ARBITRATION AGREEMENTS

Hawaii Supreme Court: Arbitration clause bites the dust . . . again

by Amanda M. Jones

The Hawaii Supreme Court recently ruled (again) that an arbitration agreement was not enforceable after finding that certain provisions were “unconscionable.” The decision followed a similar ruling by the court in the same case, but the previous ruling was overturned by the U.S. Supreme Court and sent back to the Hawaii justices for reconsideration. We will have to wait to see whether the recent decision will be appealed to the Supreme Court. However, the decision contains cautions for employers that use or are considering using arbitration agreements.

The case

We first told you about Narayan v. Ritz-Carlton Development Co. in our July 2015 issue (see “Got an arbitration agreement? Hawaii Supreme Court says maybe not” on pg. 1). As a refresher, individuals who purchased units in a luxury condominium development in Maui sued the project’s development and management companies and other entities. The developer sought to compel arbitration of the purchasers’ disputes under an arbitration clause in the condominium declaration, which was incorporated into the purchase contracts.

In a June 2015 opinion, the Hawaii Supreme Court ruled that the arbitration clause was not enforceable because the parties did not have an “unambiguous” intention to submit disputes to arbitration. According to the court, there was ambiguity about the parties’ intentions because the purchase agreements indicated that certain disputes would be resolved in court. The court also found that some of the provisions in the arbitration clause were unfair.

U.S. Supreme Court says not so fast

The defendants appealed the Hawaii court’s decision to the U.S. Supreme Court. In a two-sentence opinion issued in January 2016, the Supreme Court overturned the Hawaii court’s decision and ordered that the decision be reconsidered in light of a 2015 ruling that concerned the Federal Arbitration Act (FAA). The FAA requires state courts (like the Hawaii Supreme Court) to place arbitration contracts “on equal footing with all other contracts.” In other words, courts cannot impose additional requirements on arbitration agreements if the requirements do not exist for other types of agreements. Thus, if other contracts did not require an “unambiguous” intention to be enforceable, the court could not impose such a requirement on arbitration agreements.

Round two: Agreement still unenforceable

After the U.S. Supreme Court issued its decision, we predicted that after
reconsideration, the Hawaii Supreme Court would again conclude that the arbitration agreement was unenforceable (see “Do-over ordered for Hawaii Supreme Court’s arbitration decision” on pg. 1 of our February 2016 issue). That prediction proved to be accurate. In July 2017, the Hawaii court again ruled that the arbitration clause in the condominium declaration was unenforceable, albeit for a different reason.

Obviously concerned about the Supreme Court’s instruction to comply with the FAA, the Hawaii court’s recent decision focused exclusively on unconscionability, a doctrine that applies generally to all contracts. A party can raise an unconscionability defense to prevent the enforcement of a contract when (1) the party seeking to avoid the contract did not have a meaningful choice about accepting the contract and was unfairly surprised because of the manner in which the offensive terms found their way into the agreement and (2) the terms of the contract are unreasonably favorable to the other party.

The court found that the first prong of the unconscionability doctrine was satisfied because the arbitration clause was drafted by the party with “superior bargaining strength” and the purchasers were required to conform to the terms if they wanted to purchase a condominium unit. The court also found that the arbitration clause, which was near the end of the 36-page condominium declaration, contained terms that were unfair to the purchasers.

Provisions declared unconscionable

The Hawaii Supreme Court took aim at three specific provisions in the arbitration clause.

(1) Damages limitation. The arbitration clause prohibited the arbitrator from awarding “punitive, exemplary, or consequential damages.” The court concluded that the limitation on the types of damages that could be awarded was unenforceable when combined with the “inequality of bargaining power” between the purchasers and the developer that drafted the condominium declaration. The court reasoned, “It would create an untenable situation if parties of superior bargaining strength could use adhesionary contracts to insulate ‘aggravated or outrageous misconduct’ from the monetary remedies that are designed to deter such conduct.”

