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

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PART II

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I. INTRODUCTION

While many new businesses have fully developed business plans and strategies, human resource planning issues are often overlooked. This series of articles is designed to provide an overview of some specific California employment laws and best practices with respect to hiring and pre-employment onboarding concerns for startups and growing businesses. Part I of this two-part series focused on areas of exposure in the hiring process for new employees at startups and growing businesses in California such as employment agreements, pre-hiring inquiries, anti-discrimination laws, and background checks. Part II focuses on common considerations startups and growing business have when onboarding new hires. This includes topics such as setting wages, reimbursements, notices, employee classifications, leave policies, and payroll requirements. Although this paper focuses on specific areas of concern within California law that apply to startups and growing businesses, it is not intended to cover all areas of employment law. We recommend you consult an attorney with any questions or concerns.

II. NEW HIRE ONBOARDING CONSIDERATIONS

There are a number of considerations for California startups and growing businesses to consider when onboarding employees that may not be obvious or intuitive. These considerations include compliance with federal and state wage and hour laws, required disclosures, and leave policies.

A. Minimum Wage Compliance

There seems to be a common misconception among California startups and growing businesses that minimum wage and overtime compliance laws do not apply to them. The California Labor Code applies to small companies just as it does to Fortune 500 companies operating in California. This means that, unless an employer can demonstrate an employee falls into an exemption, an employer is required to pay the non-exempt employee the minimum wage and overtime. Additionally, the federal Fair Labor Standards Act (FLSA) applies to all private employers engaged in interstate commerce or the production of goods for commerce and any employees employed by enterprises engaged in commerce or the production of goods for commerce with gross annual sales of at least $500,000.[1]

[1] 29 U.S.C. §§ 203(r) & (s).

The California minimum wage laws apply to nearly all California employers.[2] The current minimum wage, as of August 2019, is $11.00 per hour for employers with less than 26 employees, and $12.00 per hour for employers with 26 or more employees. For employers with at least 26 employees, California's minimum wage will increase on the following schedule:

- January 1, 2019 through December 31, 2019: $12.00 per hour.
- January 1, 2020 through December 31, 2020: $13.00 per hour.
- January 1, 2021 through December 31, 2021: $14.00 per hour.
- Beginning January 1, 2022: $15.00 per hour.

Employers with fewer than 26 employees will follow a minimum wage schedule that lags behind the above schedule by one year. Accordingly, for these employers, the minimum wage will be:

- January 1, 2019 through December 31, 2019: $11.00 per hour.
- January 1, 2020 through December 31, 2020: $12.00 per hour.
- January 1, 2021 through December 31, 2021: $13.00 per hour.
- January 1, 2022 through December 31, 2022: $14.00 per hour.
- Beginning January 1, 2023: $15.00 per hour[3]

In addition to the state minimum wage, local ordinances can set higher minimum wages. For example, the local minimum wage in many cities is currently higher than the minimum wage set by California law, such as: Alameda, Berkeley, Cupertino, El Cerrito, Emeryville, Los Angeles (for employers with 26 or more employees), Mountain View, Oakland, Pasadena (for employers with 26 or more employees), San Diego, San Francisco, San Jose, Santa Monica (for employers with 26 or more employees), and Sunnyvale.

Both federal and California law require that non-exempt employees be paid for all compensable time. Employees must be compensated for the time an employee is subject to the control of the employer, including time the employee is permitted to work. This could include time spent checking and responding to emails or voicemails after work hours. Lectures, meetings, and trainings are compensable unless attendance is voluntary, attendance is outside of normal work hours, it is not directly related to the employee's job, and the employee does not perform productive work while attending.[4]

California employers are also required to provide non-exempt employees who work at least five hours in a day with at least a 30-minute meal period, which may be unpaid.[5] The meal period may be waived through mutual consent if the employee's total daily work does not exceed six

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[2] Outside salespersons and individuals who are the parent, spouse, or children of the employer are examples of employees exempt from the California Minimum Wage Order, MW-2014.

