

Remember the famous quote from Ben Franklin, “An ounce of prevention is worth a pound of cure?” Nothing could be truer for small businesses. As employers, small businesses face serious legal liabilities almost every day – Do we have to pay overtime? Can I protect my recipes? Can we fire that person who has been out sick? Do we have to pay for break time? Should we make him an independent contractor rather than an employee? What if we install a camera over the cash register? The list goes on and on. Although often overlooked, serious legal issues are imbedded in the employer-employee relationship.

Restaurants and other small businesses are at particular risk of overlooking – or even consciously ignoring – the mundane issues that come with being an employer. Restaurants are dynamic environments, often with young employees and inexperienced managers, where HR formalities are seen as unnecessary or outdated. Many restaurants intentionally strive to be more relaxed, more informal and less hierarchical because of their very nature as friendly, service-oriented businesses. These employers made a purposeful decision not to be governed by rigid rules and policies because they want to attract young, outgoing employees who like interacting and socializing with other people. Other companies simply ignore the issue. They either don’t understand the importance of creating an effective employment infrastructure or they don’t care.

Yet it is this very infrastructure which, if it is done early and done right, will help to prevent the kinds of employment lawsuits and problems which could literally bankrupt a small business. Margins are thin, and cash flow is tight. There is no room for error. Yet even a single bogus employee lawsuit could cost the company \$100,000 or more in defense costs alone. And that’s money lost even though you “won” in court. At Sloan, we don’t think you’ve “won” if you had to pay your lawyers \$100,000 to get to your “victory.” That’s why our goal is to help clients avoid lawsuits in the first place. With a little time, energy and resources devoted now – before employment problems develop – your growing company will minimize the risks of a devastating and costly problem later.

With this in mind, we thought it would be helpful to address some of the most common legal issues that confront restaurants and other small businesses, and to provide you with some guidance as you think about ways to protect your company’s resources:

### **I. Exempt vs. Non-Exempt – Who Gets Overtime?**

Many companies find the thought of hourly payroll to be too cumbersome, outdated and expensive. Why not pay everyone a straight salary? The employees then don’t have to account for their time (which they like), and the employer doesn’t have to worry with the administrative details of a complicated payroll system (which you like). It’s a seemingly simple and perfect solution

– everyone is classified as an “exempt” employee, everyone gets a salary, and the employer doesn’t have to worry about providing meal or rest breaks or paying overtime to anyone.

But wait! While there is great appeal to this simple approach, it usually results in incorrect employee classifications. The State of California will hold the employer liable for up to 3 years of back overtime due to the employee because of the wrongful classification. On top of that, the employer will owe interest and penalties. One wrongly classified employee can create a huge liability, so it’s best to classify employees correctly the first time.

Under California law, an employee is entitled to overtime for each hour worked over 8 on any day or 40 in any week. An employer cannot ignore this rule simply by labeling an employee as “exempt.” Nor can you just give someone a fancy title – a job title alone does not determine whether a worker is truly exempt. What matters is whether the employee’s job duties, responsibilities, and earnings fit one of the defined exemptions. Only employees who fall into one of these exceptions can legally be exempt from overtime:

- ◆ *“Executive” employees* – If the employee (a) is primarily engaged in the management of the business or a recognized department/division of it, (b) regularly directs the work of at least two other full-time employees, (c) has the authority to hire and fire employees, (d) exercises independent judgment and discretion in fulfilling her duties, and (e) earns a monthly

salary equivalent to no less than two times the state minimum wage for full-time employment, then that employee is likely to fit the executive exemption and be classified as exempt from overtime under California law.