(2) Discovery. The arbitration clause also limited the types of discovery the arbitrator could order. Discovery is a general term that refers to various methods for parties to obtain information from each other and third parties in preparation for the arbitration hearing. In this case, the arbitrator could not order depositions or other types of discovery unless the parties agreed in writing. The court explained that some limitations on discovery are enforceable and can “serve an important purpose” in arbitration. However, the court found that the provision went too far because it placed “severe limitations on discovery” that hindered the purchasers’ ability to prove their claims and violated Hawaii’s arbitration statute, which gives arbitrators considerable discretion in permitting discovery. The court concluded that such limitations, whether in arbitration or litigation, were unconscionable.

(3) Confidentiality. The arbitration clause prohibited the parties, witnesses, and the arbitrator from disclosing the “facts of the underlying dispute” or the “contents or results of any negotiations, mediation, or arbitration” without the prior written consent of all parties, with some exceptions. The court concluded that confidentiality provisions are not per se unconscionable. However, when combined with the limitations on discovery, the provision could deprive the purchasers of the ability to obtain the information necessary to pursue their claims. Thus, the court ruled that the confidentiality provision was unconscionable.

Statute of limitations. As a side note, the condominium purchasers also argued that a provision in the arbitration clause that shortened the period in which the parties could file claims was unfair. The Hawaii Supreme Court declined to decide the issue because there was no indication that the purchasers’ claims against the developer would have been barred by the limitations provision.

Unfair provisions couldn’t be severed

Importantly, a court finding that certain provisions of an agreement are unconscionable does not automatically result in the entire agreement being unenforceable. Generally, the problematic provisions can be “severed” while the remainder of the agreement is enforced. The defendants argued that the Hawaii Supreme Court should have done that. Their request was rejected. The court explained that when “unconscionability so pervades the agreement, the court may refuse to enforce the agreement as a whole.” The court concluded that was the case, and thus, the entire arbitration provision was unenforceable. Narayan v. Ritz-Carlton Development Co., SCWC-12-819 (Haw., July 14, 2017).

Bottom line

Although Narayan did not involve an employment arbitration agreement, the unconscionability analysis applied by the Hawaii Supreme Court could be used by parties seeking to avoid all types of arbitration agreements, including in employment settings. Thus, employers should pay attention. If your company’s arbitration agreements contain confidentiality clauses or limitations on damages or discovery, the contracts may be in jeopardy. A review by experienced counsel familiar with Narayan is advisable. Employers should stay tuned because the defendants appealed the earlier decision to the U.S. Supreme Court and could do so again. The U.S. Supreme Court could say that the Hawaii justices got this one wrong a second time.

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SEX DISCRIMINATION

Final warning dooms Hawaii employee’s sex discrimination lawsuit

by Amanda M. Jones

A Hawaii appellate court recently ruled that an employee’s sex discrimination lawsuit was properly dismissed because she failed to present any evidence that her termination was discriminatory. In its ruling, the appellate court relied heavily on a “final written warning” in which the employer advised the employee that further mistakes would result in termination.

Employee’s mistake results in NLRB charge

Arley Nozawa was employed by the Operating Engineers Local Union No. 3. She made a “serious dispatching error” that reportedly caused one of the union’s members to lose a job opportunity. The union member filed an unfair labor practice charge against the union with the National Labor Relations Board (NLRB). The union paid the member nearly $20,000 to settle the charge.

Final warning issued

The union said the dispatching error that resulted in the NLRB charge was not Nozawa’s first mistake. The union’s financial secretary was ready to fire Nozawa after the error but was persuaded to give her a final written warning instead. The final warning explained that Nozawa continued to make mistakes, some of which were “seriously exposing [the union] to potential legal liability.” The document concluded by warning Nozawa that “any further mistakes on your behalf in carrying out your duties . . . will result in the immediate termination of your employment.”

The union maintained that Nozawa continued to make mistakes after she received the final written warning. About 10 months after the issuance of the warning, the union terminated her “as part of a staffing reorganization.” She was replaced by a male employee.

