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Case No. C079670

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA
THIRD APPELLATE DISTRICT

YORK CLAIMS SERVICE WAGE AND HOUR CASES

Appeal from the Superior Court of the County of Sacramento,
Case No. JCCP 4560
The Honorable Michael P. Kenny

APPELLANT'S OPENING BRIEF

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CERTIFICATE OF INTERESTED ENTITIES OR PERSONS

Pursuant to California Rules of Court, rule 8.208, Appellant York Risk Services Group, Inc. (formerly known as York Claim Services, Inc.) hereby states that the following entities or persons have either (1) an ownership interest of 10 percent or more in York Risk Services Group, Inc. (rule 8.208(e)(1)), or (2) a financial or other interest in the outcome of the proceeding that the Justices should consider in determining whether to disqualify themselves (rule 8.208(e)(2)):

1. Fox Hill Holdings, Inc. owns 100% of York Risk Services Group, Inc.;

2. York Insurance Holdings, Inc. owns 100% of Fox Hill Holdings, Inc.;

3. York Risk Services Holding Corp. owns 100% of York Insurance Holdings, Inc.;

4. Onex York Mid Corp. owns 100% of York Risk Services Holding Corp.;

5. Onex York Holdings Corp. owns 100% of Onex York Mid Corp. Thus, Onex York Holdings Corp. is the ultimate parent corporation of appellant York Risk Services Group, Inc. Onex York Holdings Corp. is owned by a number of people and entities. The only entities that have more than a 10% interest in Onex York Holdings Corp. are Onex Partners III LP and Onex American Holdings II LLC.

DATED: April 6, 2016 MUNGER, TOLLES & OLSON LLP

By: *<u>/s/ Malcolm A. Heinicke</u>*

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INTRODUCTION AND SUMMARY OF THE CASE

The entire insurance industry routinely classifies claims adjusters as salaried (as opposed to hourly) employees under the administrative exemption. For decades, the federal Department of Labor ("DOL") has made clear that claims adjusters who perform the duties commonly associated with this position satisfy the administrative exemption. (See, e.g., 29 C.F.R. § 541.205(c)(5) (2000) [specifically citing "claim agents and adjusters" as performing administrative work]; *In re Farmers Ins. Exch.* (9th Cir. 2007) 481 F.3d 1119, 1128 ["*Farmers*"] [by 1940, the DOL had already "*long recognized* that claims adjusters typically perform work that is administrative in nature"].) California law expressly incorporates this federal law. (See 8 Cal. Code Regs. § 11040(1)(A)(2)(f) ["Wage Order 4-2001"] [mandating that exempt and non-exempt work "shall be construed in the same manner" as the key terms in the federal regulations].)

Nevertheless, the trial court concluded that a class of insurance adjusters employed by appellant York Risk Services Group, Inc. ("York")[1] are not exempt. On that basis, the trial court awarded class members millions of dollars in damages for unpaid overtime under the Labor Code, as well as interest, civil penalties, and attorneys' fees. The reason for this outlier decision is simple: the trial court accepted Plaintiffs' unfounded legal arguments wholesale, and among other errors, it applied a superseded exemption analysis that has been rejected by the California Supreme Court and also impermissibly ignored controlling federal law. Indeed, in reciting

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[1] York was formerly known as York Claim Services, Inc. The spelling in the caption and in the trial court record, which refers to the company as "York Claims Service, Inc.," is incorrect.

the governing law, the trial court simply copied Plaintiff's incomplete statement of the exemption test and literally wrote the Wage Order's express incorporation of federal law out of the regulation. (*Post*, 34-35.)

The history of the Wage Order is instructive: before 2001, California law did not clearly define the administrative exemption, forcing one Court of Appeal to resort to the so-called "administrative/production" dichotomy to determine whether insurance adjusters were exempt. (*Bell v. Farmers Ins. Exch.* (2001) 87 Cal.App.4th 805, 814 ["*Bell II*"].) In 2001, to promote uniform enforcement, the Industrial Welfare Commission ("IWC") adopted a new exemption test derived from federal law that expressly incorporated federal guidance. (See Wage Order 4-2001.) Based on that new Wage Order, the California Supreme Court has reversed a finding that *Bell II* and the administrative–production dichotomy render claims adjusters non-exempt. (See *Harris v. Superior Court* (2011) 53 Cal.4th 170, 187 [reversing lower court because it applied a "superseded" version of the administrative–production analysis instead of considering "all of the relevant aspects" of the federal regulations].)