- ◆ *“Administrative” employees* – An employee qualifies for the administrative exemption if that employee (a) customarily exercises discretion and independent judgment in the performance of non-manual work directly related to the management policies or the general business operations of the employer, (b) regularly assists the proprietor or performs work which requires specialized skill, training or knowledge, (c) spends at least 50% of her work time engaged in such administrative activities, and (d) earns a monthly salary equivalent to no less than two times the state minimum wage for full-time employment.
- ◆ *“Professional” employees* – An employee fits the professional exemption if that employee (a) is licensed or certified by the state in which he is employed and actively practices medicine, dentistry, pharmacy, optometry, architecture, law, teaching, accounting, engineering, or (b) works in a “learned or artistic” profession. In addition, the employee must exercise discretion and independent judgment and earn a monthly salary equivalent to no less than two times the state minimum wage for full-time employment.
- ◆ *Outside Salespersons* – An employee qualifies for the outside salesperson exemption if that employee (a) is over 18 years of age, and (b) regularly spends more than 50% of her time away from the employer’s place of business selling items or obtaining orders for products.
- ◆ *Computer Professionals* – An employee qualifies for the

“computer professional” exemption if that employee is (a) primarily engaged in work that is independent and creative and requires the exercise of discretion and independent judgment, (b) highly skilled and is proficient in the theoretical and practical application of highly specialized information to computer systems analysis, programming, and software engineering, (c) paid an annual salary of not less than \$79,050 (effective January 1, 2010), and (d) primarily engaged in duties that consist of (1) “the application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software, or system functional specifications”, or (2) “the design, development, documentation, analysis, creation, testing, or modification of computer systems or programs, including prototypes, based on and related to, user or system design specifications”, or (3) “the documentation, testing, creation, or modification of computer programs related to the design of software or hardware for computer operating systems.”

There are several important qualifications and caveats to these general rules, so before designating anyone as “exempt” it’s best to consult your employment counsel. But the bottom line is clear – it is not easy for an employee to qualify as an exempt employee.

## **II. Using Independent Contractors – Penalties and Pitfalls**

For many small businesses, hiring independent contractors can be a smart move. It allows the employer to obtain the specialized services and skills that it needs without the costs of payroll taxes and employee benefits. Since the independent contractor is not a legal employee of the company, she is not covered by labor laws or wage

and hour laws. There is no need to pay overtime. There is no need to set up a payroll system because independent contractors are paid on a gross basis, with no payroll, social security, unemployment or other taxes deducted. In addition, there is a reduced risk of future litigation. Most anti-discrimination statutes protect only employees and not independent contractors. Designating your new hire as an independent contractor has some definite, immediate advantages.

In some cases, however, the advantages can be offset by huge liabilities should the IRS or the California Franchise Tax Board (“FTB”) later determine that your new recruit was not, in fact, properly designated as an independent contractor. An employer who misclassifies someone as an independent contractor is liable to the IRS or FTB for back taxes, fines, penalties and any overtime that was worked but not paid during the last 3 years. If the company can’t afford these sums, the “responsible person” of the employer may be subject to personal liability and criminal penalties. In short, if you designate someone as an independent contractor but the state or federal government later decides you did it wrong, you will have made a costly mistake.

So, all this begs the question – when is a worker an “independent contractor” and when is she an “employee?” The IRS uses a list of 20 factors to analyze whether a worker is an independent contractor or employee. Space does not allow us to go through each of them here, but the most important factor is *who controls the means and manner of performance*. In other words, if the worker provides her own tools, effectively supervises herself, sets her own work schedule, has a business of her own, and has the right to also work

for others, that worker is probably an independent contractor. On the other hand, if the employer sets the work schedule, closely supervises the worker, provides subordinates and supervisors to assist her, or provides an office or other location to perform the work, that worker will likely be an employee. The distinction can often be blurry – and the stakes are high – so employers should analyze the situation carefully with experienced employment counsel.

We recommend that all companies who use independent contractors confirm their engagement in a formal Independent Contractor Agreement. Then be sure to pay the independent contractor on a “per job” basis, never on an hourly basis. Do not require progress reports, and do not provide training, feedback, or extensive instructions. Allow the worker the freedom to work whatever hours, days, and times she wants; do not require her to work full-time. Require the worker to hire, supervise, and pay her own assistants. Do not reimburse the worker for expenses as you would an employee. Require the worker to furnish her own tools and other equipment necessary to complete the project. Ask the worker to provide you with ongoing (quarterly) evidence that all income and other taxes are being paid.

Finally, we also encourage clients to keep a “compliance file” for each independent contractor which contains evidence necessary to support the independent contractor designation. This file should include, among other things:

- ◆ A copy of the Independent Contractor Agreement
- ◆ Insurance policies, if any, carried by the independent contractor

- ◆ Copies of any business licenses or registration certificates
- ◆ Copies of stationery, business cards, or other evidence of the worker’s business
- ◆ A compilation of special equipment or tools used by the independent contractor

If you are ever audited, these files will be critical for defending your decision to designate these workers as independent contractors.

