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The Buck Stops Here: What You Owe Your Employees

By David G. Jones



The passage of California Assembly Bill 5 codified the distinction between employees and independent contractors in a manner that runs contrary to the understanding of many business owners as to appropriate independent contractor status and usage.



A KEY ROLE OF AN EMPLOYMENT LAWYER IS to advise clients of California’s rapidly changing laws that impact their daily decision-making processes. The sheer volume of questions attorneys receive regarding California’s employment laws from both clients and acquaintances highlight the common misperceptions that pervade the business community.

An example of this collective misperception can be seen in the major legal shift to California’s gig economy brought on by the landmark *Dynamex Operations West, Inc. v. Superior Court* decision and subsequent passage of California Assembly Bill 5.¹

AB-5 codified the distinction between employees and independent contractors in a manner that runs contrary to the understanding of many business owners as to appropriate independent contractor status and usage.

Together these misperceptions leave employers vulnerable to costly lawsuits and legal exposure. That risk is especially acute for small businesses that may lean on instinct or the internet to make decisions regarding wages earned and hours worked, rather than consulting legal counsel.

A reoccurring issue in worker classification is the common misperception that business entities shield owners from individual liability.

While a primary reason for most businesses utilizing the corporate or limited liability entity structures is the protection against individual liability for their company’s debts, recent legislation and case law have established a basis for the imposition of individual liability upon owners, directors, officers, and managing through the Labor Commissioner or a Private Attorneys General Act (PAGA) action.

Preventing Wage Theft

In an effort to combat what it characterized as widespread wage theft throughout the state, the California Legislature passed California Labor Code Sections 558 and 558.1.

The original bill, dubbed A Fair Day’s Pay Act, was characterized in the California Senate Judiciary Committee Bill Analysis as giving the Labor Commissioner “the authority to hold individual business owners accountable for their debts to workers.

By applying an existing enforcement law to wage claims, responsible individuals can be issued citations personally. This will discourage business owners from rolling up their operations and walking away from their debts to workers and starting a new company.”²

In identifying some of the concerns that formed the foundation of the new law, the Legislature further stated that “... it is difficult and rare for workers in California to recover stolen wages. Even if a worker wins their case before the California Division of Labor Standards Enforcement (DLSE) and received a judgment, only 17 percent were able to collect any payment. This is possible “because many of the businesses that are the worst violators of our labor laws simply roll up their operations and close shop when workers try to hold them accountable, thus avoiding any responsibility for their exploitative employment practices. In fact, in over 60 [percent] of the cases where DLSE found an employer owed wages, the employer was listed as non-active, i.e., defunct.”³

Without a doubt, many unsavory small businesses were playing a shell game in the two decades before the legislation was enacted. Too often, such businesses would simply reestablish themselves under a different name making it nearly impossible for employees to collect their unpaid wages.

Protecting Employee Wages

While the purported purposes of the Act are tied to abusive practices of certain employers, the ultimate tool established by Labor Code Section 558.1 has, however, proved to be a double-edged sword.

In the 2019 California Supreme Court decision *Voris v. Lampert*, the court essentially eliminated the tort of conversion as a basis for wage recovery.⁴

In Justice Mariano-Florentino Cuéllar’s dissent, he explained the importance of wages under California law and expressed the importance of vindicating employees who are not paid for their labor.

In California, he wrote, “unpaid wages are not merely contractual obligations to pay a sum. This is because, as we long ago observed, ‘wages are not ordinary debts.’ The reason for this is practical: “because of the economic position of the average worker and, in particular, his dependence on wages for the necessities of life for himself and his family, it is essential to the public welfare that he receive his pay when it is due.”

