Deadbeat bosses beware!

California appellate ruling reinforces that business owners may be personally liable for their corporation's violations of state wage laws

By Bryan Schwartz and Rachel Terp

While grim efforts to narrow joint-employer liability under federal employment and labor law have captured national headlines in 2017,[1] the year also ended with a California Court of Appeal decision on individual joint-employer liability that reaffirms workers' robust wage theft protections under California law.

In *Turman v. Superior Court* (2017) 17 Cal.App.5th 969, California's Fourth District Court of Appeal, Division Three (in Orange County), held that a sole shareholder and president of a closely held corporation may be personally liable in a lawsuit to recover overtime, meal and rest period premiums, tip compensation, and minimum wages under California law. *Turman* provides the first published interpretation of California Supreme Court's marquee decision on the definition of an "employer" in California (see *Martinez v. Combs* (2010) 49 Cal.4th 35), as it applies to personal, rather than corporate, liability.[2]

Federal and state laws have long recognized that more than one defendant may be liable as an employer of the same workforce.[3] Joint-employer liability aims to protect workers from those that would exercise control over workers' labor, but attempt to shirk responsibility for workplace violations by foisting sole liability elsewhere. By holding responsible all persons (individual and corporate) that control working conditions, each is incentivized to comply with labor and employment laws.

The availability of joint-employer liability is a practical necessity in many wage and hour cases. When a plaintiff-side wage and hour attorney assesses whether to accept a case, after determining the alleged workplace violations are meritorious, the next question the attorney typically asks is, "Who's the boss?" If no solvent party exists to pay damages and penalties, then obtaining a large verdict in even the most righteous case will not result in payment of the client's judgment, and will do little to deter bad actors.

All too often in California, workers who bring legal claims for wage theft are unable to collect from the company that employed them[4] – even when one or more individuals

responsible for the wage violations could afford to make the workers whole. Plaintiffs may name these individuals as defendants, but individual defendants have historically relied on lack of specificity in the state's jurisprudence to argue that they should not be personally liable. State and federal courts have been reluctant to find individuals personally liable for unpaid wages under California law.

Historic statutory and regulatory authorities

California's wage statutes have provided causes of action for a broad range of wage theft practices, largely without specifying

who may be liable.[5] The Industrial Welfare Commission ("IWC") has been defunded for years, but previously had been delegated authority over wage and hour practices in California, and its Wage Orders (regarding a host of industries) continue to have regulatory force.[6] The Wage Orders provide broad definitions of employer.[7] Each defines "Employer" as "any person . . . who directly or indirectly, or through an agent or any other person, employs or exercises control over the wages, hours, or working conditions of any person."[8] Under the orders, "Employ" means "to engage, suffer, or permit to work."[9]

The Unfair Competition Law ("UCL"), Business & Professions Code section 17200, et seq., at section 17201, has expressly included "natural persons" unjustly enriched (e.g., because they stole workers' wages) among those who are liable for restitution.[10]

The Private Attorneys General Act (PAGA), Labor Code section 2698, et seq., has permitted recovery for civil penalties for wage violations, under Labor Code section 558, with liability extending to "[a]ny employer or other person acting on behalf of an employer." (See *Thurman v. Bayshore Transit Mgmt., Inc.* (2012) 203 Cal.App.4th 1112, 1148; see also Labor Code § 2699(b) (incorporating Lab. Code, § 18: "'Person' means any person, association, organization, partnership, business trust, limited liability company, or corporation.").)[11]

Reynolds set forth a common law test

In *Reynolds v. Bement* (2005) 36 Cal.4th 1075 (later abrogated by *Martinez,* 49 Cal.4th 35), the Supreme Court considered whether, as a matter of first impression, individuals may be liable under Section 1194. Plaintiff brought a class action against parent and subsidiary corporations as well as officers, directors, and shareholders of the companies, alleging all were joint employers.[11] The trial court sustained defendants' demurrer regarding the individual defendants. The higher courts affirmed.

