faith and reasonable reporting of fraud, the court emphasized that even a *mistaken belief* that an employer engaged in fraud – as long it is reasonable – may support a SOX whistleblower claim. Moreover, the court concluded that *merely requesting an investigation* of potential shareholder fraud can constitute protected conduct.

The Ninth Circuit also held that plaintiffs in-house counsel may proceed with a retaliation claim that may require the disclosure of attorney-client privileged information. The court concluded that "Congress plainly considered the role attorneys might play in reporting possible securities fraud," and thus, to the extent that a suit may implicate confidentiality-related concerns, a court must use "equitable measures at its disposal to minimize the possibility of harmful disclosures, not dismiss the suit altogether."

This case illustrates the broad scope of protection under SOX and highlights the importance for public companies to have preventive policies and procedures in place to address employee concerns.

DLSE Issues New Opinion Letter Permitting Employers To Reduce Work Schedules And Salaries Of Exempt Employees

The California Department of Labor Standards Enforcement (DLSE) recently issued an important opinion letter permitting an employer to reduce the work schedules of its exempt employees, accompanied by a reduction in the exempt employees' salaries, without violating the salary basis test for overtime exemption under California law.

The DLSE's opinion approved an employer's request to reduce its exempt employees' scheduled work days from five to four days per week, along with a corresponding 20 percent cut in salary. This approach was designed to address the employer's significant economic difficulties, with the expectation that as soon as business conditions permitted, the employer would restore the full five-day work schedule and the full salaries of its exempt employees.

The DLSE found that the salary basis test does not preclude a bona fide fixed reduction in the salary of an exempt employee corresponding with a reduction in the normal workweek, so long as the reduction is not designed to circumvent the salary basis requirement. The DLSE specifically noted that this opinion letter replaces an earlier 2002 DLSE opinion that had reached a contrary conclusion.

Under this recent DLSE opinion, employers confronted with significant economic difficulties may reduce exempt employees' work schedules in less than full-week increments and may make proportional reductions in their salaries, provided the employee still earns a monthly salary equivalent to no less than two times the state minimum wage and continues to satisfy the duties test for the applicable exemption. However, in California, an exempt employee's salary must not fluctuate on a week-by-week basis in accordance with the number of hours worked.

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NEWSBITES

California Court Of Appeal Holds That Customer Non-Solicitation Provisions In Employment Agreements Are Unenforceable

In *The Retirement Group v. Galante*, the employer sued former employees for misappropriation of trade secrets and violating a customer non-solicitation agreement. The employer obtained a preliminary injunction that prohibited the former employees from (1) soliciting any current customers and (2) using the company's information found solely and exclusively on its customer databases, except if the names and contact information were available through independent third party sources.

The Court of Appeal found that California courts have repeatedly held that a former employee may be barred from soliciting existing customers to redirect their business away from the former employer and to the employee's new business *if the employee is utilizing trade secret information* to solicit those customers. Thus, the court found that "it is not the *solicitation* of the former employer's customers, but is instead the *misuse of trade secret information*, that may be enjoined." While the former employees could be prohibited from using the employer's trade secrets, the court found that the customer non-solicitation restriction was an unenforceable restraint on competition in violation of California Business and Professions Code Section 16600.

This decision, along with other recent California case law, emphasize that customer non-solicitation provisions must be carefully drafted to only restrain customer solicitation to the extent an employee does so by using or disclosing the employer's trade secret information.

Ninth Circuit Clarifies When Commuting Time And Work Performed Before And After A Shift Are Compensable

In *Rutti v. LoJack*, the U.S. Court of Appeal for the Ninth Circuit held that employees are not entitled to pay for time spent driving to and from home to work under both California and Federal law. The court clarified that this is true even if the employee is driving a company-owned vehicle and is required to use such vehicle as a condition of employment. The fact that the company placed certain restrictions on the employee's use of its vehicle—restrictions against using the vehicle for personal pursuits and transporting passengers, the requirement that the employee drive directly from home to work, and that the employee have his cell phone on—also did not render his commute time compensable as these restrictions did not amount to legally cognizable work.

Plaintiff, a technician that commuted from his home to customer sites to install and repair vehicle recovery systems, also sought compensation for his daily morning activities prior to arriving at the customer site, including mapping out his routes, prioritizing his jobs for the day, and receiving instructions on the day's jobs. The court found that these activities were non-compensable because they were preliminary activities related to plaintiff's commute and were clearly distinct from his principal activities for the company. The court also found that these activities did not take up sufficient time and were therefore non-compensable "de minimis" work.

The court, however, found that plaintiff may be compensated for "postliminary" activity, which involved uploading his data in his handheld computer to the company's system at the end of his workday. This was found to be an integral part of the job and was performed every day. The court remanded the matter back to the trial court to determine whether this postliminary work was "de minimis."

