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I.

LEGISLATIVE/ADMINISTRATIVE UPDATE

Federal Minimum Wage Increased on July 24, 2009

California's minimum wage is currently \$8.00 (even higher for some employers subject to living wage ordinances, and in cities such as San Francisco). However, for employers with operations in states other than California, the federal minimum wage increased to \$7.25 per hour on July 24, 2009.

E-Verify to Become Mandatory on September 8, 2009

On July 8, 2009, the Department of Homeland Security's ("DHS") secretary reiterated that the government's E-Verify System will become effective on September 8, 2009. Under the new system, all contractors and subcontractors working on federal projects will be required to utilize the E-Verify System to ensure that their employees are eligible to work in the United States.

E-Verify is an Internet-data system operated by the DHS in partnership with the Social Security Administration. The system allows employers to electronically verify name, date of birth and social security number, along with immigration information for non-citizens, against federal databases in order to verify the identity and employment eligibility of both citizen and non-citizen hires.

On a related note, Homeland Security Secretary Janet Napolitano announced on July 8, 2009 that the Obama Administration intends to rescind regulations and procedures for employers that receive employee "no-match" letters from the Social Security Administration. The no-match rules were originally promulgated in 2007. A federal court, however, issued a temporary injunction blocking enforcement of the no-match rules shortly after they were published. The U.S. Senate has taken issue with Secretary Napolitano's announcement, approving an amendment that prohibits using federal funds to withdraw the regulation. The amendment was attached to the DHS Appropriations Bill (H.R. 2892) which passed the Senate on July 9, 2009.

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II.

JUDICIAL UPDATE

Gross v. FBL Financial Services: U.S. Supreme Court Holds that Plaintiffs Must Prove “But-For” Causation in Federal Age Discrimination Cases

Unlike Title VII of the Civil Rights Act of 1964 (“Title VII”) and California’s Fair Employment and Housing Act (“FEHA”), the federal Age Discrimination in Employment Act (“ADEA”) does not allow a plaintiff to merely establish that a discriminatory motive was just one of many motives in an employment decision.

Jack Gross (“Employee”) began working for FBL Financial Group, Inc. (“Employer”) in 1971. As of 2001, the Employee held the position of claims administration director. However, in 2003, when the Employee was 54 years old, he was reassigned to the position of claims project coordinator. At that same time, the Employer transferred many of the Employee’s job responsibilities to a newly created position entitled claims administration manager. The new position was given to another employee, who was in her early forties. Although the Employee and the claims administration manager received the exact same compensation, the Employee considered the reassignment a demotion because of the Employer’s reallocation of his former job responsibilities.

The Supreme Court’s 5-4 majority reasoned that the ADEA is worded differently from Title VII, and that although Congress passed a law amending Title VII to permit employees to recover on “mixed motive” cases, the ADEA was not similarly amended. The Court opined: “[w]e hold that a plaintiff bringing a disparate-treatment claim pursuant to the ADEA must prove, by a preponderance of the evidence, that age was the ‘but-for’ cause of the challenged adverse employment action. The burden of persuasion does not shift to the employer to show that it would have taken the action regardless of age, even when a plaintiff has produced some evidence that age was one motivating factor in that decision.”

Congress can overturn this decision by simply incorporating Title VII’s causation standards into the ADEA, or by adding “age” to Title VII and ending the separate statutory schemes. While *Gross v. FBL Financial Services* is an important case pursuant to the ADEA, it will have little meaningful effect on California age discrimination litigation under the FEHA because of the different standard of proof under California law.

U.S. Supreme Court Rules for White Firefighters in Reverse Discrimination Case

In *Ricci v. Destefano et al.* the U.S. Supreme Court held that an employer cannot achieve a more desirable racial distribution of promotion-eligible candidates by discarding objective test results in the absence of a strong showing that the examination was deficient or that discarding the examination is necessary to avoid potential liability for disparate impact.

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The petitioners were a group of white and Hispanic firefighters from New Haven, Connecticut who passed the City’s promotion examination¹ but who were denied a chance at promotion by the City’s refusal to certify the test results. They sued the City, alleging that discarding the test results discriminated against them based on their race in violation of Title VII of the Civil Rights Act of 1964 (“Title VII”). In defense of its actions, the City argued that had it certified the test results, it could have faced Title VII liability for adopting a practice having a disparate impact² on minority firefighters.