In 2004, to prevent further litigation, the DOL issued clarifying regulations specifying claims adjusters as paradigmatic exempt employees. (29 C.F.R. § 541.203(a).) California courts have held that because the 2004 federal regulations simply clarify the federal regulations in place when Wage Order 4-2001 was adopted, these 2004 regulations now guide the application of the California administrative exemption. (See, e.g., *Soderstedt v. CBIZ S. Cal., LLC* (2011) 197 Cal.App.4th 133, 149-150.) Applying these clarifications, the Ninth Circuit has held if some of the claims adjusters' tasks "track" those identified in the federal clarifying

regulations as exempt, "that says it all" and "establish[es] that [the] claims adjusters are exempt." (*Farmers*, *supra*, 481 F.3d at p. 1129 [reversing bench-trial decision to the contrary].)

Here, the trial court committed the same legal errors that required reversal in *Harris*. The trial court applied the "superseded" administrative–production dichotomy, and it entirely ignored (and actually contravened) the governing federal law that California expressly incorporates. York should not be held to a different standard from its competitors, and the trial court's legal errors should not be permitted to disrupt longstanding industry practice or render California out of step with the rest of the nation. Because the factual record makes clear that the claims adjusters here spent a majority of their time on the duties that the regulations identify as exempt, "that says it all" and judgment should be entered for York. At the very least, remand is warranted to require the trial court to apply the proper legal standard consistent with the California Supreme Court's mandate in *Harris*.

To reach its outlier decision, the trial court not only applied an impermissible legal standard, but it also committed other reversible errors.

First, the trial court deprived York of its constitutional right to a jury trial by resolving the entire case on its own, over York's objections. The court did so under the fiction that it was resolving "equitable" issues. But the court awarded legal remedies—including damages, prejudgment interest, and attorney's fees—under the Labor Code. A defendant's constitutional right to a jury trial in actions at law cannot be "defeat[ed]" in this manner. (*People v. One 1941 Chevrolet Coupe* (1951) 37 Cal.2d 283, 299.)

Second, the trial court's class-wide finding of liability and damages award is not supported by substantial evidence. The *only* evidence at trial regarding the hours worked by absent class members—an essential element both of Plaintiffs' liability case against York and their asserted damages—came in the form of hearsay testimony regarding certain class members' responses to an anonymous survey. The responding class members knew this survey would be used to support their claims for unpaid overtime, but they were assured that their responses would be entirely anonymous, *i.e.*, never subject to verification or cross-examination. This inherently unreliable approach contradicts both long-established legal principles governing survey evidence and recent precedent regarding the use of statistical evidence to prove an employer's liability in class actions. (*Duran v. U.S. Bank Nat'l Ass'n* (2014) 59 Cal.4th 1, 40-43; *Tyson Foods, Inc. v. Bouaphakeo* (Mar. 22, 2016) ___ S.Ct. ___, 2016 WL 1092414, at *8-11.)

Third, the trial court erred by awarding civil penalties under Labor Code section 226 because York's wage statements did not include accrued vacation time. Nothing in section 226 requires an employer to include accrued vacation time in wage statements, and courts that have addressed this issue have rejected the trial court's conclusion.

In sum, the trial court's multiple errors infected all aspects of the judgment, which must be reversed.

STATEMENT OF APPEALABILITY

The trial court entered a final judgment on April 21, 2015. York timely filed its Notice of Appeal from the judgment on June 19, 2015. The

trial court's judgment is appealable under Code of Civil Procedure section 904.1, subdivision (a)(1).

STATEMENT OF FACTS AND PROCEDURAL HISTORY

The named plaintiffs, Lonetta Williams and Roshon Green, brought this action against York in June 2008. In September 2012, the trial court, per the Honorable Michael P. Kenny, certified a class of "all claims examiners employed on an exempt basis in California by York between April 11, 2004 and the present." (Appellant's Appendix ["AA"] 198.) The class encompasses 122 current and former York employees. (AA 18.)

