



### A Good Faith Defense to Punitive Damage Claims

While some may find this counterintuitive, the defense of an employment discrimination or harassment claim should begin before any alleged wrongful conduct occurs. A recent Ninth Circuit Court of Appeals decision (*Boswell v. Federal Express Corp.* (filed June 16, 2010)) illustrates this point.

In *Boswell*, Federal Express had asked the trial court for a jury instruction that it would not be liable for punitive damages if the jury found it engaged in good faith efforts to implement policies prohibiting and addressing discrimination, harassment, and retaliation. As the Supreme Court explained in 1999, “in the punitive damages context, an employer may not be vicariously liable for the discriminatory employment decisions of managerial agents where those decisions are contrary

to the employer’s good faith efforts to comply with Title VII.” This is so, the Ninth Circuit panel noted, even when the punitive damages stem from actions taken by managers, unless the manager is “sufficiently senior” to be treated as “the corporation’s proxy.” Because the trial court failed to instruct the jury on the good faith defense to a punitive damages claim, the *Boswell* court overturned the punitive damage award.

The *Boswell* decision is unpublished and, perhaps because of that, did not go into detail in defining and elaborating on some of these terms. It provides a valuable reminder, however, that the defense of a claim for discrimination, harassment, and retaliation begins with policies, practices, and training implemented long before any complaint is filed.

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### How Hiring Older Workers Can Be Age Discrimination

In 1997, a California appellate court in *Hersant v. Department of Social Services* stated that, to prove age discrimination, an employee must show that he or she was replaced by someone significantly younger. An unpublished appellate court decision issued May 24, 2010 (*Chapman v. Safeway, Inc.*), rejects that assertion and holds that there is no such requirement. **In fact, according to *Chapman*, a plaintiff could proceed with an age discrimination claim even if the**

**replacement was someone older!** Citing to an opinion from 2000, *Begnal v. Canfield & Associates, Inc.*, the court in *Chapman* explained that “a jury could . . . infer that the replacement (an older person) was hired to protect against an anticipated claim of age discrimination.” So in California, you can fire a 40-year-old, hire a 50-year-old replacement, and get sued for age discrimination. Why would any employment lawyer want to practice anywhere else?

### Sometimes When You Win, You Really Lose — *Rent-a-Center v. Jackson*

Last month, the U.S. Supreme Court issued its decision in *Rent-a-Center v. Jackson*. The justices split 5-4 (with Scalia, Roberts, Kennedy, Thomas, and Alito in the majority). The opinion reversed a Ninth Circuit decision holding that issues regarding the unconscionability of arbitration agreements must be decided by the courts, even if the agreement specifically delegates those decisions to the arbitrator. In doing so, the Court distinguishes between challenges to the validity of the agreement as a whole and challenges to the validity of the arbitration

provision. The distinction goes back to the Court’s 1967 decision in *Prima Paint v. Flood & Conklin Mfg. Co.* In the *Rent-a-Center* decision, the Court ruled that arbitrators decide challenges to the validity of the agreement as a whole, but courts decide challenges to the validity of the arbitration provision.

This distinction may be easier to articulate than to apply. In *Rent-a-Center*, for example, the agreement at issue was an agreement to arbitrate. Where that occurs, how do you distinguish between attacks

on the agreement as a whole and attacks on the arbitration provision? According to the majority opinion, the focus is on the provision delegating exclusive authority to resolve disputes relating to the agreement's enforceability to the arbitrator. The Court held that challenges to this "delegation provision" are within the exclusive purview of the courts. Challenges to the entire agreement, or to other provisions, can be decided by the arbitrator where the agreement so provides.

Justice Stevens wrote a dissent, joined by Justices Ginsburg, Breyer, and Sotomayor. The dissent argues that questions regarding the validity of arbitration agreements are decided by the courts unless (1) the parties have clearly and unmistakably demonstrated their intent that the arbitrator decide such issues; or (2) the validity of the arbitration provision depends entirely on the validity of the contract as a whole. Applying the first of these exceptions, Stevens argues that a claim that the arbitration agreement is unconscionable precludes any determination that there was a clear, unmistakable agreement to submit such issues to the arbitrator.