The California Supreme Court held that while a corporate defendant's employer status is defined by the IWC wage order, individuals are subject to the common law definition of employer.[12] The Court observed that while the relevant IWC order's definition of employer controlled,[13] the IWC order did "not expressly impose liability under section 1194 on *individual corporate agents*."[14] The Court reasoned that absent a clear statutory directive, a common law definition of employer should apply.[15] Under "common law, corporate agents acting within the scope of their agency are not personally liable for the corporate employer's failure to pay its employees' wages."[16]

Following *Reynolds,* many state and federal courts applying California law precluded wage relief against owners, officers and directors as a matter of course.[17]

Martinez abrogated *Reynolds* with a three-part test under the IWC wage orders

In *Martinez*, the Supreme Court abrogated *Reynolds*, redefining joint-employer liability under the Labor Code. The Supreme Court held that the applicable IWC wage order, *not the common law*, defines the employment relationship.[18] The Court explained the legislature had delegated authority to the IWC over wages, hours, and working conditions.[19] The Court reasoned: "Were we to define employment exclusively according to the common law in civil actions for unpaid wages, we would render the commission's definitions effectively meaningless."[20]

Instead, the Supreme Court interpreted the IWC wage orders as incorporating the common-law test into the IWC's three-prong, disjunctive test for joint employment. To "employ" means: "[1] to exercise control over the wages, hours or working conditions, *or* [2] to suffer or permit to work, *or* [3] to engage, thereby creating a common law employment relationship."[21]

The Supreme Court in *Martinez*, concluded: "In sum, we hold that the applicable wage order's definitions of the employment relationship do apply in actions under [Labor Code] section 1194 [concerning overtime and minimum wage claims]. The opinion in *Reynolds* [citation], properly holds that the IWC's definition of 'employer' does not impose liability on individual corporate agents acting within the scope of their agency. [Citation.] The opinion should not be read more broadly than that."[22]

Despite *Martinez* setting a new course on the definition of "employer" in California wage law, with rare exceptions,[23] courts remained reluctant to find liability against an individual, harkening back to *Reynolds*[24] – until now.

Turman clarifies *Martinez*'s application to individual defendants

The *Turman* decision finally provides clarity regarding who may be personally liable as an employer.

Trial court decision

The underlying case, originally filed in 2010, *sub. nom. Quiles, et. al. v. Koji's Japan, Inc. et al.* (Orange Cnty. Sup. Ct.) Case No. 30-2010-00425532, was filed on behalf of low-wage restaurant workers at two restaurants.[25] Plaintiffs brought a class action lawsuit alleging wage theft against the closely held corporation that owned the restaurants.[26] The restaurant's sole shareholder, president, and director, Mr. Parent, closed the restaurants after the case was filed.[27] Though the restaurant-corporation's bank accounts were drained of funds, Mr. Parent stipulated to a net-worth of over $10 million.[28] After the closures, the litigation focused on whether workers could recover their unpaid wages from Mr. Parent as a joint employer, or alternatively, from him

and his other business entity as the restaurant-corporation's alter egos.[29]

In 2015, after a bench trial on joint employer and alter ego liability, the trial court ruled that although Mr. Parent had "absolute control" over his restaurant business, and could be personally liable under the FLSA's "economic reality test,"[30] Mr. Parent could not be a joint employer under California law, based on the Supreme Court's ruling in *Reynolds,* which (the trial court held) survived *Martinez.*[31] The trial court reasoned that *Reynolds* was binding because it dealt with the application of joint-employer liability for officers, directors, and managers of a closely held corporation, whereas *Martinez* dealt with corporate joint-employers.[32]

The trial court expressed concern that if it found Mr. Parent liable by virtue of his control as a sole shareholder and president of the restaurants, then all owners of closely held corporations would be liable for wage violations.[33]

Appellate decision

On November 7, 2017, the California Court of Appeal ordered the trial court to vacate its ruling on Mr. Parent's joint-employer liability (among other vacated rulings). The Court of Appeal held that Mr. Parent's status as a sole shareholder and president of a company cannot insulate him from wage and hour liability, if his actions meet any one of the three definitions of an employer as set out in *Martinez*.[34] The Court was careful to note that the IWC's three-part test "incorporates the common law definition as one [of the three] alternative" definitions.[35]

The Court's reasoning demonstrates that the joint-employer inquiry for Mr. Parent should be no different than for a parent corporation. In reaching its decision, the Court analogized to two recent rulings involving corporate joint employers. (See *Castaneda v. Ensign Group, Inc.* (2014) 229 Cal.App.4th 1015, 1017-1018 ("A corporation with no employees owns a corporation with employees. If the corporation with no employees exercises some control over the corporation with employees, it also may be the employer of the employees of the corporation it owns."); *Guerrero v. Superior Court* (2013) 213 Cal.App.4th 912, 950 ("an entity that controls the business enterprise may be an employer even if it did not 'directly hire, fire or supervise' the employees.").)[36]

