



**Sustainable
Economies
Law Center**

Legal education, research, advice and advocacy for just and resilient economies
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Memorandum on the Constitutionality of California Labor Code Section 226.3

BACKGROUND

In October 2012, the California Department of Labor Standards and Enforcement (DLSE) visited multiple farms in Morgan Hill to audit for employment law violations. The DLSE cited at least three low-income immigrant farmers for minor errors on employee wage statements and issued fines amounting to 12% - 30% of each farmer's annual income. The Sustainable Economies Law Center (SELC) and a group of volunteer attorneys attended lengthy appeal hearings with the farmers, at no cost to the farmers, and ultimately worked with DLSE to reduce the fines. Yet, the underlying injustice resulting from the disproportionately high fines for minor errors remains unaddressed. Below are two examples, demonstrating the reasons why SELC brings this issue to DLSE's attention.

Farmer #1: DLSE fined one farmer **\$6,000** for failing to write the pay period end date on wage statements she provided to employees. The farmer has two employees who work with her to farm three acres of Chinese vegetables. Her wage statement otherwise complied with all legal requirements, and her mistake was entirely unintentional. The fine amounted to more than 25% of the farmer's annual income. After a hearing, DLSE reduced the fine to \$5,000. Paying the full \$5,000 fine would have forced the farmer to cut her workers' hours and squeeze her own food and living expenses. She also considered leaving farming altogether as a result of her experience with DLSE. SELC wrote letters and called DLSE for nearly a year, until DLSE finally agreed to reduce her fine to \$1,000. Even with a reduced fine, the outcome is still unjust, because no one should have to pay \$1,000 for making such a small, unintentional clerical error.

Farmer #2: DLSE fined yet another farmer **\$9,000** for two mistakes on his wage statements. The immigrant farmer's nephew and two long-term family friends (a married couple) live with him and work with him on the farm. He wrote his "doing-business-as" name instead of his own name and he did not include the last four digits of his employees' social security numbers on wage statements, because the store-bought wage statement form did not include a space for this. After more than 100 hours of legal work by SELC and a volunteer attorney, DLSE ultimately reduced the fine to \$1,800, still an extremely high fine for an unintentional clerical error.

As these real-life examples demonstrate, the enforcement of Section 226.3 results in unreasonably excessive fines that raise questions as to the law's constitutionality as applied to small farmers and other small businesses who make a good faith attempt to comply with the law but commit minor, unintentional violations.

ISSUES

Under what circumstances will a California court find that a statutory penalty is excessive as applied? Has DLSE applied California Labor Code section 226.3 to small California farmers in an unconstitutionally excessive manner?

BRIEF ANSWER

Oppressive penalties may violate the U.S. and California constitutions as excessive fines or violations of due process. Courts will assess whether a statutory penalty is constitutionally excessive on its face or as applied in a specific situation. Certain factors may make a penalty provision “manifestly suspect;” although it may be constitutional on its face, a court may find that its excessiveness as applied violates due process in a particular case. The court will consider the circumstances of the case, including good faith attempts of the defendant to comply with the law, in order to determine whether the penalty was excessive as applied. This inquiry does not turn on the liability of the defendant for violating the statute at issue. Even where the defendant can make no defense to his noncompliance and the penalty is applied in conformance with the statute, the penalty may nonetheless be unconstitutionally excessive.

Penalties for wage statement violations issued to small California farmers likely fit this description. Section 226.3 requires mandatory, accumulative penalties for both minor and egregious wage statement violations, making the provision “manifestly suspect.” When applied to these farmers’ circumstances, their good faith attempts to comply with the law, the nature of their businesses, and the conduct at issue make the penalties unconstitutionally excessive.

DISCUSSION

A penalty provision may be “manifestly suspect” based on five factors

The California Supreme Court has identified five factors relevant to whether a statutory penalty is unconstitutional. The Court considers whether (1) the agency has any discretion in determining the amount of the penalty; (2) the penalty’s duration is potentially unlimited; (3) the penalty covers “a broad range of culpable conduct and widely divergent injuries”; (4) “the penalty is imposed equally on those with different levels of sophistication and financial strength”; and (5) the penalty could exceed those given for more egregious conduct under the same statutory scheme. *Starving Students, Inc. v. Dep’t Of Indus. Relations*, 125 Cal. App. 4th 1357, 1368 (2005) (citing *Kinney v. Vaccari*, 27 Cal. 3d 348, 352 (1980) and *Hale v. Morgan*, 22 Cal. 3d 388, 399-400 (1978)).