The amended complaint alleged three causes of action against York: (1) unpaid overtime wages under the Labor Code; (2) restitution and injunctive relief under the Unfair Competition Law ("UCL"), Bus. & Prof. Code § 17200 *et seq*.; and (3) civil penalties under the Labor Code Private Attorney General Act of 2004, Labor Code section 2698 *et seq.* (AA 191-193; AA 215.)

A. York and Its Claim Adjusters

York provides insurance claims adjusting services to other companies. (Reporter's Transcript ["RT"] 970:3-6, 327:24-26.) These services are "the investigation, evaluation, negotiation, and settlement" of insurance claims. (RT 745:24-746:1.) York has a fiduciary duty to its clients. Its adjusters help fulfill that duty by adequately investigating claims and posting appropriate reserves. (RT 969:23-970:28, 977:4-22.) "The acts or omissions of the claims adjusters could expose York to malpractice claims or expose York's clients to bad faith claims." (RT 868:13-21.) The types of claims that York adjusts include personal injury,

general liability, premise liability, automobile liability, and auto property damage. (RT 743:25-28, 1276:3-9.)

York classifies claims adjusters who handle property and casualty claims as exempt. (RT 818:5-26.) York also employs worker's compensation adjusters who practice under different guidelines, and it classifies them as non-exempt. (RT 929:18-930:6.) Plaintiffs were property and casualty insurance adjusters who worked for York in Roseville. (RT 431:2-5, 334:1-3.) Plaintiffs assert that they and other class members should have been classified as hourly employees and paid overtime wages beyond their agreed-upon salaries.

The adjusters' duties are not significantly disputed. As the trial court observed: "It seems like the basic job that the adjusters do is fairly clear. I think all of the witnesses are in agreement on that." (RT 1517:14-16.) Jerry Russ, who had been a claims adjuster at York and is now a supervisor (RT 1239:19-1240:14), testified that adjusters' duties included "contacting … the insured, the claimants, taking statements, … doing liability evaluations, damages evaluations, … coverage reviews … to arrive at a result," which means determining if "the claim going to be settled or is it going to be denied." (RT 1245:9-26.) "If [they] feel there is liability and there is an amount to be paid that is within [their] authority," they would proceed with "settling, paying, and closing that claim." (RT 1260:17-1261:1.) Mr. Russ noted that his duties and responsibilities as a claims adjuster at York were "very similar to what [he] did at Travelers," an insurance company, before he started working at York. (RT 1245:9-12.)

The named Plaintiffs' testimony was consistent. Ms. Williams testified that she would "evaluate and determine liability" and "negotiate

bodily-injury settlements[,]" including negotiations with counsel. (RT 644:22-645:3; AA 238-240.) When she received a new file, she would "look at the loss description to see what happened in the accident, and then [she] would contact all involved parties" (RT 645:5-10), and ask follow-up questions if she heard statements that did not make sense to her (RT 657:14-18). She would also review the insurance policy or rental agreement to determine if the loss was covered. (RT 644:8-18, 658:2-11.) She would determine "what the bodily-injury claim is worth" on her own if it was under $5,000, and consult with a supervisor if more. (RT 646: 6-13). In discussions with the supervisor, she would provide a range of "what we think we should do." (RT 650:26-651:2.) As Ms. Williams explained, "if the liability is correct and in order, then I just basically settle the claim." (RT 645:11-18.)

Ms. Green worked at three insurance companies before moving to York and testified that "throughout [her] career as an adjuster," "part of an adjuster's responsibility is to assess liability issues before writing a check." (RT 324:2-13, 373:8-19). When she was assigned a claim at York, she would "read what was in the file" and "investigate whatever was in the file." (RT 419:7-16.) She determined from whom to take recorded statements, "conduct[ed] those recorded statements," and in some cases decided what questions to ask. (RT 419:23-410:8.) It was part of her job to "weigh the evidence," "try to figure out if the liability picture ma[de] sense," and "consider whether there was comparative negligence on the part of the plaintiff or the claimant." (RT 373:28-374:12). Because York is a third-party administrator, "the policies did vary" from insurance company to insurance company, and so she would also "[m]ake sure they had the

proper coverage." (RT 374:19-375:10.) After receiving the information she needed, she would then review the file with her supervisor "in most instances," and "come to a conclusion and then extend an offer, if appropriate, or send a denial letter, if possible—if appropriate." (*Ibid*.)