The Court of Appeal found that Mr. Parent was not a removed sole shareholder and president who kept his hands off of the Koji's restaurants' operations. The Court pointed to trial court findings that Mr. Parent: "'dominated and controlled' Koji's;'" "was the 'big boss' to Koji's employees;" "'had the ability to control [Koji's], whether he chose to delegate that authority to managers or not;'" and exerted "'actual control over the employees of Koji's'" when he "'hired and fired'" non-exempt managers; instructed his managers to "get rid of" the original named plaintiff after she filed the lawsuit, resulting in her swift termination; and chose to lay off all employees by closing the restaurants.[37]

The Court of Appeal appropriately expressed the flip-side of the trial court's concern – in light of courts' duty to enforce the wage laws robustly, and the difficulty workers have collecting against closely held companies. If Mr. Parent "was immune from [joint employer] liability, notwithstanding such activity, because he was simply a corporate agent acting within the scope of his agency," then "no sole shareholder and officer of a closely held corporation would ever be liable as a joint employer for wage violations, even if he or she suffered or permitted another to work, controlled wages hours and working conditions, or engaged employees."[38]

Finally, the Court rejected the trial court's holding that the FLSA's "employer" definition is broader than California's, noting that analysis of joint-employer liability under the FLSA and the Labor Code "ordinarily involves the consideration of similar factors."[39] Indeed, as *Martinez* made clear, California's definition of employer is broader than the FLSA's.[40] The Court observed that the trial court's ruling that Mr. Parent was a federal joint employer cast serious doubt upon its state joint-employer analysis.

California Fair Day's Pay Act placed "other persons" on the hook

After extensive negotiations in drafting and intense lobbying by the California Employment Lawyers Association, Wage Justice, and others, on January 1, 2016, the California Fair Day's Pay Act[41] took effect, which specifies that owners, directors, officers, and managing agents may be liable for violations of overtime and minimum wages (Cal. Lab. Code, §§ 1193.6, 1194), meal and rest breaks (Cal. Lab. Code § 226.7), waiting time penalties (Cal. Lab. Code § 203), itemized wage statements (Cal. Lab. Code, § 226), and indemnification (Cal. Lab. Code, § 2802) statutes.[42]

Labor Code section 558.1, provides that an "employer," and any "*other person* acting on behalf of an employer, who violates, or causes to be violated" any of those wage statutes may share liability.[43] "Other person" is defined as "a natural person who is an owner, director, officer, or managing agent."[44]

Section 558.1 clarified the scope of personal liability for common wage violations occurring after January 1, 2016.[45] It will take time for meaningful case authority on Section 558.1 to develop, but thus far, defense counsels' attempts to dramatically limit its application have failed.[46] Regardless of how Section 558.1 jurisprudence develops, employees and advocates may now rely on *Turman* to hold bad business owners, officers, and directors accountable, applying the three-part *Martinez v. Combs* test.

Schwartz

Bryan Schwartz, lead trial and appellate counsel in Turman v. Koji's Japan, Inc., *has an Oakland-based firm representing workers in class, collective, and individual actions in wage/hour, discrimination, whistleblower, and unique federal and public employee claims. He practices in state and federal trial and appeals courts, in arbitration, and before a variety of administrative agencies. Schwartz is the past Chair of the 8,000+-member State Bar Labor and Employment Law Section, and on the Boards of Directors of Legal Aid at Work, the California Employment Lawyers Association, and the Foundation for Advocacy Inclusion and Resources (FAIR). He is a regular speaker, moderator, and conference co-chair on wage and hour and other employment law issues, and a frequent contributor to* Plaintiff Magazine. *www.BryanSchwartzLaw.com.*

Terp

Rachel Terp is the Senior Associate at Bryan Schwartz Law. *She second-chaired the trial of the* Turman *case, resulting in the important precedent discussed in this article.*

Endnotes

[1] See, e.g., Noam Scheiber, *Labor Board Reverses Ruling That Helped Workers Fight Chains*, NYTimes (Dec. 14, 2017), *available at* https://nyti.ms/2jTDOIQ; Christine Owens (Op-Ed), *Don't Let Congress Cheat Workers Out of Basic Rights*, NYTimes (Nov. 8, 2017), *available at* https://nyti.ms/2hmQDNP.

