

Ten HR Issues from 2007¹
Employment Roundtable
December 13, 2007

The following are ten important developments in labor and employment law during 2007:

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¹ This memorandum contains a summary of information obtained from laws, regulations, court cases, administrative rulings, and legal publications and should not be viewed or relied upon as legal advice. Ater Wynne LLP urges readers of this memorandum to consult legal counsel regarding specific legal issues and factual circumstances.

1. GENERAL WAGE AND HOUR UPDATE

The Oregon Legislature enacted several new wage and hour laws. Employers should adapt their practices as necessary to comply with these new requirements. Even minor violations of wage and hour law can expose the employer to substantial liability, particularly in the class action context. While the Bureau of Labor and Industries (BOLI) is still in the process of promulgating related rules, most of the new laws and amendments go into effect on January 1, 2008.²

- HB 2255 (Or. Law 278³) amends ORS 652.355, ORS 659A.060 and ORS 659A.885 to make discrimination or retaliation against employees who complain about or inquire about wages an unlawful employment practice under ORS chapter 659A. Employees may now file complaints with BOLI or with the court. In November, BOLI issued proposed implementing amendments to OAR 839-010-100.⁴
- HB 2256 (ch 546⁵) explicitly allows employers to pay wages via electronic transfers under specific conditions. Although BOLI has taken the position that payment via electronic paycards and similar methods was allowed under prior law, the authority for this was less than clear. The new law amends ORS 652.110 to specify the permissible parameters of electronic payroll practices, which include payment by direct deposit, ATM card, payroll card, or other similar method. Employees must explicitly agree to such an arrangement; there must be no charge for the employee to withdraw the entire amount of net pay upon initial withdrawal; and employers must stop such use of electronic payment method as requested by the employee.
- HB 2258 (ch 453⁶) amends ORS 652.120 to create deadlines for correcting underpayments to employees. If the unpaid amount is less than five percent of the employee's gross wages due on the regular pay day, the unpaid amount must be paid no later than the next regular pay day. If it is a greater amount, it must be paid within three days after the employer becomes aware of the unpaid amount, excluding weekends and holidays.
- HB 2674 (ch 676⁷) amends the wage deduction statute to specify the time in which the deducted amount must be paid to the recipient – either the time specified by the applicable law or agreement or within seven days after the deduction. Failure to pay such sums in a timely manner constitutes an unlawful deduction from wages.

In addition to the legislative changes, the Oregon Court of Appeals changed the landscape of wage and hour litigation with its decision in *Gafur v. Legacy Good Samaritan Hospital and*

² http://www.oregon.gov/BOLI/LEGAL/H_Notices.shtml.

³ <http://www.leg.state.or.us/07orlaws/sess0200.dir/0278.htm>.

⁴ <http://www.oregon.gov/BOLI/LEGAL/docs/Rules0100215etseqMemo.pdf>.

⁵ <http://www.leg.state.or.us/07orlaws/sess0500.dir/0546.htm>.

⁶ <http://www.leg.state.or.us/07orlaws/sess0400.dir/0453.htm>.

⁷ <http://www.leg.state.or.us/07orlaws/sess0600.dir/0676.htm>.

*Medical Center*⁸ in 2007. The court held that employees who miss a paid *rest* break can sue their employer in court despite numerous prior trial court rulings stating that only BOLI could enforce rest break rules. The court stopped short of allowing employees to sue for missed or partial unpaid *meal* breaks. In Oregon, employers still are responsible for ensuring that nonexempt employees take their unpaid lunch breaks, even if the employees do not cooperate – and, such a failure to take breaks is a legitimate ground for disciplinary action. However, under *Gafur*, employers must now pay the employee for an additional ten minutes of time for each missed *rest* break (previous logic was that since the breaks themselves were paid time, no extra pay was due for a missed rest break). Employers should audit their practices to minimize their rest break liability. Nonexempt employees are generally entitled to a paid, uninterrupted ten-minute rest break for every four-hour segment of work, or major portion thereof.⁹ The Oregon Supreme Court has accepted review of *Gafur*, with oral argument currently scheduled for February of 2008.¹⁰ For now, however, the Court of Appeals decision governs in Oregon.

Finally, in case you missed it, Oregon's 2008 minimum wage is \$7.95 per hour. This change applies to wages earned after January 1, 2008 (*i.e.*, if wages are earned in 2007, but paid in 2008, the increase does not apply).

LESSON:

Wage and hour lawsuits are on the rise. Minor payroll issues can become big headaches. Employers need to audit rest and meal break policies and enforcement on a regular basis, so any problems do not balloon into class action liability.

2. EMPLOYMENT CLASS ACTION UPDATE

Employment-related class actions have continued to gain both notoriety and momentum throughout 2007. Although California continues to lead the employment class action litigation charge,¹¹ *Gafur v. Legacy Good Samaritan Hospital and Medical Center*,¹² a rest and meal break class action (which allowed a private right of action for missed paid rest breaks) may be a sign of things to come in Oregon. In addition, several legislative changes may impact wage and hour class action litigation in the coming years. For example, a court may allow a class action if an employer uniformly and inappropriately charges employees for electronic payroll processes.

In *Dukes v. Wal-Mart, Inc.*, the Ninth Circuit allowed a sex discrimination class action to proceed, which involved approximately 1.5 million class members.¹³ The lawsuit alleges that Wal-Mart discouraged the promotion of women to management positions and paid them less

⁸ 213 Or.App. 343, 161 P.3d 319 (2007); <http://www.publications.ojd.state.or.us/A130070.htm>.

