MCLE Self-Study:

California Supreme Court Clarifies the Definition of "Employer" in Minimum Wage Actions

By Terry O'Connor & Effie Anastassiou

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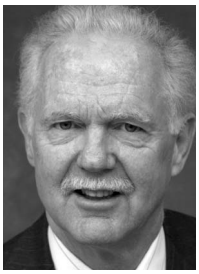

In what many commentators are calling the most significant wage and hour decision in years, the California Supreme Court's long-awaited decision in *Martinez v. Combs*[1] clarified the definition of "employer" under Cal. Lab. Code § 1194. In addition to delineating who is and who is not subject to a minimum wage action under that section, the decision recognized the considerable authority of the Industrial Welfare Commission (IWC) to define employment relationships in its wage orders. The court's ruling is favorable for businesses because it establishes useful criteria for evaluating third party business relationships, which are common in agriculture as well as other industries. The case also affirms the IWC's broad definitions of employment, which favor employees.

The plaintiffs, strawberry harvesters, sought unpaid minimum wages from the 2000 season. The complaint sought damages under Cal. Lab. Code §§ 1194 (minimum wage), 1194.2 (liquidated damages), 216 (failure to pay contract wages) and 203 (waiting time penalty) from their employer, Isidro Munoz, from two produce merchants who sold Munoz's strawberries—Apio, Inc. and Combs Distribution Company and its principals—and from Combs' field inspector, Juan Ruiz. In a nutshell, the plaintiffs alleged that through their marketing agreements with Munoz, the produce merchants exercised sufficient control over the plaintiffs' wages, hours and working conditions that they could be liable for Munoz's failure to pay wages to his workers.

FACTUAL BACKGROUND

In an arrangement common to production agriculture, Apio and Combs acted as brokers for Munoz's fruit. The brokers received an 8 % commission for their marketing efforts and remitted the net proceeds to Munoz. Apio and Combs also advanced money to Munoz in exchange for the exclusive right to market Munoz's product from specified fields. Munoz also had a similar arrangement with a third shipper. When the fresh market season was over, Munoz harvested and sold processing berries to a fourth entity, Frozsun.

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Toward the end of the fresh season and the beginning of the processing berry season, Munoz stopped paying his workers. The workers filed suit for unpaid wages against Munoz, who declared bankruptcy. The workers also sued Apio, Combs, Combs' field inspector Ruiz (who at one point "guaranteed" that Combs would pay Munoz), and later, Frozsun,[2] even though the workers had never been directly employed by any of them.

Defendant produce merchants Combs and Apio successfully moved for summary judgment in the trial court. The court of appeal affirmed in part, using the federal "economic reality" test to decide that they were not the workers' employers.

The Supreme Court deferred its review of the case pending its decision in *Reynolds v. Bement*,[3] in which the court addressed the individual liability of a corporate agent under Cal. Lab. Code § 1194. Finding no definition of "employer" connected to that section, the court looked to the common law rather than the applicable IWC wage order for the definition of "employer."[4]

The *Martinez* court, at the plaintiffs' urging, revisited the definition of "employer" in light of the legislative history of § 1194 and the IWC's orders going back to 1913. The plaintiffs argued that, for purposes of § 1194, the employment relationship is defined by terms in the IWC's wage orders—specifically, "suffer or permit to work" and "exercise control over the wages, hours or working

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conditions."[5] Relying on *Reynolds*, Combs and Apio argued that a common law definition of employer should apply in minimum wage actions under § 1194.

The court found that the California Legislature and voters had given the IWC a broad mandate to regulate wages, that included the authority to define the terms "employer" and "employment" in its wage orders.[6] The court agreed with the plaintiffs that the IWC's wage orders define the employment relationship in actions under Cal. Lab. Code § 1194.[7]

Turning to the language in the wage orders that the plaintiffs cited, the court found that use of the phrase "suffer or permit to work" was intended to give the IWC jurisdiction over employment relationships that did not fit the common law master/servant model. As for the wage orders' definition of "employer"—one who "employs or exercises control over the wages, hours or working conditions of any person"—the court found that the use of the word "or" extended the definition to more than one entity, one of which may "engage" and the other of which may "exercise control" over the same employee. The court further held that the adoption of this definition in 1947, in response to amendments to the federal Fair Labor Standards Act (FLSA), showed an intent to define "employer" more broadly in California than under federal law.[8] The court thus concluded that the IWC wage orders have three alternative definitions of employment:

(1) "to exercise control over the wages, hours or working conditions;" or
(2) "to suffer or permit to work;" or
(3) "to engage," a common law definition.[9]

Rather than distinguishing *Reynolds*, the court narrowed it in light of its more in-depth consideration of the legislative background of the IWC and its wage orders. It determined that *Reynolds* "properly holds that the IWC's definition of 'employer' does not impose liability on individual corporate agents acting with the scope of their agency" and nothing more.[10]

In response to the defendants' argument that the court should use the federal definition of employment, the court found that the term "employ" in the IWC wage orders was not based upon federal law and thus federal precedent and federal regulations cannot be used to interpret it.[11] The court reiterated its position in recent cases—that courts may not rely upon federal precedent where the state law provides greater protections.[12] The court also noted that, while the IWC definition "suffer or permit" was quite similar to the FLSA definition, the alternate definition "exercise control" does not appear in the federal act.[13] Consequently, the court refused to apply the federal "economic reality" test for employment used by the court of appeal in its decision.

