Key Employment Rulings of the Past Year

The California Supreme Court decided a number of key cases in 2009 that offer a mixed bag for employers attempting to manage and prevent employment litigation. A review of these decisions is instrumental as they can significantly impact employment policies and practices.

On Nov. 30, 2009, the California Supreme Court issued its decision in *Costco Wholesale Corp. v. Superior Court*, S163335, reaffirming the importance of the attorney-client privilege by holding that the privilege protects all communications with outside counsel. Specifically, the Court vacated and rejected the trial court's ruling ordering an in camera review and redacted disclosure of the "factual" portions of the privileged communication.

In June 2000, Costco retained outside counsel to conduct an evaluation and provide legal advice regarding classification of certain manager positions as exempt from California's overtime laws. The outside counsel conducted a fact-finding investigation, which included interviewing Costco managers and thereafter prepared a 22-page opinion letter to Costco's in-house counsel, that contained both factual and legal analysis of their findings (outside-counsel letter). In 2001, Costco reclassified its ancillary manages as non-exempt employees.

Plaintiffs filed a wage and hour class action lawsuit against Costco, alleging that it had misclassified certain manager positions, including the ancillary manager positions evaluated in the outside-counsel letter. A discovery dispute ensued where plaintiffs sought production of the outside-counsel letter. The trial court ordered an in camera review of the outside-counsel letter by the discovery referee, who then ordered certain portions of the letter containing "factual" information be produced in redacted form. Costco sought a writ. The court of appeal denied relief, concluding that Costco had failed to show irreparable harm.

The California Supreme Court reversed. The Court found the outside-counsel letterwas clearly "communication made in the course of an attorney-client relationship" and any disruption of this privilege can create "irreparable harm." It further explained that the in camera review and order for production of redacted portions of the letter were inappropriate, because when the primary purpose of the communication is for "legal advice," the privilege attaches to the communication in its entirety.

The *Costco* decision underscores the importance of preserving and protecting privileged communications with counsel. It is particularly important in the context of legal audits or other legal evaluations assigned to counsel, where factual summaries are discussed as part of the legal analysis. It is equally important that counsel involved in the process are those acting in their capacity as an attorneys and clearly attach privilege to all communications.

In *Roby v. McKesson*, S149752, the Supreme Court addressed two key issues: whether personnel actions taken by a supervisor can be used as evidence of harassment, and the constitutional limits of punitive damages on these types of claims.

In *McKesson*, plaintiff who suffered from panic disorder filed a claim of wrongful termination, harassment, and discrimination against her former employer McKesson. Plaintiff claimed her supervisor ignored her, excluded her from meetings, reprimanded her in front of co-workers and commented on her scabs and body odor - conditions related to her panic disorder. McKesson's attendance policy imposed discipline on employees for unscheduled absences and plaintiff was eventually terminated due to absences she attributed to her panic disorder. At trial, the jury awarded plaintiff $3,511,000 in compensatory damages against McKesson, $500,000 against the supervisor, and punitive damages in the sum of $15,000 against McKesson and $3,000 against the supervisor.

First, the California Supreme Court reversed the court of appeal's opinion and found that evidence of personnel actions (e.g. write-ups and disciplinary actions) could be introduced in support of a claim of harassment; such conduct can contribute to hostility and be an "abusive message." The Court explained that plaintiff's evidence presented in support of her alleged discrimination claim (e.g. being excluded from meetings and parties, ignored by her supervisor and getting mocked in front of others), could also be introduced as evidence of harassment.

Second, the Supreme Court found that Plaintiff's supervisor who managed only four people (in a company of 20,000 employees) did not qualify as a managing agent for purposes of an award of punitive damages. The Court found that McKesson's implementation of its attendance policy and failure to designate plaintiff's leave under the FMLA were not intentional and malicious. The Court found the maximum punitive damages award was a one-to-one ratio to compensatory damages, reducing the punitive damages award to $1,905,000.

The *McKesson* decision offers mixed results for employer. It is favorable for employers defending against employment litigation by setting more reasonable caps on awards of punitive damages. However, it makes it more challenging to defend against claims of harassment as it blurs the line between evidence plaintiffs can introduce in support of a claim of discrimination compared to that for harassment.

On Nov. 2, 2009, the California Supreme Court issued its decision in *Schachter v. Citigroup, Inc.*, S161385, finding Citigroup's incentive compensation plan's forfeiture of unvested stock did not violation California Labor Code Sections 201 or 202.

Citigroup's voluntary incentive stock compensation plan provided participating employees with shares of restricted stock in lieu of compensation. The plan specified that upon resignation or termination for clause, the unvested stock would be forfeited. Plaintiff, who voluntarily terminated his employment, brought a putative class action against Citigroup, alleging that the plan's forfeiture provision violated Labor Code Sections 201 and 202 (requiring prompt payment of all earned wages at the time of separation of employment) and constituted an unlawful conversion of wages.

The California Supreme Court affirmed the court of appeal's decision, which found that the specific language of the plan governed. The Citigroup plan clearly specified that the restricted stock was not earned and would not fully vest until two years later, if plaintiff remained employed. The Court explained that per the terms of the agreement, plaintiff's restricted stock was not vested and not earned at the time of his termination, and all other earned wages were timely paid.

This decision is helpful in so far as it offers further clarification regarding employer's obligations to pay under the terms of such incentive compensation plans. However, it serves as a critical reminder that such agreements must be carefully drafted to clearly set forth all conditions precedent and vesting requirements to avoid any potential liability.

The California Supreme Court's decision in *Arias v. Superior Court*, S155965, made it easier for plaintiffs to proceed with representative actions, by alleging such claims under the PAGA.

In *Arias*, plaintiff brought claims against his employer on behalf of a putative group of other employees under California's unfair competition law ("UCL") (Business and Professions Code section 17200) and the PAGA (Labor Code Section 2698). The UCL permits a plaintiff to assert claims on behalf of a representative group of people, but requires the same certification requirements to assert a class action lawsuit (e.g. numerosity, commonality, typicality, etc.).

The California Supreme Court found that such representative claims can also be alleged under the PAGA, without meeting the class action requirements. Rather the Court explained PAGA claims are intended to permit recovery of penalties by aggrieved employees who can act as private attorney generals for purpose of enforcing labor code regulations.

In *Hernandez v. Hillsides, Inc.*, S147552, the California Supreme Court offered guidance to employers seeking to monitor employees at work. The Court provided guidance to employers as they balance employee privacy rights and legitimate business needs for monitoring employees.

Hillsides learned that someone was accessing pornographic Web sites using plaintiffs' computers, after hours. In response Hillsides installed hidden surveillance cameras in plaintiff's office to monitor activity after hours. When plaintiffs discovered the cameras, they sued for invasion of privacy and intentional and negligent infliction of emotional distress.

The trial court granted summary judgment in favor of Hillsides and the court of appeal overturned, finding there was an invasion of privacy. The Supreme Court noted that "while privacy expectations may be significantly diminished in the workplace, they are not lacking altogether," and found that privacy rights can be greater in enclosed spaces, such as offices. The Court also noted Hillsides had failed to provide any notice to plaintiffs that such surveillance might take place as none were noted in its handbook. The Court found that because there was a greater expectation of privacy and the method of intrusion was invasive, Hillsides had intruded on a zone of privacy. Nonetheless, the Court held that the claim for invasion of privacy did not survive as the surveillance was limited to one computer and after hours.

Hillsides makes clear that employers must specifically outline possibility of surveillance or any other monitoring system in their policies to provide adequate notice to their employees. It also highlights the employer's obligation to support any such surveillance with legitimate business reasons and be limited in scope.

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