⁹ See OAR 839-020-0050.

¹⁰ Oregon Supreme Court case no. S055175.

¹¹ See, e.g., *Gentry v. Superior Court*, 42 Cal.4th 443 (2007) (waiver of right to class wide arbitration on overtime pay claims held unconscionable); *Belaire-West Landscape, Inc. v. Sup.Ct.*, 149 Cal.App.4th 554 (2007) (employee privacy rights in wage and hour class action); *Harris v. Sup. Ct.*, 154 Cal.App.4th 164 (2007) (class certification upheld for claims adjusters allegedly improperly classified as administrative employees); *Estrada v. FedEx Ground Package System, Inc.*, 154 Cal.App.4th 1 (2007) (class action against shipper for improperly classifying delivery truck drivers as independent contractors).

¹² 213 Or.App. 343, 161 P.3d 319 (2007).

¹³ 474 F.3d 1214 (9th Cir. 2007).

than it paid men. The case is significant for several reasons: (1) it is the largest employment discrimination class action ever certified in the United States and (2) it demonstrates the developing theory of “unconscious bias” discrimination litigation.¹⁴ The suit seeks more than one billion dollars in back pay, plus punitive damages, in addition to injunctive relief.

The tremendous size of the class in *Dukes v. Wal-Mart, Inc.*, the vast differences in the putative class members in terms of positions, salary, time and place of employment, and the fact that such a diverse class was approved by the Ninth Circuit, means plaintiffs’ attorneys can be expected to continue to push the boundaries of class action litigation even further. It also appears to make it somewhat more difficult for defendants to argue that cases should not be certified due to the unmanageability of large classes involving diverse fact issues. The Ninth Circuit seemed to find the use of experts’ testimony and statistical evidence sufficient to solve many of the problems in dealing with such a large class, a trend that provides both opportunities and problems for employers.

The *Dukes* case, which has been in litigation for several years already, also is notable for the relatively novel concept of liability for “unconscious bias.” This is “a social science theory premised upon the belief that people inherently and unthinkingly apply race and gender stereotypes to everyday decisions.”¹⁵ Expert witness testimony may provide evidence that such a bias exists and affects employment decisions “even when there is no objective evidence of animus.”¹⁶ In the *Dukes* case, such evidence was utilized by plaintiffs to demonstrate “commonality” among the diverse group of plaintiffs – all the plaintiffs were allegedly affected by such “unconscious bias.” A petition for an *en banc* rehearing is currently pending before the Ninth Circuit in the *Dukes* case.

LESSON:

With the scope of employment class actions broadening, one important way for an employer to shorten its statute of limitations and, hence, reduce its exposure, is to regularly audit employment practices and rectify any problem areas promptly.

3. DOMESTIC PARTNERSHIP ACT (OREGON FAMILY FAIRNESS ACT)

The Oregon Family Fairness Act,¹⁷ establishes a domestic partnership system for same-sex couples.¹⁸ Oregon joined the small but growing number of states, including California,¹⁹ Connecticut,²⁰ Hawaii,²¹ Maine,²² Massachusetts,²³ New Hampshire,²⁴ New Jersey,²⁵ Vermont²⁶

¹⁴ See generally, Charles E. Feuss and Jeremy D. Sosna, *Courts are Warming to Claims of ‘Unconscious Bias’; as a Result, Employers Face Bigger Class Actions and Costlier Litigation*, 10/1/2007 Nat’l L. J. S2 (Col. 1).

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ 2007 Or. Law 99 (HB 2007), <http://www.leg.state.or.us/07orlaws/sess0001.dir/0099.htm>.

¹⁸ Oregon also enacted the Oregon Equality Act, 2007 Or. Law 100 (SB 2), <http://www.leg.state.or.us/07orlaws/sess0100.dir/0100.htm>, prohibiting sexual orientation discrimination.

¹⁹ California Family Code §297, *et seq.*

²⁰ <http://www.cga.ct.gov/2005/act/Pa/2005PA-00010-R00SB-00963-PA.htm>.

²¹ Hawaii allows “reciprocal beneficiary registration” for adults who are prohibited by state law from marrying, including same-sex couples. Hawaii Statutes § 572C.

and Washington²⁷ that formally recognize same-sex unions, whether through the institutions of marriage, civil unions or domestic partnerships.²⁸ Oregon's law explicitly recognizes that the Oregon Constitution does not allow same-sex marriage. Instead, the domestic partnership law allows same-sex couples to file a notarized "Declaration of Domestic Partnership"²⁹ that will allow them to receive a "Certificate of Registered Domestic Partnership" from the applicable county.³⁰ The Certificate grants the domestic partners the same benefits and responsibilities granted to married couples by the state of Oregon (*i.e.*, hospital visitation rights, medical decision-making, mutual financial obligations, parentage rights, etc.). Rights granted include:

Any privilege, immunity, right, benefit or responsibility granted by statute, administrative or court rule, policy, common law or any other law to an individual because the individual is or was married, or because the individual is or was an in-law in a specified way to another individual, is granted on equivalent terms, substantive and procedural, to an individual because the individual is or was in a domestic partnership or because the individual is or was, based on a domestic partnership, related in a specified way to another individual.³¹

Domestic partnerships may be terminated only by a judgment of dissolution, a judgment of annulment, or the death of one of the partners.