The Court held that before an employer can engage in intentional discrimination against one racial group in order to avoid or remedy an unintentional, disparate impact against another group, the employer must have a “strong basis in evidence” to believe it will be subject to disparate impact liability if it fails to take the race-conscious, discriminatory action. In this case, the City’s race-based rejection of the test results could not satisfy the strong basis-in-evidence standard since a statistical disparity, without more, “is far from a strong basis in evidence that the City would have been liable under Title VII had it certified the test results.” In fact, the City could be liable for disparate impact discrimination only if the exams at issue were not job-related and consistent with business necessity, or if there existed an equally valid, less discriminatory alternative that served the City’s needs but that the City refused to adopt.

The City’s assertion that the exams at issue were not job-related and consistent with business necessity were contradicted by the fact that detailed steps had been taken to develop and administer the test, and that painstaking analysis of the questions had been performed to assure their relevance to the positions at issue. The City also failed to show the existence of an equally valid, less discriminatory testing alternative that the City, by certifying the test results, would necessarily have refused to adopt.

The Court ultimately concluded that “fear of litigation alone [could not] justify the City’s reliance on race to the detriment of individuals who passed the examination and qualified for promotions.” Accordingly, the decision to discard the test results was impermissible under Title VII. The Court’s decision effectively warns employers that efforts to combat potential discrimination against one group can amount to actual discrimination against another.

California Supreme Court Applies “Severe or Pervasive” Standard to Civil Code Section 51.9 Claims

In *Hughes v. Pair*, the California Supreme Court issued a decision interpreting California Civil Code Section 51.9. *Hughes* does not have direct application to either Title VII of the Civil Rights Act of 1964 (“Title VII”) or California Fair Employment and Housing Act (“FEHA”) sexual harassment cases; however, the Court applied the precise FEHA standard to Civil Code section 51.9 claims. Plaintiff Suzan Hughes (“Plaintiff”) sued one of the trustees (“Trustee”) of

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¹ The examination results showed that white candidates had outperformed minority candidates.

² Title VII prohibits intentional acts of employment discrimination based on race, color, religion, sex, and national origin (disparate treatment), as well as policies and practices that are not intended to discriminate but in fact have a disproportionately adverse effect on minorities (disparate impact).

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her son's trust fund for sexual harassment pursuant to Civil Code section 51.9. The action stemmed from comments the Trustee allegedly made to the Plaintiff during one phone call and then a comment the Trustee purportedly made to the Plaintiff in person that night.

Civil Code section 51.9 was enacted to address "relationships between providers of professional services and their clients." The statute sets forth a nonexclusive list of such professional providers, including, but not limited to, trustees, physicians and attorneys. To prevail under Civil Code section 51.9, a plaintiff must establish: (1) a qualifying "relationship"; (2) a relationship is one that the plaintiff cannot "easily terminate"; (3) conduct of a sexual nature that was unwelcome and pervasive or severe; and (4) that such conduct caused some "economic loss or disadvantage or personal injury." The Court found that the terminology "pervasive or severe" should be given the same meaning as those are provided in the employment context. Applying the Title VII and FEHA definitions, the Court found the Trustee's alleged statements were neither pervasive ("the alleged sexual harassment consisted only of comments [Trustee] made to [Plaintiff] during a single telephone conversation and a brief statement . . . made later that day") nor severe (the alleged comment in person "would not plausibly be construed by a reasonable trier of fact as a threat to commit a sexual assault on [Plaintiff].")

California Supreme Court Makes it Easier for Employees to Pursue Representative Actions Under UCL and PAGA

The California Supreme Court recently decided two companion cases, *Arias v. Superior Court* and *Amalgamated Transit Union v. Superior Court*, which effectively lower the bar for employee/plaintiffs to bring lawsuits under California's Unfair Competition Law ("UCL") and Private Attorneys General Act ("PAGA").

In *Arias*, a former employee brought suit against his former employer alleging Labor Code violations such as unpaid overtime and missed meal and rest periods. In addition to seeking penalties and wages on his own behalf, the employee also sought the same remedies on behalf of other current and former employees based on his PAGA and UCL claims. The Court held that a plaintiff seeking relief on behalf of others (i.e., by way of a representative suit) under the UCL must satisfy the stringent requirements for a class action set forth in California Code of Civil Procedure section 382 ("Section 382"). However, with respect to PAGA claims, the Court held that an individual may pursue a representative claim for penalties without satisfying class action requirements listed in Section 382. The Court made this distinction based upon its reasoning that PAGA, in contrast to the UCL, does not expressly require that an individual comply with the class action mandates.

