



Litigating California Wage & Hour and Labor Code Class Actions

14TH EDITION



Editor's Note

The current edition of this volume is the result of thousands of hours of work, stretching back to before the turn of the last century, by scores of Seyfarth Shaw attorneys. While it is impossible to list them all here, their efforts are sincerely appreciated.

The 14th Edition contains significant contributions from Co-Editors Jonathan L. Brophy, Nicholas Rosenthal, Andrew Crane, Rachel Gradstein, Maya Harel, Leo Li, and David Rosenberg. David Kadue deserves special thanks for performing the unenviable task of editing the Editors. And thanks to Andrew Paley for his leadership and guidance.

Christopher A. Crosman, *Editor in Chief*

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I. Introduction and Overview

Since the turn of the century, there has been a huge increase in the number of class action lawsuits filed in state courts alleging violations of California's overtime laws or other Labor Code statutes and wage and hour regulations. Currently, several such class actions are filed every day in California.

The reasons for this trend are essentially fourfold. First, California's wage and hour law differs from federal law in subtle yet important ways. This means that an employer might be compliant with federal law, but not California law. Second, California procedural rules make it easier to file a class action or collective action. In contrast, the federal Fair Labor Standards Act requires an "opt-in" procedure that tends to restrict the size of classes as compared to the "opt-out" class action procedure used in California. Third, California's unfair competition law allows claimants to borrow violations of other laws and extend the statute of limitations to four years, which tends to make class actions more lucrative. Fourth, many California Labor Code provisions allow for the recovery of attorney's fees to a prevailing plaintiff, creating additional incentives to pursue litigation.

California Labor Code class actions come in various shapes and sizes. Essentially, however, any Labor Code violation that can be tied to a corporate policy could support a class action. For that reason, plaintiffs in California continue to come up with new theories as to how wage and hour violations may support class litigation. This publication reviews the most commonly filed wage and hour and Labor Code class claims and the development of the law over the last several years. It does not, however, attempt to provide a comprehensive overview of California wage and hour law.

Sections II through X of this paper address some of the most common types of class claims in California, such as claims for exempt classification, meal period violations, and denial of expense reimbursement. Sections XI and XII then address some peculiar provisions in California law that tend to expand potential damages recoverable in California class actions such as the Labor Code Private Attorneys General Act, and the Unfair Competition Law ("UCL"). Lastly, Sections XIII through XVIII address various aspects of class action procedure in California—the rules governing class certification, class discovery, class settlement, class arbitration, and individual liability.

II. Common Exempt Misclassification Claims

The first wave of class claims filed against large California employers challenged the exempt status of groups of employees holding the same job. In short, the plaintiffs' counsel argued that the employer had engaged in a common practice of misclassifying a group of employees as exempt from overtime, thus entitling all employees in the group to back overtime pay, interest, and

associated statutory penalties.¹ The following discussion addresses some of the issues that have arisen concerning the misclassification of employees under the various available exemptions.

A. Overview of State Overtime Law

Before January 1, 2000, the California Industrial Welfare Commission (“IWC”) was the body authorized by statute to set overtime requirements. It acted in a quasi-legislative capacity, promulgating a series of “Wage Orders” that set rules for wages, hours, and working conditions that differed slightly from one industry to another. The IWC eliminated daily overtime from the Wage Orders in 1997.² In response, in 1998 the Legislature passed AB 60 which amended the Labor Code to provide for daily overtime and to enshrine various employee protections into the Labor Code so that they could not be altered by the IWC.³ The Wage Orders are still in effect, but the IWC is precluded from promulgating rules within the Wage Orders that are inconsistent with the Labor Code itself.⁴

Under Labor Code Section 510, employees are entitled to one and one-half times their regular rate when they work more than eight hours in a single day, more than forty hours in a workweek, or during the first eight hours of the seventh straight day of a single workweek.⁵ Employees are entitled to double time when they work more than twelve hours in a single day or beyond the eighth hour of the seventh straight day of a single workweek. These rules apply to non-exempt employees in California in every industry.⁶ These rules

¹ Punitive damages are not recoverable when liability is premised solely on Labor Code wage and hour violations. *Brewer v. Premier Golf Properties*, 168 Cal. App. 4th 1243, 1252 (2008).

² *Collins v. Overnite Transp. Co.*, 105 Cal. App. 4th 171, 176 (2003).

³ See, e.g., Lab. Code § 510 (daily overtime requirement) and Lab. Code § 226.7 (meal and rest period requirements). Note that Labor Code section 510 does not apply to employees covered by a valid collective bargaining agreement if “the agreement expressly provides for the wages, hours of work, and working conditions of the employees” and “provides premium wage rates for all overtime hours worked and a regular hourly rate of pay for those employees of not less than 30 percent more than the state minimum wage.” Lab. Code § 514; see also *Vranish v. Exxon Mobil Corp.*, 166 Cal. Rptr. 3d 845 (2014) (affirming trial court ruling that employer: (1) properly paid overtime under the terms of a collective bargaining agreement; and (2) was exempted from Labor Code section 510 pursuant to Labor Code section 514).

⁴ *Collins*, 105 Cal. App. 4th at 178-80 (Wage Orders and Labor Code should be read together to understand scope of wage and hour regulation of California employees).

⁵ Note that employers may assign employees to work schedules that differ from company’s designated workweek/workday and base overtime calculations on the designated workweek/workday as long as the schedule is not established for the purpose of evading lawful overtime requirements. *Seymore v. Metson Marine*, 194 Cal.App. 4th 361 (2011).

⁶ However, employees and employers may specifically agree in advance to a “specific mutual wage agreement” that provides a guaranteed salary covering both base hours and a specific number of overtime hours. The required elements of such an agreement are: “(1) the days that [employee] would work each week; (2) the number of hours [employee] would work each day; (3) that [employee] would be paid a guaranteed salary of a specific amount; (4) that [employee] was told the basic hourly rate upon which his salary was based; (5) that [employee] was told his salary covered both his regular and overtime hours; and (6) the agreement must have been reached before the work was performed.” *Archiega v. Dolores Press, Inc.*, 192 Cal. App. 4th 567, 571 (2011) quoting *Ghory v. Al-Lanham*, 209 Cal. App. 3d 1487, 1491 (1989).

also apply to non-resident employees who perform work in California for California employers.⁷

Individual employees have a private right of action for unpaid overtime. Typically, a plaintiff invokes a private right of action by alleging violation of Labor Code Section 510 or a provision of the governing IWC order. Such a claim does not depend on the Fair Labor Standards Act (“FLSA”) or other federal law. A prevailing plaintiff may recover attorney’s fees for an overtime claim,⁸ but California law, unlike the FLSA, does not provide a remedy of double damages for willful overtime violations.⁹ In a private action for unpaid overtime compensation under the Labor Code, the statute of limitations reaches back to three years before the date the lawsuit is filed in court.¹⁰

B. The Executive (Managerial) Exemption

One issue frequently raised in misclassification class actions is that a proposed class of exempt managers—most often “working managers” in a retail establishment—do not qualify for the “executive” (aka “managerial”) exemption. The FLSA and California law contain similar executive exemptions, but California’s is more restrictive in key respects.

California requires that an “executive” employee be paid a higher level of compensation than required under the FLSA.¹¹ The salary must be set at a level at least twice the minimum wage, which, as of July 1, 2014, is \$9.00 per hour in the State of California.¹²

⁷ The California Supreme Court in *Sullivan v. Oracle*, 51 Cal. 4th 1191 (2011), held that California overtime laws apply to out-of-state employees who perform work within the state. Further, the Court held that overtime work performed by out-of-state employees within California can serve as the basis for a claim under California’s unfair competition law. Cal. Bus. & Prof. Code § 17200 (“UCL”). However, the Court also held that FLSA violations as to out-of-state employees outside California cannot serve as the basis for a California UCL claim. Although the *Sullivan* court explicitly limited its decision to “the circumstances of this case,” the plaintiff’s bar may argue its reasoning suggests that similar conclusions may result for non-California-based employers. The *Sullivan* court declined to opine on the different burdens that a non-California-based employer may face in applying California overtime laws to nonresident employees working in California, but the plaintiff’s bar will undoubtedly seek to obtain judicial rulings that the California Supreme Court’s conflict of laws analysis suggests no reason for why a different conclusion would result for non-California-based employers.

⁸ The California Court of Appeal has held that only the prevailing employee, and not the prevailing employer, may recover attorney’s fees in an action for overtime pay or for unpaid minimum wages. *Early v. Superior Court*, 79 Cal. App. 4th 1420 (2000).

⁹ *But see* Lab. Code § 1194.2 (providing double damages for minimum wage violations).

¹⁰ As explained *infra*, this statute of limitations can be extended to four years through the pleading of a companion claim under the state Unfair Competition Law, Bus. & Prof. Code § 17200, *et seq.*

¹¹ The revised FLSA regulations that went into effect on August 23, 2004, increased the minimum salary from \$250 per week to \$455 per week. Even under this revised minimum, California’s minimum remains higher than the FLSA’s minimum.

¹² The minimum wage in California was \$8.00 per hour prior to July 1, 2014, and will increase to \$10.00 per hour on January 1, 2016. The federal minimum wage is currently \$7.25; employees working within California are generally subject to the higher state minimum wage.

Accordingly, to qualify for the exemption, a manager must now be paid \$37,480 per year. A manager who does not meet the threshold compensation test is automatically disqualified from the exemption.

The other requirements are that the manager (1) must have the power to hire and fire, or make recommendations on those topics that are given particular weight; (2) must supervise at least two full-time equivalent positions; (3) must “primarily” be engaged in managerial duties; and (4) must “customarily and regularly” exercise discretion and independent judgment.¹³

Most litigation in California arises out of element (3) above, because the California Supreme Court in *Ramirez v. Yosemite Water Co.*¹⁴ held that an employee meets element (3) only when the employee spends more than half of the work time on exempt duties. By contrast, under the FLSA’s executive exemption, the employer need only establish that management is the employee’s “primary duty,” which focuses on the relative importance of the duty rather than just the amount of time devoted to the duty.¹⁵

Aside from its emphasis on the percentage of work time devoted to exempt duties, there has been little California case law explaining precisely which duties qualify as exempt “managerial work.” Since July of 2000, however, the Wage Order has expressly incorporated by reference the then-existing FLSA regulations defining “managerial” duties.¹⁶ Accordingly, federal authority construing those specific regulations is highly relevant in interpreting the California executive exemption.¹⁷

Some examples of exempt work set forth in the federal regulation are interviewing, selecting and training employees, setting and adjusting pay rates and work hours, directing

¹³ See IWC Wage Order 1-2001(1)(A)(1); *Nordquist v. McGraw-Hill Broad. Co.*, 32 Cal. App. 4th 555, 573 (1995) (“Discretion and independent judgment’ within the meaning of IWC Order No. 11-80 involves the comparison of possible courses of conduct, and acting after considering various possibilities. It implies that the employee has the power to make an independent choice free from immediate supervision and with respect to matters of significance . . . [meaning matters] of substantial significance to the policies or general operations of the business of the employer.”).

¹⁴ 20 Cal. 4th 785 (1999).

¹⁵ *Id.* at 797; see also *Baldwin v. Trailer Inns, Inc.*, 266 F.3d 1104, 1113-16 (9th Cir. 2001) (although store managers spent less than one-half their time on duties that met the federal executive exemption, they still qualified as exempt because management was found to be their “primary” or most important duty).

¹⁶ See *Whiteway v. FedEx Kinko’s Office & Print Servs., Inc.*, 2007 U.S. Dist. LEXIS 61239; 12 Wage & Hour Cas. 2d (BNA) 1503 (N.D. Cal. Aug. 21, 2007) (citing IWC Wage Order 7-2001 § (1)(A)(1)(e) and noting that it incorporates the federal definition of management as set forth in 29 C.F.R. § 541.102).

¹⁷ See *Whiteway*, 2007 U.S. Dist. LEXIS 61239, at *22 (relying on federal cases construing 29 C.F.R. § 541.202 to interpret California executive exemption); see also *Bldg. Material & Constr. Teamsters Union v. Farrell*, 41 Cal. 3d 651, 658 (1986) (“[f]ederal decisions have frequently guided our interpretation of state labor provisions the language of which parallels that of federal statutes”); *Alcala v. Western Agric. Enters.*, 182 Cal. App. 3d 546, 550 (1986) (“It has been held that when California’s laws are patterned on federal statutes, federal cases construing those federal statutes may be looked to for persuasive guidance”).

work, keeping production records for subordinates, evaluating employees' efficiency and productivity, handling employee complaints, disciplining employees, planning work, determining techniques to be used, distributing work, deciding on types of materials, supplies, machinery and tools to be used or merchandise to be bought, stocked, and sold, controlling the flow and distribution of merchandise and supplies, and providing for employee safety.¹⁸

Seyfarth Shaw has successfully defended many cases where liability turned on whether a particular job duty qualifies as exempt or non-exempt. From our experience in such cases, it is important to carefully analyze cases that have addressed similar duties under the FLSA regulations that are expressly incorporated into the Wage Orders. For example, we defended a case for a large HMO that turned on whether working pharmacy managers were misclassified as exempt executives. One of the main duties of the managers was to check the work of other pharmacy employees for medication errors in filling prescriptions—a duty also performed by licensed pharmacists who were not managers. We obtained summary judgment by relying on numerous cases holding that (1) a manager checking another employee's work for compliance with a standard qualifies as exempt "supervision"¹⁹ and (2) it does not alter the analysis that non-managers also perform the same task.²⁰

Another federal regulation expressly incorporated into the IWC Wage Orders is (former) 29 CFR Section 541.108, which includes in the definition of exempt work all work that is "directly and closely related to exempt work." The FLSA regulation explains that this concept allows seemingly non-exempt duties to be treated as exempt duties:

[It] brings within the category of exempt work not only the actual management of the department and the supervision of the employees therein, but also activities which are closely associated with the performance of the duties involved in such managerial and supervisory functions or responsibilities. The supervision of employees and the management of a department include a great many directly and closely related tasks which are different from the

¹⁸ 29 C.F.R. § 541.102. Although the FLSA regulations were updated in 2004, the definition of exempt "executive" work has remained substantially the same for decades.

¹⁹ See *Sturm v. Toc Retail, Inc.*, 864 F. Supp. 1346, 1351 (M.D. Ga. 1994) (convenience store manager checking for employees compliance with "Majik Market dos and don'ts" was exempt supervision even though often performed by senior clerks as well as the manager); see also *Baldwin*, 266 F.3d at 1117 (trailer park managers' duty of ensuring that park employees followed company policy was supervisory and, therefore, exempt work); *Beauchamp v. Flex-N-Gate LLC*, 357 F. Supp. 2d 1010, 1015-17 (E.D. Mich. 2005) (supervisory duty for a plant manager to "ensure that employees in their charge actually meet [company] standards in their daily work").

²⁰ *Sturm*, 864 F. Supp. 1346; see also *Baldwin*, 266 F.3d at 1115 ("[Having non-exempt employees perform] managerial tasks does not render the tasks non-exempt."); *Sepulveda v. Wal-Mart Stores, Inc.*, 237 F.R.D. 229, 239 (C.D. Cal. 2006) ("[T]he (assistant managers) seem to consider any task performed by an hourly employee to be a non-exempt task. That is not the law.").

work performed by subordinates and are commonly performed by supervisors because they are helpful in supervising the employees or contribute to the smooth functioning of the department for which they are responsible. Frequently such exempt work is of a kind which in establishments that are organized differently or which are larger and have greater specialization of function, may be performed by a non-exempt employee hired especially for that purpose.²¹

In other words, non-discretionary work can be “directly and closely related” to exempt work—and hence itself considered exempt work—even if it is not strictly speaking essential to the exempt work,²² and even if it is work that need not be performed by managers.²³ As long as the work is related to a management function, it is considered to be exempt. These amendments raise substantial arguments that activities, which when viewed in the abstract seem non-exempt, may be considered exempt if they are undertaken with the purpose of effectuating exempt functions of a manager’s job.

Another important issue in these cases that *Ramirez* does not resolve is how one applies the purely quantitative approach to time spent simultaneously performing exempt and non-exempt tasks: Is this time exempt, non-exempt, or some combination of the two? Under federal law, a manager might concurrently be engaged in hands-on, non-exempt type work *and* be monitoring the operation of a business for managerial purposes (e.g., pouring coffee at a restaurant while directing work).²⁴

Employers received a different answer under California law when, in 2005, the First District Court of Appeal in *Murphy v. Kenneth Cole Productions, Inc.*²⁵ rejected an employer’s argument that time spent simultaneously managing and engaged in non-exempt work counts entirely as “exempt time.” The California Supreme Court, by granting review of the

²¹ Former 29 C.F.R. § 541.108(a).

²² *Harrison v. Preston Trucking Co.*, 201 F. Supp. 654, 658-59 (D. Md. 1962) (“[T]he test is not whether the work is essential to the proper performance of the more important work, but whether it is related. Thus, notemaking, by a consultant when standing alone or separated from his primary duties, would be routine and, hence, not directly and closely related within the meaning of the regulations, but at the same time such work is necessary to the proper performance of his primary duties and thus is considered to be ‘directly and closely related’ when performed by the consultant.”).

²³ *Adams v. United States*, 36 Fed. Cl. 91, 98 (1996) (“A supervisor does not become non-exempt merely by doing tasks which are incidental to his main work, even if non-supervisory workers might perform them as well. The question is whether a supervisor engages in those tasks because he is a supervisor.”).

²⁴ See *Donovan v. Burger King Corp.*, 672 F.2d 221, 225-26 (1st Cir. 1982). The 2004 FLSA regulations added a new regulation entitled “concurrent duties,” 29 C.F.R. § 541.106, explaining that a manager is engaged in exempt managerial work when he is engaged simultaneously in exempt and non-exempt work. This new regulation has not been incorporated into the IWC regulations, however.

²⁵ 134 Cal. App. 4th 728 (2005), *revd. on other grounds in Murphy v. Kenneth Cole Products, Inc.*, 40 Cal. 4th 1094 (2007).

meal period issues within *Murphy* but not the concurrent duties issue, effectively rendered the *Murphy* discussion of concurrent duties unciteable. Nonetheless, the appellate court's analysis is instructive as to how other courts might address the issue of concurrently exempt and non-exempt duties going forward.

The *Murphy* appellate court held that a manager could not satisfy the executive exemption where he spent 90 percent of the time working in non-exempt tasks even though he was continually keeping an eye on other employees and otherwise “managing” throughout the day while his hands engaged in the same kind of work his non-exempt subordinates performed. The court reasoned that a manager is non-exempt when he is “a nominal coxswain who performed most of the time as an oarsman alongside the rest of the crew.”²⁶ The court did not state, however, that time spent simultaneously directing other employees and engaged in non-exempt tasks counts *purely* as non-exempt time. Rather, the court suggested that the time spent in such a dual capacity may need somehow to be allocated between exempt and non-exempt time.²⁷ As such, time engaged simultaneously in exempt and non-exempt work might generate at least *partial* credit towards the 50 percent exempt threshold to qualify for the exemption. Further development in the case law is required to clarify this concept.

C. The Administrative Exemption

1. General Overview

Like the FLSA, California wage and hour law recognizes an administrative overtime exemption.²⁸ To qualify for the exemption in the most common circumstances,²⁹ the employer must establish four elements:

- 1) More than one-half the employee's work time involves the performance of office or non-manual work directly related to the employer's management policies or general business operations;
- 2) The employee customarily and regularly exercises discretion and independent judgment in carrying out job duties as to matters of significance to the business.³⁰

²⁶ *Id.* at 744.

²⁷ *Id.* at 744 n.8.

²⁸ See, e.g., Wage Order 7-2001 § 1(A)(2).

²⁹ There are alternative bases to qualify for the administrative exemption such as through regularly and directly assisting a proprietor or performing administrative function in a school system, but those alternative bases rarely come up in class litigation.

- 3) The employee performs his or her job only under general supervision and works along specialized or technical lines in work requiring special training, experience, or knowledge; and
- 4) The employee is paid a salary equivalent to at least twice the state minimum wage.³¹

As with the executive exemption, the IWC Wage Order provision on the administrative exemption has since 2001 incorporated several FLSA regulations by reference. As a result, decisions interpreting the federal administrative exemption often provide persuasive guidance to California courts interpreting the California administrative exemption.³² Nonetheless, as explained below, California's interpretation of the administrative exemption in some ways departs from the way the administrative exemption has been interpreted in most other jurisdictions.

2. California Develops a Unique Interpretation of the Administrative/Production Dichotomy

An issue of substantial dispute under the administrative exemption is whether the employees at issue are working in an "administrative" capacity or in a "production" capacity. Generally speaking, only employees in the former group are eligible for the exemption. This distinction between production and administrative workers is sometimes referred to as the "administrative/production dichotomy."

One of the few class actions that actually went to trial in California, *Bell v. Farmers Insurance Exchange*,³³ was a case challenging whether certain insurance adjusters of the defendant qualified for the administrative exemption. The plaintiffs prevailed on the basis that the insurance adjusters at issue were found, on a classwide basis, not to qualify for the administrative exemption. Following the plaintiffs' success in *Bell*, numerous other cases have been filed to challenge the exempt status of insurance adjusters.

³⁰ Some courts mistakenly hold that employees must exercise discretion and independent judgment more than fifty percent of the time. In fact, the term "customarily and regularly" is defined in the FLSA regulations that are incorporated in the Wage Orders and "more than occasionally but less than constantly." It is generally established by showing that a duty is carried out on a recurrent, non-sporadic basis. See *Baca v. United States*, 1 Wage & Hour Cas. 2d (BNA) 1066 (U.S. Fed. Cl. 1993) (doing exempt duties only one-third of the total work time, but on a regular recurring basis, qualified as performing the task "customarily and regularly").

³¹ Wage Order 7-2001 § 1(A)(2)(f).

³² *Combs v. Skyriver Communications, LLC*, 159 Cal. App. 4th 1242, 1254-55 (2007) (recognizing that the incorporation of FLSA regulations was intended to make the California exemption "closely parallel the federal regulatory definition of the same exemption").

³³ 87 Cal. App. 4th 805 (2001).

In *Bell*, the California Court of Appeal addressed the requirement that an administratively exempt employee work in an administrative job rather than a production role—a concept referred to as the “administrative/production dichotomy.”³⁴ In doing so, the court examined FLSA regulations and case law that draw a distinction between “administrative work” which can qualify as exempt work under the exemption and “production work” which cannot qualify.³⁵

Because Farmers Insurance Exchange was the claims subsidiary of Farmers Group, performing adjusting services for a variety of underwriting entities within the group, and because Farmers Group provided administrative support to Farmers Insurance Exchange, the court held that the work of adjusters was inherently production of Farmers’ product (insurance adjusting), which rendered them ineligible for the exemption regardless of their duties.³⁶ In a more recent published decision from the same *Bell* case, the court declined to reconsider its earlier holding on this point.³⁷ Both these decisions left open the possibility that an insurance adjuster that did not work for a special claims adjusting subsidiary insurance company might still qualify for the exemption.

Bell was decided under the pre-2000 version of the Wage Orders, which did not expressly incorporate the FLSA’s regulations on its administrative exemption. Given that the current version of the IWC regulations expressly incorporates the federal administrative exemption regulations, and given that numerous federal decisions have refused to apply *Bell*’s reasoning to FLSA insurance adjuster cases,³⁸ employers have at least a colorable argument that *Bell* is not good law for cases arising since 2001. Moreover, the 2004 amendments to the FLSA regulations, which purport merely to clarify and to update what the FLSA has always required, state that insurance adjusters can be covered by the administrative exemption “whether they

³⁴ *Id.* at 811-12.

³⁵ *See, e.g., Dalheim v. KDFW-TV*, 918 F.2d 1220, 1230 (5th Cir. 1990) (“The distinction § 541.205(a) draws is between those employees whose primary duty is administering the business affairs of the enterprise from those whose primary duty is producing the commodity or commodities, whether goods or services, that the enterprise exists to produce and market.”).

³⁶ *Bell*, 87 Cal. App. 4th at 823-28. Although the court specifically held that it did not need to look at the duties test, it noted that the undisputed evidence showed that the adjusters at issue simply acted as claims processors with little authority or discretion.

³⁷ *Bell v. Farmers Ins. Exch. (Bell III)*, 115 Cal. App. 4th 715 (2004).

³⁸ *See, e.g., Miller v. Farmers Ins. Exch.*, 481 F.3d 1119 (9th Cir. 2007) (criticizing *Bell*’s interpretation of the administrative/professional dichotomy and finding insurance adjusters categorically to qualify as exempt employees); *In re Farmers Ins. Exch.*, 336 F. Supp. 2d 1077, 1087-88, 1091 (D. Or. 2004) (rejecting notion that Farmers’ adjusters were non-exempt “production” workers regardless of whether they met the other requirements of the administrative exemption; refusing to apply *Bell* to a case under the FLSA).

work for an insurance company or another type of company.”³⁹ Several federal decisions have concluded that under the FLSA, insurance adjusters are not entitled to overtime.⁴⁰

Employers hoped that subsequent developments in case law would limit *Bell* to its facts. Their hopes were bolstered with the Ninth Circuit’s 2007 issuance of *Miller v. Farmers Insurance Exchange*.⁴¹ In this opinion, the Ninth Circuit held that insurance adjusters, as a rule, qualify for the administrative exemption, and it criticized the *Bell* decisions’ overbroad construction of the meaning of “production work.”⁴²

More recently, the Fourth District Court of Appeal provided some additional ammunition to employers trying to demonstrate that workers fit within the administrative exemption. In *Combs v. Skyriver Communications, Inc.*,⁴³ the appellate court affirmed the trial court’s decision not to apply the administrative/production dichotomy at all in connection with evaluating the exempt status of an information technology (“IT”) professional.

The *Combs* opinion distinguished *Bell* on multiple grounds. First, the court noted that *Bell* was legally distinguishable because it was decided before Wage Order Number 4 was revised to expressly incorporate the applicable federal regulations.⁴⁴ The court also found *Bell* to be factually distinguishable because the insurance adjusters at issue in *Bell* were found to have job responsibilities that were restricted to “handling of the routine and unimportant.”⁴⁵ In contrast, the plaintiff in *Combs* was found to have more specialized job duties that “cannot be readily categorized in terms of the administrative/production worker dichotomy.”⁴⁶

³⁹ 29 C.F.R. § 541.203(a). The current regulations still require an adjuster to meet the duties test to qualify as exempt, which requires the adjuster to perform such activities as “interviewing insureds, witnesses and physicians; inspecting property damage; reviewing factual information to prepare damages estimates; evaluating and making recommendations regarding coverage of claims; determining liability and total value of a claim; negotiating settlements; and making recommendations regarding litigation.” See also former 29 C.F.R. § 541.205(c)(5) (identifying insurance adjusters within the universe of employees often covered by the administrative exemption).

⁴⁰ See, e.g., *Munizza v. State Farm Mut. Auto. Ins. Co.*, 103 F.3d 139 (9th Cir. 1996) (memorandum); *Blinston v. Hartford Accident & Indemn. Co.*, 20 Wage & Hour Cas. (BNA) 6 (W.D. Mo. 1970).

⁴¹ 481 F.3d 1119 (9th Cir. 2007).

⁴² 481 F.3d at 1124, 1132.

⁴³ 159 Cal. App. 4th 1242, 1260-62 (2008), *review denied* (May 14, 2008).

⁴⁴ *Id.* at 1259-60.

⁴⁵ *Id.* at 1259.

⁴⁶ *Id.* at 1261.

Some thought that *Combs* signaled a backlash against the *Bell* decision, which many believe went too far in emphasizing the administrative/production dichotomy over other aspects of the test for the administrative exemption. Although *Combs* has some pro-exemption language in its discussions distinguishing *Bell*, its application may be somewhat limited because the plaintiff held a fairly high-level, atypical IT position. This makes it more difficult to apply *Combs* to other situations involving lower level IT jobs or other sorts of mid-level administrative positions.⁴⁷

3. The Administrative/Production Dichotomy Test Survives—*Harris v. Superior Court*

On December 29, 2011, the California Supreme Court issued its decision in *Harris v. Superior Court*,⁴⁸ holding that the Court of Appeal mistakenly concluded that claims adjusters, as a matter of law, do not qualify for the administrative exemption. The Supreme Court did not provide definitive guidance on this topic in its opinion. Rather, the Court simply held that the Court of Appeal had improperly applied the “administrative/production worker dichotomy” as a dispositive test.

Liberty Mutual claims adjusters had filed a class action alleging that Liberty Mutual misclassified them as exempt administrative employees. The trial court denied plaintiffs’ motion for summary adjudication on Liberty Mutual’s administrative exemption affirmative defense, but the Court of Appeal reversed the trial court and held that as a matter of law, the administrative exemption did not apply to the claims adjusters. The Court of Appeal strictly applied the “administrative/production worker dichotomy” test set forth in the *Bell v. Farmers Insurance Exchange* cases and held that adjusting claims was part of the “product” that their employer sold and therefore not an administrative duty.

While the administrative exemption analysis depends on multiple factors, the *Harris* decision focused on only one—whether the employees’ work qualified as administrative. The California Supreme Court broke this analysis down into two components, one “qualitative” (i.e., whether the work is administrative in nature) and the other “quantitative” (i.e. whether it is of “substantial importance” to the employer’s management policies or general business operations).

⁴⁷ In *Heffelfinger v. Electronic Data Systems*, 580 F. Supp. 2d 933, 961-62 (C.D. Cal. 2008), *affirmed in part, reversed in part*, 492 Fed. Appx. 710 (9th Cir. 2012), a federal district court surveyed various cases that analyzed whether IT workers were exempt, and found there to be a “clear demarcation point,” with employees who “were tasked to install, maintain, and troubleshoot software” falling on the non-exempt side, and those “charged with writing code, programming, or ‘administering’ databases or networks” falling on the exempt side.

⁴⁸ 53 Cal. 4th 170 (2011).

In reversing the Court of Appeal, the California Supreme Court distinguished *Bell*. First, the Court noted that the *Bell* opinions limited their holding to the specific facts of that case (including defendants' stipulation that the work performed by all plaintiffs was 'routine and unimportant'). Second, the Court noted that the analysis in *Bell* relied on the applicable Wage Order at that time (Wage Order 4-1998). That order did not provide a sufficient definition of the administrative exemption, thereby requiring the *Bell* court to look beyond the Wage Order's language. In contrast, Wage Order 4-2001 (the current Wage Order, applied in *Harris*) incorporates specific federal regulations and contains "detailed guidance" concerning the administrative exemption. The Court of Appeal in *Harris* erred by focusing too heavily on the administrative/production dichotomy rather than applying the language of the relevant wage order and regulations.

The Supreme Court ultimately declined to adopt a rule precluding the use of the dichotomy as an analytical tool. Instead, the Court held that, in determining whether work is administrative, courts must consider the particular facts and apply the language of the statutes and wage orders at issue.⁴⁹ If the statutes and wage orders fail to provide adequate guidance, the Court held, then it would be appropriate to consider other sources, including, presumably, the administrative/production dichotomy.

The only concrete guidance from the California Supreme Court in *Harris* is that the administrative/production dichotomy is not a dispositive test for the administrative exemption. The Court left open the possibility that the dichotomy may still apply in future cases. Employers who were looking for more specific guidance from the Court on the administrative exemption were disappointed, as, even after *Harris*, determining whether an employee satisfies the administrative exemption remains a highly fact-specific venture.

D. The Outside Sales Exemption

The outside sales exemption is the broadest of all in that it exempts the employees from **all** provisions in the Wage Orders, even minimum wage protections.⁵⁰ To qualify as an outside salesperson, an employee must "customarily and regularly work more than half the working time away from the employer's place of business selling tangible or intangible items or

⁴⁹ The Court specifically noted that to properly interpret California's administrative exemption, courts should only consider the FLSA regulations effective as of 2001. See also *Heffelfinger v. Electronic Data Systems Corp.*, 2012 WL 2045960 (9th Cir. June 7, 2012) (applying *Harris* rule in determining administrative exemption for computer professionals).

⁵⁰ IWC Wage Order 1-2001(1)(c) ("the provisions of this wage order shall not apply to outside salespersons"). By contrast, the white collar exemptions exempt employees only from Section 3 through 12 of the Wage Orders and other exemptions exempt employees only from Section 3 (governing hours of work).

obtaining orders or contracts for products, services or use of facilities.”⁵¹ This definition is slightly different from the definition of an outside salesperson under the FLSA, which provides that an employee is an outside salesperson if (1) the employee’s primary duty is making sales (as defined in the FLSA), or obtaining orders or contracts for services or for the use of facilities for which a consideration will be paid by the client or customer; and (2) the employee is customarily and regularly engaged away from the employer’s place or places of business.⁵²

In 1999, in *Ramirez*,⁵³ the California Supreme Court held that the difference in the wording of the federal and state outside sales exemptions was intentional and that California therefore has an exemption narrower than the FLSA’s. In particular, the inclusion of the phrase “more than half the employee’s working time” in the California definition of an outside salesperson indicated that employees could not qualify for the California exemption if they consistently spent more than one-half their time on work other than “outside sales” work.⁵⁴ The Supreme Court also noted that there was no reference in the California definition to work “incidental to or in conjunction” with an employee’s sales work, which the court interpreted as excluding any such “incidental” work from the 50 percent standard.⁵⁵ Nonetheless, the Supreme Court held that if the employer could show that it reasonably expected that its employees would spend the majority of their time engaged in outside sales, but the employee violated those expectations by not doing so, then the employer could still take advantage of the exemption.⁵⁶

The facts of the *Ramirez* case were relatively straightforward and thus did not provide the Supreme Court with the opportunity to address more nuanced situations. The job at issue in *Ramirez* had employees spending virtually all their work time away from the employer’s place of business and doing essentially the same small set of tasks every day—i.e., driving to the homes of customers to deliver bottled water and attempting, where possible, to sell them additional water products. The job duties were easily divided into “sales” and “delivery,” and the court merely held that more time had to be devoted to sales than to delivery for the delivery salespersons to qualify as outside salespersons.⁵⁷

⁵¹ IWC Wage Order 1-2001(2)(j) (defining “outside salesperson”).

⁵² 29 C.F.R. § 541.500.

⁵³ 20 Cal. 4th 785 (1999). This decision was discussed, *supra*, in the context of the executive exemption.

⁵⁴ *Id.* at 797-98.

⁵⁵ *Id.* at 797.

⁵⁶ *Id.* at 802.

⁵⁷ *Id.* at 801.

Ramirez left open the following questions:

- What does it mean to “customarily and regularly” spend more than one-half of the work time on outside sales? “Customarily and regularly” is defined in the FLSA regulations as “more than occasionally but less than constantly.”⁵⁸ If an employee has a habit of often spending two or three days working away from the employer’s place of business, but spends the overall majority of all work time at the employer’s place of business, would that qualify as “customarily and regularly” spending more than one-half the work time outside?
- How does one attribute time spent before a sale preparing to make a sales call or time spent after a sale completing the paper work? The *Ramirez* decision mentions that the employer argued it would be absurd to exclude those tasks from the “outside sales” calculation, but the California Supreme Court did not explain how those duties should be analyzed under the exemption.
- What constitutes “away from the employer’s place of business”? Clearly delivering water to a customer’s home qualifies, but what if the employee is in a job where he is making customer contact by telephone? Is any time selling outside the employee’s designated “office” considered time “away from the employer’s place of business”?
- How does an employer enforce reasonable expectations that its employees spend the majority of their time outside selling? Where the employer encourages selling, but allows the employees to make sales any way they want without tracking their movements, what is the employer’s reasonable expectation as to “outside sales” activity?

Because all these questions remain open, there is still a great deal of litigation over the outside sales exemption.

Separate from the substantive issue of whether a particular employee meets the outside sales exemption, there has been significant litigation over whether outside sales exempt status can be decided collectively on a class basis. Courts have been more willing to deny class certification in these cases where the only question is whether employees who undisputedly focus on sales spend enough of their time “outside” to meet the exemption.

⁵⁸ See *Baca v. United States*, 1 Wage & Hour Cas. 2d (BNA) 1066 (U.S. Fed. Cl. 1993) (doing exempt duties only one-third of the total work time, but on a regular recurring basis, qualified as performing the task “customarily and regularly”); *Shriner v. Smurfit-Stone Container*, 2006 Mont. Dist. LEXIS 606 (D. Mont. Aug. 30, 2006) (employee who spent less than half of his total work time supervising employees still “customarily and regularly” supervised employees because “his role as a relief supervisor was expected, relied upon and regularly performed” and was his role “on more than isolated or occasional incidents”).

Most notably, in a case in which Seyfarth Shaw represented the prevailing defendant, the Ninth Circuit, in *Vinole v. Countrywide Home Loans, Inc.*,⁵⁹ affirmed a district court order that the outside sales exempt status of branch loan originators could not be litigated on a collective basis. There was no evidence that Countrywide required its employees to spend a certain amount of time inside, and there was great variation in the testimony as to how different loan originators actually spent their time. The Ninth Circuit explained how this made class certification inappropriate:

“Plaintiffs seek to minimize the district court’s main concern--that although there are common issues, including uniform classification, the inquiry into each HLC’s exempt status would burden the court.”⁶⁰ “The principal factor in determining whether common issues of fact predominate is whether the uniform classification, right or wrong, eases the burden of the individual inquiry. But this is a legitimate concern. Plaintiffs’ claims will require inquiries into how much time each individual HLC spent in or out of the office and how the HLC performed his or her job; all of this where the HLC was granted almost unfettered autonomy to do his or her job. This must be considered along with the lack of issues subject to common proof that would actually ameliorate the need to hold several hundred mini-trials with respect to each HLC’s actual work performance.”⁶¹

III. Unlawful Deductions from Wages

A. Generally

A second allegation commonly made in Labor Code class actions is that the employer unlawfully deducted from the employee’s wages. Plaintiffs have used these allegations to challenge policies designed to hold employees liable for cash shortages or theft, to pay bonuses based on net profits, and to advance commissions subject to recoupment or “chargeback.”

Under California law, an employer cannot deduct from an employee’s wages to account for losses to the business that occurred as a result of simple negligence or through no fault of the employee. Courts have held that such losses are part of the cost of doing business and, therefore, should be borne by the enterprise rather than the individual employees. This principle is codified specifically in Section 8 of the Wage Orders:

⁵⁹ 571 F.3d 935 (9th Cir. 2009).

⁶⁰ *Id.* at 946.

⁶¹ *Id.* at 947 (emphasis added); see also *Mevorah v. Wells Fargo Home Mortgage, Inc.*, 268 F.R.D. 604 (N.D. Cal. Jan. 12, 2010) (on remand after reversal of certification decision for reconsideration, district court denied certification as to class of Wells Fargo home loan consultants); *Maddock v. KB Homes, Inc.*, 248 F.R.D. 229 (C.D. Cal. 2007) (denying class certification as to putative class of commissioned home salespersons).

No employer shall make any deduction from the wage or require any reimbursement from an employee for any cash shortage, breakage, or loss of equipment, unless it can be shown that the shortage, breakage, or loss is caused by a dishonest or willful act, or by the gross negligence of the employee.

In dicta, several California cases have indicated the rule codified in Section 8 extends beyond deductions for cash shortage, breakage, or loss of equipment. The seminal case on this issue, *Kerr's Catering Service v. Dep't of Industrial Relations*,⁶² held only that the IWC had the authority to promulgate Section 8. In explaining its reasoning, however, the California Supreme Court used sweeping language and invoked several provisions from the California Labor Code, such as Section 221 (which precludes an employer from demanding an employee pay back wages once the wages are earned), and Sections 400-410 (which limit employers' rights to seek cash bonds from employees). The court did **not** hold that those Labor Code provisions barred deductions for cash shortages, but rather held that the public policies that underlie those Labor Code Sections gave the IWC authority to enact Section 8.

Later cases read *Kerr's Catering* to say that the Labor Code **itself** barred deductions for "unanticipated losses" or "business losses that may result from the employee's simple negligence."⁶³ By locating this anti-deduction rule in the Labor Code rather than the Wage Orders, these decisions effectively nullified Section 1(A) of the Wage Orders, which provides that the anti-deduction rules within Section 8 do not apply to exempt administrators, professionals, or executives.⁶⁴ If the anti-deduction rule stems from the Labor Code rather than Section 8, then it applies to exempt **and** non-exempt employees.

B. Unlawful Bonus Plans

Based on the broad anti-deduction dicta in cases that cited *Kerr's Catering*, some class actions were filed alleging that certain bonus plans violated Labor Code Section 221 and Sections 400-410 when the size of the bonus was determined in any part by the level of net profits of the business. Although an appellate court adopted much of the plaintiffs' reasoning in the 2003 opinion *Ralphs Grocery Co. v. Superior Court (Ralphs I)*,⁶⁵ the

⁶² 57 Cal. 2d 319, 329 (1962).

⁶³ *Hudgins v. Neiman Marcus Group, Inc.*, 34 Cal. App. 4th 1109, 1118 (1995) (discussed *infra*); see also *Quillian v. Lion Oil Co.*, 96 Cal. App. 3d 156, 162-63 (1979) (citing *Kerr's Catering* for the principle that the Labor Code itself bars unexpected deductions for losses not the result of an employee's willful misconduct).

⁶⁴ Section 1(A) provides that "[p]rovisions of Sections 3 through 12 shall not apply to persons employed in administrative, executive, or professional capacities."

⁶⁵ 112 Cal. App. 4th 1090 (2003).

California Supreme Court in *Prachasaisoradej v. Ralphs Grocery Co. (Ralphs II)*⁶⁶ rejected much of that decision and instead held that net-profit based bonus systems are lawful.

The plaintiffs had reasoned that net profits were reduced when merchandise in the store was lost or broken or when cash went missing from the cash register. Accordingly, they argued, reducing an employee's bonus when net profits decreased was tantamount to holding the employee personally liable for "business losses" that were not the employee's fault. Furthermore, these plaintiffs also turned to Labor Code Section 3751, which forbids employers, "directly or indirectly," to "exact or receive from any employee any contribution, or make or take any deduction from the earnings of any employee" to pay for workers' compensation expenses. The plaintiffs argued that if these workers' compensation expenses were factored into the net profit calculation, then any reduction in bonus to account for increased workers' compensation expenses plainly violated Section 3751, just as a bonus taking cash shortages into account violated Section 8 of the Wage Orders, as interpreted by *Kerr's Catering*. At least one appellate decision agreed that net profits based calculations ran afoul of Section 3751.⁶⁷

After several years in which many bonus plan class actions were filed, the California Supreme Court effectively put an end to them in 2007 with the issuance of *Ralphs II*.⁶⁸ There, the Court held that traditional net-profits-based bonus systems are lawful in California and are not the functional equivalent of a scheme to deduct from employee's wages on improper bases.