A recent study estimated that “minimum wage violations alone cost California workers nearly \$2 billion per year,” he stated. “When workers cannot collect wages they are owed, they are unable to pay for food, housing, or other bills. They spend less overall, slowing local economies and decreasing tax revenue for state and local governments. And employers who fail to pay wages in full and on time create

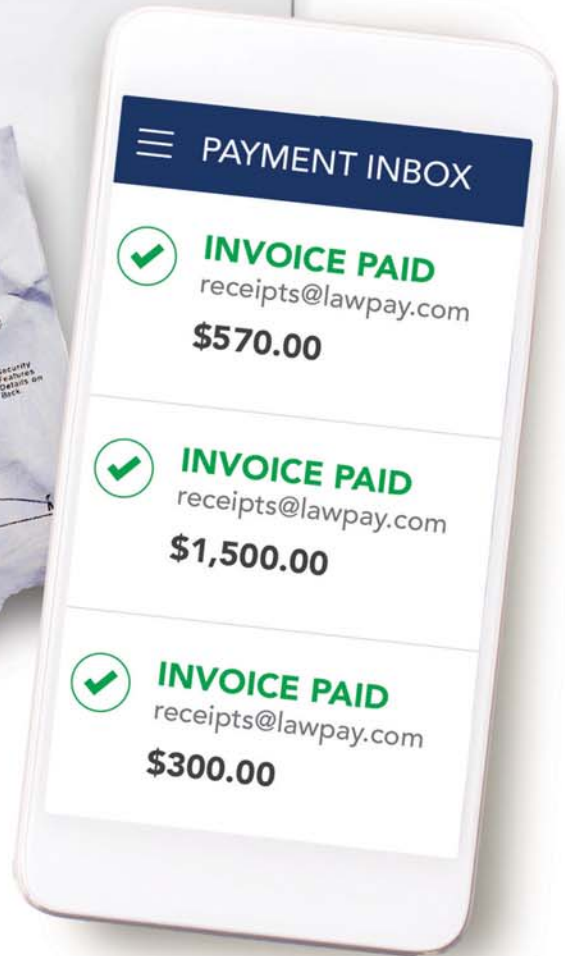


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an uneven playing field in which law-abiding businesses are unable to compete. [This], in effect, leads to a badly distorted and fundamentally unfair marketplace for both labor and consumers...”

Justice Cuéllar asserted that, “Where unpaid wages diverge from garden-variety contractual promises to pay a debt is in the fundamental importance of earned wages to workers, their families, and the public. Our case law has repeatedly highlighted and enforced that distinction.

“In *Cortez*, for example, we declared that ‘[o]nce earned, those unpaid wages became property to which the employees were entitled.’ Indeed, they are ‘as much the property of the employee who has given his or her labor to the employer in exchange for that property as is property a person surrenders through an unfair business practice.’”

Labor Code Section 558.1

According to the text of Labor Code Section 558, “Any employer or other person acting on behalf of an employer, who violates, or causes to be violated, any provision regulating minimum wages or hours and days of work in any order of the Industrial Welfare Commission, or violates, or causes to be violated, Sections 203, 226, 226.7, 1193.6, 1194, or 2802, may be held liable as the employer for such violation.

“For purposes of this section,” it continues, “the term ‘other person acting on behalf of an employer’ is limited to a natural person who is an owner, director, officer, or managing agent of the employer, and the term ‘managing agent’ has the same meaning as in subdivision (b) of Section 3294 of the Civil Code.”⁵

The key and defining language in subsection (b) shows that *any natural person* in a position of authority with a company can be held personally liable for certain wage and hour violations, as specified in subsection (a).

That broad list of potential judgment debtors extends to owners and even managing agents as that term is defined in the well litigated Civil Code Section 3294, reflecting the punitive damage law for the state of California.

By including the *managing agent* language, the legislature both broadened the category of responsible persons and created some measure of certainty given the breadth of legal authority on this concept in California law.

The implicated violations categorically include unpaid minimum wages, unpaid overtime, rest and meal break violations, incorrect wage statements, waiting time penalties, and unreimbursed business expenses.

Essentially, all the primary and most common wage violations are included in the types of violations for which individuals may be held personally responsible under 558.1.

Based on the broad language in Section 558.1, employees now systematically name principals and involved management-level employees as defendants in private actions seeking recovery of penalties. An unfortunate and unintended result of this is that non-discriminatory lawsuits are misused

in efforts to leverage the individual owners and managers of companies.