[3] Cal. Lab. Code § 1182.12; S.B. 3, 2015-2016 Leg., Reg. Sess. (Cal. 2016).

[4] DLSE Manual § 46.6.5; *see* 29 C.F.R. §§ 785.27 to 785.31.

[5] Cal. Lab. Code § 512.

hours. If an employee works more than 10 hours per day, an employer must provide a second meal period of at least 30 minutes.[6]

Employers must also provide non-exempt employees with a net 10-minute paid rest period for every four hours worked or major fraction thereof. Insofar as is practicable, the rest period should be in the middle of the work period. Accordingly, rest breaks should be provided to non-exempt employees pursuant to the following parameters:

- No rest break is required if an employee's daily work time is less than three and a half hours;
- One 10-minute rest break for work shifts from three and a half hours to six hours;
- Two 10-minute rest breaks for work shifts of more than six hours up to ten hours; and
- Three 10-minute rest breaks for work shifts of more than ten hours up to 14 hours.

Rest breaks must be paid and employers may require the employee to remain on the work premises during rest breaks.[7] The California Supreme Court held in *Augustus v. ABM Security Services, Inc.*,[8] that employees on a rest break must be relieved of all duties, even the duty to be on call.

California startups and growing businesses have a variety of options when determining the type of compensation schemes they will use to pay their employees. One common form of compensation for startups is equity stake in the company. Should a startup choose this option, it should keep in mind that the minimum wage and overtime provisions still apply for non-exempt employees.

B. Reimbursement of Business Expenses

California employers are required to reimburse their employees for any out-of-pocket expenses they may incur while traveling or performing regular job duties.[9] The duty to reimburse employees can extend to expenses such as required equipment, materials, training, business travel, and the business use of personal cell phones (even when the business use does not amount to any additional cost to the employee). An employer's reimbursement policy should: indemnify its employees for those expenses required by law; state whether the employer will require supporting documentations, such as receipts; and state whether certain expenses require supervisor pre-authorization and by whom. This policy should be applied consistently among all employees and any exceptions should be documented along with the rationale.

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6 *Id.*; IWC Wage Order No. 5; *Brinker Rest. Corp. v. Superior Court*, 273 P.3d 513 (Cal. 2012). The employer and employee can agree to waive the second meal period only if the first meal period is not waived and if the total hours worked is 12 hours or less.

7 IWC Wage Order No. 5; *Brinker*, 273 P.3d at 536-37.

8 *Augustus v. ABM Sec. Servs., Inc.*, 2 Cal. 5th 257, 385 P.3d 823 (2016), *as modified on denial of reh'g* (Mar. 15, 2017).

9 Cal. Lab. Code § 2802.

C. Calculating Overtime Pay

California overtime laws are more extensive than the FLSA requirements. In California, employers must not only compensate non-exempt employees at a premium rate of one and a half times the regular rate of pay for all hours worked over 40 hours in a workweek, but must compensate non-exempt employees at this premium rate for hours worked over eight hours in any workday, and for the first eight hours of work on the seventh consecutive workday in a workweek.[10] An employer must also compensate a non-exempt employee at double the employee's regular rate of pay for any hours worked over 12 in one workday, or more than eight hours on the seventh consecutive day of work in a workweek. If an employee accrues both daily and weekly overtime, the employee is not entitled to double overtime—the employee is owed the greater of the two calculations. If an employee earns overtime in a pay period in which the employee also earns a flat rate bonus, the employer must divide the total compensation earned in the pay period by the employee's non-overtime hours, rather than the total hours worked.[11]

D. California Wage Notice Requirements

California startups and growing businesses should be aware that certain information must be given to a non-exempt employee in writing regarding the employee's wages at time of hire.[12] Such information includes: the pay rate and basis (i.e. hourly, salary, commission) with overtime rates; allowances (such as meals or lodging) included into the employees minimum wage; the regular payday; the employer's name (including "doing business as" names); the employer's physical address or principal place of business and mailing address (if different); the employer's telephone number; the name, address and telephone number of the employer's workers' compensation insurance carrier; and any information deemed material and necessary by the Labor Commissioner.