The California Supreme court distinguished earlier cases that invalidated bonus plans that tied a bonus or commission to an employee's individual sales effort, but which then reduced the bonus amount to cover employer costs. Under those types of bonus plans, employers used the bonus as an artifice to hide the fact that they were charging employees on a dollar-for-dollar basis for losses to the company and merely hid the deduction in the calculation of the so-called "bonus."⁶⁹

By contrast, "the [Ralphs plan] did not create an expectation or entitlement in a specified wage, then take deductions or contributions from that wage to reimburse Ralphs for its business costs." Each Ralphs store employee received a guaranteed dollar wage, which was paid regardless of a store's profit or loss for a specified period. Under the Ralphs bonus plan, employees were entitled to a supplementary incentive compensation payment

⁶⁶ 42 Cal. 4th 217 (2007).

⁶⁷ *Ralphs I*, 112 Cal. App. 4th at 1104-5.

⁶⁸ 42 Cal. 4th 217 (2007).

⁶⁹ See, e.g., *Quillian*, 96 Cal. App. 3d 156 (1970) (manager received bonus calculated as a percentage of store sales minus the dollar value of any cash shortages during the bonus period).

“only after the store had completed the relevant period of operation” and the resulting profit or loss figure was calculated. This final figure “was the amount offered or promised as compensation for labor performed by eligible employees, and it thus represented their supplemental ‘wages’ or ‘earnings.’” Therefore, the amount “offered or promised as compensation for labor performed” already accounted for the deductions about which the plaintiff complained.⁷⁰

Accordingly, the *Ralphs* plan did not illegally shift business losses to employees. Rather, it provided supplemental compensation the company used to “encourage and reward certain employees’ cooperative and collective contributions to the profitable performance of their stores” by providing them a portion of their store profits that “*Ralphs* would otherwise be entitled to retain itself.”⁷¹

Ralphs represents a victory for employers because its holding permits a business to have a bonus plan that distributes sums based on the level of the company’s net profits. Although *Ralphs* addressed and reconciled a significant question of California wage law, it remains to be seen how the lower courts will treat bonus plans that depart from the standard net-profit-based bonus system at issue in *Ralphs*.

C. Unlawful Commission Chargebacks

1. Nature of the Violation

Another Labor Code class action that was once common, but has become less so, is one alleging that commission chargebacks constitute illegal deductions. Companies often employ commissioned salespeople who receive a commission immediately upon the completion of a sale, subject to the occurrence of some future event. For example, a salesperson might sell a product on day one and immediately receive a commission that is subject to “chargeback” if the customer fails to pay within sixty days.

Plaintiffs attack chargebacks primarily by citing Labor Code Section 221, which makes it unlawful for an employer to “collect or receive from an employee any part of wages theretofore paid” to the employee. In addition, where the chargeback occurs for reasons beyond the control of the sales employee (such as the customer’s failure to pay for the item), plaintiffs have invoked Section 8 of the Wage Orders and the *Kerr’s Catering* line of cases for the argument that a chargeback constitutes an “unlawful deduction” from an employee’s wage not attributable to the employee’s willful misconduct.

⁷⁰ 42 Cal. 4th at 229.

⁷¹ *Id.* at 228.

In particular, plaintiffs have attempted to derive a “no-chargebacks” rule from *Hudgins v. Neiman Marcus*,⁷² a case involving commission chargebacks for retail sales employees on certain returns of merchandise. Plaintiffs read the case as generally prohibiting chargebacks where the employee was not at fault for the return. Defendants respond that the case’s holding is more limited, addressing only the situation where Neiman Marcus held its employees collectively responsible for the return of any item that could not be traced back to the particular salesperson who sold it. The court never suggested that charging back the commission was unlawful where the sale can, in fact, be traced back to the person who received the commission and only that employee experiences the chargeback when the item is returned. In fact, the state Division of Labor Standards Enforcement (“DLSE”) has construed *Hudgins* as approving a commission chargeback for such an **identified** return.⁷³ Moreover, multiple cases have since echoed that interpretation of *Hudgins*.⁷⁴

As discussed below, guidelines have now emerged that should allow employers to craft compensation systems that include a chargeback element without running afoul of California law.

2. The *Steinhebel* Case Approves Certain Chargeback Plans

In February 2005, in *Steinhebel v. Los Angeles Times Communications, LLC*,⁷⁵ the Second District Court of Appeal rejected the broad reading of Section 221 that the plaintiffs advanced. The court expressly held that California’s various “anti-deduction” provisions do **not** preclude an employer from advancing a commission to an employee subject to chargeback if a condition for “earning” the chargeback is not satisfied.

More specifically, the court upheld a pay system that advanced newspaper telesales employees a commission the day they sold a newspaper subscription, but wherein

⁷² 34 Cal. App. 4th 1109 (1995).

⁷³ DLSE Opinion Letter 1999.01.09. The DLSE has also opined that chargebacks of commissions are acceptable when a customer fails to pay for an item so long as the sales contract makes clear that the commission is not earned until payment is received. DLSE Opinion Letter 1999.01.09 (“A commission is ‘earned’ when the employee has perfected the right to payment; that is, when all of the legal conditions precedent have been met. Such conditions precedent are a matter of contract between the employer and the employee, subject to various limitations imposed by common law or statute.”); see also DLSE Opinion Letter 2002.12.09-2 (“Commissions are earned only after the reasonable conditions precedent of the employment agreement have been met and commissions can be calculated.”).

⁷⁴ See *Steinhebel v. Los Angeles Times Communications, LLC*, 126 Cal. App. 4th 696, 711 (2005); *Harris v. Investor’s Bus. Daily* 138 Cal. App. 4th 28, 41, *modified*, 138 Cal. App. 4th 871 (2006) (discussed below, each interpreting *Hudgins* as allowing chargebacks for *identified* returns).

⁷⁵ 126 Cal. App. 4th 696 (2005).

the subscription was not “earned” until the customer kept the subscription for twenty-eight days without canceling. If the customer canceled sooner for any reason, then the commission was “charged back” by being deducted from the employee’s next commission advance. The court held that the contract was consistent with the Labor Code and public policy because the contract plainly defined the “earning” of the commission as the customer keeping the newspaper for twenty-eight days without canceling, and the overall pay system inured to the benefit of the employees by allowing them to be paid sooner than the “earning” date.⁷⁶ Indeed, given the widespread nature of commission chargeback systems, the court was reluctant to declare such a system illegal without some express language in the Labor Code requiring such a result:

Compensating employees in part with advances on commissions is a longstanding practice. No prior case has held the practice to violate the California Labor Code, and we are pointed to no statute that expressly bars such a practice. In view of its widespread nature, we are loathe to hold the Labor Code bars such a practice by implication.⁷⁷

3. Further Development of the Law Since *Steinhebel*

Steinhebel remains good law, and an employer setting up a chargeback system may use the *Steinhebel* system as a safe template. It is important to note, however, that *Steinhebel* involved ideal facts for the defendant: the chargeback agreement was in a writing signed by the employees; the agreement referred to the initial payment as an “advance”; the conditions to earn the commissions were spelled out in the compensation plan; and those conditions did not seem particularly onerous. But what if some of the ideal elements are missing?

The first word on chargebacks following *Steinhebel* suggested that if an employer did not document the chargeback agreement properly, it could violate California law. In *Harris v. Investor’s Business Daily*,⁷⁸ another panel of the Second District Court of Appeal held that the lack of a written chargeback agreement precluded summary judgment for the employer. As in *Steinhebel*, the plaintiffs sold newspaper subscriptions, and the money they initially received was subject to chargeback if the customer canceled the subscription without holding it a certain period of time. Unlike *Steinhebel*, however, there was no written agreement that described the initial payment as an advance or otherwise suggested that it was not “earned” upon the

⁷⁶ *Id.* at 708-09.

⁷⁷ *Id.* at 709.

⁷⁸ 138 Cal. App. 4th 28, *modified*, 138 Cal. App. 4th 871 (2006).

completion of the sale. Given that the plaintiffs testified that they understood they earned the money when their sale was completed, the court held that there was a triable issue of fact whether the chargeback system violated Labor Code Section 221.⁷⁹

Later, the First District Court of Appeal issued a far more favorable chargeback opinion in *Koehl v. Verio, Inc.*,⁸⁰ a case involving chargebacks against salespersons who sold internet services. As in *Steinhebel*, the chargeback plan in *Koehl* was in a writing acknowledged by each employee. Unlike *Steinhebel*, however, the compensation plan did **not** refer to the original payment as an “advance,” although it did state expressly that the commission was not “earned” until the customer made three months of payments on the contract. The *Koehl* court held that, as long as the plan made clear that the commission was not earned until a later condition was satisfied, it made no difference whether the payment was labeled a “commission” or an “advance.”⁸¹ The court further noted that this conclusion was entirely consistent with *Harris*, which merely held that, in the absence of a writing memorializing the parties’ agreement, a material dispute between the employer and employee as to when the commission was “earned” made summary judgment of the Section 221 claim inappropriate.⁸²

Koehl actually went further than *Steinhebel* in two respects. *Steinhebel* ended the chargeback inquiry at whether the chargebacks at issue violated Section 221. *Koehl* went further by affirming the judgment in the defendant’s favor on a separate, alternative basis—i.e., that even if the chargeback violated Section 221, it was nonetheless saved by an exception to Section 221 set forth in Labor Code Section 224.⁸³ *Koehl* also went beyond *Steinhebel* in holding that the doctrine of unconscionability did not invalidate the chargeback system.⁸⁴

Section 224 provides, in relevant part, that Section 221 “shall in no way make it unlawful for an employer to withhold or divert any portion of an employee’s wages when . . . a deduction is expressly authorized in writing by the employee to cover . . . deductions not amounting to a rebate or deduction from the standard wage.” Although *Steinhebel* took note of Labor Code Section 224, it did not rely on it to

⁷⁹ *Id.* at 41.

⁸⁰ 142 Cal. App. 4th 1313 (2006).

⁸¹ *Id.* at 1334.

⁸² *Id.*

⁸³ *Id.* at 1337-38.

⁸⁴ *Id.* at 1338-40.

support the holding that the chargeback there was lawful.⁸⁵ By contrast, *Koehl* held that Section 224 rendered the chargeback system at issue lawful even if it otherwise violated Section 221.⁸⁶

To support that conclusion, the court interpreted Section 224 as saving a chargeback system where (1) the chargeback is authorized in writing; and (2) the compensation system includes base pay (i.e., a “standard wage”) that is not subject to the chargeback.⁸⁷ If that is indeed the proper meaning of “standard wage,” then employers should be able to defend existing chargeback systems as long as the employees have acknowledged the system in writing and the chargeback is taken only from incentive pay that is paid over and above a base wage.

The *Koehl* court also held that the chargeback at issue was not unconscionable. The court noted that there was no element of unfair surprise given that the chargeback system was common in the industry and was clearly disclosed to the employees. Furthermore, given that the employees had a continuing duty to service the customers, there was a valid basis for the employer to hold them responsible for customers canceling internet service in the first three months.⁸⁸

Although the California Supreme Court denied review to both the *Steinhebel* and *Koehl* decisions, it implicitly approved of those decisions in its *Ralphs II* opinion. In discussing the limited scope of Section 221, the California Supreme Court cited *Steinhebel* and *Koehl* with approval, effectively strengthening them as precedents.⁸⁹

In 2012, the California Court of Appeal went even further than *Steinhebel* with its decision in *Deleon v. Verizon Wireless, LLC*.⁹⁰ In *Deleon*, the court ruled that a commission advance is not a wage, because all conditions for performance have not been satisfied; accordingly, Verizon’s chargeback provisions did not violate Section 221.⁹¹ The *Deleon* court also held that an employee does not have to sign an acknowledgement of a compensation plan in order to be bound by its terms, as in

⁸⁵ *Steinhebel*, 126 Cal. App. 4th at 707.

⁸⁶ *Koehl*, 142 Cal. App. 4th at 1337-38.

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ *Ralphs II*, 42 Cal. 4th at 220.

⁹⁰ 207 Cal. App. 4th 800 (2012).

⁹¹ *Deleon*, 207 Cal. App. 4th at 809-10.

Steinhebel: rather an employee's continued employment can constitute acceptance of those terms.⁹²

IV. Reimbursement of Employee Expenses

A. The Duty to Reimburse Expenses Under Labor Code Section 2802

Labor Code Section 2802 requires an employer to “indemnify” its employees for “all necessary expenditures incurred” in the course of their employment. This provision has been in effect since 1937, and over the next sixty-plus years, litigation over Section 2802 focused almost exclusively on seeking “indemnification” from the employer in the narrow insurance-context sense of the word—to reimburse (another) for a loss suffered because of a third party's act or default.”⁹³

Plaintiffs have attempted to use Section 2802 as a vehicle to obtain reimbursement of routine business expenses that employees incur in the course of their duties—such as driving a car or talking on a cell phone. Before 2005, all the published cases under Section 2802 involved circumstances where an employee sought to have the employer pay the cost of tools or equipment lost or damaged on the job,⁹⁴ or to indemnify the employee for the cost of legal counsel the employee incurred in defending a claim based on the employee's performance of job duties.⁹⁵ But in November 2007, the California Supreme Court in *Gattuso v. Harte-Hanks Shoppers, Inc.*⁹⁶ assumed (without deciding) that Section 2802 does indeed require the reimbursement of necessary business expenses.

⁹² *Id.* at 812 (“[A] signed acknowledgement that the employee read, understood and agreed to the compensation plan as was the case in *Steinhebel* and *Koehl*, is not the only form of assent under contract law.”).

⁹³ BLACK'S LAW DICTIONARY, 342 (2d pocket ed. 2001).

⁹⁴ See, e.g., *Machinists Auto. Trades v. Utility Trailers Sales*, 141 Cal. App. 3d 80 (1983) (mechanic entitled to indemnification for loss of his tools from employer's premises in a burglary when employer required that employee have tools and leave them on employer's premises); *Earll v. McCoy*, 116 Cal. App. 2d 44 (1953) (employee not entitled to reimbursement under Section 2802 for tools lost in a fire on employer's premises when employee was not required to leave tools at the place of employment).

⁹⁵ See, e.g., *Jacobus v. Krambo Corp.*, 78 Cal. App. 4th 1096 (2000) (expenses employee incurred in successful defense against sex harassment allegations); *Devereaux v. Latham & Watkins*, 32 Cal. App. 4th 1571 (1995) (expenses incurred by employee in connection with her depositions in two actions brought by third parties against her employer); *Grissom v. Vons Companies, Inc.*, 1 Cal. App. 4th 52 (1991) (expenses incurred by employee in defending third party lawsuit arising out of auto accident that occurred during course and scope of employee's employment; employee who retained his own counsel after employer provided counsel is due reimbursement for attorney's fees incurred because retention of separate counsel was deemed necessary); *Douglas v. Los Angeles Herald-Examiner*, 50 Cal. App. 3d 449 (1975) (expenses incurred by employee in defending lawsuit filed as a result of services rendered by employee in course and scope of employment).

⁹⁶ 42 Cal. 4th 554 (2007) (noting the issue was not before the Court).

The most common targets for Section 2802 class actions are businesses employing large numbers of outside salespersons who are paid on straight commission. Many such businesses encourage their salespeople to make sales calls and to entertain clients to generate business. In addition, many such salespeople are constantly using cell phones because they are on the road often and lack an office. Many businesses believe that these expenses are self-reimbursing in that employees incur expenses to generate more sales, which generate more commissions, thereby covering those higher expenses.

Before *Gattuso*, the law was unclear on how the employer could satisfy its duty to reimburse necessary expenses. The plaintiff in *Gattuso* argued that with respect to business mileage, the employer had to allow employees to submit expense reports and then reimburse the employees at the IRS mileage rate. By contrast, the defendant argued that Section 2802 allows any method to reimburse employee expenses so long as the employer does, in fact, reimburse the employee for the full value of all expenses necessarily incurred on the job.

The California Supreme Court largely sided with the defendant. The Court agreed that an employer could choose among various alternative methods to reimburse employee mileage, including (1) tracking the actual costs to the employee for necessary fuel, insurance, depreciation, and service, and reimbursing that amount; (2) paying the employee a lump sum payment each month so long as the lump sum actually covered all necessary mileage expenses; (3) paying a per-mile rate, such as the IRS mileage rate; or (4) increasing the salespersons' commission rate with the extra commissions being devoted to cover the employees' expenses.⁹⁷

The California Supreme Court did set some limits, however. For one, the Court held that, pursuant to Labor Code Section 2804, the employer and employee could not agree to waive the right to reimbursement, so the employee was entitled to reimbursement of all necessary expenses. As such, if an employer offered a fixed expense allowance or an enhanced commission rate, the employer would violate Section 2802 to the extent that payment did not, in fact, cover all the employee's necessary expenses.⁹⁸

The Court also established a requirement that the employer must communicate to the employees to the extent any portion of the employees' wages is intended to be devoted to expense reimbursement. For example, if two percentage points of a 10 percent commission is intended to cover expenses, the Court suggested that the employer would have to make this fact known to employees to comply with Section 2802. The Court also stated that, going forward, the employer would be required to identify the portion of the

⁹⁷ *Gattuso*, 42 Cal. 4th at 568-71, 574.

⁹⁸ *Id.* at 570-71.

wage payments that was allocated to expenses on the employees' itemized wage statements (required under Labor Code Section 226(a)).⁹⁹

Although the Court clarified that only necessary expenses require reimbursement—as opposed to any expense that is incurred in the course of performing work—the Court did not provide much detailed guidance on how to distinguish a necessary expense from an unnecessary one. In discussing how an employer and employee would decide whether mileage expenses were truly necessary, however, the Court suggested that it would be an individualized inquiry that could vary markedly from one employee to another:

In calculating the reimbursement amount due under Section 2802, the employer may consider not only the actual expenses that the employee incurred, but also whether each of those expenses was “necessary,” which in turn depends on the reasonableness of the employee’s choices.

For example, an employee’s choice of automobile will significantly affect the costs incurred. An employee who chooses an expensive model and replaces it frequently will incur substantially greater depreciation costs than an employee who chooses a lower priced model and replaces it less frequently. Similarly, some vehicles use substantially more fuel or require more frequent or more costly maintenance and repairs than others. The choice of vehicle will also affect insurance costs. Other employee choices, such as the brand and grade of gasoline or tires and the shop performing maintenance and repairs, will also affect the actual costs.¹⁰⁰

Separate from *Gattuso*, another decision issued in 2007 held that the employer has a duty to reimburse for employee business expenses. In *Estrada v. FedEx Ground Package System, Inc.*,¹⁰¹ three drivers brought a class action against FedEx, contending that for the limited purpose of their entitlement to reimbursement for work-related expenses, they were employees, not independent contractors, and thus were entitled to reimbursement of business expenses under Section 2802. Although FedEx maintained that payments it made as part of its operating agreement with the drivers provided reasonable compensation for expenses, the trial court disagreed and ordered FedEx to pay \$5.3 million for under-reimbursed expenses.

The Court of Appeal affirmed in part and reversed in part. The court affirmed the trial court’s central finding that the drivers were employees for purposes of Section 2802 and that FedEx had failed to indemnify the drivers fully for their business expenses as required

⁹⁹ *Id.* at 574 n.6, 575-76.

¹⁰⁰ *Gattuso*, 42 Cal. 4th at 568.

¹⁰¹ 154 Cal. App. 4th 1 (2007).

by Section 2802. The Court of Appeal held that although the drivers were entitled to recover their out-of-pocket expenses and work accident insurance premiums, they were not entitled to reimbursement for the cost of purchasing trucks to perform the job. In essence, the court held that an employer may require employees to furnish their own cars to perform a job without indemnifying the employees for the cost of such purchases. The court's reasoning also suggested that employers may be allowed to require employees to purchase other items as a pre-condition of employment, such as cell phones or computers, and that the requirement to furnish such items as a condition of employment does not violate the reimbursement requirements of Section 2802.¹⁰²

B. Reimbursement for Uniforms Under the Wage Orders

Separate from Section 2802, several Wage Orders state that when uniforms, tools, or equipment are required by the employer, or necessary to perform the job duties, they must be provided by the employer.¹⁰³ For example, employees may be required to wear a company's logo shirt while on duty. The Wage Orders define "uniform" to include "apparel or accessories of distinctive design or color."¹⁰⁴ The IWC has explained, however, that the employer's obligation to pay for uniforms does not require the employer to pay for an employee's work clothes when the employee has only a broadly-defined dress code, such as a dark suit and a tie for lawyers.¹⁰⁵

Due to the ambiguity in the meaning of "uniform," class actions have been brought alleging that employers must purchase clothing that arguably constitutes de facto "uniforms." In one case, the DLSE instituted an action (and obtained a sizeable settlement) based on allegations that a dress code consisting of a blue shirt and tan or khaki pants constituted a uniform.¹⁰⁶ Also, some retailers have been sued for requiring sales associates to purchase and wear the employer's clothing products.¹⁰⁷

¹⁰² DLSE Bulletin 84-7 states that "an applicant for employment may be required, as a condition of employment, to furnish his [] own automobile or truck to be used in the course of employment, regardless of the amount of wages paid." Under Section 2802, "an employer who requires an employee to furnish his [] own car or truck to be used in the course of employment would be obligated to reimburse the employee for the costs necessarily incurred by the employee in using the car or truck in the course of employment."

¹⁰³ See, e.g., Wage Order 7-2001 § 9.

¹⁰⁴ See, e.g., Wage Order 7-2001 § 9(A).

¹⁰⁵ See IWC Order No. 4-98, Statement as to Basis (stating that employers may "specify basic wardrobe items which are usual and generally usable in the occupation, such as white shirts, dark pants and black shoes and belts" and may require the employees to bear the expense of such items"); DLSE Enforcement Policies and Interpretations Manual (2002 Update) ("DLSE Manual") § 45.5.2. (stating same).

¹⁰⁶ *Dep't of Indus. Relations v. UI Video*, 55 Cal. App. 4th 1084, 1088 (1997) (Blockbuster Video settled action brought by DLSE alleging that dress code requirements for its 1,914 employees violated Section 9(A) of Wage Order 7).

¹⁰⁷ Such a policy might also violate Labor Code Section 450, which precludes an employer from forcing an employee to patronize the employer or to purchase a thing of value from a particular vendor.

Certain Wage Orders provide that work uniforms must also be “maintained” by employers.¹⁰⁸ In *O’Connor v. Starbucks Corp.*,¹⁰⁹ the plaintiff brought a putative class action on behalf of Starbucks employees to recover the cost of cleaning aprons issued by the company. Starbucks provided that workers were responsible for maintaining and laundering their own aprons. The plaintiff had taken his apron to a laundry service where, pursuant to the recommendation of the owner, the apron had been dry cleaned in order to avoid bleeding of the color. The district court, relying on the IWC’s written statements interpreting the Wage Orders, found the relevant question to be whether the aprons required only “minimal care” or if they required “special laundering because of heavy soil or color.” If only minimal care of the aprons was necessary, Starbucks could legitimately have placed this obligation on its employees. The district court granted summary judgment in favor of Starbucks, finding that there was no evidence that the aprons required special laundering. The court found that the opinion of the proprietor of the one laundry service to which the plaintiff had taken his apron was insufficient to establish his claim.

V. Meal and Rest Period Claims

A. Nature of Claims

Since January 1, 2001, the Labor Code has imposed on employers a duty to provide employees one additional hour of pay for each daily violation of the meal and rest period requirements of the Wage Orders. The enactment of this rule triggered a massive wave of class actions against hundreds of employers in California. Most notably, in December 2005 a jury in Alameda County awarded a class \$172 million in a meal period lawsuit against Wal-Mart.¹¹⁰

Labor Code Section 512 requires employers to “provide” an employee with a thirty-minute off-duty meal period on every day in which the employee works more than five hours.¹¹¹ The IWC Wage Order does not use the word “provide,” but states that an employer is not to employ a person for a work period exceeding five hours without a meal period. An employee who works no more than six hours in one day may waive the thirty-minute unpaid meal period, with the mutual consent of the employer.¹¹² An employee who works more than ten hours in one day must be provided a second thirty-minute meal period, although that second meal period can be waived if the employee works no more than twelve hours in

¹⁰⁸ See, e.g., IWC Wage Order 7-2001 § 9(A).

¹⁰⁹ 2008 U.S. Dist. LEXIS 53877 (N.D. Cal. Jul. 14, 2008)

¹¹⁰ *Savaglio v. Wal-Mart Stores*, No. S152827, 2007 Cal. LEXIS 7293 (Cal. Jul. 11, 2007) (Dec. 22, 2005 verdict). The verdict included an award of \$115 million in punitive damages.

¹¹¹ See, e.g., Wage Order 7-2001 § 11(A).

¹¹² *Id.*

a day and has not waived the first meal period.¹¹³ During a break that qualifies as a meal period, the employee must be relieved of all work duties.¹¹⁴

The Wage Orders also require an employer to allow employees to take paid rest breaks. This requirement is somewhat different than the meal period requirement in that nothing in the Wage Orders or the Labor Code restricts employees from voluntarily waiving their rights to rest periods. Waiver issues aside, Section 12(A) of the Wage Orders requires employers to allow employees a paid, ten-minute rest period for every four hours worked, or major portion thereof.

No rest break is required unless an employee works three and one-half hours in a workday.¹¹⁵ Employees are entitled to 10 minutes rest for shifts from three and one-half to six hours in length, 20 minutes for shifts of more than six hours up to 10 hours, and 30 minutes for shifts of more than 10 hours up to 14 hours.¹¹⁶ Employers normally must provide rest breaks near the middle of each four hour work period, but need not provide a rest period before the first meal period.¹¹⁷ Rest breaks, unlike meal periods, are not subject to any requirement that the employer keeps records.

For each workday the employer fails to provide an employee with a required thirty-minute meal period or ten-minute rest break, the employee is entitled to recover one hour of pay at the employee's regular rate.¹¹⁸ Although the statute is unclear on how failure to provide multiple required meal or rest periods in a single day is punished, the DLSE has taken the position that one penalty for missed meal periods and one penalty for denied rest periods may be imposed per workday.¹¹⁹ In 2009, a federal district court in *Marlo v. United Parcel Service*¹²⁰ analyzed the issue and agreed that an employee could recover both a meal period and a rest period penalty in the same workday.¹²¹ However, the court determined that an employee can recover penalty pay for only one meal and only one rest period violation per day, even if the employee were to miss two meal periods or two rest periods.¹²² This decision runs counter to an earlier district court decision that had

¹¹³ Lab. Code § 512(a).

¹¹⁴ Wage Order 7-2001 § 11(A).

¹¹⁵ See, e.g., Wage Order 7-2001 § 12(A).

¹¹⁶ *Brinker Restaurant Corp. v. Superior Court*, 53 Cal. 4th 1004, 1029 (2012).

¹¹⁷ *Id.* at 1031-32.

¹¹⁸ Lab. Code § 226.7. See, e.g., Wage Order 7-2001 §§ 11(D) and 12(B).

¹¹⁹ DLSE Manual § 45.2.8 and 45.3.7.

¹²⁰ 2009 WL 1258491 (C.D. Cal 2009).

¹²¹ *Id.* at *7.

¹²² *Id.*

decided—in a less detailed analysis—that an employee could recover penalty pay for only one violation per day, even if the employee were denied both meal and rest periods in the same workday.¹²³

In 2011, the California Court of Appeal agreed with *Marlo* in deciding *United Parcel Service, Inc. v. Superior Court*.¹²⁴ There, the court noted that the legislative history demonstrated that Section 226.7 was specifically drafted to conform to the IWC wage orders.¹²⁵ Because the wage orders “provide[] a separate remedy for violations of meal period requirements and violations of rest period requirements . . . up to two premium payments are allowed per work day.”¹²⁶ Therefore, it appears that this issue has finally been settled.

Many employers fail to maintain records that comprehensively establish that employees in fact took their meal and rest periods. This is especially the case when an employer has mistakenly classified a position as exempt, because employers are not required to keep time records for employees covered by the most common exemptions (administrative, executive, and professional). Section 7 of the Wage Orders requires employers to record meal periods of non-exempt employees, and the DLSE generally takes the position that in the absence of records proving that meal periods were taken, the employees are presumed not to have taken them (although the presumption is rebuttable). In addition, employees may deny they took meal breaks that they actually took if the employer has not enforced a requirement that they document such breaks.

Accordingly, when recordkeeping has been poor, these cases have been more difficult to defend, and numerous meal period class actions have been filed. With respect to rest breaks, by contrast, employers need only authorize such breaks; the law is clear that employee may waive them or that employers need not record the ones they take. For these reasons, successful rest break class actions are less common.¹²⁷

B. Debate over Whether One-Hour Payment Is a “Penalty”

Labor Code Section 226.7, which went into effect January 1, 2001, requires any employer who fails to provide meal or rest periods, as required by the governing Wage Order, to pay the employee one hour of pay at the employee’s regular rate. From the enactment of

¹²³ *Corder v. Houston’s Restaurants, Inc.*, 424 F. Supp. 2d 1205, 1207 n.2 (C.D. Cal. 2006) (“Section 226.7(b) states that the employer is liable ‘for each work day’ that a break is not provided. Thus, the plain wording of the statute is clear that an employer is liable per work day, rather than per break not provided.”).

¹²⁴ 196 Cal. App. 4th 57 (2011).

¹²⁵ *Id.* at 67-8.

¹²⁶ *Id.* at 68.

¹²⁷ Such actions also may require individualized inquiries into whether given employees understood they could take a rest break and why they failed to do so.

Section 226.7 until the California Supreme Court resolved the issue against employers on April 16, 2007, the most hotly disputed issue within the meal and rest period cases was whether the one hour of pay required by Section 226.7 is a penalty or a compensatory wage.

Although the question of whether the payment constitutes a penalty or a wage may seem arcane, construing the payment as a penalty would drastically reduce the employer's exposure for a meal period class action—sometimes by more than 75 percent—for the following reasons:

- The statute of limitations would be reduced to one year only.¹²⁸
- The penalties could not be recovered under the Unfair Competition Law, thus precluding using the UCL to extend the statute of limitations to four years.¹²⁹
- Waiting time penalty liability could not arise from meal period violations, as such penalties only arise from failures to pay wages.¹³⁰
- Arguably, no additional \$100-per-pay-period penalty would be recoverable under the Labor Code Private Attorney General Act of 2004 (“PAGA”).¹³¹
- A prevailing plaintiff would not be entitled to attorney's fees under Labor Code Section 218.5.¹³²
- The employee would not be entitled to prejudgment interest under Labor Code Section 218.6.¹³³

In 2007, in a decision that surprised many in the wage and hour community, the California Supreme Court held *unanimously* that Section 226.7 provides for “a wage or premium pay”

¹²⁸ Compare Code Civ. Proc. § 340 (one-year statute for penalty claims) with Code Civ. Proc. § 338(a) (three-year statute for an action upon a claim of liability created by a statute other than a penalty or forfeiture).

¹²⁹ See *Cel-Tech Commc'ns, Inc. v. Los Angeles Cellular Tel. Co.*, 20 Cal. 4th 163, 179 (1999) (plaintiff may not recover penalty of “treble damages” through UCL action); Bus. & Prof. Code § 17206 (penalties recoverable only in action brought by the actual attorney general).

¹³⁰ Lab. Code § 203 (penalties recovered for failure to pay promptly all wages owed to employees who quit or are discharged).

¹³¹ Lab. Code § 2698, *et seq.*, discussed *infra* in Section X. *But see Caliber Bodyworks v. Superior Court*, 134 Cal. App. 4th 365, 377 (2005) (suggesting that penalties recoverable by individuals independent of PAGA are not civil penalties, which would allow recovery of a separate civil penalty for violations of Labor Code Section 226.7 even if the one-hour-of-pay requirement is a penalty).

¹³² Lab. Code § 218.5 (attorney's fees available for actions to recover wages).

¹³³ *Cf.* Lab. Code § 218.6 (statutory pre-judgment interest recoverable in action for wages).

rather than a penalty.¹³⁴ Although the decision definitively decided that the statute of limitations on a Section 226.7 claim is three years, the decision left open several other issues of meal period law:

- Whether the meal must be provided within the first five hours of an employee's shift and after any additional stint when an employee is required to work for more than five hours; and
- Whether an employer who gives an employee an opportunity to take an off-duty meal period is nonetheless liable for "premium pay" when the employee voluntarily opts not to take the meal period.

C. Meaning of "Provide" a Meal Period

Following the Supreme Court's ruling in *Murphy v. Kenneth Cole*, the most hotly debated issue in meal period law has been whether the employer complies with its duty to "provide" a meal period by making the meal period available for employees to take, or whether the employer is liable whenever it fails to mandate its employees to go off duty for an uninterrupted thirty-minute meal break.

The implications are significant for class actions because it is much more difficult for plaintiffs to argue that common issues predominate in a case if the employer can defend itself merely by establishing that individual employees have had a bona fide opportunity to take a meal break. By contrast, under the "mandatory" interpretations, the employer is very limited in its ability to raise individualized issues as to why the employees failed to take their meal breaks. If they failed to do so a jury could assess on a collective basis whether the employer made sufficient efforts to force them to take the meal period and enter a verdict for the class if the employer's efforts were inadequate.

Aside from the issue of class action liability, a "mandatory" interpretation would also require employers to overhaul oversight of employee meal breaks. In order to comply with the law, employers would have to implement systems to ensure employees take full thirty-minute breaks. Employers would need to upgrade timekeeping systems and even discipline employees for not taking full meal periods. Without oversight, opportunistic employees might take short breaks and then later claim an hour's worth of pay, because the breaks did not last the mandated thirty minutes.

For years, the only published California decision to address the issue was *Cicairos v. Summit Logistics, Inc.*¹³⁵ The *Cicairos* decision held that an employer has an "affirmative

¹³⁴ *Murphy v. Kenneth Cole Prods.*, 40 Cal. 4th 1094 (2007).

¹³⁵ 133 Cal. App. 4th 949 (2005).

obligation to ensure that workers are actually relieved of all duty” by taking a meal break. The *Cicairos* court further held that an employer cannot simply “assum[e] that the meal periods are taken.”¹³⁶ The court suggested that the standard for meal periods was akin to the standard of when an employer must pay overtime—i.e., when it either suffered or permitted the employee to work. The court found that the defendant did not “provide” meal breaks, because the plaintiff-truckers were deprived of a meaningful ability to elect to take breaks due to pressure from management to maximize deliveries, the lack of a companywide policy on meal periods, and the fact that the plaintiffs would be penalized for taking meal breaks as the timekeeping system was unable to record meal breaks.¹³⁷

The *Cicairos* court did not define the scope of “relieving employees of all duty” and the term is subject to multiple possible interpretations. What if the employer scheduled a period each day within which the employee was told that he or she had no duty to perform any work? That sounds like it amounts to “relieving” the employee of duty, and an employee who chooses to work in that situation would have no claim for meal period penalty pay. What if the employee worked without supervision, the employer instructed the employee to take meal periods, and the employee failed to notify the employer that he had skipped meal breaks? These facts would seem to indicate that the employer neither “suffered nor permitted” the employee to work through the missed meal break, which could plausibly exonerate the employer.¹³⁸ On the other hand, “relieving of duty” could mean actually forcing the employee not to do any work. Unfortunately, *Cicairos* did not clarify this confusion and the facts of the case did not involve a situation where the employees were given a genuine opportunity to take a meal break but voluntarily declined to do so. Rather, the employees argued that they were not informed they were permitted to take meal breaks and, moreover, they had no way to record time as a break on the timekeeping system.

Employers breathed a sigh of relief when, in July 2008, the Fourth District Court of Appeal issued its decision in *Brinker Restaurant Corporation v. Superior Court*,¹³⁹ which concerned a putative class of hourly restaurant employees who contended they had not been provided with meal and rest periods.¹⁴⁰ The plaintiffs claimed that employers were required to ensure that employees took their meal breaks, to provide meal breaks as close as possible to the middle of each shift, and to provide a meal break for each five-hour block of time on a “rolling” basis. The trial court had certified a class on these claims, without first deciding

¹³⁶ *Id.* at 962.

¹³⁷ *Id.* at 964.

¹³⁸ *Forrester v. Roth's I.G.A. Foodliner, Inc.*, 646 F.2d 413, 414-14 (9th Cir. 1981) (“where the acts of an employee prevent an employer from acquiring knowledge, here of alleged uncompensated overtime hours, the employer cannot be said to have suffered or permitted the employee to work”).

¹³⁹ *Previously published at* 165 Cal. App. 4th 25 (2008).

¹⁴⁰ The complaint also alleged a claim for working “off the clock.”

any relevant legal issue, such as whether employers were required to mandate meal breaks. Instead, the trial court stated that this was a common legal issue to be decided on a classwide basis following certification.

The court of appeal reversed the trial court, holding that it was an abuse of discretion for the trial court to fail to determine the legal elements of the plaintiffs' claims in ruling on class certification. The court held that employers need only make meal periods available to employees, which rendered the plaintiffs' claims unsuitable for class adjudication because it would be necessary to determine on a case-by-case basis whether each employee was actually denied meal breaks (company policy clearly provided for meal periods).¹⁴¹ The court of appeal also distinguished *Cicairos*, essentially limiting that case to its peculiar facts.

Fresh on the heels of the *Brinker* decision, employers seemed to score another victory when the Second District Court of Appeal issued its decision in *Brinkley v. Public Storage, Inc.*¹⁴² In *Brinkley*, the plaintiff brought claims on behalf of a putative class of property managers, alleging, among other things,¹⁴³ that Public Storage violated Labor Code Section 226.7 by failing to provide meal periods within the first five hours of each shift, and by failing to ensure that its employees actually took meal breaks. The trial court granted summary adjudication as to the meal period claim, and the plaintiff appealed.

The appellate court upheld the trial court's grant of summary adjudication. As to the meal period claim, the court held that employers need only provide employees with an opportunity to take meal breaks; they are not obligated to mandate such breaks. The court distinguished *Cicairos* by noting that the employer in that case "managed and scheduled the [employees] in such a way that prevented [them] from taking their meal periods," which amounted to an active denial of the employees' right to such breaks. The court also held that employers need not provide meal periods within the first five hours of work, but rather *after* five hours.¹⁴⁴

¹⁴¹ The court also determined that: (1) employers are not required to provide a meal period during every block of five consecutive hours worked, and therefore the defendant's policy of sometimes providing meal periods early in employees' shifts was not improper; (2) employers need only provide rest breaks, not mandate them; (3) employers are only required to provide one rest period per four hours worked or "major fraction thereof," with the "major fraction thereof" meaning between three and one-half to four hours; (4) rest breaks are not required to be in the middle of each four-hour work period where that would be impracticable; and (5) employers may be liable for employees working "off the clock" only where the employer knew or should have known about such work being performed.

¹⁴² *Previously published at* 167 Cal. App. 4th 1278 (2008).

¹⁴³ The plaintiff also brought claims for pay stub and rest period violations.

¹⁴⁴ The court of appeal also affirmed summary adjudication as to the itemized wage statement and rest break claims, but those portions of the decision were vacated upon the grant of review.

These victories were short-lived, as the California Supreme Court granted review of both *Brinker* and *Brinkley* in 2008. For nearly four years thereafter, the law was unsettled as the Supreme Court wrestled with these two cases.

Rather than wait for those decisions, the California Court of Appeal decided to tell employers its view of the applicable legal standard. In October 2010, the court affirmed the trial court's decision in *Hernandez v. Chipotle Mexican Grill, Inc.* and held that Labor Code § 226.7(a) states that employers must make meal and rest periods *available, not ensure* that they are taken.¹⁴⁵ The court stressed that “provide” means “to supply or make available” and that enforcement of meal breaks would place undue burden on large employers and create perverse incentives for employees to receive extra compensation under the wage & hour laws.¹⁴⁶ The court also distinguished *Cicairos*, on the ground that there the employer effectively precluded its employees from taking their meal and rest periods.¹⁴⁷ However, the California Supreme Court also granted review in *Hernandez* pending its decision in *Brinker*, making *Hernandez* unciteable.¹⁴⁸ However, around this time at least seven federal decisions were issued that also held that an employer's duty to “provide” a meal period is to make it available and that meal period claims based on a mere failure to ensure employees took meal periods are unsuitable for class certification.¹⁴⁹

Finally, on April 12, 2012, the Supreme Court issued its decision in *Brinker*.¹⁵⁰ The opinion was mostly favorable to employers, holding—as expected—that employees need not be forcibly prevented from working through their lunch breaks in order to be properly “provided” with a meal period. The Court stated that “an employer must relieve the

¹⁴⁵ *Hernandez v. Chipotle Mexican Grill, Inc.*, 118 Cal. Rptr. 3d 110 (2010), *transferred following review*, 208 Cal. App. 4th 1487 (2012), *rev. denied, depublished*; see also *In re Lamps Plus Overtime Cases*, 195 Cal. App. 4th 389 (2011), (holding employers need not ensure meal periods be taken), *transferred following review*, 209 Cal. App. 4th 35 (2012), *rev. denied, depublished*.

¹⁴⁶ *Hernandez*, 118 Cal. Rptr. 3d at 118-19.

¹⁴⁷ *Id.* at 119.

¹⁴⁸ The Court of Appeal reached the same conclusion in *Tien v. Tenet Healthcare*, 192 Cal. App. 4th 1055 (2011), *transferred following review*, 209 Cal. App. 4th 1077 (2012), *Rev. denied, depublished*.

¹⁴⁹ See *White v. Starbucks Corp.*, 497 F. Supp. 2d 1080 (N.D. Cal. 2007) (cited in *Brinker*; first published decision to hold “provide” means “make available.”); *Brown v. Federal Express Corp.*, 249 F.R.D. 580, 585-86 (C.D. Cal. 2008) (“Requiring enforcement of meal breaks would place an undue burden on employers whose employees are numerous or who . . . do not appear to remain in contact with the employer during the day.”); *Kenny v. Supercuts, Inc.*, 252 F.R.D. 641, 645-46 (N.D. Cal. Jun. 2, 2008) (“[The Labor Code] does not require an employer to ensure that an employee take a meal break.”); *Salazar v. Avis Budget Group, Inc.*, 251 F.R.D. 529, 533 (S.D. Cal. 2008) (“The Court agrees with the compelling reasons advanced by the *White*, *Brown*, and *Kenny* decisions for interpreting ‘provide’ to mean ‘make available’ rather than ‘ensure taken.’”); *Kohler v. Hyatt Corp.*, No. EDCV 07-782-VAP (CWx), 2008 U.S. Dist. LEXIS 63392, at *18 (C.D. Cal. Jul 23, 2008) (“An employee must show that he was forced to forego his meal breaks, as opposed to merely showing that he did not take them regardless of the reason.”); *Nguyen v. Baxter Healthcare Corp.*, 2011 WL 6018284 (C.D. Cal., Nov. 28, 2011) (noting that employers only need to make meal periods available to employees and that posting a copy of the Wage Order was sufficient to advise employees of that right).

