



NOT SO FAST! THERE MIGHT BE INSURANCE COVERAGE FOR WAGE AND HOUR CLAIMS

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Employment Practices Liability ("EPL") insurers regularly deny coverage for "wage and hour" actions filed in California and elsewhere. Therefore, insured employers typically conclude such actions are not afforded coverage. However, depending on the particular statutory violations alleged, such actions may fall within the scope of EPL coverage. Depending on the policy language, an EPL insurer may have a duty to both defend and indemnify an insured against a "wage and hour" action.

The case of California Dairies, Inc. ("CDI") vs. RSUI Indemnity Company ("RSUI"), concerns interpretation of a directors and officers liability insurance policy ("the Policy") issued to CDI by RSUI. RSUI denied coverage for wage and hour claims asserted against CDI in a class action filed in state court ("Gonzalez"). The underlying lawsuit, for which the insured CDI claimed coverage, was a class action concerning employment-related issues, including failure to pay minimum wage, failure to pay regular and overtime wages, failure to provide mandated meal periods and mandated rest periods, and failure to reimburse employees for costs incurred to acquire company uniforms. No violation of the federal Fair Labor Standards Act ("FLSA") was alleged.

RSUI final denial of coverage was based on an exclusion for "violation of any of the responsibilities, obligations or duties imposed by ... the Fair Labor Standards Act ... or any similar provision of federal, state or local statutory law or common law....", otherwise known as the FLSA or wage and hour exclusion.

In a California wage and hour class action, many of the statutes

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typically invoked are not at all “similar” to the FLSA. By way of example only, such lawsuits frequently allege the employer:

- failed to reimburse its employees for uniforms or other required business expenses (California Labor Code Section 2802);
- failed to provide accurate wage statements (Section 226(a));
- failed to pay employees all wages due immediately upon the employee’s discharge or within 72 hours of the employee’s voluntary resignation (Sections 201 and 202);
- failed to pay a split-shift premium wage (IWC Wage Orders).

None of these statutory provisions have any FLSA counterpart. No California court has *ever* held that *any* California Labor Code provision is “similar” to the FLSA.

Even if an insured can prevail on the battle that the EPL carrier has a *duty to defend* the action, there is a separate and distinct duty to indemnify, and an insurer will more likely than not deny an obligation to fund a settlement based on the notion the claim does not seek recovery of an “insurable loss.” In general, the only remedies for alleged statutory violations (such as those referenced above) are restitutionary payments (uninsurable as a matter of law) and/or penalties (usually excluded from coverage under the policy).

First, several of the statutes alleged to have been violated in most wage and hour class actions entitle the plaintiffs to *damages*. Typical EPL policy definition of covered “Loss” is not strictly limited to “damages,” and is often includes “other amounts...that the Insured becomes obligated to pay.” Second, these “Loss” definitions are often broad enough to encompass claims for statutory attorneys’ fees, which tend to make up a large portion of settlement demands in class actions.

Applying this analysis to the claims plead in the Gonzalez lawsuit, the Court held that many of the claims under California law closely tracked federal law, and thus fell within the scope of the exclusion from coverage. But the Court found that federal law contained no analog to the other claims, some of which are identified above. The carrier was therefore required to cover defense and indemnity costs for these claims. The analysis and holding in *CDI v RSUI* should remind an insured employer to double check the fine print.

The insured employer, or its legal counsel, should closely examine the applicable EPL policy language and the specific allegations of the underlying complaint to determine whether the potential for coverage exists. You may not necessarily get what you are entitled to under your policy, if you don’t ask.

PRACTICE TIPS: Employers should immediately notify insurance carriers of any legal claims, even those including wage and hour. Transmit a copy of the legal claim to your insurance carriers and ask for a formal coverage opinion, regardless of the types of claims alleged.



PENALTIES FOR WAGE AND HOUR VIOLATIONS ADD UP FAST



It is surprisingly easy to run afoul of California's many tricky wage and hour law requirements. Even a minor infraction can result in a major fine.

Consider the following example:

Assumptions:

- 50 employees
- 24 pay periods

An employer is required by Labor Code § 226 to furnish each employee with an itemized wage statement, that contains specified information as set forth in that statute. One of the required disclosures is *all* applicable hourly rates in effect during the pay period and the corresponding number of hours worked at each hourly rate by the employee.

An employer's payroll department has a practice of issuing paystubs to employees that fail to include the different hourly rate charged for travel time and the amount of travel time hours engaged in by the employees each week, but rather states the *total amount* paid to the employees for the travel time as a lump sum.

If the foregoing error happened for a period of only one year, an employer could be liable to an employee for the greater of actual damages *or* a statutory penalty of \$50 to each employee the initial pay period in which the violation occurs and \$100 to each employee in each subsequent pay period, up to a maximum of \$4000:

- 50 employees x \$50 for first violation in initial pay period = \$ 2500
- 50 employees x \$100 for subsequent violations in remaining 23 pay periods = \$ 115,000

Total statutory penalty to employees = 117,500

And this is just for one year. If the foregoing practice had been on-going for more than one year, the employer would be exposed to liability for the maximum penalty available to the employees, or \$200,000.

Additionally, Labor Code § 226.3 permits a civil penalty to also be assessed in the amount of \$250 per employee for each violation upon receipt of an initial citation by the DLSE and the civil penalty increases to \$1000 per employee for each violation, upon receipt of a subsequent citation. This civil penalty can be imposed *in addition to any amount awarded to the employee*. Be reminded, under the Private Attorney Generals Act, employees have been incentivized to include PAGA claims in what may appear as a nominal wage and hour action since the employee is entitled to recover 25% of this civil penalty his or herself, with the remainder to the DLSE, while acting on behalf of the DLSE to recover them for such violations.