Registered domestic partners therefore are treated the same as spouses under Oregon law. However, when federal law conflicts with the state domestic partnership law, domestic partners may not receive the same benefits as married couples (*i.e.*, federal tax treatment, Social Security survivor benefits). At the federal level, the Defense of Marriage Act ("DOMA")³² requires that in all federal laws, the words "marriage" and "spouse" refer only to opposite-sex couples

²² Public Laws of Maine, 2003, Chapter 672, <http://janus.state.me.us/legis/ros/lom/lom121st/15pub651-700/pub651-700-32.htm>.

²³ *Goodridge v. Dept. of Public Health*, 440 Mass. 309, 798 N.E.2d 941 (2003); Mass. General Laws Ch. 207.

²⁴ <http://www.gencourt.state.nh.us/legislation/2007/hb0437.html>.

²⁵ http://www.njleg.state.nj.us/2006/Bills/A4000/3787_11.PDF.

²⁶ <http://www.sec.state.vt.us/otherprg/civilunions/civilunionlaw.html>.

²⁷ 2007 Washington Laws Ch. 156.

²⁸ The law of each of these states varies significantly, and each law should be examined independently for applicability and effect when relevant.

²⁹ A form is expected to be available from Oregon's Department of Human Services, Center for Health Statistics' web site after January 1, 2008 at <http://www.oregon.gov/DHS/ph/chs/order/dp.shtml>. FAQs and other information are currently available on the web site.

³⁰ This is different from the current registry systems that some local jurisdictions allow, such as Multnomah County –such registries do not grant the same legal rights.

³¹ 2007 Or. Law 99 § 9.

³² Pub. L. No. 104-199, 110 Stat. 2419 (Sept. 21, 1996) (codified at 1 U.S.C. § 7 and 28 U.S.C. § 1738C).

regardless of any contrary state law.³³ DOMA also provides that states need not recognize same-sex marriages from other states (although they may choose to do so).³⁴

Effect on Employee Benefits Offered by Private Employers³⁵

ERISA applies to benefits offered by non-governmental³⁶ entities to their employees. ERISA probably preempts any claim that domestic partners must be treated like spouses under those plans. All employers, however, may choose to treat spouses and domestic partners in an equivalent manner, except as required by federal law as noted below. The City of Portland has adopted an Equal Benefits Ordinance, which prohibits its contractors from discriminating “by policy or practice in the provision of employee benefits between an employee with a [same or opposite-sex] domestic partner and an employee with a spouse.”³⁷ To the extent employers that are not subject to ERISA provide benefits to spouses, they must generally also be offered on the same basis to registered domestic partners.

- **Health Insurance and Health Savings Accounts (HSA)**

Employers may provide tax-free health insurance benefits to non-employee domestic partners only if the partner meets the Internal Revenue Code’s definition of “dependent.” That requires, among other tests, that the domestic partner receive at least one-half of his or her support from the employee. To entitle a domestic partner to benefits, the employer’s health plan must expressly provide for such benefits. Employers should review their plan’s eligibility provision to ensure that the plan reflects the employer’s intent. Employers choosing to offer benefits to a domestic partner may consider requiring an affidavit or other certification process³⁸ to determine and document the eligibility of the domestic partner.

- **COBRA**

COBRA does not consider a domestic partner to be a “spouse” entitled to COBRA benefits, and such partners, therefore, are not entitled to COBRA rights or notices. Despite this, since COBRA provides minimum coverage requirements, an employer’s health plan may offer COBRA benefits to a domestic partner since COBRA does not prohibit an employer from offering continuation coverage to a larger group than required. However, unless the domestic partner is a “dependent,” the COBRA benefits are taxable. Again, careful drafting and close consultation with the health plan insurer are required. HIPAA has a slightly different definition

³³ This limitation is explicitly recognized by 2007 Or. Law 99 § 9(6)-(7).

³⁴ It is not clear if Oregon will recognize other states’ same-sex domestic partnerships, civil unions or marriages – current wisdom is that such partners will likely also register their partnership in Oregon if they desire formal legal recognition of their relationship in Oregon.

³⁵ Previously printed, in part, at John Walch, *Domestic Partners and Employee Benefit Plans*, http://www.aterwynneblog.com/oregon_business_litigation/2007/06/domestic_partne.html (June 16, 2007).

³⁶ Oregon public employers must extend the same health care benefits that spouses receive to same-sex partners as required by *Tanner v. OHSU*, 157 Or.App. 502, 971 P.2d 435 (1998).

³⁷ Portland City Code 3.100.053 (City Ordinance 180077), <http://www.portlandonline.com/shared/cfm/image.cfm?id=176322>.

³⁸ A copy of the Certificate of Registered Domestic Partnership provided by the county may be part of this process.

of dependent that may require providing a special enrollment period for domestic partners who lose their own coverage.

- **Dependent Care Assistance Program (DCAP) and Health Flexible Spending Account (FSA)**

As above, these plans may provide benefits for domestic partners that satisfy the tax code's definition of dependent, provided that the plan eligibility provision is drafted to do so. Again, the employer should review the plan(s) to ensure they are working correctly.

- **Retirement Plans**

Many 401(k) or profit sharing plans allow hardship distributions for certain educational or medical-related expenses of the participant's dependent. Such expenses incurred on behalf of a domestic partner that satisfy the dependent definition are eligible for hardship distributions.

One important element that is not available to domestic partners is automatic inheritance of a retirement plan benefit. Federal law limits that automatic right to a "surviving spouse," defined as the surviving member of an opposite-sex marriage. An employee who wishes to have his or her non-employee partner receive any death benefit must complete a beneficiary designation form for that purpose.