Failure To Give Proper Notice To Terminated Employees And Rejected Job Applicants Based On Background Checks Result In FCRA Penalties

In two separate actions filed in federal district courts in Washington and Colorado, the Federal Trade Commission (FTC) alleged that Quality Terminal Services and Rail Terminal Services contracted with a consumer reporting agency to conduct background checks, including criminal histories, on employees and job applicants, and made hiring and firing decisions based on those background checks. The employers allegedly failed to provide the employees and applicants with notices as required by the Fair Credit Reporting Act (FCRA). The parties reached a settlement agreement to resolve the dispute, which requires the employers to pay a total of $77,000 in civil penalties and enjoins future FCRA violations.

Under the FCRA, if an employer takes an adverse action (such as firing or deciding not to hire an applicant) based on information obtained from the background check, then the employer must provide advance notice to the affected individual that some adverse action will be taken (*e.g.* refusal to hire or termination). In addition, the employer must provide the affected individual with a copy of the report, the contact information for the consumer reporting agency that furnished the report, as well as a statement that the consumer reporting agency did not make the adverse decision. It must also inform the affected individual of his or her right to obtain a free copy of the report from the consumer reporting agency and dispute its accuracy.

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Washington Court Admits Settlement Letters Into Evidence To Show Employer's Willfulness In Denying Wages

In *Durand v. HIMC*, the plaintiff sued his former employers alleging claims for breach of contract and unpaid wages under Washington state law. Washington law requires that an employer must pay an employee all wages due him or her upon termination, and imposes twice the amount of wages unlawfully withheld (along with attorneys fees and costs) if the employer's failure to pay was "willful." An employer does not willfully withhold wages if there is a bona fide dispute as to the amount owed.

Before trial, the parties jointly submitted settlement negotiation letters in which the employers acknowledged that they owed plaintiff a minimum of $125,000 based on the terms of his employment contract but disputed additional sums above that amount. Although the employers later sought to withdraw this evidence, the trial court admitted the letters and found that the employers willfully withheld $150,000 of plaintiff's contracted wages but that a bona fide dispute existed as to what amounts over that were owed. The Court of Appeal in Washington upheld the admission of the settlement letters. The court noted that while settlement negotiations are inadmissible to "prove liability for or invalidity of the claim or its amount," they are admissible to prove other matters, including mental state, especially when the settlement offeror submits the evidence. The court concluded that the trial court properly considered the settlement letters to determine the employers' mental state regarding how much of the money owed from the underlying contract was subject to a bona fide dispute, and thus, whether the employers willfully withheld wages.

This case serves as a stark reminder to employers to exercise the utmost care during settlement negotiations when communicating with plaintiffs regarding potential legal liability.

Jury Finds Employer Accessed "Private" MySpace.com Group Page In Violation Of The Federal Stored Communications Act

In *Pietrylo v. Hillstone Restaurant Group*, a server at a Houston's restaurant in New Jersey created a MySpace.com group whose purpose was to let current and former employees "vent" about their experience while working at the restaurant. The user group was invitation-only and required a password to enter and view the postings. The page included posts containing vulgar and sexually explicit comments as well as references to violence and illegal drug use. Eventually, a manager of the restaurant learned of this group page and asked a hostess (who had been invited to join the group) to provide him with her personal login information so he could access the page. Although the manager made no threats against her if she refused, the hostess testified that she thought she "would have gotten in some sort of trouble" if she refused to cooperate. Shortly thereafter, the company terminated plaintiffs based on their comments on the site and involvement in creating it.

Plaintiffs sued in federal district court in New Jersey, alleging, among other claims, terminations in violation of public policy, invasion of privacy, and violation of the federal Stored Communications Act (SCA) and parallel state statutes. A federal jury found that the restaurant's managers violated state and federal laws that protect the privacy of online communications, and awarded plaintiffs $3,400 in back-pay and $13,600 in punitive damages. Specifically, the jury determined that the company violated the SCA and parallel state provisions in the way that it gained access to the MySpace postings, namely management requesting and using the hostess's password to access the site. The jury, however, rejected plaintiffs' privacy claims, explaining that plaintiffs did not have a reasonable expectation of privacy in the MySpace group page. The jury also rejected plaintiffs' claims for damages suffered as a result of emotional distress.

This case highlights the challenges employers face with respect to employees' blogs and social networking sites that contain work-related speech. While this decision does not restrict an employer's right to monitor communications and information within its own computer networks, it demonstrates the risks of attempting to access an employee's restricted online content without the employee's authorization. Employers should consider implementing written policies that address employee work-related speech on social networking and other online sites to require that employees observe appropriate guidelines when referring to the company, its employees, services, and customers.

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