¹⁵⁰ *Brinker Restaurant Corp.*, 53 Cal.4th 1004 (2012).

employee of all duty for the designated period, but need not ensure that the employee does no work.”¹⁵¹ “Indeed, the obligation to ensure employees do no work may in some instances be inconsistent with the fundamental employer obligations associated with a meal break: to relieve the employee of all duty and relinquish any employer control over the employee and how he or she spends the time.”¹⁵² Furthermore, if an employee who is properly relieved of all duty decides to continue working anyway, the employer will *not* be liable for payment of one hour of penalty pay, and will be liable to pay straight-time pay only if it “knew or reasonably should have known that the worker was working through the authorized meal period.”¹⁵³

The Court did find, however, that employers must provide meal periods “after no more than five hours of work, and a second meal period after no more than 10 hours of work.”¹⁵⁴ This would mean that, for example, an employee who starts work at 9 a.m. would need to be provided a lunch break beginning by no later than 2 p.m., or else the employer would be liable for one hour of premium wages. However, it would also seem that the employee could voluntarily decide to take meal breaks later on in the work day, as long as they were made available in a timely manner. The Court rejected the plaintiffs’ contention that a meal break must be provided during every “rolling” 5-hour block of work time, and thus held that employers can provide meal breaks quite early in the work day.¹⁵⁵

Following the issuance of its decision in *Brinker*, the Supreme Court remanded to the Court of Appeals three other meal break class actions for which it had granted review pending issuance of a ruling in *Brinker: Flores v. Lamps Plus*,¹⁵⁶ *Tien v. Tenet Healthcare*¹⁵⁷ and *Hernandez v. Chipotle Mexican Grill*.¹⁵⁸ Employers rejoiced when the Court of Appeal, Second District, Division Eight, quickly issued opinions in each of these cases affirming denial of certification, citing to *Brinker*.¹⁵⁹ This jubilation was short-lived, however. The

¹⁵¹ *Id.* at 1034. The Court of Appeal in *Brinkley* reached the same conclusion in an unpublished decision issued after *Brinker*. *Brinkley v. Public Storage, Inc.*, 2012 WL 3126606, at *5 (Aug. 2, 2012) (“[An employer’s obligation is to relieve its employee of all duty, with the employee thereafter at liberty to use the meal period for whatever purpose he or she desires, but the employer need not ensure that no work is done.”). The *Brinkley* court also held that an employer not need not ensure that an employee take rest periods. *Id.* at *6 (“California law does not require an employer to ensure that employees take rest periods.”).

¹⁵² *Id.* at 1038-39 (citing *Morillion v. Royal Packing Co.*, 22 Cal 4th 575, 584-585 (2000)).

¹⁵³ *Id.* at 1039-40 n.19 (quoting DLSE Opinion Letter No. 1991.06.03).

¹⁵⁴ *Id.* at 1049.

¹⁵⁵ *Id.* at 1048.

¹⁵⁶ 195 Cal. App. 4th 389 (2011).

¹⁵⁷ 192 Cal. App. 4th 1055 (2011).

¹⁵⁸ 118 Cal. Rptr. 3d 110 (2010).

¹⁵⁹ *Tien*, 209 Cal. App. 4th 1077 (2012); *Lamps Plus*, 209 Cal. App. 4th 35 (2012); *Hernandez*, 208 Cal. App. 4th 1487 (2012).

plaintiffs in these cases all petitioned the Supreme Court for review, and while these petitions were all denied, the Supreme Court took the unusual step of depublishing each of these opinions.

The Supreme Court did not provide any reason for its decision to depublish these cases, and employers are nervous that this may be a signal that the Court is reconsidering its holding in *Brinker*, or that it intends *Brinker* to have a very narrow application. Clues to the Court's reasoning may lie within the petitions for review filed by the plaintiffs in these cases. Among other arguments, in each petition the plaintiffs argued that the Court of Appeal had simply tacked on some language paying lip-service to *Brinker* to the earlier opinion, while leaving intact discussion that the plaintiffs argued ran contrary to *Brinker*.¹⁶⁰ Specifically, each petition asserted that the Court of Appeal had erred in supposedly stating that an employer could “provide” lawful meal periods by having a policy making lawful meal periods available to employees, while the Court in *Brinker* had stated that employees must affirmatively be “relieved of all duty” and that practices that discouraged or prevented employees from taking meal periods were improper.¹⁶¹ In any event, the fact that the Court declined review of these cases indicates that it likely agreed with the end result, but may have felt that some of the reasoning did not completely fit with *Brinker*.¹⁶² Employers should therefore continue to assert that *Brinker* precludes certification of meal period claims except in the most clear-cut cases where workers are uniformly prevented from taking their meal breaks.

D. Limits on IWC's Power to Alter Labor Code Meal Period Rules

Effective September 19, 2000, before Labor Code Section 226.7 went into effect, the California Legislature amended Labor Code Section 516. As amended, the statute provides that the IWC may adopt or amend Wage Orders with respect to break periods and meal periods “except as provided in Section 512.” On its face, this language would seem to limit the IWC's authority to adopt or to amend Wage Orders in such a way as to be inconsistent with the specific provisions of Labor Code Section 512.

In 2006, in *Bearden v. U.S. Borax, Inc.*,¹⁶³ the Second District Court of Appeal held that Section 516 invalidated provisions of IWC Wage Order No. 16 on the ground that the Wage

¹⁶⁰ *Tien* petition, 2012 WL 6608787; *Lamps Plus* petition, 2012 WL 5868726; *Hernandez* petition, 2012 WL 5392867.

¹⁶¹ *Id.*, *Tien* petition at *16-18; *Lamps Plus* petition at *9-11; *Hernandez* petition at *

¹⁶² The plaintiffs in *Tien*, *Lamps Plus* and *Hernandez* also argued that Justice Werdegar's concurring opinion in *Brinker* gave rise to a rule that records showing missed meal periods could establish a rebuttable presumption that these meal periods were unlawfully denied. Because the Supreme Court declined to grant review and consider this issue, thereby leaving the rulings on these cases intact, it seems likely that this argument was *not* the reason for the depublishation. Rather, it seems likely that the Supreme Court felt these decisions reached the correct result, but depublished them due to some concern that the language used by the Court of Appeal did not completely comport with *Brinker* in all respects.

¹⁶³ 128 Cal. App. 4th 429 (2006).

Order was inconsistent with specific meal period regulations within Labor Code Section 512.

By way of background, Section 512 specifies these regulations on meal periods:

- An employer may not employ an employee for a work period of more than five hours per day without providing a meal period of not less than thirty minutes, except the meal period can be waived by mutual consent if the total work period is no more than six hours [§ 512(a)].
- The IWC is empowered to adopt a Wage Order permitting a meal period to commence after six hours of work [§ 512(b)].
- The general rule in Section 512(a) does not apply to certain employees in the wholesale baking industry [§ 512(c)].
- The general rule in Section 512(a) does not apply to certain employees in the broadcasting industry covered by a collective bargaining agreement.

Effective January 1, 2001, the IWC adopted Wage Order 16-2001 covering employees in the construction, drilling, logging, and mining industries. Unlike other Wage Orders, Wage Order 16-2001 includes a collective bargaining exemption to the meal period requirements, which provides that meal period requirements do not apply to employees covered by a collective bargaining agreement that provides for wages, hours of work and working conditions, a regular pay rate at least 30 percent above minimum wage, and premium pay for all overtime hours worked. The defendants argued that this provision exempted them from the normal requirement to provide meal periods.

The *Bearden* court held that this collective bargaining exemption from meal period requirements was invalid because it created a new exemption not recognized in Section 512.¹⁶⁴ The court noted that Section 512 contains specific exemptions from the normal meal period requirement—i.e., when an employee working no more than six hours in a day waives the meal period and under other specified conditions for employees working in the wholesale baking and broadcasting industries.¹⁶⁵ The court reasoned that where the Legislature has set forth specific exemptions in a statute, those exemptions are generally assumed to be exclusive. Proceeding on that premise, the court reasoned that Section 516 forbade the IWC to adopt exemptions beyond those set forth in Section 512.¹⁶⁶ Despite the invalidity of the collective bargaining exemption, the court held that the

¹⁶⁴ *Id.* at 486-88.

¹⁶⁵ *Id.* at 487.

¹⁶⁶ *Id.* at 487-88.

employer could not be held liable for any penalties because Section 226.7 allows for such penalties only when the employer violates an IWC Wage Order, and U.S. Borax had complied with Wage Order 16-2001.¹⁶⁷

VI. Tip-pooling

Labor Code Section 351 makes it unlawful for an “employer or agent” to “collect, take, or receive any gratuity or a part thereof that is paid, given to, or left for an employee by a patron.” In the past, this statute led to two distinct types of class actions on behalf of employees who claim their tips were unlawfully taken. The first type of action alleged that the employees unlawfully were required to share tips with co-workers for whom the patrons did not leave the tips. The second type of action alleged that “agents” of the employer unlawfully took employees’ tips. In 2010, the California Supreme Court held in *Lu v. Hawaiian Gardens Casino, Inc.*¹⁶⁸ that Section 351 does not authorize a private right to sue. Although this decision was certainly a victory for employers, it does not necessarily mean the end of tip-pooling actions.

A. Actions Alleging Tips Were Diverted to Co-Workers Who Did Not Earn Them

In 2006, some twenty separate class action lawsuits were filed in quick succession alleging a claim for “tip-pooling violations” against various restaurants and restaurant chains in California. The underlying theory in the cases was that when a customer leaves a tip for a server at a restaurant table, the employer may not require the server to share the tip with bartenders who do not provide “direct table service” to the customer who left the tip. This alleged prohibition on certain tip-pooling arrangements is purportedly derived from Labor Code Section 351, which bars an employer from “tak[ing], collect[ing] or receiv[ing] any gratuity or a part thereof” left for a server, or from using such tips as a credit against the state minimum wage.

This wave of lawsuits was unexpected, given that a published case from 1990, *Leighton v. Old Heidelberg, Ltd.*,¹⁶⁹ expressly held that Section 351 does **not** preclude tip-pooling among restaurant employees. Moreover, the tip-pooling arrangement approved in *Leighton* required that servers share tips left at the table with both the busboy and the bartender, and there was no suggestion anywhere in the case that the bartender had provided “direct table service.” Nonetheless, the “direct table service” notion derives from one rationale for finding tip-pooling lawful and consistent with public policy:

¹⁶⁷ *Id.* at 493.

¹⁶⁸ 50 Cal. 4th 592 (2010).

¹⁶⁹ 219 Cal. App. 3d 1062 (1990) (emphasis added).

[T]he restaurant business has long accommodated this practice which, through custom and usage, has become an industry policy or standard, a 'house rule and is with nearly all restaurants,' by which the restaurant employer, as part of the operation of his business and to ensure peace and harmony in employee relations, pools and distributes among those employees, **who directly provide table service to a patron**, the gratuity left by him, and enforces that policy as a condition of employment.¹⁷⁰

The plaintiffs in these tip-pooling cases contended this language meant that **only** those who provide direct table service may share in the tip pool. Employers responded by pointing to the fact that *Leighton* approved a pool that included bartenders, and that this gloss on *Leighton* ignores other statements by the court that suggest that its holding was much broader, such as the court's reasoning that (1) the legislative history shows that Section 351 was not intended to address tip-pooling at all, but rather was intended to prevent employers from using tips as a method of paying employees sub-minimum wages; (2) Section 351 makes no mention of tip-pooling among co-workers; and (3) tip-pooling has been around a long time, so the presumption should be that the California Legislature would have been explicit if it had wanted to outlaw the practice.¹⁷¹

A DLSE opinion letter did once suggest that it is inappropriate for an employer to include in the tip pool those employees who do not provide "direct table service."¹⁷² But even that opinion places "bartenders" in the category of employees who provide "direct table service," and notes only dishwashers, cooks, and chefs as examples of employees who should not be included in the tip pool. Moreover, the DLSE has apparently retreated from that position. A more recent DLSE opinion letter states that tip pools may include anyone in the "chain of service," which is an undefined term that presumably would include anyone who provides any service to clients (e.g., bartenders making their drinks).¹⁷³

The sudden tide of tip-pooling cases was stemmed by the issuance of a lengthy and persuasive district court opinion, *Louie v. McCormick & Schmick Restaurant Corp.*¹⁷⁴ The court in *Louie* held that Section 351 allows management to force servers to share tips with other employees who provide any service to customers at all (whether or not at the patron's table). Following this federal decision, the trial courts handling the other cases filed at the same time all reached the same conclusions and dismissed their tip-pooling cases.

¹⁷⁰ *Leighton*, 219 Cal. App. 3d at 1067.

¹⁷¹ *Id.* at 1067-68.

¹⁷² DLSE Opinion Letter 1998-12-28-1 at 2.

¹⁷³ DLSE Opinion Letter 2005-09-08 at 2.

¹⁷⁴ 460 F. Supp. 2d 1153 (C.D. Cal. 2006) (Seyfarth Shaw case).

Post-*Louie* California appellate courts appear to have slain this species of tip-pooling action altogether. Three decisions in early 2009 – *Lu v. Hawaiian Gardens Casino, Inc.*,¹⁷⁵ *Budrow v. Dave & Buster's of California, Inc.*,¹⁷⁶ and *Grodensky v. Artichoke Joe's Casino*¹⁷⁷ – confirmed that Section 351 does not preclude forced sharing of tips with other non-management employees. Meanwhile, in *Etheridge v. Reins International*, the Court of Appeal resolved the remaining issues in the employer's favor when it held that management can mandate that tips be shared with any employee who "contributes" to a patron's service, which arguably could include cooks and kitchen staff as well as bartenders.¹⁷⁸ Accordingly, it appears that tip-pooling cases may have been extinguished except in the unusual circumstance where an employer forces employees to share tips with their managers.

B. Actions Alleging "Agents" of Management Wrongfully Took Tips

The *Leighton* line of cases all permitted the sharing of tips among *non-management* employees. Employers have fared much worse, however, in cases where employees with supervisory power have shared in tip pools. Several courts have held that such tip-pooling arrangements violate the prohibition in Section 351 against "agents" of the employer sharing in the tip pools. Perhaps the highest profile of these cases was a now-overturned trial court decision in March 2008 that held Starbucks Corporation liable for \$105 million in restitution to a class of approximately 120,000 baristas for the share of tips Starbucks allocated to its shift supervisors.¹⁷⁹

These cases spring from a 2003 decision, *Jameson v. Five Feet Restaurant*,¹⁸⁰ in which the court of appeal held that it violated Section 351 for a "floor manager" to receive 10% of the tips left for servers. The court noted that Section 350 defines "agent" as any person who has "authority to hire or discharge any employee or supervise, direct, or control the acts of employees." Because the floor manager's duties included "scheduling servers' stations, disciplining servers, hiring employees, and recommending the discharge of employees," the court found that there was a sufficient basis in the record to support the jury's finding that they qualified as agents.

¹⁷⁵ 170 Cal. App. 4th 466, 479 (2009) ("In its analysis of Labor Code Section 351, the legislative history, and related statutes, Leighton's statements were not restricted to restaurants").

¹⁷⁶ 171 Cal. App. 4th 875, 878 (2009) (Seyfarth Shaw case; noting that "section 351 does not distinguish between the various functions that restaurant employees perform").

¹⁷⁷ 171 Cal. App. 4th 1399 (2009), *disagreed with by Lu v. Hawaiian Gardens Casino, Inc.*, 50 Cal. 4th 502 (2010) (holding § 351 does not authorize a private right to sue, contrary to the holding in *Grodensky*).

¹⁷⁸ 172 Cal. App. 4th 908 (2009).

¹⁷⁹ *Chau v. Starbucks Corp.*, San Diego County Case No. GIC836925, *rev'd*, 174 Cal. App. 4th 688 (2009).

¹⁸⁰ 107 Cal. App. 4th 538 (2003).

Several cases have reaffirmed *Jameson* and held other types of supervisory employees to be agents who may not participate in tip pools.¹⁸¹ In the *Grodensky* case, however, the court of appeal affirmed the trial court's finding that "floor managers" were not agents because they lacked the power to hire and fire and had a power to supervise, direct, or control the acts of the dealers that was limited to resolving disputes between customers and the dealers.¹⁸²

In the appeal of *Chau*, the appellate court held that "shift supervisors" at Starbucks – who performed the same work as regular employees 90 percent of the time, lacked any authority to discipline, and were not considered by the company to be part of "management" – could get a share of the tips.¹⁸³ It should be noted that the decision distinguished itself from "tip-pooling" cases because the tips in question were left in collective tip jars, making this instead a "tip apportionment" case because the tips are already "pooled."¹⁸⁴ The court held that in this kind of case it is presumed the patron intends for the tip to be shared by the entire service "team," particularly in light of the fact that it is probably difficult for the average patron to distinguish between those who are "shift supervisors" and those who are not.¹⁸⁵ While this decision was a significant victory for employers, the specific circumstances of the case mean that it should not be interpreted to suggest that supervisors with the powers normally attributed to managers (power to discipline, hire and fire, and give commands, etc.) may share in a traditional "tip pool." It is unclear whether Section 351 was intended to preclude the supervisor from receiving tips in the situation where the tips were actually left for the supervisors.

C. The Future of Tip-pooling Cases Under California Law

Although it has now been clarified that certain types of tip-pooling arrangements are permissible under California law, there remained a dispute about whether Section 351 contained a private right of action that allowed plaintiffs to sue under the statute at all. This dispute was finally put to rest in 2010 when the California Supreme Court decided *Lu v. Hawaiian Gardens, Inc.* There, the Court held that no private right of action to sue exists under Section 351, foreclosing any future tip-pooling cases under that statute.¹⁸⁶ What the

¹⁸¹ *Hawaiian Gardens*, 170 Cal. App. 4th at 485-86 (triable issue of fact whether customer service representatives qualified as agents because they had responsibility to write reports about and evaluations of tipped dealers); *Grodensky*, 171 Cal. App. 4th at 1409-10 (shift managers who assigned work, had power to discipline and were responsible for operation of casino in card room manager's absence were agents not permitted to share in tip pool).

¹⁸² *Grodensky*, 171 Cal. App. 4th at 1452-53.

¹⁸³ 174 Cal. App. 4th 688 (2009).

¹⁸⁴ *Id.* at 700.

¹⁸⁵ *Id.* at 705.

¹⁸⁶ 50 Cal. 4th 592 ("there is no clear indication that the Legislature intended to create a private cause of action under the statute").

Court did not do, however, is foreclose the possibility of tip-pooling cases altogether. The *Lu* Court specifically found that if an employee is entitled to misappropriated gratuities, the employee could collect them under other legal theories, e.g., conversion.¹⁸⁷ A plaintiff could also, most likely, recover such monies as restitution under California's Unfair Competition Law or recover penalties for the violation under Labor Code Section 203, Section 226, or PAGA.

VII. Vacation/Paid Time Off Forfeiture

Another type of wage and hour class action prevalent in California is one seeking payment of forfeited vacation or other paid time off ("PTO"). California law does not require that employers provide employees with vacation or PTO.¹⁸⁸ Furthermore, an employer can lawfully require that employees work for a certain period of time without any vacation benefit, and then begin to accrue vacation only after the waiting period has ended.¹⁸⁹

If the employer provides a vacation benefit, however, it may not create a plan whereby the employee "forfeits" vested vacation or PTO time. Under California law, accrued vacation or PTO constitutes "wages," which is payable to the employee at termination.¹⁹⁰ As such, employers may not have a "use it or lose it" provision in their vacation or PTO policy. A policy that places a reasonable cap on accrual of vacation or PTO generally is acceptable.¹⁹¹ The DLSE has taken the position, however, that an accrual cap that is set near one year's allotment of vacation is a *de facto* use it or lose it policy since many employees will earn no additional vacation in a year if they do not take the vacation that year.¹⁹²

"Use it or lose it" policies are lawful in most other states. Therefore, many out-of-state employers doing business in California are unaware of this requirement. Needless to say, where an action is filed challenging a written corporate vacation policy containing a "use it or lose it" provision, class certification and liability likely will follow.

A vacation decision that came down in 2006, *Church v. Jamison*,¹⁹³ has made vacation class claims more attractive because it creates the possibility that they may reach back much further than the

¹⁸⁷ *Id.* at 603-04 ("holding that section 351 does not provide a private cause of action does not necessarily foreclose the availability of other remedies").

¹⁸⁸ DLSE Manual 15.1.2.

¹⁸⁹ *Owen v. Macy's, Inc.*, 175 Cal. App. 4th 462 (2009) (employer's policy of delaying onset of accrual of vacation benefits for first six months was lawful).

¹⁹⁰ *Suastez v. Plastic Dress-up Co.*, 31 Cal. 3d 774 (1982).

¹⁹¹ DLSE Manual 15.1.4.

¹⁹² DLSE Manual 15.1.5.

¹⁹³ 143 Cal. App. 4th 1568 (2006).

four-year period of a typical wage and hour class action. The decision was not actually a class action decision, but rather addressed the appropriate statute of limitations on any claim for unpaid vacation. Vacation differs from regular wages in that an employee has no entitlement to be paid for accrued but unused vacation until the employee quits or is discharged. That leaves open the question of whether an employee may sue only for vacation accrued but unpaid during the four years before the lawsuit, or for any vacation that accrued that was unpaid during the employment (assuming the employee brings suit within four years of leaving his employment).¹⁹⁴

The *Church* court reasoned that the statute of limitations begins to run only when a cause of action accrues, and that no cause of action for unpaid vacation accrues until termination of employment.¹⁹⁵ Accordingly, the court held that an employee who sues within the limitations period can sue for any unpaid vacation that accrued at any time throughout the entire tenure of employment.¹⁹⁶

The *Church* decision is squarely at odds with an older decision, *Sequeira v. Rincon-Vitova Insectaries, Inc.*,¹⁹⁷ which had adopted the DLSE position that an employee suing for unpaid vacation may sue only for vacation accrued within the limitations period (which is four years for claims based on a written contract such as a written vacation policy). The DLSE reasoned that although an employee cannot demand payment of unused vacation until termination, the employee is entitled to take vacation upon earning the vacation. The DLSE also noted that allowing an employee to reach back throughout the entire employment would create serious recordkeeping problems for employers who may not save such records for periods that exceed the typical limitations period (e.g., three or four years). Accordingly, *Sequeira* held that the statute of limitations on a claim for vacation pay begins running as soon as the vacation is earned.¹⁹⁸

The *Church* court declined to follow *Sequeira* because the *Church* court thought that the *Sequeira* decision improperly deferred to a DLSE interpretative bulletin.¹⁹⁹ The *Church* court noted that intervening California Supreme Court precedent in *Tidewater Marine Western, Inc. v. Bradshaw*²⁰⁰ had held that such a bulletin is an invalid underground regulation that is not entitled to any deference. Re-evaluating the issue anew, the *Church* court thought that the more persuasive reasoning was that a cause of action for unpaid vacation pay does not accrue until the termination

¹⁹⁴ *Church* suggested, without deciding, that the statute of limitations on a vacation claim may be either two years (if based on oral promises) or four years (if based on a written contract). *Id.* at 1577. Given a plaintiff's ability to recover unpaid vacation through a claim under the UCL, Bus. & Prof. Code § 17200, *et seq.*, which has its own four-year statute of limitations, the discussion in *Church* of the appropriate statute of limitations is primarily academic.

¹⁹⁵ *Id.* at 1576-77, 1582-83.

¹⁹⁶ *Id.* at 1578-79.

¹⁹⁷ 32 Cal. App. 4th 632 (1995).

¹⁹⁸ *Id.* at 635-36.

¹⁹⁹ *Church*, 143 Cal. App. 4th at 1578.

²⁰⁰ 14 Cal. 4th 557 (1996).

of employment and, therefore, chose not to follow *Sequeira*.²⁰¹ Despite this clear conflict in appellate decisions, the California Supreme Court declined to review the *Church* decision. Accordingly, the law remains uncertain in this area.

Another employer policy fomenting class actions, has been a “floating holiday” policy that allows employees to take a paid day off at the employee’s discretion but does not treat the floating holiday as vacation—i.e., the employee who does not use the floating holiday is not credited with a day of vested vacation time, but instead simply loses the opportunity for a paid day off. The DLSE has opined that an employer may have a use-it-or-lose-it policy with bona fide “holidays,” but only when the holiday is tethered closely to a specific event. For example, an employer may give employees Martin Luther King, Jr. Day as a paid day off, on a use-it-or-lose-it basis. But where “holiday” pay can be claimed on any day, at an employee’s discretion, the DLSE views it as disguised “vacation” pay, and has opined that an employer must treat any such holiday pay as vested vacation time.²⁰²

Based on this announced interpretation of the law, numerous class actions have been filed against employers who have a use-it-or-lose-it policy with respect to floating holidays. To date, no court decision has adopted or rejected the DLSE’s interpretation.

VIII. Waiting Time Penalties

A. Generally

Many class actions assert, on behalf of class members who are former employees, claims for “waiting time penalties” under Labor Code Section 203.²⁰³

Under California law, all wages due must be paid at the time of termination, unless the employee quits without notice, and then within seventy-two hours of termination.²⁰⁴ When wages of a terminated employee are not timely paid, the employee’s wages continue, as a penalty, until paid or up to thirty days, whichever is shorter. Thirty days of penalties means thirty *consecutive* calendar days, including Saturdays, Sundays and holidays (typically equivalent to six weeks of pay), rather than simply one month’s pay. Each calendar day that passes before the employer pays all wages owed triggers an additional day of

²⁰¹ *Church*, 143 Cal. App. 4th at 1582-83.

²⁰² DLSE Enforcement Manual § 15.1.12, *et seq.* (“there must be an objective standard by which it can be established that the leave time is attributable to holidays, sick leave, bereavement leave or other specified leave.”)

²⁰³ The statute of limitations period on Lab. Code § 203 claims is three years, regardless of whether only penalties are sought or whether underlying wages are also sought in same action. *Pineda v. Bank of America*, 50 Cal. 4th 1389, 1401 (2010), *overruling McCoy v. Sup. Ct.*, 157 Cal. App. 4th 225, 233 (2008).

²⁰⁴ Lab. Code § 203.

penalties at the employee's regular daily rate, even if the employee is not normally scheduled to work on all of these days.²⁰⁵

On its face, the waiting time penalty provision reads as though it were designed to apply when an employer fails to give a terminating employee the employee's final paycheck. The Labor Commissioner, despite regulations providing that a good faith dispute precludes the imposition of penalties,²⁰⁶ routinely applies the penalty provision when the employer has failed to pay any wage claim over the entire course of employment and continues not to pay it at the time of termination. As a result, an employer who shorts an employee \$1 of owed vacation pay could be required to pay the employee the equivalent of six weeks' pay in penalties.

Courts have ruled that good faith, or lack of willfulness, is a defense to waiting time penalties.²⁰⁷ As the California Supreme Court explained: "A good faith dispute that any wages are due will preclude imposition of waiting time penalties under Section 203."²⁰⁸ Simple ignorance of the law, as opposed to a reasonable, good faith belief that the law provided a defense to payment of wages, generally is insufficient to avoid waiting time penalties.²⁰⁹

Unvested stock that an employee chose to receive in lieu of full wages is not viewed as wages that must be paid to an employee if the employee resigns prior to the vesting date of the stock, though the wages not paid due to the receipt of the stock must be paid (without interest) to an employee who is involuntarily terminated prior to the vesting date.²¹⁰

²⁰⁵ *Mamika v. Barka*, 68 Cal. App. 4th 487 (1998).

²⁰⁶ 8 C.C.R. § 13520 ("[A] good faith dispute that any wages are due will preclude imposition of waiting time penalties under Section 203.").

²⁰⁷ *Road Sprinkler Fitters Local Union No. 669 v. G&G Fire Sprinklers, Inc.*, 102 Cal. App. 4th 765 (2002); *Davis v. Morris*, 37 Cal. App. 2d 269 (1940).

²⁰⁸ *Smith v. Rae-Ventner Law Group*, 29 Cal. 4th 345, 354 n.3 (2002), *superseded on other grounds by statute*, Code Civ. Proc. § 98.2(c) as recognized in *Eicher v. Advanced Business Integrators, Inc.*, 151 Cal. App. 4th 1363 (2007); *Amaral v. Cintas Corp.*, 163 Cal. App. 4th 1157, 1201-03 (2008)(defendant's failure to pay wages according to "living wage" clause in contract did not constitute a willful violation of the Labor Code where the defendant's position raised "complicated issues of first-impression"); *see also Nordstrom Com'n Cases*, 186 Cal. App. 4th 576, 584 (2010) (holding that the trial court did not abuse its discretion in discounting the penalties on a Section 203 claim because the defendant could avoid the penalties by showing that a "good faith dispute" existed regarding the claimed wages).

²⁰⁹ *Barnhill v. Robert & Saunders Co.*, 125 Cal. App. 3d 1, 7 (1981).

²¹⁰ *Schacter v. Citigroup, Inc.*, 47 Cal. 4th 610 (2009). This decision did not foreclose the possibility of a different outcome if the employee were fired rather than voluntarily resigned.

B. Application to Fixed-Term and Temporary Employment

1. Assignments for a Fixed Term

By Section 203's terms, waiting time penalties are recoverable only by an employee "who is discharged or who quits."²¹¹ But what happens when the assignment simply comes to an end by its own terms, either because a fixed term has expired, or a fixed project is completed? The appellate court held that neither of those circumstances was a "discharge" triggering application of Section 203, but the California Supreme Court reversed.

In *Smith v. Superior Court*,²¹² the plaintiff worked a one-day assignment as a hair model for L'Oreal, for which she earned \$500. The employer, pursuant to its regular practice, did not pay her until sixty days after the model shoot ended.²¹³ If the delayed payments violated Labor Code Section 203 as to every hair model L'Oreal paid in a similar fashion in California, potential liability would have amounted to \$15,000 per model per assignment (thirty working days of penalty pay times \$500 per day), which could quickly add up to millions of dollars. If the end of the assignment was not a "discharge," however, then the employee would be limited solely to suing for payment of the wages, interest, and any attorney's fees accrued in bringing the suit.²¹⁴

The California Supreme Court ruled that the end of the one-day assignment resulted in a "discharge" of the employee. The court explained that the term "discharge" was ambiguous: it could mean either "fire" or "release from one's obligations." When someone has an assignment of a fixed term or performs a fixed task, the employer "discharges" (i.e., releases) the employee at the end of the term or completion of the task. The California Supreme Court analyzed the legislative history and concluded that this interpretation—"discharge" as synonymous with "release from one's obligations"—was more consistent with the overall purpose of the statute and the strong public policy for immediate payment underlying Section 203. Accordingly, the end of a fixed-term assignment that ends the employment relationship between the employer and employee triggers the obligation for immediate payment under Labor Code Sections 201-203.

²¹¹ Lab. Code § 203. In addition, the penalties for employees who quit are limited to employees "not having a written contract for a definite period." Lab. Code § 202.

²¹² 123 Cal. App. 4th 128 (2004) (single-plaintiff case).

²¹³ The employer erroneously treated its models as independent contractors. If the employer lacked a reasonable basis for that position, that could qualify as a "willful" violation sufficient to trigger waiting time penalties.

²¹⁴ Lab. Code § 218.5 (attorney's fees recoverable); Lab. Code § 218.6 (pre-judgment interest recoverable from the date payment was owed).

2. Temporary Employment Agencies

In 2006, a slew of class actions were filed against temporary agencies, arguing that the end of every temporary assignment is a “discharge” that triggers the right to immediate payment and the application of waiting time penalties. Temporary agencies typically do not pay wages on the date a given assignment ends, but rather send paychecks in regular one or two-week intervals (except in the rare case where the agency “fires” the temporary employee by giving notice that the temp will not be considered for further work).

In one such class action, *Elliot v. Spherion Pacific Work, LLC*,²¹⁵ Seyfarth Shaw obtained summary judgment for the defendant temporary agency. The plaintiff was employed by Spherion as a temporary worker for over a year, during which time she completed 15 temporary assignments of varying length. Plaintiff submitted time sheets for work performed each Friday, and was paid by Spherion on the following Friday via direct deposit. Following what turned out to be her last assignment with Spherion, the plaintiff was paid pursuant to the normal pay schedule, and continued to seek assignments through Spherion for over a month thereafter. The district court held that the plaintiff was not “discharged” each time one of her temporary assignments ended, noting that she remained employed by Spherion and she understood that assignments would be intermittent. Therefore, the plaintiff was not entitled to waiting time penalties under the Labor Code.²¹⁶ The Ninth Circuit affirmed the decision in early 2010.

Effective January 1, 2009, Labor Code Section 201.3 resolved this issue, providing that:

If an employee of a temporary services employer is assigned to work for a client, that employee’s wages are due and payable no less frequently than weekly, regardless of when the assignment ends, and wages for work performed during any calendar week shall be due and payable not later than the regular payday of the following calendar week. A temporary services employer shall be deemed to have timely paid wages upon completion of an assignment if wages are paid in accordance with this subdivision.

²¹⁵ 572 F. Supp. 2d 1169 (C.D. Cal. 2008), *aff’d*, 368 Fed. Appx. 761 (9th Cir. Feb. 26, 2010) (unpublished).

²¹⁶ See also *Sullivan v. Kelly Services, Inc.*, No. C 07-2784 CW, 2008 U.S. Dist. LEXIS 91608 (N.D. Cal. Nov. 12, 2008) (granting summary judgment in favor of defendant temporary agency on Labor Code Section 201 claim on grounds that plaintiff was not “dismissed” by the agency at the conclusion of a temporary work assignment).

The legislative history of Section 201.3 provides that its enactment effects a clarification of existing law, rather than a change in the law.²¹⁷ Because of this, courts have applied it retroactively to claims arising before the Section's effective date.²¹⁸

IX. Itemized Wage Statement Claims

Labor Code Section 226 has for many years required that employers include certain specific information in an itemized wage statement provided to employees with every paycheck. Section 226(a) requires that each wage statement of non-exempt employees show (1) gross wages earned; (2) total hours worked by the employee; (3) the number of piece-rate units earned (for piece-rate workers); (4) all deductions taken; (5) net wages earned;²¹⁹ (6) the inclusive dates of the period for which the employee is paid; (7) the name of the employee and either the last four digits of the employee's social security number or the employee ID number;²²⁰ (8) the name and address of the employer; and (9) all applicable hourly rates in effect during the pay period and the corresponding number of hours worked at each hourly rate.²²¹ Any departure from these rules arguably could violate Section 226(a).²²²

The primary remedy for violations of Labor Code Section 226(a) is a penalty set forth in Section 226(e). Section 226(e) provides that when an employer "knowingly and intentionally" violates Section 226(a) any employee "suffering injury" may sue and collect actual damages or a penalty of \$50 or \$100 (for repeat offenders), whichever is greater, up to a maximum of \$4,000 per employee.²²³

Before 2003, the statute required only that employers furnish a wage statement. There was no requirement that the information in the wage statement be *accurate*. With the amendments in 2003, however, the statute required that all information be accurate. As a result of this change,

²¹⁷ See Senate Bill Analysis, SB 940 at p. 5.

²¹⁸ *Elliott v. Spherion*, 572 F. Supp. 2d 1169 (C.D. Cal. 2008); *Sullivan v. Kelly Services, Inc.*, Case No. C 07-2784 CW, 2008 U.S. Dist. LEXIS 91608 (N.D. Cal. 2008).

²¹⁹ Seyfarth Shaw convinced a federal district court that a wage statement claim premised on a failure to pay for missed breaks under labor Code section 226.7 did not constitute a failure to identify wages earned pursuant to Labor Code section 226. *Jones v. Spherion Staffing LLC*, 2012 WL 3624081 at *9 (C.D. Cal., Aug. 7, 2012) ("Because the underlying violation that gives rise to a section 226.7 claim is not the nonpayment of wages, other claims premised on nonpayment of wages do not arise.").

²²⁰ Until January 2008, the wage statement was allowed to contain the employee's entire social security number. Now, an employee ID or the last four digits of the Social Security Number must be substituted.

²²¹ Lab. Code § 226(a).

²²² See, e.g., *Zavala v. Scott Bros. Dairy, Inc.*, 143 Cal. App. 4th 585 (2006) ("The failure to list the precise number of hours worked during the pay period conflicts with the express language of the statute and stands in the way of the statutory purpose."); *Cicairos*, 133 Cal. App. 4th at 954, 961 ("[T]he wage statements and driver trip summaries do not list the defendant employer's name and address and thus are not adequate itemized wage statements.").

²²³ Lab. Code § 226(e); as with other Labor Code penalty provisions, the limitations period is one year.

plaintiffs' lawyers began including wage statement claims in class actions alleging exempt misclassification or failure to properly calculate overtime. Their theory was that all those employees' wage statements were "inaccurate" because they failed to set forth the proper amount of overtime owed. The plaintiffs would then seek penalties for each employee receiving an inaccurate wage statement.

Plaintiffs have generally used wage statement claims as bargaining chips in mediation, without placing much settlement value on them. Two primary aspects of Section 226 claims have been hotly disputed.

First, there was substantial dispute whether the language in subsection (e) that an employee must "suffer injury" to recover the penalties means that only employees suffering actual harm from a wage statement violation can recover. Defendants, arguing that there must be actual harm to "suffer injury," relied on the definition of "injury" as used in other aspects of California law.²²⁴ Defendants also supported their position by pointing out that employees who did not suffer actual injuries could obtain injunctive relief pursuant to Labor Code Section 226(g), which does not contain language about "suffering injury."

Plaintiffs, by contrast, argued that the term "injury" is simply the violation of one's legal rights.²²⁵ Plaintiffs contended that Section 226 created a right for employees to receive an accurate wage statement, and that right is violated when the employer knowingly provides a defective wage statement. By this logic, *any* violation of Section 226(a) causes an injury sufficient to trigger penalties under Section 226(e).

In a blow to employers, effective January 1, 2013, the Legislature amended Labor Code section 226 to adopt a pro-plaintiff definition of "injury" for purposes of certain violations of the statute. An employee now is deemed to suffer injury if (A) the employer fails to provide a wage statement or (B) fails to provide accurate and complete information and the employee cannot promptly, without reference to other documents or information, determine the following from the wage statement alone: (1) gross or net wages paid during the pay period, (2) total hours worked, (3) piece rate units earned and rate, (4) deductions, (5) pay period, (6) hourly rates and corresponding hours worked at each rates, (7) the employer's name and address, (8) the employee's name, and (9) the employee's last 4 digits (only) of his or her social security number or employee identification number. Following

²²⁴ See, e.g., *Steketee v. Lintz, Williams & Rothberg*, 38 Cal. 3d 46, 55 (1985) ("The word 'injury' signifies both the negligent cause and the damaging effect of the alleged wrongful act and not the act itself."); *Lueter v. State of Cal.*, 94 Cal. App. 4th 1285, 1303 (2002) ("'Injury' refers to the fact of harm suffered by the plaintiff due to the defendant's conduct."); *San Fran. Unified Sch. Dist. v. W.R. Grace & Co.*, 37 Cal. App. 4th 1318, 1330 (1995) ("[W]hen injury or damage is the last element of a tort cause of action to occur, the cause of action accrues once any actual and appreciable harm has occurred.").

²²⁵ See, e.g., BLACK'S LAW DICTIONARY 466 (4th ed. 1968) ("the injury is the violation of the legally protected interest . . . and not necessarily the resulting harm"); *Migliori v. Boeing N. Am., Inc.*, 97 F. Supp. 2d 1001, 1007 (C.D. Cal. 2000) (distinguishing "injury" from "damages" for purposes of *res judicata* analysis).

this amendment, an employer can no longer argue that employees must individually demonstrate that they suffered actual injury resulting from a violation of Labor Code section 226(a), which previously was a very potent weapon when opposing certification of such claims. It is anticipated that the plaintiffs' bar may now more aggressively pursue such claims.

The remaining dispute over the construction of Section 226 concerns the meaning of the phrase "knowing and intentional." This standard appears, on its face, to differ from the standard for awarding waiting time penalties under Labor Code Section 203, which is mere "willfulness." Normally, if an employer is conscious that it committed an act, and if the employer lacks a *reasonable* basis for believing the act is lawful, then the act is "willful" for purposes of Section 203 even where the employer lacked bad faith or an intention to break the law.²²⁶ Although this statutory interpretation departs from the common-sense understanding of the term "willful violation," it furthers a strong public policy favoring payment of final wages to an employee (who may depend on such wages for survival), so there is a colorable reason to use a broad interpretation of "willful."²²⁷

With wage statement violations, by contrast, any true injury to the employee is often purely theoretical. Employers contend there is no strong public policy reason to hold them liable for penalties totaling thousands (or even millions) of dollars merely because they were ignorant of a technical requirement as to what should appear on an itemized wage statement. Accordingly, they believe there is no strong reason to assume the Legislature intended to equate "knowing and intentional" with "willful." Several district court decisions have now granted summary adjudication against a claim for penalties on the ground that while the wage statements violated Section 226(a), there was no evidence that the employer knew of Section 226 and intended to violate it.²²⁸

Recent court decisions have begun to flesh out the meaning of the phrase "knowing and intentional" in the context of Section 226. These cases, however, do not provide clear guidance as to the lower threshold for the "knowing and intentional" standard, because the defendants in these cases were alleged to have been aware that their wage statements were not in compliance and to have done nothing to fix them. In any event, the January 2013 amendment to the statute clarified that a

²²⁶ *Barnhill v. Robert & Saunders Co.*, 125 Cal. App. 3d 1, 7 (1981).

²²⁷ *See id.* at 7-8 (explaining public policy underlying Section 203).

²²⁸ *See Harris v. Vector Marketing Corp.*, 656 F. Supp. 2d 1128, 1145-46 (N.D. Cal. 2009) (summary adjudication warranted on plaintiff's § 226(e) claim where dispute existed as to whether plaintiff was independent contractor or employee and record lacked evidence that conduct was knowing or willful); *Reber v. AIMCO/Bethesda Holdings, Inc.*, No. SA CV07-0607 DOC (RZx), 2008 WL 4384147 (C.D. Cal. Aug. 25, 2008) (summary adjudication appropriate on plaintiff's § 226 claim because of a good faith dispute as to whether employees are exempt precludes finding defendant's conduct was knowing and intentional); *Mutec v. Huntington Mem'l Hosp.*, LASC Case No. BC 288727 (LA Superior Court, Mar. 10, 2006) (Hon. Tricia Ann Bigelow) (granting summary adjudication against claim for penalties where employer did not know that its pay stubs violated Section 226(a)). *But see Heritage Residential Care, Inc. v Division of Labor Standards Enforcement*, 192 Cal. App. 4th 75, 88 (2011) (defendant's "good faith mistake of law" that employees who lacked Social Security numbers were not required to be provided with wage statements was not an "inadvertent" mistake, such as a clerical error would be).

"knowing and intentional failure" will not include an isolated and unintentional payroll error due to a clerical or inadvertent mistake. The fact finder can consider whether the employer, prior to an alleged violation, has adopted and complied with a set of policies, procedures, and practices that fully comply with section 226.

