SIDLEY AUSTIN BROWN & WOOD LLP
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CALIFORNIA EMPLOYMENT LAW UPDATE

A periodic newsletter summarizing legal developments of importance to California employers

Meal Rules Still Up In The Air

As we noted in our last edition of the *California Employment Law Update*, the Division of Labor Standards Enforcement ("DLSE") had withdrawn its proposed emergency meal period regulation and, in its place, issued a proposed regulation that was subject to the normal rule making process. Subsequent to a series of hearings and the receipt of comments, the DLSE modified the proposed regulation and solicited further comments. After considering these comments, the DLSE issued a further modification on May 9 and solicited additional public comments by May 25, 2005. The next step is for the DLSE to consider these additional comments and then send the regulation to the Office of Administrative Law ("OAL") for review.

The OAL will then have 30 working days in which to review the rulemaking record to determine whether it demonstrates that the DLSE satisfied the procedural requirements of the APA, and to review the regulation for compliance with six standards: authority, reference, consistency, clarity, non-duplication, and necessity. Regulations approved by the OAL normally become effective within 30 days. Should the OAL approve the proposed meal period regulation, it is likely that a lawsuit will be filed challenging the propriety of the regulation.

In the meantime, the issue of whether meal period and rest break penalties are "penalties" or "wages" is currently the subject of hundreds of class actions. At least three cases are now at the appellate level, and although one Court of Appeal recently issued a tentative decision finding that they are "penalties," that decision has yet to become final. And, within the last two weeks, the AFL-CIO and a Carpenters Union filed a writ of mandate proceeding against the DLSE in the Sacramento Superior Court. One of the objects of the suit is to force the DLSE to construe meal and rest period penalties as "wages," which would make claims for unpaid meal and rest period penalties subject to a three or four year statute of limitations, arguably allow awards of wait-

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ing time penalties if the employee left his employment without being paid for all penalties, and possibly pave the way for the imposition of additional penalties.

Finally, in March, the California Supreme Court ordered depublished the favorable decision in *Westside Concrete, Co. v. Dept. of Industrial Relations* that was reported in our previous Update. It therefore may no longer be cited as precedent.

Court Rejects 7-Day Background Check Disclosure Rule For Internal Investigation Of Prior Wrongdoing

In a case of first impression, the California Court of Appeal held that when an employer investigates suspected employee wrongdoing, the employer must furnish to the employee copies of any public records uncovered by a background check "within a reasonable time" after the investigation concludes, rather than within a fixed period of time determined by statute. *Moran v. Murtaugh, Miller, Meyer & Nelson, LLP*, 126 Cal.App.4th 323 (January 31, 2005).

Shortly after hiring him, the Murtaugh law firm performed a computerized legal search on Gene Moran that uncovered three publicly available appellate cases indicating that Moran had several felony convictions. When confronted, Moran admitted the felony convictions and agreed to resign. Several days later, Moran requested copies of the public record information the firm had uncovered, and the firm complied.

Moran filed suit under California's Investigative Consumer Reporting Agencies Act, Civ. Code §1786, et seq. (ICRA). The ICRA provides, *inter alia*, that when an employer who does not use the services of a background check agency obtains background information that is a matter of 'public record,' the employer must provide the employee with copies of the public record information within seven business days after receiving it. (The ICRA defines 'public records' as any records documenting any arrest, indictment, conviction, civil action, tax lien, or outstanding judgment.) Moran alleged that the firm violated the ICRA by waiting more than seven business days to provide him with copies of the appellate cases.

The Court of Appeal rejected Moran's claim. In doing so, it relied on another section of the ICRA, which provides that if an employer obtains a public record for the purpose of investigating suspected wrongdoing, the employer can withhold the information "until the completion of the investigation." That section, the Court noted, does not contain a seven-day time limit, nor could it, as it would impede an employer's ability to conduct and complete its investigation. Because the latter section does not specify a time limit for disclosure, the Court concluded that the employer need only provide copies of the public information "within a reasonable time" after the investigation is completed.

The Court also noted that the firm's method of investigating Moran's prior misconduct - withholding the background check results temporarily in order to confront Moran with the information and measure his response - was appropriate.

In the case before it, the Court concluded that, because the firm provided Moran with the appellate cases within eight business days after meeting with him about the information, the firm acted within a reasonable amount of time as a matter of law. The Court also noted that the firm's method of investigating Moran's prior misconduct - withholding the background check results temporarily in order to confront Moran with the information and measure his response - was appropriate.

The case serves as a useful reminder that the ICRA imposes requirements on employers' obtaining public record information concerning employees and job applicants, even when that information is obtained without using a background check company's services.

Court Upholds Certain Commission Chargeback Plans

California Labor Code § 221 makes it unlawful for any employer "to collect or receive from an employee any part of wages theretofore paid by said employer to said employee." Plaintiffs have used this statute to challenge employer commission arrangements that, through deductions, offsets or reconciliations, result in a forfeiture of earned wages.

