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BURKHALTER KESSLER CLEMENT & GEORGE LLP

Understanding California's New Cannabis Use Laws For Employers

As if California employers did not already have enough legal red tape to be mindful of before hiring a potential employee or terminating a current one, the California legislature has graciously added another: lawful cannabis use off the job and away from the workplace.

Prior to January 1, 2024, employers could use hair or urine marijuana tests – which can detect traces of cannabis's active ingredient, Tetrahydrocannabinol (THC), that can impair and cause psychoactive effects – as a basis to make hiring or terminating decisions based on positive findings. No longer, as an employer who continues this practice may face liability under the Fair Employment and Housing Act (FEHA).

Effective January 1, 2024, Governor Newsom's Assembly Bill 2188 (AB 2188) makes it "unlawful for an employer to discriminate against a person in hiring, termination, or any term or condition of employment, or otherwise penalizing a person" for that person's "off the job and away from the workplace" cannabis use. AB 2188 is specific in that it only precludes the employers from basing such employment actions in reliance upon cannabis tests *that only search for THC metabolites*.

The presence of cannabis metabolites in a person's system does not automatically indicate impairment at the time of testing. It simply suggests recent cannabis consumption, as metabolites take time to leave the body. Therefore, it is conceivable for someone to have metabolites present without being impaired or experiencing psychoactive effects. This scenario could occur if an individual used cannabis off-duty and away from the workplace, yet remains capable of fulfilling their responsibilities at a later time effectively. Simply, just because a drug test finds THC metabolites does not mean that the individual is actively impaired and experiencing psychoactive effects.

Notably, AB 2188 does not apply to all employees. The new law explicitly does not apply to employees in the building and construction trades, applicants or employees requiring federal government background investigations or security clearance, and the law does not preempt other state or federal laws that require applicants/employees to be tested for controlled substances.

Ultimately, an employer can still rely on certain drug tests to make employment related decisions, but the tests used must not solely rely on the presence of non-psychoactive cannabis metabolites and instead should be able to detect active psychoactive impairment caused by cannabis.

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Southwest Airlines Obtains Coverage For Its Cyber Claim

Most businesses purchase first party property insurance policies that provide coverage for the physical assets of the business. The first party policy oftentimes also provides coverage for business interruption; that is, coverage for the net profits of the business in the event of a covered loss. Business interruption coverage can be a life saver for a company. That said, in many instances, business interruption coverage is limited to loss that occurs "solely" as a result of the covered event. This raises the question of whether business decisions that are made to mitigate damages fall within the parameters of coverage.

In *Southwest Airlines v. Liberty Insurance Underwriters Inc.,* 90 F.4th 847 (5th Cir. 2024), Southwest Airlines ("SWA") became embroiled in a coverage dispute over whether its cyber policy covered payments it made to customers in the form of discounts, refunds, vouchers, points, and advertising fell within the parameters of coverage after it sustained a massive, three-day failure of its computer system. SWA submitted a $77M claim. The primary and lower layer insurers paid $50M of the claim. Amounts above $50M were to be paid by Liberty Insurance Underwriters, Inc. ("Liberty") but Liberty denied the claim. According to Liberty, $35M of the claim was not covered because SWA made the discretionary business decision to pay its customers. Simply put, the expenditures were not required. Liberty argued that the policy only covers loss incurred "solely" as a result of a system failure and the claimed losses were due to SWA's independent "business decision." On summary judgment, the district court ruled in favor of Liberty. (continued on page 4)

In This Issue

4 Important Things For California Businesses To Consider In The New Year

As 2024 begins, we wanted to remind and advise you of some important issues that you should consider in order to minimize the risk of lawsuits and other legal difficulties for your business.

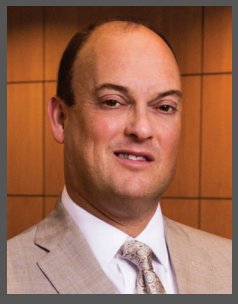
1. Employment Law Issues: Increase in Minimum Annual Salary for Exempt Employees; Employee Cell Phone and Internet Reimbursement. As is the case every year, a raft of new employment laws went into effect on January 1, 2024. Some of these laws are discussed elsewhere in this newsletter and, of course, your company should discuss these changes with your HR Manager or consultant, and update your Employee Handbook, as needed, as soon as possible. However, an important issue that often gets overlooked when the California minimum wage increases is the fact that, since the minimum legally-required annual salary for exempt employees is twice the minimum wage, a minimum wage increase also potentially necessitates a salary increase for your exempt employees. As of January 1, the minimum wage in California is $16.00/hour for all employees (regardless of company size), meaning that the minimum legally-required annual salary for exempt employees is now $66,560. If you are not already paying any of your exempt employees this amount, you should immediately begin doing so and contact BKCG to determine how best to address any legal oversight on your part.