In *Arias*, the Court also ruled that because PAGA claims are a substitute for action by a government agency, a judgment against the plaintiff binds all those who would be bound by a judgment in an action brought by a government agency (including aggrieved employees who are not a party to the lawsuit). However, the Court acknowledged that an adverse judgment against the plaintiff in a PAGA action will not bind non-party aggrieved employees with respect to claims for

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Labor Code remedies that may be recovered in addition to civil penalties (*e.g.*, claims for failure to provide a meal or rest period under section 226.7 of the Labor Code). Therefore, if an aggrieved employee prevails in a PAGA action for civil penalties by proving that the employer has committed a Labor Code violation, the employer will be bound by the resulting judgment, and non-party aggrieved employees can invoke collateral estoppel against the employer for remedies other than civil penalties for the same Labor Code violations. However, if the employer prevails in such an action, the non-party employees will not be bound by the judgment with respect to remedies other than civil penalties. The reasoning for this was that the non-party employees were not given notice of the action or afforded an opportunity to be heard.

In *Amalgamated Transit*, the Court ruled that unions may not bring lawsuits on behalf of their members under the UCL or PAGA because a union is not an “aggrieved employee,” as defined in PAGA. There, seventeen individual plaintiffs and two labor unions sued three employers for Labor Code violations. The plaintiffs alleged that the unions were representatives of the defendants’ employees, and that the lawsuit was brought on behalf of the union and all aggrieved employees currently or formerly employed by the defendants. The Court concluded that both the UCL and PAGA required a plaintiff to have suffered injury. As a result, the employees’ claims were not assignable to the unions because assignment of the UCL claims would violate the UCL’s requirement that plaintiffs suffered an “injury in fact”; and assignment of the PAGA claim would violate existing California law prohibiting the assignment of the right to recover a statutory penalty. In sum, the Court reasoned that injured parties’ claims may not be assigned to an uninjured party, and that an uninjured party does not have standing to sue under either PAGA or the UCL.

Taken together, *Arias* and *Amalgamated Transit* provide both bad news and needed guidance for California employers defending class actions. It is now clear that plaintiffs who bring UCL representative actions must satisfy class action requirements, and that plaintiffs who bring PAGA representative actions need not satisfy class action requirements. It is also clear that judgments in PAGA actions are binding on plaintiffs, state labor law enforcement agencies, and non-party employees. However, an adverse judgment against a plaintiff in such an action will not preclude non-party employees from recovering any available Labor Code remedies. The cases also demonstrate that UCL claims are not assignable, whereas PAGA claims may be brought only by employees who have suffered injury resulting from Labor Code violations, and are assignable to past or current employees, but not non-employees such as a union.

The requirement that representative UCL actions be certified as class actions may slow the growth of such lawsuits against employers. However, the absence of any similar requirement under PAGA creates a significant potential for increased litigation. Without the need to satisfy class action requirements, plaintiffs and their counsel will find PAGA claims more enticing, thereby increasing the stakes for employers. As a result, employers should *consider* taking the following steps:

- Conduct an in-depth wage and hour audit on an annual basis in order to determine potential areas of concern;

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- Confirm that all employment policies and training materials regarding wage and hour issues are up to date; and
- Implement bi-monthly (rather than bi-weekly) payroll periods to reduce PAGA penalty exposure (unless otherwise required by law).

The Second District Court of Appeal Upholds Vacation Policy Deferring Vacation Time Accrual and Confirms Employers' General Discretion in Setting Vacation Policies

Labor Code section 227.3 provides that paid vacation is a form of wages. The California Supreme Court confirmed this in *Suastez v. Plastic Dress-Up Co.*, stating that paid vacation “is not a gratuity or a gift, but is, in effect, additional wages for services performed.” Labor Code section 227.3, *Suastez*, and several California cases — now including the Second District’s recent decision in *Owen v. Macy’s, Inc.* — make clear, however, that: (1) vacation time is not mandatory—an employer may choose to offer no vacation; and (2) if an employer chooses to provide vacation time, as long as a vacation policy does not result in forfeiture of accrued, unused vacation time, and employees are paid for such time at termination, the parties’ rights and duties in connection with vacation time are defined and limited by the employer’s vacation policy.

In *Owen*, plaintiff Lisa Owen (“Employee”), a former sales associate at Robinsons-May (“Employer”), sought to bring a class action on behalf of herself and all other similarly situated employees who she claimed were not paid accrued, unused vacation time at termination pursuant to Labor Code section 227.3. The Employee worked at a store that closed on March 1, 2006. The Employee and other employees continued to work after the store closed. The Employee’s employment ended on April 14, 2006, and no employee of that store worked there beyond April 30, 2006.

