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Navigating the Changing Waters of California Wage Laws

By Emily Loupee and Linda Pierce

Senate Bill (SB) 588, also known as "The Fair Day's Pay Act" went into effect in California on January 1, 2016. This legislation will give the California Labor Commissioner broad powers to collect judgments for unpaid wages. In addition, the new legislation expands potential liability to individuals for violations of wage laws. Because previous California case law held that individuals could not be held personally liable for wage violations, this new legislation may be cause of concern for employers and their directors, officers and managers doing business in California.

While the stated purpose of SB 588 is to provide recourse for employees of small businesses who are not paid wages from "fly-by-night" business owners closing shop without paying wages due, its impact on the directors and officers and employees of larger organizations remains to be seen.

This article will examine the background of personal liability for wage violations, and review the available insurance coverages for personal wage-related liability.

Background

It should come as no surprise that California's wage laws are among the most complex in the country. With its cumbersome overtime rules and industry-specific wage orders, California has become a hotbed of wage claims, including claims for unpaid minimum wage, unpaid overtime (including overtime allegedly due as a result of misclassification of employees as exempt from overtime compensation), and wages owed for missed meal breaks and rest periods. Aggrieved employees may bring these claims in state courts either individually or as a class action. Employees can choose to file their claims with the Labor Commissioner rather than seek redress in court.[1]

Historically, California courts and the Labor Commissioner have not been in agreement when determining who is liable to employees for wage violations. For example, Labor Code Section 1194 (a), allows an employee receiving less than the legal minimum wage or overtime compensation to file a civil suit for the unpaid balance of the full amount of this minimum wage or overtime compensation, including interest, attorney's fees and costs of the suit. The statute, however, is silent as to who is responsible for paying the employee. On the other hand, the California Supreme Court has declined to hold individuals liable for wage claims.

In 2005, in deciding a suit brought under wage statutes, the California Supreme Court refused to hold an employer's officers, directors and shareholders liable for state law wage violations arising from alleged nonpayment of earned wages. The Court noted the lack of any California statute that held corporate control figures liable for unpaid wage. The Court determined that "corporate agents acting within the scope of their agency are not personally liable for the corporate employer's failure to pay its employees' wages" (*Reynolds v. Bement* (2005) 36 Cal.4th 1075, 1087). Interestingly, many federal Circuit Courts of Appeal have ruled differently, citing the federal Fair Labor Standards Act and have determined that individuals may be liable for unpaid wages.[2]

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[1] The Department of Labor Standards Enforcement ("DLSE") is headed by the Labor Commissioner and is authorized to enforce California labor law, including the Industrial Welfare Commission wage orders.

[2] In *Boucher v. Shaw*, 572 F.3d 1087 (9th Cir. 2009) the Ninth Circuit imposed personal liability on corporate agents with the control over the employment relationship for unpaid minimum wages and overtime. Unlike California statutes, the FLSA defines "employer" as "any person acting directly or indirectly in the interest of an employer in relation to an employee." 29 U.S.C. §203(d).

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The California Labor Commissioner has continued to use a control test found in the Industrial Welfare Commission (IWC) wage orders to determine personal liability for wage claims it investigated and resolved. The IWC language defines an "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." This definition was the subject of another California Supreme Court decision, *Martinez v. Combs*, 49 Cal.4th 35 (2010). In *Martinez*, the Supreme Court held that the IWC's definition of "employer" could apply to situations in which multiple entities controlled aspects of the employment relationship. The Court reaffirmed its conclusion in *Reynolds* that California law does not impose personal liability for wage violations on individual corporate agents.

The New Law

In 2015, the Legislature passed Senate Bill (SB) 588 (popularly referred to as "The Fair Day's Pay Act") which took effect on January 1, 2016. SB 588 amends the existing wage law to give the Labor Commissioner the procedural ability to collect "any outstanding amount of a judgment [for wages, penalties, interest, and attorney fees." This includes the ability to levy individuals' assets, including real estate. Additionally, SB 588 allows the Labor Commissioner to require an employer that has been found to have illegally withheld wages to post a bond in order to continue to conduct business in the state. The bond amount ranges from $50,000-$250,000, depending upon the wages owed.

Furthermore, SB 588 prevents an employer from avoiding wage liability by closing down its business and reopening under a new name. SB 588 extends the liability for judgments to subsequent employers that are similar in operation and ownership to an employer with an unsatisfied judgment. This applies to situations where (1) the employees of the subsequent employer are engaged in substantially the same work in substantially the same working conditions under substantially the same supervisors or (2) if the new entity has substantially the same production process or operations, produces substantially the same products or offers substantially the same services and has substantially the same body of customers.

While there are additional aspects of SB 588 not discussed in this article, including potential criminal liability, we think the most interesting aspect of SB 588 is the potential expansion of individual liability to any "person" who would be liable as an "employer" for any violations of statutes providing for payment of wages, penalties, meal periods and rest breaks, and reimbursement of expenses.[3] It remains to be seen how courts will address claims against individual corporate agents in light of these amendments and prior Supreme Court decisions addressing liability of "persons" for wages due from an employer.[4]

Insurance Coverage

This leaves the question as to whether this newly-defined liability can be covered by insurance. There are two coverage types to consider; employment practices liability insurance (EPLI) and directors and officers liability insurance (D&O).

In California, the EPLI policy forms typically contain an exclusion for any claims related to wage violations. Some insurers offer a small sublimit of $100,000 to $250,000 to cover defense costs for wage-related claims, but no coverage for unpaid wages, fines or penalties. Furthermore, for claims against entities and individuals for successor liability created by SB 588, there may be an issue as to whether or not the insuring agreement would be triggered because the claim would have initially been brought by an employee of another predecessor organization. As a result, it is not likely that an EPLI policy would provide any coverage for personal liability arising out of SB 588.

D&O policies may be more likely to respond than EPLI policies. Most private and not-for-profit company forms, however, exclude wage claims. Companies may purchase an excess Side-A difference in conditions (DIC) policy that contains broader terms than the primary policy, and those typically do not contain wage exclusions. Public company policy forms generally do not exclude wage-related matters, potentially for providing coverage for claims against individual directors and officers. Successor liability claims, however, may lead to a capacity issue, similar to those possible under EPLI policies if the claim arises from an individual's affiliation with a prior organization. Additionally, it is unclear if unpaid wages can be considered a "loss" under the policy as many D&O policies exclude wages, fines, and penalties from coverage.

Insurers such as AIG, Beazley, AWAC, Markel have launched new products specific to wage and hour exposures out of London and Bermuda. The policies impose high retentions of $5M and up and relatively high premium, but are written to pick up wage-related loss. This option also benefits clients, such as publicly traded companies, who may not want to expose their D&O liability policy limits to wage related liability.

Conclusion

Only time will tell exactly how SB 588 will be interpreted and enforced in California, and how EPLI and D&O insurers will respond. There is likely not coverage for the personal liability in a typical EPLI policy, but there may be some coverage in a D&O or excess Side-A DIC for claims against individual directors and officers, though that coverage may be limited to defense costs. If coverage for this risk is deemed necessary, a stand-alone wage and hour policy may be the best option, despite its higher cost and retention.

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[3] SB 588 added the following to the Labor Code: "Any person who would be liable for any violation under Section 558 may also be held liable in an action pursuant to Section 98, 203, 226, 1193.6, 1194, or 2802.

[4] It is important to note that the increased authority of the Labor Commissioner for pursuing successors for wage claims is likely due to the Labor Commissioner being more involved in smaller claims against smaller employers who are more inclined to engage in potential fraudulent transfer of assets than larger employers.

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