York has guidelines and procedures to establish best practices and help ensure that its adjusters fulfill York's fiduciary duty to its clients and comply with legal requirements. York's Quality Assurance Guide "is a manual which basically spells out what the expectation is in terms of a quality claims file for York Claims Services; what goes into a quality claims file, what goes into a quality investigation, a quality evaluation, specifically." (RT 731:20-27.) The manual's purpose is to help claims adjusters "adher[e] to best practices," follow "client instructions," and comply with "statutory requirements." (RT 1031:28-1032:16.) York also conducted internal audits "to make sure we are adhering to both statutory compliance with the states, the various states we do business in, as well as making sure that we are taking care of the fiduciary obligations we have to our clients to make sure we are performing the job that we said we would do for the client." (RT 953:8-13.)

B. Evidence Regarding Hours Worked

York did *not* have a policy requiring claims adjusters to work more than 40 hours a week. (RT 344:2 [Ms. Green: "The expectation was 40 hours a week, 8 hours a day."]; 734:20-21 [branch manager Michael Bentz: "The expectation is they put in a minimum of 40 hours a week."]; 826:7-10; 838:7-14; 944:26-945:1.) At trial, 4 class members testified that, on occasion, they worked more than 40 hours a week. (RT 443:23-444:6, 351:3-6, 1456:2-7, 1486:13-16.) But with respect to the 118 other class

members, class counsel presented no competent witness testimony to prove that the class members worked *any* overtime.

Instead, class counsel sought to prove overtime liability solely through testimony from Dr. Dwight Steward, an economist. (RT 447:5-448:17.) Dr. Steward had no personal knowledge regarding the hours worked by class members while employed at York. Rather, his testimony regarding class members' hours worked was based upon the results of a paid, anonymous telephone survey of some class members. (RT 453:5-11.) Dr. Steward did not conduct this survey personally; instead, Plaintiffs retained Heffler. (RT 460:2-5, 468:28-469:21; AA 245.) Heffler is the class action claims-administration firm frequently used by Plaintiffs' counsel that sent the earlier notice letting class members know about their membership in the class and potential for recovery. (RT 48:20-49:1 [Plaintiffs' counsel "has worked for many years" with the Heffler project manager].)

In 2013, shortly after class members received the class notice (AA 200-203), Heffler spoke by telephone with 65 class members whose numbers were available (i.e., not on the "Do Not Call" list) and willing to participate. (AA 253; RT 478:8-19, 520:4-5.) Heffler did not undertake any effort to ensure that the population responding to the survey was representative of the entire class. (See *ibid.*)

Heffler informed participants that it was conducting a "study by the lawyers who the court appointed to represent you and other York claims adjusters in a class action lawsuit." (AA 245; RT 512:7-17.) Heffler offered each respondent $20 to participate and promised that "your answers will be kept completely confidential and will never be connected with your

name. And no one will ever be told that you participated in this survey." (AA 245.) After assuring each participant that his or her estimate concerning potential recovery would be anonymous and thus never subject to individualized verification, Heffler asked each respondent to state his or her average work hours per week at York, going back as far as nine years. (AA 248.)

Heffler reported a wide range of answers. Several respondents stated that they did not work any overtime at all, while others indicated they worked an average of 80 hours a week or more for several years on end. (AA 169-171 [printout of raw survey data listing average weekly work hours reported by respondents by year, including six respondents who reported working no more than 40 hours per week]; see AA 161.) Heffler then reported the results to Dr. Steward on an entirely anonymous basis. (RT 472:14-21.) York attempted to obtain through discovery allowing it to match respondents with their identities (AA 165), but Plaintiffs refused to provide such information.

At trial, over York's repeated objection, the trial court permitted Dr. Steward to testify as to the hours worked by class members, based solely upon class members' anonymous responses to Heffler. (RT 478:27-479:10.) This was the only evidence Plaintiffs offered on absent class members' hours.

