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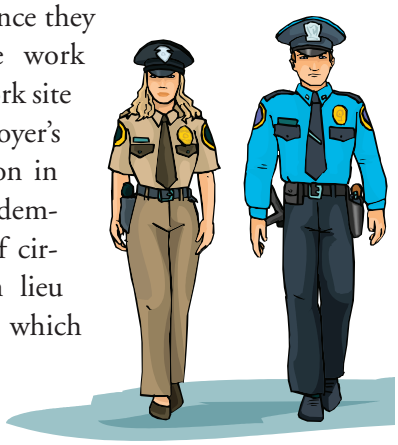
Employers Must Pay for Employee "Donning and Doffing" and More...

by Diane M. O'Malley, Amy Keyser, Molly Lee, Connie Hiatt & Ed Frueh

Unlike 2004, when employers were faced with new legislation imposing new obligations upon employers such as the mandatory sexual harassment training for supervisors, this past year, the more significant developments occurred on the judicial front rather than the legislative front. This year, the courts ruled that employers need not pay for employee uniforms in some instances, that employers must pay for employees once they "don" certain protective work clothing and travel to a work site and, finally, that an employer's adverse employment action in a retaliation claim can be demonstrated by a "totality of circumstances" approach in lieu of the usual approach, which focuses on one discrete unequivocally adverse act—such as a demotion or termination. Read on to find out the latest developments in state and federal labor and employment law for 2006.



STATE DEVELOPMENTS

Cases

- **California Supreme Court Rules on What Constitutes "Protected Activity" and an "Adverse Employment Action" in Retaliation Cases**

Yanowitz v. L'Oreal USA, Inc.

In August of this year, a divided California Supreme Court (4-2) issued its decision in *Yanowitz v. L'Oreal USA*, Inc. The case creates troubling new law in the area of retaliation claims. Briefly stated, Yanowitz was a former San Francisco-based regional sales manager for L'Oreal. She claimed that, while she was walking through a department store with her male manager, the manager ordered her to fire a woman he deemed not "hot" enough for the company's image. Yanowitz refused to fire the woman, asking why she should do so. She claimed that the same manager later retaliated against her by soliciting negative information about her from her subordinates, by giving her negative evaluations, by criticizing her unjustly, and by otherwise creating a hostile working environment for her.

The California Supreme Court determined two issues related to Yanowitz's retaliation claim. First, it found that Yanowitz's refusal to fire the female employee and her complaint over it could be "protected activity." Second, it found that the various actions of which she complained—none of which were the traditional indicia of "adverse employment actions" such as demotions, firings or transfers with pay cuts—could be considered "adverse employment actions."

Specifically, the Court first held that protected activity exists "when the circumstances surrounding an employee's conduct are sufficient to establish that an employer knew that an employee's refusal to comply with an order was based on the employee's reasonable belief that the order is discriminatory." Thus, the relevant question for the court became whether the employee somehow communicated to the employer that she believed the employer was engaging in discriminatory conduct. As a result, in *Yanowitz*, the plaintiff's objection to the direction to fire a female employee for not being "hot" enough was found to be sufficient to put the employer on notice that the plaintiff was engaging in the protected conduct of protesting a personnel action she found discriminatory.

Second, the Court's ruling on what constitutes an adverse employment action, while at first blush encouraging, ultimately, provides little insight into what is and what is not an "adverse employment action." The Court adopted a "materiality standard." Under that standard, the personnel action must "materially affect the terms, conditions, or privileges of employment" in order to be actionable as an adverse employment action. However, the Court also went on to state that, in determining whether retaliation has occurred, the Court must take a "totality of circumstances" approach and, with that approach, would use a "continuing violations" theory, thus allowing acts of retaliation occurring outside the statute of limitations period to be considered to determine whether unlawful retaliation occurred.

Patten v. Grant Joint Union High School (California Ct App 12/19/2005)

Soon after the Supreme Court's *Yanowitz v. L'Oreal* decision, one lower court applied the *Yanowitz* adverse employment action standard to an alleged violation of California's whistleblower statute: Labor Code Section 1102.5(b). In *Patten*, the plaintiff claimed that her employer school district transferred her from one school principal position to another in retaliation for her protected activities. Patten argued that the Court should not follow the *Yanowitz* Court's "materiality standard" for defining adverse employment actions. Instead, she argued that the Court should adopt the easier "deterrence" test. In other words, if a personnel action would "deter" an employee from reporting alleged illegal conduct, then the personnel action is an "adverse employment action." The Court disagreed and instead utilized the "materiality" test in *Yanowitz* to plaintiff's whistleblower claims.

