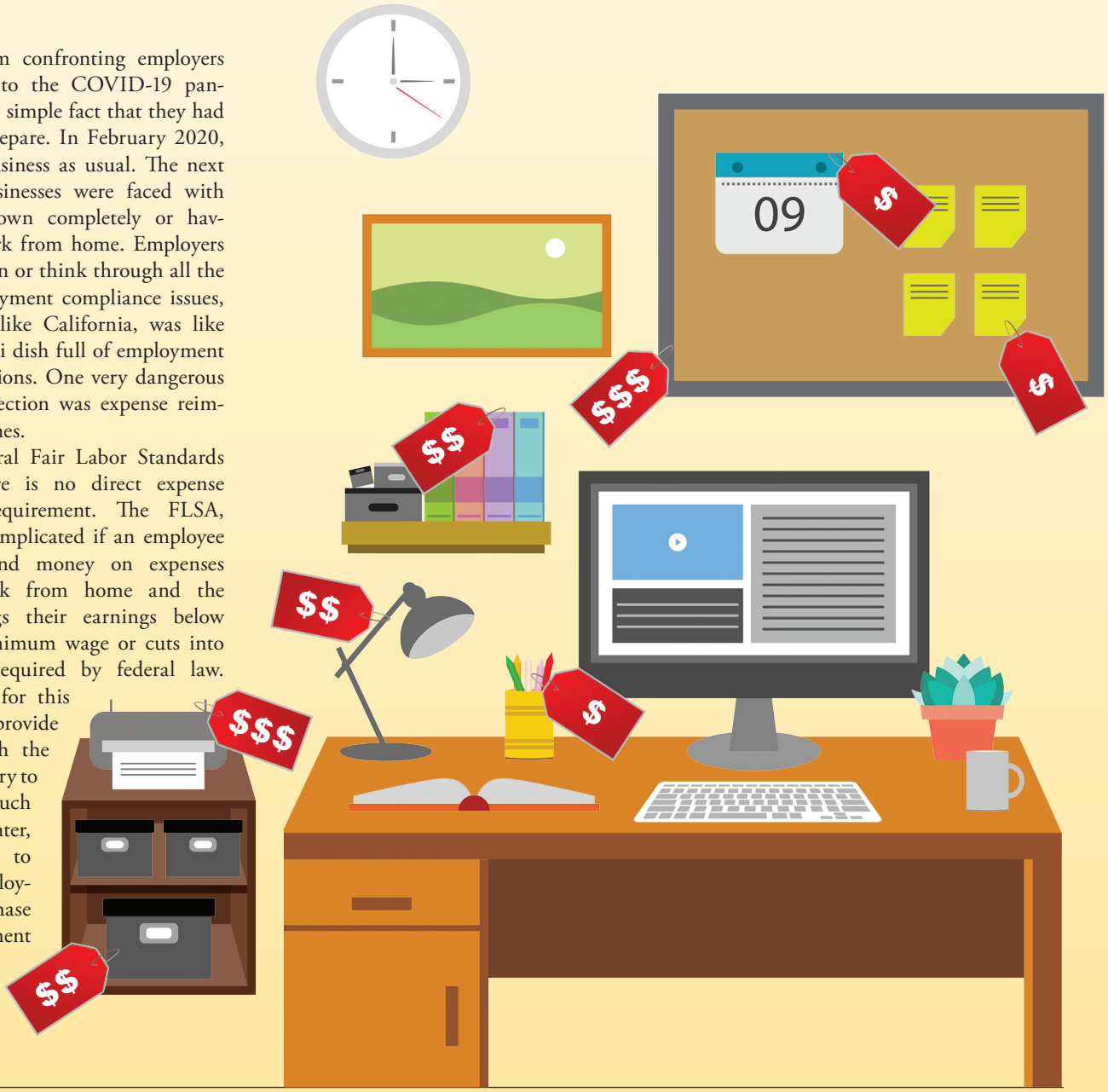
EXPENSE REIMBURSEMENT GUIDELINES IN CALIFORNIA HAVE ACQUIRED AN INFECTION

by TODD R. WULFFSON AND COREY J. CABRAL

A major problem confronting employers with respect to the COVID-19 pandemic was the simple fact that they had no time to prepare. In February 2020, everything was business as usual. The next month, many businesses were faced with either shutting down completely or having employees work from home. Employers had no time to plan or think through all the payroll and employment compliance issues, which in a state like California, was like warming up a petri dish full of employment law liability infections. One very dangerous such potential infection was expense reimbursement guidelines.