Employee sues for sex discrimination

Nozawa sued the union, claiming she was terminated based on her sex in violation of Hawaii law. The union sought dismissal of the lawsuit based on evidence that the termination was due to her repeated errors and its staffing reorganization, not her sex. Nozawa disputed that she had been performing poorly and claimed that she was “falsely accused” of making the dispatching error that resulted in the NLRB charge.

The trial court judge agreed with the union’s argument that Nozawa failed to present evidence that warranted the case going to trial, so the case was dismissed. Nozawa appealed the dismissal to the Hawaii Intermediate Court of Appeals (ICA).

Final warning supports union’s case

The ICA agreed that Nozawa’s case had been properly dismissed. In doing so, the ICA explained that the union “articulated legitimate and nondiscriminatory reasons for Nozawa’s termination.” The court pointed out that the union considered her errors and the final written warning during its staffing reorganization. The court explained that although she disputed making a mistake, she provided “no documentation or further details about disputing the Final Written Warning.” Additionally, she did not contest that a reorganization occurred or provide evidence that she was more qualified than the male employee who took her dispatcher position after she was fired. Nozawa v. Operating Engineers Local Union No. 3, CAAP-14-21 (Haw. Ct. App., June 21, 2017).

Bottom line

Nozawa could challenge the ICA’s decision by asking the Hawaii Supreme Court to overrule it. If she does, we likely won’t know the outcome for several months. In the meantime, the ICA’s decision is a good reminder of the importance of documenting employees’ performance problems as well as the consequences if improvement does not occur. The evidence provided strong support for the union’s position that it had a legitimate basis for terminating Nozawa that was unrelated to her sex, which defeated her discrimination claim.

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PENSIONS

Supreme Court delivers sermon on ERISA ‘church plan’ exemption

The Employee Retirement Income Security Act of 1974 (ERISA) generally requires private employers offering pension plans to adhere to a lengthy list of rules designed to ensure plan solvency and protect plan participants. Church plans, however, are exempt from those requirements. But what exactly constitutes a “church plan”? The U.S. Supreme Court has just ruled—unanimously—on this issue.

Church-affiliated hospital pension plans

The case involved three church-affiliated nonprofits that run hospitals and other healthcare facilities. The hospitals offer defined-benefit pension plans to their employees. The plans were established by the hospitals themselves—not by a church—and are managed by internal employee benefits committees.
The three hospitals involved in the case were Advocate Health Care Network, associated with the Evangelical Lutheran Church in America and the United Church of Christ; Saint Peter’s Health Care System, which is both owned and controlled by a Roman Catholic diocese; and Dignity Health, which maintains ties to the Catholic religious orders that initially sponsored some of its facilities.

A group of current and former employees filed class actions alleging that the hospitals’ pension plans didn’t fall within ERISA’s church-plan exemption because they weren’t established by a church. The district courts agreed with the employees, ruling that a plan must be established by a church to qualify for the exemption, and the appeals courts affirmed the district court’s ruling.

The U.S. Supreme Court, however, ruled 8-0 (Justice Neil Gorsuch didn’t participate in the case) that a plan maintained by a principal-purpose organization qualifies as a “church plan,” regardless of who established it.

**Majority opinion**

Justice Elena Kagan wrote the majority opinion. The definition of “church plan” came in two distinct phases, noted the Court. Initially, ERISA defined it as a “plan established and maintained . . . for its employees . . . by a church or by a convention or association of churches.”

But in 1980, Congress amended the statute to expand the definition. Now, for purposes of the church-plan definition, an “employee of a church” includes an employee of a church-affiliated organization, such as the hospitals in this case.

Congress in 1980 also added a provision stating that the definition of “church plan” includes a plan established or maintained by an entity whose principal purpose is to fund or manage a benefit plan for the employees of churches or church affiliates.