The *Patten* Court then held that there was a triable issue of fact as to whether the plaintiff's transfer from one middle school principal position to another was an adverse employment action. The two positions had the same wages, benefits, and duties. However, according to the Court, the new school was a magnet school for about 240 high-achieving students and thus was not as much of a challenge as the plaintiff's former school, which enrolled nearly 1,000 students and was an underperforming school. According to the Court, the new school did not possess "the kinds of administrative challenges an up-and-coming principal wanting to make her mark would relish." Apparently, the plaintiff had testified at her deposition that she viewed the transfer as a demotion.

Patten further muddies the waters as to what will constitute an adverse employment action. For example, what about negative performance evaluations or a counseling that results in no wage loss, but are placed in an employee's file. While they would not seem to pass the "materiality" standard adopted in *Yanowitz*, based upon *Patten*, they may, at least, be sufficient to withstand summary judgment.

- **Employer Sexual Harassment Liability Extended to Co-Workers When Supervisors Accord Favorable Treatment to Female Employees With Whom They Have Sexual Relationships**

Miller v. Department of Corrections, 36 Cal. 4th 446 (2005)

In *Miller*, two former Valley State Prison for Women female employees claimed that the prison warden accorded unwarranted favorable treatment to numerous female employees with whom he had sexual relationships. The plaintiffs alleged that such conduct constituted sexual harassment in violation of the California Fair Employment and Housing Act (FEHA).

The California Supreme Court agreed and concluded that sexual conduct not directed at the plaintiffs but at other female employees, which is sufficiently widespread, can support a claim for sexual harassment based on a hostile work environment.

Relying on guidelines published by the federal Equal Employment Opportunity Commission, the Court reasoned that widespread sexual favoritism sends a demeaning message, that is, female employees are viewed as "sexual playthings" or that women must engage in sexual conduct with supervisors in order to advance in the workplace.

The Court rejected the defendant's argument that the conduct should be considered merely personal preference and not sexual discrimination, because male and female non-favored employees are equally disadvantaged. The

Court reasoned that whether a defendant is motivated by personal preference or by discriminatory intent, a hostile work environment may be shown by widespread favoritism based upon intimate personal relationships, and that such conduct may create a hostile environment based upon gender and is actionable by both men and women.

In light of this clear direction from the Court, employers should be mindful that multiple consensual relationships between supervisors and subordinates can lead to actionable claims in the workplace. An isolated incident is not actionable. However, what constitutes "widespread" conduct is not clear.

- **Labor Code Section 2802 Does Not Require State and Local Government Employers in California to Reimburse Their Employees for the Costs of Buying and Maintaining Uniforms Employees Are Required to Wear on the Job**

In re Work Uniform Cases (Goshorn, et al. v. State of California, et al) (October 11, 2005)(First District)

Uniformed employees of the State, numerous counties and cities, and of The Regents of the University of California, filed coordinated class actions alleging that their respective employers had failed to compensate them for costs related to the acquisition and maintenance of work uniforms. They claimed that their employers were responsible for such costs under California Labor Code Section 2802. The majority of the plaintiffs were covered by memoranda of understanding with their respective employers. These memoranda provided for reimbursement of uniform costs, yet the plaintiffs claimed that the amounts were not adequate to fully reimburse them.

Labor Code Section 2802 provides that an employer must indemnify employees for all necessary expenditures or losses incurred by the employees in direct consequence of the discharge of his or her duties, or of his or her obedience to the directions of the employer, even though unlawful, unless the employee, at the time of obeying the directions, believed them to be lawful.

The Court framed the primary issue on appeal as whether Section 2802 requires public employers to pay for the cost of purchase and maintenance of uniforms required for work in light of the governmental entity status of each of the defendants. While Section 2802 has been interpreted and applied broadly in the private sector, it has never been applied to public employers. Claiming that the issue of uniform reimbursement was one of statewide concern, the plaintiffs sought a judicial determination applying Section 2802 to public entities.

