BUSINESS LAW NEWS

The State Bar of California • Issue 2 2010

In this issue

Employment Law Primer for Corporate Attorneys 1

Executive Committee: Message from the Chair 2

BLN Editorial Board: Message from the Editor 2

The Limits of "Bankruptcy Proofing" in the Wake of General Growth Properties 3

MCLE Article: Ethical Issues for the In-House Transactional Lawyer 5

Foreign Companies Doing Business in the United States: Choice of Entity Considerations 7

Use of Captive Insurance in Estate and Business Planning (Part 1) 9

Home Workers and the Debate Over "Who's a Statutory Employee" Under the Internal Revenue Code 11

Securities Laws Governing Private Offerings in California 13

MCLE Test No. 10: Ethical Issues for the In-House Transactional Lawyer 32

The State Bar of California
180 Howard Street
San Francisco, CA 94105
(415) 538-2341
www.calbar.ca.gov

The Top Ten Things Corporate Attorneys Should Know About California Employment Law

Nancy Yaffe

Very often a corporate attorney is a company's first point of contact for legal issues of all shapes and sizes. This article is intended to give corporate counsel some tips on key concepts in California employment law, including some important distinctions between California and federal employment laws. Familiarity with these concepts will enable you to spot key issues for your clients and to know when to seek input from employment counsel.

Nancy Yaffe

Nancy Yaffe is a partner in the Labor & Employment Department of Fox Rothschild LLP's Los Angeles office. She focuses her practice on labor and employment law counseling and litigation, with an emphasis on problem prevention. Ms. Yaffe defends employers in all types of employment litigation, and provides counseling and advice to clients nationwide on employment-relatedissues including harassment, discrimination, ADA disability compliance, wage-and-hour issues, reduction-in-force planning and union avoidance.

Issue #1: Offer Letters

Employment often begins with an offer letter. Corporate counsel should take care to make sure that offer letters are clear and compliant with applicable state laws. Here are three aspects of offer letters that can create more problems than they prevent.

Termination. All too often, offer letters are drafted to include both at-will language and termination for cause language, including explicit definitions of what constitutes cause. These concepts are mutually exclusive and including them both creates ambiguity and enforcement difficulties. Either the employee is at-will, which means both the employee and the employer can terminate the employment relationship with or without cause, at any time, for any reason,or the employment can only be terminated for "cause," as that term is defined, either in the offer letter itself or in the company's employee handbook. [1] You can't have it both ways; therefore, be sure your client is clear on how she wants to handle termination.

Exempt/Non-Exempt Status. Another issue, which is often missing from offer letters, is an explicit statement as to whether the employee is classified as exempt or non-exempt. As discussed below, there are specific rules for when an employee can be exempt from California's overtime and related requirements. It is particularly important to figure this issue out ahead of time, and to make sure that the employee's compensation program is set up accordingly.

Company Policies. Finally, avoid including detailed provisions on specific issues such as vacation time, benefit plans, and confidentiality agreements, lest they wind up being different from—or even worse, contrary to—the employer's actual policies and agreements. Do not be specific on the details in the offer letter, but instead simply state that the employee will be required to sign an employee handbook, confidentiality agreement, arbitration agreement, etc. upon hire, and that she will be governed by those policies as they are updated from time to time.

Issue #2: Confidentiality and Non-Compete Agreements

It is common knowledge that non-competes are generally invalid in California, except in limited circumstances involving the sale of a business or the dissolution of a partnership or limited liability corporation.[2] That being said, every new employee at most businesses in California should be required to sign a very carefully drafted

Continued on Page 20

but requires the SEC to issue rules within one year after enactment of the Dodd Bill for disqualification of offerings under Rule 506 that are substantially similar to Rule 262 under Regulation A of the Securities Act, or are disqualified by a final order of a state securities commission.

The Dodd Bill was sent to a House/Senate Conference Committee for consolidation with the House bill.