- **Cafeteria (Section 125) Plans**

Cafeteria plan rules allow participants to make changes to their elections if the participant has a "change in status event." One such event is a change in "legal marital status." However, registering as domestic partners is not considered a change in legal marital status. Even a same-sex marriage is not a change in status event, again because of the federal law's restrictive definition of "marriage."

Other benefit plans (life insurance, dental, vision, etc.) should undergo a similar analysis. Failing to know and understand the tax consequences of benefit plan coverage in a rapidly evolving area of the law can have an adverse impact on both the employer and the employee.

LESSON:

Employers should review their policies and benefit plans to ensure that they are complying with both state and federal law in their treatment of domestic partnerships. They may also wish to consider whether or not they will require same-sex domestic partners to be certified under state law in order to access any available benefits. Employers may also wish to review their treatment of opposite-sex domestic partners at the same time.

4. NON-COMPETITION AND ARBITRATION AGREEMENTS

At the end of its 2007 session, the Oregon legislature passed Senate Bill 248,³⁹ which imposes significant new restrictions on employee arbitration and non-competition agreements. The new

³⁹ <http://www.leg.state.or.us/07reg/measpdf/sb0200.dir/sb0248.en.pdf>.

law applies to arbitration and non-competition agreements entered into on or after January 1, 2008.

Under the amendments to ORS 36.620 and 653.295, both arbitration and non-competition agreements between employers and employees are voidable unless:

- (1) The employer informs the employee in a written employment offer received by the employee at least two weeks before the first day of the employee's employment that the agreement is required as a condition of employment; or
- (2) The agreement is entered into upon a subsequent bona fide advancement of the employee by the employer.

The new restrictions apply to all arbitration agreements between an employer and employee. It is unclear, however, whether this restriction will be applied to arbitration agreements between an employer and employee that are not imposed as a condition of employment, such as separation, stock, or change of control agreements. In contrast, the non-compete statute expressly excludes from its scope agreements that are outside of the context of an employment relationship.

Non-competition agreements will not be enforceable for a period longer than two years. In addition, excluding certain restrictions specific to the broadcast industry, most non-competition agreements will not be enforceable unless:

- (1) The employee is an administrative, executive, or professional employee exempt from overtime pay under ORS 653.020(3);
- (2) The employee has access to trade secrets or other competitively sensitive business information; and
- (3) The employee's annual gross compensation at termination exceeds the median family income for a four-person family under Census Bureau guidelines (currently around \$62,000).

If the employee is non-exempt and/or does not meet the income requirements, a non-compete may be enforced for up to two years if the employer pays the employee for the duration of the non-compete period the greater of fifty percent of the employee's annual gross base salary and commissions at the time of the employee's termination, or fifty percent of the median family income for a four-person family, as determined by the United States Census Bureau for the most recent year available at the time of the employee's termination.

A significant change in the law that benefits employers is the express exclusion of employee and customer non-solicitation agreements from the scope of the non-compete statute. Employers may enter into such agreements at any time during the employment relationship and will no longer be required to show protectable interest as a condition to enforcing them. However, while there is no longer any statutory bar to entering into such agreements, they are still subject to standard contracting requirements (*e.g.*, requiring offer, acceptance, and consideration).

LESSON:

The new law imposes significant limitations and benefits on employers who seek to enter into arbitration and/or non-compete agreements with their employees. Requiring such agreements as a condition of employment requires advance planning and documentation of the timing and terms of the agreement to maximize the likelihood that a court or arbitrator will enforce it. Employers should have agreements and procedures in place well in advance of making an offer of employment to any new employees.

5. NEW LEAVE AND BREAK LAWS

Oregon Victims of Certain Crimes Leave Act

The 2007 legislature enacted additional protection for employees affected by crime.⁴⁰ The new leave law is effective January 1, 2008. Specifically, ORS 659A.805 requires employers with six or more employees to allow employees affected by sexual assault, domestic violence or stalking crimes to take time off to address their circumstances including leave to attend proceedings, obtain healthcare, and to relocate or secure their homes.

To be eligible, an employee must be a victim of (or the parent or guardian of a victim of) specified crimes (discussed below). The employee must have worked at least an average of 25 hours per week during the 180 days prior to the leave. The Oregon Bureau of Labor and Industries is in the process of drafting rules implementing this statute and the final rules may expand the individuals who may be eligible for leave (for example, the draft rules make leave available to victims of certain crimes and “any other person who has suffered financial, social, psychological or physical harm as a result of domestic violence committed against the victim * * *.”⁴¹

The types of crimes for which leave is allowed under the statute include sexual assault,⁴² domestic violence,⁴³ and stalking crimes.⁴⁴ Leave may be taken for specific reasons which include: to seek legal or law enforcement assistance, to ensure the health and safety of the employee, including participating in legal proceedings, to seek medical treatment to recover from injuries caused by the crime, including mental health counseling, to obtain other services, and to relocate or secure the home.

Employers must allow a reasonable amount of leave, unless it causes an undue hardship, which is defined as “significant difficulty and expense” in consideration of the size of the employer and the need for the employee’s services. The leave is unpaid except that employers must allow employees to use any available vacation or other paid time off. Employees must provide

⁴⁰ The 2003 Oregon Legislature enacted a new state law requiring employers with six or more employees to allow employees to take time off to attend criminal proceedings arising from the employee or family member having been a victim of certain serious crimes (person felonies), unless undue hardship would result. ORS 659A.192. The employer must allow the employee to use available paid time off, including vacation, for the leave.

