HIRING AND ONBOARDING EMPLOYMENT LAW ISSUES FACING CALIFORNIA STARTUPS AND GROWING BUSINESSES: PART I

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PART I

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I. INTRODUCTION

Upon inception of a new company or startup, growing businesses generally focus their time and energy on developing business plans and strategies for accomplishing the company's core business goals. Issues concerning human resources and compliance with employment laws seem to be an afterthought, if a thought at all. There are, however, substantial financial and operational risks associated with employment-related litigation and there are many federal, state and local employment-related laws with which employers must comply. A company's employment and human resources-related issues should always be a primary concern. Significant thought and planning should go into determining how these issues will be resolved and who will manage and resolve them. Failure to comply with and address employment-related issues could result in high litigation costs, liability for large jury awards (especially in class actions), negative publicity, and overall business disruption which could stifle the company's growth trajectory or, in a worst-case scenario, cause the company to fail.

This whitepaper provides an overview of some specific California employment laws and best practices with respect to hiring and onboarding for startups and growing businesses. This part of the paper addresses areas of consideration in the hiring process, including employment applications, interviews, background checks, and employment agreements or offer letters. Part II of this paper will discuss considerations for new hire onboarding.

Although this paper focuses on general areas of concern under California law, it is not intended to cover all areas of employment law. State and local employment laws change frequently. We recommend you consult an attorney with any specific questions or concerns.

II. AREAS OF CONSIDERATION IN THE HIRING PROCESS

Employees are an important part of any company and the hiring process may be fraught with potential risks for a newly-formed company. There are several different phases of the application and hiring process where an employment-related claim could arise, including job applications, interviews, background checks, and offers of employment.

A. Considerations For Employment Applications And Interviews

There is no specific language or terms that California employers must include in their employment applications, however, employers should consider the following:

1. An authorization to check all references listed by the applicant.
2. An acknowledgment that any future employment is on an at-will basis.

3. A question that asks the applicant whether he or she is authorized to work lawfully in the United States.

Employers can also ask about an applicant's place of residence, whether the applicant has the ability to perform essential job functions with or without a reasonable accommodation for a disability, languages applicant can read, write and speak (if relevant), statement of hours or shifts to be worked, the name and address of a parent or guardian (if applicant is a minor), a list of professional references, and relevant skills applicant acquired during military service.

On the other hand, California employers cannot ask applicants to:

1. Disclose any information about applicants' criminal history, including (a) criminal conviction history; (b) arrests or detentions that did not result in conviction, (c) convictions for which the record has been sealed, expunged, or statutorily eradicated, (d) misdemeanor convictions for which probation has been successfully completed and the case has been judicially dismissed; (e) juvenile records relating to arrest, detention, processing, or adjudication while the applicant was subject to the juvenile court system; (f) referrals to or participation in any pre-trial or post-trial diversion program; or (g) information about marijuana-related convictions two or more years old.[1]
2. Provide a photograph of themselves.[2]
3. Disclose their username or password for their personal social media accounts or otherwise provide access to their personal social medical accounts.
4. Respond to questions about their immigration or citizenship status.
5. Disclose salary history information.[3]
6. Disclose whether the applicant takes medication and/or has any physical or mental conditions or disabilities.

California employers may only require medical or psychological examinations ***after*** an offer of employment has been made if the employer can show the exam is job-related and consistent with business necessity. The exam must be the same exam given to all entering employees in the same job category. Additionally, California employers may not ask about an applicant's criminal history until ***after*** a conditional offer of employment has been made. Employers should also know that Proposition 64, which was passed on November 8, 2016, and

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[1] Cal. Gov't Code § 12952; Cal. Lab. Code §§ 432.7(a), 432.8; CA Code Regs. 2 §7287.4(d)(1)). Employers may inquire into applicants' criminal history, barring certain exceptions, after a conditional offer of employment has been made.

[2] Cal. Code Regs. tit. 2, § 11016. It is worth noting that an employer can require a post-employment photograph.

[3] Cal. Lab. Code § 432.3.

legalized the recreational use of marijuana in California, expressly states that it does not affect the rights of a private employer to maintain a drug and alcohol-free workplace. Accordingly, employers should ensure that they have a well-drafted workplace drug and alcohol policy in place and be prepared to address inquiries from applicants regarding marijuana use in light of Proposition 64.

While California employers are prohibited from asking about an applicant's salary history, employers *may* inquire about an applicant's salary expectations. Notwithstanding salary expectations, California employers may not rely on the salary history information of an applicant as a factor in determining whether to offer employment to an applicant or what salary to off an applicant. Upon reasonable request from an applicant, California employers must provide the applicant with the pay scale for the position to which the applicant is applying.

