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Who shall we invite to our party?

NAMING THE PROPER DEFENDANTS IN AN EMPLOYMENT CASE

When counsel meets with a potential client to determine if a case is worth pursuing, much of the focus is on the types of claims that may be supported by the facts presented, as well as an estimate of the type and amount of damages that may be claimed.

Equally important, however, is a consideration of what persons or entities may and should properly be named as defendants in the lawsuit. Naming the right persons or entities is crucial for many strategic reasons. This article examines the factors to be considered in identifying the proper parties to be named in an employment-related lawsuit, focusing mainly on cases brought under the Fair Employment and Housing Act ("FEHA"), but expanding to other employment-related civil claims, as well.

Why does it matter?

There are many reasons why naming the right defendants is important. The first and most obvious reason is that the plaintiff may only recover damages from those parties to whom liability can attach under the substantive laws.

There are important strategic reasons, as well. The selection of defendants named in the lawsuit can affect jurisdiction. When a plaintiff is suing a corporate employer that is both incorporated in a state other than California and has its principal place of business out of state, the employer can remove the action to federal court. (28 U.S.C. §§ 1332, 1441.) Naming an individual defendant who is a resident of California or naming an entity that is either incorporated in California or that has its principal place of business in California will destroy diversity and prevent removal to federal court.

Naming all possible liable parties also increases the chances that a judgment or settlement will be collectible. Perhaps a subsidiary experiences financial difficulties during the course of the litigation and is no longer viable at the time a judgment is entered. Having the parent company on the hook provides a measure of financial security. Moreover, more parties may also mean more applicable insurance policies, potentially increasing the amount of coverage available to satisfy a judgment or settlement.

Identifying the employer

The first step is to determine the identity of the employee's employer. There is a rebuttable presumption that the person or entity listed on the employee's W-2 wage and tax statement is the employer. (Gov. Code, § 12928.) However, that may not be the entire story. It is important to examine in detail the employee's relationship with other related entities that may not write the employee's paycheck, but nevertheless maintain a level of control such that those entities can be considered co-employers.

Joint employers

Where two entities have the right to exercise a certain degree of control over the employee, both entities may be considered the employee's joint employers, and both may be liable to the employee for harassment or other violations of the Fair Employment and Housing Act. (*Mathieu v. Norrell Corp.* (2004) 115 Cal.App.4th 1174, 1183-1184.) An example of this might be where an employee is paid by an employment agency, but performs services for an entity that contracts with the employment agency. Another example might be where an employee works for a subsidiary company, but also performs services for the parent company or an affiliated company.

In determining whether a defendant is a joint employer, courts consider the "totality of the circumstances" of the parties' work relationship, with an emphasis on the degree of control exerted over the employee. (*Vernon v. State of California* (2004) 116 Cal.App.4th 114, 124-126.) There must be sufficient indicia of an interrelationship to justify the belief on the part of the aggrieved employee that the alleged co-employer is jointly responsible for the wrongful acts. (*Id.* at 126.) There is no magic formula for determining whether an organization is a joint employer. Rather, the court must engage in a careful factual inquiry. (*Id.* at 125.) The types of factors that are relevant to the inquiry include the following:

- Who pays the employee's salary?
- Who provides employment benefits to the employee?
- Who owns the equipment used to perform the job?
- At whose location is the work performed?
- Who hires, fires, disciplines or promotes the employee?
- Who trains the employee?

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(*Ibid.*) It is thus important for counsel to examine carefully, and explore during discovery, the indicia of control exerted by each entity over the employee.

In cases brought alleging violations of the California Family Rights Act ("CFRA"), the level of control each entity has is also the key inquiry. However, the regulations interpreting the CFRA provide an expansive definition of joint employer in discussing what is a "covered employer" subject to the Act:

> (3) Where two or more businesses exercise some control over the work or working conditions of the employee, the businesses may be joint employers under CFRA. Joint employers may be separate and distinct entities with separate owners, managers, and facilities. A determination of whether or not a joint employment relationship exists is not determined by the application of any single criterion, but rather the entire relationship is to be viewed in its totality based on the economic realities of the situation. Where the employee performs work which simultaneously benefits two or more employers, or works for two or more employers at different times during the workweek, a joint employment relationship generally will be considered to exist in situations such as:
>
> (A) Where there is an arrangement between employers to share an employee's services or to interchange employees;
>
> (B) Where one employer acts directly or indirectly in the interest of the other employer in relation to the employee; or
>
> (C) Where the employers are not completely disassociated with respect to the employee's employment and may be deemed to share control of the employee, directly or indirectly, because one employer controls, is controlled by, or is under common control with the other employer.

(Cal. Code Regs., tit. 2, § 11087, subd. (d)(3).) Thus, in a case involving violation of the California Family Rights Act, counsel should consult these regulations in assessing whom to name as a defendant.