Hale v. Morgan is the leading case in California to consider whether a penalty is unconstitutionally excessive on its face or as applied. In *Hale*, a mobile-home park owner disconnected the water and electrical lines to a trailer with the intent to evict a resident who had stopped paying rent. The tenant had no access to those utilities for 173 days. The statute at issue assessed a mandatory penalty of \$100 per day that the landlord deprived the tenant of utilities, so the defendant here was charged \$17,300.

The court found that the statute was not unconstitutional on its face, but the sanction assessed in these circumstances was excessive. The court noted that the amount was mandatory (the landlord “shall” be liable for \$100 per day), there was no limit to the number of days the

landlord may be penalized for, the statute afforded the agency no discretion to mitigate the penalty, the penalty was assessed equally for a range of conduct and injuries (the interruption of *any* utility service was prohibited) as well as types of defendants (corporate landlords and elderly widows with a single tenant). *Id.* at 399-400. Additionally, the penalty could potentially exceed that imposed for more serious offenses within the same statutory scheme, indicating that the statute may allow penalties that exceed the Legislature's own view of the nature of the offense or the appropriate remedies. *Id.* at 400. The court reasoned that "[i]n our view, a statute which applies such a mandatory, fixed, substantial and cumulative punitive sanction against persons of such disparate culpability is manifestly suspect." *Id.* at 400. The court further noted that statutes imposing "ever-mounting penalties" where "reasoned discretion is replaced by an adding machine" are disfavored. *Id.* at 401-02. For these reasons, the court held that such a statute may, in certain cases, result in constitutionally excessive penalties. *Id.* at 404. It further held that the penalty that the landlord incurred here was indeed excessive. *Id.*

Subsequent cases have looked at similar language in the relevant statutes to determine whether the penalty provision was unconstitutional on its face or as applied. *See, e.g. People ex rel. Bill Lockyer v. Fremont Life Ins. Co.*, 104 Cal. App. 4th 508, 521 & n.8 (2002) (noting that the statute allowed discretion in setting the penalty based on considerations such as the defendant's culpability and net worth); *Starving Students*, 125 Cal. App. 4th at 1368-69 (noting that the penalties for failing to provide workers compensation insurance were subject to a maximum limit and varied by degree of culpability); *City & Cnty. of San Francisco v. Sainez*, 77 Cal. App. 4th 1302, 1312 (2000) (reasoning that a penalty provision lacking discretion and potentially imposing an unlimited penalty must be evaluated for constitutionality as applied).

California Labor Code section 226.3 imposes a mandatory penalty: a \$250 fee "*shall*" be assessed for each violation in an initial citation. Moreover, DLSE has emphasized the mandatory nature of the sanction as a defense for its refusal to mitigate penalties. The same penalty is imposed equally on a wide variety of conduct and injuries; an employer could fail to provide paystubs entirely or fail to include one required piece of information and receive the same penalty. The statute additionally does not indicate a maximum penalty amount. DLSE inspection agents have cited small California farmers for 12 months of violations, but there is no direction in the statute as to how many months a business owner may be liable for. Like in *Hale*, discretion has been "replaced by an adding machine."

Courts will consider whether the penalty is proportionate to the defendant's good faith and nature of the conduct at issue

A statute that does not allow the trier of fact to take into account a defendant's good faith when issuing a penalty may be unconstitutional. The statute at issue in *Hale* "violated the due process clause of the federal and California Constitutions because it did not permit the trial court any discretion in imposing the civil penalty—it did not allow the court, for example, to take into account the good faith motivation of the offending landlord." *People ex rel. Lungren v. Superior Court*, 14 Cal. 4th 294 (1996).