C. The Trial Court Judgment

Trial commenced on May 12, 2014, and it concluded on May 28, 2014. The court issued its Statement of Decision on January 30, 2015. The trial court concluded that the administrative exemption did not apply to class members. (AA 223-232.) Relying solely on Dr. Steward's estimate

that the “average” number of “overtime hours per week” for each class member was 8.61, the court further concluded that class members worked overtime and awarded total “damages” of $8,354,658, including prejudgment interest, for work performed between 2004 and 2014. (AA 219-223.) The court ultimately attributed Dr. Steward’s estimate of average hours worked (8.61 hours per week) to each class member, and entered a damages award and plan of distribution calculated by multiplying 8.61 overtime hours per week by the number of weeks each employee worked at York. (AA 222-223.) The individual awards averaged over $60,000 and some awards exceeded $300,000. (AA 84-86.)

The court also awarded civil penalties of $609,900 for failure to pay overtime wages and wages earned (AA 15, 219-223), and $309,000 for not stating information about vacation and sick time on wage statements under Labor Code section 226 (AA 15, 232-233).

The trial court entered judgment on April 12, 2015. York filed a motion for new trial on May 18, 2015, and the court denied the motion. (RT 1581:9-12.)

This appeal followed.

ARGUMENT

I. THE TRIAL COURT APPLIED AN INCORRECT LEGAL STANDARD AND IMPERMISSIBLY IGNORED APPLICABLE FEDERAL PRECEDENT DEMONSTRATING THE ADJUSTERS HERE ARE EXEMPT

A. Standard of Review

Whether an employee is exempt “within the meaning of applicable statutes and regulations is, like other questions involving the application of

legal categories, a mixed question of law and fact." (*Ramirez v. Yosemite Water Co.* (1999) 20 Cal.4th 785, 794.) Determining which duties the employees are expected to and actually perform are questions of fact, which are reviewed under a "substantial evidence" standard. (*Heyen v. Safeway Inc.* (2013) 216 Cal.App.4th 795, 817.) However, the "appropriate manner of evaluating the employee's duties"—i.e., whether the duties fall within an exemption—"is a question of law that we review independently." (*Ibid.*) Where "the predominant controversy is the precise meaning of" the exemption definition, this is a question of law and appellate courts review "the trial court's judgment independently on the question of this term's meaning in this context." (*Ramirez*, *supra*, 20 Cal.4th at p. 794.) And, when the court below applies the improper legal standard, the minimum appropriate result is remand with instructions to apply the proper standard. (*Harris*, *supra*, 53 Cal.4th at pp. 190-191.)

B. History of the Wage Order: The *Bell II* Analysis Is Outdated, and Courts Must Apply the Incorporated Federal Guidance

1. The Exemption Prior to 2001 and *Bell II*

Although the prior version of the regulation (Wage Order 4-1998[2]) contained an "administrative" exemption, no California regulation or statute defined "administrative capacity" before 2001. (*Harris*, *supra*, 53 Cal.4th at p. 177 ["Wage Order 4-1998 did not articulate the precise scope of the administrative exemption"].) Indeed, unlike Wage Order 4-2001, which expressly incorporates relevant federal law, Wage Order 4-1998

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[2] Available at https://www.dir.ca.gov/iwc/Wageorders1998/IWCarticle4.html.

"contain[ed] only a single sentence" about administrative employees. (*Id.* at p. 178.)

In *Bell II*, the Court of Appeal found a class of Farmers claims adjusters non-exempt under the imprecise 1998 Wage Order. (*Bell II, supra,* 87 Cal.App.4th at p. 814.) The court noted "the absence of detailed interpretative regulations comparable to those in federal cases" and declined to "make the entire corpus of federal regulations construing the administrative exemption directly applicable to the exemption provision of wage order No. 4." (*Id.* at pp. 820, 827.) Instead, the court considered only whether the overall *role* of the claims adjusters within the company (as opposed to their specific duties) was "production" as opposed to "administration," because Farmers had stipulated that they did the work that "the organization exists to produce." (*Id.* at p. 828.) In relying upon this administrative–production dichotomy, the court never considered the actual *duties* of a claims adjuster. (*Ibid* ["Our conclusion obviates the need to inquire into plaintiffs' duties[.]"].)