Another often overlooked employment issue which can lead to legal claims is for the failure to reimburse certain employee expenses. Please bear in mind that if you have employees working from home who are using the internet, you are required to contribute to their home internet expenses. Similarly, as has been the established law in California for a number of years now, if employees use their personal cell phone for work purposes, the employer is required to contribute to their personal cell phone expenses - even if the employee has a flat rate cell phone plan and the employee's work usage does not cause the employee's plan cost to increase. While we cannot offer any clear- cut guidance on how much those reimbursement amounts should be (since it will depend on the amount of employee usage), we recommend a minimum employee stipend of $35/month for cell phone usage and $35/month for home internet expenses. Employment laws in California are constantly changing and the failure to keep up with them can be ruinously expensive. We can help!

2. Use of Independent Contractors. California law remains inherently hostile to the use of independent contractors. What many businesses *still* do not comprehend is that treating someone as a properly classified independent contractor is not just as simple as both parties agreeing to the nature of the relationship and then signing an Independent Contractor Agreement. Nor is it sufficient that an individual simply forms an entity, so that you can issue a Form 1099 to the entity, rather than to the individual, and consider the entity an independent contractor. Rather, the legitimacy of treating someone as an independent contractor hinges almost entirely on the facts and circumstances of the underlying business relationship between the parties. As a recap to our prior articles on this subject, to begin with, unless the worker is in an exempted occupation (mostly professional occupations such as doctors, lawyers, dentists, licensed insurance agents, accountants, architects and engineers, private investigators, real estate agents, translators, appraisers and home inspectors, etc.), the worker must satisfy California's ABC test (modelled on the identical Massachusetts test) in order to be properly classified as an independent contractor. All three of the following conditions must be met: (A) the worker is free from the control and direction of the hiring entity in connection with the performance of the work, (B) the worker performs work that is outside the usual course of the hiring entity's business, and (C) the worker is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed. For most businesses, the (B) prong of the test is the kiss of death since, in most situations, the hiring entity *does* intend to have the worker perform tasks that are very much a part of its regular core business. That factor alone precludes independent contractor status. The analysis does not stop there either, however, because even if the worker is engaged in an exempt occupation, the business relationship must still satisfy the *Borello* test that used to be the default test in California. The *Borello* test, together with more details on the ABC test, are explained on the California Department of Industrial Relations' website here: https://www.dir.ca.gov/dlse/faq_independentcontractor.htm. The legal penalties and ramifications of employee misclassification can be severe and punitive so please tread carefully and seek legal advice before you hire an independent contractor!

3. Reviewing Your Major Business Contracts. We definitely appreciate the fact that business owners may not see the value in digging out and reviewing the contracts they have previously signed with their landlords, key vendors, suppliers and other business partners. However, doing so is essential in order to avoid unintended consequences, or nasty surprises. Contracts contain clauses such as renewal options, automatic renewals, and periodic adjustments in prices or terms which require notice to be given within a specified period or by a certain date to either exercise the option or to avoid an unwanted automatic renewal, or some other action on the part of the business. Ideally, those deadlines or time windows should be calendared when the agreement is signed; however, business owners are often so relieved to get an agreement negotiated and signed, and to get back to running their business, that they neglect to do so. To that end, if you are reading this article, stop and think about your company's most significant current business contracts. Do you know where they are and do you have fully-executed copies of them (as you cannot rely upon unsigned drafts)? Do you know when they expire? Have they already expired? Have you calendared the date by which you need to tell your landlord whether you want to exercise your lease extension option, or your option to purchase the building you occupy? Have you calendared the date by which you have to give the other party written notice of non-renewal to prevent an economically undesirable, or otherwise unwanted, contract from automatically renewing, perhaps for a multi-year period? I can assure you that a few minutes spent reviewing the contracts most critical to your business may save you months, or even years, of headaches, legal problems and regrets. And, if you can't bring yourself to do so, send them to me and I will review them for you!