⁴¹ Proposed Rule 839-009-0325.

⁴² As defined by reference to ORS 163.305 to 163.467 or 163.525.

⁴³ As defined by reference to ORS 107.705.

⁴⁴ As defined by reference to ORS 163.732.

reasonable advance notice of the need for leave, unless giving notice is not feasible. The employer can require the employee to provide certification justifying the need for leave. Certification can include a copy of a police report, protective order, or other evidence from a court or attorney or member of law enforcement, health care provider, member of the clergy or victims services provider. All records must be kept confidential.

LESSON:

Covered employers (those with six or more employees in Oregon) should institute policies governing leave under this statute. Employers may want to create a single leave policy that includes leave under this new law (the Oregon Victims of Certain Crimes Leave Act),⁴⁵ and the prior leave law enacted in 2003 allowing leave for employees who are victims of certain “person felonies.”⁴⁶ As soon as final regulations implementing the Oregon Victims of Certain Crimes Leave Act are issued by the Oregon Bureau of Labor and Industries, employers should again review their policies for consistency with the rules.

Breaks for Nursing Mothers

Under a law passed by the 2007 state legislature, Oregon employers with over 25 or more employees must provide reasonable rest periods to accommodate an employee who needs to express breast milk for her child age 18 months or younger, unless doing so would present an undue hardship.⁴⁷ Unless otherwise agreed between the employer and employee, the employer shall provide a 30-minute rest period to express milk during each four-hour work period, to be taken near the middle of the work period.⁴⁸ If feasible, the employee is required to take the rest periods at the same time rest or meal periods are otherwise provided to employees. The rest period is unpaid except to the extent the employer is otherwise required to provide a paid rest period. For example, it appears that under this statute, if an employee takes a 30-minute rest break to express milk at the same time the employee normally takes her required 10-minute paid rest break, 10 minutes of the break would be paid and 20 minutes unpaid. The statute specifies, however, that unpaid leave time used to express breast milk must be counted towards hours worked for purposes of determining amounts employer pays towards the employee’s health insurance (some employers vary the amount they contribute towards an employee’s health insurance depending upon the number of hours the employee works). Employers are required to make reasonable efforts to provide a private location (other than a public restroom or toilet stall) close to the employee’s worksite, for expression of milk. Although break laws do not generally apply to exempt employees, this particular law does apply to exempt employees (i.e., executive, administrative, professional).

LESSON:

Employers should adopt an appropriate policy governing breaks for expression of breast milk, should determine which facilities are available (i.e., a private room or location other than a

⁴⁵ ORS 659A.805.

⁴⁶ ORS 659A.192.

⁴⁷ “Undue hardship” is defined as “significant difficulty or expense when considered in relation to the size, financial resources, nature or structure of the employer’s business.” ORS 653.077(1)(b).

⁴⁸ ORS 653.077(1)(c).

public restroom or toilet stall), and institute payroll procedures to account for the break periods as paid or unpaid, as appropriate.

6. SEVERANCE PAYMENTS UNDER CODE SECTION 409A

By passing Section 409A of the Internal Revenue Code (the “Code”), Congress sought to comprehensively regulate “deferred compensation.” While separation pay arrangements were not previously thought of as deferred compensation, Section 409A now regulates separation pay as “deferred compensation” unless certain exceptions apply.

Why Is Section 409A Important?

“Deferred compensation” that does not comply with Section 409A results in significant adverse tax consequence for the recipient: the deferred compensation is taxable as income when it vests, plus an additional 20% penalty and any applicable interest from the vesting date until the tax is paid. For example, an offer letter promising severance benefits to a new CEO that is not exempt from Section 409A makes all the CEO’s severance arrangements (including those that comply with Section 409A) retroactively taxed as of the hire date with interest and a 20% penalty.

Types of Severance Covered by Section 409A

Section 409A defines deferred compensation as a legally binding right to compensation in one tax year that is payable in a future tax year. The legal right is deferred compensation even if it is subject to a substantial risk of forfeiture, unless the employer has complete discretion to not make the payment (in which case there is no legally binding right).

The general principle discussed above is distinguished from situations where the legal right does not exist until the year in which payments are made. For example, if upon a termination of employment, an employer offers an employee an immediate lump sum payment in exchange for a release of claims and before then the employer had no contractual obligation to make such a payment, there is no deferred compensation since obtaining the legal right and the payment itself occurred in the same taxable year.

Severance Arrangements Exempt from Section 409A

The Section 409A regulations exempt the following types of severance arrangements:

- Severance payments made due to an *involuntary* termination or participation in a reduction in force (“RIF”) program that do not exceed the lesser of (i) two times the employee’s annual compensation, or (ii) \$460,000 (for calendar year 2008). Annual compensation is based on the calendar year before the year in which the employee terminates employment. In addition, all payments must be made before the end of the second calendar year following the year in which the employee terminates employment. Certain “good reason” terminations may qualify as involuntary, as discussed further below.
- Reimbursement of expenses that are (i) otherwise excludible or deductible from the gross income of the employee, (ii) reasonable outplacement and moving

expenses, and (iii) medical expenses, provided that the expenses are incurred and the reimbursements are made by no later than the end of the second calendar year following the year in which the employee terminates employment. This exemption also applies to in-kind reimbursements. Note that payment of COBRA premiums or other health benefit amounts beyond this two-year period will create deferred compensation.

- Severance payments that do not exceed \$15,500 (during 2008).
- Collectively bargained separation pay arrangements that provide for payments upon an involuntary termination of employment or pursuant to a RIF program.

