Fenwick Employment Brief

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U.S. SUPREME COURT VALIDATES "CAT'S PAW" THEORY OF LIABILITY

In a troubling decision for employers, the United States Supreme Court has endorsed the so-called "cat's paw" doctrine of employment discrimination. Under the "cat's paw" doctrine – named for a fable in which a monkey flatters a cat into extracting roasted chestnuts from an open fire and results in the cat burning its paws in the process – an employer may be held liable for the discriminatory animus of a supervisor who influenced, but did not make, the adverse employment decision.

Staub v. Proctor Hospital involved a claim of military status discrimination in violation of the Uniformed Services Employment and Reemployment Rights Act ("USERRA"). Vincent Staub, a medical imaging technician and Army Reservist, alleged that his two supervisors were hostile to his military obligations and were out to "get rid of him." Mr. Staub claimed that one of his supervisors improperly disciplined him for leaving his work area and issued him a written directive to check in with his supervisors when he was not working with patients, and that the other supervisor falsely reported to the VP of Human Resources that Mr. Staub subsequently violated the written directive. The VP of Human Resources (the "cat's paw"), relying upon the reported violation and her own review of Mr. Staub's personnel file, made the decision to terminate Mr. Staub. Despite Mr. Staub's insistence that the violation was fabricated and that his supervisors were improperly motivated by hostility towards his military obligations, the VP of Human Resources did not follow up with Mr. Staub's supervisors to investigate further. Mr. Staub subsequently filed a lawsuit under USERRA, claiming that his supervisors (but not the decisionmaker) were motivated by hostility to his military obligations, and that their actions unlawfully influenced the termination decision.

After a jury verdict in favor of Mr. Staub, which was later reversed by the Seventh Circuit Court of Appeals, the Supreme Court accepted review of the case to consider the circumstances under which an employer can be liable for "cat's paw" discrimination. Relying on general tort law causation principles, the court held that if a supervisor performs an act motivated by unlawful discrimination that is intended by the supervisor to cause an adverse action, and the act is a proximate cause of the adverse action, the employer is liable for discrimination. However, the Court further held that if an employer can establish that it undertook an independent investigation and determined that the adverse action was entirely justified, apart from and without considering the biased supervisor's actions, the employer will avoid liability.

In *Staub*, the Court determined that there was sufficient evidence to allow the jury to decide the case. Staub presented evidence that both supervisors were motivated by hostility towards Mr. Staub's military obligations (including comments that other workers had to "bend over backwards" due to Mr. Staub's military obligations and that such obligations were a "waste of taxpayers' money"), that the supervisors' actions were causal factors underlying the decision to terminate Mr. Staub and that both supervisors intended to cause Mr. Staub's termination.

While *Staub* involved discrimination on the basis of military status, its rationale will likely be applied to discrimination covered by Title VII and other laws, which may make it more difficult for employers to prevail in discrimination lawsuits or get lawsuits resolved on summary judgment. The *Staub* holding invites several fact-intensive determinations – including an analysis of the motivations of all supervisors involved in the termination decision and whether any improper actions can be said to have reasonably caused the ultimate adverse action – which require resolution by a jury and which are not generally susceptible to resolution prior to trial.

Staub also emphasizes the critical importance of conducting thorough, independent investigations into allegations of biased employment actions. To prevent a biased action from unlawfully tainting an adverse employment action, *Staub* makes clear an employer must independently review and make a determination regarding the proposed action without relying on improper conduct by supervisors.

CALIFORNIA COURTS CONTINUE TO SCRUTINIZE MANDATORY EMPLOYMENT ARBITRATION AGREEMENTS

While many employers favor mandatory employment arbitration for the resolution of employment-related disputes, they must be careful to ensure that their arbitration agreements meet strict legal requirements. Two recent California cases demonstrate that courts continue to heavily scrutinize such agreements to ensure that employees' rights are being adequately protected.