And, remember, California employers who pay any individual independent contractor over \$600 in any calendar year must file a must file a DE-542, “Report of Independent Contractors,” with the Employment Development Department (“EDD”). The law is very strict about what information must be included in your DE-542 and when it has to be filed, so be sure to consult with your accountant or counsel if your company uses independent contractors.

### **III. Complying with Unique Local Laws and Ordinances**

Many cities and counties have unique laws and regulations that apply only in their jurisdictions. Not surprisingly, many employers in these jurisdictions often operate in violation of these local laws because they are unaware of them.

For example, employers in San Francisco must offer paid sick leave to their employees. This law, which went into effect in February 2007, requires employers in San Francisco to provide all employees (both full-time and part-time) with 1 hour of sick leave for every 30 hours worked. Employees may take paid sick leave for their own illness or to provide care for a sick child, parent,

sibling, grandparent, grandchild, spouse, domestic partner, or other “designated person.”

Under this San Francisco law, paid sick leave begins to accrue 90 days after the start of employment in San Francisco. If an employer already has a paid time off policy that provides employees with paid leave that meets the law’s requirements, the employer is not required to provide additional sick leave.

The law permits civil actions by the Office of Labor Standards Enforcement, the City Attorney, and “any person aggrieved by a violation.” The prevailing party in any such action may recover all “legal or equitable relief as may be appropriate to remedy the violation” including, but not limited to, reinstatement, back pay, the payment of any sick leave unlawfully withheld, liquidated damages, injunctive relief, and reasonable attorneys’ fees and costs.

In addition, San Francisco has a Health Care Security Ordinance (“HSCO”) that requires all for-profit employers in the City with 20 or more employees, and all non-profit employers with 50 or more employees, to provide minimum health care expenditures for their “covered employees.” A “covered employee” is anyone who has been employed in San Francisco for at least 90 days and who works at least 8 hours per week. For each such “covered employee,” the employer must (a) provide access to group health insurance for that employee, (b) provide contributions to a health savings account in the employee’s name, (c) contribute to a flexible spending account in the employee’s name, (d) reimburse the employee for health care expenses, or (e) making payments to the City to fund the

employee's membership in the City's Health Access Program.

The amount of the benefit to be paid to or on behalf of the employee is determined by multiplying that employee's hours paid in San Francisco by the then-current spending rate. As of January 2010, the mandated spending rate is \$1.96 per hour. Failure to make the required health care expenditure subjects the covered employer to a penalty of up to \$1,000 for each employee for each week that such expenditures were not made, plus interest of up to 10%. The City Attorney may also bring a civil action against the employer.

This local law, often referred to as "Healthy San Francisco," was challenged in federal court by the Golden Gate Restaurant Association ("GGRA"). The ordinance was upheld by the Ninth Circuit Court of Appeals in September 30, 2008. The GGRA then petitioned the U.S. Supreme Court to hear its appeal and invalidate the ordinance. As of this writing, the U.S. Supreme Court has not issued a final decision on whether it will hear the appeal. So "Healthy San Francisco" continues to be the law of the land in San Francisco.

Other Bay Area cities and counties have similar laws, and still others have different laws on entirely different subjects. Employers should consult experienced local counsel to ensure compliance on all levels.

#### IV. Sexual Harassment

Sexual harassment remains one of the biggest – and costliest -- legal issues confronting California employers. Even if an employer wins a sexual harassment case, the cost of defense alone can reach \$100,000 or more. And that's just the price for

"winning" the case! Imagine the total cost if you have to settle, or if the jury rules against you?

Restaurants, hotels, and other hospitality companies often face greater sexual harassment risks. Employees at these companies often are younger and work longer hours. Managers have often purposely created an informal work environment. The result is generally an upbeat, friendly, and lively workplace, but sometimes these policies and attitudes can create an overly permissive atmosphere where employees frequently date each other or where sexual comments and jokes are tolerated. That's the very deal downside to creating a fun, informal workplace. In today's world, even one manager-employee romance or one sexual joke can create serious sexual harassment liability. It is therefore critical that employers understand their sexual harassment obligations, and to take every precaution to avoid creating those liabilities in the first place.