E. Exempt vs. Non-Exempt Employees

Employee exemption classification is generally a difficult area of compliance for California startups and growing businesses. Certain employees that meet the particular requirements may be properly classified as exempt from federal and state minimum wage and overtime laws. If properly classified by the employer, startups and growing companies with exempt employees can avoid the accrual of massive overtime payments in a setting where employees are working long hours to get the business off the ground. Whether an employee meets a specific exemption, however, is sometimes very unclear and requires a highly fact-intensive inquiry into the employees' job duties. The risks of misclassification can be grave. California startups and growing businesses should keep in mind when classifying employees that, even if they outsource HR issues such as payroll to third parties, this does not insulate the company from liability for misclassification.

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[10] Cal. Lab. Code § 510.

[11] *Alvarado v. Dart Container*, 411 P.3d 528 (Cal. 2018).

[12] *See* Cal. Lab. Code § 2810.5.

Under California law, the primary exemptions that might apply for employees of startups and growing businesses are: administrative, executive, professional, outside salespersons, and computer software professionals. For these exemptions to apply, the employee must meet certain salary requirements (except for the outside salespersons exemption) and perform certain job duties. Currently, employees exempt under the administrative, executive, professional exemptions must earn a monthly salary equivalent to no less than twice California's minimum wage for full-time employment (or $45,760 annually under the current $11.00 per hour minimum wage for small employers under 26 employees). Exempt computer software professionals must be paid at least $45.41 per hour or an annual salary of at least $94,603.25 per year.[13]

In addition to salary requirements, exempt employees must also perform certain enumerated job duties. In determining whether an employee was properly classified as exempt, courts will evaluate the employee's actual job duties and responsibilities and not just his or her title or job description. As opposed to the FLSA's "primary duty" test, which analyzes the principal or most important duty that the employee performs, in California, exempt employees must spend more than one-half of their work time performing exempt duties.[14] As a result, California administrative exempt employees must spend more than 50 percent of their work time performing non-manual work directly related to the general business operations of the company or the company's clients in a capacity that regularly exercises discretion and independent judgment and for which the employee (a) regularly and directly assists a proprietary or employee employed in an executive or administrative capacity; (b) under only general supervision, performs work along specialize for technical lines requiring special training, experience or knowledge; or (c) executes, under only general supervision, special assignments and tasks. For the California executive exemption to apply, the employee must spend more than 50 percent of his or her work time performing duties that involve the management of the company in which he or she is employed or a customarily recognized department or subdivision thereof in a capacity that regularly exercises direction and independent judgment, and customarily and regularly directs the work of two or more other employees, and has the authority to hire or fire other employees (or whose recommendations as to the hiring or firing will be given particular weight).

Many tech startup employees may be classified as exempt under the computer software exemption. The exemption applies to employees primarily engaged in work that is intellectual or creative, requires the exercise of discretion and independent judgment, and duties that consist of: applying systems analysis techniques and procedures (including consulting with users, to determine hardware, software or system functional specifications); designing, developing, documenting, analyzing, creating, testing or modifying computer systems or programs (including prototypes, based on and related to user or system design specifications); or documenting, testing, creating or modifying computer programs related to the design of software or hardware for computer operating systems. To meet the exemption, these employees must be highly skilled and proficient in the theoretical and practical application of highly specialized information to computer systems analysis, programming and software engineering. There are also a number of express

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[13] *See* Department of Industrial Relations Memorandum (October 19, 2018), *available at:* https://www.dir.ca.gov/oprl/ComputerSoftware.pdf.

