

The Accidental Employer

The California Supreme Court Expands the Pool of Potential Wage-and-Hour Defendants

by Chad D. Greeson

SECTION 1194 OF THE LABOR CODE gives an employee in California the right to bring a civil action for failure to pay minimum wage or overtime as required by law. The Labor Code, however, is less clear about who may be sued for such claims. The California Supreme Court recently addressed this issue in *Martinez v. Combs* (May 20, 2010, S121552) ___ Cal.4th ___ [2010 Cal. LEXIS 4660,]. The court's broad definition of "employer" may very well prove to be the next wave of wage-and-hour litigation in this state.

Defendant Munoz operated a strawberry farm and hired plaintiffs to harvest fresh berries, which he then sold to several distributors, including defendants Apio and Combs. Apio and Combs advanced money to Munoz before the 2000 season in exchange for the exclusive right to distribute fresh berries from certain fields. At the end of the season, the market price for berries dropped; Munoz was unable to pay his workers and ultimately filed bankruptcy. Plaintiffs sued Munoz for the unpaid wages, a relatively uncontroversial claim. More controversial, however, was plaintiffs claim against Munoz's distributors to recover their unpaid wages.

Plaintiffs argued that Apio, Combs and Munoz were joint employers as defined by the prevailing wage order. The trial court disagreed and granted defendants' motion for summary judgment. The Court of Appeal, finding no case law defining

"employer" under §1194, applied the federal courts' "economic reality" test and affirmed the trial court's conclusion.

The Supreme Court affirmed — but not before undertaking a lengthy analysis of the applicable definition of "employer" under California law — an analysis that potentially expands the kinds of defendants who may fit that definition. First, the court examined the legislative history of §1194 and determined that the IWC's wage orders generally define the employment relationship. The high court reasoned that the current version of §1194 is derived directly from the (uncodified) statute creating the IWC, which gave the commission the authority to regulate wages, hours and working conditions in California. The *Martinez* court also noted that the Legislature had strengthened and broadened the IWC's mandate on numerous occasions since it was created in 1913. For all of these reasons, the Supreme Court concluded that the IWC's wage-and-hour orders generally defined who was an "employer" under the statute.

Based on this analysis, the *Martinez* court defined an "employer" as anyone who: (1) exercises control over wages, hours, or working conditions; (2) suffers or permits another to work; or (3) engages another, thereby creating a common law employment relationship. The high court concluded that this three-part definition was broad enough for the IWC to carry out its mandate to regulate wages, hours,

and working conditions in modern labor situations where multiple entities may control different aspects of the employment relationship.

By adopting the IWC's definition of employer, the court in *Martinez* rejected defendants' contention that the federal "economic reality" test should apply. The court held that the IWC's definition of employer belonged to a set of revisions intended to distinguish state law from its federal analogue, the Federal Labor Standards Act or FLSA, and provide California employees with greater protection than federal law affords.

The *Martinez* court also rejected plaintiffs' "downstream benefit" theory of liability — i.e., that the distributors directly benefited from plaintiffs' labor and thus should be considered plaintiffs' employer—for two reasons. The Supreme Court held that the concept of an economic benefit is neither a necessary nor sufficient condition for liability under the "suffer or permit" standard. Instead, the basis for liability is the defendant's "knowledge of" and "failure to" prevent the unlawful work from occurring. In *Martinez*, neither Apio nor Combs suffered or permitted plaintiffs to work because neither had the power to prevent plaintiffs from working.

Second, the court rejected plaintiffs' theory because it would impose endless liability on those in the chain of distribution. For example, under plaintiffs' theory, a grocery store could be held liable

for an employee's unpaid wages because it benefited from the employee's labor. In the court's view, had the IWC intended to impose liability on the entire chain of distribution for unpaid wages, it would have done so in plain terms.

Finally, on a factual basis, the *Martinez* court rejected plaintiffs' contention that defendants' field representatives exercised control over plaintiffs' working conditions. The high court acknowledged that defendants' representatives spoke with Munoz's employees about the manner in which fresh strawberries were packed for its retail customers. However, the facts overwhelmingly showed that Munoz — and Munoz alone — exercised control over his employees. For example, Munoz was responsible for hiring, firing, training, and supervising the employees; for determining the rate and manner of pay; and for determining the hours and manner of work. Furthermore, Munoz's supply contracts with defendants expressly precluded them from directing his employees' work, and there was no evidence to suggest that any of the plaintiffs believed that defendants' field representatives had such a right. For all of these reasons, the *Martinez* court held that defendants were not joint employers and could not be held liable for plaintiffs' unpaid wages under §1194.

In *Martinez*, the Supreme Court also attempted to harmonize its definition of "employer" with its previous decision in *Reynolds v. Bement*, 36 Cal. 4th 1075 (2005). In *Reynolds*, plaintiffs sought unpaid wages

under §1194 against a corporation and several officers and directors in their individual capacities. The issue in *Reynolds* was whether plaintiff had stated a valid §1194 claim against the individual defendants. In *Reynolds*, the court held that where a statute like §1194 refers to employees without defining the term, the common law test of employment should apply. Under the common law, a corporate agent acting within the scope of his or her agency cannot be held liable for a corporate employee's failure to pay wages. For that reason, the *Reynolds* court held that plaintiffs failed to state a valid claim under §1194.

After further reconsideration in *Martinez*, the court specifically held that the IWC's wage orders — not the common law alone — define the employment relationship under §1194. However, the Supreme Court in *Martinez* also reiterated its decision in *Reynolds* that §1194 does not impose liability on an individual corporate agent acting within the scope of his or her agency.

It is unclear at this point how far *Martinez* will go. Certainly, plaintiffs will rely on *Martinez* to seek recovery of unpaid wages (and overtime, and meal and rest break violations, etc.) from entities other than their primary employer. The Supreme Court's opinion in *Martinez* definitely expands the class of potential defendants in wage-and-hour litigation, and plaintiffs' counsel would be remiss not to pursue additional parties. In addition, the factual nature of the "suffer and permit" and

"exercises control" prongs of the *Martinez* definition would seem to significantly hamper the ability of more "indirect" employers to obtain pleading-stage resolution of wage-and-hour claims.

Employers' counsel, on the other hand, should carefully review their clients' relationships with third parties to avoid any legitimate argument that they exercise control, suffer or permit, or engage their affiliates' employees' work. The *Martinez* court provides some guidance in this regard — particularly the notion that the contractual provision between Munoz and Apio/Combs expressly precluded the distributors from exercising control over Munoz's employees. Further steps will likely be necessary, however, including indemnity and other risk-shifting provisions in virtually every type of commercial contract or relationship, to avoid exposure to liability for the unpaid wages of third-party employees.

With wage and hour litigation continuing to represent a significant part of employment litigation in California, *Martinez* will certainly increase the stakes, the size, and the potential scope of one of the busiest areas of civil litigation in the state. ♦

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