Under both California and federal law, employers have an affirmative obligation to implement effective policies that prohibit sexual harassment. The policy must be clearly and regularly explained to all employees, and it must contain sanctions for those who violate it. The policy must also contain an effective complaint procedure, a listing of available legal remedies, and a guarantee that those who use it will not face retaliation. California law requires that sexual harassment information be distributed to all employees.

An employer also has affirmative obligations to investigate any charges of sexual harassment. Consequently, the employer should develop an adequate procedure for

investigating those claims, gathering evidence, notifying the accused and providing him/her an opportunity to be heard. At all times during the investigation the employer must be careful to avoid making comments or accusations that could constitute defamation. If the employer determines that sexual harassment occurred, the employer *must* take immediate and appropriate corrective action to remedy the situation, even if the victim does not request it.

According to the Supreme Court, an employer has an absolute defense to a charge of sexual harassment if (a) the employer has exercised reasonable care to prevent and correct sexually harassing behavior, and (b) the plaintiff employee unreasonably failed to take advantage of the preventive or corrective opportunities provided by the employer. This standard emphasizes the importance of maintaining an effective sexual harassment policy, training all employees on how to recognize and prevent sexual harassment, and taking swift and appropriate action to enforce the policy when it is violated. This is often the employer's *only* defense in a sexual harassment case.

We therefore encourage all clients to adopt a formal sexual harassment policy. That policy should contain, at a minimum, a precise explanation of what sexual harassment is, how to report it, an explanation of the company's investigation process, and the company's policy of non-retaliation. The policy should be communicated to all employees in the employee handbook (see discussion below), on company bulletin boards, and in periodic training sessions conducted by qualified consultants or attorneys. California law now requires 2 hours of sexual harassment training every 2 years for the

supervisors of organizations with 50 or more employees. The law is very clear about what content this training must include, and who is qualified to provide it, so if your organization employs 50 or more people you should work with experienced counsel to develop your mandatory training program.

## V. Employee Handbooks

As a general rule, an employer may implement any *lawful* policy as a term or condition of employment. An employee handbook is the compilation of all lawful rules, policies and procedures that you have implemented for your workforce.

Companies often find that they need a formal mechanism that puts employees on notice of applicable rules and policies and promotes uniformity in their application. Misunderstandings or confusion about an employer's policies can lead to employee morale problems, claims of discrimination, employee lawsuits, or even union organizing. A well-drafted employee handbook minimizes these risks. An employee handbook can be a powerful defense in an unlawful discrimination case because it demonstrates that the employer adopted lawful, neutral policies and applied them consistently. If the handbook contains proper language, it also can serve as helpful evidence in wage and hour claims for overtime or missed meal/rest breaks. The employee handbook also serves as powerful written evidence of the employee's awareness of her "at will" status and the employer's "zero tolerance" for sexual harassment. And, finally, a well-drafted employee handbook conveys a message to your employees that you take your obligations as an employer seriously. That alone is often helpful if a dispute later arises.

Once you decide to memorialize your employment policies in a formal employee handbook, it is critical that you (a) implement only lawful policies, and (b) follow the policies announced in your handbook.

While it may seem obvious, you would not believe how many employers innocently implement illegal policies. For example, many employers still maintain a "use it or lose it" vacation policy. If an employee does not use their pay in a given year, their policy says, that employee forfeits that year's vacation pay. Such a policy is illegal in California yet it appears in many employers' handbooks. Similarly, many employers have a policy for paying terminated employees their final check on the next regular pay date. That, too, is illegal. California law requires a terminated employee to be paid either 24 or 72 hours after termination, depending on the circumstances. Yet many handbooks fail to mention this important rule.

Moreover, once you adopt a handbook, you should follow the policies contained within it. Failure to do so puts the employer at risk for a claim of discrimination. To minimize the risk of such a claim, an employee handbook should contain language stating that the employer always reserves the rights to (a) deviate from its policies should circumstances warrant, and (b) modify or change its policies at any time for any reason, with or without notice.