In 2005, the California Supreme Court held that "although ignorance of the law is not a defense to a violation of [the statute], a defendant's good faith or bad faith is relevant to the evaluation of the fine assessed against the defendant." *People ex rel. Lockyer v. R.J. Reynolds Tobacco*

Co., 37 Cal. 4th 707, 730 (2005). In this case, R.J. Reynolds was cited for violating the state statute regulating the distribution of free cigarette samples. The company had been distributing free cigarettes at a street fair and believed it was complying with the safe harbor provision within the statute regarding private functions limited to adults. The Attorney General contended, and the trial court agreed, that its conduct was not protected by that provision, since, for instance, it excluded minors from the tent where samples were given out, but not from the street fair altogether. The court held that the trial court erred when it granted the Attorney General's motion for summary judgment based on a finding that the question of good faith irrelevant. The court remanded the case, stating that there were triable issues of fact regarding the good faith of the defendant (as well as whether the Attorney General delayed issuing a citation in order to let the penalty accumulate) which could indicate that the fine was unconstitutionally excessive.

The court reasoned that the issue could be considered under an Excessive Fines Clause or Due Process analysis, and cited the four considerations the United States Supreme Court considered when evaluating a civil penalty for excessiveness under the Eighth Amendment. *Id.* at 728. The Court considered: "(1) the defendant's culpability; (2) the relationship between the harm and the penalty; (3) the penalties imposed in similar statutes; and (4) the defendant's ability to pay." *Id.* (citing *United States v. Bajakajian*, 524 U.S. 321 (1998)). The *R.J. Reynolds* court also cited *Hale's* due process analysis and noted the similarity between its reasoning and that of the United States Supreme Court in *Bajakajian*. It further noted that the concurrence in *Hale* reasoned that the fine in that case also violated the state's constitutional prohibition against excessive fines.

The court pointed to California Supreme Court and appellate court decisions where good faith was relevant to a penalty assessment. *Id.* at 730. In two cases the court found that the defendant's good faith attempts to comply with the law may make it inequitable to impose penalties at all. *Id.* (citing *Lusardi Construction Co. v. Aubry*, 1 Cal. 4th 976 (1992) and *People ex rel. Lungren v. Superior Court*, 14 Cal. 4th 294, 314 f.n. 8 (1996)). Additionally, the lack of good faith may support a large fine, such as the failure to stop unlawful activities after being notified that it was illegal. *Id.* (citing *City and County of San Francisco v. Sainez*, 77 Cal. App. 4th 1302, 1316 (2000) and *People ex rel. Bill Lockyer v. Fremont Life Ins. Co.*, 104 Cal. App. 4th 508, 524 (2002)).

In sum, the court concluded that "a defendant's good faith or bad faith *is relevant* to the evaluation of the fine assessed against the defendant" even though ignorance of the law is not a defense against liability. *Id.* (emphasis added).

Shortly after *Hale* was decided, the California Supreme Court found an even larger fine under the same penalty provision as in *Hale* to be constitutional, based largely on the bad faith of the landlord. *Kinney v. Vaccari*, 27 Cal. 3d at 352-56. Unlike the landlord in *Hale*, the *Kinney* landlord's actions were not provoked by nonpayment by the tenants, and at times he even refused to accept their payment. *Id.* at 354. While *Hale's* tenant was uninvited and the utilities were shut off in spring and summer; in *Kinney* the landlord terminated heat and gas utilities in the middle of winter in order to evict multiple families who had been longstanding tenants. *Id.* at 355. Based on this conduct, which was far more "reprehensible" than that of the *Hale* landlord, the court held that "the punitive assessments imposed by the trial court here are 'both proportioned to the landlord's misconduct and necessary to achieve the penalty's deterrent purposes,'" and are not constitutionally excessive. *Id.* at 353 (citing *Hale*, 22 Cal.3d at p. 404); *see also Sainez*, 77 Cal. App. 4th at 1312-13 (noting that lower court judge properly "asked counsel for argument on 'culpability,

moral culpability,' and said case law required him to consider 'the nature, the seriousness, the number of violations, persistence of the misconduct, ... willfulness'" to determine if the housing code penalty was excessive as applied).

DLSE has not considered the good faith efforts of small California farmers to comply with the law, and it has insisted that the statute gives it no such discretion to mitigate penalties based on culpability or egregiousness of the offense. One farmer could not show that his paystub deficiencies were "inadvertent mistakes," as narrowly defined to mean accidental and rare errors, so he received the maximum penalty for an entire year of violations. However, if the harm done by the inadequacies in the wage statements is compared to the severity of the penalty, it is clearly excessive under *Bajakajian*. The farmer's culpability does not even compare to that of the landlord in *Hale*, who, though provoked by the tenant's nonpayment of rent, nonetheless intended to deprive him of necessities in order to forcibly evict him. In contrast, there is no evidence that the farmer intended any harm to his employees or to evade the law. Indeed, he immediately corrected his mistakes once the inspection agents made him aware of them. Courts should consider good faith attempts to comply with the law and find that such penalties are neither "proportioned to . . . misconduct" nor "necessary to achieve the penalty's deterrent purposes." See *Hale*, 22 Cal. 3d at 404.