Just What is an “Employer”?

As a general proposition, wage and hour law is encompassed in two main sources—the Labor Code and the Wage Orders issued by the Industrial Welfare Commission (IWC).

The IWC Wage Orders define the term “employer” broadly to include “any person...who directly or indirectly, employs or exercises control over the wages, hours or working conditions of any person” and further defines “employ” to mean “engage, suffer, or permit to work.”⁶

Under the IWC definition, “employ” is defined as “(a) to exercise control over the wages, hours or working conditions, (b) to suffer or permit to work, or (c) to engage, thereby creating a common law employment relationship.”⁷

The IWC definition reaches irregular working arrangements outside the common law definition of “employer” and the language “directly or indirectly” is broad enough to impose liability for wages on the actual employer and identify “straw men” and other sham arrangements.^{8,9}

The Federal Fair Labor Standards Act

The federal government’s counterpart wage and hour law, the Fair Labor Standards Act, creates liability for “any person” acting in the employer’s interest in dealing with employees.¹⁰

“Where an individual exercises control over the nature and structure of the employment relationship...that individual is an employer within the meaning of the Act, and is subject to liability.”¹¹

Federal courts have developed an “economic reality” test, which determines whether a “person” is “acting directly or indirectly in the interest of an employer” in managing the employment relationship with company employees.¹²

The courts consider the “totality of the circumstances of the relationship,” including factors such as hiring and firing, setting wage amounts, scheduling, the facilitation of payment and general control over the employee workplace.¹³

While California’s employment laws are generally consistent with their federal counterpart, there are notable exceptions.

Individual liability for unpaid wages is one such area. The conflict in the law at the state and federal levels creates a strange divergence, which creates a more favorable outcome for employees litigating claims against individual defendants in federal court.

Despite the recent employee-friendly legislative swing in California, employees might often be better served by pursuing individual defendants for large sums of unpaid wages on the federal level.

Liability and Mandatory Penalties for Violations

California’s Labor Code authorizes civil penalties under many

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statutes, but for purposes of this article the statutes of concern are Labor Code (LC) Sections 558.1, 1197.1, and 2699.

Pursuant to LC Section 558.1, the Department of Labor Standards Enforcement, through the Labor Commissioner, has the authority to impose liability on “[a]ny employer or other person acting on behalf of an employer” who causes overtime pay violations to occur.¹⁴

LC Section 1197.1 imposes individual liability on “[a]ny employer or other person acting either individually or as an officer, agent, or employee of another person” for failure to pay minimum wages.¹⁵

All wage and hour violations carry penalties and liquidated damages as a deterrent to employers who flout wage and hour laws. These penalties are mandatory on a finding of statutory liability.

Accordingly, even with effective lawyering as to unpaid wage claims, ultimately those who control the payment of wages to employees will be saddled with likely non-dischargeable penalty judgments as to claims which are converted to judgments.

Without referring specifically to the Bankruptcy Code, suffice it to say that it is incredibly difficult to discharge penalties imposed by a governmental entity in a bankruptcy situation.

Accordingly, every effort must be made to avoid exposure to these claims at the earliest possible juncture.

With the wave of Private Attorney General Act (PAGA) claims recently filed by employees, it is critical to understand the exposure for individual business owners under Labor Code Section 2699 which governs these claims.

Section 2699(a) provides that, “Notwithstanding any other provision of law, any provision of this code that provides for a *civil penalty to be assessed and collected* by the Labor and Workforce Development Agency or any of its departments, divisions, commissions, boards, agencies, or employees, for a violation of this code, may, as an alternative, be recovered through a civil action brought by an aggrieved employee on behalf of himself or herself and other current or former employees pursuant to the procedures specified in Section 2699.3.”¹⁶

Atempa v. Pedrazzani: A Critical Decision

In the case of *Atempa v. Pedrazzani*,¹⁷ the California Court of Appeal found personal liability for civil penalties as they applied to individuals responsible for overtime and/or minimum wage violations under PAGA.

