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Officers' and Directors' Personal Liability for Wages: The Impact and Limits of *Boucher v. Shaw*

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Personal liability for unpaid wages is a significant issue for companies and management as they reach a liquidity crisis or insolvency—and it is in this context that the laws imposing personal liability on corporate principals for unpaid wages acquire their sting. Corporate agents' personal liability for unpaid wages derives from an overlay of U.S. federal and state laws and regulations. State law varies widely on whether officers and directors of corporations can be held personally liable for wages. Certain states, such as New York, Washington¹ and Illinois,² have held managers, officers and directors personally liable, and New York has imposed criminal penalties.³ Other states, such as California and Nevada, have refused to extend personal liability to corporate agents for claims based on state wage law.

There are a host of federal laws designed to address different employment issues. Because these laws have different definitions of "employers," those who can be liable under these laws vary

¹ In Washington, state law imposes personal liability on officers and directors for unpaid wages, and allows for punitive damages and attorneys' fees if the violation is "willful." *Morgan v. Kingen*, 169 P.3d 487 (Wash. Ct. App. Div. 1, 2007), *aff'd*, 210 P.3d 995 (Wash. 2009) (finding willful violation because executives were in control of funds when payroll was due).

² In Illinois, employers and their agents can be civilly and criminally liable for the willful nonpayment of wages. See *Stafford v. Puro*, 63 F.3d 1436 (7th Cir. 1995); *Johnson v. Western Amusement Corp.*, 510 N.E.2d 991, 991-94 (1987) (holding executive responsible for failing to pay union benefits after company went bankrupt).

³ New York has imposed criminal penalties for knowing failures to pay wages, as well as failing to provide wage supplements or benefits, such as reimbursement for expenses, health, welfare and retirement benefits, and vacation, separation and holiday pay. See New York Labor Law §198(c); *People v. Milton C. Johnson Co.*, 337 N.Y.S.2d 477 (N.Y. City Crim. Ct. 1972); *c.f. People v. Lustig*, 420 N.Y.S.2d 624 (N.Y. App. Term 1979) (requiring that officer have active involvement or actual authority in running company to be liable).

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significantly. To highlight two key statutes, the Federal Worker Adjustment Retraining and Notification Act (the WARN Act) is designed to prevent mass layoffs but has not been interpreted to impose personal liability on individual corporate agents. On the other hand, the Fair Labor Standards Act of 1938 (FLSA),⁴ which guarantees employees federal minimum wages and overtime compensation, broadly imposes personal liability on officers and directors

Feature

if certain additional factors exist. However, the FLSA's coverage is limited and does not cover claims for immediate payment of contractual wages, accrued vacation pay and other accrued benefits to which employees may be entitled under state law.



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In *Boucher v. Shaw*,⁵ the Ninth Circuit recently held (as many other circuits had) that the FLSA's definition of "employer" includes corporate agents who have economic control or exercise control over the

nature and structure of the employment relationship, based on the circumstances and economic reality of the relationship. *Boucher* at 9739. This broad definition of "employer" under the FLSA is cause for real concern for corporate agents, particularly since the director/officer and employment practices of insurance policies frequently exclude coverage for claims based on the FLSA or similar state laws.⁶ However, while *Boucher* is significant in that it clearly establishes a corporate agent's personal liability under the FLSA in the Ninth Circuit, the impact of this case ruling is limited to the definition of "employer" under the FLSA and should not affect claims under other federal and state laws with different "employer" definitions, such as the WARN Act. In light of the current economic situation, officers and directors should understand

the risks and nuances of personal liability for unpaid wages, particularly because such liabilities are typically excepted from their insurance coverage.

California Law

In *Reynolds v. Bement*, 36 Cal. 4th 1075, 116 P.3d 1162, 32 Cal. Rptr. 3d 483 (Cal. Sup. Ct. 2005), the California Supreme Court refused to hold an employer's officers, directors and shareholders liable for state law wage violations arising from nonpayment of overtime hours. The case was dismissed based on the allegations on the face of the pleading without discovery or trial.

Sections 510 and 1194 of the California Labor Code obligate "an

⁴ Fair Labor Standards Act of 1938 (29 U.S.C. §201 *et seq.*).
⁵ Page references are to *Boucher v. Shaw*, available at www.ca9.uscourts.gov/opinions/view_subpage.php?pk_id=0000009810; also available at 2009 U.S. App. LEXIS 16555 (9th Cir. Nev. July 27, 2009).