The Court held, with respect to employees of the cities and counties, that payment for uniforms fell under the category of compensation, which is determined by each local government agency. Similarly, the Court held that, The Regents is constitutionally empowered, as an independent branch of state government, to manage its internal affairs without interference from the State except in very limited circumstances. Section 2802, as interpreted by the plaintiffs, did not fall within one of the permitted exceptions and therefore could not be applied to The Regents to require reimbursement of uniform costs. As to the State, there is a separate law that makes state government employees responsible for buying their own uniforms and requires the State to provide an annual allowance for replacement wear, subject to any additional payments provided in union contracts.

The Court of Appeal's decision reinforces the constitutional authority of cities, counties, the State and The Regents to establish the terms of employee compensation. These public employers are required to bargain over uniform reimbursement costs with employees but, according to the *Goshorn* decision, are not obligated, under Labor Code Section 2802, to pay for those costs.

The California Supreme Court denied the plaintiff's petition for review.

❑❑ CALIFORNIA LEGISLATION

The California Legislature did pass some laws that employers should note:

- **AB 1093: Amended Several Provisions of the California Labor Code**

Before AB 1093, the law provided that an employer may deposit employee wages directly into an account in any

bank, savings and loan association, or credit union of the employee's choice "in this state," provided the employee has voluntarily authorized such deposit, as is provided in Labor Code Section 213. In addition, under prior law, if an employer discharged an employee or the employee quit, the voluntary authorization for direct deposit terminated and the provisions of existing law concerning final payment of wages applied. Thus, if an employer discharged an employee, the wages earned and unpaid were due and payable immediately. If an employee quit, the wages were due not later than 72 hours later, unless the employee had provided 72 hours notice, in which case the wages are due at the time of quitting. These provisions did not take into account the fact that an employee's direct deposit payment authorization was on file.

AB 1093 clarifies that the bank, savings and loan association, or credit union of the employee's choice have a "business location" in this state (and need not be headquartered in California). More importantly, AB 1093 also authorizes an employee's final payment of wages to be made by his or her authorized direct deposit, as long as the existing time periods for payment of such wages are satisfied.

Overtime Exemption for Highly Paid Software Employees

AB 1093 also clarifies existing law relating to the overtime exemption for computer software employees in Labor Code Section 515.5. Previously, in addition to the other requirements to qualify for the exemption, the employee's hourly rate of pay must be not less than forty-one dollars ($41.00). The Division of Labor Standards Enforcement (DLSE) is responsible for adjusting this pay rate on October 1 of each year to be effective on January 1 of the following year, by an amount equal to the percentage increase in the California Consumer Price Index for urban wage earners and clerical workers. Thus, as of January 1, 2005, to qualify for the exemption, computer professionals had to earn an hourly wage of at least $45.84.

The only change to this scheme made by AB 1093 is that the overtime exemption for software workers is not lost as long as the employee's "salary" meets the minimum rate when annualized. Thus, it is now clear that a salaried employee is exempt even though the employer does not pay "by the hour" provided that all other requirements for satisfying the exemption are met.

- **AB 1400: Amendment to the Unruh Civil Rights Act**

The Unruh Civil Rights Act (Act) provides that all persons, regardless of their sex, race, color, religion, ancestry, national origin, disability, or medical condition are entitled to the full and equal accommodations, advantages, facilities, privileges and services in all business establishments of every kind. AB 1400 clarified that marital status and sexual orientation are among the characteristics that are protected against discrimination under the Act.

Vetoed Bills

It is also interesting to note two bills, which the Governor vetoed. We will be seeing at least one of the bills again next year.

- **AB 48**

Vetoed by the Governor on September 29, 2005, AB 48 would have increased the state minimum wage. California's current minimum wage is $6.75 per hour. The bill would have raised the state minimum wage to $7.25 in 2006 and to $7.75 in 2007, and provided for indexing increases every year thereafter. This is the second year in a row that Assembly Member Sally Lieber has brought forth a minimum wage bill.

Already in this year's legislation session, on January 10, 2006 Assembly Member Lieber has introduced another minimum wage bill (AB 1835) seeking the same increases, as last year's bill, respectively in July 2007 and 2008. Senator Cedillo as well has introduced (SB 1162) (co-authored by Lieber) seeking to increase the minimum wage to $7.25 on September 1, 2006 and to $7.75 on July 1, 2007.