Because every employment environment is unique, every employer will want to adopt its own set of lawful policies and procedures. Consequently, it is beyond the scope of this article to delve into all of the myriad terms and conditions that an employer might want to consider for

inclusion in an employment handbook. But the following is a list of some of the most common issues that are addressed in most employee handbooks:

- ◆ *Introductory Comments* – Welcomes the employee and discusses the employer's philosophy towards the business.
- ◆ *Terms and Conditions of Employment* – Sets forth the employer's policy on equal employment opportunity, any applicable "probationary" period, the "at will" nature of employment, work schedule issues, prohibition on outside employment, required medical examinations, personnel records, inspections of work stations and personal belongings, and email/voicemail and computer network system privacy.
- ◆ *Payroll Policies and Procedures* – Discusses pay periods, pay days, timekeeping requirements (if any), overtime, bonuses, expense reimbursement, payroll deductions, and wage garnishment issues.
- ◆ *Employee Benefits* – Itemizes all current employee benefits, including health insurance, dental insurance, vision insurance, 401(k) eligibility, paid leave (vacation accrual, personal holidays, firm holiday, sick leave) and unpaid leave policies.
- ◆ *Standards of Performance, Discipline and Termination* – Explains the employee evaluation process, states clearly whether any "progressive discipline" policy exists, discusses attendance, absence, tardiness and discipline policies, and provides a list of examples of those actions or omissions that are grounds for immediate termination.
- ◆ *On The Job Illness or Injury* – Discusses workers' compensation

issues and benefits, as well as occupational disability leave.

- ◆ *Workplace Safety and Health* – Elaborates the employer’s general rules regarding employee health and safety, including any smoking, first aid, CPR, appearance/grooming, violence prevention, life threatening illness and/or substance abuse policies.
- ◆ *Sexual Harassment* – Discusses the employer’s intolerance for sexual harassment in the workplace, explains the types of conduct and comments that constitute sexual harassment, sets forth a procedure for reporting violations of the policy, and ensures against retaliation.
- ◆ *Non-Discrimination Policy* – Discusses the employer’s non-discrimination policy and makes clear that the employer does not discriminate based on race, age, sex, sexual orientation, gender identity, disability, religion, marital status, or any other characteristic protected by federal, state, or local law.
- ◆ *Arbitration Policy* – Sets forth the requirement that all disputes between the employee and employer be resolved by mandatory arbitration rather than court action.
- ◆ *Acknowledgment of Receipt* – Requires that the employee execute a general statement confirming that she has read, understands and agrees to be bound by the policies contained in the employee handbook.

## **VI. Protecting Your Company’s Intellectual Property**

A company’s intellectual property can often times be its most valuable asset. But what is “intellectual property,” and how does a company protect it?

In general, *patent* protection is only available for certain novel inventions. The goal of patent law is to incentivize invention by granting inventors a limited, exclusive right to profit from that invention for a set number of years. In contrast, *trademark* protection extends to symbols and slogans that indicate the origin of a good or service. The goal of trademark law is to restrict other businesses from using these slogans and symbols so that consumers will not be confused about the source of a particular good or service. Finally, *copyright* protection extends only to ideas that are fixed in a “tangible medium of expression,” such as on a DVD or in a book. The goal of copyright law is to incentivize people to express creative ideas by granting them exclusive ownership to those ideas for a set number of years.

On the other hand, *trade secret* protection is available for all types of sensitive business information. It can be anything – it is not limited to inventions, or ideas, or information recorded on a DVD. Whereas patent, copyright, and trademark protection only last for a set period of time, trade secret protection may last indefinitely. Many companies realize the need for patent, trademark, and copyright protection, but they often forget about their rights to protect their sensitive business information under California’s trade secrets law.

So, how do you protect your trade secrets and other sensitive, private business information? The *first* step is to identify what your “trade secrets” are. Under California law, a trade secret is generally defined as any information, including a formula, pattern, compilation, program, device, or method, that (1) derives independent economic value from not being known to the general

public, and (2) is the subject of reasonable efforts to maintain its secrecy.

The *second* step is to develop a written policy prohibiting the disclosure of trade secrets and other confidential information by potential, current or former employees, independent contractors and consultants. All employees, independent contractors and consultants should sign an acknowledgement indicating that they have read, understood and will comply with the company policy.