[2] This article focuses on direct, statutory liability under California wage laws and the Business and Professions Code – not alter ego liability, an equitable doctrine which has always remained an option – albeit, typically an uphill battle for workers to invoke. Generally, alter ego is available to cure an inequitable result – focusing on corporate formalities, overlapping finances, etc. – rather than wages, hours, and working conditions. *Turman* emphasizes that for alter ego liability to attach, a worker need not show fraud in the inception as to a business entity, but must only show that maintaining the corporate shield would perpetuate an inequitable result. See *Turman,* 17 Cal.App.5th at 980-981.

[3] See e.g., 29 C.F.R. section 791.2 (regulation defining joint employment under Fair Labor Standards Act ("FLSA"); *Pruitt v. Industrial Acc. Commission of Cal.* (1922) 189 Cal. 459, 461 (recognizing joint-employer liability in workers' compensation context).

[4] A 2013 empirical study by the UCLA Labor Center and the National Employment Law Project examined data from the Labor Commissioner's wage claim cases between 2008 and 2011 and determined that in 60 percent of cases where the employer was held liable, the employer was found to be non-active, e.g., having a status of suspended, forfeited, cancelled, or dissolved with the California Franchise Tax Board or the California Secretary of State. Eunice Hyunhye Cho, et al., Nat'l Emp't Law Project & UCLA Lab. Ctr., Hollow Victories: The Crisis in Collecting Unpaid Wages for California's Workers (2013) 1, 10-14. The study also found that only 17 percent of workers who prevailed before the Labor Commissioner ever recovered money from the judgment awarded. (*Id.* at 2, 13-14.)

[5] *Martinez*, 49 Cal.4th at 49 (describing the overtime and minimum wage statute, Lab. Code, § 1194). There are some wage claims where the "employer" definition is further defined, for example – as to unlawful tip pooling, Labor Code section 350 defines "employer" to include every "person" "irrespective of whether the person is the owner of the business" and a liable employer's "agent" as one "having the authority to hire or discharge any employee or supervise, direct, or control the acts of employees."

[6] *Id.* at 50, 52; *Kilby v. CVS Pharmacy, Inc.* (2016) 63 Cal.4th 1, 9 n.3 ("Although the Legislature defunded the IWC in 2014, its wage orders remain in effect.")

[7] See IWC wage orders Nos. 1-2001 through 16-2001, Cal. Code. Regs., tit. 8, sections 11010-11160.

[8] *Id.* at subd. 2(H).

[9] *Id.* at subd. 2(E).

[10] See *Troyk v. Farmers Group, Inc.* (2009) 171 Cal.App.4th 1305, 1338 (discussing scope of UCL protections); *County of Solano v. Vallejo Redevelopment Agency* (1999) 75 Cal. App.4th 1262 (citing Rest. of Restitution, § 1: "A person who has been unjustly enriched at the expense of another is required to make restitution to the other."). *Turman* is the first case to expressly hold that courts have the obligation to assess whether an individual is liable for wage violations under the UCL standard separately from whether he/she is liable under the Labor Code.

[11] Federal courts enforcing PAGA have held individual owners liable for wage violations for years. *McDonald v. Ricardo's on the Beach, Inc.* (C.D. Cal. Jan. 15, 2013) 2013 WL 153860, at *4; *Ontiveros v. Zamora* (E.D.Cal. Feb. 20, 2009) 2009 WL 425962, at *6. As with the UCL, *Turman* expressly held that a Court must consider the PAGA standard separately, in determining an individual's liability for wage violations.

[12] *Reynolds*, 36 Cal.4th at 1081.

[13] *Id.* at 1085-1089.

[14] *Martinez*, 49 Cal.4th at 63 (citing *Reynolds*, 36 Cal.4th at 1086).

[15] *Reynolds*, 36 Cal.4th at 1086 (ital. added).

[16] *Id.* at 1087-1088. The *Reynolds* concurrence by Justice Carlos Moreno did acknowledge, "The exploitation of such vulnerable workers by unscrupulous individuals hiding behind the corporate form takes place against a backdrop of diminished public resources for the enforcement of the state's labor laws . . . . [PAGA], in time, may provide workers with a mechanism for recovering unpaid overtime wages [from] corporate officers and agents in some cases. (§ 558, subd. (a))." *Id.* at 1094.

[17] *Id*.

[18] See, e.g., *Bradstreet v. Wong* (2008) 161 Cal.App.4th 1440, 1449-1455 *abrogated by Martinez,* 49 Cal.4th 3 (shareholders, officers, managing agents not liable under *Reynolds*); *Jones v. Gregory* (2006) 137 Cal.App.4th 798, 800, 803-806, 810 *abrogated by Martinez,* 49 Cal.4th 35 (sole corporate owner not liable under *Reynolds*); *Martinez v. Antique & Salvage Liquidators* (N.D. Cal. Feb. 8, 2011) 2011 WL 500029, at *5 (relying on *Reynolds*).

