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Recent California Supreme Court Decisions on Unpaid Wages and Retaliation Claims

California Supreme Court Clarifies Standards For Personal Liability For Unpaid Wages

On August 11, 2005, the California Supreme Court held that none of the officers, directors, and shareholders of a corporation, sued for unpaid overtime wages, can be directly sued as an “employer” even if they “exercised” control over the payment of wages. *Reynolds v. Bement*, No. S115823, 2005 Cal. LEXIS 8595 (Cal. 2005). The court also rejected a theory that the individual defendants were jointly liable for directing or participating in tortious conduct: a “simple failure to comply with statutory overtime requirements” does not qualify as tortious, the court explained. Finally, the court held that the individual defendants could not be liable for “conspiring” with their corporate employer to withhold wages, because corporate agents acting on the corporation’s behalf are not considered to be co-conspirators. By rejecting the plaintiff’s various theories of liability, the high court upheld the dismissal of the claims against the individual defendants, thereby leaving only the corporate defendants named in the lawsuit.

At the same time, however, the court volunteered statements suggesting how there can be personal liability in wage claims brought under different circumstances.

Facts

Steven Reynolds, while working as an assistant shop manager and as a shop manager at an automobile painting shop, was classified as an exempt employee and therefore did not receive premium pay for his overtime hours of work. Reynolds, suing on behalf of himself and a class of other managers, sued his corporate employer for unpaid overtime wages, under California Labor Code sections 510 and 1194, both of which entitle a non-exempt employee to overtime premium wages. For good measure, Reynolds added, as individual defendants, eight shareholders, officers, and directors of his corporate employer who had authorized and participated in the denial of overtime compensation by

improperly classifying him as exempt. Although the California Labor Code does not specially define who qualifies as an “employer” obligated to pay overtime wages, Reynolds argued that each defendant was personally liable under a definition found in the California wage orders — a person who “exercises control over the wages, hours, or working conditions or any person.”

The Court of Appeal, affirming the trial court, held that Reynolds could not state a wage claim against the individual defendants. The Supreme Court agreed to decide whether Reynolds could seek to impose “employer” liability for unpaid wages against the individual defendants for actions they had taken in their capacity as shareholders, officers, or directors.

The Supreme Court’s Decision

The California Supreme Court affirmed the lower courts’ rulings, rejecting the contention that corporate shareholders and agents should be held personally liable for a corporate defendant’s failure to comply with overtime compensation requirements imposed by state law.

First, the Supreme Court rejected the contention that each corporate agent could be personally liable under the Labor Code as an “employer.” The Industrial Welfare Commission (“IWC”), since 1947, has defined that term to include any individual who “exercises control over the wages, hours, or working conditions of any person.” While acknowledging that the Legislature did not specifically define employer in any relevant section of the Labor Code, Reynolds argued that applying the IWC definition was “reasonably necessary to effectuate the purposes” of the statutory overtime provisions. The court rejected that argument because (a) under the common law, corporate agents who act within the scope of their agency are not personally liable for a corporate employer’s failure to comply with wage laws, and (b) the Legislature did not express an intent to depart from that common law principle simply by remaining silent following the IWC’s promulgation of its broad definition of “employer.”

The Supreme Court also rejected Reynolds' contention that the individual defendants should be held personally liable on the grounds that they had personally engaged in "tortious conduct." The court held that the alleged conduct — a "simple failure to comply with statutory overtime requirements" — failed to qualify as tortious conduct.

Nonetheless, the court suggested that other Labor Code provisions, including the recently enacted Labor Code Private Attorney General Act of 2004, might permit recovery against individual officers and directors.

Justice Moreno, concurring, lamented that the corporate form has been abused to avoid personal liability for the failure to pay regular and overtime wages, and proposed that the Legislature "extend the reach of section 1194 to include individuals who are directly responsible for the nonpayment of overtime wages but who hide behind the corporate form. Permitting workers to recover unpaid overtime wages from corporate officers and agents in some limited circumstances is neither a novel nor an untested remedy."

What This Case Means for Employers and Their Managers

Plaintiffs' lawyers add individual defendants to employment lawsuits to make the case more difficult to remove to federal court, to exert settlement leverage over the corporate defendant, or to gain other perceived tactical advantages. The *Reynolds* case forestalls some uses of this tactic in wage-hour cases, but the opinion of the court and the concurrence by Justice Moreno suggest other ways in which employees can create mischief for the individuals who have managed them:

- ♦ the California Labor Commissioner can continue to use the broad definition of "employer" to seek financial recovery from individuals in administrative hearings,
- ♦ for thinly capitalized corporations that have played fast and loose with the corporate form, the "alter ego" doctrine can cause controlling individuals to be liable for wages owed by the corporation, and
- ♦ huge civil penalties (\$100 per underpaid employee per pay period) can be sought on a class-wide basis by aggrieved employees, under the Labor Code Private Attorney General Act of 2004, against "any person acting on behalf of an employer who violates, or causes to be violated," a statute or wage order regarding wages.