The intent of Congress, the Supreme Court concluded, was to encompass a different type of plan in the definition—one that “should receive the same treatment (i.e., an exemption) as the type described in the old definition.” And these “newly favored plans” are described by the Court as those maintained by “principal-purpose organizations,” regardless of their origins.

In short, the Court stated that “because Congress deemed the category of plans ‘established and maintained by a church’ to ‘include’ plans ‘maintained by’ principal-purpose organizations, those plans—and all those plans—are exempt from ERISA’s requirements.” *Advocate Health Care Network v. Stapleton*, U.S. Supreme Court 581 U.S. ___ (June 5, 2017).

**Sotomayor: Right decision, but a troubling one**

Justice Sonia Sotomayor, in a concurring opinion, noted that the majority opinion meant that “scores of employees—who work for organizations that look and operate much like secular businesses—potentially might be denied ERISA’s protections. In fact, it was the failure of unregulated ‘church plans’ that spurred cases such as these.”

While Sotomayor joined the majority opinion because she was “persuaded that it correctly interprets the relevant statutory text,” she was nonetheless “troubled by the outcome of these cases.” She noted that while Congress acted in 1980 to exempt plans established by orders of Catholic Sisters, “it is not at all clear that Congress would take the same action today with respect to some of the largest health-care providers in the country . . . organizations [that] bear little resemblance to those Congress considered when enacting the 1980 amendment.” ♦

**RETAIATION**

**Employer’s lawyer in hot water after threatening worker with possible deportation**

Only an employer can violate the minimum wage and overtime provisions of the federal Fair Labor Standards Act (FLSA). But the statute’s nonretaliation provisions are broader and may sweep in “any person” who retaliates against an individual based on conduct protected by the FLSA. The U.S. 9th Circuit Court of Appeals (whose rulings apply to all Hawaii employers) recently found an employer’s outside lawyer to be such a person after the lawyer attempted to arrange the detention—and possible deportation—of an undocumented worker when he appeared for a deposition.

**Undocumented status used against claimant**

Jose Arias was hired in 1995 as a milker for Angelo Dairy in California. The dairy, owned by three members of the Angelo family, didn’t complete an I-9 form to establish Arias’ employment eligibility. Instead, they used his undocumented status to keep him in their employ. When Arias reported in 1997 that he had a job offer from another dairy, the Angelos threatened that if he left, they would report the competitor to federal immigration authorities as an employer of undocumented workers. So Arias stayed on.

In 2006, Arias sued Angelo Dairy in California state court for various workplace violations, including failure to pay overtime and to provide rest and meal periods. After protracted proceedings, the case was finally set for trial in August 2011.

Ten weeks before the trial date, Anthony Raimondo, the Angelos’ attorney, set in motion a plan to derail the lawsuit. He enlisted the services of U.S. Immigration
and Customs Enforcement (ICE) to apprehend Arias at a scheduled deposition and then deport him. Raimondo also had plans to block an attorney from California Rural Legal Assistance from representing Arias. These efforts were documented in e-mail messages between Raimondo, one of the Angelos, and an ICE official.

When Arias found out that the Angelos had been providing information about him to ICE, he became fearful of deportation and separation from his family. Due in large part to those fears, he settled his wage and hour claims in July 2011. Nearly two years later, he filed a new lawsuit against both Angelo Dairy and Raimondo claiming unlawful retaliation under the FLSA.

The Angelos settled the second case, but Raimondo argued that he couldn’t be liable for FLSA retaliation because he had never been Arias’ employer. The trial court agreed with Raimondo’s position and dismissed the claim against him. Arias appealed.

**Could employer’s lawyer be liable for retaliation?**

The 9th Circuit began its review by focusing on the FLSA provision prohibiting retaliation. The statute bars “any person” from discharging or discriminating against any employee because of the filing of a complaint under or related to the FLSA. A private legal action for retaliation may be filed against an employer as well as “any person acting directly or indirectly in the interest of an employer in relation to an employee.” Under the FLSA, the term “person” includes a “legal representative.”