[14] Cal. Code Regs., tit. 8, § 11040, subd. 2(N).

exceptions to this exemption, including (but not limited to): employees in training or entry-level positions; employees who are engaged in the maintenance or repair of computer hardware; and engineers, drafters, or machinists whose work is highly dependent on or facilitated by computer software programs and who are skilled in computer-aided design software (including CAD/CAM).[15]

F. Internships and Unpaid Training Programs

California startups and growing businesses should be aware of the rules governing unpaid interns and unpaid training programs because the time spent participating in these activities may be considered time worked and the minimum wage requirements may apply. To determine whether a training program has created an employer-employee relationship and time spent participating in the program is compensable, courts examine the economic realities of the parties' relationship. The United States Supreme Court held that individuals performing work for another for the benefit of the individuals and without the expectation of compensation were not "employees" under the FLSA, and thus, need not be compensated at the minimum wage rate of pay.[16] Based on the factors considered by the United States Supreme Court, DOL has promulgated six criteria to determine whether a training program is non-compensable under the FLSA:

1. the training, even though it includes actual operation of the facilities of the employer, is similar to that which might be obtained through a vocational school;
2. the training is for the benefit of the trainees;
3. the trainees do not displace regular employees as part of the training, but train under their close observation;
4. the employer does not derive any immediate advantage from the activities of the trainees, and the employer's operations may actually be impeded;
5. the trainees are not necessarily entitled to a job at the completion of the training; and
6. both the trainees and the employer understand that no wages will be paid for the time spent in training.

The DLSE has followed the federal interpretation of the terms "employee," "employer," and "to engage, suffer, or permit to work" to determine whether training programs fall under the state minimum wage requirements. Additionally, the DLSE has used the DOL's six-factor test, with slight variation, in analyzing the compensability of unpaid internship programs.[17] The Ninth Circuit has followed the similar seven-factor primary beneficiary test established in *Glatt v. Fox Searchlight Pictures, Inc.*[18]

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15 *See* Cal. Lab. Code § 515.5; Cal. Code Regs., tit. 8 § 11090.

16 *Walling v. Portland Terminal Co.*, 330 U.S. 148 (1947).

17 *See* DLSE Opinion Letter (Apr. 7, 2010), *available at:* http://www.dir.ca.gov/dlse/opinions/2010-04-07.pdf.

18 791 F.3d 376 (2d Cir. 2015), *amended and superseded by* 811 F.3d 528 (2d Cir. 2016), and *Schumann v. Collier Anesthesia, P.A.*, 803 F.3d 1199 (11th Cir. 2015). *See Benjamin v. B & H Educ.*, Inc., 877 F.3d 1139, 1143 (9th Cir. 2017).

G. Employee vs. Independent Contractor Classifications

Another major area of employment classification is the difference between employees and independent contractors. Frequently, businesses try to avoid tax and other liability by classifying their workers as independent contractors. Small businesses frequently rely on independent contractors to aid with product design while in the early stages of business development. Employers should be aware that worker misclassification can result in significant liability in California. Various enforcement agencies interpret independent contractor status narrowly and penalties can include back payment of wages, unpaid overtime, benefits, taxes owed, and monetary penalties. Misclassification lawsuits for companies that depend on independent contractor labor can also lead to large, costly settlements, as evidenced by the current Uber misclassification lawsuit in which the judge rejected a $100 million settlement as not fair and reasonable given the potential monetary damages in the case could be upwards of $850 million.[19]

Adding to the difficulty, whether an individual is properly classified as an independent contractor is an extremely fact-intensive inquiry that requires the consideration of many different factors. The California Supreme Court has adopted the "ABC" test, for determining whether a worker is an employee or independent contractor: (a) the worker is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract to perform the work and in actual practice; (b) the worker performs work that is outside the usual course of the hiring entity's business; (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 entity.[20]

In analyzing these factors courts look at factors such as: whether the principal supplies the individual's tools, equipment, and the place for the individual to perform the work; the individual's own investment in the equipment or materials required by the work; whether the services rendered are highly skilled; whether the work is typically conducted with little supervision; the length of time the service is performed; the degree of permanence of the working relationship; whether payment is by time worked or by job; and whether the parties believe they have entered an employer-employee relationship.[21]