The Court determined that employees were authorized to recover penalties as “aggrieved employees” through PAGA and affirmed the trial court’s award of section 558 civil penalties against the individual defendant.¹⁸

Pedrazzani was an owner and officer of a corporation. His employees filed wage and hour claims against him, individually,

and his corporation, seeking civil penalties for unpaid minimum wages and overtime. After the employees obtained a judgment finding that Pedrazzani and his corporation were jointly liable for civil penalties, Pedrazzani appealed and the corporation filed bankruptcy.¹⁹

The *Atempa* court first determined that an aggrieved employee seeking to recover PAGA civil penalties must proceed under...Section 2699(a).²⁰

The Court held that “personal liability can attach even if a person has no formal relationship with the corporate employer (e.g., employee, manager, officer). Rather, for overtime violations, it is sufficient that the ‘other person’ was ‘acting on behalf of the employer.’ For minimum wage violations, it is sufficient that the ‘other person’ ‘pays or causes to be paid less than the prescribed minimum wage.’”

Ultimately, the Court held that the statutes at issue “provide for an award of civil penalties against the person who committed the underlying statutory violations,” reasoning that Section 558 was broad enough to include an officer or agent of a corporate employer as an “other person” subject to civil penalties.^{21 22}

(Recognizing claim for Section 558 penalties against officer/agent of a corporate employer upon a sufficient showing that the officer/agent was responsible for the underlying wage violation).²³

Next, the court recognized not only that Section 558 authorized the Labor Commission to recover civil penalties, but that Section 2699 authorized “aggrieved employees” to seek civil penalties.²⁴

In *Ochoa-Hernandez v. Cjaders Foods, Inc.*,²⁵ the plaintiff sought leave to add a PAGA claim against individuals who allegedly took specific actions on behalf of a corporate employer to violate or cause to be violated wage and hour provisions.

The court, in that case, held that the proposed amendment was not futile, observing that “Section 2699(a) makes no reference to an ‘employer’ and contains no limitation on who can be liable for labor code violations.”²⁶

The court reasoned that “[g]iven Section 2699(a)’s silence on liability, it likely does not stretch the plain language of PAGA to find that a person who acts on behalf of an employer can be held liable if the provision to be enforced explicitly permits liability against that person.”²⁷

Consistent with *Atempa* and *Ochoa-Hernandez*, it is clear that that Labor Code Section 2699 creates potential liability for individuals who cause an underlying wage violation for purposes of PAGA penalties.

Eliminating Individual Liability for Unpaid Overtime

In *Martinez v. Combs*, the California Supreme Court held that the Industrial Welfare Commission (IWC) definition of the employment relationship applies to actions under Section 1194.²⁸

Under IWC definition, “to employ” has three alternative definitions—(a) to exercise control over the wages, hours or working conditions; or, (b) to suffer or permit to work; or, (c) to engage, thereby creating a common law employment relationship.²⁹

The California Supreme Court observed that the first IWC definition “has the obvious utility of reaching situations in which multiple entities control different aspects of the employment relationship, as when one entity, which hires and pays workers, places them with other entities that supervise the work.”³⁰

Martinez makes clear that the IWC definition of the employment relationship “does not impose liability on individual corporate agents acting within the scope of their agency.”³¹

The *Reynolds v. Bement*³² court ruled that the plain language of the IWC Wage Order No. 9 did not expressly impose liability under Section 1194 on individual corporate agents as employers under the Wage Order. Reynolds also indicated that “[u]nder the 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.”^{33 34}

Reynolds found that the law was clear that “corporate agents and employees acting for and on behalf of a corporation cannot be held liable for inducing a breach of the corporation’s contract. And ‘[d]irectors or officers of a corporation do not incur personal liability for torts of the corporation merely by reason of their official position.’”³⁵

The court held that the plaintiff could not state a Section 1194 cause of action against the individual defendants.³⁶

Reynolds v. Bement explained that “[h]ad the Legislature meant in Section 1194 to expose to personal civil liability any corporate agent who ‘exercises control’ over an employee’s wages, hours, or working conditions, it would have manifested its intent more clearly than my mere silence after the IWC’s promulgation of Wage Order No. 9.”³⁷

Implications of Labor Code Section 2802

Labor Code Section 2802(a) provides that “an employer shall 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, or of his or her obedience to the directions of the employer, even though unlawful, unless the employee, at the time of obeying the directions, believed them to be unlawful.”³⁸

Because the section requires the employer to defend and indemnify employees for liability incurred in the course and scope of employment, its unequivocal terms redirect responsibility to the employer.