In *Steinhebel v. Los Angeles Times Communications*, 126 Cal. App. 4th 696 (February 7, 2005), the California Court of Appeal provided much needed clarification on the permissibility of commission plans with chargeback componets. The plaintiffs in *Steinhebel*, who were subscription sales employees for the Los Angeles Times, argued that the newspaper's commission plan authorized deductions that were illegal under Section 221. The plan provided that employees earned a commission only on "commissionable orders," and, in order to qualify as a "commissionable order," the subscriber had to continue the subscription for at least 28 days. Commissions were paid in advance to employees at the time a subscription was ordered. However, when a customer cancelled a subscription prior to the end of the 28-day period, the amount that had been paid to the sales person was deducted from his or her future commission advances.

The Court held that while commissions are "wages" under the Labor Code, and are thus subject to Section 221, *advanced* commissions are not "wages" because they are not yet "earned." It reasoned that Section 221 only prohibits an employer from "collecting or receiving wages that have already been earned by performance of agreed-upon requirements," and held that an advance is not a "wage" under the statute because the employee has not performed all of the conditions required for earning the amount advanced. Accordingly, a chargeback on future commission advances did not "take back wages theretofore paid" to the employee. In upholding the Los Angeles Times commission plan, the Court stated that an employer "may legally advance commissions to its employees prior to the completion of all conditions for payment and, by agreement, charge back any excess advance over commissions earned against any future advance should the conditions not be satisfied."

Court Recognizes Equitable Estoppel Theory Of Enforcing Arbitration Clauses

Non-signatories to an arbitration agreement may nonetheless compel arbitration under a theory of equitable estoppel, according to the California Court of Appeal in *Alliance Title Co. v. Boucher*, 127 Cal.App.4th 262 (March 2, 2005). There, the plaintiff employee had an arbitration clause within his written employment agreement with his employer. When the employer subsequently sold its business to Alliance Title, a dispute arose regarding alleged non-compliance with the employment agreement. The employee sued Alliance under the agreement for wages, breach of contract, and interference with contract and prospective economic advantage. Though it was not a signatory to the contract, Alliance moved to compel arbitration on, among other theories, equitable estoppel: the employee could not sue Alliance to enforce the contract or for benefits allegedly arising under the contract and avoid the contract's arbitration clause by claiming Alliance was not a party or signatory to it.

The Court of Appeal reviewed numerous federal cases holding that a non-signatory may compel arbitration against a signatory under a theory of equitable estoppel where the claims are "intimately founded in and intertwined with the underlying contract obligations." Here, it held that the employee's claims were completely bound up in and relied upon the agreement containing an arbitration clause. Accordingly, it held that the employee was bound by all of its terms, including the arbitration clause, and it reversed the lower court's order denying arbitration.

Ninth Circuit Rules That Medical Examinations Must Occur After "Real" Job Offer Is Made

As reported in our March 14, 2005 *Employment and Labor Alert*, the Ninth Circuit Court of Appeals has held that requiring job applicants to take a medical examination before making a "real" offer of employment may violate the Americans with Disabilities Act ("ADA") and the California Fair Employment and Housing Act ("FEHA"). *Leonel v. American Airlines*, 2005 WL 976985 (9th Cir., March 4, 2005).

In *Leonel*, American Airlines, Inc. ("American") had made offers of employment to three applicants contingent upon their passing a medical examination and a background check. American rescinded these job offers after a blood test revealed that the applicants withheld information during their medical evaluation by failing to disclose that they were HIV-positive. The applicants sued, and the district court granted American's motion for summary judgment on the applicants' claims for violations of the ADA, the FEHA, the Unfair Competition Law, and California's constitutional right to privacy.

The Ninth Circuit reversed and remanded the case for further proceedings, finding that the medical examinations occurred outside the proper sequence, as they were conducted before American completed the applicants' background checks, and thus before the company came to a decision as to their qualifications. The Court ruled that under the ADA and the FEHA, only after a "real" job offer is made — i.e., one that is preceded by the evaluation of all non-medical information — could American require applicants to take and pass a medical examination, unless it could establish that the background checks could not reasonably be completed before subjecting applicants to the medical examinations. Observing the purpose behind the sequence, the Court noted that "[b]oth the ADEA and FEHA deliberately allow job applicants to shield their private medical information, until they know that, absent an inability to meet the medical requirements, they will be hired, and that if they are not hired, the true reason for the employer's decision will be transparent."

> **"[B]oth the ADEA and FEHA deliberately allow job applicants to shield their private medical information, until they know that, absent an inability to meet the medical requirements, they will be hired."**

The *Leonel* decision underscores the importance of conducting pre-employment medical testing in the proper sequence during the hiring process, and of obtaining informed written consents that fully describe the type and scope of the tests that will be performed.

Court Of Appeal Clarifies Standard For "Adverse Employment Action" In FEHA Retaliation Cases.

In a decision favorable to employers, *McRae v. Department of Corrections*, 127 Cal.App.4th 779 (March 18, 2005), the California Court of Appeal clarified the meaning of "adverse employment action" for purposes of retaliation claims under the Fair Employment and Housing Act ("FEHA"). In doing so, the Court rejected the Ninth Circuit's definition of the term.