5 In an SEC No-Action Letter to IPONET (July 23, 1996), the SEC stated that a registered broker/dealer's activities would not amount to general solicitation or general advertising as long as the broker/dealer satisfied the following three conditions:

- Invitation to complete the questionnaire, and the questionnaire itself must be generic in nature and not refer to any specific offering;
- The password-protected page containing offerings may become available to a particular investor only after the broker/dealer determines that the particular investor is accredited or sophisticated; and
- The potential investor may purchase securities only in offerings that are posted on IPONET after the investor has been qualified as an accredited or sophisticated investor.

6 In SEC Release Nos. 33-7856 and 34-42728 (May 4, 2000), the SEC commented on unregistered finders in Section II.C. 2., On-Line Private Offerings Under Regulation D. Further, in discussing the IPONET No-Action Letter the SEC stated: "Thus, broker/dealer registration generally is required to effect transactions in securities that are exempt from registration under the Securities Act. In other words, third-party service providers who act as brokers in connection with securities offerings are required to register as broker/dealers, even when the securities are exempt from registration under the Securities Act."

7 SEC Rule 3(a)4-1 of the Securities Exchange Act.

8 § 25102.1 of the CSL. Counsel should also be aware of a recent California case, *Consolidated Mgmt. Group, LLC v. Dep't of Corps.*, 162 Cal. App. 4th 558 (2007), which held that a security must actually be a "covered security" under section 18(b)(4)(D) before federal pre-emption applies, and that the Department of Corporations has authority to determine whether the security is a covered security.

9 Pursuant to Cal. Admin. Code tit. 10, § 260.102.17, the references to a transaction under Rule 505 or 506 in paragraph (b)(2) of Rule 502 shall include a transaction under Rule 504.

10 *Id.*

11 Cal. Corp. Code § 25608(x).

12 Federal: § 11 of the Securities Act (15 U.S.C. § 77k and § 12 (15 U.S.C. § 77l); California: Corp. Code §§ 25501 & 25503.

13 Federal: § 15 of the Securities Act (15 U.S.C. § 77o); California: Corp. Code § 25504.

Continued from page 1 . . . California Employment Law

confidentiality agreement that protects the employer's confidential, proprietary, and/or trade secret information. Currently, this is the best way for most California employers to protect themselves.

Such confidentiality agreements should carefully tailor the definition of confidential and proprietary information to the needs of the particular business. Do not use boilerplate language listing items that are irrelevant to the business at hand. Do, however, include an agreement by the employee to protect the company's confidential information, including a prohibition against copying it or transferring it to any media device or non-company computer. Do include a representation that the employee is not bound by other confidentiality obligations that will affect her job with your company. Do include an agreement to return company property upon separation from employment. In addition, consider adding an acknowledgement of damages to the company if confidentiality obligations are breached and include an ability to recover attorney's fees in connection with such a breach.

Issue #3: Arbitration Agreements

Employment arbitration agreements must meet strict requirements to be enforceable in California.[3] According to current law, arbitration agreements must at a minimum be mutual and must:

i. Ensure adequate discovery. Recent case law provides that limiting discovery to just one party deposition and one expert deposition per side did not render an arbitration agreement substantively unconscionable when the agreement also stated that "additional discovery may be had where the arbitrator selected pursuant to this agreement so orders, upon a showing of need;"[4]
ii. Grant the arbitrator authority to award all relief otherwise available in court. Therefore, watch out for clauses that purport to limit the damages that would otherwise be available to the employee;
iii. Provide for a written arbitration award that permits judicial review;
iv. Designate the employer as being responsible for payment of all arbitrator's fees and costs unique to the arbitration ; and
v. Provide a mutual agreement to arbitrate claims.

In addition, make sure that the terms of the arbitration agreement are consistent with the terms of the confidentiality agreement. Take care not to undermine the arbitration agreement when the confidentiality agreement allows the employer to seek a TRO in court for violation of its provisions and obtain attorney's fees as the prevailing party. When such agreements give rights to the employer, and not the employee, they lack mutuality and may undermine the arbitration agreement. So watch out!

Issue #4: Daily Overtime for Non-Exempt Employees

Currently, wage and hour class actions are a major concern for employers in California. They are costly to litigate, and the potential liability can be staggering, even for small to medium sized businesses. Class actions are popular with plaintiff's attorneys not just because they are comparatively easy to maintain in California, but also because California's wage and hour laws are more generous to employees than they are in any other state. An employer who complies with the federal Fair Labor Standards Act (FLSA) may nevertheless be in violation of California law.