X. California Minimum Wage Claims

A. Wage Averaging Improper Under California Law

In *Armenta v. Osmose, Inc.*,²²⁹ the Second District Court of Appeal held that employees who alleged that their employer had failed to pay them for certain hours they worked off the clock had violated the state minimum wage laws with respect to every hour they worked but were not paid. The employer defended the claim with the argument that the employees' average hourly pay for the workweek was greater than the minimum wage, which defeated any claim for minimum wage under the federal "averaging method" for determining minimum wages.²³⁰ The *Armenta* court, however, rejected the averaging method and instead adopted the position set forth in a DLSE Opinion Letter that California requires that the minimum wage be paid for each and every hour worked. Accordingly, regardless of the total compensation an employee earns during a week, or even during a single day, if there are hours the employee has worked for which the employee was paid less than the minimum wage, then the employer has violated Labor Code Section 1194 by failing, for the hours in question, to pay minimum wage.²³¹

Interestingly, a federal district court in California previously had expressly rejected the DLSE's position, holding that the FLSA's averaging method applied to claims under California minimum wage law as well.²³² The *Armenta* court rejected the federal court's conclusion, reasoning that California intended its minimum wage law to be more protective than that under the FLSA, and that part of this greater protection is a requirement to pay minimum wage for "all hours worked," which is language absent from the FLSA.²³³ The *Armenta* court also noted that Labor Code Sections 221-223, which have no counterparts under the FLSA, make it illegal to secretly pay employees less than the amount designated by statute or contract.²³⁴ The court failed to explain, however, why the violation of these particular Labor Code statutes signaled an intent to treat those violations as minimum wage violations.

²²⁹ 135 Cal. App. 4th 314 (2006).

²³⁰ *Armenta*, 135 Cal. App. 4th at 319.

²³¹ *Id.* at 324-25.

²³² *Medrano v. D'Arrigo Bros. Co.*, 336 F. Supp. 2d 1053 (N.D. Cal. 2004).

²³³ *Armenta*, 135 Cal. App. 4th at 323-24.

²³⁴ *Id.*

The *Armenta* decision affects California law in several ways. First, allowing a minimum wage claim whenever there are some uncompensated work hours will allow employees who could not state a claim for unpaid overtime an alternative basis upon which to sue. For example, unionized employees whose overtime claims are preempted by Section 301 of the Labor Management Relations Act may still be able to sue under California law for unpaid minimum wages. Indeed, the plaintiffs in *Armenta* were members of a union who had pleaded claims for overtime, but later abandoned them because they recognized that those claims were preempted.²³⁵ Minimum wage law claims, by contrast, are generally not preempted given that they can be resolved entirely independently of a collective bargaining agreement.²³⁶

Second, employees who sue for minimum wage violations can recover liquidated damages under Labor Code Section 1194.1, which are not available for other sorts of wage violations. If liquidated damages are awarded, then employees will recover twice the minimum wage (which would currently amount to \$18 per hour) for each hour they can show they worked but received no pay.

Third, plaintiffs will be able to plead minimum wage claims in any case where they allege some work time was unpaid. For example, in meal period cases where the employer is alleged to have recorded meal periods automatically whether or not the employees actually took them, employees may argue that they worked through the meal period, but were not paid for that work time. Those facts might trigger minimum wage claims now. Similarly, a claim that an employee worked controlled standby time that the employer erroneously treated as unpaid will now trigger a minimum wage claim.

The ruling in *Armenta* may not apply, however, in certain situations where the state minimum wage law is preempted by federal law. In *Fitzgerald v. Skywest Airlines, Inc.*,²³⁷ the plaintiff was a flight attendant. Her governing contract called for her to receive \$1.60 an hour for “block time” while her aircraft was readied for flight, while passengers boarded and disembarked, and for flight standbys. On the whole, however, only a fraction of her hours were block time, the remainder of her hours was paid at a rate of \$20 to \$30 per hour, and there was no evidence that wages paid to the employee averaged less than minimum wage for even one day. Nonetheless, the plaintiff argued, under *Armenta*, that paying only \$1.60 for each hour of “block time” was a violation of the minimum wage law.

The court affirmed summary judgment for the defendant based primarily on the doctrine of federal preemption under the Railway Labor Act.²³⁸ In addition, however, the court suggested that *Armenta*

²³⁵ *Id.* at 318. Unionized employees’ overtime claims often fail because those employees generally work under a collective bargaining agreement that provides premium pay for all hours worked, which then brings the employees within the Labor Code Section 514 “collective bargaining exemption.”

²³⁶ *Id.*

²³⁷ 155 Cal. App. 4th 411 (2007).

²³⁸ *Fitzgerald*, 155 Cal. App. 4th at 421-22.

might not apply where, as in *Fitzgerald*, the employment contract specifies that certain hours are to be paid at less than the minimum wage, but the employee always receives an average wage for hours worked each day above minimum wage:

In *Armenta*, the employer violated its own CBA and written employment policies which required that employees be paid for time spent driving company vehicles to and from job sites. . . . Unlike *Armenta*, here there is no evidence that SkyWest pays [attendants] less than what was collectively bargained for. As discussed in *Armenta*, Labor Code “[s]ections 221, 222, and 223 articulate the principle that all hours must be paid at the statutory or agreed rate. . . .” Here the agreed rate is set forth in the SkyWest CBA which was voted on and approved by SkyWest [attendants].²³⁹

As a result of this language in *Fitzgerald*, in some circumstances employers may be able to argue that *Armenta* applies only where employees are forced to work hours without any pay, as long as there was a clear agreement in place regarding varying rates of pay, and average pay does not amount to less than the minimum wage.²⁴⁰

B. The Conflict Between Piece Rate Formulas And The Requirement To Pay Minimum Wages

Several recent cases have raised questions regarding the ability of employers to pay workers on a piece rate basis. In *Bluford v. Safeway Stores, Inc.*,²⁴¹ the Court of Appeal held that rest breaks must be separately compensated under a piece rate system because the breaks are considered to be work time. There, the plaintiff was a truck driver who was compensated based on the miles he

²³⁹ *Fitzgerald*, 155 Cal. App. 4th at 417.

²⁴⁰ Employers may also face both contractual liability *and* Labor Code penalties for failing to pay workers in accordance with a city “living wage” ordinance that sets minimum pay above the statutory minimum wage rate. *Amaral v. Cintas Corp.*, 163 Cal. App. 4th 1157 (2008) (employee class could bring claims to recover contract damages for unpaid wages, as well as Labor Code penalties for failure to pay wages and accrued vacation on termination, and for improper wage statements, pursuant to living wage clause in laundry services contract between the City of Hayward and Cintas); *see also McKenzie v. Fed. Express Corp.*, 765 F. Supp. 2d 1222 (C.D. Cal. Apr. 14, 2011) (judgment entered against defendant for PAGA penalties where violation under Section 226 is established; injury need not be shown). But *see Balasanyan v. Nordstrom, Inc.*, Nos. 3:11-cv-2609-JM (WMC), 3:10-cv-2671-JM (W<C), 2012 WL 6675169, at *1-2 (S.D. Cal. Dec. 12, 2012), the district court denied Nordstrom’s motion for summary judgment with respect to plaintiff’s claims under Labor Code sections 1194 and 1197. Plaintiffs contended that Nordstrom underpaid its sales people by compensating them only through commissions earned for time spent on stocking assignments, pre-opening, and post-closing periods. *Id.* at *1. Plaintiffs contended they worked at least 1.5 hours per work shift without compensation. *Id.* Nordstrom contended that its commission plan did not violate Sections 1194 and 1197, because “California law permits employers to pay commissions for *all* hours worked and does not impose any restrictions on the type of work employers can pay with commissions.” *Id.* at *2. Furthermore, Nordstrom argued that commissions may be used to compensate employees for “non-sell time” work as it is part of the services provided in connection with sales, and that the employment contracts, which comply with minimum wage laws, should govern. *Id.* at *2-3. Plaintiffs argued that averaging is impermissible under *Armenta, supra*, and Nordstrom countered that here, unlike *Armenta*, the commissions Nordstrom paid for selling time here always exceeded minimum wage. *Id.* at *4. The court denied Nordstrom’s motion for summary judgment with respect to the Section 1194 and 1197 claims. *Id.* at *6. It remains to be seen whether this type of commission plan will be held to be lawful when it is evaluated on its merits

²⁴¹ 216 Cal. App. 4th 864 (2013).

drove and for the performance of specific tasks. The plaintiff argued that because his employer did not separately pay him for the time he spent on rest breaks, this constituted a violation of the California minimum wage law. The Court of Appeal agreed, holding that a piece rate compensation formula that does not provide separate wages for time spent on rest breaks is improper.

Piece rate compensation systems were dealt another significant blow in *Gonzalez v. Downtown LA Motors, LP*.²⁴² In *Gonzalez*, the plaintiffs were automobile service technicians who were paid a flat rate based on a formula for each repair job satisfactorily completed. Although the employer kept time records for the employees and maintained a “minimum wage floor” to ensure that workers were always paid at least the minimum wage times the total number of hours worked in a pay period, the plaintiffs complained that they were not separately paid an additional hourly rate for downtime or time spent on non-repair tasks. The Court of Appeal ruled in favor of the plaintiffs, holding that “averaging all hours worked ‘in any work week’ to compute an employer’s minimum wage obligation under California law is inappropriate.”²⁴³

The *Bluford* and *Gonzales* decisions have negative implications for California employers who use piece rate compensation formulas. The core purpose of paying employees a piece rate is to incentivize them to be productive. This incentive is counteracted when employers are required to also pay employees for non-productive time.²⁴⁴ These recent decisions are especially alarming because the Wage Orders specifically permit paying employees piece rates, and the types of piece rate plans used by the employers in these cases had been widely utilized without incident for decades. It is anticipated that the plaintiffs’ bar will initiate a new wave of class action litigation attacking piece rate compensation plans, so employers utilizing such plans should ensure that they comply with the latest legal developments.

C. Neutral Time-Rounding Practices Are Lawful

Federal law allows employers to use a neutral practice of rounding reported time, up or down, as long as the overall effect is not to underpay employees for their time.²⁴⁵ Under one such policy, for example, employees who work between 1 and 7 minutes during a quarter-hour segment of time

²⁴² 215 Cal. App. 4th 36 (2013), *review denied* July 17, 2013.

²⁴³ *Id.* at 48.

²⁴⁴ Employers paying piece rates compensation formulas may wish to consider utilizing a hybrid compensation system that pays employees a base rate for each hour and an additional piece rate or “bonus” for each completed item. This would ensure compliance with the minimum wage law as well as incentivizing employees to be productive. Note, though, that the production bonus would still be subject to rules governing overtime premium pay.

²⁴⁵ See 29 C.F.R. § 785.48(b); see also *Alonzo v. Maximus, Inc.*, 832 F. Supp. 2d 1122, 1127-29 (C.D. Cal. 2011)(facially neutral policy rounding time to the nearest quarter hour was proper).

would have their time rounded down, while those who work between 8 and 14 minutes would be paid for a full 15 minutes.²⁴⁶

Until the recent Court of Appeal holding in *See's Candy Shops, Inc. v. Superior Court*,²⁴⁷ California law did not expressly permit this employer practice, thus giving rise to lawsuits contending that employees were not being compensated at the minimum wage for all hours worked, as required under Labor Code Section 1194. In *See's Candy*, the employer used a timekeeping software system that required employees to punch in at the beginning and out at the end of their shifts.²⁴⁸ Two company policies provided for adjustments to the timecards: a "rounding" policy and a "grace period" policy.²⁴⁹ Under the "rounding" policy, punches in and out were rounded up or down to the nearest tenth of an hour.²⁵⁰ Under the "grace period" policy, an employee could voluntarily punch in up to 10 minutes before the scheduled start time and punch out 10 minutes after the scheduled end time, but was prohibited from working during these periods.²⁵¹ If an employee punched into the system during the grace period, the employee was paid based on the scheduled start/stop time, rather than the punch time.²⁵²

Plaintiff, a former retail sales employee, sued See's on behalf of herself and others, claiming that the company's time-rounding and "grace period" practices failed to compensate employees for all hours worked.²⁵³ The company alleged that any unpaid amounts were *de minimis*, and that the rounding policy and grace period policy complied with federal and state law. The trial court granted summary judgment for the plaintiff and the company appealed.²⁵⁴

The Court of Appeal reversed, finding both policies to be lawful.²⁵⁵ Citing the federal rounding standard, the court held that a rounding policy is permissible under California law if it is "fair and neutral" on its face and is "used in such a manner that it will not result, over a period of time, in failure to compensate the employees properly for all the time they have actually worked."²⁵⁶ With respect to the grace period policy, the court concluded that the plaintiff failed to produce any

²⁴⁶ All timekeeping systems employ rounding at some point, whether to the minute, second, or tenth of a second. The discussion of rounding here generally applies to situations where rounding is done in increments greater than the nearest minute.

²⁴⁷ 210 Cal.App.4th 889 (2012).

²⁴⁸ *Id.* at 892.

²⁴⁹ *Id.*

²⁵⁰ *Id.*

²⁵¹ *Id.* at 892-93.

²⁵² *Id.* at 893.

²⁵³ *Id.*

²⁵⁴ *Id.* at 899.

²⁵⁵ *Id.* at 907.

²⁵⁶ *Id.*

evidence showing that class members who clocked in during the grace period were working or were under the employer's control, and the parties agreed that under California law a grace period is permitted if the employee is not working or is not under the employer's control.²⁵⁷

As a result of the *See*'s decision, California employers should be able to employ neutral rounding policies in their timekeeping systems. Rounding policies that round only in favor of the employer, however, are improper. Furthermore, even properly implemented, facially-neutral rounding policies may still be subject to claims that they tend to result in underpayment to employees over a period of time, and thus result in litigation.

XI. California Labor Code Private Attorneys General Act

A. General Scope of the Law

Effective January 1, 2004, California law greatly expanded the prospect of litigation under the Labor Code. Labor Code Section 2698, *et seq.*, the Labor Code Private Attorneys General Act ("PAGA"), provides employees with added financial incentives to sue and creates new penalties for Labor Code violations. Previously, many of the Labor Code provisions carried no civil penalty at all, and others had a civil penalty but provided no private right of action. Civil penalties could generally be obtained only if the DLSE actually brought an enforcement action against the employer.

PAGA drastically altered Labor Code enforcement by creating (1) new civil penalties for every provision of the Labor Code that affects employees and that did not previously have a civil penalty²⁵⁸ and (2) a private right of action to recover civil penalties.²⁵⁹ Where no specific civil penalty is previously attached to a Labor Code violation, the new penalty is \$100 for each aggrieved employee per pay period for an initial violation, and \$200 for every further violation.²⁶⁰ The law requires the successful plaintiff to give three-fourths of any civil penalties recovered to the Labor and Workforce Development Agency. The aggrieved employees are allowed to keep only the remaining one-quarter of the penalties awarded.²⁶¹

²⁵⁷ *Id.* at 909.

²⁵⁸ Lab. Code § 2699(f).

²⁵⁹ Lab. Code § 2699(a).

²⁶⁰ Lab. Code § 2699(f)(2). In *Amaral v. Cintas Corp.*, 163 Cal. App. 4th 1157, 1209 (2008), the California Court of Appeal held that an "initial" violation encompassed violations covering multiple employees for multiple pay periods, up until such time as "the employer has learned that its conduct violates the Labor Code," at which point "the employer is on notice that any future violations will be punished just the same as violations that are willful or intentional," meaning the penalty rate will be doubled.

²⁶¹ Lab. Code § 2699(i).

An aggrieved employee suing pursuant to this statute sues on behalf of himself or herself, or on behalf of any other current or former employees.²⁶² A union may not bring a PAGA claim on behalf of “aggrieved employees.”²⁶³ The California Supreme Court has held that PAGA claims may proceed as collective actions without satisfying class certification requirements.²⁶⁴ In so holding, the Court stated that because a PAGA suit is analogous to a suit brought by a government agency on behalf of the public interest, there is no need to satisfy class certification requirements.²⁶⁵ Furthermore, as initially drafted, the statute contained no requirement that the employee exhaust administrative remedies by first filing a claim with the Labor Commissioner (or even that the employee notify the Labor Commissioner of the lawsuit).

Seyfarth Shaw has estimated that this statute created a new right to recover penalties on more than 100 Labor Code provisions, several of which are quite obscure. Even though the limitations period for a penalty claim would be only one year,²⁶⁶ the effect of these penalty provisions can be significant. Suppose, for example, that an employer of 150 employees is sued for a repeated violation of some obscure Labor Code section, and the violation affected each employee over the course of one year—during each of 26 biweekly pay periods. In this example the employer could be subject to penalties in the amount of more than \$700,000.²⁶⁷ Because penalties are cumulative for distinct Labor Code violations, that figure could be doubled or tripled if there were multiple, recurrent Labor Code violations (or if one act of misconduct violated multiple Labor Code provisions). Attorney’s fees to the prevailing plaintiff would augment that total.²⁶⁸

When Arnold Schwarzenegger became governor in 2004, one of his first initiatives was an attempt to repeal PAGA. Although he did not succeed in obtaining total repeal, he and the

²⁶² At least one court has held that the employee does *not* sue on behalf of the state. *Waisbein v. UBS Financial Services Inc.*, No. C-07-2328 MMC, 2008 U.S. Dist. LEXIS 21727 (N.D. Cal. Mar. 19, 2008). It appears this holding was overruled by *Arias v. Superior Court*, 46 Cal. 4th 969 (2009). Furthermore, in *Reyes v. Macy’s, Inc.*, 202 Cal. App. 4th 1119, 1123 (2011), the Court of Appeal held that a plaintiff “may not . . . bring the PAGA claim as an individual claim, but ‘as the proxy or agent of the state’s labor law enforcement agencies’” (quoting *Arias*, 46 Cal. 4th at 986).

²⁶³ *Amalgamated Transit Union v. Superior Court*, 46 Cal. 4th 993 (2009).

²⁶⁴ *Arias v. Superior Court*, 46 Cal. 4th 969 (2009).

²⁶⁵ *Id.* at 987.

²⁶⁶ Code Civ. Proc. § 340(a) (one-year statute of limitations on statutes to recover a penalty); *Moreno v. Autozone, Inc.*, No. C05-04432-MJJ, 2007 U.S. Dist. LEXIS 43873, at *4-10 (N.D. Cal. June 5, 2007) (analyzing PAGA and holding that a one-year statute of limitations applies); *Thomas v. Home Depot USA Inc.*, 527 F. Supp. 2d 1003 (N.D. Cal. 2007) (same).

²⁶⁷ \$15,000 (\$100 x 150 employees) for the first violation and then \$30,000 for each of the 25 further violations, if the \$200 penalty is found to apply for all later pay periods. An employer may be able to demonstrate that it should only be fined for one continuous violation, in which case the proper penalty might be \$100 for each violation, but under that scenario the employer would still be liable for \$390,000 (\$15,000 x 26 pay periods) see *Amaral v. Cintas Corp.*, 163 Cal. App. 4th 1157, 1209 (2008).

²⁶⁸ Lab. Code § 2699(g).

Legislature did scale back a few of the most controversial provisions and to insert some additional procedural protections. SB 1809, signed into law in August 2004, effected the following changes to PAGA:

- The bill repealed the requirement (formerly in Labor Code Section 431) that employers file a copy of their job application forms with the Division of Labor Standards Enforcement.
- Violations of Labor Code provisions that merely require notice, posting, agency reporting, or filing of documents with a state agency are now exempt from prosecution by aggrieved employees. An exception to this exemption was carved out for “mandatory payroll or workplace injury reporting.”²⁶⁹
- All settlements in which penalties are paid must now be judicially approved.
- The court now may reduce the amount of civil penalty if, under the circumstances, the penalty otherwise would be “unjust, arbitrary and oppressive, or confiscatory.”²⁷⁰
- Before suing, an aggrieved employee now must exhaust an administrative procedure that involves providing written notice of the particular Labor Code violation to the employer and the Labor Commissioner, for possible investigation before filing suit.²⁷¹ Failure to exhaust this administrative remedy within one year of the violation bars the suit.²⁷²
- The Labor Commissioner now has authority to promulgate regulations to implement the statute (although they have yet to attempt to do so).

Although the 2004 reforms to PAGA may seem modest, they appear to have had the effect of substantially reducing the attractiveness of these kind of lawsuits. PAGA claims are not typically asserted by themselves, but rather are added to standard wage and hour class actions, typically for bargaining leverage.

²⁶⁹ Lab. Code § 2699(g)(2).

²⁷⁰ Lab. Code § 2699(e)(2).

²⁷¹ Lab. Code §§ 2699(a), 2699(g)(1), and 2699.3.

²⁷² *Moreno*, No. C05-04432-MJJ, 2007 U.S. Dist. LEXIS 43873, at *4-10 (N.D. Cal. June 5, 2007) (employee who filed lawsuit within one year, but failed to exhaust administrative remedies until more than one year after leaving employment was time-barred from asserting PAGA claims).

B. Scope of the “Civil Penalty” Provisions

With the creation of the administrative remedy requirement before an employee could seek penalties under PAGA, the question arose whether this administrative requirement applied to all statutes covered by PAGA. More specifically, Section 2699.3 sets forth a long list of particular statutes that are purportedly subject to the administrative remedy. Included on this list are several statutes that provided for penalties recoverable by individual employees even before the passage of PAGA (e.g., Labor Code Section 203, which provides for waiting time penalties where employers willfully fail to pay terminating employees all wages owed to them). Defendants began to argue that no employee could sue to recover penalties under any statute listed in Section 2699.3 without first exhausting administrative remedies.

In November 2004, the Second District Court of Appeal issued *Caliber Bodyworks v. Superior Court*,²⁷³ which clarified the scope of the administrative remedy exhaustion requirement in PAGA. The court held that the administrative remedy requirement applied only to actions seeking to recover a “civil penalty,” which the court distinguished from actions that could be advanced by individuals to recover “statutory penalties,” such as Labor Code Section 203. In short, the court held that if a plaintiff seeks to recover penalties that were available under a statute and recoverable by an individual prior to PAGA’s passage, then the employee could still recover such statutory penalties without complying with the administrative prerequisites of PAGA.²⁷⁴

Although not at issue in the *Caliber Bodyworks* decision, the court’s holding that statutory penalties differ from “civil penalties” arguably expanded the scope of PAGA beyond what had broadly been understood. PAGA created a new civil penalty for every section of the Labor Code that did not previously provide for a “civil penalty.”²⁷⁵ If statutes that always provided for a statutory penalty (e.g., Labor Code Section 203) are not statutes that provide for a “civil penalty,” then an employee arguably can recover civil penalties **in addition** to the penalties already available under those statutes.

On the other hand, the *Caliber Bodyworks* decision leaves open the possibility that no new civil penalty is created for those Labor Code provisions that do not themselves provide for a civil penalty, but for which civil penalties may be recovered under a separate Labor Code provision.²⁷⁶ Furthermore, even if it is theoretically possible to obtain an award of civil

²⁷³ 134 Cal. App. 4th 365 (2005).

²⁷⁴ *Id.* at 377-78. The Second Appellate District reached the same result again in *Dunlap v. Superior Court*, 142 Cal. App. 4th 330 (2006).

²⁷⁵ Lab. Code § 2699(f).

²⁷⁶ See, e.g., Lab. Code § 256 (providing a separate civil penalty previously recoverable only by the DLSE for violations of Labor Code Section 203); Lab. Code § 210 (providing a separate civil penalty recoverable only by the DLSE for violations of Labor Code Sections 204, 204b, 204.1, 204.2, 205, 205.5, and 1197.5).

penalties on top of statutory penalties for the same violation, courts may exercise discretion not to award double penalties pursuant to Labor Code Section 2699(e)(2), which allows a court not to award a penalty where doing so would be “unjust, arbitrary and oppressive, or confiscatory.”

C. Pursuing PAGA Claims Collectively Without Class Certification

PAGA provides very little procedural guidance as to how an “aggrieved employee” is to seek penalties on behalf of other aggrieved parties. Given that the statute does not ever require that the other “aggrieved parties” consent to a suit being brought on their behalf, a dispute arose whether a party seeking to use PAGA to sue on behalf of aggrieved parties who did not actively join the action as parties would need to satisfy the requirements for class certification under Code of Civil Procedure Section 382.

In *Arias v. Superior Court*,²⁷⁷ the California Supreme Court held that there is no requirement that a party seeking to sue on behalf of other aggrieved parties under PAGA must first obtain class certification.²⁷⁸ Rather, the employee bringing the issue stands in the shoes of the Labor Commissioner and may seek to recover penalties in essentially the same manner as the Labor Workforce Development Agency (“LWDA”). The LWDA may pursue penalties against an employer on behalf of employees who do not expressly consent to the LWDA’s efforts. If an employee can establish a violation affects a group of aggrieved employees, then he may prove his case, recover the penalties, and the result of the case will be res judicata (i.e., precluding litigation of the claim) as to the Labor Commissioner and the “aggrieved employees” on whose behalf the action was brought.²⁷⁹ The Court also stated that while PAGA actions need not be brought as class actions, they can be.²⁸⁰

The *Arias* decision raised many questions. For example, if a plaintiff were to pursue a meal period class action as well as a derivative PAGA action for penalties, and a court denied certification of the case on the ground that individualized issues predominate as to whether different employees experienced meal period violations, could the case proceed nonetheless on a collective basis? Presumably, this would require that the plaintiff individually prove each employee’s claim to meal period violations, but if that could be done in a manageable manner, the court likely would have certified a class. If it required each aggrieved employee individually to prove a violation, would each of possibly hundreds of

²⁷⁷ 46 Cal. 4th 969 (2009).

²⁷⁸ *Id.* at 985; see also *Henderson v. JP Morgan Chase Bank*, No. CV 11-3428 PSG, at *8-9 (C.D. Cal. July 10, 2013) (affirming reasoning in *Arias* and denying motion to strike PAGA claims even though class certification was denied with respect to the same claims).

²⁷⁹ *Id.* at 985-86.

²⁸⁰ *Id.* at 981 n.5 (“Actions under the Labor Code Private Attorneys General Act of 2004 may be brought as class actions.”).

such employees be required to appear and testify? And if they failed to do so, would that provide a basis for the court to rule against them on the merits?

The most sensible reading of *Arias* was not that it endorsed the notion that every action for Labor Code civil penalties could proceed collectively without class certification, but rather that it was not *always* necessary to use class action procedures. In cases where the violation can be proven through records or some other collective mechanism (e.g., a minimum wage violation that could be proven by reference to payroll records), an employee could prove it on behalf of a group of aggrieved employees without the need to obtain class certification. Of course, if it were that simple, a plaintiff presumably could obtain class certification, and likely would want to do so. It remains to be seen if appellate courts interpret *Arias* more broadly and if it will lead to a wave of PAGA-only non-class group actions. Thus far, this wave has not materialized.

D. Release of PAGA Claims Through Class Settlement

Plaintiffs' lawyers generally try to avoid characterizing any money from a settlement as being attributed to PAGA claims,²⁸¹ as three-quarters of any such money must be paid to the state.²⁸² Indeed, it is fairly common for plaintiffs' counsel not to assert PAGA claims at all, but rather simply to proceed with Labor Code claims. If the case settles, however, the defendant generally insists that the release cover all claims arising out of the same underlying facts, including any claims for PAGA penalties. Otherwise, the defendant would face the risk of another lawsuit on the same issues.

A dispute may arise if a member of the settlement class later seeks to bring his own PAGA action. The plaintiff will argue that the previous class representative had not exhausted the administrative remedy under PAGA and thus never had a right to release PAGA claims. Rather, until that administrative remedy is exhausted, the plaintiff argues, the PAGA claim is the property of the state. In short, the plaintiff argues that a prerequisite to a release of PAGA claims is the exhaustion of the administrative remedy and the receipt of notice from the state that it is opting not to pursue the claim.

The court of appeal addressed this issue in *Villacres v. ABM Industries Inc.*,²⁸³ and held that the class members could indeed waive their right to pursue PAGA claims and that a judgment entered on such a class settlement creates a res judicata bar to those class members pursuing PAGA claims in a separate action. The court explained that the party in

²⁸¹ See *Nordstrom Com'n Cases*, 186 Cal. App. 4th 576, 589 (2010) (affirming trial court's approval of a class wide settlement that apportioned zero dollars to PAGA claims).

²⁸² It is unclear in a class settlement whether the attorney may recover a percentage of the gross on a common fund basis or whether the state is entitled to three-quarters of the gross sum, with the lawyer being limited to recovering a separate sum on a lodestar basis (reasonable number of hours times a reasonable hourly rate).

²⁸³ 189 Cal. App. 4th 562 (2010).

a PAGA action is the aggrieved employee, rejecting the plaintiff's argument that the State of California is the real party in interest in a PAGA action.

Separate from the res judicata argument, however, an employer may argue that where the class release includes language that the class members are releasing PAGA claims based on the same underlying facts as the Labor Code claims, the doctrine of release precludes any class member from pursuing PAGA relief. In other words, while there is no sort of res judicata bar, basic contract principles of release prevent someone who agreed to the release from going ahead and suing on the released claim. This argument was approved in a federal decision, *Waisbein v. UBS Financial Services Inc.*,²⁸⁴ which is not binding on California courts but is persuasive authority.²⁸⁵ Accordingly, while it remains unsettled whether PAGA claims can be released other than through a settlement of a class action that asserted PAGA claims, the law that exists suggests that such settlements are proper.²⁸⁶

E. Wage Order Claims

California's Industrial Welfare Commission sets forth minimum work standards for California employees in Wage Orders. These Wage Orders contain a variety of provisions that employers must follow, including everything from overtime and minimum wage requirements to the timing of meal and rest breaks. The Wage Orders, however, also contain more obscure sections, with no corresponding Labor Code provision, regulating things such as the location of clocks and, in some cases, bathroom temperature. These obscure sections have inspired claims that their violation constituted a violation of California Labor Code section 1198,²⁸⁷ and therefore give rise to PAGA penalties.

The first case to reach the California Court of Appeal asserting this theory was *Bright v. 99¢ Only Stores*.²⁸⁸ There, Bright filed a putative class action alleging that her employer

²⁸⁴ 2007 U.S. Dist. LEXIS 92051, at *8-9 (Dec. 5, 2007) (“[T]he question is whether the Bowman class members voluntarily entered into an agreement in which they accepted a monetary benefit from UBS in exchange for not pursuing their claims under PAGA. The indisputable answer to that question is ‘yes.’”)

²⁸⁵ *Harris v. Investor's Business Daily, Inc.*, 138 Cal. App. 4th 28, 34 (2006) (“even unpublished federal opinions have persuasive value in [the superior] court”).

²⁸⁶ In any event, the best practice for settling PAGA claims in connection with an action where they were not alleged is to require the plaintiffs' counsel to amend the complaint to include a PAGA claim and also to provide the required notice to the State.

²⁸⁷ California Labor Code section 1198 states:

The maximum hours of work and the standard conditions of labor fixed by the commission shall be the maximum hours of work and the standard conditions of labor for employees. The employment of any employee for longer hours than those fixed by the order or under conditions of labor prohibited by the order is unlawful.

²⁸⁸ 189 Cal. App. 4th 1472 (2010).

violated a requirement in Wage Order 7-2001²⁸⁹ to provide employees with “suitable seats” where the nature of the work reasonably permits their use. Bright argued that 99¢ Only Stores, by violating the Wage Order, also violated California Labor Code section 1198, entitling her to PAGA penalties under Section 2699(f).²⁹⁰

In response to the complaint, 99¢ Only Stores demurred on two grounds: (1) that the violation of the Wage Order’s seating provision is not a violation of Section 1198, because it is not a “prohibited” condition of labor; and (2) that even if a violation of the seating provision was a violation of Section 1198, civil penalties under PAGA are not available because the Wage Order has its own penalty provision.²⁹¹ The trial court sustained the demurrer.²⁹² Bright appealed and the appellate court, in a case of first impression, found in her favor, holding that the seating requirement in Wage Order 7-2001 is a condition of labor under Section 1198 and that the use of the word “prohibited” in the statute did not mean that the conduct had to be prohibited by the Wage Order for it to come within the statute’s protections.²⁹³ Moreover, the court found that the penalties provided for in Wage Order 7-2001 section 20 are, by the Wage Order’s own terms, nonexclusive. And because Section 1198 does not contain its own penalty provision, the penalty provision contained within PAGA applies.²⁹⁴

Shortly thereafter, another Division of the Court of Appeal for the Second District reached the same result. In *Home Depot U.S.A., Inc. v. Superior Court*,²⁹⁵ the appellate agreed with the *Bright* ruling and held that PAGA provides employees with a private right of action to recover civil penalties for violations of the “suitable seats” requirement in Wage Order 7-2001.²⁹⁶

²⁸⁹ Wage Order 7-2001 applies to retail employers.

²⁹⁰ 189 Cal. App. 4th. at 1475.

²⁹¹ *See id.* at 1476.

²⁹² *See id.*

²⁹³ *See id.* at 1478-79.

²⁹⁴ *See id.* at 1481.

²⁹⁵ 191 Cal. App. 4th 210 (2010).

²⁹⁶ *Id.*; *see also Thurman v. Bayshore Transit Management, Inc.*, 203 Cal. App. 4th 1112 (2012) (Fourth District Court of Appeal affirmed a trial court’s award of underpaid “wages”—*i.e.* premium payments for violations of California’s meal and rest period laws and regulations—as a penalty under Cal. Labor Code section 558; underpaid wages may also be recoverable under PAGA).

In another appellate decision validating an action for “suitable seats,” the Ninth Circuit recently held that an employee need not actually request a seat to be entitled to one.²⁹⁷

These cases represent a new breed of class action lawsuit in California.²⁹⁸ Though they refer to the “suitable seats” requirement in Wage Order 7-2001, it is likely that plaintiffs’ counsel will attempt to use the rulings to create private causes of action for similar Wage Order provisions. Courts have differed on whether seating claims are good candidates for class treatment.²⁹⁹

XII. Unfair Competition Claims, Business & Professions Code Section 17200

A. Former Law—Pre-Proposition 64

Beginning in the late 1990s, many plaintiffs in wage and hour cases also filed companion claims under California’s Unfair Competition Law (“UCL”), Business & Professions Code Section 17200, *et seq.* Before the UCL was amended in 2004, it was an extremely potent weapon because it had no traditional standing requirement. Rather, it literally authorized “any person acting for the interests of itself . . . or the general public” to bring an action to enjoin unfair competition. Court decisions gave a generous reading to the term “general public.”³⁰⁰ Moreover, unfair competition was defined as any “unlawful, unfair or fraudulent business practice.” The California Supreme Court construed this language in the disjunctive, so that the UCL was turned into an omnibus consumer protection law, reaching such issues as the sale of whale meat,³⁰¹ the filing of small claims court lawsuits by a

²⁹⁷ *Green v. Bank of America*, 2013 U.S. App. LEXIS 2988, No. 11-56365 (9th Cir. Feb. 13, 2013). The court also held that it would be premature at an early stage of the litigation—when no facts of the case had been developed—to determine whether an award under PAGA was unjust.

²⁹⁸ See also *Garvey v. Kmart Corp.*, No. C 11-02575 WHA, 2012 U.S. Dist. LEXIS 178920 (N.D. Cal. Dec. 18, 2012), the first of the “seating” cases to go to trial, plaintiff alleged that Kmart Corp. failed to provide suitable seating for checkout cashiers in violation of Labor Code § 1198 and Section 14(A) of Industrial Welfare Commission Wage Order 7-2001. The court summarized its holding: “All working employees shall be provided with suitable seats when the nature of the work reasonably permits the use of seats,” according to the law in California. In this civil action, class counsel have failed to prove that the nature of the work reasonably permits the seating modification urged by counsel at trial. Possibly a different modification involving a lean-stool would be provable but this record does not support it.” *Id.* at *2.

²⁹⁹ In *Hall v. Rite Aid Corp.*, San Diego Superior Court Case No. 37-2009-00087938-CU-OE-CTL (Oct. 11, 2012), the trial court granted Rite Aid Corp.’s motion to decertify a class of cashiers and clerks, concluding that individualized issues predominated as to whether the “nature of the work” of a cashier reasonably permitted the use of a suitable seat. The court concluded that the Rite Aid cashier job must be viewed as a whole, but the evidence demonstrated that an improper individual-by-individual analysis was required. However, in *Garvey v. Kmart Corp.*, *supra*, the federal district court found a seating claim by cashiers to be a good fit for class treatment, at least as to a single store.

³⁰⁰ A UCL representative action cannot, however, be brought on behalf of sophisticated business entities in their capacities as “consumers” of goods or services. *Rosenbluth Int’l, Inc. v. Superior Court*, 101 Cal. App. 4th 1073 (2002).

³⁰¹ *People v. Sakai*, 56 Cal. App. 3d 531 (1976).

collection agency in counties distant from where the defendants live,³⁰² the use of the “Joe Camel” caricature to advertise cigarettes,³⁰³ marketing sugar coated breakfast cereals as something other than candy,³⁰⁴ and the sale of cigarettes to minors. The statute has never, however, permitted damage awards.³⁰⁵ It has authorized only injunctive relief, including, significantly, any order that “may be necessary to restore to any person in interest any money or property . . . which may have been acquired by means of such unfair competition”—i.e., restitution.

The California Supreme Court held that restitution included ordering an employer who failed to pay premium overtime pay required by statute to disgorge the premium pay to the affected employees,³⁰⁶ an exercise functionally equivalent to paying damages for a statutory overtime claim under the Labor Code. California courts have subsequently clarified, however, that equitable relief does not include forcing the defendant to go beyond returning money wrongfully withheld from the plaintiff by disgorging additional profits the employer earned as a result of its unfair practices.³⁰⁷

There were three primary advantages a plaintiff would gain by joining a UCL claim to a wage and hour suit. First, because the restitutionary remedy under the UCL was similar to a damages remedy for a wage law violation, a companion UCL claim effectively expanded the statute of limitations on a Labor Code wage claim³⁰⁸ from three years to four years, the length of the UCL’s statute of limitations.³⁰⁹ Second, a UCL claim provided a potential vehicle for plaintiffs to secure class relief without satisfying the procedural burdens of class certification.³¹⁰ Third, a plaintiff who lacked traditional standing to sue because he or she was never impacted by an alleged wage and hour or Labor Code violation could

³⁰² *Barquis v. Merchants Collection Ass’n*, 7 Cal. 3d 94 (1972).

³⁰³ *Mangini v. R. J. Reynolds Tobacco Co.*, 7 Cal. 4th 1057 (1994).

³⁰⁴ *Comm. on Children’s Television, Inc. v. Gen. Foods Corp.*, 35 Cal. 3d 197 (1983).

³⁰⁵ The UCL cannot be used, for instance, to recover waiting time penalties, precisely because the damage awards are penalties and not compensation. *Pineda v. Bank of America, N.A.*, 170 Cal. App. 4th 388 (2009), *review granted*, 207 P.3d 1 (2009). The UCL also cannot be used to recover attorneys’ fees; these may be recovered only in cases where the UCL is used to “borrow” other laws that specifically provide for recovery of attorneys’ fees. *People ex rel. City of Santa Monica v. Gabriel*, 186 Cal. App. 4th 882 (2010).

³⁰⁶ *Cortez v. Purolator Air Filtration Prods. Co.*, 23 Cal. 4th 163, 177-78 (2000).

³⁰⁷ *Korea Supply Co. v. Lockheed Martin Corp.*, 29 Cal. 4th 1134, 1152 (2003); *see also Feitelberg v. Credit Suisse First Boston, LLC*, 134 Cal. App. 4th 997 (2005) (non-restitutionary disgorgement of profits unavailable under UCL even where case has been certified as a class action).

³⁰⁸ Labor Code penalties, however, are not recoverable under the UCL, because they do not constitute restitution. *See, e.g., Pineda v. Bank of America*, 50 Cal. 4th 1389, 1401-2 (2010) (Labor Code section 203 waiting time penalties are not recoverable under the UCL).

³⁰⁹ *Cortez*, 23 Cal. 4th at 179.

³¹⁰ *Kraus v. Trinity Mgmt. Servs., Inc.*, 23 Cal. 4th 116 (2000).

nonetheless sue as a “private attorney general” on behalf of those employees who were impacted by the violation.³¹¹

B. Reform of the Law—Passage of Proposition 64

On November 2, 2004, California voters passed Proposition 64 (“Prop 64”), which amended two of the three broadest aspects of the UCL—i.e., the near-universal standing requirement and the ability to bring a collective action without obtaining class certification. Prop 64 had no impact on the governing statute of limitations for UCL claims, however.

With respect to standing, Prop 64 revised Business & Professions Code Section 17203 and 17204 to impose real standing requirements on individuals seeking to bring UCL claims. The statute previously gave standing to sue to any person suing on behalf of the “general public.” Individual standing under the UCL is now limited to a person “who has suffered injury in fact and has lost money or property as a result of . . . unfair competition.”³¹² The proponents of the law argued that this change was intended to stop “shakedown lawyers” who “appoint themselves to act like the Attorney General and file lawsuits on behalf of the people of the State of California.”³¹³ The proponents also argued that voters should support Prop 64 because it “[p]rotects your right to file a lawsuit if you have been damaged” while it “[a]llows only the Attorney General, district attorneys, and other public officials to file lawsuits on behalf of the People of the State of California to enforce California’s unfair competition laws.”³¹⁴

As for class certification requirements, Prop 64 amended Business & Professions Code Section 17203 to include an express requirement that individuals seeking to bring collective actions under the UCL must satisfy the requirements for class certification set forth in Section 382 of the Code of Civil Procedure, including (1) a community of interest among the class members; (2) common questions of law or fact which predominate over individualized issues; (3) a claim that is typical of the class; and (4) the plaintiff must be able to adequately represent the interests of the class.³¹⁵

³¹¹ *Stop Youth Addiction v. Lucky Stores, Inc.*, 17 Cal. 4th 553 (1998) (purported anti-smoking public interest advocacy organization had standing under UCL to sue Lucky Stores for allegedly selling cigarettes to minors).

³¹² Bus. & Prof. Code § 17204.

³¹³ Official Voter Information Guide, Arguments and Rebuttals, Proposition 64, www.voterguide.ss.ca.gov/propositions/prop64-arguments.htm (accessed November 17, 2004).

³¹⁴ Official Voter Information Guide, Arguments and Rebuttals, Proposition 64, www.voterguide.ss.ca.gov/propositions/prop64-arguments.htm (accessed November 17, 2004).

³¹⁵ *Lockheed Martin Corp. v. Superior Court*, 29 Cal. 4th 1096, 1103-04 (2003).