*Third*, publicize your trade secret policy in company materials and mark highly sensitive documents as “CONFIDENTIAL” or “TRADE SECRET” to make your claim clear and to alert others to it.

*Fourth*, limit access to only those employees who need the information to effectively perform their jobs. Courts have been unwilling to classify information as protected where every employee had access to, or knew, the alleged confidential information.

*Fifth*, use computer and other access codes limiting the employees who may obtain the information.

And, *finally*, limit disclosure to third parties. If your company must share its trade secrets with business partners or vendors, require them to execute a confidentiality agreement containing the key elements discussed above. Never post your trade secrets on your public website.

Another valuable company asset is employees. An employer’s worst nightmare is the talented employee who leaves to start a competing business. Since you’ve already protected your trade secrets,

you needn't worry about information, but what if your former employee tries to woo away current employees or clients? What can you do to protect yourself? Although covenants not to compete are void in California (hence you cannot prohibit your employee from working for a competitor), employers may prohibit employees from soliciting company employees or clients upon their departure. Non-solicitation agreements often go hand-in-hand with confidentiality agreements and can be prepared as one complete document or included in your employee handbook.

## VII. Proper Interviewing/Hiring

So you've finally made the decision to hire a new regional manager. What should be your first step? Most employers know what qualities they want in a prospective employee. The question, however, is how to protect your company during the interview and hiring process so that you hire the person you want without creating any unnecessary liabilities along the way.\

### *Lawful and Effective Interviewing*

State and federal law prohibit employers from discriminating on the following bases: gender, racial or ethnic minority, disability, sexual orientation, age, veteran status, religion, immigration or citizenship status, marital status or pregnancy. To avoid any appearance of a discriminatory motive, we encourage clients to follow these guidelines:

- ◆ set legally justifiable employment criteria
- ◆ ask open-ended questions (e.g. "What interests you in this position?")

- ◆ do not ask questions aimed at protected classes (e.g. "How old are you?")
- ◆ do not ask about criminal charges or other improper topics
- ◆ review and update your employment application regularly
- ◆ instruct all employees who interview candidates on these guidelines

Once you've interviewed your prospective employee, you'll want to check their references. Recent cases have held former employers liable for defamation, negligence or interference with prospective business relations when providing employment references. As a consequence, many former employers refuse to give out any information except the former employee's job title and dates of employment. As a result, new employers are often frustrated because they cannot get substantive feedback on their candidate. We have developed several strategies to help you solve that problem:

- ◆ ask the applicant to sign a written authorization/release before contacting references
- ◆ ask named references for other references, and contact those "secondary" references
- ◆ ask objective open-ended questions that quantify the employee's performance
- ◆ pay attention to what a reference will not say – that is often important data

### *Drug Testing and Background Checks*

Other effective employment screening devices include checking credit reports and conducting pre-

employment drug testing. Credit reports present some thorny problems, however, when they are used in the employment screening process. For example, employers must carefully follow the Consumer Credit Reporting Agencies Act and Investigative Consumer Reporting Agencies Act. These acts require an employer to provide notice, and an opportunity to request a copy of the report, to an applicant. In addition, if the employer makes an employment decision based on information in the report, it must advise the applicant of that fact and provide the name and address of the agency that furnished the report.

What about pre-employment drug testing? California state law generally allows reasonable drug testing under certain limited conditions, but only if such testing is not barred by a local ordinance. It is therefore critical for all employers to know whether their local city or county has a specific ordinance on employee drug testing. For example, in San Francisco, Police Code § 3300A.4 prohibits drug testing of a particular employee unless (a) the employer has reasonable grounds to believe that an employee's faculties are impaired on the job, and (b) the employee is in a position where impairment would present a clear and present danger to the physical safety of themselves, other employees, or members of the public. Your jurisdiction may have a different law, so you should consult experienced local counsel before you ask any employee to submit to a drug test.