- **AB 391**

Vetoed by the Governor on September 29, 2005, AB 391 proposed to grant eligibility for unemployment insurance benefits to workers who are prevented by their employers from entering the worksite during a labor dispute. Current law denies unemployment compensation benefits to an employee who is unemployed because of a labor dispute

with his or her employer if the individual's unemployment is due to that dispute.

AB 391 would have allowed a locked-out worker to receive unemployment compensation benefits, even if the employee is locked out as a result of a labor dispute with the employee's employer.

The legislative history indicates that additional costs to the employer-paid State Unemployment Insurance Fund as a result of this proposed bill were estimated to be $16.8 million per year.

Reminder and Alert about AB 1825 Mandatory Sexual Harassment Training

By now employers should have completed the mandatory sexual harassment training of all supervisors. *Remember, as of January 1, 2006, any new supervisors must be trained within six (6) months of hire or promotion to a position with supervisory duties.*

In addition, the Fair Employment and Housing Commission has issued long awaited draft Harassment Training Regulations. The Commission will hold two public hearings to consider comments, objections and recommendations regarding its proposed regulations:

- February 1, 2006, in San Francisco, starting at 1:00 p.m. in the Auditorium located in the basement of the Hiram Johnson State Building at 455 Golden Gate Avenue.
- February 10, 2006, in Los Angeles, starting at 10:00 a.m., in the Auditorium located on the ground floor of the Ronald Reagan State Office Building at 300 South Spring Street.

There is also a written comment period, which closes at 5:00 p.m. on February 10, 2006. Comments should be submitted to:

Ann Noel
Acting Executive and Legal Affairs Secretary
Fair Employment and Housing Commission
455 Golden Gate Avenue, Suite 10600
San Francisco, California 94102

❑❑ FEDERAL DEVELOPMENTS

Cases

- **Is donning protective clothing and walking time to the work site thereafter compensable? And, what about doffing protective clothing? Recently, the United States Supreme Court said "yes," ruling that employees should be paid for all time from the moment they begin donning the protective gear at the beginning of the day until they doffed it at the end of the day. The Court also ruled that, after the employees donned the protective gear, the time spent walking to and from the locker room and the work station is also compensable.**

***IBP, Inc. v. Alvarez*, 546 U.S. ___ (2005)**

In *IBP, Inc.* the U.S. Supreme Court reviewed two cases interpreting the federal Fair Labor Standards Act's (FLSA) coverage with respect to the compensability to employees for the time they are required to dress in protective clothing on the employer's premises before beginning work. This decision is applicable to California employers. The Court examined two questions regarding employee protective clothing. First, it looked at whether the time employees spend waiting to receive the protective gear is compensable under the FLSA. Second, the Court looked at whether time spent walking between the changing area and the production area is compensable as "hours worked" under the FLSA.

Some background on this area of employer pay responsibility is helpful to understand the impact of the Court's decision. In *Anderson v. Mt. Clements Pottery Co.,* 328 U.S. 680, 691-92 (1946) the Supreme Court held that the FLSA term "workweek" included time spent walking from time clocks to work stations. One year later, in response to the *Anderson* decision, Congress amended the FLSA with the Portal-to-Portal Act. The amendment specifically exempted from FLSA coverage time spent walking to and from the location of the employee's "principal activities" and specifically exempted any activities that are "preliminary or postliminary" to the principal activities. Eight years later, the Court found that "principal activities" include those activities which are "an integral and indispensable part of the

principal activities." These activities included time spent putting on or taking off special protective gear "before or after the regular work shift, on or off the production line." *Steiner v. Mitchell,* 350 U.S. 247, 256 (1956).

In *IBP, Inc. v. Alvarez,* a case involving the meat cutting industry, the first of two consolidated cases, employees filed a class action seeking compensation for time spent "donning and doffing" required protective gear and walking from lockers to the production floor of a meat processing plant.

In the second consolidated case, *Tum v. Barber Foods, Inc.,* poultry processing facility employees sought compensation for time spent waiting to don protective gear. The Fifth Circuit below had ruled that these activities were "preliminary or postliminary" activities and thus not compensable under the FLSA.