[19] *Martinez*, 49 Cal.4th at 62, 66.

[20] *Id.* at 59 (citing to Cal. Lab. Code §§ 1173, 1178.5; see Stats. 1913, ch. 324, §§ 3, 5 & 6, pp. 633–635).

[21] *Id.* at 62.

[22] *Id.* at 64.

[23] *Id.* at 66.

[24] See, e.g., *Garcia v. Bana* (N.D. Cal. Feb 19, 2013, No. C 111-02047 LB) 2013 WL 621793, at **1, 8-9, *aff'd* (9th Cir. 2015) 597 Fed.Appx. 415 (after a bench trial, the court found individual-owner defendant was a joint employer under California and federal wage laws, where he "had the power to hire and fire [plaintiff], supervised and exercised control over [plaintiff]'s wages, hours, and working conditions, determined the method of payment of Mr. Garcia's wages, and maintained [the business's] employment records").

[25] See, e.g., *Bain v. Tax Reducers, Inc.* (2013) 161 Cal.Rptr.3d 535, 564-567 (depublished Dec. 11, 2013) (holding that *Martinez* affirmed *Reynolds*); *Guifu Li v A Perfect Day* (N.D. Cal. 2012) 281 F.R.D. 373, 402 n.28 (*Martinez* notwithstanding, *Reynolds* "forecloses Plaintiffs' ability to hold a corporation's directors, officers, and shareholders personally liable for the corporation's state law wage and hour violations").

[26] *Turman*, 17 Cal.App.5th at 972, 974.

[27] *Id.* at 974-975.

[28] *Id.* at 974.

[29] Parent made the stipulation in a related proceeding. The original named plaintiff, Amanda Quiles, obtained a jury verdict that Parent retaliated against her in violation of the federal FLSA for filing the wage and hour class action, saying "get rid of her" after learning of her lawsuit. Though her wage loss was only $3,000 and her emotional distress was just $27,500, the jury awarded $350,000 in punitive damages, based upon Parent's stipulated $10 million net worth.

[30] See *Turman*, 17 Cal.App.5th at 974-978.

[31] *Id.* at 978, 987; Statement of Decision on Trial of Issues of Alter Ego and Joint Employer, *Quiles* (Apr. 2, 2015) Case No. 30-2010-00425532, at p. 10:22-23.

[32] *Id.* at 978, 983-984.

[33] *Id.* at 983-984.

[34] *Id.* at 986.

[35] *Id.*

[36] *Id.* at 985.

[37] *Id.* at 986.

[38] *Id*.

[39] *Id.*at 986-987.

[40] *Id.* at 987 (citing *Martinez*, 49 Cal.4th at 59-60).

[41] See *Guerrero,* 213 Cal.App.4th at 945; *Torres v. Air to Ground Servs., Inc.* (C.D. Cal. 2014) 300 F.R.D. 386, 394 (citing *Martinez* for the proposition that "the IWC's definition of 'employer' is designed to afford greater protection to employees than the FLSA's definition of that term"); *Carrillo v. Schneider Logistics Trans-Loading & Distribution, Inc.* (C.D. Cal. Jan. 14, 2014) 2014 WL 183956, at *15 n. 5 (California joint-employer standard broader than FLSA's). See also generally *Mendiola v. CPS Sec. Solutions, Inc.* (2015) 60 Cal.4th 833, 843 ("Federal regulations provide a level of employee protection that a state may not derogate. Nevertheless, California is free to offer greater protection.").

[42] Stats. 2015, Ch. 803, Sec. 10. (SB 588), codified as Cal. Lab. Code § 558.1.

[43] Cal. Lab. Code § 558.1 subd. (a).

[44] *Id.*

[45] Cal. Lab. Code § 558.1 subd. (b).

[46] Cal. Lab. Code § 558.1 subd. (c) ("Nothing in this section shall be not construed to limit the definition of employer under existing law.").

[47] See, e.g., *Carter v. Rasier-CA, LLC* (N.D. Cal., Sept. 15, 2017) 2017 WL 4098858, at *5 n.1 ("Defendants' attempt to limit California's 'A Fair Day's Pay Act' to enforcement actions by the Labor Commissioner is belied by the language of the provision itself").