C. Proposition 64's Restrictions on UCL Class Actions

An issue raised by Prop 64 was whether, in a UCL-based class action, the Prop 64 standing requirement applies to all members of the proposed class, or just to the class representatives. Initially, it appeared that courts were tending toward requiring all class members to have standing.³¹⁶ However, in 2009, the California Supreme Court handed down *In re Tobacco Cases II*,³¹⁷ which held that Prop 64's standing requirement applied only to the class representative and not to each and every person within the proposed class. More specifically, the California Supreme Court held that:

imposing this unprecedented requirement would undermine the guarantee made by Proposition 64's proponents that the initiative would not undermine efficacy of the UCL as a means of protecting consumer rights, because requiring all unnamed members of a class action to individually establish standing would effectively eliminate the class action lawsuit as a vehicle for the vindication of such rights.³¹⁸

The ramifications of *Tobacco II* are substantial. In many wage and hour class actions, the plaintiffs use a UCL claim to extend the statute of limitations on their statutory claims to four years. In most of these cases, however, a significant portion of the certified class did not lose any money or property as a result of the violation, but plaintiffs argue that the mere fact that some class members have no damages does not preclude certification. For example, significant numbers of managers may not have worked any overtime, or significant numbers of a meal period class may have actually taken all their meal periods. After *Tobacco II*, trial courts may still certify classes despite the existence of members of the class without any grounds for recovery.³¹⁹ While this is largely the way the courts had handled class actions traditionally, if the California Supreme Court had adopted the position of the dissent in *Tobacco II*, it might have substantially undercut the ability to use the UCL as a vehicle for advancing Labor Code class actions.^{320 321}

³¹⁶ See, e.g., *Pfizer, Inc. v. Superior Court*, 141 Cal. App. 4th 290 (2006).

³¹⁷ 46 Cal. 4th 298 (2009).

³¹⁸ *Id.* at 321.

³¹⁹ See *Sav-On*, 34 Cal. 4th at 333 (explaining that "a class action is not inappropriate simply because each member of the class may at some point be required to make an individual showing as to his or her eligibility for recovery or as to the amount of his or her damages").

³²⁰ Nevertheless, the reforms instituted by Proposition 64 still do apply where the class representatives themselves lack any basis for recovery. See, e.g., *Birdsong v. Apple*, 590 F.3d 955, 959-62 (9th Cir. 2009) (dismissing putative class action where plaintiffs alleged that injury was possible, but failed to allege that they themselves suffered any actual harm).

³²¹ Another key development in regard to the application of the UCL was the decision of the California Supreme Court in *Sullivan v. Oracle*, 51 Cal. 4th 1191 (2011). There, the Court held that overtime work performed by out-of-state employees within California can serve as the basis for a claim under California's FLSA claims by competition law. Cal.

XIII. Class Action Fairness Act of 2005

A. The Purpose of the Act

The Class Action Fairness Act of 2005 (“CAFA”) amended the federal diversity jurisdiction statute, 28 U.S.C.A. § 1332, to broaden the basis for federal diversity jurisdiction. In enacting the CAFA, Congress’s intent was to shift class action litigation from state courts to the federal courts.³²² The most significant increase in filings of class actions has been in labor class actions.³²³ Most of these class actions are brought under either F.R.C.P. 23 or the Fair Labor Standards Act (FLSA).³²⁴

B. General Requirements

The CAFA grants the federal court jurisdiction over any class action in which: 1) the proposed class consists of at least 100 members, 2) the total amount in controversy exceeds \$5 million after combining claims, exclusive of interest and costs, and 3) there is diversity between at least one plaintiff class member and one defendant.³²⁵

The CAFA expands the jurisdiction of the federal courts to hear class action lawsuits and replaces the strict complete diversity requirement with a more lenient rule, thereby granting jurisdiction where *any* diversity exists between plaintiffs and defendants.³²⁶ CAFA diversity exists when at least one plaintiff is a citizen of one state and one defendant is a citizen of a different state, or when one plaintiff is a citizen of a foreign country and one defendant is a U.S. citizen, or when one plaintiff is a U.S. citizen and one defendant is a citizen of a foreign country.³²⁷

Bus. & Prof. Code § 17200 (“UCL”). However, the Court also held that out-of-state employees working outside California cannot serve as the basis for a California UCL claim. Although the *Sullivan* Court explicitly limited its decision to “the circumstances of this case,” it is anticipated that the plaintiff’s bar will argue that a logical extension of its reasoning suggests that similar conclusions may result for non-California-based employers. The *Sullivan* Court declined to opine on the different burdens that a non-California-based employer may face in applying California overtime laws to nonresident employees working in California, but the plaintiff’s bar will undoubtedly seek to obtain judicial rulings that the California Supreme Court’s conflict of laws analysis suggests no reason for why a different conclusion would result for non-California-based employers.

³²² Federal Judicial Center, *Impact of CAFA on the Federal Courts: Fourth Interim Report*, at 1-2, Apr. 2008 (reporting a 72% increase in class action cases filed in the 88 district courts from January to June 2007 compared with July to December 2001).

³²³ *Id.* at 7.

³²⁴ *Id.* (reporting a 228 percent increase when comparing the first six-month period to the last six-month period).

³²⁵ 28 U.S.C. § 1332(d)(2). CAFA does not confer federal subject matter jurisdiction when the primary defendants are states, state officials, or other governmental entities against whom the district court may be foreclosed from ordering relief. *Id.* § 1332(d)(5).

³²⁶ *Natale v. Pfizer, Inc.*, 379 F. Supp. 2d 161, 167 (D. Mass. 2005), *aff’d*, 424 F.3d 43 (1st Cir. 2005).

³²⁷ *Id.* § 1332(d)(2); *Bush v. Cheaptickets, Inc.*, 425 F.3d 683, 684 (9th Cir. 2005).

The CAFA defines *class actions* as any civil action filed under Federal Rule of Civil Procedure 23 or similar state law.³²⁸ Also included within this definition, for removal purposes, are *mass actions*, i.e., actions in which monetary claims by 100 or more plaintiffs are proposed to be tried jointly because they involve *common questions of law or fact*.³²⁹

The CAFA is not retroactive and does not apply to class actions filed in state court before its enactment on February 18, 2005, and removed to federal court after that date.³³⁰

C. Removal Under CAFA

The burden of establishing removal jurisdiction remains on the proponent of federal jurisdiction.³³¹ Removal must be timely and must be done during one of two thirty-day periods for removing the case. The first thirty-day removal period is triggered “if the case stated by the initial pleading is removable on its face.”³³² The second thirty-day removal period is triggered if the initial pleading does not indicate that the case is removable, and the defendant receives “a copy of an amended pleading, motion, order or other paper” from which removability may first be ascertained.³³³

If a complaint alleges damages in excess of \$5 million, then the amount in controversy is “presumptively satisfied” unless it appears *to a legal certainty* that the claim is actually for less than the jurisdictional minimum.³³⁴

If the complaint fails to specify any amount in damages, the removal papers must provide the court with facts to support the jurisdictional amount. Moreover, the Ninth Circuit has held that the defendant seeking removal must prove by a “preponderance of the evidence” that the amount in controversy has been met.³³⁵

The third scenario is when the complaint affirmatively states that the amount in controversy is *less than* \$5 million. The Ninth Circuit addressed this situation in *Lowdermilk v. United States Bank*, holding that the removing defendant must prove to a “legal certainty” that the

³²⁸ 28 U.S.C. § 1332(d)(1)(B). At least one district court has held that representative actions under PAGA are not “class actions” and therefore are not removable pursuant to CAFA. *Sample v. Big Lots Stores, Inc.*, 2010 WL 4939992 (N.D. Cal.)

³²⁹ *Id.* § 1332 (d) (11)(B)(i).

³³⁰ See *Bush v. Cheaptickets, Inc.*, 425 F.3d 683 (9th Cir. 2005).

³³¹ See *Standard Fire Ins. Co. v. Knowles*, 133 S. Ct. 1345 (2013); *Rodriguez v. AT&T Mobility Services LLC*, 728 F.3d 975 (9th Cir. 2013).

³³² *Harris v. Bankers Life & Cas. Co.*, 425 F.3d 689, 694 (9th Cir. 2005).

³³³ *Carvalho v. Equifax Info. Serv., LLC*, 629 F.3d 876, 885 (9th Cir. 2010).

³³⁴ *Abrego Abrego v. Dow Chem. Co.*, 443 F.3d 676 n.8 (9th Cir. 2006).

³³⁵ *Id.* at 683; *Sanchez v. Monumental Life Ins. Co.*, 102 F.3d 398, 404 (9th Cir.1996).

CAFA amount in controversy has been met.³³⁶ The Ninth Circuit noted that federal courts are courts of “limited jurisdiction” and therefore should strictly construe subject matter jurisdiction.³³⁷ Second, the court noted that the plaintiff is “master of her complaint” and can plead to avoid federal jurisdiction.³³⁸ Moreover, the court raised the bar in cases where there is no evidence of bad faith, requiring the defendant to not only contradict the plaintiff’s own assessment of damages, but also overcome the presumption against federal jurisdiction.³³⁹

The *Lowdermilk* rule threatened to eviscerate CAFA by making it easy for plaintiffs to avoid removal by disingenuously stating that the amount in controversy was less than \$5 million. Plaintiffs could then later amend their complaints or otherwise contend that they had discovered additional evidence supporting greater damages than they had initially alleged, and there was no way to bind class members to the initial amount-in-controversy estimate.

Lowdermilk was dealt an initial blow in 2013 when the United States Supreme Court restored CAFA’s integrity in *Standard Fire Insurance Co. v. Knowles*.³⁴⁰ There, the named plaintiff, Knowles, claimed that his homeowners insurer had shorted him and “hundreds [or] possibly thousands” of other policyholders in the putative class that he sought to represent by failing to include certain benefits when paying out claims. Knowles sued in Arkansas state court and attempted to avoid removal to federal court by stating in his complaint that he was seeking less than \$5 million in damages on behalf of the class.³⁴¹

The defendant nonetheless removed the case to federal court, invoking CAFA. In analyzing jurisdiction, the district court concluded that the total potential damages put in controversy by the class action claim exceeded the threshold amount. But the court concluded that the plaintiff’s statements that he would not seek more than \$5,000,000 on behalf of the class served to limit the amount in controversy to less than the jurisdictional minimum, making CAFA inapplicable.³⁴²

³³⁶ *Lowdermilk v. United States Bank*, 479 F.3d 994, 1000 (9th Cir. 2007); see also *CiFuentes v. Red Robin Int’l, Inc.*, No. C-11-5635-EMC, 2012 WL 693930 (N.D. Cal. 2012) (holding that defendants failed to provide “concrete evidence” to estimate the amount in controversy to a “legal certainty” as required under *Lowdermilk* —“a very high, although not insurmountable, threshold for defendants.”).

³³⁷ *Id.* at 998.

³³⁸ *Id.* at 999.

³³⁹ *Id.*

³⁴⁰ 133 S. Ct. 1345 (2013).

³⁴¹ *Id.* at 1347.

³⁴² *Id.* at 1348.

After the Eighth Circuit declined the insurer's interlocutory appeal, the Supreme Court granted certiorari.³⁴³ The Court overturned the trial court's holding and found that the plaintiff's supposed "stipulation" did not limit the amount in controversy in the case. Writing for a unanimous Court, Justice Breyer noted that while the plaintiff could agree to limit his *own* request for damages, he could not do so on behalf of absent members of a class that no court had yet empowered him to represent.³⁴⁴ These individuals thus might seek more damages if, for example, Knowles was replaced as the named plaintiff or another class member intervened in the case. Because the named plaintiffs' stipulation was thus not effective, the district court's original finding that the total potential damages in the case exceeded \$5,000,000 was controlling and the requirements for CAFA jurisdiction were met.³⁴⁵

Although *Standard Fire* is incompatible with *Lowdermilk*, it did not expressly overrule it. Because of this, some courts in California clung to the notion that removing defendants must prove to a "legal certainty" that the CAFA amount in controversy has been met. The Ninth Circuit corrected this situation in *Rodriguez v. AT&T Mobility Inc.*,³⁴⁶ holding that the Supreme Court's ruling in *Standard Fire* effectively overturned *Lowdermilk*. In *Rodriguez*, the Ninth Circuit found that the lead plaintiff's asserted waiver of any claim in excess of the \$5 million amount-in-controversy requirement was ineffective in light of *Standard Fire*.³⁴⁷ Accordingly, the court held that the proper burden of proof imposed upon a defendant to establish the jurisdictional amount is the "preponderance of the evidence" standard, and not the "legal certainty" standard set forth in *Lowdermilk*.³⁴⁸

1. "Other Paper" Requirement

Defendants should be aware that mere verbal statements that opposing counsel or the plaintiff make regarding the amount in damages may not qualify as the "other paper" that can trigger removal.³⁴⁹ The published decisions have considered only oral statements made in the context of mediation and settlement communications, so

³⁴³ *Id.*

³⁴⁴ *Id.* at *1348-49.

³⁴⁵ *Id.* at 1350.

³⁴⁶ 728 F.3d 975 (9th Cir. 2013).

³⁴⁷ *Id.* at 982.

³⁴⁸ *Id.* at 981.

³⁴⁹ See *Molina v. Lexmark Int'l, Inc.*, 2008 U.S. Dist. LEXIS 22031, at *4 (C.D. Cal. 2008) (holding that oral communications during settlement do not constitute "other papers for the purposes of § 1446(b)"); see also *Jiminez v. Sears, Roebuck & Co.*, 2010 U.S. Dist. LEXIS 22031, at *4 (C.D. Cal. 2010); see also *Mendoza v. OM Fin. Life Ins. Co.*, 2009 U.S. Dist. LEXIS 59008 (N.D. Cal. 2009).

it is unclear whether oral statements made in other contexts can be used to satisfy the “other paper” requirement.

The Ninth Circuit has established the framework for determining whether the amount in controversy meets the jurisdictional threshold. A district court “may consider whether it is ‘facially apparent’ from the complaint that the jurisdictional amount is in controversy. If not, the court may consider facts in the removal petition, and may ‘require parties to submit summary-judgment-type evidence relevant to the amount in controversy at the time of removal’.”³⁵⁰

2. Premature Removal and Sanctions

The Ninth Circuit has made clear that it disfavors premature removal. The seminal case, *Abrego Abrego v. The Dow Chemical Co.*, reaffirmed the principle of “guard[ing] against premature and protective removals and minimiz[ing] the potential for a cottage industry of removal litigation.”³⁵¹ The court reminded the parties that CAFA’s legislative history agreed with such a conclusion, citing to a portion of the Senate Judiciary Committee Report:

The Committee understands that in assessing the various criteria established in all these new jurisdictional provisions, a federal court may have to engage in some fact-finding, not unlike what is necessitated by the existing jurisdictional statutes. The Committee further understands that in some instances, limited discovery may be necessary to make these determinations. However, the Committee cautions that these jurisdictional determinations should be made largely on the basis of readily available information. Allowing substantial, burdensome discovery on jurisdictional issues would be contrary to the intent of these provisions to encourage the exercise of federal jurisdiction over class actions.³⁵²

Defendants eager to remove a case should also consider the possibility of sanctions in the event their removal petition is deemed unreasonable. The Supreme Court has noted that an award of costs and fees is permissible under Section 1447(c), when “such an award is just” and “the removing party lacked an objectively reasonable basis for removal.”³⁵³ The Ninth Circuit has also previously stated that an award of

³⁵⁰ *Singer v. State Farm Mutual Auto. Ins. Co.*, 116 F.3d 373, 377 (9th Cir. 1997) (citing *Allen v. R&H Oil & Gas Co.*, 63 F.3d 1326 (5th Cir. 1995)).

³⁵¹ *Abrego Abrego*, 443 F.3d at 691.

³⁵² *Id.* at 692 (citing S. Rep. No. 109-14, at 44, 2005 U.S.C.C.A.N. at 42 (emphasis added)).

³⁵³ *Martin v. Franklin Capital Corp.*, 546 U.S. 132 (2005); see also *Mosaic Sys., Inc. v. Bechtolsheim*, No. C 07-3892-SI, 2007 WL 3022581, at *5 (N.D. Cal. Oct. 15, 2007) (denying request for fees and costs given “objectively reasonable” basis for removal); *Gardner v. UICI*, 508 F.3d 559, 561-62 (9th Cir. 2007) (reversing award of fees and costs where

attorney fees is permitted even when defendant's removal was "fairly supportable," but wrong as a matter of law.³⁵⁴ But, a California federal district court has previously held that all a defendant may need to support the removal is an argument "that is not irrational or implausible."³⁵⁵

D. Exceptions to CAFA Jurisdiction

There are narrow exceptions to CAFA jurisdiction.³⁵⁶ The party that is seeking remand back to the state court bears the burden of proof in establishing any exceptions to CAFA jurisdiction.³⁵⁷

1. Local Controversy Exception

Under the local controversy exception, a federal court must decline jurisdiction where: (1) greater than 2/3 of the proposed class members are citizens of the forum state, (2) at least one "significant" defendant (i.e., from whom significant relief is sought and whose alleged conduct forms a significant basis for the claims asserted by the class) is a citizen of the forum state, (3) the principal injuries caused by the alleged conduct or any related conduct of each defendant were incurred in the forum state, and (4) no other class action was filed within the past three years asserting the same or similar factual allegations against any of the defendants on behalf of the same or other persons.³⁵⁸

Some circuits, including the Eleventh Circuit, have made it clear that the CAFA's language favors federal jurisdiction over class actions and that its legislative history suggests that Congress intended the local controversy exception to be a narrow one, "with all doubts resolved 'in favor of exercising jurisdiction over the case.'"³⁵⁹ Consistent with this notion, several circuits agree that the party seeking remand back to the state court bears the burden to demonstrate that the court lacks jurisdiction under the "local controversy" exception.³⁶⁰

removing party had "an objectively reasonable basis for removal;" if a "reasonable litigant . . . could have concluded that federal court was the proper forum," a request for fees and costs must be denied).

³⁵⁴ *Balcorta v. Twentieth Century-Fox Film Corp.*, 208 F.3d 1102, 1106 n.6 (9th Cir. 2000).

³⁵⁵ *Hornung v. City of Oakland*, No. C-05-4825 EMC, 2006 WL 279337, at *4 (N.D. Cal. Feb. 3, 2006).

³⁵⁶ 28 U.S.C. § 1332(d)(4)(A)-(B).

³⁵⁷ *Serrano v. 180 Connect, Inc.*, 478 F.3d 1018, 1024 (9th Cir. 2007).

³⁵⁸ 28 U.S.C. § 1332(d)(4).

³⁵⁹ *Evans v. Walter Indus., Inc.*, 449 F.3d 1159 (11th Cir. 2006).

³⁶⁰ See *Serrano*, 478 F.3d at 1019 (noting agreement with other circuits that party seeking remand must demonstrate applicability of "local controversy" exception); *Frazier v. Pioneer Americas LLC*, 455 F.3d 542, 546 (5th Cir. 2006); *Hart v. FedEx Ground Package Sys. Inc.*, 457 F.3d 675, 680-81 (7th Cir. 2006); see also S. Rep. No. 109-14, at 44 ("It is the

The Ninth Circuit finally addressed this issue on January 25, 2011, in *Coleman v. Estes Express Lines*, holding that a “district court cannot look beyond the complaint in determining whether the criteria of subsections (aa) [“significant relief”] and (bb) [“significant basis”] have been satisfied.”³⁶¹ Thus, extrinsic evidence will not be considered in evaluating this exception. The court explained that this conclusion was required not only by the plain language of these subparts, but also because any contrary holding would result in an expansive “mini-trial,” contrary to congressional intent that jurisdiction determinations be made quickly under CAFA.³⁶²

2. Home State Exception

Under the home state exception, a federal court must decline jurisdiction where: (1) 2/3 or more of the proposed class members are citizens of the forum state and (2) the primary defendants are citizens of the forum state.³⁶³ Unlike the local controversy exception, this exception does not require the court to consider other lawsuits. The party moving to remand the class action to state court must prove that the home state exception applies.³⁶⁴

E. Waiver

A defendant may be considered to have waived the right to remove to federal court when, after it is apparent that the case is removable, it takes actions in state court that manifest an intent to have the matter adjudicated there.³⁶⁵

The Ninth Circuit has held that “a waiver of the right of removal must be clear and unequivocal.”³⁶⁶ In *Carvalho v. Equifax Info. Serv., LLC*, the plaintiffs argued that defendant’s removal was untimely because defendant filed a demurrer in state court and then waited a year after the complaint was filed to remove.³⁶⁷ The district court held that because the complaint did not specify an amount of damages, the defendant’s filing of a demurrer did not waive its right to remove.³⁶⁸ The court stressed that the defendant did not

Committee’s intention with regard to each of these exceptions that the party opposing federal jurisdiction shall have the burden of demonstrating the applicability of an exemption.”).

³⁶¹ *Coleman v. Estes Express Lines*, 631 F.3d 1010, 1015 (9th Cir. 2011).

³⁶² *Id.* at 1017.

³⁶³ 28 U.S.C. § 1332(d)(4)(B).

³⁶⁴ *Serrano*, 478 F.3d at 1024.

³⁶⁵ *Resolution Trust Corp. v. Bayside Developers*, 43 F.3d 1230, 1240 (9th Cir. 1995).

³⁶⁶ *Id.*

³⁶⁷ *Carvalho v. Equifax Info. Serv. LLC*, 2008 WL 2693625, at *4 (N.D. Cal. 2008).

³⁶⁸ *Id.*

engage in “any conduct that manifested its intent to stay in state court” after removability was first ascertained, and therefore did not waive its right.³⁶⁹

F. After Removal and Effect of Denial of Class Certification

A long-standing rule set out by the United States Supreme Court (the “*Red Cab* rule”) is that “events occurring subsequent to removal which reduce the amount recoverable, whether beyond the plaintiff’s control or the result of his volition, do not oust the district court’s jurisdiction once it has attached.”³⁷⁰ Although courts have disagreed over whether denial of class certification affects federal jurisdiction, the trend is to apply the *Red Cab* rule in this context as well.

A number of courts have held that denial of class certification eliminates CAFA jurisdiction as to that federal court, especially if it is not “reasonably foreseeable” that a class will be certified in the future.³⁷¹ Other courts have held that denial of class certification does *not* destroy CAFA jurisdiction, because jurisdiction is determined at the moment the case was removed and thus any subsequent changes do not affect the court’s continued jurisdiction.³⁷²

Initially, the decisions were split on this issue among the various California district courts. In *In re HP Inkjet Printer Litigation*, a court in the Northern District extended the *Red Cab* rule to apply to CAFA jurisdiction. The court held that it continued to have subject matter jurisdiction even after denying the motion to certify a nationwide class.³⁷³ But in *Arabian v. Sony Electronics*, a Southern District court held otherwise, dismissing the case for lack of subject matter jurisdiction because a class could not be certified, nor was certification likely in the foreseeable future.³⁷⁴ And in *Darneal v. Allied Waste Transp., Inc.*, a defendant employer attempted to obtain remand to state court because it realized it had erroneously calculated the number of potential class members when it originally removed the case.³⁷⁵

³⁶⁹ *Id.*

³⁷⁰ *St. Paul Mercury Indem. Co. v. Red Cab Co.*, 303 U.S. 283, 293 (1938).

³⁷¹ *McGaughey v. Treistman*, 2007 WL 24935, at *3-4 (S.D.N.Y. 2007); *Gonzalez v. Pepsico, Inc.*, 2007 WL 1100204, at *4 (D. Kan. 2007).

³⁷² *Vega v. T-Mobile, USA, Inc.*, 564 F.3d 1256, 1268 at n. 12 (11th Cir. 2009); *Cunningham Charter Corp. v. Learjet, Inc.*, 592 F.3d 805, 806 (7th Cir. 2010); *Falcon v. Phillips Electronics N.A., Corp.*, 489 F. Supp. 2d 367 (S.D.N.Y. 2007); *In re HP Inkjet Printer Litig.*, 2009 U.S. Dist. LEXIS 12271 (N.D. Cal. Feb. 5, 2009); *Giannini v. Schering-Plough Corp.*, 2007 U.S. Dist. LEXIS 48392, at *7-8 (N.D. Cal. June 26, 2007) (holding that jurisdiction was not necessarily divested upon post-removal action and that supplemental jurisdiction provided the basis for retaining subject matter jurisdiction of the claim at hand).

³⁷³ *In re HP Inkjet Printer Litig.*, 2009 U.S. Dist. LEXIS 12271, at *7.

³⁷⁴ *Arabian v. Sony Elecs. Inc.*, 2007 WL 2701340 (S.D. Cal. 2007).

³⁷⁵ *Darneal v. Allied Waste Transp., Inc.*, 2010 WL 5292341 (E.D. Cal. 2010).

The court refused to remand, holding that the question of the number of potential class members is a factual inquiry that is likely to be resolved through continued litigation.

The Ninth Circuit Court of Appeal resolved this split in *United Steel, Paper & Forestry, Rubber, Manufacturing, Energy, Allied Industrial & Service Workers International Union v. Shell Oil Co.*³⁷⁶ In that case, the defendant, represented by Seyfarth Shaw, defeated plaintiffs' motion for class certification, and plaintiffs thereafter obtained remand to state court on the grounds that there was "no reasonably foreseeable possibility" that a class would be certified, and that therefore CAFA's jurisdictional requirements could not be satisfied.³⁷⁷ The Ninth Circuit disagreed, and held that, in the context of CAFA jurisdiction, the *Red Cab* rule applies "because no one suggests that a class action must be certified before it can be removed to federal court under the Act."³⁷⁸

G. Settlement Process

The enactment of CAFA has also brought changes to class action settlement procedures.³⁷⁹ In contingency fee cases, if a proposed settlement of a class action provides for provision of coupons to class members, the portion of any attorney's fee award that is attributable to the coupons is based on the value to class members of the coupons that are actually redeemed.³⁸⁰ Alternatively, the fee award may be based on the lodestar method which considers the amount of time the class counsel reasonably expended working on the action.³⁸¹

In any event, in connection with any proposed coupon settlement, the court may approve the settlement only after a hearing and "a written finding" that the settlement is "fair, reasonable, and adequate for class members."³⁸²

In *True v. American Honda Motor Company*, the district court reiterated that heightened scrutiny is necessary in reviewing coupon settlements, which are generally disfavored.³⁸³ The court gave three reasons why such settlements are generally disfavored: "they often do not provide meaningful compensation to class members; they often fail to disgorge ill-gotten gains from defendant; and they often require class members to do future business

³⁷⁶ 602 F.3d 1087, 1091-2 (9th Cir. 2010)

³⁷⁷ *Id.* at 1090.

³⁷⁸ *Id.* at 1091.

³⁷⁹ 28 U.S.C. § 1711.

³⁸⁰ *See id.* § 1712(a).

³⁸¹ *See id.* § 1712(b)(1).

³⁸² *See id.* § 1712(e).

³⁸³ *True v. Amer. Honda Motor Co.*, 749 F. Supp. 2d 1052, 1069 (C.D. Cal. 2010).

with the defendant in order to receive compensation.”³⁸⁴ Nonetheless, coupon settlements can be approved if the value of the specific coupon settlement is “reasonable in relation to the value of the claim surrendered.”³⁸⁵

Settling parties must also be careful to avoid conditioning incentive awards to class representatives on their acceptance of the settlement. In *Radcliffe v. Experian Info Solutions*, the Ninth Circuit determined that class counsel and class representatives were inadequate where a settlement conditioned the provision of incentive awards to class representatives on the representatives’ approval of the settlement.³⁸⁶ The Ninth Circuit reasoned that this condition “corrupted” the settlement by motivating the class representatives to support a possibly unfair settlement in exchange for the award, as opposed to seeking a fair settlement for the entire class.³⁸⁷

Settlements may also not be approved if any class member is forced to pay an amount to class counsel that would result in a net loss to the class member, unless the court makes a written finding that the benefits substantially outweigh the loss.³⁸⁸ Finally, the court will not approve a settlement that provides for a payment to some class member that is more than the payment to others solely due to their geographic proximity to the court.³⁸⁹

The CAFA also contains specific requirements regarding the issuance of class settlement notifications.³⁹⁰ The CAFA requires defendants to serve a notice on (1) the “appropriate federal official” and (2) the “appropriate state official.”³⁹¹ The notice must include several things, including copies of the complaint, notices of scheduled judicial hearings, proposed or final notification to class members of rights to request for exclusion, any proposed or final class action settlement, among other papers.³⁹²

³⁸⁴ *Id.* (citing *Figuroa v. Sharper Image Corp.*, 517 F. Supp. 2d 1292, 1302 (S.D. Fla. 2007)).

³⁸⁵ *Id.*

³⁸⁶ *Radcliffe v. Experian Info. Solutions*, 715 F.3d 1157 (9th Cir. 2013).

³⁸⁷ *Id.* at 1164. The Court went on to explain that a large disparity between the incentive award and the payments to the rest of the class members “exacerbated the conflict.” *Id.* at 1165.

³⁸⁸ *See* 28 U.S.C. § 1713.

³⁸⁹ *See* 28 U.S.C. § 1714.

³⁹⁰ *See* 28 U.S.C. § 1715.

³⁹¹ *See id.* § 1715(a).

³⁹² *See id.* § 1715(b).

XIV. Class Certification

A. General Requirements

In order to certify a class action, plaintiffs must show “the existence of an ascertainable class and a well-defined community of interest among the class members.” The community of interest requirement embodies three factors: (1) predominant common questions of law or fact, (2) class representatives with claims or defenses typical of the class, and (3) class representatives who can adequately represent the class.³⁹³ There must also be enough class members to make the effort worthwhile. These elements are referred to as ascertainability, commonality or predominance, typicality, adequacy, and numerosity. Class certification is most often defeated on commonality or predominance grounds, and less often on the grounds of typicality, adequacy, ascertainability, and numerosity.

In the past, some defendants resisted class certification by arguing that plaintiffs would not be able to establish liability on the merits. In 2000, the California Supreme Court formally rejected such a practice, holding that a trial court could not consider the factual or legal merits in deciding class certification, except to the (limited) extent that the merits affected the ascertainability of the class.³⁹⁴ In other words, while it is appropriate for the trial court to examine the evidence closely to determine if the relevant class action factors have been met (e.g., predominance of common issues), the court may not deny class certification on the ground that the class claims ultimately lack substantive merit.³⁹⁵

However, as discussed in more detail below, courts must make necessary factual and legal inquiries regardless of whether they overlap with the merits, in order to ascertain whether the claims alleged are amenable to resolution on a class-wide basis.³⁹⁶ Recent

³⁹³ *Richmond v. Dart Indus., Inc.*, 29 Cal. 3d 462, 470 (1981).

³⁹⁴ *Linder v. Thrifty Oil*, 23 Cal. 4th 429 (2000). The procedure disallowed in *Linder* should be distinguished from a pre-certification motion for summary judgment as to the individual’s claims. Such a motion, if granted as to all named plaintiffs, effectively would defeat class certification because it would remove all adequate representatives. *Allen v. Pacific Bell*, 348 F.3d 1113, 1115 (9th Cir. 2003). Such a pre-certification summary judgment would not bind the class, however.

³⁹⁵ See *Brinker Restaurant Corp. v. Superior Court*, 53 Cal.4th 1004, 1025 (2012) (“Presented with a class certification motion, a trial court must examine the plaintiff’s theory of recovery assess the nature of the legal and factual disputes likely to be presented, and decide whether individual or common issues predominate. To the extent the propriety of certification depends upon disputed threshold legal or factual questions, a court may, and indeed must, resolve them”); *Bartold v. Glendale Fed. Bank*, 81 Cal. App. 4th 816, 829 (2000) (“when the merits of the claim are enmeshed with class action requirements, the trial court must consider evidence bearing on the factual elements necessary to determine whether to certify the class”).

³⁹⁶ *Wal-mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541, 2551-52 (2011) (citing *Gen. Telephone Co. of S.W. v. Falcon*, 457 U.S. 147, 102 S. Ct. 2364, 72 L. Ed. 2d 740 (1982)); see also *Ellis v. Costco Wholesale Corp.*, 657 F.3d 970, 984 (9th Cir. 2011) (holding the district court erred by failing to conduct a “rigorous analysis” of the merits to determine whether the plaintiffs had established commonality under Rule 23); *In re Hydrogen Peroxide Antitrust Litig.*, 552 F.3d 305, 318 (3d Cir. 2008) (class certification requires “thorough examination” of factual and legal allegations; “rigorous analysis may include a preliminary inquiry into the merits” and consideration of “the substantive elements of the plaintiffs’ case in

developments in this aspect of the law concerning class action certification procedures have significantly bolstered defendants' ability to defeat class certification.³⁹⁷

B. Class Certification in Exempt Misclassification Cases

It is well established that "class actions will not be permitted where there are diverse factual issues to be resolved, despite the existence of common questions."³⁹⁸ In the 2003 decision *Lockheed Martin Corp. v. Superior Court*,³⁹⁹ the California Supreme Court explained the plaintiffs' burden in moving for class certification:

Plaintiffs' burden on moving for class certification, however, is not merely to show that some common issues exist, but, rather, to place substantial evidence in the record that common issues *predominate*. As we previously have explained, this means "each member must not be required to individually litigate numerous and substantial questions to determine his [or her] right to recover following the class judgment; and the issues which may be jointly tried, when compared to those requiring separate adjudication, must be sufficiently numerous and substantial to make the class action advantageous to the judicial process and to the litigants."⁴⁰⁰

The executive exemption has the potential to raise inherently individualized issues that are not consistent with class treatment as outlined in the *Lockheed* case.⁴⁰¹ The Wage Orders caution that:

order to envision the form that a trial on those issues would take"); *In re Coordinated Pretrial Proceedings in Petroleum Prods. Antitrust Litig.*, 691 F.2d 1335, 1342 (9th Cir. 1982) (affirming denial of class certification, where "any theory on which [plaintiffs] might rely [to prove the allegations of the complaint] would raise predominantly individual questions").

³⁹⁷ In *Morgan v. Wet Seal, Inc.*, 210 Cal.App.4th 1341, 1371 (2012), the Court of Appeal affirmed the denial of class certification with respect to two wage and hour claims: (1) that Wet Seal unlawfully required employees to buy Wet Seal clothing and merchandise, and (2) that Wet Seal failed to reimburse employees for work-related travel. The court determined that assessing whether common issues predominated over individualized issues necessitated an evaluation of the merits of the legal claims. *Id.* at 1354. The court then evaluated the policies at issue, and determined that because Wet Seal did not have a facially unlawful dress code policy, the employees failed to show that liability could "rest on proof of a company-wide policy" and individualized inquiries would be required. *Id.* at 1365. Similarly, proving the travel expense reimbursement claim would require individualize inquiries because the policy itself was not facially unlawful. *Id.* at 1358.

³⁹⁸ *Clousing v. San Francisco Unified Sch. Dist.*, 221 Cal. App. 3d 1224, 1233 (1990).

³⁹⁹ 29 Cal. 4th 1096 (2003).

⁴⁰⁰ *Id.* at 1108 (2003); see also *Newell v. State Farm Gen. Ins. Co.*, 118 Cal. App. 4th 1094 (2004) (class certification inappropriate even though insurer had uniform policy for evaluating earthquake claims, because individual liability for each policy holder would require examination of numerous individualized factors); *Frieman v. San Rafael Rock Quarry*, 116 Cal. App. 4th 29, 40-41 (2004) (class certification denied for nuisance claims against a quarry arising from blasting noise where liability varied from one homeowner to another based on a "myriad of different factors").

⁴⁰¹ In *Lockheed*, a medical monitoring case, the California Supreme Court ultimately reversed the trial court's ruling granting class certification because "[t]he questions respecting each individual class member's right to recover that would remain following any class judgment appear so numerous and substantial as to render any efficiencies attainable

The work actually performed by the employee during the course of the work week must, first and foremost, be examined and the amount of time the employee spends on such work, together with the employer's realistic expectations and the realistic requirements of the job, shall be considered in determining whether the employee satisfies this requirement.⁴⁰²

Given California's complete rejection of any form of qualitative test for exempt status, it would be possible for one manager to spend only 45 percent of his or her time performing exempt tasks (or closely and directly related tasks), and for another manager in the same position to spend 55 percent. The first manager would not be exempt, while the second manager would be exempt. In *Nordquist v. McGraw-Hill Broadcasting Co.*,⁴⁰³ this is precisely what happened: the court of appeal refused to rely on another court's ruling that the plaintiff's own successor was exempt because the inquiry was too "fact specific." While *Nordquist* was not a class action, its reasoning seemed inconsistent with the notion that exempt misclassification cases would be good candidates for class litigation.

In light of the various pronouncements about the individualized inquiry necessary to determine an employee's exempt status, the defense bar was hopeful that courts would disapprove of a plaintiff obtaining class certification on the ground that a class of managers was uniformly misclassified as exempt. If an employer could bring forth some declarations from managers attesting that they spend more than half their time on exempt tasks, the best a plaintiff could argue was that many managers at other stores spent the majority of their time on non-exempt tasks. In any case, the finder of fact would need to examine each store and each manager individually to determine if the managers there were misclassified as exempt—an inquiry inconsistent with class litigation.

Employers were disappointed when the California Supreme Court issued *Sav-On Drug Stores, Inc. v. Superior Court*,⁴⁰⁴ which indicated that exempt misclassification cases may often be appropriate for certification. In *Sav-On*, the trial court certified a class of store managers notwithstanding evidence that exempt status of individual managers varied from store manager to store manager based on differences in how they divided their time between exempt and non-exempt tasks. The court of appeal held that individualized issues *necessarily* predominated over common issues because the fact finder would need to examine each store manager's work habits to see whether that manager spent the majority of his or her time on exempt tasks.

through joint trial of common issues insufficient, as a matter of law, to make a class action certified on such a basis advantageous to the judicial process and the litigants." *Lockheed*, 29 Cal. 4th at 1111.

⁴⁰² See, e.g., Wage Order 7-2001 § 2(K).

⁴⁰³ 32 Cal. App. 4th 555, 569 (1995).

⁴⁰⁴ 34 Cal. 4th 319 (2004).

In reversing, the California Supreme Court emphasized that the appellate court had given insufficient deference to the trial court's determination that common issues predominated. The court clarified that if a reasonable person *might* conclude from the record that common issues predominated over individualized ones, then a trial court's certification order should not be disturbed on appeal.⁴⁰⁵ The court also suggested that the reverse would be true, in that a trial court's order denying certification was entitled to similar deference: "We need not conclude that plaintiffs' evidence is compelling, or even that the trial court would have abused its discretion if it had credited defendant's evidence instead."⁴⁰⁶ Accordingly, the same types of arguments that the defendant in *Sav-On* raised—that individualized issues will predominate over common ones—still have potential to persuade a trial court to deny certification; the trial court simply has the discretion to accept or reject the argument based on its assessment of the facts before it.

While the California Supreme Court's decision does not mandate certification in misclassification cases, the court specifically identified several issues that are commonly present in many manager misclassification cases that the court indicated could be established through collective proof:

- whether, as the plaintiff argued, the defendant had a deliberate policy to misclassify non-exempt employees as exempt;
- whether the defendant implicitly conceded all the employees were non-exempt when it reclassified all the employees at issue as non-exempt in 1999;
- whether any given task within the limited universe of tasks that managers performed qualifies as exempt or non-exempt; and
- whether a manager following the defendant's reasonable expectation for performing the job would spend the majority of the work time on exempt duties.⁴⁰⁷

The court held that a trial court could rationally conclude that those common issues predominated over the individualized issues concerning how individual managers spent their time. Dismissing concerns that these cases could prove unmanageable, the court further noted that the trial court had broad discretion as to how to handle individualized issues once the class issues were resolved. The court said little more about those

⁴⁰⁵ *Id.* at 331; *but see Aguiar v. Cintas Corp. No. 2*, 144 Cal. App. 4th 121 (2006) (reversing court's decision to deny certification because the court did not consider the use of subclasses, but affirmatively ruling that certification was required rather than remanding with instructions for trial court to exercise *its* discretion using proper standard).

⁴⁰⁶ *Id.*

⁴⁰⁷ *Id.* at 327.

proceedings other than to encourage trial courts to be “procedurally innovative” in fashioning procedures to resolve remaining individualized issues efficiently.⁴⁰⁸

In the immediate wake of *Sav-On*, there appeared to be a trend among trial courts to certify more exemption misclassification cases. That trend was offset somewhat in 2006 by the issuance of a published appellate decision that expressly made the point that *Sav-On* had implied—i.e., that a trial court’s decision to *deny* certification is entitled to the same deference as a decision to certify a class. In two post-*Sav-On* cases, *Dunbar v. Albertson’s Inc.*,⁴⁰⁹ and *Keller v. Tuesday Morning, Inc.*,⁴¹⁰ the Court of Appeal held that the trial court did not abuse its discretion when it determined that differences in how specific managers allocated their time between exempt and non-exempt duties was a predominant issue in the case, and an issue that supported denial of class certification or decertification.

In the years that have passed since *Sav-On*, a body of federal district court cases (removed on diversity jurisdiction grounds) has emerged deciding class certification in a variety of different exemption contexts. It is notable how two cases with closely similar facts often result in one being certified while the other is not. Certification decisions appear to vary depending on the policy preferences of the particular judge assigned to the case. Several cases have come down issued by judges with a more pro-certification bent that suggest that exemption cases should commonly be certified if all the employees were uniformly classified as exempt without the employer engaging in a person-by-person audit of the employees’ job duties (something that almost never occurs in real life).⁴¹¹ On the flip side, numerous cases from judges more skeptical of class certification have denied class certification notwithstanding a common job description and an absence of an employer’s exemption audit of each person in the proposed class.⁴¹²

⁴⁰⁸ *Id.* at 339.

⁴⁰⁹ 141 Cal. App. 4th 1422 (2006).

⁴¹⁰ 179 Cal. App. 4th 1389 (2009).

⁴¹¹ See, e.g., *Wells Fargo Home Mortg. Overtime Pay Litig.*, 527 F. Supp. 2d 1053 (N.D. Cal. 2007) (Judge Patel certified class of loan originators because employer had a common policy of treating all such employees as exempt without conducting an individual inquiry into their job duties), *rev’d*, 571 F.3d 953 (9th Cir. 2009); *Alba v. Papa John’s USA*, 2007 U.S. Dist. LEXIS 28079, 12 Wage & Hour Cas. 2d (BNA) 710 (C.D. Cal. Feb. 7, 2007) (Judge Feess certified class of restaurant managers on the ground of common job description and evidence that employer encouraged uniform practices among stores); *Wang v. Chinese Daily News, Inc.*, 231 F.R.D. 602 (C.D. Cal. 2005) (Judge Marshall found that predominant common issue was defendant’s “policy of classifying all reporters and account executives as ‘exempt’”); *Tierno v. Rite-Aid Corp.*, 2006 U.S. Dist. LEXIS 66436 (N.D. Cal. 2006) (Judge Henderson granted certification based on common job description and casting doubt on credibility of surveys obtained by employer post-litigation).