The *Bell II* court resorted to this type of analysis because, as the California Supreme Court later observed, it "did not have the benefit [of the] clarifications" set forth in the 2001 Wage Order, including the incorporated federal regulations. (*Harris*, *supra*, 53 Cal.4th at p. 185.) This administrative–production dichotomy has an "industrial age genesis" and limited use "in the modern service-industry context." (*Roe-Midgett v. CC Servs., Inc.* (7th Cir. 2008) 512 F.3d 865, 872 [holding that claims adjusters are exempt and finding the dichotomy "not terribly useful" in the insurance context].)

2. The Current Exemption and Wage Order 4-2001's Express Incorporation of Federal Regulations

In 1999, the Legislature passed Assembly Bill 60, enacting Labor Code section 515, which sets forth administrative, executive and professional exemptions tracking the parallel federal exemptions. At that time, the federal DOL had already "long recognized" the exempt status of claims adjusters in its regulations. (See *Farmers*, *supra*, 481 F.3d at p. 1129; 29 C.F.R. § 541.205(c)(5) (2000) [specifically referencing "claim agents and adjusters" as administrative employees].)

Through A.B. 60, the Legislature instructed the IWC to "conduct a review of the *duties*," as opposed to the overall roles within the company, "that meet the test of the exemption and, if necessary, modify the regulations." (*Harris*, *supra*, 53 Cal.4th at p. 178, italics added.) In 2001, the IWC issued Wage Order 4-2001, whose administrative exemption tracked the key elements of the existing federal definition. (See 8 Cal. Code Regs. § 11040(1)(A)(2); see also IWC, Statement as to Basis, § 1, https://www.dir.ca.gov/iwc/statementbasis.htm[3] [the IWC "derived the duties that meet the test for the administrative exemption from language in the federal regulation[s]".) Confirming the intent to align state and federal law, the regulation expressly incorporates pertinent federal regulations:

> The activities constituting exempt work and non-exempt work *shall be construed in the same manner as such terms are construed in the following regulations under the Fair Labor Standards Act* effective as of the date of this order: 29 C.F.R. Sections 541.201-205, 541.207-208, 541.210, and 541.215.

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[3] Subject to judicial notice. (See Evid. Code § 452, subd. (b)-(c).)

(8 Cal. Code Regs. § 11040(1)(A)(2)(f), italics added.) The IWC explained the purpose was to "provide clarity regarding the federal regulations that can be used to describe the duties that meet the test of the exemption under California law, as well as to promote uniformity of enforcement." (Statement as to Basis, § 1, *supra*.)

3. The Incorporated Federal Regulations and Precedent Specify Claims Adjusters as Paradigmatic Exempt Employees

Wage Order 4-2001 adopted not only the language of the federal regulations, but also the manner in which those regulations have been "construed." (8 Cal. Code Regs § 11040 (1)(A)(2)(f).) The regulations uniformly have been construed to deem claims adjusters exempt employees.

In 2004, the Department of Labor issued regulations clarifying the existing administrative exemption. (See 69 Fed. Reg. 22122, 22125 (Apr. 23, 2004).) The clarification did not "represent a change in the law." (*Farmers*, *supra*, 481 F.3d at p. 1128.) The purpose was to "reduce the likelihood of litigation over employee classifications because both employees and employers will be better able to understand and follow the regulations." (69 Fed. Reg. at p. 22125.)

The DOL specifically addressed claims adjusters:

> Insurance claims adjusters generally meet the duties requirements for the administrative exemption, whether they work for an insurance company or other type of company, if their duties include activities such as interviewing insureds, witnesses and physicians; inspecting property damage; reviewing factual information to prepare damage estimates; evaluating and making recommendations regarding coverage of claims; determining liability and total value of a claim;

> negotiating settlements; and making recommendations regarding litigation.

(29 C.F.R. § 541.203(a).)