The dissent also accuses the majority of adopting a rule that is not supported by precedent, was not argued by either of the litigants and is unworkable. According to Justice Stevens, "a general revocation challenge to a standalone arbitration agreement is, invariably, a challenge to the 'making' of the arbitration agreement itself . . . and therefore, under *Prima Paint*, must be decided by the court." Instead, he argues, the Court "adds a new layer of severability – something akin to Russian nesting dolls – into the mix: Courts may now pluck from a potentially invalid arbitration agreement even narrower provisions that refer particular arbitrability disputes to an arbitrator."

The impact of this decision remains to be seen. There is certainly greater incentive now for employers drafting arbitration provisions to include language that delegates disputes regarding the validity of the agreement to the arbitrator. But is it just a matter of time before Congress "overrules" this decision?

To the extent the *Rent-a-Center* decision is a victory for employers, it will be short-lived if it leads to greater support for the Arbitration Fairness Act (HR 120, S. 931),

which would ban mandatory pre-dispute employment arbitration agreements. That legislation already includes language objecting that "a series of United States Supreme Court decisions have changed the meaning of the [Federal Arbitration] Act so that it now extends to disputes between parties of greatly disparate economic power, such as consumer disputes and employment disputes . . ." Proponents of this legislation have wasted no time in using the *Rent-a-Center* decision to support their campaign against mandatory pre-dispute arbitration.

In addition, the Supreme Court has another Ninth Circuit arbitration decision before it: *AT&T Mobility v. Concepcion*. In that case, AT&T Mobility argued that the Federal Arbitration Act preempts California state laws regarding the unconscionability of arbitration agreements. That decision, although many months away, could also have a profound impact on the enforceability of mandatory arbitration agreements in the employment context. Between the pending Supreme Court case and the pending legislation, the law in this area remains fluid.

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## Martinez v. Combs: A New Definition of an Employer!

Ninety-seven years after California passed Labor Code § 1194, which enables recovery for minimum wages, the California Supreme Court finally defined who is an employer subject to §1194 and various other Labor Code provisions. The court defined an "employer" as one who, directly or indirectly, or through an agent or any other person, engages, suffers, or permits any person to work or exercises control over the wages, hours, or working conditions of any person as outlined by the Industrial Welfare Commission's (IWC) Wage Order 14-2001. *Martinez v. Combs*, 49 Cal.4th 35 (2010).

In *Martinez*, plaintiff strawberry pickers sued their employer, strawberry harvester Isidoro Munoz (who was later discharged in bankruptcy), and the companies that sold Munoz's strawberries ("brokers"), for unpaid minimum wages under §1194. Section 1194 never defined the employment relationship or who may be liable under the statute for unpaid wages. The court determined that as a quasi-legislative branch, the IWC's wage orders are to be given great deference. Therefore,

the IWC's Wage order 14-2001, and not the federal "economic realities" definition, defined the employment relationship under Section 1194.

However, when applying the new definition, the court determined the brokers were not employers because: (1) the brokers did not "suffer or permit" plaintiffs to work as the brokers did not have the right to hire or fire, set wages and hours, or tell the workers when and where to report to work; (2) the brokers did not "exercise control over" the plaintiffs' wage and hours as Munoz alone decided which fields to harvest, trained and supervised the workers, determined their rate and manner of pay, set hours and working conditions, and decided what type of fruit to harvest at what time; and (3) the plaintiffs knew they owed their obedience to Munoz and not the broker's field representatives. Accordingly, though the court broadens the definition of an employer, the court held that the brokers, as investors or business partners, could not be held liable for unpaid wages under Section 1194.

There will continue to be litigation over who is or is not an "employer." To minimize the chance of getting dragged into those disputes, companies should insist on contract language that:

- Specifies that the other party is solely responsible for selecting, hiring, firing, supervising, training, assigning, and setting the wages, hours, and working conditions of its workers;
- Requires the other party to represent that it will comply with all laws applicable to its operations, including wage and hour laws; and
- Requires the other party to provide indemnity for employment-related claims by its workers.