Plaintiff Margie McRae alleged that, after she filed a complaint of discrimination with the Department of Fair Employment and Housing, her employer retaliated by issuing her a letter of instruction regarding her job duties, commencing an internal investigation of her work performance that led to a decision to suspend her (which was never implemented), and transferring her to a different work site.

Reversing a jury verdict in favor of McRae, the Court held that the employer did not subject her to any "adverse employment action." The Court noted that, in order to make out a *prima facie* case of retaliation, McRae must show the following:

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(1) she engaged in protected activity; (2) her employer subjected her to an adverse employment action; and (3) a causal link between the protected activity and the adverse employment action.

The "mere fact that an employee is displeased by an employer's act or omission does not elevate that act or omission to the level of a materially adverse employment action."

The Court held that McRae failed to establish that she was subjected to an "adverse employment action" because she did not show that any of the employer's allegedly retaliatory actions caused her "substantial and tangible" harm. The Court stated that an employment action is not an "adverse employment action" unless it results in a materially adverse change in employment conditions comparable to a termination of employment, a demotion evidenced by a decrease in wages or salary, a less distinguished title, a material loss of benefits, or significantly diminished material responsibilities. According to the Court, the "mere fact that an employee is displeased by an employer's act or omission does not elevate that act or omission to the level of a materially adverse employment action."

In reaching its decision, the Court rejected the Ninth Circuit's definition of "adverse employment action," which includes any adverse treatment based on a retaliatory motive that is reasonably likely to deter the charging party or others from engaging in protected activity.

Second-level Arbitrator "Appellate" Review May Be Included in Binding Arbitration Agreements

In *Cummings v. Future Nissan*, 27 Cal.Rptr.3d 10 (April 8, 2005), the California Court of Appeal issued an opinion helpful to employers who use arbitration processes that permit subsequent review by a second arbitrator. The decision also limits arbitration agreement challenges to those arguments raised in response to a petition to compel, foreclosing attempts by parties to challenge defects in arbitration procedures after the fact.

The employer in *Cummings* had a two-stage binding arbitration procedure wherein claims between the employer and employee were first tried before an arbitrator. Any award of the first arbitrator could then be challenged by either party before a second arbitrator, who would be authorized to employ the same standards as the California Court of Appeal sitting in review of a trial court verdict.

The employee in *Cummings* obtained an award before the first arbitrator, which the second arbitrator then overturned. She claimed for the first time in response to the employer's petition to confirm that the provision for review by the second arbitrator was unconscionable because it permitted an arbitrator to do what the Court of Appeal (and superior court itself) could not do, namely engage in plenary appellate review of a binding arbitration award.

The Court first held that the employee had forfeited any right to assert unconscionability as a defense to the arbitration agreement because she had not raised this challenge to the arbitration procedure at the time of the petition to compel, waiting instead until the petition to confirm. A contrary outcome, the Court held, "might tempt a party to 'play games' with the arbitration and not raise the issue of illegality until and unless it lost."

The Court nonetheless proceeded to hold that, in any event, there was nothing unconscionable about contracting to permit review of an arbitration award by a second arbitrator. Such a process did not interfere with an otherwise "speedy and efficient" process, so long as it was truly mutual and comported with other aspects of substantive conscionability. In doing so, the Court upheld the second arbitrator's "reversal" in favor of the employer.

The decision in *Cummings* stands as a firm endorsement of binding arbitration procedures that have "appellate" type review

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as an added safeguard against unfounded or extraordinary arbitration awards.

Uncompensated Volunteers Are Not "Employees" Protected By The FEHA

In *Mendoza v. Town of Ross*, 2005 WL 895171 (April 19, 2005), the California Court of Appeal has held that the Fair Employment and Housing Act ("FEHA") does not apply to volunteers who receive no remuneration in exchange for the work that they perform.

Peter Mendoza, a quadriplegic, alleged disability discrimination under the FEHA against the Town of Ross, where he had served as a volunteer Community Service Officer from 1996 to 2001. Mr. Mendoza had been assigned to a school, where he assisted with traffic duties, crime prevention, and neighborhood crime watch programs. He was not paid, but had a regular work schedule and took two weeks of vacation each year.

The court determined that Mendoza was not an "employee" under the FEHA for two reasons. First, it held that an individual may only be employed by a public entity in accordance with the applicable statute or ordinance providing for such employment, and Mendoza was not "employed" under the applicable Town of Ross ordinance.

Second, the Court held that Mendoza was not an employee because he was unpaid and did not allege that he received any form of remuneration from the Town of Ross. Following analogous federal cases under Title VII, the Court held that an individual must receive some remuneration in exchange for his or her work in order to qualify as an "employee" under the FEHA. However, the court noted that any "substantial indirect benefits," such as health insurance or vacation or sick pay, qualify as "remuneration."

This case is significant for many employers, such as hospitals and schools, who frequently utilize the services of unpaid volunteers. However, the standard for persons qualifying as volunteers is typically more restrictive for private employers than for many public employers such as the Town of Ross. Accordingly, the question of whether specific individuals may qualify as volunteers should be discussed with counsel.

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