California startups should be aware that an individual working on a "work-made-for-hire" basis, or under an agreement that engages a creative individual to create a work of authorship under contract that expressly provides that the work is made for hire, is expressly considered an "employee" under the Labor Code for certain purposes such as workers' compensation, unemployment insurance, and other reporting, posting, and notice requirements under the workers' compensation and unemployment statutory schemes.[22]

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19 *O'Connor v. Uber Technologies, Inc.*, No. C13-3826 EMC (N.D. Cal. 2016).

20 *See Dynamex Operations West, Inc. v. Super. Ct.*, 4 Cal. 5th 903, 916-17 (2018)

21 *See S.G. Borello & Sons, Inc. v. Dep't of Indus. Relations*, 48 Cal. 3d 341, 350 (Cal. 1989).

22 Cal. Lab. Code § 3351.5(c); and Cal. Unemployment Insurance Code § 686.

H. Leave

Both federal and state laws require employers to provide their employees with certain types of leave, which may be paid or unpaid depending on the applicable law. The federal Family Medical Leave Act (FMLA), which applies to companies with 50 or more employees within a 75-mile radius of the worksite, provides employees who have worked for the employer for at least 12 months and worked at least 1,250 hours during the 12 months prior to the start of leave, with up to 12 weeks of unpaid leave per year. The FMLA requires that the employee's job be protected and group health benefits be maintained for the duration of the leave. The leave may be used for the birth and care of a newborn child of an employee, the placement with the employee of a child for adoption or foster care, the care for an immediate family member of the employee with a serious health condition, or the employee's inability to work because of his or her own serious health condition. California also has the California Family Rights Act (CFRA), which applies to employers with 50 or more employees and provides similar protections. Even though the FMLA and CFRA do not apply to smaller employers, most small businesses should still consider granting leave as a possible reasonable accommodation for the employee's own disability under the Americans with Disabilities Act (ADA) and Fair Employment and Housing Act (FEHA), unless doing so would impose undue hardship on the employer.[23]

In addition to CFRA, California has enacted the California Pregnancy Disability Leave Law (PDL), which generally requires that employers with five or more employees provide up to four months of unpaid job-protected leave to women requiring time off of work because of pregnancy, child birth, or a related illness. PDL also requires that covered employers transfer an employee to a less hazardous or less strenuous position within the company during pregnancy, if necessary and unless such accommodation would cause an undue burden on the company. Unlike CFRA, the PDL does not have a length of service or hours worked requirement, however, the employee must be unable to perform one or more job function due to her pregnancy or pregnancy-related condition.

California is one of a few states that provide short-term disability benefits for eligible employees out of work due to non-work-related injuries and/or illness and paid family leave through the California State Disability Insurance (SDI) program. These partial wage replacement benefits are funded through employee-paid contributions to the SDI program. With limited exceptions, employers are required to withhold from payroll and remit employee contributions to the SDI program, as well as provide information regarding sickness, injury, pregnancy, and paid family leave to new hires and again when an employee notifies the employer that he or she needs to take time off of work due to a non-work related medical condition. Effective January 1, 2017, covered employers in San Francisco will be required to pay certain employees with supplemental compensation for paid family leave taken through the SDI program, such that the employee will receive 100% of his or her gross weekly wages for the leave period.