The characteristics of the defendant and the business are relevant to the excessiveness inquiry

After the court in *Hale* found that the statute was "manifestly suspect" and "subject to both constitutional and unconstitutional applications," it determined that the penalty as applied to the landlord in that case was unconstitutional. *Id.* at 400, 404. The court also noted that the statute was problematic, in part, because it required fixed penalties upon defendants "who may vary greatly in sophistication and financial strength." *Id.* at 399. For example, a corporate landlord capriciously evicting tenants would incur the same penalty as a widow who is unfamiliar with the law and unable to pay the utility bill. *Id.* at 399-400. The court made much of the characteristics of this particular defendant and his business: he had owned it for about one year, his trailer park had only a few mobile homes on site, and he managed it on his own. *Id.* at 405. The court compared the amount of rent (\$780) to the total fine (\$17,300). "These facts suggest a modest operation by a relatively unsophisticated landlord." *Id.* The amount of the fine was so high, in fact, that the plaintiff might be able to purchase the entire park as a result. *Id.* The court concluded that "[s]uch a confiscatory result is wholly disproportionate to any discernible and legitimate legislative goal, and is so clearly unfair that it cannot be sustained." *Id.*

Other cases have similarly considered the financial status of the defendant and the practical effect the penalty would have on his/her business. In *Walsh v. Kirby*, 13 Cal. 3d 95, 104-05 (1974), the court found an accumulative penalty for nearly identical fair trade violations as excessive, in part because it would "effect a de facto revocation of a licensee without prior adequate notice of wrongdoing." This was especially true because of the small scale of the business. *Id.* at 104. The court in *Sainez* held that "as in the case of substantive due process protection against excessive punitive damages awards, substantive due process protection against civil penalties under the rationale of *Hale* and *Kinney* allows inquiry into a defendant's full net worth." *Sainez*, 77 Cal. App. 4th at 1319. In *Starving Students*, the court observed that the penalty was unlike the fine in *Hale* which was so disproportionate to the income the landlord received in rent; rather, if the employer

paid the full fine it would actually benefit financially compared to what it had should have paid to obtain the required insurance. *Starving Students*, 125 Cal. App. 4th at 1370.

Courts have also subsequently considered the sophistication of the defendant. The court in *Starving Students* noted that unlike in *Hale*, the penalty for noncompliance with the workers compensation code “was not assessed upon a small, unsophisticated businessperson, but instead was assessed against a large business with approximately 300 employees.” *Id.* In *Sainez*, the court noted the landlord’s experience with the real estate market, city codes, and consequences of noncompliance, finding that the lower court judge could have reasonably concluded that the lack of formality was a sign of “solid sophistication” and “canniness.” *Id.* at 1317.

Small California farmers resemble the “modest,” “unsophisticated” business owners in *Hale* and *Walsh*. The penalties DLSE imposed were for violations of which the farmer was ignorant due to educational, cultural, and language barriers. The fines were equivalent to 12% – 30% of the annual incomes generated by their small farms. Forcing small farmers to pay such severe penalties for paperwork mistakes that in no way benefited their businesses could cause a de facto closure of farms and loss of work for farm employees. This surely goes beyond the legislative goal of the statute. In fact, the farmers were clearly trying to abide by the Labor Code, demonstrated by their immediate compliance upon notification of the violations. The penalties mandated by section 226.3 are therefore disproportionate to effect the deterrent purposes of the provision. Considering the characteristics of these farmers and their family farms, a court would likely find that the penalty as applied by DLSE is unconstitutionally excessive.

CONCLUSION

A court would likely find that section 226.3 of the California Labor Code is manifestly suspect under *Hale* because it is accumulative, mandatory, and does not afford discretion to mitigate the penalty based on the good faith efforts of an employer or characteristics of the employer that would make the fine excessive. Although a farmer’s ignorance of the law does not relieve her of liability, the court will nonetheless consider such factors when evaluating the application of the penalty provision. The court also would likely hold that the provision resulted in excessive penalties in the cases of these farmers based on their good faith efforts to comply with the law, their lack of sophistication or culpability, and the disproportionate burden the fine would place on small family farms.