California Supreme Court Broadens Scope of Retaliation Claims

On August 11, 2005, the California Supreme Court permitted a retaliation suit to proceed on the ground that the plaintiff had suffered harassing and degrading treatment after quietly defying an order to fire a female cosmetics sales clerk for not being pretty enough. *Yanowitz v. L'Oreal USA, Inc.*, No. S115154, 2005 Cal. LEXIS 8594 (Cal. 2005). This decision broadens employer liability for retaliation in three significant respects. First, the court held that the plaintiff had engaged in protected activity even though she had not reported or protested the offensive order, but rather simply advised that she needed "adequate justification" to fire the sales clerk; it was enough that the plaintiff reasonably believed that the order to fire the clerk was discriminatory, and that the employer, "in light of all the circumstances," was aware of that belief. Second, the court held that the plaintiff could have suffered an adverse employment action under "the totality of the circumstances" even if she suffered no formal job detriment. Third, the court permitted the plaintiff to rely on a continuing violation doctrine to rely upon allegedly retaliatory acts preceding the limitations period if those acts are related to acts that occurred within the limitations period.

Facts

Elysa Yanowitz worked for many years for the defendant, a cosmetics and fragrance company. Beginning as a sales representative, she rose to the position of regional sales manager and regularly earned high performance evaluations. In 1996, her boss was Richard Roderick, vice-president of sales for the designer fragrance division, who reported to Jack Wiswall, the divisional general manager. Both men worked out of New York, while Yanowitz was based in California. On a visit to California, Wiswall told Yanowitz to fire a dark-skinned female sales clerk because she was not "sufficiently physically attractive." He advised Yanowitz to get "somebody hot" as a replacement sales clerk. On a return visit, when Wiswall discovered the clerk still employed, he repeated his instruction to Yanowitz, telling her she should be hiring a "young" and "very sexy" blonde.

Yanowitz resisted the instruction. She asked Wiswall to provide her with "adequate justification" for dismissing the sales clerk. Yanowitz never, however, told Wiswall she thought his order was discriminatory, and never discussed the incident with anyone else in the company.

In April 1998, Yanowitz's immediate supervisor, Roderick, began soliciting negative information about her from her subordinates. During the next three months, in meetings with Roderick (and sometimes with Wiswall as well), Yanowitz was sharply criticized for "dictatorial" management style and for how she was handling a

particular account. Roderick and Wiswall also had her travel and expense reports audited and Roderick wrote several memoranda to human resources documenting his concerns about her job performance.

The situation came to a head in July 1998, when Roderick wrote Yanowitz a memorandum criticizing her promotional activities and questioning a business trip she had made to Hawaii. He expressed surprise at how quickly she'd become "ineffective" after so many years in the business. Yanowitz viewed the memorandum as an "intent to develop pretextual grounds" to dismiss her. She asked to respond to Roderick's memorandum but was denied the time to do so. At a meeting to discuss Roderick's memorandum, she broke down in tears. Two days thereafter, she went on a stress leave, never to return.

Her retaliation claim was dismissed on the defendant's motion for summary judgment, the trial court finding as a matter of law that because she never protested or complained regarding discriminatory conduct, she had not engaged in any protected activity. The Court of Appeal reversed, holding that she had engaged in protected activity when she refused to comply with Wiswall's sexually discriminatory order to fire the female employee. The court further held that there was a triable issue whether the employer's stated reasons for its actions towards Yanowitz were pretextual.

The Supreme Court's Decision

In a 4-2 ruling, the California Supreme Court affirmed the Court of Appeal. As the court noted, a prima facie case of retaliation involves proof that 1) the plaintiff engaged in protected activity, 2) the employer subjected the plaintiff to adverse employment action, and 3) there is a causal link between the protected activity and the adverse action. The court's reasoning was helpful to the plaintiff with respect to all three of these elements.

Broad definition of protected activity. The court held that Yanowitz had engaged in protected activity in opposing Wiswall's termination order. First, it was reasonable for Yanowitz to believe that it was sexually discriminatory for the employer to impose standards of physical attractiveness on female, and not male, employees. Second, even though Yanowitz never communicated that belief, Wiswall could have inferred, from her repeated refusal to fire the insufficiently attractive sales clerk, well as from her request for "adequate justification," that she believed the dismissal order was discriminatory. The court thus held that Yanowitz could have engaged in protected activity even if she failed to state that she believed the order was discriminatory.