The employee handbook set forth a vacation policy which provided that during the first six months of employment, new employees do not accrue vacation time; the vacation year is May 1 through April 30; and vacation is earned in the same vacation year it accrues. It further provided that on May 1 of each year, as long as the employee had been employed for the previous six months, he/she accrued up to 50 percent of his/her annual vacation time *for the upcoming 12 months*, and on August 1, the employee earned up to the remaining 50 percent of annual vacation time *for the nine months remaining in that vacation year*.

The Employee alleged that (1) requiring new employees to wait six months before beginning to accrue vacation time was unlawful; and (2) a vacation policy must provide that vacation time for a given vacation year accrues during the previous year. The Employee’s claims arose from her belief that because her employment ended so close to May 1, 2007, she must be entitled to some vacation pay in connection with her work during May 1, 2006 through April 14, 2007 (even though she conceded that in the 2006-2007 vacation year, she used all vacation time she accrued during that year).

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The *Owen* court held that the Employer's vacation policy clearly provided that no vacation time would be accrued during the first six months of employment, and therefore rejected the claim.

The Employee also claimed, without any articulated basis, that employees who left employment on or before April 30 of the year in which her store closed forfeited vacation time/pay that was earned during the preceding year. The court noted how the Employer's vacation policy provided that vacation time for a given vacation year did not begin to accrue until the first day of that vacation year. The court noted that the only event in connection with the Employer's vacation policy that occurred "in advance" was the rate at which vacation time accrued (on May 1 of each year, employees accrued up to half of their vacation time for the *upcoming* year, and on August 1, employees accrued their remaining vacation time for the nine months *remaining in that year*). The court therefore rejected the Employee's second claim.

The Fourth District Court of Appeal Underscores the Importance of Hiring Licensed Subcontractors for Construction Projects and Obtaining Proof of the Required License – As the "Statutory Employer" of an Unlicensed Subcontractor's Employees, the General Contractor Is Responsible for Those Individuals' Wages

Labor Code section 2750.5 can have significant consequences for construction contractors. Section 2750.5 provides that any party who performs work for which a contractor's license is required, and who does not in fact have a valid license, is, as a matter of law, an "employee" and not an "independent contractor." Section 2750.5 most often applies to (1) extend workers' compensation benefits to injured workers to whom workers' compensation law would not apply because they are otherwise independent contractors; and (2) make a principal responsible for unpaid unemployment contributions to the Employment Development Department and for withholding taxes on behalf of unlicensed individuals or entities.

The limited exception to the rule in section 2750.5 is that a principal is not liable if (1) the unlicensed individual or entity misrepresents to the principal that he/she/it has the required license; or (2) the parties have an ongoing relationship wherein the individual or entity previously provided the principal with proof of a valid license but that license has since expired. Under those circumstances, the individual or entity is precluded from asserting employee status. The principal has the burden to prove the facts establishing application of the exception. Section 2750.5, therefore, imposes on the principal an affirmative duty to contract with licensed subcontractors and obtain proof of the subcontractor's valid license.

Here, *Sanders Construction Co., Inc. v. Cerda* involves application of section 2750.5 in a new context, and further underscores the importance of contracting with licensed subcontractors and obtaining proof of a valid license. In *Sanders*, a general contractor hired a "subcontractor" to install drywall on a hotel project. The subcontractor entity did not have a contractor's license, and its workers did not themselves act as independent contractors. The general contractor paid the subcontractor with the understanding that the subcontractor would pay its employees. The subcontractor told its employees that the general contractor would

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pay them. The subcontractor's employees were not paid, and they filed a Labor Commissioner claim against the general contractor for unpaid wages, interest, and waiting time penalties.

The *Sanders* court stated that "Labor Code section 2750.5 operates to conclusively determine that that a general contractor is the employer of not only its unlicensed subcontractors but also those employed by the unlicensed subcontractors." The general contractor argued that section 2750.5 applies only to cases involving workers' compensation and unemployment benefits. The court rejected the argument, holding that the policy considerations underlying section 2750.5 that have been cited in support of the traditional applications of that section (e.g., helping end the "subterranean economy" where contractors hire unlicensed subcontractors and pay them in cash, resulting the loss of large sums in taxes, employee social insurance contributions, and employee pension funds) apply equally to cases where employees of an unlicensed subcontractor claim unpaid wages. The court affirmed the lower court's award of wages and interest to the subcontractor's employees and also awarded them costs on appeal, all to be paid by the general contractor.

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