The Supreme Court found, with respect to time spent waiting to don protective gear at the beginning of the workday, that such waiting time is two steps removed from the employee's "principal activities," thus qualifying as "preliminary" and non-compensable. Although waiting time may be necessary, that does not automatically mean it is "integral and indispensable" to the principal activities. Thus, the court held that the time was not compensable.

However, the Court held, with respect to walking to the worksite, that, under the FLSA, time spent walking between changing areas and production areas is compensable, as "integral and indispensable" to the employees' principal activities. In so holding, the Court found that donning specialized protective gear was a "principal activity." The Court compared time spent walking between changing areas and production areas to time spent walking between two different positions on an assembly line and found "no plausible argument" that the language in the Portal-to-Portal Act could have a different meaning.

The implications of this decision are clear for California employers. If an employer requires its employees to wear specialized protective gear, it must compensate them for time spent walking from the changing area to the production area after putting on the gear, as well as time spent walking from the production area to the changing area to take off the gear. If employees have to wait to receive the gear before beginning work, however, the employer does not have to compensate them for that time. Employers should consider reviewing employee work activities to determine whether employees wear specialized protective gear such that they are engaging in activities that are integral and indispensable to the employee's principal duties for which they should be compensated, and if so, implement procedures to ensure compliance, such as requiring employees to clock-in at the time they are given protective gear. As with all major policy changes, employers should consult legal counsel before implementing them as we can expect to see actions brought and court decisions interpreting what activity is "de minimis" activity, what is principal and whether certain clothing changes qualify for compensation.

Regulations

- **Department of Labor Issues Opinion Letter Regarding Non-Exempt Status of Maintenance Supervisors**

An October 2005 Labor Department Wage and Hour Division letter interpreting the 2004 revisions to the white-collar exemptions from overtime and minimum wage requirements of the FLSA reports that a maintenance supervisor does not qualify for an exemption because the maintenance supervisor's primary work is manual labor. Many transit related companies employ various levels of supervisory personnel in the maintenance departments—some considered exempt —some not. Employers should reexamine the job descriptions and actual duties of the persons occupying those positions to make sure that they are classified correctly.

- **Look Out for IRC Section 409A When Drafting Severance and Other Employment Agreements**

Nonqualified deferred compensation plans, employment agreements, long-term incentive or bonus plans, severance arrangements and equity plans need to be reassessed in

light of recently released IRC 409A proposed regulations. On September 29, 2005 the Treasury Department and the Internal Revenue Service issued proposed regulations under section 409A of the Internal Revenue Code ("the Code"). Section 409A was added to the Code as part of the American Jobs Creation Act in 2004 and was effective January 1, 2005.

Generally, section 409A imposes new restrictions and eliminates flexibility for non-qualified deferred compensation plans. For example, distributions from plans subject to section 409A may be made only upon specified distribution events such as termination of employment, death, disability, change in control or as stated in the plan. Additionally, elections to defer compensation must be made before the year in which the services generating the compensation are provided. Section 409A generally prohibits accelerating distributions and substantially restricts one's ability to defer distributions. Non-qualified deferred compensation plans that fail to comply with section 409A trigger immediate taxable income to the affected plan participant as well as a 20% penalty on such income.

Section 409A has a surprisingly broad reach. Section 409A covers not only non-qualified deferred compensation plans, which are generally provided to a limited number of executives, but also covers severance arrangements and certain equity compensation arrangements as discussed below.

Severance Pay

The Section 409A regulations define severance pay broadly as any amount of compensation (including reimbursement of expenses incurred and other taxable benefits) where one of the conditions to the right of payment is separation from service, whether voluntary or involuntary. Separation pay thus defined is subject to section 409A unless an exception applies. The most important exceptions are:

1. Payments in Year of Termination—Section 409A excludes amounts payable in the same year in which the legally enforceable right to payment arises. In other words, for employees who negotiate severance at the time of departure from the employer, section 409A does not apply if severance is paid in the same taxable year.

