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In a case of first impression, a California Court of Appeal finds that the definition of employer or deemed employer under the California Labor Code and Business and Professions Code does not include individual supervisors, managers or owners unless the statute specifically imposes individual liability.

California Edition

A Littler Mendelson California-specific Newsletter

California Court of Appeal Affirms Decision Finding No Individual Liability for Supervisors or Managers Under State Wage Laws

By Michelle B. Heverly and Blaire A. Cleveland

When major customers failed to pay for goods, Wins Corporations, a group of three garment manufacturing companies that had successfully operated for over a decade in the highly competitive sewing business, went into financial crisis. Attempting to push through the crisis, the company urged its employees to continue working without pay until it collected slow-paying accounts receivable and stabilized its finances. As a result, employees were either paid late, underpaid, or not paid at all. When the employees complained, the Division of Labor Standards Enforcement (DLSE) and Department of Labor (DOL) filed suit against Wins and its individual owners and bookkeeper.

In the first decision of its kind under California's wage payment laws in an action brought by the Labor Commissioner, the court of appeal in *Bradstreet v. Wong*, No. A113760 (Apr. 16, 2008), found that the definition of *employer* and *deemed employer* under the California Labor Code and the Business and Professions Code does not include individual supervisors, managers or owners. In reaching its decision, the *Wong* court relied on the California Supreme Court decision in *Reynolds v. Bement*, 36 Cal. 4th 1075 (2005) (Reynolds) that held the common law definition of *employer*, under which corporate agents acting within the scope of their agency are not personally liable for a corporate employer's failure to pay its employees wages, applied to overtime statutes rather than the more stringent interpretation advocated by the Industrial Welfare Commission's (IWC).

Factual Background

Wins Corporations, a group of three San Francisco garment manufacturing companies, Wins of California (WCA), Wins Fashion, and Win Industries of America, was run by a husband and wife team, Toha Quan and Anna Wong, who served as corporate officers or directors for all three companies, and who were named as individual defendants in the action. Jenny Wong, who was also named as an individual defendant, performed bookkeeping and payroll work for all three corporations and served on the board of directors for one of them. All three companies were closely held corporations successfully doing business since the 1980's and early 1990's.

In the summer of 2001, Wins Corporations suffered a financial crisis caused by a variety of things, including slow or no-paying customers, and the failure of a large client to accept and pay for a sizable order. Accordingly, for several months during 2001, Wins Corporations failed to pay suppliers and other expenses, including employee payroll. During this period, defendants told employees that there was inadequate cash to meet the payroll, but encouraged employees to continue working with the promise that they would eventually be paid. The defendants also issued some checks to employees, but instructed them that they could not be cashed, or issued pay stubs that that defendants

stated could be used to verify the amounts owed when cash became available.

Ultimately, after several months of failing to receive regular paychecks, employees complained, and the Division of Labor Standards Enforcement (DLSE) and Department of Labor (DOL) filed suit and obtained injunctive relief that resulted in the closing of Wins Corporations and the seizure of its assets and accounts receivables. These actions resulted in a bankruptcy declaration on the part of Wins Corporation and stipulated judgment against them by the DOL in the amount of $500,000. The DLSE paid employees from the seized funds, and then the Labor Commissioner filed a further lawsuit against the individual owners and bookkeeper seeking to hold them personally liable for the unpaid wages. The Commissioner sought liquidated damages for unpaid minimum wages and overtime, unpaid vacation, penalties for bad payroll checks, waiting time penalties for failure to pay wages due at termination and for failure to timely pay wages, and other penalties under various Labor Code sections.

Issues & Relief Sought

As the legal basis for imposing personal liability on the defendants, the original complaint relied exclusively on a provision in the IWC wage order applicable to the garment industry that 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."[1] The complaint alleged that defendants employed or exercised control over the wages, hours, and working conditions of the employees of Wins Corporations, and therefore were personally responsible for Labor Code violations arising out of the failure of the corporation to pay wages.

The complaint was later amended to include the argument that the defendants had so abused the corporate entity and the limited liability it provides that they should be deemed the alter egos of the Wins Corporations. Two former employees also intervened, adding a claim for violation of California's Unfair Competition Law (UCL), Business and Professions Code section 17200, seeking restitution from the individual defendants.

The matter was tried to the court, which issued a tentative ruling against the individual defendants, ordering them to pay more than $1 million in back wages and penalties. Before the decision was final, however, the California Supreme Court issued its ruling in *Reynolds v. Bement*, and the trial court reversed itself and entered judgment in defendants' favor. The trial court found that under the common law definition, the employers were Wins Corporations and not the individual owners or managers. The trial court also found that the plaintiffs had failed to prove that there was sufficient grounds to "pierce the corporate veil," as there was no evidence of inadequate capitalization or improper commingling of funds. The Labor Commissioner and one of the interveners appealed.