B. Discrimination And Retaliation Claims Based On Applicant's Membership In Protected Class

California startups and growing businesses should be aware of the potential risks of discrimination and/or retaliation claims asserted by applicants. California's anti-discrimination laws apply to employers with five or more employees, and for harassment purposes, the law applies to employers in California with one or more employees.[4] Under California's Fair Employment and Housing Act ("FEHA"), an employer may not fail or refuse to hire or otherwise discriminate against any individual concerning compensation, terms, condition, or privileges of employment, based on that individual's membership in a protected class. Protected class categories include an applicant's:

- Race;
- Color;
- Age (40 years or older);
- Ancestry;
- Marital status;
- Military and veteran status;
- Medical condition;
- Mental disability;
- Physical disability;
- Religious creed, belief, observance, and practice, including religious dress and grooming practices;

- National origin, including language use restrictions, and an applicant's possession of a driver's license issued under California Vehicle Code section 12801.9, which authorizes licenses to individuals who cannot provide satisfactory proof of their presence in the US under federal law;

- Sex, including gender; gender expression, meaning a person's gender-related appearance or behavior, whether or not stereotypically associated with the person's sex at birth; gender identity, meaning a person's identification as male, female, a gender different from the person's sex at birth, or transgender; and pregnancy, childbirth, breastfeeding or medical conditions related to pregnancy, childbirth, or breastfeeding;

[4] Cal. Gov't Code §§ 12926(d), 12940(j)(4).

- Sexual orientation, heterosexuality, homosexuality, and bisexuality;

- Genetic information, including the applicant's genetic tests, the applicant's family members' genetic tests, diseases or disorders; the applicant's or family member's receipt of or requests for genetic services, and participation in clinical research that includes genetic services.

California law also forbids harassment based on a perceived characteristic listed above, or association with someone with an actual or perceived protected characteristic.[5] Local ordinances may also create additional protected categories. For example, a San Francisco ordinance expressly prohibits discrimination or harassment on basis of an individual's height and weight or AIDS / HIV status.

In light of the above-mentioned issues, California startups and growing businesses should ensure that their job applications and interview questions are in compliance with California's anti-discrimination laws. Employers can consider having interviewers use a checklist to ensure that applicants are treated uniformly.

C. Background Checks

Employers may want to use background checks to gain access to information about applicants, however, California startups and growing businesses should know that California's background check laws have more stringent disclosure, consent and use requirements than the federal Fair Credit Reporting Act.[6] Under the Consumer Credit Reporting Agencies Act ("CCRAA"), California employers cannot use an applicant's credit report in making hiring decisions, except for certain positions, including (but not limited to) positions in law enforcement, positions involving regular access to private and confidential information like bank or credit card information, social security numbers and dates of birth and positions involving access to confidential and proprietary information, such as trade secrets.[7] If the position falls within an exception, the employer must provide advance written notice to the applicant that the consumer credit report will be used pursuant to the specific exception under CCRAA Section 1024.5(a), the source of the report, and the option to request a free copy of the report.[8]

In addition to an applicant's credit information, California law prohibits employers from using an applicant's criminal history in employment decisions if doing so would have an adverse

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[5] Cal. Gov't Code § 12926(o) and 12940(a).

[6] The Fair Credit Reporting Act, 15 U.S.C. §§ 1681-1681x ("FCRA"), applies to employers' use of third-party service providers (consumer reporting agencies) to obtain background information on applicants and existing employees. Under the FCRA, employers must provide written notice, disclosure, and consent requirements in conjunction with obtaining reports and taking adverse employment actions because of information in reports. Obligations under the FCRA apply to any report obtained for employment purpose related to the employment, promotion, reassignment or retention of employees.

[7] Cal. Lab. Code § 1024.5(a).

[8] Cal. Civ. Code § 1785.20.5(a).

impact on protected classes of individuals unless the employer can prove that the policy of using such criminal history is justifiable because it is job-related and consistent with business necessity, taking into consideration the nature and gravity of the offense, the time that has passed since the offense and/or completion of the sentence, and the nature of the job held or sought. Further, the employer is required to either:

(1) demonstrate that the "bright line" conviction disqualification policy properly distinguishes between applicants/employees that do and do not pose an unacceptable risk, and that the convictions directly bear on the person's ability to perform job duties; or

(2) conduct individualized assessments of the circumstances and qualifications of the applicant/employee excluded by the conviction screen. The assessment must include (a) notice to individual impacted (pre-adverse action notice); (b) a reasonable opportunity for the individual to explain or dispute the accuracy of the information contained in the background report (at least five business days); and (c) consideration by the employer as to whether an exception to the policy should be made consistent with job-relatedness and business necessity. After the individualized assessment, if an employer decides not to hire a candidate based on information contained in the background check, the employer must inform the individual in writing (adverse action notice), including a notice of the individual's right to file a complaint with the Department of Fair Employment and Housing ("DFEH").