2. Short-Term Deferral Exception for Involuntary Separation Pay—Section 409A generally does not apply to deferred compensation that is paid within 2-1/2 months after the applicable year following the vesting of such amounts, or the lapse of a substantial risk of forfeiture. The proposed regulations reflect the position that only involuntary severance arrangements are subject to a risk of forfeiture and, therefore, considered to be subject to vesting. As a consequence, if an employment agreement provides for payment of severance only upon an involuntary termination and if payments are made within 2-1/2 months after the close of the applicable year after termination, the short-term deferral exception would apply. (The applicable year is the later of the calendar year or the employer fiscal year of termination). The IRS has expressed doubt that a plan providing for severance upon voluntary termination for good reason imposes a substantial risk of forfeiture on such severance. The IRS refused to include severance for such good reason in the exceptions, although acknowledging that some good reason terminations are in fact involuntary. Further guidance on the inclusion of good reason termination provisions is expected from the IRS.

3. Involuntary Separation Pay Limited in Amount—Separation pay upon an actual involuntary separation from service is exempt from section 409A if: (a) the separation pay does not exceed two times the lesser of the employee's total pay during the calendar year of separation or the compensation limit under Code section 401(a)(17) ($210,000 in 2005); and (b) the separation pay is distributed by December 31 of the second calendar year after the year of separation.

The proposed regulations also provide exceptions, if certain specified conditions are met, for so-called window programs, collectively bargained severance and reimbursement arrangements.

Special delay in payment for executives of publicly traded companies

For the "specified employees" of publicly traded companies, a distribution of amounts covered by section 409A and triggered by severance from employment generally cannot be made or commence until six months after the separation date. A specified employee includes key employees and certain shareholders and the top 50 officers whose annual pay

is greater than a specified dollar limit ($135,000 in 2005.) The proposed regulations set forth a procedure for the use of an identified group of specified employees.

Equity Compensation Arrangements

Section 409A also includes many equity compensation arrangements as deferred compensation. Section 409A specifically excludes transfers of property under section 83 of the Code, incentive stock options, non-statutory stock options ("NSOs") issued with an exercise price at fair market value (discussed below) and stock appreciation rights with an exercise price at fair market value. The exception for NSOs is available only for options to purchase common stock.

- **Stock Options – Valuation**

With respect to NSOs, the key factor for the availability of the exemption from section 409A is likely to be the determination of fair market value. Under the proposed regulations, for stock of publicly traded companies, fair market value may be based on the closing price on the day before the date of grant or another reasonable method. For example, averages over a 30-day period could be used.

For stock of privately held companies, fair market value must be determined under reasonable valuation methods. A reasonable valuation method must include consideration of factors including the value of the corporation's assets, the present value of cash flow, market value of equity interest in similar businesses, premium for control, discounts for lack of liquidity or marketability, etc. The proposed regulations require that valuations must be performed at least every 12 months and must take into account all available information or any changes since the prior valuation. The proposed regulations provide certain permissible "safe harbor" methods of for determining fair market value, with special provisions for the illiquid stock of start-up companies.

- **Modifications and Renewals**

Modifications to excepted NSOs or SARs can cause such award to become subject to section 409A. If an option is modified, for example, by adding additional deferral features, the modification will be treated as the new grant. If an option is modified by extending the exercise period, the modification is not treated as a new grant but instead becomes subject to section 409A as of the original grant date.

Effect of 409A on Equity Compensation

Any NSOs (or SARs) that are subject to section 409A, i.e., fail to fall within the exceptions, are subject to the restrictions on distributions. Such restrictions include distribution only upon separation of employment, change of control, death, disability, or at a time set forth in the plan. In other words, participants lose the ability to exercise the option or SAR at their discretion if the arrangement is subject to 409A.

Summary

Section 409A creates a need for employers to assess its nonqualified deferred compensation plans, employment agreements, long-term incentive or bonus plans, severance arrangements and equity plans. Plan amendments are needed in 2006 but plans must operate in compliance now in order to avoid harsh penalties for affected employees.

❑❑ MISCELLANEOUS

The Federal Government Goes Online

Public Law 108-390, effective April 28, 2005, provides that employers can now electronically store employment authorization forms or I-9 forms. Employers may either store paper I-9 forms electronically or complete and retain the forms electronically. The Department of Homeland Security is developing regulations to implement this law.

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More Information

If you would like to pursue the subject of this newsletter or other labor and employment matters, please contact Diane O'Malley (415-995-5045, domalley@hansonbridgett.com) or any Hanson Bridgett attorney with whom you have an existing relationship.