Broad definition of adverse employment action. With respect to what employer conduct satisfies the adverse employment action prong, the court purported to adopt a

relatively moderate test, which would require the plaintiff to prove that the adverse action materially affects terms and conditions of employment. The court thus rejected the plaintiff's proposal of the Ninth Circuit's very pro-plaintiff "deterrence test," which would define an adverse employment action as any adverse action "reasonably likely to deter the charging party . . . from engaging in protected activity." But the standard on which the *Yanowitz* court relied resembles quite closely the "deterrence test": according to the court, adverse employment actions include "the entire spectrum of employment actions that are reasonably likely to adversely and materially affect an employee's job performance or opportunity for advancement in his or her career." The court thus permitted the plaintiff to establish an adverse employment action by citing a wide variety of intermediate personnel management decisions, such as (1) unwarranted negative performance evaluations, (2) a refusal to allow Yanowitz to respond to allegedly unwarranted criticism, (3) unwarranted criticism voiced by Roderick in the presence of Yanowitz's associates, (4) a "humiliating" public reprobation by Wiswall, and (5) Roderick's solicitation of negative feedback from Yanowitz's staff.

Broad application of the continuing violation doctrine. The court rejected the employer's contention that the statute of limitations barred consideration of certain retaliatory acts that preceded the limitations period. Under the continuing violation doctrine, an employer can be liable for acts that preceded the limitations period, provided that they are sufficiently linked to unlawful acts that occurred within that period. Likening the facts of this case to a hostile work environment claim — Yanowitz had alleged "a retaliatory course of conduct rather than a discrete act of retaliation" — the court concluded that limiting employees to evidence of discrete acts within the limitations period would undermine the goals of encouraging informal resolution of disputes and avoiding prematurely filed lawsuits. The court expressly criticized a U.S. Supreme Court case, *National Railroad Passenger Corp. v. Morgan*, 536 U.S. 101 (2002), which recognized that the continuing violation doctrine, properly understood, applies only to harassment cases and does not apply to discrete personnel management decisions.

A dissent by Justice Chin (joined by Justice Baxter) sharply criticized the majority for finding triable evidence of a protected activity and of a causal link between the employer's actions and the nonexistent protected activity. Observing that Yanowitz had not reported Wiswall's edict to hire a "hot" replacement for the female sales clerk to anyone in the company and had not even expressly opined to Wiswall that his edict was discriminatory, the dissent argued that it made "no sense to extend whistleblower protection to someone . . . who

did not make any complaint, did not engage in any meaningful communication . . . and did nothing to . . . cause [the employer] to take voluntary steps to avoid or remedy a perceived FEHA violation.” The dissent also found no triable issue that the employer knew Yanowitz was engaging in that activity.

What This Case Means for Employers

The 4-2 ruling in *Yanowitz* is another dramatic example of the California judiciary choosing to make life more congenial for plaintiffs. The ruling will encourage frivolous litigation by permitting employees to sue even when they have not overtly opposed acts suspected to be “discriminatory,” and by permitting employees to claim they have suffered adverse employment action when in fact they have simply been criticized for performance deficiencies and have not suffered any economic harm. The ruling encourages employers to take steps along the following lines:

- ◆ Require employees to report promptly any acts they believe to be discriminatory (just as many employers now require employees to report harassment); this will make less believable Yanowitz-like claims of secret opposition.
- ◆ Likewise require employees to report promptly any acts they believe to be retaliatory.
- ◆ Ensure that managers listen to, document, and respond to all employee concerns regarding personnel practices.
- ◆ Separate, wherever possible, the individual who is making an adverse decision about an employee from any individual the employee has accused of discriminatory conduct.

ATLANTA

One Peachtree Pointe
1545 Peachtree Street, N.E., Suite 700
Atlanta, Georgia 30309-2401
404-885-1500
404-892-7056 fax

BOSTON

Two Seaport Lane, Suite 300
Boston, Massachusetts 02210-2028
617-946-4800
617-946-4801 fax

CHICAGO

55 East Monroe Street, Suite 4200
Chicago, Illinois 60603-5803
312-346-8000
312-269-8869 fax

HOUSTON

700 Louisiana Street, Suite 3700
Houston, Texas 77002-2797
713-225-2300
713-225-2340 fax

LOS ANGELES

One Century Plaza
2029 Century Park East, Suite 3300
Los Angeles, California 90067-3063
310-277-7200
310-201-5219 fax

NEW YORK

1270 Avenue of the Americas, Suite 2500
New York, New York 10020-1801
212-218-5500
212-218-5526 fax

SACRAMENTO

400 Capitol Mall, Suite 2350
Sacramento, California 95814-4428
916-448-0159
916-558-4839 fax

SAN FRANCISCO

560 Mission Street, Suite 3100
San Francisco, California 94105
415-397-2823
415-397-8549 fax

WASHINGTON, D.C.

815 Connecticut Avenue, N.W., Suite 500
Washington, D.C. 20006-4004
202-463-2400
202-828-5393 fax

BRUSSELS

Boulevard du Souverain 280
1160 Brussels, Belgium
(32)(2)647.60.25
(32)(2)640.70.71 fax

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