Under the federal Fair Labor Standards Act (FLSA), there is no direct expense reimbursement requirement. The FLSA, however, may be implicated if an employee is forced to spend money on expenses necessary to work from home and the expenditure brings their earnings below the applicable minimum wage or cuts into overtime wages required by federal law. An easy solution for this issue is simply to provide the employee with the equipment necessary to work from home, such as a computer, printer, postage, etc., or to reimburse the employee when they purchase necessary equipment or supplies.



A solution is less clear with respect to "mixed-use" items and services the employee uses for both business and personal reasons, such as a desk, chair, cell phone data plan, electricity, home internet, online services such as Zoom, and software programs. If the equipment or supplies are tangible, like a chair, upgraded WIFI router, or software, the employer can simply require the employee to request reimbursement (preferably in advance of the purchase), which can be evaluated and either paid or denied. Some purchases may involve the evaluation of medical information if, for example, an ergonomic chair or desk is requested as an accommodation (after all, a kitchen chair may work fine for limited computer use at home—but likely not if one is now working full-time at home). Employers need to document all reimbursed equipment, not only for accounting (they are a deductible business expense), but if the employer ultimately lets the employee keep the equipment, it may become a taxable event for the employee (as the equipment becomes compensation).

What about nontangible items and services? How does one measure the incremental cost from working from home with respect to cell phone, electricity, and home internet use? And, absent a measurable, incremental cost for an employee, does the employer need to reimburse it? In California, the answer to that question is yes—unless the employer wants to run the risk of a class action lawsuit—where the aggregated amount of small incremental costs across many employees can become a large number—and/or a Private Attorneys General Act (PAGA) claim—where a $100 civil penalty may apply to each failure to reimburse an employee, regardless of the amount of that expense. More importantly, even if the total amount of unreimbursed expenses is small, the employees' attorneys' fees (which are a recoverable component of damages) will certainly not be small.

In California, the Labor Code (specifically, Section 2802) requires employers to reimburse employees for "all necessary expenditures or losses incurred by the employee in direct consequence of the discharge of the employee's duties" or incurred at the direction of the employer. While that may sound like it excludes mixed-use items and hard-to-measure incremental costs, that is not how California courts interpret the statute. Unlike most other states in the nation, California's labor law enforcement agencies and courts (apparently viewing the state's exceptional weather as assumed reason enough for businesses to stay in the Golden State) interpret Section 2802 as requiring reimbursement of a "reasonable percentage" of an employee's cell phone, electricity, and internet costs, even when the employee already has unlimited cell phone and home internet plans, and even if the employee's utility bills do not increase as a result of working from home. They claim this interpretation "prevents employers from passing their operating expenses on to their employees."

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There are a variety of ways employers can provide this "reasonable percentage" and thereby reduce potential liability from unreimbursed business expenses, but perhaps the most important threshold matter is to ensure that neither the employee handbook nor any written policy states that employees will not be reimbursed for things like increased utility or cell phone costs attributed to working from home. Many employers, perhaps frustrated by employees submitting expense reports for hard-to-measure costs, incorporated such statements into their expense reimbursement guidelines—which invite a class action or PAGA lawsuit because the statements are contrary to law and affect all employees required to work from home—whether by the employer or a government stay-at-home order.

Some employers placed the onus for seeking reimbursement entirely on employees. Common equipment, such as a laptop, printer, and supplies are provided to the work-from-home employees automatically. The employer then states in its expense reimbursement guidelines that if those employees need additional equipment or supplies, they can expense them if the cost is under a budget, such as $100, or after they receive prior approval.

There are, however, several court decisions in California stating that if the employer knows employees are incurring expenses, it may not simply wait for the employee to request reimbursement—and many new class actions were filed during the pandemic based on this issue. When the employer knows or has reason to know an employee incurred a business expense (e.g., home internet), it is then obligated to reimburse them (e.g., a flat-sum payment for a portion of the internet bill), regardless of whether the employee submits an expense report. This is likely a good time to mention that a California claim for unreimbursed expenses may be filed up to four years after the expense was incurred—even if the employer's policy required employees to submit expense reports within a specific timeframe (e.g., thirty days) and they failed to do so.

In order to minimize the administrative burden involved in processing expense reports and to maximize the protection from work-from-home expense claims, many employers provide an automatic, monthly stipend based on a good faith, reasonable estimate of employees' reimbursable work-from-home expenses. This approach will usually expressly cover the majority of expenses, specifically stating that it is meant to cover difficult-to-measure incremental costs involved in working from home, such as increased cell phone, utility, and internet usage. The policy should also specifically state that if, in any particular month, an employee feels they have incurred more expenses than are covered by the stipend, they must contact Human Resources to report the expenses so they can be reimbursed and/or the monthly stipend can be increased. While this practice does not foreclose an expense reimbursement claim, an employee-plaintiff who received a

stipend will likely have the burden of proving it did not cover their reasonable and necessary expenses.

