

News from our Employment & Labor Group

California Update—Individual Owners, Officers and Managers Held Not Personally Liable for Unpaid Wages and Related Labor Code Violations

In *Reynolds v. Bement* (2005) 36 Cal.4th 1075, the California Supreme Court held that individual officers, directors and shareholders of a corporation have no personal liability to the corporation's employees for unpaid overtime. Following *Reynolds*, the California Court of Appeal recently held in *Bradstreet v. Wong* (2008) 161 Cal.App.4th 1440, that individual owners, officers and managers of three closely-held corporations could not be held personally liable for the corporation's failure to pay owed wages to employees or for related California Labor Code violations.

Bradstreet v. Wong

Bradstreet involved claims brought by the California Labor Commissioner (the "Commissioner") on behalf of employees of three San Francisco garment manufacturing companies (the "Wins Corporations") against the owners, officers and managers of those companies for unpaid minimum wages and overtime, unpaid vacation pay and related Labor Code violations. The defendants in the case were a husband and wife team who owned the capital stock and served as the corporate officers or directors of the Wins Corporations, and an individual who performed bookkeeping and payroll work for the companies and served on the board of directors of at least one of them.

After more than a decade of successful operations the Wins Corporations incurred financial difficulties in 2001 and failed to meet payroll for several months. During that time, the defendants told employees

that the companies had insufficient cash to meet payroll, but that they would be paid eventually. The defendants issued checks to some employees, but told them they could not yet be cashed, or issued pay stubs to employees that were to be used only to verify amounts owed when cash became available. The defendants encouraged the employees to continue working without pay until the Wins Corporations could collect on slow-paying accounts and regain its financial footing.

After employees complained about the companies' failure to pay wages due, the United States Department of Labor (the "DOL") filed suit against the Wins Corporations, as well as the individual defendants, obtaining injunctive relief that resulted in the closing of the Wins Corporations and the seizure of their assets and accounts receivables. The DOL's actions ultimately made it impossible for the Wins Corporations to close a previously approved bank loan, forcing the companies into bankruptcy.

The Commissioner then filed suit against the individual defendants under Labor Code section 1193.6, seeking to hold them personally liable for unpaid wages and related Labor Code penalties. The Chinese Progressive Association and two former employees of the Wins Corporations filed a separate complaint in the action, echoing the Commissioner's claims and also seeking payment of wages owed as restitution under California's Unfair Competition Law, Business and Professions Code sections 17200 *et seq.* (the "UCL").

The trial court found for the individual defendants on all claims, and the Court of Appeal affirmed.

Drawing heavily from the California Supreme Court's ruling in *Reynolds v.*

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Bement, which held that individual shareholders, officers and directors could not be held individually liable in an action under Labor Code section 1194 for nonpayment of overtime wages and related Labor Code violations, the *Bradstreet* court concluded that liability could not be imposed on the individual defendants in an action brought by the Commissioner pursuant to Labor Code section 1193.6. The court noted that neither Section 1193.6 nor any of the underlying Labor Code sections at issue expressly define the term “employer.” Accordingly, the issue was whether the court should apply the common law definition of “employer,” which does not include corporate agents acting within the scope of their agency, or the definition in the applicable Industrial Welfare Commission wage order, which includes any individual who “exercises control over the wages, hours, or working conditions of any person.” The *Bradstreet* court held the common law definition applied, and therefore ruled the individual defendants could not be liable for the various Labor Code violations.

The *Bradstreet* court also rejected the UCL claim. In this regard, the court stated that an order for restitution compels a defendant to return money or earned wages for services obtained through an unfair business practice to those persons from whom the property was taken. Therefore, since the employees performed their work for the Wins Corporations, not the defendants personally, and the defendants did not personally benefit from the employees’ services, the court held there was no basis for ordering restitution.

Caution—the possibility of individual liability remains

Reynolds and *Bradstreet* establish that individual directors, officers, shareholders and managers of companies generally will not be held liable for claims related to unpaid wages under Labor Code sections 1193.6 (actions by the Commissioner) and 1194

(actions by employees). Yet, these cases do not establish a flat bar against individual liability for violations of the Labor Code. Indeed, the *Bradstreet* court specifically cautioned against reading *Reynolds* as a “categorical decision that all provisions of the Labor Code using the term ‘employer’ or ‘employee’ must be interpreted in accordance with their common law definitions.” Rather, each provision must be evaluated and interpreted on its own.

Two additional points put these cases into further context. First, neither *Reynolds* nor *Bradstreet* precludes “alter ego” liability if plaintiffs can “pierce the corporate veil” by proving individual defendants disregarded the separate status of the corporate entity and used its assets for their personal benefit.

Second, individual shareholders, officers, directors and managers of a corporation might have liability under Labor Code section 558. Section 558 specifically allows for recovery of civil penalties for violation of the wage laws, including failure to pay wages, from “[a]ny employer or other person acting on behalf of an employer.” Courts have interpreted similar language to mean individual defendants. In *Bradstreet*, however, the trial court ruled that the Commissioner’s attempt to bring a Section 558 claim against the individual defendants was untimely, and the Commissioner did not appeal the ruling, leaving that battle for a future case.

If you would like to discuss these issues further and/or have questions about this *Alert*, please contact one of the attorneys listed above. ■