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EMPLOYMENT LAW UPDATE

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JUDICIAL

Federal

Epic Systems Offers Employers Epic Relief: U.S. Supreme Court Approves Class Action Waivers in Mandatory Arbitration Agreements

The United States Supreme Court held that class action waivers in mandatory employment arbitration agreements are valid and enforceable, rejecting arguments that such waivers violate the National Labor Relations Act ("NLRA"). The decision enveloped three cases: *Epic Systems Corporation v. Lewis*, *Ernst & Young LLP v. Morris*, and *National Labor Relations Board v. Murphy Oil USA, Inc*. In each of the three cases, employees signed arbitration agreements requiring them to arbitrate employment disputes individually, thus waiving their right to bring class and collective actions in court. However, the employees filed class and/or collective claims against their employers under the federal Fair Labor Standards Act and a number of state laws.

The employers moved to enforce the arbitration agreements, relying on the Federal Arbitration Act ("FAA") as authority. The employees countered that the FAA's savings clause renders an arbitration agreement unenforceable if the agreement violates some other law and, by requiring claims to be arbitrated individually, the agreements violated Section 7 of the NLRA, which protects the right of employees to engage in "concerted activities."

Various federal courts of appeal reached different conclusions as to whether the arbitration agreements should be enforced, creating a split of authority. In the decision, the Supreme Court resolved the circuit split by holding class and collective action waivers do not violate the NLRA and therefore are enforceable. Addressing the employees' arguments, the court held that the FAA's savings clause allows courts to refuse to enforce arbitration agreements based only on generally applicable contract defenses, such as fraud, duress, or unconscionability, and does not allow courts to deny enforcement based on judicial or state policies disfavoring enforcement. The court further held that while Section 7 of the NLRA guarantees the right of employees to engage in "concerted activity," that phrase is understood in the context of union organizing campaigns and collective bargaining. The Court found it unlikely that Congress had intended Section 7 to confer a right to participate in class or collective actions against employers, since class and collective actions were basically unknown when the NLRA was adopted.

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The decision is welcome news for employers, many of whom already require their employees to enter into arbitration agreements as a condition of employment. Employers should proceed with caution, however. Although arbitration agreements with class and collective action waivers are now generally enforceable, courts can still deny enforcement in cases of fraud, duress, or unconscionability.

Importantly, *Epic Systems* leaves in place California's prohibition against requiring employees to waive their right to bring representative actions under the California Labor Code Private Attorneys General Act ("PAGA"). PAGA allows an employee to bring a representative action on behalf of the employee and other "aggrieved employees" to recover civil penalties on behalf of the state for violations of the California Labor Code.

U.S. Supreme Court Overturns Ninth Circuit Ruling to Permit Overtime Exemption for Automobile Service Advisors

In *Encino Motorcars v. Navarro,* the U.S. Supreme Court held that an automobile service advisor could be classified as exempt under the Fair Labor Standards Act ("FLSA"). Hector Navarro ("Navarro") was employed as a "service advisor" by Encino Motorcars LLC ("Encino"), which sells and services high end vehicles in the Los Angeles. In his role, Navarro was responsible for greeting customers in the dealership's service area, evaluating and diagnosing customers' service needs, preparing estimates, and following up with customers throughout the service process. Notably, however, Navarro played no role in the actual servicing of customers' vehicles.

Navarro filed a lawsuit in federal court, claiming that Encino's policy of not providing service advisors with overtime compensation violated the FLSA. Encino filed a motion to dismiss, citing the FLSA's exemption of "any salesman, partsman, or mechanic primarily engaged in selling or servicing automobiles, trucks, or farm implements" from overtime requirements.

While the district court agreed with Encino's legal argument and dismissed Navarro's claim, the Ninth Circuit Court of Appeals ("Ninth Circuit") reversed. After reviewing the FLSA's legislative history, it held that the statute was ambiguous, particularly in light of a 2011 Department of Labor ("DOL") rule interpreting "salesman" to exclude "service advisors." Based on its interpretation, the Ninth Circuit overturned the district court's decision, and held that Navarro (and his fellow plaintiffs) could be entitled to overtime compensation. Encino appealed.