The main trap for the unwary in California is daily overtime. California law requires that non-exempt employees be paid overtime, at one-and-one-half times their regular rate of pay.[5] This applies not only for work in excess of forty hours in one work week, but also for work in excess of eight hours in any given workday.[6] Non-exempt employees are also entitled to overtime, at one-and-one-half times their regular rate of pay, for the first eight hours on the seventh day of work in any one work week.[7] Any work in excess of twelve hours in one workday, or eight hours on the seventh workday in any one work week, must be compensated at twice the employee's regular rate of pay.[8]

Many employers forget to define their workday and workweek in their employee handbook, and simply pay overtime based on the pay period. This mistake can be a costly one.

Issue #5: Overtime Exemptions

Overtime is not an issue if the employee is exempt from overtime. Employers often push the boundaries of the statutory exemptions to avoid California's onerous overtime requirements. Doing so can be dangerous business and can open the employer up to class action liability.

California law provides exemptions from overtime pay for certain executive, administrative, and professional employees.[9] For these exemptions to apply, the employees must be "primarily engaged in" the duties that meet the requirements of the particular exemption, including customarily and regularly exercising independent judgment and discretion in carrying out those duties, and earning a monthly salary equivalent to at least twice the California minimum wage for full time employment. While the exemptions are similar to those provided under federal law, there are some key differences.

First, federal law only requires that an employee's "primary duties" meet the test for each exemption. As such, if an employee's primary duty is to manage others, then she can be exempt even if she only spends 25% of her actual time managing. However, the standard is much stricter in California. In California, an employee must be "primarily engaged in" exempt duties. This means that the employee must spend more than 50% of her time each day on exempt tasks.[10] This standard is much harder to meet.

Second, California does not recognize a "highly compensated" exemption.[11] Under the FLSA, employees who earn over $100,000 per year (with at least $455 paid per week) perform office or non-manual work, and regularly perform at least one of the duties of an exempt executive, administrative or professional employee, qualify for the highly compensated exemption.[12] Employers often rely on this exemption in other states, and many do not realize that it does not apply in California.

Make sure that your clients carefully evaluate the exempt status of prospective employees, preferably before hire, or whenever there is turnover or significant changes in duties. If your clients are not familiar with the nuances of exempt/non-exempt classification, they should retain employment counsel to perform this evaluation.

Issue #6: Vacation Policies

In California, accrued vacation time is considered a form of earned wages and cannot be forfeited. Therefore, contrary to most other states' employment laws, an employer may not institute a "use-it-or-lose-it" vacation policy. If an employee quits or is terminated, she must be paid for all accrued, but unused, vacation based on her rate of pay when the employment ends.[13] To prevent the uncontrolled increase of vacation days employees may cash out upon departure, an employer may set a cap on the accrual of unused vacation time.[14]

In contrast to vacation, sick leave does not constitute wages and does not need to be paid out at termination of employment. But employers should be cautioned that unrestricted "personal days" and "floating holidays" or their equivalent are treated like vacation and must be paid out at termination if accrued and unused. Employers can (and should) avoid this trap by requiring employees to designate floating holidays at the beginning of each calendar year, and by eliminating personal days or simply adding more vacation days.

Issue #7: Pregnancy, Disability Leave, and Other Rights to Protected Time Off

California allows employees different rights to "protected time off," which means that the employee cannot be subject to discipline or termination for taking time off for a protected reason. One of the most important special rules in California is Pregnancy Disability Leave (PDL), which applies to employers with five or more employees. Under PDL, a woman is entitled to up to four months of protected time off when she is disabled by pregnancy or pregnancy-related medical conditions.[15] Unlike the federal Family Medical Leave Act (FMLA) or even California's Family Rights Act (CFRA),

PDL applies from the very first day of employment. Therefore, a woman in California does not have to disclose her pregnancy before being hired, and once she starts, the employer will be required not only to accommodate her during that pregnancy, but also to give her up to four months off with guaranteed job protection.[16] Moreover, employees who have been working for over a year and more than 1250 hours when they become pregnant will be entitled to up to seven months of protected time off for that pregnancy (which is up to four months of PDL, plus 12 weeks of FMLA/CFRA).[17] If your clients have questions concerning their responsibilities to pregnant employees in California, they should seek employment counsel.