Integrated-enterprise test

Another test that may be used to determine whether more than one entity can be deemed liable as an aggrieved employee's employer is the integrated-enterprise test, under which two entities may be constructively held to be a single employer in an action brought under the Fair Employment and Housing Act. Under the integrated-enterprise test, two corporations will be constructively held to be a single employer where there is (1) common ownership or financial control, (2) common management, (3) centralized control of labor relations, and (4) an interrelation of operations of the corporations. (*Laird v. Capital Cities/ABC, Inc.* (1998) 68 Cal.App.4th 727, 737-738.) This test is designed to ensure that the anti-discrimination statutes, including their definition of the term "employer," be construed liberally. (*Id.* at 738.) No single factor is conclusive, and not all four must be present. (*Armbruster v. Quinn* (6th Cir. 1983) 711 F.2d 1332, 1337-1338, *overruled on other grounds in Arbaugh v. Y & H Corp.* (2006) 546 U.S. 500.) However, centralized control of labor relations is often deemed the most important factor. (*Laird*, *supra*, at 738).

Determining whether the integrated-enterprise test has been satisfied requires a factual inquiry that examines the interrelatedness of the entities. The types of factual inquiries that should be made include the following:

- Who recruited and hired the employee?
- With which company did the employee fill out an employment application?
- Which entity provided the offer letter?
- What entities are named as parties to any written employment agreements?
- At whose facility did the employee work?
- How did the employer represent itself on internal documents?
- What entity's employees supervised the employee?
- Through what entity did the employee receive his or her benefits?
- In whose profit sharing plan was the employee eligible to participate?
- Who provided human resources functions?
- Who had input in the decision to hire and set pay rates, and to participate in the decision to terminate?
- Do any individuals serve as managers of both companies?
- Can managers be transferred from one company to another?
- Who fulfills financial, administrative, facilities, IT, legal and other functions?

This is obviously not an exhaustive list, but a good starting point of things to look at and to focus on in discovery.

Successor liability

Issues of liability also arise where one company succeeds another, through sale, merger, or other business transaction. The issue becomes whether the s uccessor entity can be held liable to the employee for the torts committed prior to the succession. The general rule of successor liability is that where a company sells or transfers its assets to another company, the successor company can only be held liable for the liabilities of the predecessor under four possible circumstances:

> (1) there is an express or implied agreement of assumption; (2) the transaction amounts to a consolidation or merger of the two corporations; (3) the purchasing corporation is a mere continuation of the seller; or (4) the transfer of assets to the purchaser is for the fraudulent purpose of escaping liability for the seller's debts.

(*Ray v. Alad Corp.* (1977) 19 Cal.3d 22, 28; accord, *McClellan v. Northridge Park Townhome Owners' Ass'n* (2001) 89 Cal.App.4th 746, 753-754.) If any one of these four circumstances is established, the successor company will be deemed a "successor in interest" and will assume the liabilities of its predecessor. (*Ray*, *supra*, 19 Cal.3d at 28.)

In the context of discrimination cases, the standard appears to be less stringent than the general rule. The courts have held that liability will be imposed on successors when necessary to protect and vindicate the public policy furthered by the anti-discrimination statutes. (See, e.g., *Bates v. Pacific Maritime*

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Assoc. (9th Cir. 1984) 744 F.2d 705, 709 [successor employer can be held liable to comply with Title VII consent decrees]; *Slack v. Havens* (9th Cir. 1975) 522 F.2d 1091, 1094-1095 [successor employer liable under Title VII]; *EEOC v. MacMillan Bloedel Containers, Inc.* (6th Cir. 1974) 503 F.2d 1086, 1091 [successorship liability applies to Title VII cases].) The emphasis placed by the anti-discrimination statutes on ensuring that employees are protected from prohibited practices and obtain relief warrants imposing liability on a corporate successor for discriminatory conduct committed by the predecessor company. (*MacMillan Bloedel Containers, Inc.*, *supra,* at 1091.) Liability is warranted, but not automatic. Rather, it is determined on a case-by-case basis. (*Ibid.*)

The three principal factors to be considered in determining the appropriateness of imposing successor liability in the context of discrimination cases are "(1) the continuity in operations and work force of the successor and predecessor employers, (2) the notice to the successor employer of its predecessor's legal obligation, and (3) the ability of the predecessor to provide adequate relief directly." (*Criswell v. Delta Air Lines, Inc.* (9th Cir. 1989) 868 F.2d 1093, 1094.) The facts supporting these factors should be explored in discovery.

While the cases cited above are federal cases interpreting Title VII and other federal anti-discrimination statutes, California courts have routinely relied upon federal law to interpret the Fair Employment and Housing Act because the objectives of the California FEHA and Title VII of the Federal Civil Rights Act are similar. (*Clark v. Claremont University Center* (1992) 6 Cal.App.4th 639, 662; *Mixon v. Fair Employment & Housing Comm'n* (1987) 192 Cal.App.3d 1306, 1316-1317.)

In the context of cases brought pursuant to the California Family Rights Act, the definition of a "covered employer" subject to the act specifically includes a successor in interest. (Cal. Code Regs., tit. 2, § 11087, subd. (d).)

