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Rules Regarding Reimbursement of Employees' Expenses

by Jennifer Brown Shaw

Under California law, employees must be fairly compensated when they use their own money or equipment at work. The Legislature's intent is that employees should not bear losses or expenses incurred in the service of their employers. There are a number of laws and regulations that require employers to reimburse expenses employees incur and to pay for employees' use of their own property.

Not surprisingly, this area of the law is not particularly glamorous. However, organizations with multi-state operations should be aware of California's requirements. Inappropriate expense reimbursement policies could provide fuel for another wave of wage and hour class actions.

Labor Code Section 2802: Employers Must Indemnify Employees

California Labor Code section 2802 requires an employer to "indemnify his or her employee for all necessary expenditures or losses incurred by the employee in direct consequence of the discharge of his or her duties . . ."

Fortunately, this law does not mean the employer must reimburse employees who decide to fly first class or stay in a four-star hotel on a business trip, if doing so is contrary to policy. The courts have said that "necessary" means "reasonable" under the circumstances. In addition, the California Division of Labor Standards Enforcement ("DLSE") has said the employer may impose reasonable limits on employee expenses.

Reimbursement of Defense Costs

Reimbursement of employees' legal fees is a recurring issue in the few cases interpreting section 2802. There are certain acts for which employees may be held personally liable to others, such as harassment or retaliation in violation of the California Fair Employment and Housing Act. Employees therefore may find themselves individually named in litigation, and requiring legal representation.

Are employers required to pay for the employee's defense? Ultimately, the answer is "yes," unless a court or jury determines the employee's acts were outside the course and scope of employment. This standard creates problems, because the employer will not know until the end of the case whether the employee is entitled to reimbursement. Additionally, most cases do not go to trial. If the case is dismissed or settled, there typically will be no finding of fault, and the employer will be responsible for the employee's attorneys' fees and portion of the settlement.

Practically speaking, employers face two choices. First, they may pay for the employee's defense "up front." There are advantages to this approach, including that the employer will have some input as to the choice of counsel and cost. Second, employers may refuse to pay the defense costs until the end of the proceedings. The affected employee will have to find and pay for counsel until the end of the case. The employer benefits because it does not have to pay for a potential wrongdoer's attorneys' fees.

However, the disadvantages to this approach are significant. For example, the employer will have no control over the choice of counsel or his or her fees. If the accused employee is still on payroll, the burden of paying his own fees may result in significant employee relations issues, not only for the employee, but also for other employees who fear similar liability. Finally, if an employee must sue for indemnification of his or her fees, the attorneys' fees expended pursuing reimbursement also must be reimbursed.

Business Use of Employees' Personal Property

One of the most common circumstances in which this issue arises is when employees use their personal vehicles to perform their duties. Given the various costs associated with owning a vehicle, it would be quite complicated to calculate the actual cost that must be reimbursed. Fortunately, the DLSE has said that the IRS' mileage reimbursement rate is a "presumptively reasonable" reimbursement rate.

The IRS rate may not always be viewed as reasonable, however. For example, when an employer requires the employee to maintain a certain level of insurance coverage, the DLSE has said the IRS mileage reimbursement rate would not be sufficient.

Fortunately, the law is more clear regarding other tools and equipment. The Industrial Welfare Commission's wage orders require employers to furnish all tools and equipment necessary to do the job. There is a narrow exception to this requirement. Employers may require employees to supply

their own hand tools (1) if the employees earn at least twice minimum wage, and (2) the hand tools are customarily required in the trade.

What About Uniforms?

If an employer requires workers to wear a uniform, the employer must purchase and pay for maintenance and cleaning of the uniform. The term “uniform” is interpreted very broadly. It means “wearing apparel of distinctive design or color.” The term “distinctive design” covers traditional “uniforms,” such as one worn by law enforcement officers. However, the DLSE has opined that “distinctive design” also includes clothing that does not contain metal that would trigger a metal detector, rugby shirts, and floral “Hawaiian-style” shirts.

The definition of uniform also includes clothing of a particular “color,” even if the clothes do not have an insignia or are not of a particular design. For example, if the employer requires workers to wear a blue shirt, even one without an insignia, the employer must pay for it because it is of “distinctive” color. Employers seeking to avoid paying for clothing may wish to specify “dark” pants and “light” colored shirts instead of particular colors.

The DLSE enforcement policy historically included an exception for clothing that may be used throughout an industry, such as a waiter’s “black and whites.” However, employers should be cautioned that the courts

may not respect this enforcement policy in the litigation context.

Requiring Employees to Patronize the Employer or the Employer’s Vendor

California Labor Code section 450 provides that employers cannot force employees to patronize a certain business, unless the employer is willing to pay for it. For example, if an employer insists employees purchase a certain brand of equipment, the employer must pay for it. Similarly, employers cannot insist employees purchase merchandise from the employer itself or from a particular vendor unless they pay for the merchandise on behalf of the employees.

Reimbursement Procedures

Section 2802 does not specify the manner in which how employers must reimburse employees. There does not seem to be any prohibition against employers’ requiring their employees to submit expense reports and obtain reimbursement of expenses. There also appears to be no legal basis supporting employers’ policies denying reimbursement when expense reports are submitted untimely or incorrectly. Employees’ failure to comply with expense reimbursement policies should be treated as disciplinary issues rather than grounds for refusing to pay the expense.

Employers are not permitted to force employees to accept “direct deposit” of their wages. The DLSE has opined the same rule

applies to expense reimbursements. While DLSE opinion letters are not binding on courts, they suggest how the DLSE will address the issue during administrative proceedings.

The Bottom Line

Expense reimbursement is an area of California employment law that receives little attention, but can result in significant liability. Employers should review expense reimbursement, uniform, tool and equipment policies and related procedures to ensure they comply with California’s special rules.

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