As with many other states, California also has state-specific rules requiring employers to provide protected time off for other purposes, including for school issues and activities, volunteer civil service, spending time with spouses on leave from military deployment, voting, and participating in judicial proceedings.[18] Make sure your clients are aware of such rules and that they are reflected in a California-specific employee handbook, or at least a California addendum to the company's nationwide employee handbook.

Issue #8: Sexual Harassment

California employers face greater risks in employment discrimination cases because of the nature of California juries and, unlike the federal Title VII,[19] there are no caps on compensatory or punitive damages a plaintiff may recover.[20] Moreover, California's anti-discrimination statutes have been drafted and interpreted more broadly than Title VII.

In addition to prohibiting harassment based on gender and any other categories protected by law (such as race, ethnicity, sexual orientation, religion, age, etc.), California law requires employers to "take all reasonable steps necessary to prevent and correct harassment and discrimination" and renders employers strictly liable for hostile environment harassment by a supervisor.[21] Individual managers and supervisors can also be held personally liable for harassment.[22]

These aspects of harassment law are unique to California, which is why policies and training are so critical in this state. Under Title VII, the employer's policies against harassment and the employee's failure to make use of the company's internal procedures to complain of harassment will provide employers with a defense to liability.[23] In California, however, the employer cannot completely escape liability. Rather, employers can only hope to reduce their liability if they can show they took reasonable steps to correct and prevent harassment; under the "avoidable consequences doctrine."[24] Under California law, the employer can establish a defense by proving that it had an effective complaint procedure. Written policies and training are critical in allowing an employer to utilize this defense.

California requires that all employers who do business in the state and have fifty or more employees provide at least two hours of sexual harassment prevention training to their supervisory employees.[25] There is no requirement that the fifty employees work at the same location or all reside in California, but employers are only required to train their California-based supervisors. The training must be provided every two years or within six months of an employee assuming a supervisory position. There are specific requirements on what subjects must be covered, who may provide the training, and the manner in which the training is offered.[26] Don't let your clients skip this requirement. It may not seem like a big deal until the supervisor who wasn't trained is named in a lawsuit as the alleged harasser. In such cases, employers can be prepared for punitive damage exposure.

Issue #9: The California Warn Act

When clients contact you about business challenges, they often want you to help them with restructuring their financing, real estate negotiations, or exit strategies for terminating contractual obligations. In situations where your clients are shutting down operations or downsizing, keep your eye out for California WARN Act issues.

California has its own version of the federal Workers Adjustment and Retraining Notification Act (WARN).[27] There are several significant differences. First, the California WARN Act has lower thresholds; it applies to any "industrial or commercial facility" that employs at least seventy-five full or part-time employees, as opposed to one hundred full-time employees at a single job site under federal law.[28] Second, it is triggered by an event where at least fifty employees are affected, not fifty employees and one-third of the workforce as the federal law provides. Third, there is no exception in the California statute for layoffs caused by unanticipated business circumstances. And fourth, while the term "layoff" is precisely defined under federal law, it is more broadly defined as a separation of employment under California, leaving plenty of room for interpretation on issues such as temporary layoffs and reduction in hours.

Issue #10: Final Paycheck

Unlike California, most states require that departing employees receive their final paychecks on the next regular payday following the discharge. But California is special, and here all wages (including accrued vacation time, as described above) are due immediately upon an involuntarily termination or layoff. Employees who quit with more than 72 hours notice must be paid on the last day of work. For employees who quit with fewer than 72

hours of notice, wages and unused vacation must be paid within 72 hours after notice is given.[29]

Failure to pay all wages due may subject an employer to a penalty of up to thirty days of wages, known as "waiting time penalties."[30] This is a bigger problem than it seems. For example, assume an employer fails to pay out one personal day upon termination, because it didn't realize that personal days were treated as vacation (i.e., wages) in California. If that employee earned only minimum wage in California, she would be owed a mere $64 in wages for that one day. But if she is not paid within thirty days, then the employer will owe not only $64, but $64 plus $1,920 (thirty days of $64). Multiply that by many employees at higher wages over several years, and you have a class action that is very interesting to a California plaintiff's attorney.

