California Agencies Don't Get Two Bites at the Apple When It Comes to Misclassification

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Happy Nails & Spa of Fashion Valley, LP, v. Julie Su, No. D060621 (July 19, 2013): A California Court of Appeal recently held that an employer does not have to relitigate the issue of whether the workers at its facilities are employees or independent contractors based on the legal principle of collateral estoppel, since the company had already litigated this issue with a state agency.

In 2003, Happy Nails, which owns several nail salons, restructured its business such that the cosmetologists working at its facilities would be independent contractors rather than employees. In 2004, the state Employment Development Department (EDD) argued that the workers were employees but lost on that issue before the Unemployment Insurance Appeals Board.

In 2008, the Division of Labor Standards Enforcement (DLSE) cited and penalized Happy Nails for failing to provide itemized wage statements to its workers. The DLSE rejected Happy Nails' argument that there was a prior finding showing that its workers were independent contractors and held that the workers were employees.

Happy Nails sued the DLSE in state court to set aside the administrative decision. The trial judge denied the company's request. Happy Nails appealed and the Court of Appeal reversed the judgment. The court held that based on a five-factor test, collateral estoppel applies and Happy Nails cannot be forced to relitigate that issue.

In making its decision, the court noted that to preclude relitigation of an issue, "the following requirements must be satisfied: (1) the issue must be identical to an issue decided in a prior proceeding; (2) the issue must have been actually litigated in the prior proceeding; (3) the issue must have been necessarily decided in the prior proceeding; (4) the decision in the prior proceeding must be final and on the merits; and (5) the party against whom preclusion is sought must have been a party to or in privity with a party to the prior proceeding."

With regard to the last factor, the Court of Appeal held that the EDD and DLSE were "in privity" with each other because both state agencies were "charged with enforcement of laws designed to benefit and protect employees." The court even stated that the DLSE was bound by the stipulations that were agreed to by the EDD and Happy Nails in the first proceedings.

According to Gregory Cheng, a shareholder in Ogletree Deakins' San Francisco office: "This decision makes clear that different California state agencies do not get 'two bites at the apple' on liability in the context of assessing taxes or penalties against a California employer for misclassification issues. Resolution of an issue adversely to one will bind the other."

Cheng added, “Although the court’s decision was positive for the employer in this case, California employers should take a hard look at whether independent contractors have been properly classified. Moreover, claims for unemployment benefits by independent contractors should be vigorously defended to avoid triggering state-wide audits or other penalties or fines that could potentially be assessed as a result of an adverse ruling.”

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