⁴¹² See, e.g., *In re Wells Fargo Home Mortgage Overtime Pay Litigation*, 571 F.3d 953 (9th Cir. 2009) (overturning grant of class certification for loan originators because a uniform exemption policy cannot be the sole basis for a class certification, but is only one factor to be looked at); *Vinole v. Countrywide Home Loans, Inc.*, 246 F.R.D. 637 (S.D. Cal. 2007) (Judge Sabraw denied certification of proposed class of loan originators on ground individualized issues predominated as to whether any originator spent enough time outside to qualify for outside sales exemption), *aff’d*, 571

The most practical lesson to draw from these cases is to pay very close attention to the assigned judge's history with respect to class certification. An employer can usually learn more about whether to settle the case or fight through class certification based upon the judge's general views on class certification than from any facts in the case.

C. Subclasses

In *Sav-On*, the California Supreme Court suggested that one way to handle individualized issues without denying class certification altogether would be to divide the class into subclasses. For example, if a key individualized factor that would affect a manager's exempt status is the size of the store managed, the trial court might divide the class into multiple subclasses based on store size. When a court is considering whether to divide a class into subclasses, the employer should be prepared to assert defenses that could defeat certification as to those particular subclasses.

Employers may have typicality and adequacy arguments as to the subclass that do not apply to a broader class. For example, if none of the named plaintiffs is a member of a particular subclass, then the court may not certify the subclass because the plaintiff's claims would not typify those of the subclass. In addition, under federal class action law that likely applies to California law as well, numerosity must be met as to *each* subclass.

F.3d 935 (9th Cir. 2009); *Jimenez v. Domino's Pizza*, 238 F.R.D. 241 (C.D. Cal. 2006) (Judge Selna denied class certification of store manager class based on predominance of individualized issues as to how store managers divide their time between exempt and non-exempt work); *Sepulveda v. Wal-Mart Stores, Inc.*, 237 F.R.D. 229 (C.D. Cal. 2006) (Judge Fischer denied class certification of assistant manager class based on predominance of individualized issues as to how employees divided time between exempt and non-exempt work); *Campbell v. PricewaterhouseCoopers*, 253 F.R.D. 586 (E.D. Cal. 2008) (certification denied as to categories of employees holding the same jobs as the class representatives, but in different departments; "The fact that an employer classifies all or most of a particular class of employees as exempt does not eliminate the need to make a factual determination as to whether class members are actually performing similar duties"); *see also Marlo v. United Parcel Service*, 453 Fed. Appx. 682 (9th Cir. 2011) (affirming Judge Pregerson's denial of class certification as to store managers because plaintiff could not devise a trial plan by which classwide misclassification could be established by use of collective proof); *Mora v. Big Lots Store, Inc.*, 194 Cal. App. 4th 496 (2011) (affirming trial court's denial of class certification as to store managers due to insufficient evidence of a uniform corporate policy requiring store managers to engage primarily in non-managerial duties); *Weigle v. Fedex*, 267 F.R.D. 614 (S.D. Cal. 2010) (Judge Sammartino decertified class of Dock Service Managers, holding that the fact the managers were all uniformly trained and classified as exempt was insufficient to overcome individualized issues concerning widespread differences in the manner in which the employees chose to manage, which affected the actual duties they performed); *Cruz v. Dollar Tree Stores*, 2011 WL 2682967 (N.D. Cal. July 8, 2011) (Judge Conti decertified a class of store managers, holding that the "glue" that gave rise to a common resolution was now missing given that the majority of the class members testified that verification forms did not accurately reflect how class members spent their time and therefore individual testimony would be required); *Gales v. Winco Foods*, 2011 WL 3794887, at *10-11 (N.D. Cal. Aug. 26, 2011) (Judge Breyer denied class certification based on predominance of individualized issues as to whether assistant store managers spent their time performing primarily exempt or non-exempt tasks); *Wang v. Chinese Daily News*, 709 F.3d 829, 835-836 (9th Cir. 2013) (remanding for reconsideration of certification of wage and hour class where class was certified on the basis of a uniform exemption policy; the Ninth Circuit disapproved "the district court's conclusion that common questions predominate in this case ... on the fact, considered largely in isolation, that plaintiffs are challenging CDN's uniform policy of classifying all reporters and account executives as exempt employees").

Thus, “carving up the class” may result in certain subclasses being too small to warrant certification.⁴¹³

Similarly, employers may argue that the “commonality” element is missing, thereby potentially avoiding the creation of a sub-class. Seyfarth Shaw successfully defeated class certification in *Hughes v. WinCo Foods* by advancing such an argument.⁴¹⁴ In *WinCo*, plaintiff brought a class action alleging that defendant failed to comply with California law with respect to providing meal and rest breaks. Plaintiff asserted that the commonality requirement was satisfied due to the store-wide policy of requiring employees to obtain management approval before going on a meal break. The court rejected that argument, explaining that the decision-making as to when employees took breaks varied from store to store and department to department. The court also concluded that the wide variation among employees even within each department would require “hundreds or thousands of ‘mini trials.’”⁴¹⁵

D. Opt-In Classes

Because of the broad language in *Sav-On* suggesting that trial courts should be innovative in fashioning class action procedures,⁴¹⁶ some commentators opined that *Sav-On* was approving the trial court’s ability to certify an “opt-in” class action, modeled after the procedure employed in FLSA and Age Discrimination in Employment Act (“ADEA”) collective actions. In 2005, however, the First District California Court of Appeal in *Hypertouch, Inc. v. Superior Court*⁴¹⁷ barred trial courts from certifying opt-in classes.

In an “opt-in” class action, employees participate in the action only if they “opt in” by signing a form. Any judgment obtained in the decision binds only those individuals who opted in. Although this procedure limits the number of class members bound by a decision, employers generally like it because it reduces the number of employees offered a recovery,

⁴¹³ See *Betts v. Reliable Collection Agency*, 659 F.2d 1000, 1005 (9th Cir. 1981) (“Each subclass must independently meet the requirements of Rule 23 for the maintenance of a class action, . . . [and as] a practical matter, the litigation as to each subclass is treated as a separate lawsuit.”); *Andrews v. Bechtel Power Corp.*, 780 F.2d 124, 132 (1st Cir. 1985) (denying certification of a subclass of three people because it had too few members); see also *Carabini v. Superior Court*, 26 Cal. App. 4th 239, 242-43 (1994) (California courts should look to precedent arising under federal class action law for guidance as to unsettled areas of California law).

⁴¹⁴ 2012 WL 34483 (C.D. Cal. Jan. 4, 2012)

⁴¹⁵ See also *Sotelo v. Medianews Group, Inc.*, 207 Cal. App. 4th 639, 650-51 (2012) (affirming trial court’s denial of certification for class of newspaper carriers and finding no error for refusing to certify subclass, where proposed subclass failed to meet other class certification requirements of predominance of common issues of law and fact); *Hadjavi v. CVS Pharmacy, Inc.*, 2011 WL 3240763 (C.D. Cal. Jul 25, 2011) (denying class certification of overtime, meal and rest period claims of nonexempt pharmacy employees and holding that the allegation that workload prohibited breaks was not enough to justify certification).

⁴¹⁶ *Sav-On*, 34 Cal. 4th at 339.

⁴¹⁷ 128 Cal. App. 4th 1527 (2005) (modified without change in judgment, 129 Cal. App. 4th 1348 (2005)).

and because those employees who elect not to opt in usually lack interest in the litigation and are unlikely to sue later.

Although opt-in classes were rare in California, nothing before *Sav-On* expressly forbade them (in contrast to Federal Rule of Civil Procedure 23, which forbids opt-in classes except where, as in the FLSA and ADEA, Congress provides that an opt-in class is the only kind permitted).⁴¹⁸ In barring opt-in classes under state law, the *Hypertouch* court reasoned that Code of Civil Procedure Section 382 should be interpreted as parallel to Rule 23, which does not allow for opt-in class actions.⁴¹⁹ The court also criticized the opt-in procedure as a device that improperly is used by the defendant to “chip away at the size of the class.”⁴²⁰ In addition, the court attempted to construe its decision as beneficial to class defendants because an opt-out class binds more potential plaintiffs in those cases where the employer prevails on the merits.⁴²¹ Whatever the merits of this reasoning, the fact remains that trial courts throughout California are now barred from certifying cases as opt-in class actions.

In 2007, however, another appellate court narrowed *Hypertouch*. In *Estrada v. FedEx Ground Package System, Inc.*,⁴²² the trial court certified an independent contractor misclassification class but only of certain drivers of certain trucks on certain routes. The only way to determine who qualified as a class member under the particular class definition the court adopted was to ask the class members, because no records existed that would reveal class membership. Accordingly, the trial court authorized the sending of a questionnaire for drivers to answer under oath to determine whether they qualified as class members. Those who failed to respond were ultimately deemed not to be class members and were dismissed from the case without prejudice.

The plaintiffs argued that this was tantamount to having certified a class on an opt-in basis, in violation of *Hypertouch*. The Court of Appeal rejected the comparison, noting that the questionnaire mechanism was not used to opt in to the class action, but merely to identify drivers as class members.⁴²³ In essence, the questionnaire was used to ascertain class membership, not to determine whether someone, once identified as a class member, wished to participate in the class action. In cases where a trial court certified a class that requires gathering information from putative class members to determine class membership, *Estrada* may provide a hook for the defendant to argue that the potential

⁴¹⁸ *Id.* at 1547-48.

⁴¹⁹ *Id.* at 1542-43.

⁴²⁰ *Id.* at 1542.

⁴²¹ *Id.*

⁴²² 154 Cal. App. 4th 1 (2007).

⁴²³ *Id.* at 26 (“discovery was necessary to determine whether in fact there was an ascertainable class”).

class must be surveyed to determine who are class members, with all non-respondents to the survey being dismissed from the case.

E. *Wal-Mart Stores, Inc. v. Dukes* - The Supreme Court Shifts The Landscape Of Class Certification

In June 2011, the U.S. Supreme Court issued its long-awaited decision in *Wal-Mart Stores, Inc. v. Dukes*.⁴²⁴ This opinion transformed Rule 23 law and dramatically changed how workplace class actions are structured and defended and, in doing so, will also assist employers in defeating certification in wage and hour cases.

The Supreme Court reversed the Ninth Circuit and held that class action certification should not have been granted as to the element of commonality. *Dukes* is because it holds requires plaintiffs to establish commonality among all putative class members as to the reason for a particular employment decision – the “glue” that holds the alleged unlawful conduct together. The Court ruled that the proof of commonality required by Rule 23(a) will frequently overlap with the merits of the case. This holding repudiates plaintiffs’ usual argument that it is inappropriate to consider the merits of claims at the certification stage of class litigation. In addition to commonality, the Court severely limited the use of Rule 23(b)(2), pertaining to class-wide injunctive and declaratory relief, in cases seeking back pay, ruling that such money damages may be awarded under this rule only when they are truly incidental to the requested equitable relief.⁴²⁵

Dukes thus contains two core holdings. First, the Court held unanimously that certification of a class of female Wal-Mart workers was inappropriate under Rule 23(b)(2), which permits certification where “the party opposing the class has acted or refused to act on grounds that apply generally to the class, so that final injunctive relief or corresponding declaratory relief is appropriate respecting the class as a whole.” Second, the Court ruled, 5-4, that the plaintiffs failed to satisfy the “commonality” requirement of Rule 23(a)(2). Each of these holdings will reverberate in important ways in wage and hour litigation.

Class Members Must All Suffer A Common Injury Capable Of Class-Wide Resolution

Dukes reiterates that, because class actions are “an exception to the usual rule,” a class representative “must ‘possess the same interest and suffer the same injury’ as the class members.” One gauge for measuring whether that requirement has been met is the “commonality” test of Rule 23(a). According to Justice Scalia’s majority opinion, commonality requires class members to have suffered the same injury as each other, not

⁴²⁴ -- U.S. --, 131 S.Ct. 2541 (2011).

⁴²⁵ See *Sepulveda v. Wal-Mart Stores*, 2011 WL 6882918 (9th Cir. 2011) (affirming that the non-incidental test should be applied when determining class certification under Rule 23(b)(2)).

just a violation of the same provision of law. Moreover, the common injury must be “capable of classwide resolution – which means that determination of its truth or falsity will resolve an issue that is central to the validity of each one of the claims in one stroke.”

Although *Dukes* was a discrimination case brought under Title VII, the Court’s discussion of the “commonality” prong of Rule 23(a) should serve as important authority in wage and hour cases.⁴²⁶

First, many wage claims are brought under state law, either in state court under Rule 23 analogues or in federal court via removal, supplemental jurisdiction, or diversity. In those cases, the *Dukes* discussion of commonality, and its tightening of the requirements to establish that prong of the Rule 23 test, will be directly applicable.

Second, *Dukes* should lead courts to narrow their application of the “similarly situated” requirement in collective actions under FLSA section 216(b). Most courts faced with §216(b) collective actions now use a two-stage approach to certification. In the first stage, plaintiffs are required to show that the named plaintiffs and other potential party plaintiffs are “similarly situated.” Courts have struggled with the meaning of “similarly situated” for almost 65 years because the statute does not define the phrase, and the courts have not settled on a uniform definition. However, courts have consistently approached this question by examining whether common factors are present, such as the geographic scope and job duties of the potential party plaintiffs, as well as whether the individuals were subject to similar practices or policies.

The Similarly Situated And Commonality Standards Are Not So Different

Most courts have set a very low bar for plaintiffs to clear at this stage in order to obtain “conditional” class certification. However, inquiries under the similarly situated standard are comparable to those that the *Dukes* Court said must be tightened under the commonality standard of Rule 23(a)(2). In fact, a number of courts have equated “similarly situated” to the commonality requirement of Rule 23(a)(2). *Dukes* should thus compel lower courts to pay closer attention to the disparities that often exist among members of a putative FLSA collective action – such as variations in supervisors, departments, facilities, divisions, and regions – because the Court held that the “dissimilarities” in the proposed class, not the common questions raised, have the most potential to determine whether classwide resolution of a matter is permissible.

⁴²⁶ See, e.g., *Wang v. Chinese Daily News*, 709 F.3d 829, 834 (9th Cir. 2013) (remanding wage and hour class action case in light of *Dukes* in order to determine whether claims of class of roughly 200 employees depended “upon a common contention ... of such a nature that it is capable of classwide resolution”).

The final certification stage of a § 216(b) action requires a more stringent judicial analysis than the first, and typically comes after discovery has been largely completed. At this stage, courts assess whether the differences among the party plaintiffs (all of whom will have opted in by this point following issuance of court-approved notice) outweigh their similarities. If so, the action should be decertified. This “differences” inquiry runs hand-in-hand with the Supreme Court’s emphasis in *Dukes* on dissimilarities in the Rule 23 class context.

The Dukes Effect Could Create An Early Evidentiary Hurdle For Plaintiffs

The effects of *Dukes* will likely be seen in all types of wage-and-hour litigation, whether the alleged violation relates to minimum wages, overtime or other legal protections, and whether the claim alleges exempt status misclassification, off-the-clock work, a violation of technical pay practice requirements under state law, or independent contractor misclassification. For example, while differences in the application of pay policies from one facility to the next, or variations in the independent judgment and discretion exercised by employees subject to the “administrative” exemption,” have sometimes been relegated to the “decertification” stage of a Section 216(b) case, after *Dukes* these or similar inquiries may be critical very early, at the first, conditional certification stage.

Likewise, in cases raising the “executive” exemption, plaintiffs often contend that they were improperly classified because they did not have the authority to make employment decisions with respect to their subordinates, performed non-managerial tasks as their primary duty, or otherwise. Courts’ resolution of certification issues based on these assertions could be based less on anecdotal evidence about the named plaintiffs and more on an analysis of whether there is a common thread tying those occurrences together on a collective basis.

The *Dukes* Court also dispelled the notion that the merits of a case may not be considered during the “rigorous analysis” required to determine if class certification is appropriate. This could lead to challenges at the conditional certification stage about how much evidence is enough to extrapolate to the group. In practice, this may mean that the critical merits question of whether putative class members actually worked off the clock, actually failed to take meal and rest periods, or otherwise were subjected to a violation of wage and hour law, gets addressed far earlier in the litigation than was previously the case.⁴²⁷

⁴²⁷ See, e.g., *Gonzalez v. Millard Mall Services, Inc.*, 281 F.R.D. 455 (S.D. Cal. 2012) (denying class certification as to claims regarding meal and rest breaks, split-shift pay, and failure to timely pay wages upon termination, because plaintiffs failed to establish the commonality prerequisite under *Dukes*; however, the court reasoned that class certification was not necessary for PAGA claim because PAGA relief is mainly “for the benefit of the general public rather than the party bringing the action” and PAGA “provides no specific class certification requirements.”).

Following *Dukes*, plaintiffs should now be pressed earlier in litigation to put forth actual evidence, beyond mere allegations, that issues common to all class or collective action members exist. From a due process perspective, this requirement could limit much of the additional burden and expense of conducting broad discovery and litigating decertification where there is no evidence of issues common to all class or collective action members. Indeed, this broad discovery is often so costly as to leave employers with little choice but to settle the case.

Show Me [You Are Owed] The Money

In the less controversial section of its decision, the *Dukes* Court held that Rule 23(b)(2) applies only when “a single injunction or declaratory judgment would provide relief to each member of the class,” not when individuals seek an individual award of monetary damages. By its very nature, the recovery of money is central to wage and hour litigation. Plaintiffs often argue that damages may be readily quantifiable based on a sample of the employer’s pay records or that backpay calculations for a random group of class or collective members can be utilized to extrapolate the damages on a classwide basis.

Although the setting was different, the Court’s rejection in *Dukes* of a “Trial By Formula” approach to class litigation should undermine this formulaic approach to the viability of trials in which the evidence is limited to groups of opt-ins providing representative testimony. The Court held that such an approach not only conflicts with Rule 23(b)(2), but also prevents the employer from litigating statutory defenses to individual claims, thereby violating its right to due process.

In *Cruz v. Dollar Tree Stores, Inc.* (N.D. Cal. July 8, 2011), the court decertified a class in part for this reason. The judge stated, “In light of the Supreme Court’s rejection of [the “trial by formula”] approach, it is not clear to the Court how, even if class-wide liability were established, a week-by-week analysis of every class member’s damages could be feasibly conducted.” Similarly, in *Aburto v. Verizon*, another federal district court cited *Dukes* in denying class certification of misclassification claims, holding that whether Verizon unlawfully classified its managers as exempt is an individualized inquiry involving facts unique to each potential plaintiff.⁴²⁸ Thus, it will be more important than ever for employers to argue that class treatment is inappropriate because the necessary individualized inquiry into each individual’s claims could result in a series of mini-trials that would undermine the efficiency benefits that class treatment is meant to offer.

⁴²⁸ *Aburto v. Verizon*, 2012 WL 10381, at *5 (C.D. Cal. Jan. 3, 2012) (“The court simply cannot conclude that all FLMS performed the same job duties, that the job duties were all clerical, or that Verizon’s restrictions on FLMS precluded ‘any exercise of independent judgment or discretion.’”).

This point also applies to FLSA cases. In particular, when courts examine whether a conditionally certified case should be decertified, typically after extensive discovery, they often require that plaintiffs set forth a trial plan explaining how the claims of the opt-in plaintiffs can be tried by collective proof. Following *Dukes*, the use of representative testimony to establish such proof simply may not suffice.

In addition to rejecting the “trial by formula” approach, *Dukes* held that employers are entitled to present individual defenses to each employee’s specific claim for damages, even if a violation of the statute is found. Following this holding, employers should now have a strong due process argument in wage-and-hour cases that even if a statutory violation is found, they are entitled to present individual defenses to each class or collective action member’s entitlement to the back wages sought in the litigation. The argument is even stronger in FLSA collective actions because an individual must affirmatively consent to be a member of the case, at which point he becomes a party plaintiff for purposes of adjudicating his individual claims.

While the full impact of *Dukes* will not be known for years, the decision has undoubtedly created an environment that will prove more friendly to employers defending against wage-and-hour claims. As always, the strongest defense to potential wage-and-hour claims is vigilant attention to compliance efforts before litigation arises, including the adoption, distribution, and effective enforcement of internal policies mandating compliance with federal and state labor laws. Such policies remain the most important weapon in the employer’s defense arsenal, and their importance will only be magnified after *Dukes*, since their existence and enforcement on a company-wide basis will underscore the atypical, “one off” nature of any alleged violations that may have occurred.

F. In *Comcast v. Behrend*, The Supreme Court Emphasizes That It Meant What It Said In *Dukes*

On March 27, 2013, the Supreme Court issued its opinion in *Comcast Corp. v. Behrend*.⁴²⁹ The Court, in a 5-4 decision, reaffirmed its holding in *Wal-Mart v. Dukes* that district courts must conduct a “rigorous analysis” to ensure that Rule 23 requirements have been satisfied, even if doing so would require consideration of the merits of the plaintiffs’ claims.⁴³⁰

The decision held that the trial court had improperly certified a class in this antitrust action. The Court said the plaintiffs failed to establish a sufficient connection between their alleged theory of liability and their claimed damages.

⁴²⁹ 133 S. Ct. 1426 (2013).

⁴³⁰ *Id.* at 1433.

THE SUPREME COURT HOLDING

The Court held that the class action was improperly certified under Rule 23(b)(3). The Rule "does not set forth a mere pleading standard."⁴³¹ Rather, a party must not only "be prepared to prove that there are in fact sufficiently numerous parties, common questions of law or fact," typicality of claims or defenses, and adequacy of representation, as required by Rule 23(a). The party must also satisfy through evidentiary proof at least one provision of Rule 23(b). The provision at issue here was Rule 23(b)(3), which requires a court to find that "the questions of law or fact common to class members predominate over any questions affecting only individual members."⁴³² A court considering that issue may need to "probe behind the pleadings before coming to rest on the certification question," an analysis that "will frequently overlap with the merits of the plaintiff's underlying claim."⁴³³

THE ANTITRUST CLAIM

According to the plaintiffs, Comcast had engaged in "clustering" cable television operations in the Philadelphia region. Comcast acquired competitor providers and swapped their own systems outside a particular region for competitor systems in the region. By 2007, Comcast's dominance of the Philadelphia Designated Market Area ("DMA"), which includes sixteen counties in Delaware, Pennsylvania, and New Jersey, had increased substantially, reaching 69% from only 24% in 1998. Based on the company's increased market share, customers in the Philadelphia DMA filed a class action suit in federal district court, alleging that Comcast had violated the Sherman Act through unlawful swapping agreements and attempted monopolization.⁴³⁴

THE DISTRICT COURT OPINION

The district court held that the plaintiffs, to meet the predominance requirement, had to show (1) that the existence of individual injury resulting from the alleged antitrust violation (referred to as "antitrust impact") was "capable of proof at trial through evidence that [was] common to the class rather than individual to its members," and (2) that the damages resulting from that injury were measurable "on a class-wide basis" through use of a "common methodology."⁴³⁵ The plaintiffs presented four distinct theories of antitrust impact. First, plaintiffs alleged Comcast reduced the benchmark levels of competition in the Philadelphia DMA. Second, Comcast's activities allegedly reduced the level of competition

⁴³¹ *Id.* at 1432.

⁴³² *Id.*

⁴³³ *Id.*

⁴³⁴ *Id.* at 1430.

⁴³⁵ 264 F. R. D., at 154.

from overbuilders, companies that build competing networks in areas where an incumbent cable company already operates. Third, the clustering technique allegedly decreased market penetration by satellite providers, as it made it profitable for Comcast to withhold local sports programming from its competitors. Finally, the plaintiffs alleged Comcast's clustering technique increased Comcast's bargaining power relative to content providers.

Although the district court accepted only one of the plaintiffs' theories of antitrust impact—that Comcast's activities reduced the level of competition from overbuilders—the Court found that plaintiffs could still prevail under Rule 23(b)(3), and certified the class under this theory. Furthermore, the court found that damages resulting from such deterrence could still be calculated on a class-wide basis, even though the plaintiffs' expert had calculated overall damages based on the combination of all four theories of impact, not just the overbuilder theory.⁴³⁶

THE THIRD CIRCUIT DECISION

Comcast appealed to the Third Circuit, arguing that plaintiffs' alleged damages were based on all four theories of antitrust impact and, thus, did not adequately measure the harm attributable only to the overbuilder theory. According to Comcast, since it was not clear which plaintiffs' damages were based on which theory, the plaintiffs could not satisfy the commonality required under Rule 23(b). On appeal, however, a divided Third Circuit panel affirmed the trial court's certification, finding "an attack on the merits of the methodology had no place in the class certification inquiry," and plaintiffs merely had to show they were able to prove damages of some sort.⁴³⁷

THE SUPREME COURT APPLIES ITS HOLDING TO THE FACTS

The Supreme Court rejected the Third Circuit's reasoning: "in light of the [damages] model's inability to bridge the differences between supra-competitive prices in general and supracompetitive prices attributable to the deterrence of overbuilding, Rule 23(b)(3) cannot authorize treating subscribers within the Philadelphia cluster as members of a single class."⁴³⁸ The Court reasoned that it was not clear whether every plaintiff was necessarily damaged by each of the four alleged theories of antitrust impact, and it was distinctly possible that some plaintiffs in the Philadelphia DMA were damaged by one type of conduct, while others were injured by another. As such, the Court held that the damages model the plaintiffs presented failed to show that individual damages calculations would not overwhelm questions common to the class. For the customers to prevail, they would have

⁴³⁶ 133 S.Ct. at 1430-31.

⁴³⁷ *Id.* at 1431.

⁴³⁸ *Id.* at 1435.

had to measure damages attributable only to the overbuilder theory of competition. In this case, it was not clear which damages resulted from which type of antitrust impact, leading to uncertainty about whether damages could be measured class wide, rather than on an individual basis." According to the majority, adopting the Third Circuit's position would render any method of measurement acceptable, "no matter how arbitrary," and would reduce Rule 23(b)(3)'s predominance requirement to a nullity.⁴³⁹

With its decision in *Comcast*, the Supreme Court left no doubt that district courts must conduct a "rigorous analysis" at the class certification stage to ensure that the requirements of Rule 23 are satisfied, even if doing so would require an inquiry into the merits of the plaintiffs' claims. The Court also clarified that the method of proving classwide damages must be tied to the theory of liability on which plaintiffs will be proceeding at trial.

In the wage and hour context, this ruling should provide further ammunition to employers in opposing class certification. Many wage and hour cases require significant individualized proof of damages—for example, determining whether and why each class member worked off the clock. After *Dukes* and *Comcast*, it is clear that plaintiffs' counsel cannot simply offer a few examples and ask the court to just assume that all other employees had identical experiences.

G. The California Supreme Court Enforces Due Process In *Duran v. U.S. Bank*

On May 29, 2014, the California Supreme Court issued its much-anticipated opinion in *Duran v. U.S. Bank*, vacating a \$15 million judgment in a wage and hour class action on the ground that the judgment resulted from a flawed statistical sampling methodology. While the Court did not foreclose the possibility of using statistical sampling to establish class-wide liability, the Court's unanimous opinion makes clear that (1) a trial plan that proposes statistical sampling must be presented to the trial court *before* class certification, (2) the proposed sampling must be statistically reliable, and (3) the trial plan must not deprive the defendants of its due process right to present affirmative defenses.

Duran is significant because it recognizes the due process concerns raised by the use of representative evidence, and it requires trial courts to meaningfully address those concerns early in litigation. These points provide welcome ammunition for employers in opposing class certification.

⁴³⁹ *Id.* at 1433.

Lower Court Proceedings

Plaintiffs filed a class action alleging that their employer, U.S. Bank, misclassified its Business Banking Officers (“BBO”) as exempt outside sales employees. After certification, the parties submitted their respective trial plans, crafted with the aid of their experts. Over U.S. Bank’s objections, the trial court adopted its own trial plan, under which a purportedly random sample of twenty class members—plus two of the named plaintiffs—would testify at trial, and the liability and damages findings based on the sample group would be extrapolated to the entire class.

After the trial court denied U.S. Bank’s decertification motion, it held a bench trial on U.S. Bank’s exemption defense. During the liability phase, the trial court excluded all evidence concerning BBOs who were not part of the sample group, including U.S. Bank’s evidence showing some class members were properly classified as exempt. Based primarily on the sample group’s testimony, the court found the entire class of 260 BBOs had been misclassified.

During the damages phase, the trial court adopted the determination of plaintiffs’ expert that class members worked on average 11.87 hours of overtime per week, subject to a 43% margin of error—meaning the actual amount of overtime worked by each BBO could range from 6.7 hours to almost 17 hours per week. Based on that extrapolation, the court entered judgment against U.S. Bank in the amount of approximately \$15 million.

The Court of Appeal reversed, holding that the trial court’s reliance on flawed and unreliable statistical sampling to extrapolate class-wide liability denied U.S. Bank its right to litigate affirmative defenses, and that the high margin of error underlying the damages calculations implicated due process concerns. Additionally, the Court of Appeal held, the trial court abused its discretion in denying U.S. Bank’s decertification motion and ordered the class decertified.

The Supreme Court Decision

The California Supreme Court, in a unanimous decision, affirmed the Court of Appeal’s judgment in its entirety and ordered a new trial. In so doing, the Supreme Court articulated several principles that are likely to have a significant impact on certification and trial proceedings in all class actions, particularly those in the wage and hour arena.

First, and perhaps most significantly, the Supreme Court recognized a defendant’s due process right to “litigate its statutory defenses to individual claims,” a proposition on which lower courts had disagreed. Thus, “any trial must allow for the litigation of affirmative defenses, even in a class action case where the defense touches upon individual issues.”

Second, while the Supreme Court was careful not to reach a sweeping conclusion regarding whether or when statistical sampling should be available as a tool for proving liability in a class action, it did set forth some concrete guidelines. As an initial matter, any trial plan involving statistical proof must allow the defendant to litigate relevant affirmative defenses, even when they turn on individualized questions, and if the trial plan fails to do so, then the statistical proof may not be appropriate. Moreover, the trial plan must employ valid statistical methodology, which means, among other things: (a) the sample size must be “sufficiently large to provide reliable information about the larger group,” (b) the sample must be random and free of selection bias, and (c) analysis of the sample must yield results within a reasonable margin of error. Further, the defendant “must be given a chance to impeach that [statistical] model or otherwise show that its liability is reduced because some plaintiffs were properly classified as exempt.”

Third, the Supreme Court instructed lower courts to consider *at the certification stage* whether a trial plan has been developed to address the use of statistical evidence, rather than “accepting assurances that [one] will eventually be developed.” That plan must show how individual issues can be managed at trial, and if the plan proves “unworkable,” then the class must be decertified.

Turning to the facts before it, the Supreme Court held that the lower court’s trial plan met none of these basic requirements. Among other things, the plan deprived U.S. Bank of its right to litigate its affirmative defenses by excluding relevant evidence relating to BBOs outside the sample group, and by extrapolating liability based on a flawed statistical model. That model, the Supreme Court held, was fatally flawed because the 22-member sample group was too small relative to the 260-member class, and because the supposed randomness of the sample group was undermined by the inclusion of the named plaintiffs and the later exclusion of others who had opted out, were replaced, or were unavailable. As a result, the sample was “biased in plaintiffs’ favor.” The Court also found the 43% margin of error to be “intolerably high,” potentially yielding a judgment twice the size of U.S. Bank’s actual liability.

What *Duran* Means For Employers

While the Supreme Court stopped short of establishing a bright-line rule that statistical sampling cannot be used to prove class-wide liability, *Duran* nonetheless makes it clear that class counsel face an uphill battle if they wish to rely on statistical evidence. Any proposed statistical methodology must allow a defendant to litigate its affirmative defenses. And, in cases involving questions unique to each class member, statistical evidence cannot create commonality where it does not otherwise exist. Nor can liability be extrapolated where commonality is absent.

Duran is also significant because it requires trial courts to consider—at the class certification stage—whether a workable trial plan involving statistical evidence can be developed. When opposing class certification, therefore, employers should be prepared to challenge the class counsel’s proposed trial plan, or their failure to identify one, based on the principles set forth in *Duran*.

Finally, *Duran* is particularly useful to employers defending misclassification cases, as it affirms that such claims—unless they turn on standardized job duties or policies that compel employees to uniformly spend their time on nonexempt work—have “the potential to raise numerous individual questions that may be difficult, or even impossible to litigate on a class-wide basis.”

H. Easing of Class Certification Standards Post-*Brinker*

In 2012, the California Supreme Court issued its long-awaited decision in *Brinker Restaurant Corp. v. Superior Court*, addressing employers’ obligations to “provide” meal and rest breaks.⁴⁴⁰ *Brinker* was a landmark ruling in the context of meal break litigation, and was widely heralded as a key victory for employers. However, the *Brinker* decision also contained unfortunate language suggesting that class-wide liability may be established by demonstrating that employees were subject to an unlawful written policy, regardless of how that policy was actually applied to individual employees.⁴⁴¹

A number of cases post-*Brinker* have certified classes based on the existence of an unlawful policy or based on the allegations that the employer had no policy, even where the employer demonstrated that many employees were, in fact, being provided lawful meal and rest breaks. For example, in *Faulkinbury v. Boyd & Associates, Inc.*,⁴⁴² the Court of Appeal concluded that the defendant’s liability would attach “upon a determination that [the employer’s] uniform on-duty meal break policy was unlawful.”⁴⁴³ It reached a similar conclusion concerning rest breaks, based solely on the plaintiff’s allegations that the employer did not have a written policy for rest breaks, despite the fact that there is no legal requirement that employers adopt their own written meal and rest break policies (as opposed to posting the Wage Orders that set forth meal period and rest break requirements). Citing to *Brinker*, the Court of Appeal in *Faulkenbury* held that “the lawfulness of [defendant’s] lack of a rest break policy and requirement that all security

⁴⁴⁰ See discussion of *Brinker*’s impact on meal break claims in Section V(C).

⁴⁴¹ *Brinker Rest. Corp. v. Super. Ct.*, 53 Cal. 4th 1004, 1033 (2012) (“An employer is required to authorize and permit the amount of rest break time called for under the wage order for its industry. If it does not—if, for example, it adopts a uniform policy authorizing and permitting only one rest break for employees working a seven-hour shift when two are required—it has violated the wage order and is liable.”).

⁴⁴² *Faulkinbury v. Boyd & Associates, Inc.*, 216 Cal. App. 4th 220 (2013).

⁴⁴³ *Id.* at 235. See also *Bradley v. Networkers Int’l, LLC*, 211 Cal. App. 4th 1129, 1150 (2012) (“The lack of a meal/rest break policy and the uniform failure to authorize such breaks are matters of common proof.”).

guard employees remain at their posts can be determined on a class-wide basis,” despite evidence provided by the defendant showing that, regardless of the policies (or lack thereof), employees were being provided proper breaks.⁴⁴⁴ The court dismissed this evidence by stating that “the employer’s liability arises by adopting a uniform policy that violates the wage and hour laws. Whether or not the employee was able to take the required break goes to damages.”⁴⁴⁵ The court did not explain how such “damages” could be ascertained on a class-wide basis where the facts demonstrated that individualized factors determined whether or not a specific employee was actually provided meal breaks, despite the uniform written policy.

In another pro-certification case, *Benton v. Telecom Network Specialists, Inc.*, telecommunications technicians filed a wage and hour class action lawsuit alleging violations of meal and rest break laws and overtime requirements.⁴⁴⁶ The plaintiffs’ theory was that the defendant violated the law by failing to adopt a policy authorizing and permitting its technicians to take meal periods or rest breaks. Citing *Brinker*, the Court of Appeal explained that “for purposes of certification, the proper inquiry is ‘whether the theory of recovery advanced by the plaintiff is likely to prove amenable to class treatment.’”⁴⁴⁷ The Court of Appeal therefore held that the class should be certified, even though the defendant had demonstrated that the experiences of individual employees varied widely, and that some employees were subcontracted out to other employers who *did* have lawful written meal and rest break policies.⁴⁴⁸

These unwelcome decisions potentially lower the certification bar for plaintiffs pursuing class claims based on an allegation that an employer instituted an unlawful policy. Employers have often defeated class certification by demonstrating that an alleged unlawful

⁴⁴⁴ *Id.* at 237. See also *Abdullah v. U.S. Sec. Associates, Inc.*, 731 F.3d 952, 962 (9th Cir. 2013) (following *Faulkinbury* and *Brinker* in certifying an action brought under Rule 23 on the basis of the employer’s uniform policy of requiring security guards to sign on-duty meal period agreements).

⁴⁴⁵ *Faulkinbury v. Boyd & Associates, Inc.*, 216 Cal. App. 4th at 234.

⁴⁴⁶ *Benton v. Telecom Network Specialists, Inc.*, 220 Cal. App. 4th 701, 705 (2013).

⁴⁴⁷ *Id.* at 726; see also *Williams v. Superior Court*, 221 Cal. App. 4th 1353, 1364 (2013) (holding that plaintiffs’ allegation that the defendant had an unwritten policy to deny overtime pay was an appropriate issue for class-wide resolution, and that the fact that the evidence demonstrated that many putative class members did not work off the clock was merely a “damages” issue); *Jones v. Farmers Insurance Exchange*, 221 Cal. App. 4th 986, 997 (2013) (holding that the plaintiffs’ theory that Farmers required unpaid pre-shift work was amenable to class-wide resolution; the trial court erred in denying certification by focusing on the fact that this only affected some employees and then only on certain days depending on a number of varying factors; all of these variables only went to “the right to recover damages” and therefore did not preclude class treatment).

⁴⁴⁸ *Id.* at 727; see also *Martinez v. Joe’s Crab Shack*, 221 Cal. App. 4th 1148, 1164-65 (2013) (holding that class could properly be certified based on the plaintiffs’ claims that managers were not properly classified as exempt, despite job description that set forth exempt duties and evidence that many putative class members performed exempt duties most of the time. The court stated “we understand from *Brinker* . . . a renewed direction that class-wide relief remains the preferred method of resolving wage and hour claims, even those in which the facts appear to present difficult issues of proof.”).

policy was applied so variably that individualized questions predominated over the common fact that the same policy applied to all employees. This new wave of cases now holds that class certification may be granted solely upon the basis that an employer's written policy violates the law, regardless of whether or not the unlawful policy was actually uniformly applied to the class. Indeed, plaintiffs' mere *allegations* that a policy did not exist may now be enough to show that there is commonality sufficient to proceed with class treatment of their claims. It remains to be seen how courts will handle these cases when they actually go to trial and it becomes apparent that individualized application of the policies makes them extraordinarily difficult, if not impossible to adjudicate on a class-wide basis, while at the same time respecting the defendant's right to due process.

I. Relitigation of Class Certification Denials

Litigation through class certification can be tremendously expensive for employers. The primary justification for the expenditure of litigating class certification is that if the employer persuades a court to deny class certification, it is therefore established that employees in the putative class must come forward and litigate their claims individually (or through a joinder action). But, what if another attorney finds another class representative, and asserts the same class action claims in a different lawsuit? Given the broad discretion that trial courts have to decide certification, class action plaintiffs' lawyers have an incentive to try their luck again in a different jurisdiction.

In *Alvarez v. May Department Stores*,⁴⁴⁹ the court of appeal limited an attorney's ability to continually relitigate class certification of the same proposed class.⁴⁵⁰ The plaintiffs' counsel first filed an action in Los Angeles in 1997. In 1998, counsel moved for class certification for a putative class of store managers and the motion was denied. In 1999, he refiled with another class representative alleging the same class claims. The trial court considered class certification anew, but ultimately also decided to deny class certification. That denial was affirmed on appeal in 2003. Undeterred, the plaintiffs' counsel filed another action in Los Angeles County asserting the same claims on behalf of essentially the same putative class. This time the defendant demurred to the complaint on the ground that the class allegations were barred by principles of collateral estoppel. The trial court agreed and sustained the demurrer.

The court of appeal affirmed the sustaining of the demurrer. The court did not go so far as to state a *per se* rule that a class certification denial always bars another class member from coming forward and seeking class certification of the same claims. The court did, however, hold that if, after class certification is denied, the same attorney brings essentially

⁴⁴⁹ 143 Cal. App. 4th 1223 (2006).

⁴⁵⁰ A similar conclusion was drawn by the Seventh Circuit in *Bridgestone/Firestone, Inc., Tires Products*, 333 F.3d 763 (7th Cir. 2003).

the same claims on behalf of essentially the same putative class, principles of collateral estoppel would preclude certification of the second action.⁴⁵¹ Although the court did not address how it would have ruled if a *different* attorney had represented the new class representative seeking to sue on behalf of the same class, it implied that collateral estoppel would apply unless the new attorney came forth with evidence that the first attorney's efforts had been incompetent or otherwise inadequate to fairly protect the putative class's interests:

It is manifestly unfair to subject respondent to a revolving door of endless litigation. In cases, such as this one, where a party had a full opportunity to present his or her claim and adequately represented the interests of a second party who seeks the same relief, principles of equity, "[p]ublic policy and the interest of litigants alike require that there be an end to litigation."⁴⁵²

The plaintiffs' bar has been unwilling to accept the notion that one lawyer losing class certification means that no other lawyer can try to get a class certified against that employer. Plaintiffs' counsel were aided in this regard when, in *Bufile v. Dollar Financial*,⁴⁵³ the court of appeal held that collateral estoppel did *not* preclude certification of meal and rest period claims for a sub-class of a broader proposed class for which certification had previously been denied. Previously, in *Chin v. Dollar Financial Group*,⁴⁵⁴ the court had denied class certification of meal and rest break claims for clerks working alone in the defendant's check-cashing stores. In the middle of the class period, the defendant adopted a policy of requesting that the clerks execute an on-duty meal period agreement, which the plaintiffs contended they were forced to sign. The *Chin* court held that the question of whether each individual clerk was pressured to sign the meal period agreement was an individualized inquiry not suitable for class treatment. Furthermore, the court found that, prior to the institution of the meal period agreement, defendant did not have a uniform meal period policy, therefore requiring individualized inquiry as to whether each class member was denied meal breaks during this time.

The Court of Appeal in *Bufile* held that this previous denial of certification did not create a *res judicata* bar to certification of the class proposed by Bufile because both the proposed class and the rationale for certification were different. The class in *Bufile* was a smaller subset of the class alleged in *Chin*, including only clerks who worked for the defendant after the institution of the meal period agreement. Furthermore, Bufile did not allege that the clerks had been forced to sign the meal period agreements, which was one of the individualized

⁴⁵¹ *Id.* at 1238-40.

⁴⁵² *Id.* at 1240.

⁴⁵³ 162 Cal. App. 4th 1193 (2008).