⁶ These exclusions are not uniform, however, and competent insurance counsel should be consulted regarding the coverage provided by any particular policy and, ideally, while negotiating coverage.

employer” to pay minimum wages and overtime compensation. See California Labor Code §§510, 1194. An employee may seek judicial relief by filing a civil action for breach-of-contract or wage-law violations, or may seek administrative relief. *Reynolds*, 36 Cal. 4th at 1084-85. If electing judicial relief, §1194 of the California Labor Code provides employees with a private right of action for minimum wage and overtime violations. However, neither §510 nor §1194 defines “employer,” and §1194 does not identify potential defendants.⁷ Under California law, no statute expressly subjects corporate control figures to liability for unpaid wages as “employers.” *Id.* at 1084-86.

The court based its decision on common-law principles under which “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*, 36 Cal. 4th at 1087.

Although the California Division of Labor Standards Enforcement (DLSE)⁸ is in the practice of using the “exercise control” prong of the California Industrial Welfare Commission’s “employer” definition to name corporate agents as joint defendants, the court refused to allow a private cause of action against individuals under state law and declined to resolve the apparent disconnect between DLSE administrative practice and litigants’ rights. *Id.* at 1088-89.

The *Reynolds* court also determined that *Frances T. v. Village Green Owners Assn.*, 42 Cal. 3d 490, 229 Cal. Rptr. 456, 723 P.2d 573 (1986), did not establish liability. *Village Green* held corporate directors jointly liable with the corporation if they “personally directed or participated in” a corporation’s tortious conduct. In *Reynolds*, personal liability did not exist because a “simple failure to comply with statutory overtime requirements” does not qualify as the kind of tortious conduct for which *Village Green* imposes personal liability. *Reynolds*, 36 Cal. 4th at 1089-90.

The California Courts of Appeal have extended the reasoning of *Reynolds* to claims under other sections of the Labor Code, holding that individuals are not liable under the Labor Code to pay wages upon termination, accrued

vacation time or expense reimbursements. See *Jones v. Gregory*, 137 Cal. App. 4th 798, 804 (Cal. Ct. App. 2006). In *Jones*, the appellate court held that like §1194, “none of the Labor Code...sections 201, 202, 203, 227.3, 1194.5 or 2802—define ‘employers.’” *Id.* The court also refused to impose personal liability for “restitution” of unpaid wages under the Unfair Competition Law (UCL),⁹ which broadly prohibits unfair business practices, as well as other Labor Code violations. *Bradstreet v. Wong*, 161 Cal. App. 4th 1440, 1449 (Cal. Ct. App. 2008).

Liability under the FLSA and the Ninth Circuit’s Rule in Boucher v. Shaw

In *Boucher*, the three defendants were managers of Castaways Hotel, Casino and Bowling Center (Castaways), including the chairman/CEO/70 percent shareholder, the chief financial officer and the 30 percent shareholder who was also responsible for labor and employment matters. Three former employees of Castaways brought suit against the managers for unpaid wages under state and federal law. Castaways filed for chapter 11 on June 26, 2003. The plaintiffs were discharged in January 2004. On Feb. 10, 2004, after the discharge, the case was converted to chapter 7 liquidation and ceased operations. *Boucher* at 9735.

Like the California Supreme Court in *Reynolds*, the Nevada Supreme Court rejected all of the plaintiffs’ state law claims. The Ninth Circuit, however, imposed personal liability on corporate agents with control over the employment relationship for unpaid, federally prescribed minimum wages and overtime compensation (under the FLSA). The court held that the FLSA’s “employer” definition was broad enough to include the CEO/shareholder, CFO/nonshareholder and a manager/shareholder with control over operations and employment matters. The practical effect of this ruling is to undermine the broad protection from liability for unpaid wages under the laws of California, Nevada and certain other states.

The FLSA provides that every “employer” must pay a minimum wage. 29 U.S.C. §206(a). Any employer who does not do so “shall be liable to the employee or employees affected in the

amount of their unpaid minimum wages, or their unpaid overtime compensation, as the case may be, and in an additional equal amount as liquidated damages,” unless the employer can show that the failure to pay was in good faith and it reasonably believed it was not breaking the law. 29 U.S.C. §216(b). 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).