### *Hiring Employees from Competitors*

What happens if your star applicant previously worked for a competitor? Many employers think of this as a great asset, without considering the potential risks. Before hiring this candidate, ask her if she

signed a confidentiality agreement and/or a covenant not to compete at her prior job. If she did, you should review those agreements with counsel to make sure that your new employee will be able to perform her job duties without risking a lawsuit from a prior employer. Also, ask the candidate what business information from her prior employers she plans to bring with her when she joins your company. Financial information, marketing plans, customer lists, or other sensitive business information brought from a prior job might put your company at risk. No new employee should be allowed to bring any trade secrets from a prior employer into your place of business.

## *The Importance of I-9 Compliance*

Finally, with all new employees, you have to ensure that they are legally authorized to work in the United States. This is done through the I-9 form. For every new hire, the employer must collect proper information from the employee at the time of hiring that confirms the employee's right to work in the United States. What information suffices to prove the employee's legal right to work is specifically stated on the form, and it can change as new versions of the I-9 are put into circulation by the U.S. Department of Homeland Security. Therefore, employers must take care always to ensure that they are working with the most current version of the I-9 form. As of this writing, the current version is OMB-1615-0047 and is dated 08/07/09. It expires on 08/31/12.

The employer and employee must both complete and sign the I-9 form. The employer must then keep a copy of the form, along with copies of the documents that were produced by the employee, for all current employees. For terminated

employees, the employer must keep the form and supporting records for at least 3 years from the date of hire or 1 year from the date of termination, whichever is later.

The I-9 form is very specific about what documents can be accepted as proof of work, and penalties for improper or incomplete I-9 forms can be severe. The penalty for a first offense can reach \$3,200 per offense, and the penalty for a third offense can reach \$16,000 per offense. Employers should take I-9 compliance very seriously because there can be multiple offenses per form. In addition, in August 2009, the U.S. Department of Homeland Security announced increased I-9 compliance audits. We therefore strongly encourage all clients to review their current I-9 files and take any steps necessary to show full compliance.

## **VIII. Put It In Writing – Offer Letters and Employment Contracts**

Many important issues arise during the interview process, and many promises are made. Salary, work hours, benefits, title, responsibilities, promotion time-frame – these and many other critical issues are constantly being raised, discussed, agreed-upon, shelved and maybe even re-asserted throughout the recruitment process. Numerous employees may have interviewed the candidate. Numerous officers may have answered questions and provided the candidate with “official” information.

Is everyone on the same page? If a dispute arises, and the employee claims that “x” was offered but “y” was delivered, will the company be able to re-create the negotiations to defend its claims?

When the employer makes the initial decision to extend an offer

to the candidate, we always encourage that employer to put the terms of that offer in writing. Make clear to the candidate what the terms of the offer are. Unless you are offering the candidate a guaranteed term of months or years, make sure the letter makes clear the offer is for “at will” employment. Clearly specify the candidate's proposed job title, key responsibilities, compensation and benefits. In addition, the offer letter should make clear what you have promised, and what you have merely stated as a “goal” or an “expectation.” If the recruit's salary, bonus or promotion depends on making sales or performance targets, specify those targets clearly. Include a copy of your employee handbook with the letter so that the candidate will have notice of all company policies and procedures before accepting the offer. Tell the candidate in the offer letter to contact you to discuss any issues that are unclear or unresolved. This prevents the candidate from later claiming that she didn't understand the terms of the offer or that she was promised something else. Also, consider whether to add an expiration clause in the offer letter.

Although a well-drafted offer letter is sometimes sufficient, there are many circumstances where having a formal, written employment agreement is critical. Some employers avoid using employment agreements because they fear that having a contract will destroy the employee's “at will” status. But that is not true. Employment contracts can and often should be used for employees of every level and status.

## **IX. Monitoring the Workplace**

Can an employer install software on its company computers so that it can monitor how much time its employees are spending on the

internet? Can an employer install a secret camera over the employee lockers to see if someone is stealing? What if an employer suspects an employee of using a company's internet connection to download copyrighted songs illegally or email pornographic pictures?