4. New Mandatory Report Due under Federal Corporate Transparency Act - Effective January 1, 2024. Just a quick reminder that, as set forth in our Winter 2023 newsletter (see https://www.bkcglaw.com/wp-content/uploads/sites/1101616/2023/12/2023_Q4_BKCG_Newsletter.pdf at page 2), a new, mandatory, anti-money laundering Federal reporting requirement went into effect on January 1, 2024 for all existing and future U.S.-formed and U.S.-registered foreign entities, unless they qualify for one of 23 exemptions. If required, the report mandates providing personal information for all 25% or greater "beneficial owners" and certain C-level executives, and must be filed by January 1, 2025 for entities formed prior to January 1, 2024. Probably the most widely applicable exemption will be for "Large Operating Companies" that employ more than 20 full-time employees in the United States, maintain an operating presence at a physical office within the United States and filed a federal income tax or information return in the United States for the previous year demonstrating more than $5,000,000 in gross sales from U.S. sources. More information on this filing requirement can be found on the U.S Department of the Treasury's FAQ page here: https://www.fincen.gov/sites/default/files/shared/BOI_FAQs_Q%26A_12.1.23.pdf



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Supreme Court Decision Regarding PAGA Claims Requires Proactive Steps From Employers

The recent California Supreme Court case of *Estrada v. Royalty Carpet Mills, Inc.* was another body-blow to employers facing class-action PAGA litigation by drastically curtailing a trial court's authority to dismiss those claims based on "manageability concerns." This latest decision requires proactive measures from employers to try and prevent such claims from occurring in the first place.

PAGA (Private Attorneys General Act) authorizes allegedly aggrieved employees to sue their employers for additional civil penalties for various alleged Labor Code violations on behalf of themselves, other employees and the state of California. In *Estrada*, two plaintiffs sued their employer alleging various claims, including violations of Labor Code provisions regarding meal periods, and they also sought PAGA penalties for alleged Labor Code violations. The trial court initially certified a class and subclasses related to meal periods but later decertified the subclasses and dismissed the PAGA claim based on manageability concerns. The plaintiffs appealed, and the Court of Appeal reversed the trial court's decision.

The Supreme Court of California granted review. When the matter reached the California Supreme Court, Courts of Appeal were split on whether trial courts possess the inherent authority to strike or dismiss a PAGA claim with prejudice by employing manageability requirements. In cases that had been dismissed for manageability issues, employers successfully argued that the California Supreme Court's decade-old decision, *Duran v. U.S. Bank National Assn.*, applies to representative actions insofar as the representative action must be manageable for trial. In *Duran*, the Supreme Court reversed a $15 million judgment based on a flawed statistical sample and acknowledged the importance of due process and managing individual issues fairly and efficiently in a class action.

In *Estrada*, however, the Supreme Court resolved the split of authority by concluding that trial courts *do not* have the inherent authority to strike PAGA claims on manageability grounds, holding that trial courts do not generally have such broad inherent authority to dismiss claims using class action manageability requirements. The decision follows a trend of recent Supreme Court holdings that have steadily eroded traditional litigation defenses used by employers in similar settings.

More than ever, employers must be vigilant to protect themselves. If you have an arbitration agreement, you should make sure that it contains a mandatory class action waiver. These can be used to successfully compel plaintiffs' individual claims to arbitration, avoid class actions and limit representative cases to PAGA only until the Supreme Court of the United States decides to weigh in. You should carefully review your wage and hour programs for compliance and implement programs, such as recording all meal and rest breaks accurately. If litigation does happen, it is important to make every effort to narrow the scope of the claims and the evidence presented at trial, in order to limit penalties from potential widespread violations. This can be done using litigation tools such as a demurrer, summary judgment/adjudication and motions for judgment on the pleadings. If you have questions about PAGA claims or how to insulate yourself from future litigation, please contact your BKCG lawyer.

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Important Changes To Laws Regarding Non-Competition Agreements

Some important new laws went into effect in California starting January 1, 2024 that impact post-employment, non-competition agreements in a number of significant ways.