The RIF program exemption applies even though a termination under such circumstances may be voluntary based on incentives or otherwise. A RIF program may not be more than one year long and must specify the circumstances under which an employee must terminate in order to receive severance under the RIF program.

The Section 409A regulations use a facts-and-circumstances test to determine if a “good reason” termination is “involuntary.” The regulations also provide a “safe harbor” good reason definition. The safe harbor requires the employee to terminate within two years after the initial existence of a material reduction in the employee’s base pay, duties or authority, a change in the employee’s work location or other similar indications of a negative change in the employee’s working conditions. The payments available for a “good reason” termination must be (i) substantially the same as those available under an actual involuntary termination; (ii) the employee must provide notice within 90 days after the initial existence of the circumstances constituting good reason; and (iii) the employer must be given at least 30 days after notice to cure the circumstances.

An arrangement that provides an employee with the full amount of severance within 2½ months after the close of the calendar year in which the employee terminates employment is not deferred compensation. Note that this allows payments larger than the “two times” rule discussed above to the extent the payments occur before the 2½ month deadline. Voluntary terminations may also qualify for this exception.

Separation from Service or Termination of Employment

The employment relationship continues while the individual is on military, sick or FMLA leave, or other bona fide leave of absence if the leave does not exceed the longer of six months or as long as the individual’s right to reemployment with the employer is mandated either by statute (e.g., USERRA) or by contract.

An employee may enter into an arrangement with an employer to continue working after the normal employment relationship has ended and, hopefully, further delay payment and taxation of any deferred compensation. A termination of employment occurs if the individual is only providing “insignificant services” to the employer. An employee provides more than “insignificant services” if the employee works at least 20% percent or more of the time he or she worked prior to termination and is paid 20% percent or more of his or her pay after the so-called termination of employment. The 20% time and pay threshold is based on a three-year average of

the time and pay preceding the year in which the termination occurs (or, if the employee was employed for less than three years, such lesser period). Service as a Board member is not considered in determining whether an employee has terminated employment.

Where an employee continues to provide services to a former employer in a capacity other than as an employee (e.g., as a consultant), the IRS regulations provide that no termination occurs where the former employee continues to work and get paid at a rate of 50% or more of his or her pre-termination levels. Similar to the 20% threshold discussed above, the 50% time and pay threshold is based on an average for the three years immediately preceding the year in which the termination occurs (or, the employee's period of employment if less).

LESSON:

Severance arrangements are just one of many areas in the deferred compensation rules where employers and employees (particularly employees, since they will be paying the income and 20% tax and possible interest) may find themselves in trouble. It is important to remember that Section 409A does not prohibit severance pay; it simply imposes specific requirements that non-exempt severance arrangements must meet to avoid additional taxes and penalties. Informed and advance planning will go a long way to avoiding mistakes.

What Employers Need to Do Now

- Identify all agreements and arrangements that might be “deferred compensation.”
- Analyze whether the time and form of payment complies with Section 409A.
- If necessary, change payment provisions to comply, considering the IRS guidance.
- Make deferral elections for 2008 compensation.
- Review stock option and stock appreciation right grants to determine if exercise price is at least fair market value, and if not, consider corrective actions.
- Consider on-going compliance with Section 409A and what processes require change.

7. CHANGES TO OREGON FAMILY LEAVE ACT

Several important changes to the Oregon Family Leave Act, which applies to Oregon employers with 25 or more employees, will be effective January 1, 2008.⁴⁹ The following is a summary of the major changes:⁵⁰

⁴⁹ ORS 659A.150, *et seq.*

⁵⁰ See Enrolled House Bill 2635 (HB 2635-A); Enrolled House Bill 2485 (HB 2485-INTRO); and Enrolled House Bill 2460 (HB 2460-A), all enacted by the 2007 legislature.

- For purposes of taking leave to care for a family member, the category of individuals who qualify as a “family member” has been expanded to include a grandparent or grandchild of the employee.⁵¹
- Employers must allow employees to use any paid accrued sick leave or paid vacation for any type of leave under OFLA.⁵² As previously written, the law did not require employers to allow employees to use accrued sick leave when the employee took leave to care for a family member if the employer’s policy limited the use of sick leave to time off for the employee’s own illness.⁵³
- Employers can no longer count time an employee is off work for an on-the-job injury against their OFLA leave entitlement.⁵⁴ A worker who refuses an offer of light duty will automatically trigger the start of OFLA leave under the new law.⁵⁵
- The legislature clarified that it is unlawful to retaliate or discriminate against an employee for taking, inquiring about, or requesting OFLA leave.⁵⁶

LESSON:

Employers will need to update their OFLA policies and practices effective January 1, 2008. Employers that are covered by both OFLA and FMLA (employers with 50 or more employees) will need to be even more diligent in tracking leave under these two laws because the number of circumstances in which the two leaves do not overlap has increased. For example, under the new OFLA provisions, an employee’s leave for a work injury (when the injury qualifies as a “serious health condition”) can be counted against the employee’s FMLA entitlement but not against the Employee’s OFLA entitlement. An employee’s leave to care for a sick grandparent can be counted against the Employee’s OFLA entitlement but not against the employee’s FMLA entitlement. The Oregon Bureau of Labor & Industries has issued proposed rules implementing these changes.⁵⁷ The final rules, when available, should be reviewed for consistency with any employer policy changes.