The answer depends on finding that delicate balance between effective employee monitoring and invasion of employee privacy. An employee's privacy interest is examined in light of an employee's reasonable expectation of privacy. If an employee has consented to monitoring in an employee handbook or other company document, then obviously this employee's expectation of privacy is minimal and the company's right to reasonable monitoring is likely assured. Similarly, even in the absence of a pre-employment agreement, if the company has maintained clear employee policies aimed at reducing privacy expectations, the employer should be able to conduct reasonable monitoring. Weighed against the employee's privacy expectation, if any, are the employer's legitimate interests in monitoring employees and the reasonableness of the privacy intrusion. If the business reason for the monitoring is weak or if the privacy intrusion caused is "highly offensive," then the employer is likely going to be liable for invasion of privacy if it proceeds with the monitoring policy.

Obviously, this balancing is delicate, complicated, and very dependent on the facts of each specific case. It is therefore not possible to give a bright-line rule for when such monitoring is legal and when it is not. If you are considering engaging in any video or other surveillance of your employees, we encourage you to contact experienced counsel.

## X. Employment Insurance

One of the main reasons why employee lawsuits are so devastating to small businesses is that there is often no insurance available to pay the company's legal bills and any judgment or settlement against it. The company is forced to absorb these huge costs on its own. Faced with increasing employee lawsuits and skyrocketing litigation costs, employers began to re-examine their insurance policies and to advance new arguments for insurance coverage. Whether you may have coverage for a particular claim depends on the type of insurance that you have:

- ◆ *Coverage under Employment Practices Liability policies* – In response to demand from businesses of all sizes, the insurance industry recently offered a new EPL policy which specifically covers employment-related claims. In general, there are many types of EPL policies available, and their coverage breadth varies from policy to policy. For example, some EPL policies provide coverage for defense costs only. The insured under these policies still has to pay any settlement or judgment that results from the action. Other EPL policies provide both defense and indemnity protection, and cover such claims as wrongful termination, sexual harassment and claims under the Americans with Disabilities Act. While we generally encourage our clients to purchase these policies, we understand that they can be costly – sometimes prohibitively so – for smaller businesses.
- ◆ *Coverage under traditional Commercial General Liability policies* – A CGL policy is the basic insurance policies that most companies purchase to cover tort claims against the company. Generally speaking, CGL policies defend and indemnify a company against any claims for "bodily injury" or "property damage" as defined in the policy. While most CGL policies now explicitly exclude coverage for employment-related claims, some may provide coverage if the harassment resulted in "bodily injury" as defined by the policy. In addition, most CGL policies also provide coverage for a variety of torts. If the lawsuit also alleges tort claims such as defamation, invasion of privacy, false imprisonment, or even discrimination, the policy may provide coverage.
- ◆ *Coverage under Excess or Umbrella policies* – In some cases, an employer can look to its excess or umbrella policies to provide coverage for employment claims. This is true even where the underlying CGL policy does not provide coverage. Excess/umbrella policies differ greatly from carrier to carrier, so we encourage all employers to immediately consult their excess/umbrella policy or broker when faced with an employment-related claim. Some policies explicitly cover discrimination claims and claims for emotional distress.
- ◆ *Coverage under Worker's Compensation policies* – Workers' compensation policies also can provide coverage for employment-related claims. Most workers' compensation policies are divided into two parts – A and B. The "A" portion usually provides traditional workers compensation benefits, and the "B" portion usually provides additional coverage for a variety of other employee injuries. Some courts have held that the "B" portion provides coverage to employers who face claims of wrongful termination.
- ◆ *Coverage under Directors and Officers policies* – If the lawsuit names individual officers or directors of the company, there

might be coverage provided under the company's D&O policy. In smaller companies, directors or officers who have direct involvement in hiring or firing sometimes get named in lawsuits. In addition, in some cases directors or officers are accused of allowing a pattern of wrongful conduct to occur. A D&O policy could provide coverage for these types of claims.

Given the fact that most businesses carry at least one of these types of policies, we always encourage clients who are faced with an employee claim immediately to review their insurance policies. Most policies contain a strict deadline for making a claim, so gather your policies and analyze promptly when faced with an employee claim.

## Conclusion

We hope we have helped you identify some of the everyday employment issues confronting small businesses. And we hope we've provided some helpful solutions to help your business grow and become more profitable. Although there is a lot of serious legal talk in this article, the main point is a simple one – that is, an ounce of prevention is worth a pound of cure. With a commitment to do things right and just a little advance planning, your business can avoid many of the most common and costly small business mistakes.

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