No matter how the legal definition of "employer" continues to evolve, it is likely to be significantly broader than the term is generally understood in the business community.

### Supreme Court Tackles Employees' Privacy Rights

On June 17, 2010, the U.S. Supreme Court issued a unanimous decision in *City of Ontario v. Quon*, ruling that an employer's review of an employee's text messages, sent via an employer-issued pager, was reasonable and did not violate the employee's privacy rights.

In *Quon*, the City of Ontario, California, issued pagers with texting capability to police officers on the city's SWAT team, including Quon, to help them mobilize and respond to emergencies. The city's written policies provided that the text messages could be monitored without notice. However, the police officer overseeing the city's pager expenses told Quon he had no intention of reviewing his text messages. Nevertheless, when Quon and other officers exceeded their monthly character limits for several months running, the city, without informing the officers, audited their text messages to determine whether the existing character limit was too low—i.e., whether the

overages were due to personal or work-related messages. The audit revealed that Quon was sending many personal text messages on his pager, some of which were sexually explicit. Quon was disciplined as a result.

Overturning the Ninth Circuit Court of Appeals, the Supreme Court concluded that the audit of Quon's text messages was reasonable because: (1) the city had a legitimate, work-related purpose in conducting the audit; (2) the scope of the audit was not excessively intrusive because it was limited to a two-month period and Quon's off-duty messages were redacted prior to the review; and (3) Quon could not reasonably expect his messages were immune from review because the city never assured him that his messages were private, and Quon should have anticipated the city might need to audit his messages to assess the SWAT team's performance in particular emergency situations.

Although *Quon* is a fact-specific decision involving a public sector employer, it provides private employers some useful lessons consistent with the California Supreme Court's recent decision in *Hernandez v. Hillsides, Inc.*, 47 Cal.4th 272 (2009) (discussed at length in our [Fourth Quarter 2009 issue](#)). Specifically, employers should:

- Adopt and consistently apply a clear, written policy stating that employees should not have an expectation of privacy or confidentiality when using employer-owned communication devices or communication systems;
- Ensure any review of employees' electronic communications is justified by a strong business purpose; and
- Keep the scope of any review as narrow and non-intrusive as possible to achieve the review's objectives.

### Making Sure Your Unpaid Interns Are Not Considered Employees

California employers that have unpaid interns should take note of an opinion letter issued by the California Division of Labor Standards Enforcement on April 7, 2010. The DLSE looked to federal law, and in the opinion letter, set forth the criteria it uses to determine whether an unpaid intern is an "employee" for purposes of California's minimum wage law. The following is the DLSE's six-part test:

1. The training, even though it includes actual operation of the employer's facilities, is similar to that which would be given in a vocational school;
2. The training is for the benefit of the students or trainees;
3. The students or trainees do not displace regular employees, but work under their close supervision;
4. The employer gains no immediate advantage from the activities of the students or trainees, and on occasion, the employer's operations may be actually impeded;
5. The students or trainees are not necessarily entitled to a job at the conclusion of the training period; and
6. The employer and the students or trainees all understand that the students or trainees are not entitled to wages for time spent in training.

Unless these requirements are met, the law requires that the individual be paid. The opinion letter can be found at: [www.dir.ca.gov/dlse/opinions/2010-04-07.pdf](http://www.dir.ca.gov/dlse/opinions/2010-04-07.pdf).

### Ninth Circuit Avoids Employer's Choice-of-Law Provision With Creative Reasoning

The first sentence of the Ninth Circuit's opinion in *Narayan v. EGL, Inc.* (filed July 13, 2010) explains what is at stake: "*The California Labor Code confers certain benefits on employees that it does not afford independent contractors.*" Indeed. At issue in *Narayan* was whether certain individuals "engaged to provide freight pick-up and delivery services for [Defendant] EGL in California" were classified properly as independent contractors. In support of a finding that no employment relationship existed, EGL argued that the issue was controlled by its "Leased Equipment and Independent Contractor Services

Agreement," which provided that the "intention of the parties" is to "create a vendor/vendee relationship" and that "[n]either Contractor nor any of its employees or agents shall be considered to be employees of" EGL. The parties also designated that Texas law should control.