Through these clarifications, the DOL sought "to reduce the emphasis on the so-called 'production versus staff' dichotomy in distinguishing between exempt and nonexempt workers." (69 Fed. Reg. at p. 22140.) The DOL explained that this clarification was "consistent with existing section 541.205(c)(5)" as well as past guidance and judicial precedent finding claims adjusters exempt. (*Ibid.*)

Consistent with this guidance, federal courts have repeatedly held that claims adjusters performing some or all of the functions listed in section 541.203(a) are exempt. In *Farmers*, the Ninth Circuit analyzed federal claims by essentially the same Farmers insurance adjusters previously at issue in *Bell II* (albeit in different states). (See *Farmers*, *supra*, 481 F.3d at p. 1125; *Bell II*, *supra*, 87 Cal.App.4th at p. 808.) Unlike the *Bell II* court, the Ninth Circuit applied the now-incorporated federal regulations and reversed the trial court's bench-trial determination that the claims adjusters were non-exempt, and instead held that the record established that the adjusters were exempt as matter of law because they:

> (i) determine whether the policy covers the loss, (ii) recommend a reserve upon estimating FIE's exposure on the claim, in accordance with state law requirements, (iii) interview the insured and assess his (or others') credibility, (iv) advise FIE regarding any fraud indicators or the potential for subrogation and underwriting risk, (v) negotiate settlements, (vi) seek additional authority from their supervisors, which is granted '75-100 percent of the time,' when the recommended settlement exceeds their established authority and (vii) communicate with opposing counsel and FIE's counsel.

(*Farmers*, *supra*, 481 F.3d at p. 1129.) Noting that these duties "track those identified in" the federal regulations, the court held that "[a]s far as we are concerned, that says it all. . . . [and] establish[es] that FIE's claims adjusters are exempt." (*Ibid.*)

Other federal courts consistently have reached the same conclusion, treating adjusters as exempt under the plain terms of the regulation. (See, e.g., *Robinson-Smith v. Gov't Employees Ins. Co.* (D.C. Cir. 2010) 590 F.3d 886, 897; *Roe-Midgett*, *supra*, 512 F.3d at p. 872; *Cheatham v. Allstate Ins. Co.* (5th Cir. 2006) 465 F.3d 578, 585-586; *Bucklin v. Am. Zurich Ins. Co.* (C.D. Cal. June 19, 2013) 2013 WL 3147019, at *17, aff'd (9th Cir. 2015) 619 F. App'x 574; *Talbert v. Am. Risk Ins. Co.* (S.D. Tex. May 14, 2010) 2010 WL 1960124, at *4 aff'd (5th Cir. 2010) 405 F. App'x 848; *In re Allstate Ins. Co. Fair Labor Standards Litig.* (D. Ariz. Aug. 7, 2007) 2007 WL 2274802, at *11; *Withrow v. Sedgwick Claims Mgmt. Serv., Inc.* (S.D.W.Va. 2012) 841 F.Supp.2d 972, 986; *Estrada v. Maguire Ins. Agency, Inc.* (E.D. Pa. Feb. 28, 2014) 2014 WL 795996, at *9; *Whitlock v. Am. Family Mut. Ins. Co.* (D. Or. Jan. 15, 2016) 2016 WL 199420, at *2-3.)

The DOL's own approach toward claims adjusters is consistent. The DOL has never initiated any action against any major insurance companies concerning the widespread practice of classifying adjusters as exempt. (Cf. *Christopher v. SmithKline Beecham Corp.* (2012) 132 S.Ct. 2156, 2168 ["while it may be 'possible for an entire industry to be in violation of the [FLSA] for a long time without the Labor Department noticing,' the 'more plausible hypothesis' is that the Department did not think the industry's practice was unlawful," citation omitted].) Just the opposite: the DOL submitted an *amicus curiae* brief to the California Supreme Court in *Harris*

stating that the clarifying regulations, including section 541.203, "provide the best indication as to the meaning of the pre-2004 regulations incorporated by California law, and confirm that insurance claims adjusters who perform specified duties … generally satisfy the duties test of the administrative exemption." (2008 WL 6083951, at *19.)[4] The DOL explained that finding that the claims adjusters there did "not qualify for the administrative exemption directly conflicts with every relevant federal court decision that has addressed the exempt status of insurance claims adjusters under DOL's pre-2004 regulations." (*Id.* at *30.)