The court held that an individual who exercises control over “the nature and structure of the employment relationship” or “economic control” over that relationship, in light of the “circumstances of the whole activity” and “economic reality,” is subject to liability as an employer under the FLSA. *Boucher* at 9739, citing *Rutherford Food Corp. v. McComb*, 331 U.S. 722, 730 (1947), and *Goldberg v. Whitaker House Coop. Inc.*, 366 U.S. 28, 33 (1961). Missing from the standard was the requirement from the jury instructions in *Lambert v. Ackerley*, 180 F.3d 997 (9th Cir. 1999) (*en banc*), of “substantial ownership,” and indeed, one of the individual defendants in *Boucher* (the CFO) was not a shareholder of Castaways.

The court also found that the Castaways bankruptcy and its conversion to chapter 7 did not exculpate the corporate agents from their obligation to pay wages. *Boucher* at 9744, citing *Donovan v. Agnew*, 712 F.2d 1509, 1511, 1514 (1st Cir. 1983); *Chung v. New Silver Palace*, 246 F.Supp.2d 220, 226 (S.D.N.Y. 2002).

Courts interpreting the FLSA have generally found that senior corporate agents who have operational control over the employing entity can be personally liable.¹⁰ The Ninth Circuit’s ruling in *Boucher* is not surprising in the context of FLSA, but has the important practical effect of significantly undermining the protections against personal liability for unpaid wages afforded corporate agents under state law by imposing liability under overlapping federal law.

⁷ This is unlike other sections, such as §1197.1, which exposes “any employer or other person acting either individually or as an officer, agent, or employee of another person” to liability.

⁸ The DLSE is headed by the Labor Commissioner and is authorized to enforce California’s labor law, including Industrial Welfare Commission wage orders. See *Tidewater*, 14 Cal. 4th at 561-62.

⁹ The UCL (Cal. Bus. & Prof. Code §17200 *et seq.*) allows an employee to receive restitution of unlawfully-withheld wages. See *Cortez v. Purolator Air Filtration Products Co.*, 23 Cal. 4th 162, 177, 96 Cal. Rptr. 2d 518, 999 P.2d 706 (Cal. Sup. Ct. 2000). Generally, UCL claims are derivative of underlying violations of other provisions of law.

¹⁰ See, e.g., *Agnew*, 712 F.2d at 1511 (expressing concern that middle management should not be held personally liable); *Baystate Alternative Staffing v. Herman*, 163 F.3d 668 (1st Cir. 1998) (discussing how “economic reality” test applies to determine personal liability); *Chao v. Hotel Oasis Inc.*, 493 F.3d 26 (1st Cir. 2007) (upholding liability for president of corporation in charge of hiring, firing, setting employees’ wages and schedules and requiring employees to attend meetings without pay); *Herman v. RSR Sec. Servs.*, 172 F.3d 132 (2d Cir. 1999) (discussing “economic reality” test); *Dole v. Elliott Travel & Tours Inc.*, 942 F.2d 962 (6th Cir. 1991); *United States Dep’t of Labor v. Cole Enters. Inc.*, 62 F.3d 775, 778-79 (6th Cir. 1995) (holding president/50 percent owner liable as employer under FLSA where he ran business, wrote checks, kept records and managed hiring, termination, employment practices and schedules).

WARN Violations under California and Federal Law

The effect of *Boucher* should be limited to that statute and not extend to other federal or state statutes with their own definitions of “employers,” such as the WARN Act, which requires employers to give employees at least 60 days notice of a plant closing or “mass layoff.”¹¹ The WARN Act defines an “employer” to be “any business enterprise” employing 100 or more full-time workers. 29 U.S.C. §2101.¹² To date, federal courts have not read this language to extend liability for WARN Act violation to officers and directors, except when the plaintiffs could pierce the corporate veil, relying on alter-ago theories of liability. *See International Union, Auto, Aerospace & Agric. Implement Workers v. Aguirre*, 410 F.3d 297, 302-03 (6th Cir. 2005).