Therefore, make sure your clients understand the final paycheck rules in California.

I hope this article has highlighted some of the issues for you to consider when counseling your California clients, and in helping them avoid these traps for the unwary.■

Endnotes

1 Cal. Lab. Code § 2922.

2 Cal. Bus. & Prof. Code §§ 16601-16602.5.

3 *Armendariz v. Foundation Health Psychcare Services, Inc.*, 24 Cal. 4th 83 (2000) (setting forth standards for procedural and substantive unconscionability that renders an arbitration agreement unenforceable).

4 *Dotson v. Amgen, Inc.*, 181 Cal. App. 4th 975 (2010).

5 As with federal law, the "regular rate of pay" under California law is not necessarily the rate the employer regularly pays. Clients who are not familiar with this term and concept should seek employment counsel.

6 Cal. Lab. Code § 510.

7 *Id.*

8 *Id.*

9 Cal. Lab. Code § 515; Cal. Code Regs. tit. 8 § 11000 et seq.

10 Cal. Lab. Code § 515.

11 29 C.F.R. § 541.601.

12 29 C.F.R. § 541.601.

13 Cal. Lab. Code § 227.3.

14 DLSE Enforcement and Interpretations Manual § 15.1.4.

15 Cal. Gov't Code § 12945(a).

16 Cal. Code Regs. tit. 2 § 7291.7, et seq.

17 Cal. Gov't Code § 12945.2.

18 Cal. Lab. Code §§ 230 et seq.

19 42 U.S.C. § 1981.

20 However, see a recent Ninth Circuit case, *Roby v. McKesson,* 47 Cal. 4th 686 (2010) (suggesting a one-to-one ratio on punitive damages in discrimination and harassment cases.)

21 Cal. Gov't Code § 12921; Cal. Code Regs. tit. 2, § 7287.6(b)(3).

22 Cal. Gov't Code § 12940(j)(3).

23 *Burlington Industries, Inc. v. Ellerth*, 524 U.S. 742 (1998); *Faragher v. Boca Raton*, 524 U.S. 775 (1998).

24 *State Department of Health Services v. Super. Ct. of Sacramento County*, 31 Cal. 4th 1026 (2003).

25 Cal. Gov't Code § 12950.1.

26 *Id.*

27 Compare 29 U.S.C. § 2101 et seq. with Cal. Lab. Code § 1400 et seq.

28 Cal. Lab. Code § 1400 et seq.

29 Cal. Lab. Code § 202.

30 Cal. Lab. Code § 201.

Continued from page 2 . . . Message from the Chair

Standing Committees are busy reviewing proposed legislation and working on affirmative legislative proposals.

It's a great time to be a member of the Business Law Section. If you are so inclined, please consider joining one of the Section's thirteen Standing Committees that focus on the following specializations: agribusiness, consumer financial services, corporations, cyberspace, financial institutions, franchise, health, insolvency, insurance, nonprofit and unincorporated associations, opinions, partnerships and limited liability companies, and uniform commercial code. Now is the time to get your application in, and be a part of what makes being a business lawyer in California so great!

If you know someone who is missing out on all of the great benefits of Section membership, please pass along the good word. Your membership is practically free if you go to one CEB program a year, with the $75 program discount offered through CEB to Section members. We hope you will continue to support the Business Law Section throughout your legal career so we can support you in your efforts to be a preeminent California business lawyer. ■

** Paul J. Pascuzzi is a partner at the bankruptcy firm Felderstein Fitzgerald Willoughby & Pascuzzi LLP in Sacramento and is the 2009-2010 Chair of the State Bar's Business Law Section. Paul can be reached at ppascuzzi@ffwplaw.com or (916) 329-7400 ext. 222.*