Practically speaking, if an employer is insolvent or otherwise unable or unwilling to pay, the agent will be placed in a scenario where they are essentially jointly liable and

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Practical Implications and Advice for Employers

Employers must always remain vigilant in their compliance with wage and hour laws.

Unfortunately, the recent influx of legislation aimed at exposing individual business owners and employees to liability raises the stakes exponentially. Where before, employers could fall back on dissolving corporate entities or consulting a bankruptcy lawyer in difficult situations where employee wages were owed, those options have been eliminated.

Employers and businesses alike are strongly advised to seek competent legal guidance to navigate through California's maze of ever-changing wage and hour laws.

As always, an ounce of prevention will be worth a pound of cure, but, perhaps an ounce of prevention can prove to be worth ten pounds of cure at the pace that California employment law is changing. 

¹ *Dynamex Operations West, Inc. v. Superior Court*, 5 Cal.5th 903 (2018).
² California Senate Judiciary Committee Bill Analysis. http://www.leginfo.ca.gov/pub/15-16/bill/sen/sb_0551-0600/sb_588_cfa_20150427_153725_sen_comm.html.
³ *Id.*
⁴ *Voris v. Lampert*, 7 Cal.5th 1141, 1167-68 (2019) (dissenting opinion, J. Cuellar).
⁵ Labor Code Section 558.1.
⁶ 8 CCR § 11140, 2(C), (F).
⁷ *Martinez v. Combs*, 49 Cal.4th 35, 64 (2010).
⁸ *Martinez v. Combs*, supra, 49 Cal.4th at 63-66 (abrogating Supreme Court's contrary holding in *Reynolds v. Bement* 36 Cal.4th 1075, 1087 (2005)).
⁹ *Martinez v. Combs*, supra, 49 Cal.4th at 71.

¹⁰ 29 USC § 203(d).
¹¹ *Boucher v. Shaw*, (9th Cir. 2009) 572 F3d 1087, 1091 (abrogated on other grounds).
¹² 29 USC § 203(d); see *Hale v. State of Arizona*, 993 F2d 1387, 1394 (9th Cir. 1993).
¹³ See *De Guzman v. Parc Temple LLC*, 537 F.Supp.2d 1087, 1094 (C.D. Ca. 2008); *Boucher v. Shaw*, 572 F3d 1087, 1091-92 (9th Cir. 2009).
¹⁴ Lab. C. § 558(a); *Atempa v. Pedrazzani*, 27 Cal.App.5th 809, 823-24 (2018).
¹⁵ Lab. C. § 1197.1; see *Reynolds v. Bement*, supra, 36 Cal.4th at 108 ("aggrieved employees may... maintain civil actions to recover such penalties"); *Atempa v. Pedrazzani*, supra, 27 Cal.App.5th at 824.
¹⁶ Cal. Labor Code § 2699(a).
¹⁷ *Atempa v. Pedrazzani*, 27 Cal.App.5th 809 (2018).
¹⁸ *Id.* at 831.
¹⁹ *Id.*
²⁰ *Id.* at 826.
²¹ *Id.*
²² *Id.* at 823-824.
²³ *Accord Adame v. Comtrak Logistics, Inc.*, No. 15-2232 DDP, 2016 WL 1389754, at *7 (C.D. Cal. April 7, 2016) (holding at pleading stage that plaintiff may assert a section 558 claim against individuals but recognizing that there may be a factual question as to whether the individuals caused the alleged violations of the applicable labor laws, particularly if the individuals were not "high-level employees or otherwise satisfied the definition of 'employer' from *Martinez*"); *Ontiveros v. Zamora*, No. 08-567 LKK, 2009 WL 425962, at *6 (E.D. Cal. Feb. 20, 2009) (holding that plaintiff had adequately alleged that individual "caused" the Labor Code violations and therefore may be liable for Section 558 penalties).
²⁴ *Id.* at 826-27.
²⁵ *Ochoa-Hernandez v. Cjadars Foods, Inc.*, No. 08-2073 MHP, 2009 WL 1404694, at *4 (N.D. Cal. May 19, 2009).
²⁶ *Id.*
²⁷ *Id.*
²⁸ *Martinez v. Combs*, 49 Cal.4th 35 (2010).
²⁹ *Id.* at 64.
³⁰ *Id.* at 59.
³¹ *Id.* at 66 (citing *Reynolds v. Bement*, 36 Cal.4th 1075, 1086 (2005)).
³² *Reynolds v. Bement*, 36 Cal.4th 1075 (2005).
³³ *Id.* at 1089, fn. 10 (abrogated on other grounds by *Martinez v. Combs* 49 Cal.4th 35, 75 (2010) (alter ego doctrine may also be utilized in wage claim actions to impose liability on controlling directors and shareholders.)).
³⁴ *Id.* at 1087.
³⁵ *Id.*
³⁶ *Id.* at 1087-88.
³⁷ *Id.* at 1088 see *Martinez*, 49 Cal.4th at 66.
³⁸ Labor Code Section 2802(a).