In *Sonic-Calabasas A, Inc. v. Moreno*, the California Supreme Court held that an arbitration agreement which precludes an employee's ability to file a wage claim with the Division of Labor Standards Enforcement ("DLSE") and proceed to a "Berman" administrative hearing is unconscionable and therefore unenforceable. In *Sonic*, the employer attempted to compel arbitration of a former employee's DLSE claim for unpaid vacation, pursuant to an arbitration agreement which required the arbitration of "all disputes" except for claims brought under the National Labor Relations Act, the California Workers' Compensation Act or claims before the Employment Development Department. After the trial court denied the employer's petition to compel arbitration and the appellate court reversed the trial court, the California Supreme Court reviewed the case. Noting that the Berman hearing process gave an employee certain advantages designed to reduce costs and risks of pursuing a wage claim, the court determined that an employee's statutory right to seek a Berman hearing is an "unwaivable right that an employee cannot be compelled to relinquish as a condition of employment." Accordingly, the court held that waiver of a Berman hearing is both against public policy and unconscionable, and a petition to compel arbitration during the pendency of a Berman hearing was premature and must be denied. However, the court did hold that arbitration provisions are enforceable **after** a Berman hearing has taken place.

In another case, *Macias v. Excel Building Services LLC*, a California federal district court refused to enforce a mandatory employment arbitration agreement on grounds that the agreement contained unconscionable terms that could not be severed from the agreement. Key to the court's ruling was a finding that the agreement's exception to arbitration for claims of unfair competition, trade secrets or confidentiality unfairly benefited the employer. The court stated that it was "implausible" that an employer would bring a lawsuit against an employee outside the scope of unfair competition, trade secrets and confidentiality, and therefore the agreement lacked mutuality. In other words, the court felt that the agreement compelled the employee, but not the employer, to submit claims to arbitration. The court held that the employer's concerns regarding protection of its trade secret information was an insufficient justification for the one-sided agreement. The court was also critical of other provisions in the agreement which: (1) apparently allowed the employer to amend terms of the agreement without giving notice to the employee; and (2) provided no details about the arbitration process but implied that a formal alternative dispute resolution and grievance process existed. Ultimately, the court determined that severing the multiple unconscionable terms was "not a viable solution" and therefore refused to enforce the agreement.

In light of these decisions, employers should review their existing arbitration agreements with counsel.

FAILURE TO PROVIDE MEAL AND REST PERIODS SUBJECT CALIFORNIA EMPLOYERS TO DOUBLE WAGE PENALTY

UPS, Inc. v. Superior Court – the first California reported appellate decision to address the issue – confirmed that California employers who fail to provide meal **and** rest periods to their non-exempt employees in the same workday are liable for two hours of pay rather than one.

UPS involved 32 coordinated actions by employees seeking compensation for an alleged failure by UPS to provide legally required meal and rest periods. During the litigation, UPS requested that the court determine the amount of damages available under California Labor Code § 226.7, which penalizes employers who fail to provide a meal or rest period for "one additional hour of pay at the employee's regular rate of compensation for each work day that the meal or rest period is not provided." UPS argued that this section authorized only one premium payment per

day, regardless of the number of missed meal or rest periods during that day. The plaintiffs contended that two premium payments were authorized per day, one for a missed meal period and one for any missed rest periods.

While the appellate court acknowledged that the statute was susceptible to either interpretation, after a detailed review of the statute, applicable IWC wage orders and the legislative history of the statute, the court determined that the more reasonable view was that the statute permitted up to two premium payments per work day. The court noted that allowing only one premium payment would encourage employers to make an employee who missed a rest period to also miss a meal period without further penalty.

The *UPS* decision effectively doubles the penalty for employers who fail to make available meal and rest periods to employees as required by California law.

NEWS BITES:

Federal Contractors Subject To Greater Scrutiny From OFCCP

According to a recently issued enforcement directive from the Office of Federal Contract Compliance Programs ("OFCCP") – the federal agency which monitors the affirmative action efforts of certain federal contractors – more federal contractors will now be subject to audits and full compliance reviews.

Under the new directive, the OFCCP will at a minimum conduct a "full desk audit" for all contractors randomly selected for review. Such desk audits which consist of a comprehensive review of all of a contractor's affirmative action plan documents and supporting documentation. The OFCCP will also conduct "full compliance reviews" at twice the rate as was previously conducted. Full compliance reviews consist of a full desk audit, an on-site inspection and an offsite review of the data collected during the on-site visit. Furthermore, in addition to searching for indicators of individual or systemic discrimination (*i.e.*, two or more victims) and non-compliance with affirmative action requirements, the OFCCP directive states that the agency will also look for non-compliance with other labor and employment laws, including wage and hour laws.