The California Supreme Court has not addressed whether the California equivalent of the WARN Act (the California WARN Act)¹³ will extend liability to a company’s officers and directors. Unlike California Labor Code §§510 and 1194, “employer” is defined in the statute to mean “any person...who directly owns or operates” an “industrial or commercial facility or part thereof that employs, or has employed within the preceding 12 months, 75 or more persons.”¹⁴ Although an open issue, the California Supreme Court’s narrow interpretation of “employer” in adherence to common-law precepts in *Reynolds* suggests that the definition of “employer” in this statute may be narrowly construed.

Impact of Boucher v. Shaw on Officers and Directors

If a business cannot make payroll, its officers and directors have serious issues to confront. While federal and California law have not yet been held to impose personal liability for WARN Act violations and mass layoffs, the Ninth Circuit now holds that officers and directors can be jointly and severally liable with the corporation for FLSA wage violations. However, to be liable under *Boucher*, corporate agents must have economic control of, or exercise control over, the nature and structure of

the employment relationship. Corporate agents are not relieved of liability by virtue of a company entering bankruptcy, either in chapter 7 or 11.

Officers and directors should endeavor to insure themselves against this risk. This is likely to be difficult because many insurance policies, including employment practices policies, exclude claims based on FLSA violations. Officers and directors should understand their coverage and involve its insurance counsel in negotiating that coverage.

A third option for corporate agents is to terminate their own employment with the corporation. To maximize the possibility that resigning will shield the corporate agent from liability, this should be done before the unpaid wages are earned and certainly before they are payable. Any resignation also needs to be done while there are remaining competent officers and directors overseeing the company’s affairs. However, putting aside the directors’ and officers’ fiduciary duties, it is not clear that a court could not look back to hold a resigning corporate agent personally liable for wages that ultimately go unpaid. Given the Ninth Circuit’s (as well as others’) expansive reading of the FLSA, courts may reach to impose liability on officers and directors who resigned shortly before payroll (that could not be met) was due.

Ultimately, meeting payroll is increasingly important with the addition of personal liability under the FLSA. Operations need to be scaled back at a rate commensurate with the company’s ability to pay employees. The general freedom from personal liability under the WARN Act and California law (both its WARN Act equivalent (unsettled) as well as its laws on unpaid wages and vacation pay) may make layoffs a preferable (although risk-laden and undesirable) option for senior leadership as compared to violating the FLSA. Other planning options, such as corporate structuring and protecting officers and directors with appropriate insurance coverage must be done in advance of insolvency.

Conclusion

Corporate officers and directors face substantial personal risk for unpaid wages and overtime compensation during insolvency planning. Limited liability is a major reason that most businesses organize themselves as legal entities rather than operating as sole proprietorships or general partnerships. The application of the basic premise of

limited liability, however, is not universal or absolute, particularly when it comes to unpaid wages.

Corporate agents’ personal liability for unpaid wages results from the interaction of U.S. federal and state laws and regulations. Federal law, through the FLSA, requires “employers” (broadly defined in the statute) to pay federally-regulated minimum wages and overtime compensation (*not* contractual wages), and allows for equal liquidated damages. *See* 29 U.S.C. §216(b). Corporate agents’ personal liability for certain common wage-related issues in California can be summarized as follows:

- Corporate agents *are* liable for FLSA violations if they have economic control or exercise control over the nature and structure of the employment relationship (based on the circumstances and economic reality of the situation);
- Corporate agents *are* not liable for unpaid wages, overtime and vacation pay based on California state law, although they may be liable for certain claims involving their own conduct, such as discriminatory harassment or retaliation;
- Corporate agents *are* not personally liable for federal WARN Act violations, unless the corporate veil can be pierced; and
- Corporate agents have not been held personally liable for violations of California’s state law equivalent of the WARN Act. Although it is an open issue, the California Supreme Court’s common law based presumption regarding personal liability may suggest that California courts will not create personal liability in such cases, absent a clear legislative mandate. ■

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¹¹ Defining “mass layoff” to mean more than 50 employees at a single site of employment.

¹² The count does not include workers employed for less than six months or working fewer than 20 hours a week.

¹³ *See generally* Labor Code §§1400-1408.

¹⁴ Labor Code §1400(a). It is as yet unclear whether this means 75 employees at one time, or a total of 75 people over any 12-month period. “Person” as defined in §18 of the Labor Code, which is referenced in the definition, provides that a “Person means any person, association, organization, partnership, business trust, limited liability company or corporation.” Cal. Code Regs. Tit. 8, §11000 *et seq.*