8. OREGON CONSUMER IDENTITY THEFT PROTECTION ACT

In response to rising concerns about the impact of identity theft, the 2007 legislature enacted Oregon Law 759 (SB 583).⁵⁸ In addition to setting up mandatory notification procedures for dealing with consumer identification security breaches involving Oregon residents,⁵⁹ the new

⁵¹ ORS 659A.150(4).

⁵² In addition, employers must allow the use of “any other paid leave that is offered by the employer in lieu of vacation leave * * *.” ORS 659A.174(2). Presumably this would include generic “paid time off” which many employers allow to be used for illness or vacation.

⁵³ ORS 659A.174(2).

⁵⁴ ORS 659A.162(6).

⁵⁵ ORS 659A.043(4).

⁵⁶ ORS 659A.183(2).

⁵⁷ http://www.oregon.gov/BOLI/Legal/h_notices.shtml.

⁵⁸ <http://www.leg.state.or.us/07orlaws/sess0700.dir/0759.htm>.

⁵⁹ Protected information includes a consumer’s name in combination with an SSN, Oregon driver’s license or Oregon identification card number, passport number, or a financial, credit or debit card number

law limits the use of Social Security numbers (SSNs).⁶⁰ Those provisions became effective on October 1, 2007. The law, however, also requires employers (and anyone else who uses protected data in the course of their business) to undertake ongoing preventative action to reduce identity theft. The law states that:

Any person that owns, maintains or otherwise possesses data that includes a consumer's⁶¹ personal information that is used in the course of the person's business, vocation, occupation or volunteer activities must develop, implement, and maintain reasonable safeguards to protect the security, confidentiality and integrity of the personal information, including disposal of the data.

The elements of the "information security program," which is required as of January 1, 2008, must include administrative, technical, and physical safeguards. Notably, the administrative safeguards include designating one or more employees to coordinate the security program and employee training on appropriate practices and procedures.

"Small businesses" as defined by the Act⁶² must only implement practices "appropriate to the size and complexity" of their business. Since this is a rather vague standard, it seems sensible for small businesses to monitor recommended practices; document their analysis of what is appropriate in their business; and document any and all implementing actions. Employers may wish to consider:

- Restricting access to personal information, both through physical (*e.g.*, locked cabinets) and electronic barriers (*e.g.*, passwords) to key personnel;
- Auditing what personal information is retrievable from employees' laptops, home computers, flash drives, and other electronic devices;
- Developing procedures and policies regarding the use and storage of personal information on laptops and other devices used outside the worksite (one of the most common types of security breaches is a stolen laptop);
- Developing a written procedure for identifying, reporting and responding to security breaches;

along with a security code or password that would permit access to a consumer's financial account. It also includes any of those items standing alone or in combination "if the information obtained would be sufficient to permit a person to commit identity theft against the consumer whose information was compromised."

⁶⁰ SSNs (1) may not be printed on any materials that are mailed unless they are either redacted or the materials are requested by the consumer; (2) may not be placed on a card to be used by the consumer as a means to access products or service; (3) may not be publicly displayed or posted (*e.g.*, on a web site). Exceptions exist for records that are required by state or federal law (*e.g.*, W2s, W4s, 1099s), that are used for internal verification or administrative processes, or that are used to enforce a judgment or court order. Businesses should not use SSNs as an account identifier.

⁶¹ "Consumer" is defined as "an individual who is also a resident of this state."

⁶² 200 or fewer employees in manufacturing or 50 or fewer in other types of businesses.

- Developing and documenting the procedure for disposing of documents containing personal information; and
- Working with IT personnel and companies to ensure reasonable security measures are in place to protect personal information.

Businesses that are subject to and in compliance with either the Gramm-Leach-Bliley Act or HIPAA may satisfy their security obligations under those laws. However, according to the Department of Consumer and Business Services (DCBS), these laws generally do not apply when there is a breach involving Oregon employees' information or to businesses developing safeguards to protect their employees' information.

The DCBS is providing education and guidance on the law and recommended practices,⁶³ and has published "Protecting Personal Information: A Business Guide."⁶⁴

LESSON:

All Oregon employers need to develop policies and procedures to prevent identity theft. While small businesses have more leeway to develop policies and procedures appropriate for their size and type of business, all steps towards compliance should be documented.

9. SOCIAL SECURITY "NO-MATCH" LETTERS

The Social Security Administration (SSA) uses W-2 information to determine employees' Social Security eligibility and benefit information. In furtherance of that goal, the SSA issues "no-match" letters to employers notifying them of employees whose names and social security numbers, as submitted on the W-2, do not match the agency's records.⁶⁵ There are many reasons for a mismatch, including clerical errors and unreported name changes due to marriage and divorce. Employers are instructed to attempt to resolve any discrepancies and send the SSA any corrected information, but there are no legal requirements to take any particular form of action. Notably, the SSA has no immigration law enforcement role. Accordingly, past no-match letters emphasized that receipt of a no-match letter "does not imply that you or your employee intentionally gave the government wrong information ***". Nor does it make any statement about an employee's immigration status.⁶⁶

In response to concerns about unlawful employment of illegal immigrants, on August 15, 2007, the Department of Homeland Security (DHS) published a new rule⁶⁷ setting out the procedure for employers to take when they receive the SSA's no-match letters. Such procedures may include terminating employees when discrepancies cannot be resolved within a 90-day period.⁶⁸

⁶³ http://www.dfcs.oregon.gov/id_theft.html.

⁶⁴ <http://www.dfcs.oregon.gov/pdf/4117.pdf>.

⁶⁵ See 20 C.F.R. §422.120(a).