As also noted above, California employers also cannot request or consider information about an applicant's marijuana-related convictions that are more than two years old. In reviewing an applicant's criminal background check, a criminal conviction should only disqualify an applicant from a job if it is either job-related[9] or required by statute.[10] The employer may consider an arrest for which an applicant is released on bail or on his or her own recognizance pending trial.

As outlined above in Section II(B), employers may not ask about an applicant's criminal history until after a conditional offer of employment has been made. Additionally, there are some cities and municipalities in California that have passed "ban the box" legislation that restricts when an employer can ask an applicant about his or her criminal background in the hiring process. These local ordinances may also limit when an employer can request a criminal background check report and under what circumstances employment can be denied based on the results of the report. Employers should check local ordinances where their employees work as these ordinances may have broader requirements than the more generally applicable California Labor Code.

Under applicable "ban the box" laws, local ordinances may also place additional burdens on employers regarding application and interview questions. For example, the San Francisco Fair Chance Ordinance requires that all job advertisements and solicitations for employers with 20 or more employees include a statement that the employer will consider qualified applicants with criminal histories in compliance with the Fair Chance Ordinance. Among other limitations, the San Francisco Fair Chance Ordinance also prohibits covered employers from asking applicants

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9 *Dep't of Fair Employment & Housing v. Housing Auths., FEHC*, 1980 WL 20893 (FEHC July 3, 1980).

10 2 Cal. Code Reg. § 11017(d); *Hetherington v. State Pers. Bd.*, 82 Cal. App. 3d 582 (Ct. App. 1978)

about any criminal conviction until after either (a) the employer has conducted an interview with the applicant, or (b) made a conditional offer of employment to the applicant. The Los Angeles Fair Chance Initiative for Hiring also places restrictions on employers in Los Angeles regarding job postings and asking applicants about criminal convictions.

D. Offer Letters

The first important decision for California startups and growing businesses to make is whether an employee will be employed on an at-will basis or whether the employee will be required to enter into an employment agreement. As an initial matter, California law presumes at-will employment status,[11] which means that either the employer or the employee can terminate the employment relationship at any time, with or without notice, for any reason (as long as it is not a discriminatory or retaliatory reason) or for no reason. Most California startups and growing businesses will likely prefer an at-will employment relationship with their employees rather than a for-cause employment relationship where the employee can only be terminated for a reason specified in an employment contract. Employment agreements/contracts are generally reserved for more senior executives and management.

As a result, California startups and growing businesses should ensure that all employment-related documents, including offer letters, employee handbooks, and workplace policies, do not contain any provisions that would create an express or implied contract with the employee that would undermine his or her at-will employment status. Even better, employers should consider inserting an express at-will provision in their employment handbook or a policy that their employees sign upon hire. This will help avoid the situation in which an employee claims that there was an implied-in-fact agreement that he or she could only be terminated for cause because the employee signed a document containing the express at-will provision.[12] Employers can also strengthen the at-will status of employees by including a disclaimer in workplace policies and employment handbooks stating that (1) disciplinary procedures and policies do not modify at-will employment and do not create a contract of employment, and (2) the employer maintains the right to skip, repeat, or modify disciplinary procedures at its discretion.

Even though most of the employees hired by California startups and growing businesses may be in an at-will employment relationship, the employment relationship should still be memorialized with an offer letter to be signed by the employee to avoid misunderstandings about the terms and conditions of employment. California law requires employers to notify their *non-exempt* employees at the time of hiring of their rate of pay, regular pay day, and other wage information, and although not required to be in an offer letter, it is good practice for this information to be included. Additionally, employers should consider including the following information in their offer letters:

- Title or position;
- Reporting relationship (who is the employee's direct supervisor);

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[11] Cal. Lab. Code § 2922.

[12] *Guz v. Bechtel Nat. Inc.*, 24 Cal.4th 317 (2000).

- Start date;
- Term of employment, if any;
- Rate and frequency of pay;
- Manner of pay (i.e. hourly, salary, commission);
- Exempt status for minimum wage and overtime purposes;
- Hours of work, including whether full-time or part-time;
- Eligibility for benefits;
- Confidentiality provision; and
- At-will acknowledgment.