The U.S. Supreme Court examined the issue and ruled that, in fact, the overtime exemption claimed by Encino was appropriate. In its ruling, the Court indicated that the Ninth Circuit's decision was too narrow in its interpretation of the scope of the term "salesman." It held, instead, that a service advisor is necessarily a salesman, as a salesman is involved in the sale of goods or services, and a service advisor is directly involved in the sale of services. By noting the disjunctive nature of the overtime exemption, the Supreme Court allowed for a far broader approach than that which was applied by the Ninth Circuit. The Court also noted that the Ninth Circuit applied too narrow a scope to the concept of "servicing": while

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service advisors do not service vehicles themselves, they are still directly involved in the service process. The Supreme Court therefore held that the overtime exemption applied by Encino was appropriate and legally justifiable.

While narrow in its scope, the holding in *Encino* demonstrates a willingness of the U.S. Supreme Court to prevent lower courts from unnecessarily restricting the applicability of overtime exemptions. Despite this encouraging decision, however, California employers must remain wary of exemption rules and ensure that employees are properly classified, lest they risk involvement in unwanted (and costly) litigation associated with alleged misclassification.

Ninth Circuit Rules that Employers Cannot Consider Prior Salary History to Justify Gender Wage Gap

Previously in *Rizo v. Yovino*, a three-judge panel of the Ninth Circuit Court of Appeals ("Ninth Circuit") concluded that *Kouba v. Allstate Insurance Co.*—another Ninth Circuit case—was controlling, and permitted prior salary alone to constitute a "factor other than sex" under the federal Equal Pay Act. The Ninth Circuit subsequently granted the employee-appellant's petition for rehearing *en banc* (a session in which a case is heard before all justices of the Ninth Circuit) in order to clarify the law, including the vitality and effect of *Kouba*.

In its *en banc* ruling, the Ninth Circuit overruled *Kouba* and held that employers cannot consider an employee's prior salary either alone or in combination with other factors to justify salary differentials between genders for the purposes of the Equal Pay Act.

Aileen Rizo ("Rizo") was hired by the Fresno County Superintendent of Schools (the "County") as a math consultant. The County utilizes a salary schedule to set compensation for new hires. The schedule consists of twelve "levels," each of which has progressive "steps" within it. New math consultants are paid starting salaries within Level 1, which consists of 10 different steps. To determine which step within Level 1 on which a new employee will begin, the County considers the employee's most recent prior salary and places the employee on the step that corresponds to his or her prior salary history, increased by 5%. Rizo later discovered that her male colleagues started on higher steps within Level 1, and consequently received higher salaries. Rizo thereafter initiated this lawsuit in federal court.

Federal law generally prohibits employers from paying employees of one sex more than employees of the other sex for performing the same work. However, a pay differential is permissible where it is based on: (1) a seniority system; (2) a merit system; (3) a system that measures earnings by quantity or quality of production; or (4) "any factor other than sex." The County argued that its pay schedule was determined solely by an applicant's prior pay, not gender. Within the meaning of the federal Equal Pay Act, prior pay was a "factor other than sex."

The Ninth Circuit, sitting *en banc*, disagreed. The Court concluded that "any other factor other than sex" is limited to legitimate, job-related factors such as a prospective employee's experience, educational background, ability, or prior job performance. Simply stated, prior salary cannot be used either on its own or in

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conjunction with other factors to justify differential pay between men and women. The Ninth Circuit reasoned that holding to the contrary would allow employers to benefit from the ongoing wage gap, enabling that gap to perpetuate indefinitely.

This decision reinforces current California law, which already prohibits employers from considering a new hire's prior salary when making compensation decisions. To that end, California employers should remove questions about salary history from employment application forms, and should refrain from asking such questions during job interviews. Additionally, employers must be able to demonstrate that any pay differential is justified by legitimate, job-related factors. Employers are advised to consult with legal counsel to ensure that their current pay policies are compliant with California and federal law.

California

California Supreme Court Narrows Test to Determine Whether Workers are Independent Contractors

The California Supreme Court issued a ruling in *Dynamex Operations, Inc. v. Superior Court* that narrows the ability of California businesses to lawfully use independent contractors in their core business operations. Dynamex is a nationwide package and documents delivery service. Dynamex classified its drivers and delivery personnel as independent contractors. The California Supreme Court held these contractors were improperly classified and must be treated as employees.