⁶⁶ SSA model 2006 no-match letter for Tax Year 2005.

⁶⁷ "Safe-Harbor Procedures for Employers Who Receive a No-Match Letter," 72 F.R. 45611 (Aug. 15, 2007).

⁶⁸ See proposed DHS insert, "Will I be liable for discrimination charges brought by the United States if I terminate the employee after following the steps outlined above?" "No. *** [I]f an employer that follows

The rule's effect is to expand the ways in which an employer may be held liable for knowingly continuing to employ an individual without valid employment authorization in the event of an I-9 audit or immigration raid (such as the well-publicized raid that occurred in June at the Fresh Del Monte Produce, Inc. food processing plant in North Portland). Under the rule, employers who can document that they properly followed DHS's recommended procedure are granted "safe harbor" protection. In other words, DHS will not use the no-match letter as evidence against the employer if it subsequently determines that the employee does not have appropriate employment authorization or citizenship status. On the other hand, a failure to follow the DHS's guidance means that the agency will presume the employer had knowledge of the employee's lack of valid employment authorization or citizenship status, which can result in civil and criminal liability. The new rule was scheduled to take effect on September 14, 2007.

The Immigration and Customs Enforcement agency (ICE), which is responsible for I-9 compliance, planned to send a letter out along with the SSA's 2007 no-match letters informing employers of the new rule, and of the potential consequences for failing to abide by it. Approximately 140,000 employers were due to receive the letters, affecting more than eight million workers. However, a federal court in California⁶⁹ issued first a temporary restraining order (TRO) (on August 31, 2007) and then a preliminary injunction (on October 10, 2007), prohibiting the federal agencies from implementing the new rule. Opponents of the rule argue that DHS does not have the legal authority to implement this rule. The injunction applies to the whole country. As a result, the SSA decided not to issue no-match letters during 2007, and the rule is blocked until the court issues a final decision on the matter.

LESSON:

The upshot is that the no-match rule is on hold pending the outcome of the court case. The SSA has the option of sending 2008 no-match letters without referencing the rule; in addition it will send no-match letters to individual workers and to employers about specific workers, again, without referencing the new rule. Employers should not implement the new rule until its legality is determined. The current focus on immigration enforcement means, however, that employers should audit their I-9 process and make sure everything is in order. At the same time, keep in mind that it is important to avoid discrimination claims based upon nationality, race and ethnicity,⁷⁰ *i.e.*, a no-match letter does not by itself indicate any kind of wrongdoing by the employee, and employers should not take adverse action on such a basis.

10. WASHINGTON STATE ANTI-BULLYING BILL⁷¹

The Washington State legislature is considering in January 2008 a law related to providing legal redress for targets of workplace bullying, abuse, and harassment. According to the Act, surveys

all of the procedures outlined by DHS in this letter cannot determine that an employee is authorized to work in the United States and therefore terminates that employee, and if that employer applied the same procedures to all employees referenced in the mismatch letter, then that employer will not be subject to suit by the United States under the Immigration and Nationality Act's anti-discrimination provision."

⁶⁹ *AFL-CIO v. Chertoff* (N.D. Cal. Case No. C 07-4472 CRB).

⁷⁰ *See generally*, 8 U.S.C. §1324b(a)(1)(A) (prohibiting national origin discrimination); OAR 659A.030 (prohibiting discrimination because of race, color, and national origin).

⁷¹ A similar bill was presented in Oregon, but it did not pass.

and studies have documented that between 16% and 21% of employees directly experience health-endangering workplace bullying, abuse, and harassment, and that this behavior is four times more prevalent than sexual harassment alone. The state legislature believes that existing workers' compensation plans and common law tort actions are inadequate to discourage this behavior or provide adequate redress to employees who have been harmed by abusive work environments. For these reasons, the legislature intends to make it an unlawful employment practice to subject an employee to an abusive work environment or to retaliate in any manner against an employee because he or she has opposed any unlawful employment practice under the law.

The law defines "abusive conduct" as conduct of an employer or employee in the workplace, with malice, that a reasonable person would find hostile, offensive, and unrelated to an employer's legitimate business interests. Abusive conduct may include repeated infliction of verbal abuse such as the use of derogatory remarks, insults, and epithets; verbal or physical conduct that a reasonable person would find threatening, intimidating, or humiliating or the gratuitous sabotage or undermining of a person's work performance.

The law does provide an affirmative defense for employers where the employer exercised reasonable care to prevent and promptly correct the abusive conduct and the aggrieved employee unreasonably failed to take advantage of appropriate preventive or corrective opportunities provided by the employer. This provision of the law is meant to encourage employers to stop the bullying of employees by demonstrating what actions they took when they were informed of the bullying.

LESSON:

There is no guarantee that the Washington state legislature will pass this law. However, even if they do not, it is clear that unacceptable behavior on the job should not be tolerated. Workplace bullies not only drive away your best employees, but also can make life difficult when you try to terminate them for their obnoxious behavior. What can employers do?

First, do not tolerate any kind of "jerkish" behavior. A long pattern of tolerating bullying behavior will make it difficult for an employer to confront it safely. Not only may the employee's behavior pattern become entrenched, but an employer may have to explain why it took so long to address these concerns. Second, be direct and specific. Confront the bully directly and point out the specific behaviors that are unacceptable and must change. Finally, make it clear that a positive work attitude is an essential function of the job.

Employers with multi-state operations will need to monitor anti-bullying laws being introduced in various states and which appear to be an emerging trend in workplace regulation.

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