First, the newly amended version of Business and Professions Code Section 16600 restates the well-settled law in California that, aside for a few narrow exceptions, all contracts that seek to restrain anyone from "engaging in a lawful profession, trade, or business of any kind" are void. Section 16600 has now been expanded, however, so that the prohibition also extends to contracts and agreements entered into in states other than California. As the law is new, there is no reliable way to say how this expansion of Section 16600 will be interpreted by courts outside of California, but it seems reasonable to assume that California's Courts would not hesitate to prevent any Californian business from enforcing such a provision even in a case brought by an individual living outside of California.

Section 16600 also now broadly provides that the prohibition on restraints of trade is not limited "to contracts where the person being restrained from engaging in a lawful profession, trade, or business is a party to a contract." Again, this provision is consistent with prior California case law, but now there is a statutory basis that disallows, for example, an employer from trying to prevent a former employee from recruiting other employees to join them at their new job. This provision is written so broadly that it potentially could affect other "non-solicitation" agreements or provisions outside of the employment context. For the time being, there is simply no way to predict how this expansive provision will be treated by the courts.

Furthermore, a new provision of the Business and Professions Code now provides a private cause of action (i.e., a right to sue) by which someone can challenge a post-employment non-competition agreement or certain other restrictive covenants as unlawful and if that person prevails they would be awarded damages and attorneys' fees. So, for example, if an individual is located in California and is presented with an employment agreement that prevents them competing in an industry once that agreement is terminated, that individual could challenge that agreement before ever signing it.

Finally, the new statutes required that employers provide written notice by February 14, 2024 to all current California employees and every former employee who left employment after January 1, 2022 and who signed a post-employment non-compete agreement or other agreement containing a post-employment non-compete provision, that those agreements are void.

California has always been very protective of competition and career mobility and the amendment and expansion of the Business and Professions Code demonstrates the state's desire to add more teeth to these protections to ensure employers comply. Since the repercussions of non-compliance have been ratcheted up in 2024, please reach out if you have any questions regarding non-competition laws.

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Southwest Airlines Obtains Coverage For Its Cyber Claim (continued from page 1)

In January 2024, the 5th Circuit ("Court") reversed the district court and remanded the case for further proceedings. Under the policy, the coverage provision provides indemnity for "all Loss… that an Insured incurs…***solely*** as a result of a System Failure." (Emphasis ours.) According to the Court, the "losses" are costs that would not have been incurred but for a covered event. Clearly there was a "loss" under the policy. The decision then focused on the meaning of the term "solely" as it was not defined in the policy. Does the term "solely" mean "to the exclusion of all else" so that there can be no intermediate cause such as a discretionary decision? Or does it mean that there just can be no other originating or precipitating causes?

As there was no case on point, the Court examined various personal injury cases and concluded that the "sole" cause is one independent of any other cause. If a person is injured in an accident and then sustains complications like septic shock or organ failure, the complications are not independent causes but rather were caused by the original injury. Similarly, in the SWA case, the question to be answered by the lower court is whether the payments made by SWA for each category of claimed damages were independent of the computer failure or more akin to complications arising from the computer failure. In other words, at trial, the inquiry needs to be on whether there were competing causes of the claimed loss or whether the business decisions were merely a link in the causal chain that led back to the system failure. The Court left it to the district court to figure things out on remand.

Liberty then attempted to escape liability by arguing that the SWA payments were "consequential damages," which are excluded under the policy. Liberty argued that "consequential damages" exclude costs that are not "direct" and "immediate." SWA countered that "consequential damages" is a legal term of art and refers to the type of harms that flow naturally, but not necessarily from the occurrence. Under SWA's interpretation, an example of "consequential damages" is a passenger who might sue the airline because her flight was cancelled thereby causing her to miss a lucrative business opportunity. Again, the Court decided in favor of SWA holding that Liberty's interpretation was far too narrow and would wipe out huge portions of the policy.

The Court's interpretation of the cyber policy is good news for insured businesses. The Court refused to allow the carrier to use the lack of definitions in the policy coupled with the carrier's decision to interpret the coverage very narrowly and the exclusion very broadly to deny coverage. Businesses that sustain a covered loss should review the language of the policy very closely and get the coverage it purchased. That means coverage provisions should be interpreted broadly and exclusions narrowly. Not the other way around.

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