Disqualification From Employment Based on Prior Failed Drug Test Does Not Violate ADA

Recognizing that "unreasonable rules do not necessarily violate the ADA or the FEHA," the Ninth Circuit Court of Appeals held in *Lopez v. Pacific Maritime Ass'n* that a "one strike rule" – which **permanently** eliminated from employment any applicant who tested positive for drug or alcohol use during the pre-employment screening process – did not violate disability discrimination laws.

While past drug addiction constitutes a protected disability under federal and state law, the court held that the plaintiff – who tested positive for marijuana in a pre-employment drug test seven years prior his most recent application for employment – could not assert either a claim of intentional or "disparate impact" discrimination under the circumstances presented. The court determined that there was no evidence of intentional discrimination because the rule was implemented for legitimate reasons – *i.e.*, to reduce the use of drugs and alcohol in the workplace and related accidents – and did not unlawfully target recovering or recovered drug addicts. The court also determined that there was no evidence that the policy had a disproportionate impact on recovered drug addicts, because the plaintiff could not produce data which compared the defendant's workforce against the relevant labor pool (*i.e.*, the plaintiff had no evidence which showed the defendant disproportionately excluded recovered drug addicts).

Even though the employer prevailed in *Lopez* under the specific facts of that case, it is important to note that had the plaintiff been able to produce evidence of how the policy disproportionately affected recovered drug addicts, the result may have been different. Any policy that has the effect of negatively impacting a protected classification – even if facially neutral – is subject to heavy scrutiny and possible challenges.

Employee Has No Right To Forfeited Unvested Stock Options At Termination

In *Artuso v. Vertex Pharmaceuticals, Inc.*, a terminated employee claimed that the forfeiture of his unvested stock options was a breach of his stock option agreement and that his termination was conducted in bad faith to deprive him of his unvested options. In affirming the dismissal of the lawsuit, the First Circuit

Court of Appeals determined that the stock agreement allowed the plaintiff to exercise only those stock options which were vested at the time of termination and the vesting of the remaining options ceased at termination. The court also held that there was no evidence suggesting that the decision to terminate was made in bad faith, and accordingly entered judgment for the employer on plaintiff's claim for breach of the implied covenant of good faith and fair dealing.

The *Artuso* decision affirms that the specific terms and conditions of stock option agreements will govern the rights and responsibilities of the parties to the contract, and highlights the importance of having clear and unambiguous vesting and forfeiture language in the agreements.

Courts Continue to Wrestle With FLSA Outside Sales Exemption

Two recent federal court decisions confirm that the FLSA overtime exemption for "outside sales" employees continues to be a tricky and unsettled area of law. In *Christopher v. Smithkline Beecham Corp.*, the Ninth Circuit Court of Appeals held that pharmaceutical sales representatives were exempt outside sales employees, even though the sales employees were legally prohibited from taking orders from physicians. The court determined that because the sales representatives had a goal of causing doctors to prescribe more of their employer's prescription drugs, they did more than merely "promote" their employer's drugs and were in facts engaged in exempt sales activities. This decision conflicts with an earlier ruling by the Second Circuit Court of Appeals, which held under similar circumstances that pharmaceutical sales representatives did not "make sales" for purposes of the overtime exemption.

On the heels of *Smithkline*, a Northern California federal district court held that certain Retail Sales Representatives employed by The Hershey Company – whose job duties included meeting and consulting with key decisionmakers at retail stores to increase sales and assisting with merchandising – did **not** qualify for the outside sales exemption. While the district court found some similarities between the sales employees in its case and in the *Smithkline* case, the court also noted that the *Smithkline* plaintiffs were rewarded with commissions when their efforts generated more sales and had substantial autonomy outside of the office, unlike the *Hershey* plaintiffs.

These cases illustrate the continuing difficulties courts have regarding application of the outside sales overtime exemption, and stress the importance of making individualized, periodic assessments of job duties to ensure compliance with the wage and hour classification requirements.

Say-On-Pay Bulletin

Earlier this year the SEC issued final rules designed to implement provisions of the Dodd-Frank Act relating to shareholder approval of executive compensation and golden parachute compensation arrangements. At this time, there is little guidance available to companies because the rules are new and sample disclosures are few. Fenwick publishes a bulletin providing companies with timely updates on say-on-pay activities, including highlights and news items.

March 7, 2011 Bulletin: http://www.fenwick.com/docstore/Publications/Corporate/Corp_Sec_03-07-11.pdf