The FLSA protection against retaliation, according to the court, is separate and distinct from the statutory provisions on payment of wages. Only an employer can violate wage and hour obligations, but retaliation is “a different animal altogether.” The prohibition of retaliation is designed to enable workers to avail themselves of their statutory rights, including filing legal actions if necessary. So a person who isn’t an employer may nonetheless be liable for retaliation under the FLSA if he acts directly or indirectly in an employer’s interest to deter such claims.

According to the court, Raimondo’s actions on behalf of the Angelos subjected him to the FLSA’s antiretaliation provisions. Information in the record showed that he had established a pattern and practice of such tactics against plaintiffs who had asserted workplace rights. Apparently to show that he hadn’t used threats of deportation, which might violate professional conduct rules, Raimondo acknowledged that “the time when I have had litigants deported, I have always simply taken action rather than make any threats. The attorneys find out when their clients are already gone.” From the court’s viewpoint, such action was “underhanded.”

The 9th Circuit observed that forbidden retaliation isn’t limited to actions taken in the workplace. It includes harm outside the workplace that could deter claimants from coming forward to enforce their rights. Raimondo’s pattern and practice of contacting ICE about suspected undocumented claimants would certainly have just such an effect.

The claim was returned to the trial court for further proceedings. *Arias v. Raimondo*, Case No. 15-16120 (9th Cir., June 22, 2017).

**Beware of acts that aim to harm a claimant**

This case draws a clear distinction between the substantive requirements of an employment law—such as wage and hour obligations—and the prohibition on retaliation against those who pursue substantive claims. Employers should understand that they can’t lawfully carry out retaliation through their lawyers, and lawyers should understand that they might have individual liability if they engage in retaliation against claimants—such as arranging their detention and possible deportation.

**EEOC ENFORCEMENT**

**Best practices for employers under EEOC’s new SEP**

The Equal Employment Opportunity Commission (EEOC) recently released its Strategic Enforcement Plan (SEP) for 2017 to 2021. The new plan replaces an earlier version issued in 2012, but it isn’t a radical departure from the agency’s previous agenda. Employers hoping for a more employer-friendly EEOC under the new administration may be disappointed by the 2017 SEP.

The plan makes clear that the agency will continue to aggressively investigate and litigate issues it sees as having the greatest impact on the development of the law or on promoting compliance across a large organization or industry. The EEOC expresses its intent to “focus on strategic impact” to be effective as a “national law enforcement agency,” despite its increasingly limited funding and staffing.

The new plan focuses on developing substantive areas, including the “gig economy,” “backlash” discrimination against Muslim and Middle Eastern employees, and discriminatory hiring and recruitment policies. It also makes clear that hot-button topics from recent years are likely here to stay. Employers are strongly urged to develop practices now to help them avoid EEOC charges and withstand the agency’s scrutiny.

**EEOC takes on ‘gig economy’**

Today, employees are more likely than ever before to be temporary, part-time, leased, employed through a staffing agency, or employed by more than one employer. These days, more workers fall in that ill-defined gray
zone between true independent contractors and employees. The “gig economy” is defined by the prevalence of short-term contracts and freelance work. In its SEP, the EEOC “adds a new priority to address issues related to complex employment relationships and structures in the 21st century workplace, focusing specifically on temporary workers, staffing agencies, independent contractor relationships, and the on-demand economy.”

Employers that use those types of employment arrangements must remember that “gig” workers can also allege discrimination or harassment. Don’t cut corners on training on your antidiscrimination and antiharassment policies. Temporary employees may be viewed as easy targets for harassment, discriminatory treatment, or bullying. As the recent events at Uber have made clear, companies that grow quickly need to make sure they “grow up” by timely implementing clear and consistent policies and encouraging a culture of professionalism.