⁴⁵⁴ 2006 WL 1351491 (unpublished, unavailable on LEXIS).

inquiries that had doomed plaintiffs' claims in *Chin*. Rather, *Bufile* contended that the employees did not work in a situation where an on-duty meal period would be permissible even with the consent of the employees, which was a legal question that could be decided on a class-wide basis.⁴⁵⁵

While *Bufile* can be harmonized with *Alvarez* as addressing a case where the plaintiff truly is seeking certification of a different class using a different theory of collective proof, a full-blown split in authority developed when the Second District decided *Bridgeford v. Pacific Health Corporation*.⁴⁵⁶ The *Bridgeford* court, relying on the U.S. Supreme Court's ruling in *Smith v. Bayer Corp.*,⁴⁵⁷ held that collateral estoppel did *not* apply; therefore a denial of class certification in one case would still leave unnamed putative class members free to file a second suit alleging identical claims.⁴⁵⁸

In *Bridgeford*, a wage and hour class action, the trial court had granted defendants' demurrer on the grounds that the named plaintiffs had been members of the putative class in an earlier action wherein class certification had been denied on the same claims, and so collateral estoppel precluded them from seeking class certification in the second action.⁴⁵⁹ The Court of Appeal reversed, stating that even if the minimum requirements for applying collateral estoppel had been met, if a party had not had a full and fair opportunity to litigate the issue in the prior proceeding, then collateral estoppel should not apply.⁴⁶⁰ The court concluded:

[U]nder California law . . . the denial of class certification cannot establish collateral estoppel against unnamed putative class members on any issue because unnamed putative class members were neither parties to the prior

proceeding nor represented by a party to the prior proceeding so as to be considered in privity with such a party for purposes of collateral estoppel.⁴⁶¹

⁴⁵⁵ See also *Johnson v. GlaxoSmithKline, Inc.*, 166 Cal. App. 4th 1497, 1513-15 (2008) (reversing trial court's application of *Alvarez* collateral estoppel where enactment of Prop 64 after first court denied certification ran counter to the rationale the first court had given for denying class certification; also considering (without deciding) whether *Alvarez* was overruled *sub silentio* by the United States Supreme Court's discussion of virtual representation in *Taylor v. Sturgell*, 553 U.S. 880 (2008)).

⁴⁵⁶ 202 Cal. App. 4th 1034, 1043 (2012).

⁴⁵⁷ 131 S. Ct. 2368 (2011).

⁴⁵⁸ *Id.* at 1044.

⁴⁵⁹ *Id.* at 1039-40.

⁴⁶⁰ *Id.* at 1042.

⁴⁶¹ *Id.* at 1044

If the reasoning in *Bridgford* is widely adopted, serial class claims could result: even if an employer is successful in defeating class certification, courts may allow attorneys to forum-shop by recruiting new plaintiffs to file a case with similar allegations and seek class certification again and again from different judges.

J. Defense Motions to Deny Class Certification (“Vinoles Motions”)

It is often to the employer’s tactical advantage to file the motion that triggers the resolution of the question of whether a class should be certified. By filing first, the employer can time the briefing to its advantage. If the employer can quickly assemble the evidence it needs to defeat class certification, then filing such a motion may put pressure on the plaintiffs’ lawyers (who often take on many cases) to oppose such a motion with less preparation than they would have if they could delay discovery for months and months until they felt prepared to file a motion for certification. Furthermore, filing first gives the employer the opportunity to file a reply brief, which it usually may not file if the plaintiff moves for class certification first.

The plaintiffs’ bar does not agree that employers should be permitted move to deny class certification before the plaintiffs file their own certification motion. Plaintiffs’ lawyers often contend that such a motion robs the plaintiff of the right to define the class it wants certified and establish that such a class is possible. The plaintiffs also contend that such motions are not allowed under California procedure (or under federal procedure if the case has been removed to federal court).⁴⁶² A problem the plaintiffs face with this argument is that the California Supreme Court rejected it more than thirty years ago in *City of San Jose v. Superior Court*.⁴⁶³ There, the court stated in no uncertain terms that *either* party can move for class certification and that such determinations should take place as soon in the litigation as practicable:

[W]e have directed [lower courts] to rule 23 of the Federal Rules of Civil Procedure, which provides: “As soon as practicable after the commencement of an action brought as a class action, the court shall determine by order whether it is to be so maintained.” This determination may be made on motion of either plaintiff or defendant – or on the court’s own motion.⁴⁶⁴

⁴⁶² However, California Rules of Court, Rule 3.764(a) appears to contemplate such motions (“A party may file a motion to . . . Decertify a class”).

⁴⁶³ 12 Cal. 3d 447 (1974); *accord Chevron USA, Inc. v. Vermilion Parish Sch. Bd.*, 364 F.3d 607 (5th Cir. 2004) (upholding trial court’s grant of defendants’ motion to deny class certification); *Sipper v. Capital One Bank*, 2002 U.S. Dist LEXIS 3881 (C.D. Cal. Feb. 28, 2002) (granting “motion to deny class certification”); *Lightfoot v. Gallo Sales Co.*, 15 Fair Empl. Prac. Cas. (BNA) 615, 616 (N.D. Cal. 1977) (granting “Motion That Class Be Denied Certification Pursuant to Rule 23(c)(1)”).

⁴⁶⁴ *City of San Jose*, 12 Cal. 3d at 453-54.

Because the *City of San Jose* case is from the 1970s, plaintiffs' counsel often argue that its statement did not survive the later enactment of the complex rules within the California Rules of Court, which set a special briefing schedule for motions to "certify a class; determine the existence of and certify subclasses; amend or modify an order certifying a class; or decertify a class."⁴⁶⁵ Plaintiffs argue that the absence from this list of "motion to deny certification" was a deliberate decision to preclude such a motion.

The employer's cause to allow such motions was aided by Seyfarth Shaw's victory in *Vinole v. Countrywide Home Loans*.⁴⁶⁶ There, the Ninth Circuit upheld the grant of a motion to deny class certification and rejected the plaintiffs' argument that such motions were inappropriate, especially when they were not decided simultaneously with a plaintiffs' motion for class certification.⁴⁶⁷ The court rejected the plaintiffs' argument, noting that Rule 23 of the Federal Rules of Civil Procedure places no limitations on which party may move for a determination whether a case should proceed as a class action. The court also noted that it is at the discretion of the trial court to decide when to rule on a certification or decertification motion and that there is no rule that the court must wait for the discovery period to end.⁴⁶⁸

Following the issuance of the district court decision in *Vinole*, the Second District Court of Appeal held that the same rules apply under California civil procedure. In *In re BCBG Overtime Cases*,⁴⁶⁹ the court held that "under both California and federal law, either party may initiate the class certification process." Relying on *Carabini v. Superior Court*,⁴⁷⁰ the court held that plaintiffs could file a motion for class certification, or defendants could move for a determination that the case should not proceed as a class action. As in *Vinole*, a key element in the court's analysis was whether the plaintiffs had sufficient opportunity to conduct relevant discovery. The court determined that the plaintiffs before it had plenty of time (more than two years) to conduct discovery relevant to class certification issues, and therefore the trial court acted within its discretion when it granted the defendant's motion to deny class certification rather than wait for the plaintiffs to file a motion for certification.⁴⁷¹

⁴⁶⁵ California Rules of Court, Rule 3.764.

⁴⁶⁶ 571 F.3d 935 (9th Cir. 2009).

⁴⁶⁷ Most cases approving defense motions to deny certification involve the filing of cross-motions by the defendant and the plaintiff. See, e.g., *Maddock v. KB Homes, Inc.*, 248 F.R.D. 229 (C.D. Cal. 2007) (motion for class certification and motion to deny certification filed simultaneously; court granted defendant's motion and denied plaintiffs' motion).

⁴⁶⁸ 571 F.3d at 943.

⁴⁶⁹ 163 Cal. App. 4th 1293, 1299 (2008).

⁴⁷⁰ 26 Cal. App. 4th 239, 242 (1994).

⁴⁷¹ *BCBG*, 163 Cal. App. 4th at 262-63.

XV. Discovery Issues in Class Actions

A. Disclosure of Class Member Names and Addresses to Allow Access to Potential Witnesses

An ongoing dispute in Labor Code class actions revolves around the disclosure of the names, addresses, and telephone numbers for potential class members prior to class certification. Plaintiffs typically argue they need this information to assist them in prosecuting their case, and to alleviate any inherent advantage the defendant has in contacting potential class members. In cases reaching back to *Atari v. Superior Court*,⁴⁷² California courts have recognized the principle that both sides in litigation should have equal access to potential class members, as they are often key witnesses.

Plaintiffs typically seek names and addresses of potential class members in order to send them some sort of communication describing the plaintiffs' case or to invite them to assist the plaintiffs' counsel in investigating the claims asserted. Of course, a defendant employer has a duty to maintain the confidentiality of the personal information of its current and former employees. Courts must strike a balance between these interests.

In 2003, the Second District Court of Appeal weighed these considerations in *Parris v. Superior Court*.⁴⁷³ In *Parris*, the plaintiffs filed a putative class action alleging that they were misclassified as exempt employees.⁴⁷⁴ The plaintiffs moved to compel the disclosure of potential class member names and addresses, and for leave to communicate with potential class members. The trial court denied the motions.

The appellate court held that plaintiffs have a constitutional right to free speech, which includes the right to communicate with potential class members.⁴⁷⁵ Requiring court approval of such communications would constitute an impermissible prior restraint on free speech.⁴⁷⁶ Therefore, the court held the trial court should have dismissed the plaintiffs' motion for leave to communicate with the class because no such motion was required.⁴⁷⁷

Regarding the disclosure of potential class member names and addresses, the *Parris* court held that it was "appropriate for the court to consider 'the possibility of abuses in class-action litigation'" in determining whether to order disclosure of potential class member

⁴⁷² 166 Cal. App. 3d 867 (1985).

⁴⁷³ 109 Cal. App. 4th 285 (2003).

⁴⁷⁴ *Id.* at 290.

⁴⁷⁵ *Id.* at 296-99.

⁴⁷⁶ *Id.*

⁴⁷⁷ *Id.* at 299-300.

information.⁴⁷⁸ Without expressing any opinion on the propriety of ordering disclosure in the case before it, the court remanded the case to the trial court to make that determination. Although this decision plainly restricted a trial court's ability to stop plaintiffs' counsel from communicating with class members once plaintiffs' counsel located them, it did not address whether plaintiffs may typically obtain discovery of the putative class members' names and personal contact information.

The California Supreme Court directly addressed this issue, albeit within the consumer class action context, in *Pioneer Electronics (USA), Inc. v. Superior Court*.⁴⁷⁹ The plaintiff in *Pioneer* filed a discovery motion seeking to compel the defendant to disclose the names and addresses of customers who complained about a defective DVD player. Ruling for the plaintiff, the Court instructed Pioneer to send a notice of the suit to all potential class members allowing them to object to the release of their names and contact information to the plaintiff. The Court ordered the defendant to release the names of those who did not respond to the notice and affirmatively object to disclosure.

The first published appellate decision to apply *Pioneer* to the wage and hour context was *Belaire-West Landscape, Inc. v. Superior Court*.⁴⁸⁰ In that case, the appellate court went even further than *Pioneer*, requiring the defendant to release the addresses and personal telephone numbers of all current and former employees who did not affirmatively opt out in response to a pre-certification class notice. Moreover, in contrast to the plaintiff in *Pioneer*, who sought information only on those putative class members who had affirmatively complained about the product at issue, the *Belaire-West* plaintiff sought personal information of all current and former employees within the putative class.

Two decisions that followed in the wake of *Belaire-West* have extended its holding to broaden the plaintiffs' rights to contact information. Indeed, the decisions have led many plaintiffs' lawyers to contend that they always have the right to the putative class members' contact information and that the court has discretion to skip the *Belaire-West* process altogether.

First, in *Puerto v. Superior Court*,⁴⁸¹ the Second District Court of Appeal held that it was an abuse of discretion to withhold the personal contact information of putative class members when the defendant had responded to discovery by listing each putative class member as a witness with information relevant to the case. The court held that "the right to privacy in

⁴⁷⁸ *Id.* at 300 (citing *Gulf Oil Co. v. Bernard*, 452 U.S. 89 (1981) and *Howard Gunty Profit Sharing Plan v. Superior Court*, 88 Cal. App. 4th 572 (2001)).

⁴⁷⁹ 40 Cal. 4th 360 (2007).

⁴⁸⁰ 149 Cal. App. 4th 554 (2007).

⁴⁸¹ 158 Cal. App. 4th 1242 (2008).

contact information [does not] trump the [plaintiffs'] right to investigate their claims by contacting witnesses."⁴⁸² Because of the unusual fact that the defendant had listed every putative class member by name and attested in verified discovery responses that each person was a percipient witness, *Puerto* could be distinguished from the typical class action.⁴⁸³

In the second decision, *Crab Addison, Inc. v. Superior Court*,⁴⁸⁴ the Second District Court of Appeal went even further, and held that a procedure by which putative class members had to affirmatively agree to the disclosure of their contact information was not permissible even where (1) the employer had *not* listed the employees as witnesses or otherwise disclosed their names and (2) the employees had signed a form indicating they did not wish to have their personal information released—including specifically in connection with “class action lawsuits.” The court found that employees, in signing the release form, would not realize that the form might encompass a class action aimed at vindicating their own Labor Code rights, and that “public policy concerns weigh in favor of enforcing unwaivable statutory wage and overtime rights through class action litigation over a right to privacy.”⁴⁸⁵

Although neither the *Puerto* nor the *Crab Addison* decision announced a *per se* rule that plaintiffs are entitled to production of all putative class member contact information without any protections being afforded to the putative class members to protect their privacy rights in that information, the decisions certainly indicate that a trial judge would not abuse discretion by simply ordering all the information to be turned over without resort to a *Belaire-West* opt-out privacy mailing. We have not yet seen a trend among courts in bypassing the *Belaire-West* opt-out process and none of the holdings in the *Belaire-West*, *Puerto*, or *Crab Addison* cases would seem to mandate that information be disclosed without any kind of protection for employee privacy.

It would appear that the need to obtain the employees' contact information would depend on the nature of the class action claims. Even the *Crab Addison* court recognized that there was enough of a privacy interest in putative class members' identities and contact information to protect against disclosure when the information “is unnecessary to the

⁴⁸² *Id.* at 1248.

⁴⁸³ *Puerto* was followed by a federal district court in *Stone v. Advance America*, 2010 WL 5892501 (S.D. Cal. 2010). In *Stone*, the court had previously allowed the plaintiff to obtain class-member contact information through notice and an opt-out procedure. Thereafter, the plaintiff propounded interrogatories requesting the identities and contact information for defendant's former employees during the class period. The court held that no notice or opt-out procedure was required to obtain this information under Rule 26 of the F.R.C.P., because it sought only basic discovery, i.e., the names and contact information for percipient witnesses, which the court distinguished from the names and contact information of class members (even though there was substantial overlap between the two).

⁴⁸⁴ 169 Cal. App. 4th 958, 973-74 (2008).

⁴⁸⁵ *Id.* at 974.

prosecution of the litigation.”⁴⁸⁶ There are class actions where the plaintiffs’ need to contact putative class members is minimal, but the lawyers seek the contact information anyway with the hope that they can locate some disgruntled former employees who might uncover *additional* possible class claims. For example, in a case concerning miscalculation of the overtime rate, the case turns almost exclusively on payroll records, so there would seem to be little need to contact class members. Although, technically speaking, the employees are witnesses, employers contend that they are not essential witnesses and that their right to privacy should outweigh the plaintiffs’ right to contact them, given the ability of plaintiffs to prosecute the case without such contact information.

As explained above, the court in *Parris* held that a court deciding whether to allow discovery of class member identities must weigh the danger of possible abuses of the class action procedure against the rights of the parties under the circumstances.⁴⁸⁷ Accordingly, the trial court has discretion to deny disclosure of names and addresses upon a showing that the plaintiff’s class claims are merely a pretext designed to gain access to the putative class members’ contact information. This will be a difficult burden to establish in most cases, but may be successful where the need for the discovery is minimal, where facts can be shown that the plaintiff lacks a reasonable basis for believing his or her individual claims are common to a broader class, or where there is evidence that the lawyer is controlling the litigation for an ulterior purpose. We expect that the law will continue to develop to address this situation, as we encounter it on a regular basis.

B. Discovery to Facilitate Location of Substitute Class Representatives

One method to defeat class certification is to argue that the class representative is atypical or inadequate. The problem with this argument is that, even when it succeeds, it leaves open the question of whether a class could properly be certified with a different member of the putative class acting as class representative.

In 1971, in *La Sala v. American Savings & Loan Association*,⁴⁸⁸ the court held that, on the facts before it, the plaintiff should have been permitted to substitute a proper class representative for a class representative who was inadequate. A key aspect of the decision, however, was that the defendant had engaged in questionable conduct that rendered the plaintiff inadequate. More specifically, the case addressed the alleged impropriety of a fee charged by the defendant savings & loan. The defendant excused the

⁴⁸⁶ *Crab Addison*, 169 Cal. App. 4th at 967.

⁴⁸⁷ 109 Cal. App. 4th at 300-01.

⁴⁸⁸ 5 Cal. 3d 864 (1971).

plaintiff from paying the fee as a basis to argue that the plaintiff suffered no harm and, thus, lacked standing to represent a class of injured customers.

The court left open the question of whether the plaintiff's lack of any injury rendered him inadequate to represent the putative class as a matter of law, but it held that a defendant should not be able to defeat a class action by simply paying off class representatives one-by-one as they come forward:

In the present case, American has waived its acceleration clause only as to [the plaintiffs]. If other borrowers bring a class action, American may again waive as to those representative borrowers, and again move to dismiss the action. Such a procedure could be followed ad infinitum for each successive group of representative plaintiffs. If defendant is permitted to succeed with such revolving door tactics, only members of the class who can afford to initiate or join litigation will obtain redress; relief for even a portion of the class would compel innumerable appearances by individual plaintiffs.⁴⁸⁹

La Sala has been interpreted to permit a plaintiff to amend the complaint to add a new class representative when the original plaintiff, although a bona fide member of the putative class, has particular traits that make him an inadequate class representative.⁴⁹⁰ Thus, under *La Sala*, a plaintiff who is deemed inadequate generally can find and substitute in another class representative.⁴⁹¹

La Sala left open the important question of whether the plaintiff may use the discovery process as a mechanism to obtain contact information for other putative class members for the express purpose of asking them if they would be willing to be a substitute class representative. That question was answered “yes” in *Best Buy Stores, L.P. v. Superior Court*.⁴⁹²

In *Best Buy*, a class action attorney was subjected to an allegedly illegal “restocking fee” when he returned an item to Best Buy. Invoking the Consumer Legal Remedies Act and the UCL, he sought to represent a class of similarly situated consumers who were charged

⁴⁸⁹ *Id.* at 873.

⁴⁹⁰ *But see Howard Gunty Profit Sharing Plan v. Superior Court*, 88 Cal. App. 4th 572, 580-81 (2001) (leave to substitute class representative may be inappropriate where trial court determines that the class representative was a “professional plaintiff” with a history of abusing the class action procedure).

⁴⁹¹ *See, e.g., Aguiar v. Cintas Corp. No. 2*, 144 Cal. App. 4th 121, 137 (2006) (“the second amended complaint may be amended once again on remand to add another named plaintiff should it be determined that . . . [plaintiff] needs an additional, adequate representative”); *Shappell Indus., Inc. v. Superior Court*, 132 Cal. App. 4th 1101, 1109 (2005) (“[*La Sala*] demonstrate[s] that California courts recognize and preserve the rights of absent class members, even before the issue of certification has been determined”).

⁴⁹² 137 Cal. App. 4th 772 (2006).

the fee. The trial court ruled that he could not simultaneously be class counsel and class representative.⁴⁹³ The plaintiff requested that the court order Best Buy to disclose to a third party administrator the names and addresses of all putative class members, so that the administrator could advise them of the case and invite them to express interest in serving as class representative in the lawyer's stead. When the trial court granted the request, Best Buy sought a writ of mandate to reverse the decision.

Although the writ petition was granted, the appellate court ultimately affirmed the crux of the trial judge's order.⁴⁹⁴ The court held that it was indeed appropriate to use the discovery process to locate a substitute class representative when the original class representative was found inadequate.⁴⁹⁵ It also held that facilitating "recruiting" of a class representative in this manner was not improper "solicitation" under the Rules of Professional Conduct, because "solicitation" was limited to in-person or telephonic contact, not a mailing.⁴⁹⁶

The result in *Best Buy* was understandable in that the class representative appeared to be a proper class representative but for the fact that he also wanted to serve as class counsel. After all, he did go to Best Buy and was charged a restocking fee, so he otherwise appeared to have a colorable claim. But what happens when the class representative has no actual claim against the defendant? For example, could a person simply pick a large employer for whom he has never worked, sue for Labor Code violations, and, upon being held inadequate (because he never was an employee), obtain a court order for a mailing to assist him recruit a "proper" class representative?

That question was answered "no" in *First American Title Insurance Company v. Superior Court*.⁴⁹⁷ The plaintiff, who was not a member of the class he purported to represent, and who had no other interest in the litigation, obtained an order for precertification discovery so

⁴⁹³ See *Apple Computer, Inc. v. Superior Court*, 126 Cal. App. 4th 1253 (2005) (attorney in class action may not also act as class representative).

⁴⁹⁴ But see *Best Buy*, 137 Cal. App. 4th at 778 (court should not have included contact information in letter for plaintiff, but rather should simply have disclosed to plaintiff contact information of all individuals who returned postcards stating they were interested in serving as class representative).

⁴⁹⁵ *Id.* at 779; see also *Rand v. American Nat'l Ins. Co.*, 2010 WL 2758720 (N.D. Cal. July 13, 2010) (permitting use of class information to solicit new class representative after previous class representative died). The *Best Buy* court cited *Budget Finance Plan v. Superior Court*, 34 Cal. App. 3d 794, 799 (1973), to reason that a proper purpose of discovery is to look for a substitute class representative when the original class representative is inadequate, and the *Budget Finance* case does state as such. But the *Budget* case cited no authority for that proposition other than the conclusory statement that the right to such discovery impliedly flows from the right of a plaintiff to substitute in a new class representative. See *First American Title Ins. Co. v. Superior Court*, 146 Cal. App. 4th 1564, 1577-78 (2007) (noting lack of analysis in *Budget Finance*'s conclusion concerning right to discovery, and questioning its continuing validity as precedent).

⁴⁹⁶ *Id.* at 776-77.

⁴⁹⁷ 146 Cal. App. 4th 1564 (2007). See also *Cryoport Sys. v. CAN Ins. Co.*, 149 Cal. App. 4th 627 (2007) ("*Best Buy Stores* does not stand for the proposition that a plaintiff with no interest in the action has a right to discovery to find a substitute plaintiff to keep the action alive.").

that he could locate a class representative. In holding that the order was an abuse of discretion, the appellate court concluded, “the potential abuse of the class action [precertification discovery] procedure greatly outweighs the rights of the parties under the circumstances.”⁴⁹⁸ The court noted that it would counter the public policy enshrined in Prop 64 to allow people without any injury in fact to sue and then use the discovery process to troll for class representatives.⁴⁹⁹ The appellate court also noted that putative class members, if they really felt aggrieved, were free to come forward and bring their own case:

Any further legal action can be pursued by members of the class, if they so desire. [Plaintiff] makes no argument that any future action they might pursue would be time-barred, or offers any other reason why the class members might be denied relief if this action is unable to proceed on their behalf. In short, the potential for abuse of the class action procedure is overwhelming, while the interests of the real parties in interest are minimal. Precertification discovery under these circumstances would be an abuse of discretion.⁵⁰⁰

However, in *CashCall, Inc. v. Superior Court*,⁵⁰¹ precertification discovery was permitted in order to locate proper class representatives, even though the original representatives, as well as the first set of replacements, were all found to *not* be members of the putative class.

CashCall involved a suit against a lender who allegedly had illegally monitored certain of its collection calls in violation of the California Penal Code.⁵⁰² The defendant notified the plaintiffs that none of the three named class representatives had been subject to monitoring. Five new class representatives were then substituted in, but it again turned out that none of these individuals had had their calls monitored.⁵⁰³ The trial court then ordered CashCall to disclose the identities of the 551 individuals for whom collection calls had been monitored so that proper class representatives could be substituted in.⁵⁰⁴

The Court of Appeal determined that the trial court had not abused its discretion in permitting discovery of the class list for the purpose of locating proper class representatives.⁵⁰⁵ The court distinguished *First American*, noting that, in that case, “the class members’ rights against the defendant had already been protected and enforced

⁴⁹⁸ *Id.* at 1577.

⁴⁹⁹ *Id.*

⁵⁰⁰ *Id.*

⁵⁰¹ 159 Cal. App. 4th 273 (2008).

⁵⁰² *Id.* at 278.

⁵⁰³ *Id.* at 280.

⁵⁰⁴ *Id.* at 283.

⁵⁰⁵ *Id.* at 292.

through state agency investigations and settlements with the defendant.”⁵⁰⁶ This was not the case in *CashCall*, where the putative class had no knowledge of the alleged unlawful conduct and the court noted that “absent precertification discovery and continuation of this class action, it appears unlikely any of the class members will have a realistic opportunity to assert claims, and potentially obtain relief.”⁵⁰⁷

More recently, *Safeco v. Superior Court*⁵⁰⁸ was decided similarly to *CashCall*, with the appellate court emphasizing that *First American* “does not stand for the proposition that a plaintiff who was never a class member in a UCL action necessarily is not entitled to conduct precertification discovery to identify a substitute class representative.”⁵⁰⁹

However, in *Starbucks Corp. v. Superior Court*, the California Court of Appeal reversed the trial court’s order permitting plaintiffs to conduct discovery to locate a suitable class representative.⁵¹⁰ There, the plaintiffs had brought a putative class action against Starbucks, alleging that the company’s preprinted job application improperly sought information relating to minor marijuana convictions that were over two years old.⁵¹¹ But because the named plaintiffs had never been convicted of any such crimes, they were dismissed as class representatives on summary judgment.⁵¹² Thereafter, class counsel amended their complaint and obtained an order from the Superior Court permitting them to discover the names of job applicants who had disclosed minor marijuana convictions on their applications, in order to locate “suitable” class representatives.⁵¹³ The Court of Appeal overturned the order, holding that the trial court had abused its discretion in allowing this precertification discovery.⁵¹⁴ The court distinguished *CashCall*, noting that, in that case, “the only conceivable class members were debtors who were unaware of the secret monitoring,” and therefore unaware that they had potential claims.⁵¹⁵ “However, in contrast, Starbucks’ job applicants who had marijuana convictions know about their own previous convictions and about the fact that they had applied for a job at Starbucks,” and therefore had a fair opportunity to file suit if they so desired.⁵¹⁶ Thus, the court held that the *Parris*

⁵⁰⁶ *Id.* at 298.

⁵⁰⁷ *Id.*

⁵⁰⁸ 173 Cal. App. 4th 814 (2009).

⁵⁰⁹ *Id.* at 829.

⁵¹⁰ *Starbucks Corp. v. Superior Court*, 194 Cal. App. 4th 820 (2011).

⁵¹¹ *Id.* at 721.

⁵¹² *Id.*

⁵¹³ *Id.*

⁵¹⁴ *Id.* at 725.

⁵¹⁵ *Id.* at 726.

⁵¹⁶ *Id.*

balancing test required the requested precertification discovery to be denied because the potential abuse of the class action procedure in this instance outweighed the rights of the class members.⁵¹⁷

To the extent that any rule derives from these cases, it appears to be that the trial court has broad discretion to deny discovery for the plaintiff to locate a new class representative when the plaintiff is inadequate, but has more narrow discretion in the absence of a showing that the plaintiff never was a proper putative class member or never experienced an injury in fact. Trial courts appear to lack any discretion to deny discovery where the plaintiff is rendered inadequate by conduct of the defendant or as a result of some other characteristic independent of the merits of the plaintiff's claims.

C. Discovery Issues Regarding Putative Class Member Declarations

Defense counsel in class actions routinely obtain declarations from putative class members to contradict the plaintiffs' allegations and defeat class certification. In gathering such witness statements, it is important to consider the manner in which the interviews are conducted, and the potential discoverability of the witness statements.

1. Employers Must Approach Pre-Certification Communications With Their Employees With Caution

In general, defendants in class actions are not barred from communications with putative class members *prior to* class certification unless the communications are misleading, coercive, or improper.⁵¹⁸ In the context of employment class actions, courts specifically recognize the heightened potential for coercion. For these reasons, many employers utilize some variation of the longstanding *Johnnie's Poultry* safeguards to minimize the potentially coercive impact of attorney interviews of putative class members. These safeguards include: communicating the purpose of the questioning to the employee prior to the interview; assuring the employee that no reprisal will take place; and explaining that participation is voluntary.⁵¹⁹ When employers violate these safeguards, courts are likely to disregard any declarations obtained and to limit any further pre-certification communications with employees.

⁵¹⁷ *Id.* at 726 (also noting that “the excessive penalties sought by class counsel bear little relationship to any true public interest for what, at most, appears to be a technical violation of Labor Code 432.8 by Starbucks”).

⁵¹⁸ Following class certification, the class members are represented by plaintiffs' counsel and should not be contacted by defense counsel.

⁵¹⁹ *Johnnie's Poultry Co. and District Union 99, Amalgamated Meat Cutters & Butcher Workmen of N. Am., AFL-CIO*, 146 NLRB 770, 775 (1964)

*Quezada v. Schneider Logistics Transloading & Distrib., Inc.*⁵²⁰ is a prime example. In that case, a wage and hour class action brought by warehouse workers, a California federal court found that an employer's communications with putative class members were deceptive and coercive, struck all declarations obtained from them, and barred any further attempts by the defendant's attorneys to contact the class members.

The facts that led to this result were as follows: shortly after the plaintiffs filed their complaint, defense counsel began interviewing employees about the allegations. The meetings were held in a manager's office during work hours and the employees were called to the office over a loud speaker or ordered to attend by their supervisors. Some employees did not know why they were being ordered to the manager's office.

Before the start of each interview, defense counsel informed the employees that the meeting was "just an interview" and that the meetings were being conducted in connection with the company's attorneys' "internal investigation about the conditions at the warehouse."⁵²¹ Applying some of the *Johnnie's Poultry* safeguards, the attorneys further explained that the interview and subsequent participation in drafting and signing the declarations were voluntary and that the employee could end the interview at any time; that if the employee decided to sign a declaration, he or she should make sure it was truthful and accurate; that the employer could not retaliate against or reward the employee based on the decision to participate or the information provided; that the employee was a potential class member in a lawsuit with claims pertaining to the subject of the meeting; that defense counsel represented the company, not the employees; and that the employees could consult with an attorney regarding the process.⁵²²

At the end of each interview, the employees were asked to sign a declaration. The attorneys did not explain, however, that the document was a sworn declaration that the employer could use to limit the employees' potential recovery in the class action.⁵²³ Instead, the attorneys told the employees that the document was a "consent form" regarding their voluntary participation in the interview process.⁵²⁴ Some employees said they felt pressure to sign and only six out of the 120 interviewees declined to sign.⁵²⁵

The court determined that, despite the attorneys' disclosures to the employees at the outset of the interviews, the communications were deceptive because the employees were never

⁵²⁰ No. CV 12-2188 CAS (DTBx) (C.D. March 25, 2013).

⁵²¹ *Id.* at 3.

⁵²² *Id.* at 2-3.

⁵²³ *Id.* at 3.

⁵²⁴ *Id.* at 4.

⁵²⁵ *Id.*

told of the nature and purpose of the interviews, which was to gather evidence to use against class members in the lawsuit.⁵²⁶ In addition, the court held that the interviews were conducted in a coercive manner because the employees were essentially ordered to attend the meetings.⁵²⁷ Even though the employees were told the interviews were voluntary, the fact that only five employees actually chose to leave and that only six refused to sign a declaration confirmed the coercive nature of the interviews.⁵²⁸ Accordingly, the court ordered the declarations struck and barred any further communications with putative class members, absent a court order.

2. Protection Of Attorney Procured Witness Interviews From Discovery

Once employers and their counsel have invested time and expense to gather witness statements, they face yet another hurdle: resisting attempts by plaintiffs' counsel to obtain their hard-earned declarations during discovery. Plaintiffs' counsel routinely request production of such declarations, which defense counsel often prefer not to disclose prior to filing them with the court in opposition to class certification.⁵²⁹ In an employer friendly decision, the California Supreme Court recently affirmed that attorney-directed internal investigations and statements taken from witnesses are entitled to at least a qualified work product protection.

For years, litigants in California had relied upon *dicta* in *Nacht & Lewis Architects, Inc. v. Superior Court*⁵³⁰ for the proposition that recorded witness statements taken by an attorney or his agent are entitled to absolute work product protection and thus, are not discoverable. In 2010, however, the Court of Appeal in *Coito v. Superior Court*⁵³¹ declined to follow *Nacht* and held that recorded witness statements and signed declarations were *not* entitled to work product protection as a matter of law. This meant plaintiffs could now sit back while defense counsel expended time and effort conducting witness interviews and then freely obtain their declarations.

In 2012, the California Supreme Court reversed the Court of Appeal, holding that attorney-directed witness interviews and statements are entitled as a matter of law to at least

⁵²⁶ *Id.* at 8.

⁵²⁷ *Id.*

⁵²⁸ *Id.*

⁵²⁹ Note that in federal court, pursuant to Rule 26 of the Federal Rules of Civil Procedure, such declarations usually must be disclosed shortly after they are executed. One way to comply with this requirement is to prepare declarations that are in final form but not signed, and then have the witnesses execute them when they are needed. A risk inherent in this approach, of course, is that witnesses may change their minds about signing declarations.

⁵³⁰ 47 Cal. App. 4th 214, 217 (1996).

⁵³¹ 182 Cal. App. 4th 758 (2010).

qualified work product protection and may be entitled to absolute protection upon a proper showing.⁵³²

Influenced by the legislative history and policy underlying the protection of attorney work product, the Court concluded that a default rule allowing discovery of attorney-procured witness statements would impede the Legislature's intent "to encourage [attorneys] to prepare their cases thoroughly and to investigate not only the favorable but the unfavorable aspects of their cases."⁵³³ There would be a chilling effect on case investigation and preparation, which might inhibit the truth from coming out. Moreover, it would undermine the legislative policy of preventing an attorney from taking advantage of an adversary's efforts.⁵³⁴

Accordingly, the Court held that where witness statements reveal an attorney's impressions, conclusions, opinions or legal research, the statement is entitled to absolute protection.⁵³⁵ The Court pointed out that absolute work product protection is more likely to apply when witness statements include or evidence: (1) explicit comments or notes by the attorney stating his or her impressions of the witness of other case issues; (2) facts that provide a window into the attorney's theory of the case or the attorney's evaluation of what issues are most important; (3) follow-up questions that reveal the attorney's thoughts or strategy; and (4) the selection of a specific witness from a multitude of witnesses available.⁵³⁶

Even if witness statements do not reveal an attorney's impressions or opinions sufficient to merit absolute protection, they will ordinarily not be discoverable unless the party seeking disclosure establishes that that denial of such discovery will result in unfair prejudice or injustice.⁵³⁷ If a party resisting discovery alleges that a witness statement is absolutely protected, that party must make a preliminary or foundational showing that the disclosure would reveal the attorney's impressions, conclusions, opinions, legal research or theories.⁵³⁸ The trial court may then determine whether and to what extent the absolute privilege applies.⁵³⁹

⁵³² *Coito v. Sup. Court*, 54 Cal. 4th 480, 496 (2012).

⁵³³ *Id.*

⁵³⁴ *Id.* at 495.

⁵³⁵ *Id.* at 496.

⁵³⁶ *Id.* at 495.

⁵³⁷ *Id.* at 500.

⁵³⁸ *Id.*

⁵³⁹ *Id.*

The Supreme Court's decision in *Coito* expanded work product protection for witness interviews and signed declarations in California state courts. This case also highlights the importance of involving legal counsel as early as possible in order to protect witness interviews and declarations through the attorney work product doctrine. Interviews should be conducted by counsel, or at the direction of counsel, because otherwise the work product of non-attorney investigators will be subject to discovery.

XVI. Class Action Settlement

A. Generally

The vast majority of class actions result in a settlement. Unlike an individual settlement of employment law claims, a court must approve a class settlement to ensure that it is fair and reasonable, is not the product of collusion, and does not subordinate the interests of the broader class to those of the named plaintiffs.⁵⁴⁰

Typically, the plaintiffs and the defendant enter into a stipulation of settlement, which a court analyzes to determine if the agreement looks reasonable on its face. If so, the court will grant preliminary approval (sometimes called "conditional certification") and then notice of the settlement will be sent to the class. Most commonly, class members will be given a choice of (1) returning a claim form to receive money under the agreement; (2) returning a request for exclusion ("opt out") form that excludes them from the settlement and preserves their individual right to sue; or (3) doing nothing, in which case the class members receive nothing but still are bound by the class release. Those class members who do not request exclusion will also have the option of filing an objection to the settlement.⁵⁴¹

After a fixed period following the issuance of notice (usually 45-60 days), the claims period will end, and class counsel will seek final approval of the settlement. Above and beyond the analysis the court conducted at preliminary approval, the court will examine the extent of class participation in the settlement, will rule on any objections, and will make final determinations as to class counsel's request for attorney's fees and an incentive payment or "enhancement" for the class representative (additional money beyond that received by other class members as a reward for taking the risk of filing the class action).

⁵⁴⁰ See generally *Dunk v. Ford Motor Co.*, 48 Cal. App. 4th 1794, 1800-01 (1996).

⁵⁴¹ See generally *Wershba v. Apple Computer, Inc.*, 91 Cal. App. 4th 224, 251-52 (2001) (explaining different choices class members typically have upon receiving class notice). Recent case law also implies that it may be permissible to settle a certified class action through the acceptance of an offer of judgment by the class representative. See *Nelson v. Pearson Ford Co.*, 186 Cal. App. 4th 983, 1024-26 (2010) (assuming without deciding that a valid California Code of Civil Procedure § 998 offer can be made in a certified class action). Should this process be used, after acceptance, the parties would then provide class notice, etc., just as if a stipulation of settlement had been entered.

When Labor Code class actions were relatively novel, there was little consistency between different judges as to the scrutiny of settlements they would undertake or the rules they would apply. Most courts who did not have much experience with class actions typically undertook very little scrutiny of class settlements beyond ensuring that they were not collusive and that the notice provided clear instruction to the class. Over the intervening years, however, a substantial body of law has developed to provide courts with better guidance as to how to evaluate class settlements in wage and hour cases.

B. Restrictions on Reversions of Settlement Funds

Most class settlements result from mediation. Unlike a court, which must protect the interests of a class, a mediator seeks solely to broker a settlement acceptable to the parties who hired the mediator—i.e., the lawyers for the parties. Irrespective of their fealty to ethical obligations, plaintiffs' counsel—who often have near absolute control over wage/hour class litigation—have a financial interest in maximizing the attorney's fees they will receive through the settlement. The employers' financial incentive is to achieve as broad of a release as possible for as little money as possible. Because the plaintiff's lawyer typically receives an attorney's fee that is a percentage on the gross value of the class settlement, employers would commonly agree to a nominally larger gross settlement value on the condition that any unclaimed settlement funds be returned to the employer. These sort of "reversionary" settlements have been popular because they allowed an employer the possibility of paying substantially less in settlement than the gross settlement would suggest, particularly in industries where the employer could predict that the claims rate would be low.

For example, in particular industries where there is a transient workforce, it is common for only about one quarter of the class members to make claims—either because they do not receive notice or because the value of the individual settlement amounts is too low to attract their attention. When a small percentage of the class submits claims in a reversionary settlement, it may actually result in class counsel receiving significantly more money than the class as a whole. For example, in connection with a settlement of one million dollars, if class counsel received thirty percent, that would leave no more than \$700,000 for the class (actually less, because settlement administration costs are typically paid out of the gross settlement). If the class claims only 25% of the amount set aside for claims, then the class would receive no more than \$175,000 versus the \$300,000 class counsel would be slated to receive. While this arrangement could be defended on the ground that class counsel secured a *potential* one million dollar settlement, courts have looked unfavorably on large payouts to class counsel as compared to the payment received by the class.

One way courts can address this inequity is simply to cut the attorney's fee and distribute the difference to those members of the class who made claims. In the above example, if class counsel's fee was reduced to 15% of the gross, then it would result in the lawyers obtaining \$150,000, and the class receiving \$325,000, an effective contingency of 31%. Of course, this result is at odds with what class counsel negotiated, so a routine reduction in fees would substantially reduce the willingness of plaintiff's counsel to agree to reversionary settlements.

Courts could also take greater pains to ensure that class members understand that they have claims and make an informed decision whether to make claims. Courts could extend the notice period, could order that the claims administrator send multiple reminders of the need to return a claim form, or even that the administrator (or class counsel) actually telephone class members and encourage them either to make claims or opt out. While such steps make settlement administration more expensive, they serve the goal of minimizing the number of situations where class members unwittingly receive no money under a settlement as a result of simple ignorance.

Rather than address the problem of low claims rates through better notice or adjustment of the attorney's fee, many courts have simply refused to approve reversionary settlements.⁵⁴² That is, courts have been reluctant to approve a settlement by which attorney's fees are calculated as a percentage of the gross value, but to the extent class members fail to claim their designated portion of the settlement fund, the money is returned to the defendant.⁵⁴³ Initially, there appeared to be a valid statutory basis for this approach. Specifically, Code of Civil Procedure Section 384(b) provides:

[P]rior to the entry of any judgment in a class action . . . the court shall determine the total amount that will be payable to all class members [and] shall also set a date when the parties shall report to the court the total amount that was actually paid to the class members. After the report is received, the court shall amend the judgment to direct the defendant to pay the sum of the unpaid residue, plus interest . . . to nonprofit organizations or foundations to support projects that will benefit the class or similarly situated persons, or that promote the law consistent with the objectives and purposes of the underlying cause of

⁵⁴² See *Managing Class Action Litigation*, A Pocket Guide for Judges (Federal Judicial Center, 2005) [http://www.fjc.gov/public/pdf.nsf/lookup/classgde.pdf/\\$file/classgde.pdf](http://www.fjc.gov/public/pdf.nsf/lookup/classgde.pdf/$file/classgde.pdf).

⁵⁴³ This can be contrasted with a true "claims made" settlement, where the employer simply agrees to pay a sum consisting of: (1) payments to class members who submit claims (pursuant to a formula), (2) payment to class counsel for fees and costs that is based on the value of the money paid out in claims rather than some fictional "gross settlement value", and (3) payment of settlement administration costs. In this scenario, there is no money returned to the employer.

action, to child advocacy programs, or to nonprofit organizations providing civil legal services to the indigent.

Many trial courts interpreted this language as forbidding the return of any funds from a class settlement fund to the defendant. Instead, leftover funds either had to be distributed to other class members, donated to charity, or escheated to the state.⁵⁴⁴

This interpretation of Section 384 was rejected, however, in *In Re Microsoft I-V Cases*.⁵⁴⁵ The court in that case faced a settlement where a portion of unclaimed funds from a consumer class action would be returned to Microsoft. The court analyzed the statutory language and legislative history of Section 384 and determined that it applied only to funds an employer has paid as a result of a **judgment** entered in favor of the class on the merits, and did not apply to a stipulated settlement of class claims.⁵⁴⁶ Accordingly, *In re Microsoft* makes clear that there is no absolute prohibition under California law on parties agreeing to reversions in class settlements.