Court of Appeal Analysis

On appeal, the issues to be decided were whether the common law definition of *employer* had been correctly applied to an action brought by the Labor Commissioner under Labor Code section 1193.6, whether defendants were liable as *employers* under the garment manufacturing regulations of the Labor Code, and whether restitution under the UCL could be imposed on the defendants as individuals.

Personal Liability Under IWC Wage Order Definition of Employer

As noted, in 2005 the California Supreme Court in *Reynolds* held that in light of the fact that neither the term "employer" or "employee" were statutorily defined in the substantive Labor Code provisions being enforced, the only appropriate definitions were the common law ones. In *Wong*, the Labor Commissioner attempted to distinguish *Reynolds*, arguing that because the action had been brought by the Commissioner under Labor Code section 1193.6, rather than by the employee under Labor Code section 1194, a more stringent definition of employer should be used.

Although the court "cautioned" that not all Labor Code sections are necessarily subject to the common law definitions of employer and employee, it ultimately held that there was no basis to distinguish *Reynolds* in this case. More specifically, the court found that the language of section 1193.6 did not "evidence a clear and unequivocal legislative intent to depart from the established common law meaning of these terms."

The court noted that in other sections of the Labor Code, such as sections 1199 and 1175, the legislature has specifically evidenced an intent to impose liability not only on employers, but also on "persons" or "individuals." As this type of language is absent from section 1193.6, the court found there was no clear intent to vary from the common law meaning of those terms. Thus, under the common law definition, the Wins Corporations, and not the individual defendants were the "employers" liable for the alleged violations of the Labor Code.

Personal Liability as "Deemed Employer" Pursuant to Section 2677

The employee intervener also appealed on the basis that under the garment industry regulations, the individuals were deemed *employers* and should be liable on that basis. The court noted that the garment industry is more highly regulated than some other industries, in part because it has traditionally received the benefit of "cheap labor" with no liability by contracting production work to independent contractors who in turn use unskilled immigrant workers. In 1980, legislation was passed making any person engaged in the garment industry who contracts with another person for production a *deemed employer* jointly liable for various wage and hour violations.

[1] Cal. Code Regs., tit. 8 § 11010, subd. 2(F).

In the case of Wins Corporations, the company had contracted with a Utah-based manufacturer named Tomi, Inc. The employee intervener argued that because the individual defendants, as owners of Wins Corporations, had a relationship with Tomi, Inc., they were deemed to be employers under the garment industry regulations and were thus jointly liable for the wage and hour violations.

The court rejected this argument as "illogical," holding that it was Tomi, Inc., not the individual defendants, who had "contracted with," Wins Corporations. Thus, to the extent that Wins Corporations were liable for wage and hour violations, Tomi, Inc., might also be liable as a deemed joint employer. The individual defendants, however, had not "contracted with" Wins Corporations , and could not be liable under this regulatory scheme.

Recovery of Unpaid Wages Under the Unfair Competition Law

Finally, the employee intervener sought to impose liability against the individual defendants on the grounds that they had "directly and actively participated in the alleged violations," and thus could be individually liable under the UCL for the practices of the corporation. The trial court did not make any findings on whether they directly or actively participated in the underlying violations. Instead, the court ruled that the *remedy* sought, (the restitution of wages), could only be imposed on Wins Corporations as the employer for whom the services were preformed, not upon the defendants as individuals.

The court of appeal upheld this decision, noting, in part, that the individual defendants "obtained no money or gains from which to disgorge or pay restitution." Thus, although they might have directly participated in an unfair business practice, there was no remedy for the intervener, as civil penalties are only assessed in "public" unfair competition actions. The court further noted that "problem with requiring defendants, rather than the Wins Corporations, to pay unpaid wages as restitution is that the labor [the employee] intervener performed was not for the defendants personally, but for the employers, the Wins Corporations." Accordingly, absent some finding that the individual defendants had personally benefited from the labor, or that they had misappropriated the unpaid wages for themselves, there was no basis upon which to impose individual remedies.

Implications of the Decision

Although the California Court of Appeal found no basis for individual liability in this case, the court by no means absolved all individuals from liability for wage and hour violations. To the contrary, the court specifically noted that some provisions of the California Labor Code contain a broader definition of *employer* that would specifically include managers, owners or officers. In addition, in the case where the labor performed was for the benefits of the individual, or where an individual uses or misappropriates the unpaid wages, restitution would be an appropriate remedy under the unfair competition statutes. Employers should remain mindful of these issues and insure that their managers and supervisors are complying with all wage and hour laws.

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