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The Buck Stops Here: What You Owe Your Employees

Test No. 136

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- California's employment laws have undergone a major shift in worker classification with the landmark *Dynamex Operations West, Inc. v. Superior Court* decision and passage of AB-5. True False
- Labor Code 558.1 codified the distinction between employees and independent contractors. True False
- Prior to the enactment of Labor Code 558.1, the California Division of Labor Standards Enforcement found that over 60 percent of cases where an employer owed wages, the employer was listed as defunct. True False
- The California Supreme Court's decision *Varis v. Lampert* created the tort of conversion as a basis for wage recovery. True False
- Labor Code 558.1 creates individual liability for owners, directors, and officers but NOT managing agents. True False
- Under Labor Code 558.1, individuals can be held personally liable for unpaid minimum wages, rest and meal break violations, incorrect wage statements, waiting time penalties, and unreimbursed business expenses. True False
- Wage and Hour law is based primarily in the Labor Code and Title VII. True False
- The IWC Wage Order definition of employer includes any person "who directly or indirectly, employs or exercises control over the wages, hours or working conditions of any person." True False
- Contrary to California law, the Federal Fair Labor Standards Act does not impose individual liability for individuals for wage and hour claims. True False
- Under the FLSA, an employee must establish a set of "economic reality" elements to determine whether a person is acting in the interest of an employer. True False
- Generally, employees are more likely to succeed in pursuing individual defendants for unpaid wages in state court versus at the federal level. True False
- Individuals responsible for controlling the payment of wages cannot be held strictly liable for penalties associated with unpaid wage violations. True False
- Wage and hour violations carry penalties and liquidated damages. True False
- Employees may bring civil actions on behalf of not only themselves, but also on behalf of other current or former employees. True False
- California courts have imposed liability to individual defendants under California's Private Attorney General Act. True False
- Atempa v. Pedrazzani* held that personal liability can only attach if a person has a formal relationship with the corporate employer. True False
- In *Reynolds v. Bement*, the court ruled that the IWC Wage Order No. 9 did not expressly impose liability under Labor Code section 1194 on individual corporate agents as employers under the Wage Order. True False
- Labor Code Section 2802(a) requires employers to defend and indemnify employees for liability incurred in the course and scope of employment. True False
- A practical implication of Section 2802(a) is that if an employer is insolvent, agents will essentially be jointly liable with insolvent employers. True False
- Martinez v. Combs* shows that the IWC definition of the employment relationship does not impose liability on individual corporate agents acting within the scope of their agency. True False

The Buck Stops Here: What You Owe Your Employees

MCLE Answer Sheet No. 136

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