Nonetheless, some trial courts have continued to exercise their general discretion to determine fairness as a basis to refuse to approve reversionary settlements. This tendency became more widespread following a determination in *Kakani v. Oracle Corporation*,⁵⁴⁷ in which United States District Court Judge William Alsup sharply criticized numerous aspects of a negotiated class settlement on the ground that they aimed to benefit class counsel and the defendant at the expense of the class. For example, he criticized settlement terms providing that (1) class members were subject to a general release of all claims (not just claims raised by the class action) if they failed to opt out of the settlement; (2) the employer would receive back any money class members failed to claim, but the plaintiff's attorney fee award was to be a percentage of the gross settlement; (3) the named class members were each to receive \$15,000 incentive awards for acting as class representatives; and (4) no one explained why class members would receive only about 11% of an amount the parties agreed was the maximum possible recovery.⁵⁴⁸

⁵⁴⁴ *Cy pres* settlements should ensure that the class is benefited and the purposes of the underlying statutes sued upon are best served. See, e.g., *Dennis v. Kellog Co.*, 697 F.3d 858, 865-867 (9th Cir. 2012) (reversing trial court's approval of settlement where *cy pres* fund benefited the hungry indigent rather than class of purported victims of statutory violations—those who relied upon false advertisements); *Nachshin v. AOL, LLC*, 663 F.3d 1034 (9th Cir. 2011) (trial court abused its discretion in approving *cy pres* settlement because the proposed distribution did not address the objectives of the underlying statutes sued upon, did not target the nationwide plaintiff class, and did not provide a reasonable certainty that any member of the class would be benefited).

⁵⁴⁵ 135 Cal. App. 4th 706 (2006).

⁵⁴⁶ *Id.* at 722.

⁵⁴⁷ 2007 U.S. Dist. LEXIS 47515 (N.D. Cal. Jun 19, 2007).

⁵⁴⁸ *Id.*

Judge Alsup's decision, although not binding on any other court, influenced judges in the complex courts in California who rule upon most of the class action settlements. More recently, the criticism of large inventive payments to class representatives was enshrined in an appellate decision, *Clark v. American Residential Services LLC*,⁵⁴⁹ which was written by an Orange County complex trial court judge temporarily sitting by designation on the court of appeal.

C. Court Scrutiny of the Adequacy of the Settlement Amount

Traditionally, if class counsel was an experienced practitioner with a good reputation and the case was settled using an experienced class action mediator, the courts would presume that the settlement amount was fair as the product of an arm's-length negotiation between sophisticated parties. Indeed, longstanding case law for evaluating class settlements in response to objections from class members that the settlement was inadequate suggested that the court's inquiry should not go beyond that level of scrutiny.⁵⁵⁰

Furthermore, it has become a common practice with Labor Code class actions for counsel for the parties to agree early in the action to forego formal discovery and set the action for early mediation. The purpose of this exercise is to minimize expense and bring the matter to a more rapid conclusion. Often, discovery will be informal and limited to disclosing relevant policies, contact information for a sample of the proposed class to interview, and enough payroll data to allow the parties to assess potential exposure under whatever theory the plaintiffs advance.

Problems may arise, however, when multiple lawyers representing distinct potential class representatives file essentially the same class action against the same defendant and then differ in their view of the value of the case. They may also differ on the propriety of settling the case. As any one of these class representatives could enter into a settlement with the defendant and seek to have the settlement approved, a dissenting class representative may be placed in the position of an objector. Because the law disfavors setting aside a class settlement on the ground that the objector could have obtained an even better class settlement,⁵⁵¹ objectors instead argue that the plaintiff failed to undertake the necessary due diligence to properly evaluate the claim.

There has never been a requirement that exhaustive formal discovery be undertaken before a class settlement could be affirmed. Rather, the general standard has been that "in

⁵⁴⁹ 175 Cal. App. 4th 785 (2009).

⁵⁵⁰ *Id.* at 1149.

⁵⁵¹ See generally *7-Eleven Owners for Fair Franchising v. Southland Corp.*, 85 Cal. App. 4th 1135, 1149-50 (2000) (noting that courts are allowed to look with skepticism on claims from objectors that settlements were inadequate and should have been for more money: "proposed settlement is not to be judged against a hypothetical or speculative measure of what might have been achieved by the negotiators").

the context of class action settlements, formal discovery is not a necessary ticket to the bargaining table where the parties had sufficient information to make an informed decision about settlement.”⁵⁵² Most courts have generally accepted the sworn statements from counsel that they conducted the necessary investigation and settled the case in mediation and in an arms-length transaction.

In late 2008, however, the First District Court of Appeal decided *Kullar v. Foot Locker Retail, Inc.*,⁵⁵³ which signaled greater judicial scrutiny of the value of class settlements, especially those obtained following limited, informal discovery.

In *Kullar*, a settlement was negotiated by experienced class action counsel (on both sides) with the assistance of a respected mediator. The parties had undertaken only informal discovery and the exchange of information had been conducted as part of the mediation, protecting the nature of the information disclosed from disclosure. The parties ultimately settled the action for \$2 million. Another plaintiff who had filed a separate class action alleging similar claims objected and contended that the plaintiff’s counsel had failed to provide any evidence that counsel had conducted enough investigation to intelligently value the case for mediation. The trial court overruled the objections and found that sworn representations from counsel that they had exchanged necessary information in mediation and that the matter was negotiated at arms-length were sufficient to support approval of the settlement. The objector appealed.⁵⁵⁴

The court remanded the case and ordered the trial court to conduct a more searching inquiry into the investigation of class counsel. The court explained that this inquiry should require the settling parties to introduce evidence reflecting the potential recovery if the plaintiffs prevailed and some explanation why the presumably lesser settlement amount represented a fair recovery for the class:

While an agreement reached under these circumstances presumably will be fair to all concerned, particularly when few of the affected class members express objections, in the final analysis it is the court that bears the responsibility to ensure that the recovery represents a reasonable compromise, given the magnitude and apparent merit of the claims being released, discounted by the risks and expenses of attempting to establish and collect on those claims by pursuing the litigation.⁵⁵⁵

⁵⁵² *Id.* at 1149.

⁵⁵³ 168 Cal. App. 4th 116.

⁵⁵⁴ *Id.* at 121-27.

⁵⁵⁵ *Id.* at 129.

Furthermore, the court ordered that the objector was entitled to some limited discovery to evaluate the case and to support an objection that the settlement amount was too low to be approved. Although the trial court is not to decide the merits of the case or easily overturn a negotiated settlement, the trial court “must at least satisfy itself that the class settlement is within the ‘ballpark’ of reasonableness.”⁵⁵⁶

For practical purposes, the main effect of this ruling has simply been to require the plaintiffs’ lawyer, in the motion for approval of a settlement, to spell out some theoretical maximum exposure and explain in general terms why a discounted amount was proper. But the ruling also creates the potential that a court could reject a settlement solely because it was reduced too much from a theoretical “maximum” exposure value.

The *Kullar* decision overlooks that forecasting a maximum exposure is problematic, especially where there is a lack of documentary evidence to prove the extent of possible damages. For example, in an exempt misclassification case, there may be no agreed way to assess what percentage of the class was misclassified or the average amount of overtime worked. In the absence of a comprehensive survey of the class (which can cost tens or hundreds of thousands of dollars to accomplish and even then may be of questionable validity), plaintiffs’ counsel will be working with cherry-picked data to estimate the average overtime worked by the class. Similarly, in a case where the employer argues great variation among the class, there may be a dispute as to what percentage of the class is properly classified. Accordingly, a theoretical maximum exposure number built on 100% misclassification of the class and 10-15 hours of overtime may bear no relation whatsoever to the fair “settlement value” of a case.

As long as this exercise of analyzing the proper value of a settlement is truly limited to some kind of “rational basis” review, judicial scrutiny of the settlement value should not have any great impact on class settlement. If the trend toward greater judicial scrutiny of settlements continues unreasonably, however, it could discourage class settlements because employers will lack confidence that the settlements they negotiate will ultimately be approved.

D. Class Notice

Courts have also exercised greater scrutiny of the notice that is sent to the class. The law requires that the class receive notice using the best “practicable” method.⁵⁵⁷ Courts have been increasingly concerned that recipients of the class notice understand the nature of the

⁵⁵⁶ *Id.* at 133.

⁵⁵⁷ *Hypertouch, Inc. v. Superior Court*, 128 Cal. App. 4th 1527, 1539 (2005) (notice “must be the best practicable, reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections”).

claim, can calculate the value of their share of the settlement, and can readily access court documents to investigate the nature of the case.

The judges in the Alameda Complex Division have required that the parties make exhaustive efforts to notify class members of the claims and have sufficient information to exercise their options under the settlement. For example, in addition to requiring that the administrator send a reminder postcard to class members who have not made claims, the judges in Alameda have ordered that the administrator make at least three telephone calls to class members.

E. Objection to Settlements

When a class settlement is slated for final approval, often the last hurdle the settling parties must surmount any objection to the settlement. Any member of the settlement class who does not opt out of the settlement may assert an objection to the settlement.⁵⁵⁸ Courts tend to be extremely reluctant to sustain objections where the sole basis is that the objector believes the settlement is not generous enough. After all, if an individual believes his wage and hour claim is worth more than the class is receiving, then he can opt out of the settlement and assert his own claim (and typically can recover attorney's fees if he prevails).

In *7-Eleven Owners for Fair Franchising v. Southland Corp.*,⁵⁵⁹ the court explained that in evaluating an objection that a settlement was too low given the merits of the case, a court must not substitute its own opinion on the merits for those of the settling parties:

“the merits of the underlying class claims are not a basis for upsetting the settlement of a class action; the operative word is ‘settlement.’ Instead the inquiry is on whether the parties conducted sufficient discovery to evaluate the claims themselves—something even the plaintiffs in the *7-Eleven* case agreed the defendants had done. In such circumstances, the court should not disapprove a settlement based on a hypothetical or speculative measure of what might have been achieved by the negotiators.”⁵⁶⁰

⁵⁵⁸ *Wershba v. Apple Computer, Inc.*, 91 Cal. App. 4th 224, 235 (2001).

⁵⁵⁹ 85 Cal. App. 4th 1135 (2000).

⁵⁶⁰ *Id.* at 1149-50; *but see Kullar v. Foot Locker Retail, Inc.*, 168 Cal. App. 4th 116, 129 (2008) (parties are not excused from explaining what the claims potentially were worth and why less money was accepted: “While an agreement reached under these circumstances presumably will be fair to all concerned, particularly when few of the affected class members express objections, in the final analysis it is the court that bears the responsibility to ensure that the recovery represents a reasonable compromise, given the magnitude and apparent merit of the claims being released, discounted by the risks and expenses of attempting to establish and collect on those claims by pursuing the litigation.”).

Furthermore, where relatively few class members object, that factor weighs against sustaining the objection.⁵⁶¹

Objectors have better success in their objections when they identify procedural defects in the settlement process. For example, objections have been sustained when the class notice was excessively vague and confusing, or when class counsel failed to undertake sufficient discovery to properly evaluate the case.⁵⁶² In short, the odds of a successful objection are low if the parties conduct an adequate investigation, make the notice documents clear, set forth some rational basis for the settlement amount, and take adequate steps that class members are informed in their choices.

F. Individual Settlements with Putative Class Members

Class actions differ from individual actions in that most of the parties on whose behalf the action allegedly is advanced have no involvement in the case (and may be totally unaware of the case) until a court orders certification and notice. This aspect of class litigation has raised the question of whether employers and their counsel should be entitled to communicate with putative class members before certification or whether they should be treated in the same manner as the named plaintiff, in which case the right to communicate with the putative class members would be severely restricted.⁵⁶³

Putative class members are *not* treated the same as parties and there is no attorney-client relationship between a plaintiff's attorney and putative class members before a court certifies a class.⁵⁶⁴ Despite this fact, an employer does not have *carte blanche* to communicate with putative class members any way it desires. Rather, courts are empowered to limit such communications where the employer engages in conduct that has been coercive or misleading.

One area where there is great potential for an employer to be accused of coercive conduct is where the employer attempts to settle a case directly with individual employees who are within a putative class in an ongoing class action. Because current employees may fear for their jobs or future career prospects if they do not cooperate with the employer, there is at

⁵⁶¹ *Id.* at 1152-53 (out of a class of 5454 people, only nine objected and only 80 opted out).

⁵⁶² *Cho v. Seagate Technology Holdings, Inc.*, 177 Cal. App. 4th 734, 747-48 (2009) (settlement disapproved without prejudice to issuance of new class notice where original notice was confusing as to who qualified as a class member); *Kullar v. Foot Locker Retail, Inc.*, 168 Cal. App. 4th 116, 132-33 (2008) (case remanded for parties to better explain what information the parties considered in reaching settlement, and to allow objector limited discovery relevant to valuation of case).

⁵⁶³ See generally Cal. Rule of Professional Conduct 2-100.

⁵⁶⁴ *Atari v. Superior Court*, 166 Cal. App. 3d 867 (1985); see also *Ochoa-Hernandez v. Cjaders Foods, Inc.*, 2010 WL 1340777 (N.D. Cal. April 2, 2010) (denying plaintiff's motion for a protective order seeking to prohibit defense attorneys from interviewing "aggrieved employees" in connection with a PAGA claim, finding that no attorney-client relationship existed between plaintiff's counsel and those employees).

least the potential for coercion when an employer tries to settle individually. At the same time, an employer may seek to resolve a case on fair terms in situations where a plaintiff's counsel has staked out an overly aggressive position on class settlement. The law must strike a balance between promoting genuine settlement efforts and employee coercion.

The proper steps that an employer should take to ensure that their settlement efforts are seen as non-coercive were discussed in *In re M.L. Stern Overtime Litigation*.⁵⁶⁵ Among the steps the court suggested an employer should undertake to ensure its settlements will be enforceable include:

- Preparing a handout that explains the case in **neutral** terms, and is up front about the fact that the employee may be able to obtain more money than the settlement offered by pursuing the class action.
- Providing each employee with a copy of the operative class action complaint and letting putative class members know that they are free to contact plaintiffs' counsel to discuss the case if they so desire.
- Reassuring employees that they have the right to participate in the class action rather than agree to the settlement, and that they will suffer no retaliation if they choose to participate in the class action.
- If a settlement agreement is offered to the employee, the employee should be given a reasonable period of time (several weeks) to consider the offer and discuss it with counsel of their choice.⁵⁶⁶

The Labor Code also includes extra protections for employees to prevent them being coerced into waiving their wage claims for less than the claims are truly worth. Labor Code Section 206.5 provides: "An employer shall not require the execution of a release of a claim or right on account of wages due . . . , unless payment of those wages has been made." The Section goes on to provide that any release obtained in violation of the section "shall be null and void as between the employer and the employee." Before 2009, there was some ambiguity whether this language precluded enforcement of any settlement of a claim for unpaid wages where the employee could prove that the amount received in settlement was less than the total amount the employee was owed.

In 2009, however, two decisions clarified that the protection in Labor Code Section 206.5 applies only to releases obtained where there was no genuine dispute over the wages

⁵⁶⁵ 250 F.R.D. 492 (S.D. Cal. 2008).

⁵⁶⁶ *Id.* at 498-500.

owed.⁵⁶⁷ In other words, where an employer concedes (or lacks a genuine dispute) that it owes an employee wages, it cannot obtain a release of that claim by paying less than the undisputed amount owed. But, where the employer has a good faith defense to wage claims and seeks to compromise them with a member of a putative class in an ongoing class action, such a settlement would not be invalidated by Labor Code Section 206.5.

It should be emphasized that the above decisions arose under facts where the employer took pains to ensure it did nothing in its individual settlement efforts that could be viewed as coercive conduct. As the law currently stands, employers who are careful to be fair may settle individually with class members and enforce the releases obtained as a result. Notwithstanding that ability, employers must be very careful not to overreach and attempt to settle these cases in a coercive manner or at an unreasonable discount, as those sorts of facts may yield a less favorable outcome for employers in the next case.

XVII. Class Action Waivers and Arbitration

Employers have attempted to protect themselves from potential class actions by including provisions in mandatory arbitration agreements that the employee must individually arbitrate any claims and that the arbitrator cannot certify a class or otherwise allow employees covered by the arbitration agreements to pursue their claims on anything other than an individual basis. Federal courts outside California have enforced such provisions.⁵⁶⁸ Unfortunately for California employers, the California Supreme Court issued two decisions – *Discover Bank* and *Gentry* – that severely hampered the ability of an employer in California to enforce a class action waiver in an employment arbitration agreement.

In *Discover Bank v. Superior Court*,⁵⁶⁹ the Court struck down as unenforceable a class action waiver in a **consumer** contract.⁵⁷⁰ The *Discover Bank* case involved a credit card holder who

⁵⁶⁷ *Chindarah v. Pick up Stix, Inc.*, 171 Cal. App. 4th 796, 803 (2009) (individual settlements enforceable when they involve “a bona fide dispute over wages already earned,” settle “a dispute over whether [the employer] had violated wage and hour laws in the past”; and do not “purport to exonerate [the employer] from future violations.”); *Watkins v. Wachovia Corp.*, 172 Cal. App. 4th 1576, 1586-87 (2009) (same).

⁵⁶⁸ See, e.g., *Livingston v. Assocs. Fin., Inc.*, 339 F.3d 553, 559 (7th Cir. 2003) (class action waiver enforceable in action filed under federal Truth-in-Lending Act); *Snowden v. Checkpoint Check Cashing*, 290 F.3d 631, 638-39 (4th Cir. 2002) (same); *Burden v. Check Into Cash of Kentucky, LLC*, 267 F.3d 483, 492 (6th Cir. 2001) (same); *Randolph v. Green Tree Fin. Corp.-Alabama*, 244 F.3d 814, 819 (11th Cir. 2001) (same); *Johnson v. West Suburban Bank*, 225 F.3d 366, 370-78 (3d Cir. 2000) (same).

⁵⁶⁹ 36 Cal. 4th 148 (2005).

⁵⁷⁰ In contrast, the Second District Court of Appeal held that the U.S. Supreme Court’s decision in *AT&T Mobility Corp. v. Concepcion*, 131 S. Ct. 1740 (April 27, 2011) (discussed below), invalidated California authority prohibiting the waiver of class action rights in an arbitration agreement contained in a retail installment sale contract for a BMW in *Sherf v. Rusnak/Westlake*, 2012 WL 4882547, at *1 (Oct. 16, 2012). The court concluded that “*Concepcion* rejects the argument that class action waivers in consumer contracts can be invalidated in order to vindicate statutory rights even if the statutory right is desirable for other reasons. *Concepcion* expressly concludes that nothing in FAA ‘suggests an intent to preserve state-law rules that stand as an obstacle to the accomplishment of the FAA’s objective’ and arbitration

initiated a class action alleging that Discover Bank had made misleading statements that imposed late fees on him and thousands of other credit card holders. Meanwhile, Discover Bank had included a notice within the card holder's monthly bill that the arbitration agreement was being amended to preclude class actions and that the credit card holder would have to cancel the credit card to prevent this change from going into effect. Although the agreement provided for alternative means of recovery, individual card holders had little incentive to sue over the imposition of a small late fee.

In a split decision, a bare majority of the California Supreme Court held that the class action waiver within the arbitration agreement rendered the arbitration agreement unconscionable. The primary bases for the ruling in *Discover Bank* were that the arbitration agreement was part of a "bill stuffer" that made it a true contract of adhesion and that the claims at issue in the consumer setting were too small to be viable without resorting to the class action device.⁵⁷¹

The reasoning of *Discover Bank* would not seem to preclude class action waivers in the employment context. After all, California has in place procedures to incentivize individual employees to sue to recover for Labor Code violations (including various substantial penalties and the right to recover attorney's fees). Moreover, mandatory arbitration and class action waivers are usually presented to employees in a more visible manner than a bill stuffer with a credit card bill.

In *Gentry v. Superior Court*,⁵⁷² the California Supreme Court took review of an employment case that seemed to provide good facts for the employer. The employee at issue presented no evidence that he had been coerced to agree to arbitration and, on the contrary, the employee had declined to take advantage of a company policy that allowed him to opt out of mandatory arbitration of employment disputes. Despite these facts, the seven California Supreme Court justices split along the same 4-3 lines as in *Discover Bank* and invalidated the class action waiver.

In concluding that class action waivers in arbitration agreements are generally not enforceable, the majority first noted that the rights to minimum wage and overtime compensation are unwaivable statutory rights. The majority reasoned that class action arbitration waivers may tend to create a "de facto waiver" of employee rights, as employees are more likely to pursue such claims in a class action rather than on an individual basis. Given the "modest" damages at issue in many overtime cases, the expense of litigation, and potential for retaliation by the employer, the majority concluded that class action waivers in employment arbitration agreements should not be enforced if a trial court determines that class arbitration would be more effective than individual arbitration in vindicating employee rights.

agreements must be enforced 'notwithstanding any state substantive or procedural policies to the contrary.'" *Id.* at *5 (citing *Concepcion*, 131 S. Ct. 1740, 1748-49 (2011)).

⁵⁷¹ *Id.* at 161.

⁵⁷² 42 Cal. 4th 443 (2007).

As such, the court set forth several factors a trial court must consider when evaluating whether a class action waiver to pursue overtime wages contained in an arbitration agreement is valid:

- whether individual recovery amounts sufficiently incentivized litigation;⁵⁷³
- the risk of retaliation to employees;
- employees' lack of knowledge about their legal rights; and
- "other real world obstacles to the vindication of class members' right to overtime pay through individual arbitration."⁵⁷⁴

Another interesting wrinkle in the *Gentry* case is that the employer did not present the arbitration agreement on a take-it-or-leave-it basis, but rather gave employees an opportunity to opt out of the arbitration system if they did so within the first thirty days of employment. Even if class action waivers were substantively unconscionable, an arbitration agreement of the sort used in *Gentry* should arguably be enforceable on the ground that it is not *procedurally* unconscionable. A contract typically must be infected *both* by procedural and substantive unconscionability to be unenforceable as unconscionable.⁵⁷⁵ Yet the *Gentry* Court held that in determining whether an arbitration agreement was unenforceable based on unconscionability, procedural unconscionability could be found in employment arbitration agreements even when employees are given an opportunity to opt out of arbitration.⁵⁷⁶

The *Gentry* decision seemingly eliminated an employer's ability to place effective class action waivers in employment arbitration agreements. Decisions since *Gentry* have applied its reasoning to invalidate class action waivers for other types of wage and hour claims, such as meal and rest break claims.⁵⁷⁷

For example, in *Samaniego v. Empire Today, LLC*,⁵⁷⁸ the First District Court of Appeal affirmed a trial court's refusal to compel contractual arbitration of claims by carpet installers who alleged that Empire violated multiple provisions of the Labor Code. The Court ruled that the arbitration provision

⁵⁷³ The Court cited *Bell III*, 115 Cal. App. 4th 715 (2004), indicating that even an award as large as \$37,000 would not be "ample incentive," and concluding even more broadly "class actions may be needed to assure the effective enforcement of statutory policies even though some claims are large enough to provide an incentive for individual action."

⁵⁷⁴ *Gentry*, 42 Cal. 4th at 463.

⁵⁷⁵ See *Little v. Auto Stiegler, Inc.*, 29 Cal. 4th 1064, 1071 (2003) (unconscionability has both procedural and substantive element); see also *Hicks v. Macy's Dep't Stores, Inc.*, No. C 06-02345 CRB, 2006 U.S. Dist. LEXIS 68268, at *9-12 (N.D. Cal. Sept. 11, 2006) (arbitration agreement containing class action waiver not procedurally unconscionable because employee had an opportunity to opt out of arbitration system).

⁵⁷⁶ *Gentry*, 42 Cal. 4th at 470.

⁵⁷⁷ *Franco v. Athens Disposal Co.*, 171 Cal. App. 4th 1277 (2009).

⁵⁷⁸ 205 Cal.App.4th 1138 (2012) .

was unconscionable under California Law. First, the court found the agreement procedurally unconscionable because it consisted of 11 densely worded, single-spaced pages with no individual headings.⁵⁷⁹ Furthermore, plaintiffs had to sign the agreement after they were hired but before starting work, but they were not able to read English and were not provided with a requested Spanish translation, and neither was provided with a copy of the agreement or the arbitration rules.⁵⁸⁰ Second, the court found that the agreement was substantively unconscionable because (1) it shortened the limitations period for the statutory wage and hour claims asserted from three or four years to six months, (2) it obligated employees to pay attorneys' fees incurred by Empire under certain circumstances, but did not impose a reciprocal obligation on Empire, and (3) the agreement exempted claims typically brought by employers from the arbitration requirement, such as those seeking declaratory and preliminary injunctive relief to protect Empire's proprietary information and noncompetition/nonsolicitation provisions.⁵⁸¹

Next, the Court of Appeal held that California law applied, even though the parties' contract called for Illinois law and an Illinois venue. The Court noted that "the same factors that render the arbitration provision unconscionable warrant the application of California law" because "the Agreement was obtained by 'improper means' and to the extent Illinois law might require enforcement of its arbitration clause, enforcing Empire's choice-of-law provision would result in substantial injustice."⁵⁸² The court also held that the trial court did not err in declining to sever the objectionable portions of the agreement and enforcing the remainder.⁵⁸³ Lastly, the court held that the Supreme Court's decision in *AT&T Mobility LLC v. Concepcion*, discussed below, does not prevent courts from rejecting arbitration agreements that the court finds unconscionable.⁵⁸⁴

The Impact of the Federal Arbitration Act on Class Action Arbitration Waivers

While California courts have essentially negated any employer efforts to restrict class actions, the United States Supreme Court has developed other ideas. In a 2010 decision, *Stolt-Nielsen S.A. v. AnimalFeeds International Corp.*,⁵⁸⁵ the Court held that imposing class arbitration on parties that did not specifically agree to it would be inconsistent with the Federal Arbitration Act ("FAA").⁵⁸⁶ Employers have attempted to utilize this decision in the trial courts to compel class representative plaintiffs who had entered into arbitration agreements with class action waivers to arbitrate their

⁵⁷⁹ *Id.* at 1146.

⁵⁸⁰ *Id.*

⁵⁸¹ *Id.* at 1147.

⁵⁸² *Id.* at 1148-49.

⁵⁸³ *Id.* at 1149.

⁵⁸⁴ *Id.* at 1150.

⁵⁸⁵ 559 U.S. 662 (2010).

⁵⁸⁶ *Id.* at 687.

cases as individuals. Thus far, these attempts have sometimes been successful and sometimes unsuccessful. Until there is guidance on this issue at an appellate court level, it remains unclear as to what effect *Stolt-Nielsen S.A.* will have on California law regarding class action waivers.

Another potentially even more favorable class action decision for employers came in 2011 in *AT&T Mobility LLC v. Concepcion*, where the Supreme Court held that the FAA preempted California's *Discover Bank* rule in a consumer class action case.⁵⁸⁷ This holding has been extended to employment cases in some instances.⁵⁸⁸ If given full recognition by courts, *Concepcion* would effectively overturn *Gentry* and permit employers to require arbitration of employment claims while ensuring that class arbitration does not proceed.⁵⁸⁹ Many employers are now exploring the implementation of arbitration agreements with an eye towards limiting or eliminating class actions of various sorts.

For example, in *Quevedo v. Macy's Inc.*,⁵⁹⁰ the court compelled arbitration of plaintiff's individual PAGA claims because the arbitration agreement properly encompassed those "employment-related legal disputes." The arbitration agreement permissibly precluded the plaintiff from "representing, and seeking relief, on behalf of a group." The fact that the plaintiff's PAGA claim was not arbitrable on behalf of a group did not mean it could proceed in court because there was "no authority suggesting that [plaintiff could] pursue PAGA claims on behalf of others without also pursuing them himself." Relying on *Concepcion*, the court held that California case law requiring arbitration agreements to allow for representative PAGA claims on behalf of other employees would be inconsistent with the FAA.⁵⁹¹

⁵⁸⁷ *AT&T Mobility LLC v. Concepcion*, ___ U.S. ___, 131 S. Ct. 1740 (2011); *but see Sanchez v. Valencia Holding Company, LLC*, 201 Cal. App. 4th 74, 89 (2011), *review granted*, (holding that "*Concepcion* is inapplicable where . . . [the court is] not addressing the enforceability of a class action waiver or a judicially imposed procedure that is inconsistent with the arbitration provision and the purposes of the Federal Arbitration Act," and therefore courts may still invalidate arbitration agreements by applying "unconscionability principles [that] govern all contracts, are not unique to arbitration agreements, and do not disfavor arbitration").

⁵⁸⁸ In *Sonic-Calabasas A, Inc. v. Moreno*, 57 Cal. 4th 1109 (2013), the California Supreme Court applied *Concepcion* and held that the FAA preempts any state laws preventing arbitration of employment disputes. However, the *Sonic-Calabasas A* court also held that an arbitration agreement can still be held to be unconscionable if the agreement conflicts with state unconscionability rules that do not involve the "fundamental attributes of arbitration."

⁵⁸⁹ *But see Balasanyan v. Nordstrom*, No. 11-CV-2609 (S.D. Cal. Mar. 8, 2012), the district court denied defendant's motion to compel arbitration because the arbitration agreement originally was mailed to employees about two months after the complaint was filed. Employees subsequently were provided with "the most current version" of the arbitration agreement at work and were asked to sign a form acknowledging receipt of the information. The court held that "the purported imposition of the agreement constituted an improper class communication."

⁵⁹⁰ *Quevedo v. Macy's Inc.*, 798 F. Supp. 2d 1122, 1141-42 (C.D. Cal. 2011).

⁵⁹¹ The decision in *Quevedo* was mirrored in *Gerardo Miguel v. JPMorgan Chase Bank, N.A.*, 2013 WL 452418 (C.D. Cal. Feb. 5, 2013). The court in *Gerardo* held that the FAA applied to PAGA claims and that as a result an employee who was subject to an arbitration agreement banning representative actions could bring PAGA claims in arbitration only on an individual basis.

While the full impact of *Concepcion* is yet to be determined, the California Court of Appeal for the Second District has held that PAGA claims are *not* preempted by the FAA. In *Brown v. Ralphs Grocery Co.*, the court reasoned that PAGA claims are inherently different from private causes of action because, in a PAGA claim, “the aggrieved employee acts as the proxy or agent of the state labor law enforcement agencies, representing the same legal right and interest as those agencies, in a proceeding that is designed to protect the public, not benefit private parties.”⁵⁹² The court concluded that, because the purpose of the FAA was to govern arbitration of *private* disputes, as opposed to enforcing “public rights,” the FAA does not preempt state law exemptions PAGA claims from arbitration.⁵⁹³

The National Labor Relations Board has also entered the fray, joining the assault on class-action waivers, in *Cuda v. D.R. Horton, Inc.*, where the Board ruled that *Concepcion* did not apply in cases that involved waiver of rights protected by the NLRA.⁵⁹⁴ The Board held that employers cannot force employees to sign arbitration agreements that include class action waivers. Such an agreement unlawfully restricts employees’ Section 7 right to engage in concerted action for mutual aid or protection, notwithstanding the FAA. The Board stressed that arbitration agreements are not per se unenforceable. However, whether the class/collective action mechanism is used in arbitration or in a court of law, the Board held that class resolution must be available to employees. The Board distinguished *Concepcion* on the ground that it involved a conflict between the FAA and state law, whereas *D.R. Horton* involved a conflict between two federal statutes.

Before the ink was dry on the *D.R. Horton* decision, however, it faced a hostile reaction by the judiciary. The California Court of Appeal expressly rejected *D.R. Horton* in *Leos v. Darden Restaurants, Inc.*, stating that “*D.R. Horton* does not invalidate class or collective action waivers in an arbitration agreement.”⁵⁹⁵ Further, in *Gerardo Miguel v. JP Morgan Chase Bank, N.A.*, a federal District Court rejected *D.R. Horton* and held that the NLRB is owed no deference in its interpretation of the FAA.⁵⁹⁶ The Ninth Circuit has also disapproved of *D.R. Horton*, but has yet to explicitly reject it. In *Richards v. Ernst & Young, LLP*, the Ninth Circuit noted that *D.R. Horton* had been roundly rejected by virtually every federal court that had an opportunity to weigh in on it. The Ninth Circuit also noted that the FAA can be overridden only by an act of Congress.⁵⁹⁷

⁵⁹² 197 Cal. App. 4th 489, 500 (2011); *see also Reyes v. Macy’s, Inc.*, 202 Cal. App. 4th 1119, 1123 (2011) (holding that PAGA claims were not individual claims but rather were brought by plaintiff “as the proxy or agent of the state’s labor law enforcement agencies”).

⁵⁹³ *Id.* (“AT&T does not provide that a public right, such as that created under PAGA, can be waived if such a waiver is contrary to state law”).

⁵⁹⁴ *Cuda v. D.R. Horton, Inc.*, 12-CA-25764 (N.L.R.B. Jan. 3, 2012).

⁵⁹⁵ 217 Cal. App. 4th 473, 496 (2013).

⁵⁹⁶ 2013 WL 452418 at *2 (C.D. Cal. Feb. 5, 2013).

⁵⁹⁷ 2013 WL 6405045 at *2, n.3 (9th Cir. Dec. 9, 2013).

In 2012, two California appellate courts reached opposite conclusions as to whether *Gentry* survived *Concepcion*. The California Supreme Court has decided to review both decisions.⁵⁹⁸

In *Iskanian v. CLS Transportation Los Angeles, LLC*, Division Two of the Second District Court of Appeal affirmed a trial court's decision to compel arbitration and dismiss class claims.⁵⁹⁹ The plaintiff had brought a putative class action and representative PAGA action alleging wage and hour violations, but had signed an arbitration agreement that expressly waived his right to bring a class action or representative action.⁶⁰⁰ The Court of Appeal held that *Gentry* did not apply after *Concepcion*, because "*Concepcion* thoroughly rejected the concept that class arbitration procedures should be imposed on a party who never agreed to them."⁶⁰¹ The court also expressly held that *Brown v. Ralphs Grocery Co.*, incorrectly concluded that PAGA waivers were not preempted by the FAA.⁶⁰²

In contrast, in *Franco v. Arakelian Enterprises, Inc.*, Division One of the Second District Court of Appeals reached the opposite conclusion.⁶⁰³ The plaintiff there also brought a putative class action and representative PAGA action alleging wage and hour violations and had also signed an arbitration agreement that waived his rights to proceed as a class action or representative action.⁶⁰⁴ The Court of Appeal reasoned that *Gentry* "is not a categorical rule against class action waivers" which *Concepcion* found impermissible under the FAA.⁶⁰⁵ Rather, *Gentry* requires courts to apply a multifactor test for arbitration agreements, which must be considered on a case-by-case basis to determine if they are preempted by the FAA and *Concepcion*.⁶⁰⁶ Furthermore, the court concluded

⁵⁹⁸ *Iskanian v. CLS Transportation Los Angeles, LLC*, 206 Cal. App. 4th 949, 959 (2012) ("[W]e find that the *Concepcion* decision conclusively invalidates the *Gentry* test."), *rev. granted*, 286 P.3d 147 (Sep. 9, 2012); cf. *Franco v. Arakelian Enterprises, Inc.*, 211 Cal. App. 4th 314, 368 (2012) ("Accordingly, *Gentry* is not preempted by the FAA because it is not a categorical rule that invalidates class action waivers---the type of rule that *Concepcion* condemned."), *rev. granted*, 294 P.3d 74 (Feb. 13, 2013).

⁵⁹⁹ *Iskanian*, 206 Cal. App. 4th at 961.

⁶⁰⁰ *Id.* at 954.

⁶⁰¹ *Id.* at 959.

⁶⁰² *Id.* at 966 ("Following *Concepcion*, the public policy reasons underpinning the PAGA do not allow a court to disregard a binding arbitration agreement. The FAA preempts any attempt by a court or state legislature to insulate a particular type of claim from arbitration."). Similarly, in *Nelsen v. Legacy Partners Residential, Inc.*, 207 Cal. App. 4th 1115, 1131-32 (2012), Division One of the First District Court of Appeal called into doubt *Gentry*'s enforceability after *Concepcion*. The court declined to reach the issue, however, because the plaintiff failed to set forth evidence requiring a court to conduct the multifactor test under *Gentry* in the first instance.

⁶⁰³ *Franco v. Arakelian Enterprises, Inc.*, 211 Cal. App. 4th 314, 368 (2012).

⁶⁰⁴ *Id.* at 327.

⁶⁰⁵ *Id.* at 367-68.

⁶⁰⁶ *Id.*

that where Gentry's multifactor test is satisfied as to a plaintiff's substantive claims, the PAGA claims are similarly not subject to arbitration.⁶⁰⁷

The California Supreme Court has granted review of these two decisions and will have to decide *Gentry's* continued viability in light of *Concepcion*.

XVIII. Individual Liability

Some plaintiffs seeking allegedly unpaid wages have employed the tactic of suing corporate officials personally. In 2005, in *Reynolds v. Bement*,⁶⁰⁸ the California Supreme Court held that individuals cannot be held liable for overtime pay under Labor Code Sections 510 or 1194. The court left open the possibility, however, that individual supervisors could be held liable for civil penalties.

Seyfarth Shaw advocated in *Reynolds* that California law does not impose individual liability on managers for wage and hour violations. Rather, the law imposes the primary civil obligation to comply with the wage and hour laws—including the obligation to provide back pay or damages—upon “employers” (a term that is not defined), while expanding the scope of criminal liability or civil punishment to broader categories, such as “other persons” or “officers or agents” of an employer. Where the Legislature wanted to create individual liability, it referred to “any person” being liable, as opposed to cases where it held that an “employer” is liable.⁶⁰⁹

The plaintiffs attempted to justify suing individual officers for damages by invoking the expansive definition of “employer” contained in the IWC Wage Orders. The defendants responded that to the extent anything in the Wage Orders could be read as creating individual liability for failure to pay overtime, such pronouncements are void in that they would exceed the scope of the Labor Code, which authorizes the IWC to adopt only regulations “consistent with” the Labor Code.⁶¹⁰

In 2005, the California Supreme Court largely adopted the defendants' position, holding that under general common law principles of managerial immunity, managers are not liable for the corporate

⁶⁰⁷ *Id.* at 375 (“[W]hen substantive Labor Code claims must be adjudicated in court under *Gentry*, the PAGA remedies ‘tag along’ under the same unwaivable statutory rights analysis that applies to the substantive claims.”).

⁶⁰⁸ 36 Cal. 4th 1075 (2005).

⁶⁰⁹ Compare Lab. Code § 553 (criminal liability for overtime violations available against “[a]ny person”) with Lab. Code § 510 (discussing only “employer’s” liability); see also Lab. Code § 1197.1 (imposing a civil fine on “[a]ny employer or other person acting either individually or as an officer, agent, or employee of another person” who fails to pay the minimum wage); Lab. Code § 210 (imposing a fine on “every person” who fails to make payments on paydays as required by §§ 204, 204b, and 205); Lab. Code § 215 (imposing criminal liability against “[a]ny person, or the agent, manager, superintendent or officer thereof” who violates statutory requirement to post a notice identifying when and where pay is made); Lab. Code § 1175 (imposing criminal liability on “[a]ny person, or officer or agent thereof” who fails to make certain kinds of work records and to make those records available to state inspectors).

⁶¹⁰ Lab. Code § 517(a).

employees' failure to pay wages. The Court found nothing in the plain meaning of the relevant Labor Code sections or in public policy to read individual overtime liability into the overtime statute.⁶¹¹ The Court left the door open, however, to the recovery by an employee of statutory **penalties** from individual supervisors, such as the recovery of Section 558 penalties through a PAGA claim.⁶¹² Moreover, the Court reaffirmed that a manager might be held liable under an alter ego theory if the employee proves the elements for this common law liability theory.⁶¹³

In 2010, the Supreme Court backtracked on its decision in *Reynolds* when it issued its ruling in *Martinez v. Combs*.⁶¹⁴ There, the Court held that “[i]n actions under section 1194 to recover unpaid minimum wages, the IWC’s wage orders *do* generally define the employment relationship, and thus who may be liable.”⁶¹⁵ The Court noted that the Wage Orders set forth a multi-pronged, disjunctive definition of employment: an employer is one who, directly or indirectly, or through an agent or any other person, engages, suffers, or permits any person to work, or exercises control over the wages, hours, or working conditions of any person.⁶¹⁶ The “engage, suffer, or permit” component of the definition does not require a common law “master and servant” relationship, but is broad enough to cover “irregular working arrangements the proprietor of a business might otherwise disavow with impunity.”⁶¹⁷ Further, “phrased as it is in the alternative (i.e., wages, hours, or working conditions), the language of the IWC’s ‘employer’ definition has the obvious utility of reaching situations in which multiple entities control different aspects of the employment relationship, as when one entity, which hires and pays workers, places them with other entities that supervise the work.”⁶¹⁸

The Court noted that the plaintiffs in *Reynolds* had conceded that “the plain language of Wage Order No. 9 defining employer does not expressly impose liability under section 1194 on individual corporate agents.”⁶¹⁹ “In a footnote, we added that the ‘plaintiff . . . ha[d] not persuaded us that one may infer from the history and purposes of section 1194 a clear legislative intent to depart, in the application of that statute, from the common law understanding of who qualifies as an employer.’”⁶²⁰ The *Martinez* plaintiffs, however, gave the Court extremely detailed, exhaustive briefing on the history of California’s minimum wage law, the IWC, and the Wage Orders. This effort apparently convinced the Court that “an examination of section 1194 in its full historical and statutory context

⁶¹¹ *Reynolds*, 36 Cal. 4th at 1087.

⁶¹² *Id.* at 1089.

⁶¹³ *Id.*

⁶¹⁴ *Martinez v. Combs*, 49 Cal. 4th 35 (2010).

⁶¹⁵ *Id.* at 52 (*emphasis added*).

⁶¹⁶ *Id.* at 57.

⁶¹⁷ *Id.* at 58.

⁶¹⁸ *Id.* at 59.

⁶¹⁹ *Id.* at 63.

⁶²⁰ *Id.* at 64.

shows unmistakably that the Legislature intended to defer to the IWC's definition of the employment relationship in actions under the statute."⁶²¹ As a result, the Court limited the application of *Reynolds*:

In sum, we hold that the applicable wage order's definitions of the employment relationship do apply in actions under section 1194. The opinion in *Reynolds, supra*, 36 Cal.4th 1075, properly holds that the IWC's definition of employer does not impose liability on individual corporate agents acting within the scope of their agency. (*Reynolds*, at p. 1086.) The opinion should not be read more broadly than that.⁶²²

⁶²¹ *Id.*

⁶²² *Id.* at 66. The Court of Appeal in *Futrell v. Payday California, Inc.* held that, because Wage Order 12 and Wage Order 14 use identical language to define the terms "employ," "employee" and "employer," the Supreme Court's holding in *Reynolds* that applied Wage Order 14's definition of "employment" also applies to Wage Order 12. 190 Cal. App 4th 1419, 1429 (2011).



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