Proposed Revisions to California Labor Code Section 226.3

(Deleted language is in ~~red strikethrough~~, added language is in *blue italics*)

Version One – Discretionary Penalties

226.3. Any employer who violates subdivision (a) of Section 226 ~~shall~~ *may* be subject to a civil penalty *of up to* ~~in the amount of~~ two hundred fifty dollars (\$250) per employee per violation in an initial citation and one thousand dollars (\$1,000) per employee for each violation in a subsequent citation, for which the employer fails to provide the employee a wage deduction statement or fails to keep the records required in subdivision (a) of Section 226. The civil penalties provided for in this section are in addition to any other penalty provided by law. In enforcing this section, the Labor Commissioner ~~shall take into consideration whether the violation was inadvertent, and~~, in his or her discretion, may *reduce a fine or* decide not to penalize an employer for *an initial* ~~a first~~ violation when that violation was due to a clerical error or inadvertent mistake, *or in a situation where evidence shows that no employee was harmed and the employer made a good faith attempt to comply with the law. In the latter case, the Labor Commissioner may issue a stop order instead of a monetary penalty, in order to give the employer an opportunity to bring wage statements into compliance.*

Rationale:

- The “shall” language in the section conflicts with the discretion ostensibly afforded the Labor Commissioner. Instead, replace “shall” with “may,” and provide the Commission with greater discretion.
- The Commissioner should also have the authority to issue stop orders in lieu of monetary penalties in the appropriate situations.

Version Two – Discretionary, Separate Penalties

226.3. (a) Any employer who violates subdivision (a) of Section 226 ~~may~~ **shall** be subject to a civil penalty ~~of up to in the amount of twenty dollars (\$20) two hundred fifty dollars (\$250)~~ per employee per violation ~~for each item of required information listed in subdivision (a) of Section 226 that the employer omits from a wage statement in an initial citation and one thousand dollars (\$1000) per employee for each violation in a subsequent citation, for which the employer fails to provide the employee a wage deduction statement or fails to keep the records required in subdivision (a) of Section 226.~~

(b) Any employer who violates subdivision (a) of Section 226 by failing to provide an employee with any wage statement ~~may~~ **shall** be subject to a civil penalty of up to ~~in the amount of~~ two hundred fifty dollars (\$250) per employee per violation in an initial citation and one thousand dollars (\$1,000) per employee for each violation in a subsequent citation, for which the employer fails to provide the employee with a wage statement.

(c) The total civil penalties per employee in an initial citation shall not exceed \$1,000 per employer, unless the Labor Commissioner finds, by a preponderance of the evidence, that the employer acted in bad faith and intentionally deprived employees of wage statements and/or of information required by subsection (a) of Section 226. The total civil penalties per employee in a subsequent citation shall not exceed \$4,000, unless the Labor Commissioner finds, by a preponderance of the evidence, that the employer acted in bad faith and intentionally deprived employees of wage statements and/or information required by subsection (a) of Section 226. The civil penalties provided for in this section are in addition to any other penalty provided by law.

(d) In enforcing this section, the Labor Commissioner ~~shall take into consideration whether the violation was inadvertent, and,~~ in his or her discretion, may ~~reduce a fine or~~ decide not to penalize an employer for ~~an initial a first~~ violation when that violation was due to a clerical error or inadvertent mistake, ~~or in a situation where evidence shows that no employee was harmed and the employer made a good faith attempt to comply with the law. In the latter case, the Labor Commissioner may issue a stop order instead of a monetary penalty, in order to give the employer an opportunity to bring wage statements into compliance.~~

Rationale:

- Section 226.3 should distinguish between failure to provide certain items of information on a wage statement and failure to provide any wage statement at all.
- There should be an upper limit on civil penalties associated with violation of section 226.3, *unless* the preponderance of the evidence shows bad faith on the part of the employer.
- The Labor Commissioner should retain the discretion to reduce or to not issue monetary penalties in certain situations. The Commissioner should also have the authority to issue stop orders in lieu of monetary penalties in the appropriate situations.