**Discrimination against Muslim, Middle Eastern employees**

Another focus area for the EEOC is “addressing discriminatory practices against those who are Muslim or Sikh, or persons of Arab, Middle Eastern, or South Asian descent, as well as persons perceived to be members of these groups.” While it’s somewhat unusual for the EEOC to announce that it will specifically focus on particular religious groups or nationalities, the plan explains that strategic protection is necessary because of “backlash against [those groups] from tragic events in the United States and abroad.” It’s unclear how enforcement of the issue will proceed under the new presidential administration.

Remember that you must provide employees reasonable accommodations for religious observances, including breaks for prayers. Appearance and dress code standards that arbitrarily ban or restrict beards, turbans, or head coverings likely will draw increased scrutiny from the EEOC. Backlash discrimination should be specifically covered in antidiscrimination training.

**Barriers in recruitment and hiring**

The EEOC restated its commitment to eliminating barriers in recruitment and hiring and added new details to its goal. Specifically, the EEOC will take aim at the lack of diversity in certain industries, including technology and police work, and the increasing use and impact of data-driven employment screening tools. Employers in targeted industries should continue to focus on recruiting a diverse workforce.

Employers that use online applications, algorithms, or similar data tools to screen applicants must be particularly careful. Those tools can provide a first look at applicants and assist hiring managers. However, you must know what parameters are used in the screenings and make sure you consider how the screenings could present barriers (even unintentionally) for groups such as older workers, minorities, women, and people with disabilities. For example, a screening tool that automatically eliminates applicants with a long gap in employment may unintentionally have a disparate impact on women who left the workforce to care for a young family. Date-of-birth inquiries could discriminate against older workers. Online application processes that aren’t accessible to people with disabilities present an obvious problem.

Screening applicants by checking their social media profiles also can be risky. Social media profiles may reveal more than a potential employer should know about employees’ religion or other protected characteristics.

**Pregnancy discrimination, unequal pay, LGBT protections**

The EEOC will continue to prioritize substantive issues such as rooting out pregnancy discrimination, preventing unequal pay, and protecting LGBT individuals from discrimination.

The EEOC has focused on accommodating employees’ pregnancy-related limitations. Employers are reminded that pregnant employees should be treated the same as nonpregnant employees with a similar ability or inability to work. Remember, if a pregnant employee hasn’t requested leave or a new role, you can’t force her to take leave or change roles because you believe she shouldn’t perform a certain job. At the same time, a pregnant employee who requests an accommodation should be treated the same as other employees who request accommodations.

The EEOC will continue to focus on equal pay. However, the SEP makes clear the agency won’t focus on equal pay strictly as a gender issue: “The Commission will also focus on compensation systems and practices that discriminate based on any protected basis.” The guidance reminds employers that pay differentials should be based on seniority, merit, or quantity or quality of production, not on protected characteristics.

Finally, as you likely know by now, the EEOC interprets the prohibition against sex discrimination under Title VII of the Civil Rights Act of 1964 as forbidding employment discrimination based on gender identity and sexual orientation. The agency has enjoyed great success in enforcing its position. It has obtained more than $6 million in monetary relief for LGBT workers, required policy changes by employers, and convinced a growing number of courts to endorse its interpretation of Title VII.

The number of EEOC charges based on sexual orientation or gender identity increased by 34 percent in 2015. The agency is unlikely to slow down in its strategic enforcement in this area, and you would do well to include sexual orientation and gender identity as protected
characteristics in your equal employment and anti-harassment policies. The Human Rights Campaign has reported that the vast majority—89 percent—of Fortune 500 companies already prohibit discrimination based on sexual orientation, and two-thirds prohibit discrimination based on gender identity.

Bottom line

The EEOC expects employers to follow not only the laws it enforces but also its interpretations of those laws. Take the time to analyze your work environment regarding the issues in the agency’s SEP. Consider revising your policies and practices to more closely align them with the EEOC’s strategic positions. Your efforts will prove to be invaluable if your company faces an EEOC charge or investigation.