There have been no class action or PAGA cases yet challenging the adequacy of such stipends (which are typically around $25/month), but the failure to provide a stipend to employees working from home has been the basis for dozens of such claims in the last year. Employers providing stipends should maintain documentation to support both the reasonableness of the established stipend amount and the basis for providing it. Too small a stipend can be argued to be insufficient to indemnify the employees. And providing stipends to employees who do actually incur the expenses may be deemed taxable wages to the employee, rather than expense reimbursements (the Employment Development Department in California is attracted to large monthly stipends like a moth to a candle because of the potential unpaid taxes involved).

As the pandemic unfolded last year, many employers, being caught without the time to adequately plan, simply went to the most conservative option—the monthly stipend. Most employers picked a monthly stipend amount based more on guesswork than anything else since there was not a great deal of data on which to draw for incremental, work-from-home expenses. Some employers asked their employees for input, but that simply transferred the guesswork over to the employees.

Just about the time vaccinations and hope were increasing for the business community, in February of this year, the Ninth Circuit Court of Appeals came out with its decision in *Clarke v. AMN Services.* The Ninth Circuit, which covers the federal courts in California, held that an employer's per diem expense reimbursement payments (i.e., a daily stipend) functioned as compensation for work, rather than business expense reimbursements, because the amount of the stipend and its uniform issuance to a group of employees were not clearly associated with actual business expenses they incurred. As a result, the employer in that case was required to factor those stipend payments into the employees' "regular rate of pay" for purposes of calculating overtime compensation. Since California law uses federal law for guidance on such things as calculating the regular rate of pay, the Ninth Circuit essentially infected the expense reimbursement policies of all California employers who had *conservatively* begun using a monthly stipend to cover mixed-use, incremental expenses for their work-from-home employees, with a disease as difficult to predict as COVID-19. *See Clarke v. AMN Services, LLC*, 987 F.3d 848 (2021).

AMN Services is a healthcare staffing company that places hourly-paid clinicians on short-term assignments. Each week, AMN paid traveling clinicians a per diem (i.e., stipend) amount to reimburse them for the cost of meals, incidentals, and housing while working over fifty miles away from their homes. AMN did not report these payments as wages, and classified them as tax-exempt, since they were reimbursing employees for out-of-pocket expenses. AMN used a number of factors to calculate the per diem payment, including the extent to which clinicians worked their scheduled shifts. Notably, under the per diem policy, the payments could decrease if clinicians worked less than their scheduled shifts, and work hours in excess of those scheduled could be "banked" and used to "offset" missed or incomplete shifts. AMN also provided "local" clinicians with per diem payments under the same policy, but such payments were reported as taxable wages.

The Ninth Circuit determined that these characteristics indicated that the per diem payments to traveling clinicians functioned as compensation for hours worked, and not merely expense reimbursements. The court relied heavily on AMN's decision to pay both local and traveling clinicians under the same per diem policy while treating the per diem payments to local clinicians as wages. The court also noted that "AMN offers no explanation for why 'banked hours' should affect" per diem payments, and found "the only reason to consider 'banked hours' in calculating" per diems was to compensate clinicians for hours worked.

What does this mean for California employers paying monthly stipends to employees working from home? The *Clarke* decision is a new avenue to sue employers if monthly stipends, in whole or in part, are deemed to function as "wages" that must be factored into the regular rate of pay because overtime and paid sick leave compensation will be impacted and the employees will claim that they were not properly reimbursed for their expenses. Since the monthly stipend affects all employees working from home, it is systemic and, thus, an easy target for a class action or PAGA claim.

In light of the *Clarke* decision, it is even more important for California employers to carefully review the language of any monthly stipend or other automatic reimbursement policies, and to ensure that those policies do not present any of the dangers in the *Clarke* decision (i.e., have one stipend amount, subject to adjustment if appropriate, that is only reduced on a pro-rata basis for employees perhaps working a hybrid work-from-home schedule). It is also important to remove as much of the guesswork as possible regarding the monthly stipend amount. An employer certainly would not want to inform its employees that the amount it has been paying for the last year is way off, but hopefully, a year's worth of experience provides better data upon which to tweak the monthly stipend amount.

Just like it takes a detailed study of a virus to make a vaccine, perhaps one good use of the *Clarke* decision is to give employers paying stipends the opportunity to review their expense reimbursement policies and to make any necessary changes now, before the employer winds up in the courthouse with an incurable infection.

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