Under prior law, the test for determining contractor status relied upon a number of factors. Now to establish an exemption, the employer must prove that all factors point to independent contractor status under a new test.

First, the courts will presume that anyone whom the employer "suffers or permits" to work is presumed to be an employee. This definition presumes that "all workers who would ordinarily be viewed as working in the hiring business" are employees. The only examples of exclusions given by the Court would be workers – like plumbers or electricians – who the Court called "genuine independent contractors" – who do not perform services that are part of the employer's scope of operations or line of business.

Second, the Court adopted the ABC test. Under this test, a worker is properly considered an independent contractor only if the employer establishes all of the following:

A. The worker is free from control and direction of the hirer in connection with the performance of the work, both under the contract and in fact; and

B. The worker performs tasks that are outside the usual course of the hiring party's business; and

C. The worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed for the hiring business. This normally means the worker will have established and

promoted his or her own business; is licensed; does advertising; has other clients or potential customers; etc. Although this test is new, the Court ruled that its decision was merely explaining existing law, which means it will likely be applied retroactively. As such, California employers should conduct a prompt audit of their use of independent contractors.

Court of Appeal Reminds Potential Litigants That Nothing Is Free in a Wage and Hour Class Action

In a victory for employers and staffing companies, a California Court of Appeal ruled in *Castillo v. Glenair, Inc.* that a class of workers could not settle a lawsuit against a staffing company and then bring identical claims against the company where those workers had been placed to work.

The facts in *Castillo* will be familiar to any employer who has worked with a staffing company. The named plaintiffs were employed by a temporary staffing company ("GCA") to perform work onsite at Glenair. Although the plaintiffs performed work for Glenair under Glenair's general oversight and direction, GCA hired, fired, and paid the *Castillo* plaintiffs. GCA made payments to the plaintiffs based on time records provided by Glenair. Glenair collected and reviewed for accuracy the plaintiffs' time records. When Glenair no longer needed the plaintiffs' services, Glenair so advised GCA and the plaintiffs stopped performing work for Glenair. The plaintiffs subsequently filed a putative class action against Glenair, alleging wage and hour causes of action.

While the *Castillo* case was pending, two separate named plaintiffs filed a putative wage and hour class action against GCA and its related entities (the "*Gomez*" case). Glenair was not a named defendant in *Gomez*. *Gomez* settled before *Castillo*, and the settlement agreement contained a broad release barring settlement class members from asserting wage and hour claims against GCA and its "agents." The *Castillo* plaintiffs were members of the *Gomez* settlement class and did not opt out of that settlement.

After the *Gomez* settlement had been finalized, the *Castillo* trial court granted Glenair's motion for summary judgment on the grounds that the *Gomez* settlement barred the *Castillo* case. On appeal, the *Castillo* court upheld the trial court's ruling, holding that Glenair was in privity with GCA such that it could benefit from the *Gomez* settlement. The *Castillo* court noted that Glenair and GCA shared the same relationship to the *Castillo* plaintiffs: they were involved in and responsible for payment of the plaintiffs' wages; GCA had authorized Glenair to record, review, and transmit the plaintiffs' time records to GCA; GCA paid the plaintiffs based on Glenair's time records; and by virtue of the settlement in *Gomez*, the *Castillo* plaintiffs had been compensated for any errors in their wages.

The *Castillo* court also ruled that Glenair was an agent of GCA for the purpose of collecting, reviewing, and providing GCA's employee time records for review and processing. Thus, Glenair could benefit from the *Gomez* settlement agreement because it was acting as an agent for GCA in GCA's dealings with the employees it had placed at Glenair.

Although the court's ruling is beneficial to employers that utilize staffing agencies, it also highlights an unfortunate problem for such businesses, which in many cases may be considered "joint employers" with, and/or "agents" of, their staffing agencies. Both staffing agencies and their clients should carefully review and consider the impact of any indemnification provisions in their contracts with each other. They should also consider requiring workers to sign arbitration agreements containing class action waivers.

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