The court then noted the judicial deference required of IWC wage orders derived from the power delegated by the Legislature and the voters' approval of a constitutional amendment forming the IWC. The court referred to its own approval of the IWC's definitions to exclude waitpersons' tips from the minimum wage, require compensation for travel time controlled by the employer, and to define the term "outside salesperson" for overtime purposes.[14]

Having set forth the IWC's alternative definitions of employment, the court applied the first two definitions to the facts and found for defendants. The plaintiffs argued that Combs and Apio were employers under the "suffer or permit" standard, because they knew of the plaintiffs' employment and benefitted from it. Discounting this argument, the court noted that the grocery stores that purchased Munoz's strawberries also benefitted, and that to hold Combs responsible on such a theory would create an "endless chain of liability."[15] The key test was that neither defendant had the power to prevent the plaintiffs from working because neither was involved in hiring or firing the workers, or setting or paying their wages. Grower Munoz hired, fired, assigned the work and had the power to decide whether to send his strawberry harvest to the freezer or to assign his workers to work for the other fresh market shipper rather than to the fields. The court disapproved of this down-stream benefit theory on the grounds that the IWC had never sought to propose such a theory.[16]

The court also found no basis to conclude that the defendants "exercised control" over the workers. Apio had written contracts with Munoz, which provided that Munoz would grow strawberries on land he subleased from Apio, and then deliver the strawberries to Apio for sale. Apio gave Munoz a loan for a portion of his growing costs, and

provided Munoz with a pick-and-pack advance for produce harvested and delivered. Apio had the right to deduct its loans and advances from crop proceeds. Apio also had the right to go to Munoz's field to confirm the quality and quantity of fruit to be delivered for marketing. But Apio did not exercise control over Munoz's workers, because Apio's business relationship with Munoz did not allow Apio to exercise control over his employees' wages and hours. Munoz was an independent businessman who had complete control over his employees' wages and the work they performed.

Unlike Apio, Combs had a one-page agreement with Munoz that essentially provided a loan to Munoz on condition that he allow Combs to be the exclusive marketer of the fruit. Combs neither leased land to Munoz nor paid per-box advances to Munoz. The plaintiffs contended that Combs exercised control through Ruiz, Combs' field representative. Munoz' employees, including the plaintiffs, staged a work stoppage when Munoz did not pay them. Ruiz spoke to the striking employees to encourage them to return to work, telling Munoz's employees that he was bringing grower return payments to Munoz and that he guaranteed they would be paid. The plaintiffs contended that this was both evidence of control and an offer of employment.

The court held that this was not an offer of employment because Ruiz was asking them, in their own words, to "help Munoz."[17] Furthermore, the employees could not have been working for Combs on the date in question, because they were picking freezer berries, not market strawberries that were sold by Combs. The court dismissed the claims against Ruiz based on the fact that he was ostensibly acting as an agent and thus could not be liable under *Reynolds*.[18]

The plaintiffs also contended that they were third party beneficiaries of Apio's contract with Munoz, which required Munoz to comply with all labor laws, including paying his workers' wages. The court found no merit in this argument. It held that the contract only imposed an obligation on Munoz, not Apio, to pay the workers' wages. The court declined to "rewrite the contract to impose on Apio an obligation to pay wages that it never undertook."[19]

CONCLUSION

Martinez provides a significant clarification of the definition of "employer" and "employment" for both employers and employee representatives. First, it expands the definition of employment in wage and hour actions under the Labor Code significantly beyond the common law. A putative employer will not have to "engage" the employee if he or she controls the employee. For example, where one entity hires and pays the employee and a second supervises and controls working conditions, both will be "employers."

The court's ruling further limits the relevance of federal precedent to interpret these relationships. Practitioners will not be able to rely on federal cases and the federal regulations interpreting the FLSA.

The decision holds that the Legislature intended to delegate to the IWC the authority to define "employment" in actions under Cal. Lab. Code § 1194. Assuming that this delegated authority will also apply to other Labor Code sections, the IWC is now vested with increased power to define employment relationships. Arguably, this authority could be extended to prohibiting other disfavored employment practices.

On the other hand, the court clearly did not open the floodgates of litigation to allow actions against entities that merely benefit from employees' labor and had some financial control over the common law employer. Although any downstream purchasers of goods can force choices on a supplier, that does not make the purchaser an employer of the supplier's employees. Finally, the court recognized that any such purchaser may interact with suppliers, and even to a limited extent with the supplier's workers, in order to satisfy production schedules and quality control needs.

"Martinez *provides a significant clarification of the definition of "employer" and "employment" for both employers and employee representatives."*

END NOTES

1. 49 Cal. 4th 35 (2010).
2. The case against Frozun was stayed pending decision of the case against defendants.
3. 36 Cal. 4th 1075 (2005).
4. *Id.* at 1087.
5. Cal. Code Regs. tit. 8, § 11140.
6. *Martinez*, 49 Cal. 4th at 54.
7. *Id*. at 52.
8. *Id*. at 60. The court has previously noted that some of California's wage laws are more expansive than federal laws. *See, e.g., Morillion v. Royal Packing Co.*, 22 Cal. 4th 575, 582 (2000).
9. *Id.* at 57–60, 64.
10. *Id.* at 66.
11. *Id.* at 66–68.
12. *See, e.g., Morillion v. Royal Packing Co.*, 22 Cal. 4th 575, 588 (2000); *Ramirez v. Yosemite Water Co.*, 20 Cal. 4th 785, 798 (1999).
13. *Martinez*, 49 Cal. 4th at 67.
14. *Id*. at 60–62; see *Morillion*, 22 Cal. 4th at 581–95; *Ramirez*, 20 Cal. 4th at 794–803; *California Drive-In Restaurant Ass'n v. Clark*, 22 Cal. 2d 287, 302–03 (1943).
15. *Martinez*, 49 Cal. 4th at 70.
16. *Id.*
17. *Id.* at 74–75.
18. *Id.* at 75.
19. *Id.* at 77.

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