WORKING OVERTIME

Mortgage loan underwriters aren’t exempt ‘administrative’ employees

Among the various “exemptions” from the overtime compensation requirements of the Fair Labor Standards Act (FLSA) are “administrative” employees. The question presented in a recent decision by the 9th Circuit was whether mortgage loan underwriters who work for lending banks fit the administrative exemption. In the last eight years, two other federal courts of appeal have disagreed over the answer to this question. The 2nd Circuit found that they don’t, and the 6th Circuit found that they do. The 9th Circuit agreed with the 2nd Circuit that they don’t.

Administrative exemption requirements

There are three requirements an employee must meet to qualify for the administrative exemption:

1. The employee must be paid a salary of at least $455 per week;
2. The employee’s primary duty must be “office or non-manual work related to the management or general business operations” of the employer or its customers; and
3. The employee’s primary duty must involve the “exercise of discretion and independent judgment with respect to matters of significance.”

As with other overtime exemptions, the administrative exemption is narrowly construed, with the employer having the burden of proving that the exemption applies. Also, all three requirements must be met; failing to satisfy one of them means the employee isn’t exempt. Of the three requirements, only the first is relatively straightforward, however. The second and third are notoriously difficult to apply.

Work of mortgage loan underwriters

The employer of the underwriters was Provident Savings Bank. The bank provides loans to customers who purchase homes or refinance existing home loans. It then sells those loans on the secondary market. The role of the mortgage underwriters is to decide whether the customer’s application, documentation, and creditworthiness satisfy the bank’s criteria—the “guidelines”—for the particular type of loan being sought.

The underwriters can add other conditions to be satisfied before the loan is approved, and they can suggest a “counteroffer” when the customer doesn’t qualify for the desired loan but may qualify for a different loan. They can also request that the bank make an exception in an individual case by approving a loan that doesn’t satisfy the guidelines. However, they don’t deal directly with the customer, they don’t handle the sales on the secondary market, and they have no role in setting the bank’s loan guidelines.

Does their work satisfy second requirement?

According to the regulations under the FLSA, “work related to the management or general business operations” of the employer—the second of the three requirements of the administrative exemption—means that “an employee must perform work directly related to assisting with the running or servicing of the business, as distinguished, for example, from working on a manufacturing production line or selling a product in a retail or service establishment.”

That distinction is commonly referred to as the “administrative production dichotomy.” Its purpose, according to the U.S. Department of Labor (DOL), is to distinguish between “work related to the goods and services which constitute the business’ marketplace offerings and work which contributes to ‘running the business itself.’” If the employees engage in running the business itself or determining its overall course or

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policies, they would meet this requirement, but those whose work is the day-to-day carrying out of the business’ affairs don’t.

Applying this distinction, the court concluded that the mortgage underwriters fell clearly on the “production” side of the line and were thus nonexempt. The court relied on the fact that the underwriters didn’t decide whether the bank should take on a risk; their role was limited to assessing whether a particular loan satisfied the guidelines established by the bank. Their role in assessing a loan’s riskiness was quite different from assessing or determining the loan guidelines themselves or the bank’s other business policies. Because the underwriters didn’t meet the second requirement, it wasn’t necessary for the court to consider their argument that they also failed to meet the third requirement.

The court sent the case back to the trial court to enter judgment in favor of the underwriters. McKeen-Chaplin v. Provident Savings Bank, FSB, Case No. 15-16758 (9th Cir., July 5, 2017).

A note of caution

Because the underwriters weren’t exempt, the bank will be liable for overtime compensation that should have been paid to them for all hours they worked in excess of 40 in a week, retroactively to two or three years before the lawsuit was originally filed, plus prejudgment interest and attorneys’ fees. Determining the exact amount of overtime compensation owed may prove to be difficult because the bank, believing that its underwriters were exempt, probably didn’t keep accurate records of the hours they worked.

This case demonstrates the uncertainties employers face when attempting to apply the administrative exemption. It is by far the most challenging of the FLSA’s exemptions. Care also must be taken to comply with any applicable state-law requirements because they may be even more challenging than the federal requirements. ✪

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