Similarly, the Labor Code provides protections to employees with unsatisfied judgments for unpaid wages by holding successor companies "similar in operation and ownership" to the prior employer liable for those unpaid wages if one of two conditions is met:

> (1) the employees of the successor 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.

(Lab. Code, § 238, subd. (e).) This provision, effective as of January 1, 2016, was enacted as part of California's Fair Day's Pay Act and was designed to further the public policy of making sure employees receive their wages.

Alter-ego doctrine

Another theory under which to extend liability to other entities and individuals is through the alter-ego doctrine. While a corporation generally shields its shareholders, officers and directors from personal liability, this shield may be penetrated:

> where an abuse of the corporate privilege justifies holding the equitable ownership of a corporation liable for the actions of the corporation. [Citation.] Under the alter ego doctrine, then, when the corporate form is used to perpetrate a fraud, circumvent a statute, or accomplish some other wrongful or inequitable purpose, the courts will ignore the corporate entity and deem the corporation's acts to be those of the persons or organizations actually controlling the corporation, in most instances the equitable owners. [Citations.]

(*Sonora Diamond Corp. v. Superior Court* (2000) 83 Cal.App.4th 523, 538.)

The alter-ego doctrine may be invoked where two requirements are met: (1) "there must be such a unity of interest and ownership between the corporation and its equitable owner that the separate personalities of the corporation and the shareholder do not in reality exist"; and (2) "there must be an inequitable result if the acts in question are treated as those of the corporation alone. [Citations.]" (*Ibid.*)

There are many factors that are considered in applying the alter-ego doctrine, including the following: (1) whether there is a commingling of funds and other assets between the corporation and its owners; (2) whether one person or entity holds itself out as liable for the debts of the other; (3) whether the entities use the same offices and share employees; (4) whether the entities have identical officers and directors; (5) whether one entity is used as a mere shell or conduit for the other's affairs; (6) whether the equitable ownership in the two entities is identical; (7) whether the corporation was adequately capitalized; and (8) whether the corporation observes corporate formalities. (*Id.* at 538-539.)

The courts examine the totality of the circumstance in determining whether the corporate veil should be pierced. (*Id.* at 539.) If there appear to be grounds to apply the alter-ego doctrine, counsel should explore the facts supporting these factors in discovery.

Whether to name individual defendants

Another issue for counsel to consider is whether to name individual defendants. One benefit of naming individual defendants may be to avoid removal to federal court where the company is incorporated and maintains its principal place of business outside of California. (See 28 U.S.C. § 1441, subd. (b) [any case that could have been brought in federal court based on diversity of citizenship is removable].)

Where a public entity is the employer, counsel may consider naming individual defendants in order to trigger the

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ability to recover punitive damages. (See Gov. Code, § 818 [punitive damages are not recoverable against a public entity].)

Another benefit may be the access to individual defendants for purposes of obtaining deposition and trial testimony through service of a notice of deposition or notice to appear at trial served on their counsel.

There may be factors militating against naming an individual defendant. For example, will the individual be more likely to testify favorably if he or she is not named as a party to the lawsuit? Will the jury be more sympathetic if there is an individual defendant – and particularly a likeable individual defendant – sitting at the defense table at trial? These are factors that need to be taken into account.

Whether an individual may be properly named as a defendant depends on the claims being asserted. Under current law, supervisors may not be held personally liable for discrimination or for retaliation under the Fair Employment and Housing Act. (*Reno v. Baird* (1998) 18 Cal.4th 640, 663; *Jones v. The Lodge at Torrey Pines Partnership* (2008) 42 Cal.4th 1158, 1173.) However, they may be held individually liable for harassment under the FEHA. (Gov. Code, § 12940, subd. (j)(3).)

Individual liability may also attach in cases involving certain wage and hour violations. California's Fair Day's Pay Act, effective as of January 1, 2016, imposes individual liability on owners, directors, officers, or managing agents who violate or cause to be violated certain enumerated statutes, including unpaid minimum wages, unpaid overtime wages, waiting time penalties, premiums for missed meal and rest breaks, and unreimbursed business expenses. (Lab. Code, § 558.1.)

Individuals can also be held personally liable for traditional tort claims, such as defamation and intentional infliction of emotional distress. (See *Light v. Calif. Dept. of Parks & Recreation* (2017) 14 Cal.App.5th 75, 101-102 [claim for intentional infliction of emotional distress allowed to proceed against the plaintiff's individual supervisors]; *Sheppard v. Freeman* (1998) 67 Cal.App.4th 339, 343 fn. 4 & 349 [reversing demurrer sustained in favor of individual coworkers on libel claim].)

Conclusion

Identifying the proper defendants to name in an employment-related lawsuit may require research and creativity. Counsel should evaluate the potential defendants at intake and continue to re-evaluate through the discovery process. Naming all possible entities and persons with potential liability can help to maximize the outcome for the client.

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