But these provisions delayed the court not at all. Rather, the court limited the choice of law provision to claims that "rise or fall on the interpretation and enforcement of any contractual provision." Such provisions do not "encompass all disputes between the parties." And here, says the court, "[t]he Drivers' claims involve entitlement to

benefits under the California Labor Code. Whether the Drivers are entitled to those benefits depends on whether they are employees of EGL, which in turn depends on the definition that the otherwise governing law—not the parties—gives to the term 'employee.'" Nice trick! Using this reasoning, the court simply ignored Texas law and held that California law applies. But this reasoning seems shallow. Whether an individual is an employee is a question of law. And here the parties agreed to answer that question using Texas law. The court's analysis merely assumed what it should have proven—i.e., that the

## California Update

California Labor codes applies in the first instance. Individuals cannot make claims under the Labor Code unless they are employees.

As an added bonus to employees, the court also emphasized the burdens that exist in litigation under the Labor Code. This topic is not heavily litigated but can be a very effective tool in avoiding summary judgment. Those principles are as follows:

- Under California law, once a plaintiff comes forward with evidence that he

provided services for another, the plaintiff has established a prima facie case the relationship was one of employer/employee.

- The fact that one is performing work and labor for another is prima facie evidence of employment, and such person is presumed to be an employee in the absence of evidence to the contrary.
- Once the employee establishes a prima facie case, the burden shifts to the

employer, which may prove, if it can, that the presumed employee was an independent contractor.

- The ultimate burden of proof is on the party attacking the employment relationship.

Having avoided Texas law and having emphasized the various burdens of persuasion, it is not a surprise that the court reversed the lower court's decision to award the employer summary judgment.

## The Need for "Mini-Trials" on Individual Factual Issues Prompts Denial of Class Certification

Two recent rulings found that cases were not suitable for class action treatment because individualized issues of law and fact predominated over common issues.

In *Arenas v. El Torito*, 183 Cal.App.4th 723 (2010), the California Court of Appeal affirmed denial of class certification in a lawsuit brought by salaried managers claiming they were misclassified as exempt from overtime wage laws. The plaintiffs claimed that the defendant automatically classified the managers as exempt, based on their job description, and that they spent less than half of their working hours on exempt job duties. The defendant

presented evidence that the managers' job duties and the time spent on specific tasks differed significantly among restaurant locations. The court found the conflicting evidence provided by the parties would require "mini-trials" on each individual manager's job duties to determine whether each was misclassified. The court concluded that plaintiff's theory that "managers, based solely on their job descriptions, were as a rule misclassified, was not amenable to common proof."

In *Nguyen v. Starbucks Corporation* (filed May 5, 2010), the Ninth Circuit denied an appeal by a putative class member and

affirmed the district court's denial of class certification in *Koike v. Starbucks Corporation*. The plaintiffs were former assistant managers who alleged that Starbucks forced them to work off the clock without pay. The trial court found class action treatment was not appropriate because "individualized factual determinations" were needed to determine whether the class members actually engaged in off-the-clock work and whether Starbucks had knowledge of any such work being performed.

## Supreme Court Lets Stand San Francisco's Health Care Ordinance

In June, the U.S. Supreme Court declined to hear the appeal, brought by San Francisco employers, of a federal court's decision upholding the city's health care law. The ordinance, passed in 2007, requires employers to provide health insurance or

pay into a city fund to provide insurance. An association of restaurants argued that the ordinance conflicted with federal ERISA law governing benefit plans. The Ninth Circuit Court of Appeals disagreed and upheld the ordinance. Despite an

arguable split among the lower courts of appeal on this issue, the Supreme Court let the San Francisco law stand. San Francisco also imposes a super-minimum wage within the city and requires employers to provide paid time off.

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