With limited exceptions, employees who work for an employer for more than 30 days in California within a year and have been employed by the employer for more than 90-days are

[23] Cal. Code of Regs., tit. 2 § 7293.5(p)(2)(M).

entitled to take paid sick leave.[24] Generally, employers are required to allow employees to take up to three days (24 hours) of paid sick leave per year. Employers may choose how to comply with the law — they may offer an accrual policy or a "no accrual / up front" policy. An accrual policy allows an employee to accrue paid sick leave based on the number of hours worked, earning at least one hour for every 30 hours worked. Under the accrual method, while use of accrued paid sick leave can capped at 24 hours or three days per year, accrual of paid sick leave can only be capped at 48 hours (six days) or more per year and unused paid sick pay must be carried over from year to year. Exempt employees are assumed to work a 40-hour week, and accrue paid sick leave accordingly, unless the employee works less than 40 hours per week. Under a "no accrual / up front" policy, employers automatically grant existing employees at least three days (or 24 hours) of paid sick leave immediately at the beginning of each year, and new hires must be provided with three sick days (24 hours) of paid sick leave by the 120th calendar day of employment. Paid sick leave may be used for the diagnosis, care, or treatment of a health condition, preventative care, the health condition of a family member, or suffering as a result of domestic abuse, sexual assault, or stalking.[25] Unused paid sick leave need not be paid out at termination. In addition to the minimum state-wide paid sick leave requirements, some municipalities and counties have their own sick leave ordinances that create additional requirements for employers, such as Berkeley, Emeryville, Los Angeles, Oakland, San Diego, San Francisco, and Santa Monica. Employers must check the local ordinances of the counties, cities and municipalities where they have employees to confirm whether the paid sick leave requirements are more onerous than the California paid sick leave law.

Other than providing paid sick leave as outlined above, California employers are generally not required to provide additional vacation time or paid time off. If an employer does provide employees with vacation or paid time off, however, California law prohibits employers from instituting "use it or lose it" policies in which earned vacation or paid time off is forfeited if the employee does not use the time off within a certain time period or is terminated or resigns from employment. This means that accrued vacation and paid time off cannot expire and must be paid out to an employee upon termination or resignation. Nonetheless, California employers may place reasonable caps on accrual and use of vacation and paid time off.

I. Payroll

With some exceptions, California employers are required to pay employees at least twice per calendar month on regularly designated paydays.[26] Employers are required to establish regular paydays and post a notice stating the day, time and location of payment.[27] When the employer establishes a semi-monthly payroll period, wages earned between the 1st and 15th days of a calendar month must be paid no later than the 26th day of the month during which the labor was performed, and wages earned between the 16th and last day of the month must be paid by the 10th

[24] Cal. Lab. Code § 245-249.

[25] Cal. Lab. Code § 246.5.

[26] Cal. Lab. Code § 207. Employers may pay administrative, executive, and professional employees their entire month's salary, once a month before the 26 day of the month.

[27] Cal. Lab. Code § 212.

day of the following month. Other payroll periods such as weekly, biweekly (every two weeks) or semi-monthly (when the earning period is something other than between the 1st and 15th, and 16th and last day of the month), must be paid within seven calendar days of the end of the payroll period within which the wages were earned.

Employers must keep adequate records of the daily hours worked and wages paid to employees. It is recommended that such records be retained for at least four years. California Labor Code section 226(a) requires employers provide employees with wage statement for every pay period, itemizing certain information specifically enumerated in the statute, including (but not limited to): gross and net wages earned, total hours worked (except for employees exempt from overtime payment), all deductions taken from wages, the date of the payroll period, the name and address of the legal entity that is the employer, and all applicable hourly rates in effect during the pay period and corresponding number of hours worked at each hourly rate.

Employers may only withhold an employee's wages when required or allowed by law, when the deduction is expressly authorized in writing by the employee to cover insurance premiums, benefit plan contributions, or other deductions not amounting to a rebate on the employee's wages. Finally, an employee who is discharged or provides at least 72 hours of notice of resignation must be paid all of his or her final wages, including accrued vacation or paid time off, immediately at the time of termination.

III. CONCLUSION

California employment laws can be complicated and are constantly changing. Companies of all sizes must take steps to ensure they are in compliance with all the California laws and minimizing their legal risks. If you are a California employer, particularly a startup or growing business looking to hire and onboard employees, we highly recommend consulting an attorney to ensure that your hiring and onboarding practices are in compliance with the law.