SELF AUDITS— THE GOOD, THE BAD AND THE UGLY TRUTH

Because employment practices and policies create potential liabilities for employers if they run afoul of either state or federal labor laws, many more businesses are recognizing the need to conduct “self audits” of their own practices before employees threaten or file litigation. For example, an organization may want to examine its exempt/nonexempt classifications, or scrutinize time records for meal periods or overtime. As illustrated by the article on page 3, even one incorrect practice could expose the employer to major financial liability, depending on the nature of the violation and the number of employees affected, and result in expensive and lengthy litigation.

Although regular audits of HR practices are critical to ensure compliance and to minimize exposure to lawsuits, there are risks associated with an audit.

Create Safeguards

Before embarking down the path on an audit, however, an employer should carefully explore issues regarding the discoverability and the attorney-client and attorney work product privileges that may envelop the results of an audit. The most important safeguard in doing an audit is to work closely and directly with an attorney. The attorney-client privilege protects communications made (and kept) in confidence to an attorney by a client for the purpose of seeking or obtaining legal advice. Its purpose is to promote openness, and to encourage clients to be completely truthful so that the attorney can provide competent legal advice.

Counsel should be involved intimately, not just as a reviewer of the audit. Why you might ask? The attorney-client privilege does not automatically attach simply because an attorney is involved in an audit. For example, merely providing the attorney with copies of documents generated by the company, or having an attorney review an audit report, will not invoke the privilege. If questionnaires are used to gather information from employees, it is critical that an employer clarify to the employees completing the questionnaire that the document is confidential and the information is needed to obtain legal advice. Otherwise, such questionnaires will not be afforded protection and the very evidence that was created by the company could serve as a road map for an employee and/or his or her counsel in future adverse litigation.

It is important to recognize, an employer as the client could waive the attorney-client privilege if it conveys privileged communications to third parties (other than those to whom disclosure would be needed in furtherance of the rendition of legal services or those reasonably necessary for transmission of the communication). A employer-client, as the holder of the privilege, may also waive the privilege if it discloses or produces a substantial portion of the privileged document or information to a third party. So caution must be exercised in the handling of any audit information in order to maintain any privilege that may be created. The company should treat the audit trail documents as confidential and lock up the documents or mark the documents confidential or privileged, and ensure those documents are not commingled with other personnel documents.

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Active participation or directing by counsel will provide, to some extent, legal privileges that could protect against disclosure of the audit results, especially during the discovery phase of any potential future litigation. Notably, the underlying material—that is, data, facts, objective information—is not protected. The attorney work-product doctrine is separate and distinct from the attorney-client privilege. This doctrine protects from discovery the documents, reports, communications, memoranda, mental impressions, opinions, or legal conclusions counsel prepares in anticipation of litigation or for trial. The privilege accorded to "work product" is to some extent broader than the absolute attorney-client privilege. The primary hurdle in protecting information and documents as attorney work product is the "in anticipation of litigation" requirement. To meet this requirement, the threat of litigation must be real and imminent.

Courts have been split on finding protections due to this requirement. The courts analyze whether the legal memorandums were created "because" of the prospect of litigation or whether there was another "driving force" behind the preparation of the requested documents. Employers must take extra care to establish that they are engaging outside counsel to *provide them with legal advice*, and to conduct an investigation that is tied to a genuine prospect of litigation or to pending claims. To invoke the attorney work product privilege, counsel should conduct employee interviews, prepare the witness questionnaires or interview outlines. Finally, all documents generated in connection with the audit should be labeled as: "Privileged and Confidential—Attorney Work Product," and disclosure limited.

Additionally, the appropriate focus and scope of the audit must be determined. Finally, once an employer decides to undertake an audit, it must take corrective action to remedy any violations of the law uncovered during the audit.

PRACTICE TIPS:

- Use outside counsel, if at all possible, to direct and control the auditing process. Discuss with them how to work to maintain the privileges.
- Mark all documents confidential and privileged and treat them as such consistently.
- Instruct all involved employees that the audit or questionnaire and associated materials are strictly confidential.
- Restrict access to documents. (If control is not maintained and the documents are distributed to third parties without restriction, the privilege will likely be lost.)
- Make sure management is committed to fixing any problems discovered, and thoroughly document all corrective action. (If management is not going to correct violations that are disclosed, perhaps the audit should not be conducted. An employer would not want to be in the position of being "on notice" of violations and a record of having taken no action.)



FUTURE SEMINARS

Disability Law Awareness: During Recruiting and Retention

Date: October 21, 2010 **Time:** 11:30am-1:00pm
Location: The Brigantine Restaurant, La Mesa
Sponsor: East County Personnel Association
Cost: Members \$30, Non-members \$35

Unemployment Insurance 101: Assessing and Responding to Claims for U.I Benefits

Date: January 12, 2011 **Time:** 8:30am-4:30pm
Location: TBD
Sponsor: Lorman Education Services
Cost:
Continuing education credits available, AIPB, HRCI, HRPD, CPE

Time Off: State and Federal Laws on Employee Leaves

Date: March 23, 2011 **Time:** 8:30am-4:30pm
Location: TBD
Sponsor: Lorman Education Services
Cost:
Continuing education credits available, AIPB, HRCI, HRPD, CPE

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