California startups and growing businesses should be aware that California law generally prohibits non-compete and non-solicitation agreements. Generally, post-employment non-compete agreements are unlawful in California, unless the agreement falls within the narrow statutory exceptions, and even the less restrictive non-solicitation provisions are closely scrutinized and may be unenforceable, unless they are protecting trade secrets or confidential information.[13] Employers should also know that recently enacted California Labor Code section 925 prohibits the use of contract provisions that apply another state's law ("choice of law") or require adjudication of disputes in another state ("choice of venue") as a condition of employment for a California employee.

E. Commissioned Employee Compensation Agreements

California Labor Code section 2751 requires that all employers (regardless of size) must have written commission agreements for employees who are compensated on a commission basis, regardless of whether it represents all or just a portion of the employee's compensation. The written commission agreement must specify how the commission payments will be calculated and paid. Short-term productivity bonuses, like those paid to retail clerks, and short-term incentives, such as a bonus to a car salesman who sells a particular car on a particular day ("$1,000 to whoever sells the most red cars on the Fourth of July"), are specifically exempted and do not require a written commission agreement.

F. Mandatory Arbitration Agreements

To minimize the risks associated with employment-related litigation, some California employers require mandatory arbitration agreements with their employees as a condition of employment. Mandatory arbitration agreements require an employee to resolve any employment-related disputes by binding arbitration rather than in court. The advantages of arbitration can include: the potential elimination of class actions for discrimination and certain wage and hour claims, less discovery and motion practice than in a court proceeding (which can result in faster resolution and reduced cost of litigation), more confidentiality and less publicity, and reduced risk of unpredictable jury verdict and punitive damage awards. The disadvantages of

[13] California courts will enforce agreements containing restrictions regarding non-solicitation of *customers or clients* only to the extent necessary to protect the employer's trade secrets. California courts may enforce agreements containing non-solicitation of *employees* only to the extent necessary to protect the employer's trade secrets and goodwill. If, however, the effect of any such provision prevents an employee from engaging in his or her profession, a California court is likely to find that such provision runs afoul of the state's prohibition on non-compete restrictions.

mandatory arbitration include significant arbitration fees usually paid by the employer, typically less of a chance that dispositive motion (i.e. motion to dismiss or summary judgment motion) will be granted, hearsay and other irrelevant hearsay may be admitted, and arbitration is binding and courts rarely disturb arbitration award even if clear error. Employers should be aware that courts are likely to strike down arbitration agreements as unconscionable if they impose unreasonable arbitration costs and fees on the employee.

California law regarding mandatory arbitration agreements in the employment context is in a state of flux, particularly with respect to agreements that purport to contain waivers of representative claims under the Labor Code Private Attorneys General Act of 2004 ("PAGA"). Under PAGA, aggrieved employees are authorized to file lawsuits to recover civil penalties on behalf of themselves, other aggrieved employees, and the State of California for certain Labor Code violations. Both the United States Supreme Court and California Supreme Court have ruled that class action claims may be waived by arbitration.[14] In *Iskanian v. CLS Transp. Los Angeles*, however, the California Supreme Court expressly held that the statutory right to bring representative claims under PAGA may not be waived by an arbitration agreement. Although some federal courts have recently upheld the arbitrability of PAGA claims, employers who have arbitration agreements with employees should recognize that the ability to compel PAGA claims to arbitration may be limited under California law.

Employers should also be wary of including arbitration provisions in job application forms, employment agreements, or employee handbooks given to an employee on a take it or leave it basis, as these agreements to arbitrate could be struck down as procedurally unconscionable. Employers should note, however, that even if deemed *procedurally* unconscionable, an agreement to arbitrate may still be enforceable so long as it is limited and the provision is not otherwise substantively unconscionable.

III. CONCLUSION

There are many risks involved in running a business and employing and managing employees. California laws related to employment are constantly changing and it is difficult for companies, big or small, to ensure they are complying with them all. If you are a California employer, particularly a startup or growing business looking to hire and onboard employees, you should consult with an employment attorney to ensure that your hiring and onboarding process is in compliance with California law.

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[14] *AT&T Mobility v. Concepcion*, 131 S.Ct. 1740 (2011); *Iskanian v. CLS Transp. Los Angeles, LLC*, 59 Cal. 4th 348 (2014), cert. denied, 2015 WL 231976, 83 USLW 3196 (Jan. 20, 2015). Additionally, the Ninth Circuit Court of Appeals has issued decisions holding PAGA claims may be forced into arbitration based on arbitration agreements for which the State of California is not a party. *Valdez v. Terminix International Co.*, No. 15-56236, 2017 WL 836085 (9th Cir. March 3, 2017); *Wulfe v. Valero Refining Co. Cal.*, 641 Fed. Appx. 758 (9th Cir. 2016).