Any contention from Plaintiffs that Wage Order 4-2001 did not incorporate the subsequent clarifying regulations issued in 2004 would fail. As the Court of Appeal has recognized, the 2004 regulations govern the administrative exemption under Wage Order 4-2001 because the DOL's "addition of the functional areas to which the administrative exemption would apply … was intended to be illustrative and did not amount to a substantive change." (*Soderstedt, supra*, 197 Cal.App.4th at p. 150; see also *Farmers*, *supra*, 481 F.3d at p. 1128 [holding that the 2004 regulations did "not represent a change in the law" and applying the pre-2004 and 2004 regulations together]; *Combs v. Skyriver Commc'ns, Inc*. (2008) 159 Cal.App.4th 1242, 1255-1256 & fn.5 [describing 2004 regulations' interpretation guidance regarding the administrative exemption as "expressly incorporated in IWC Wage Order No. 4-2001"].) Likewise, the California Supreme Court noted in *Harris* that federal decisions finding claims adjusters exempt under the 2004 regulations are "instructive because the regulations enacted by the [DOL] after Wage Order 4-2001 were

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[4] Subject to judicial notice. (See Evid. Code § 452, subd. (d).)

intended to be consistent with the old regulations." (53 Cal.4th at p. 189 & fn.8.)

4. The California Supreme Court Confirms That *Bell II* Is Outdated Given California's Incorporation of the Federal Regulations

In its 2011 *Harris* decision, the California Supreme Court disavowed the continued application of *Bell II*'s analysis under the now-operative Wage Order. (53 Cal.4th at p. 190.) In *Harris*, a divided Court of Appeal, believing itself bound by *Bell II*, applied the administrative–production dichotomy and deemed a class of claims adjusters non-exempt. (*Ibid.*) The Supreme Court, in reversing the judgment, recognized that there had been significant changes to the Wage Order since *Bell II*, which had "considered Wage Order 4-1998." (*Id.* at p. 184.) *Harris* explained:

> The whole approach in *Bell II* rested on the conclusion that Wage Order 4-1998 failed to provide a sufficient explanation of the extent of the administrative exemption. By comparison, Wage Order 4-2001, the operative order here, along with the incorporated federal regulations, set out detailed guidance on the question.

(*Id.* at p. 187, citations omitted.)

The Court of Appeal had followed *Bell II* to conclude that the claims adjusters were non-exempt because their "work—investigating claims, determining coverage, setting reserves, etc.—is not carried on at the level of policy or general operations, so it falls on the production side of dichotomy." (*Ibid.*) *Harris* rejected this approach because it "fails to recognize that the dichotomy is a judicially created creature of the common law, which has been *effectively superseded in this context by the more*

specific and detailed statutory and regulatory enactments." (*Id.* at p. 188, italics added.)

As *Harris* explained, "Wage Order 4-2001, the operative order here, along with the incorporated federal regulations, set out detailed guidance on the question." (*Id.*at p. 187.) California courts must construe the current administrative exemption "in light of the incorporated federal regulations," which "delineate what work qualifies as administrative." (*Id.* at p. 179; see also *id*. at p. 187 [remanding because the Court of Appeal "did not, however, consider all of the relevant aspects of the Federal Regulations"].)[5]

C. The Trial Court Applied the "Superseded" Test and Ignored Governing Federal Precedent

1. The Trial Court Applied the Test Rejected by *Harris*

The trial court, stating that the "the *Bell* line of cases" was "[c]entral" to its analysis, found that the claims adjusters did not "perform work that is directly related to York's management policies or general business operations" because they "were processing a large number of claims—essentially producing York's product." (AA 225-226.) The trial court concluded that the adjusters were non-exempt because the work they "performed was carrying out the daily activities for which the business exists, not advising management, determining policies, or any other such administrative tasks." (*Ibid* [also relying on the fact that claims adjusters

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[5] After the Supreme Court's remand in *Harris*, the Court of Appeal issued an opinion in 2012 that reached the same conclusion as its original decision. (207 Cal.App.4th 1225.) The California Supreme Court then ordered that new decision depublished. The depublication means that *Harris II* "has no precedential value among California courts and, perhaps more importantly, suggests that the California Supreme Court would not adopt its reasoning." (*Bucklin*, *supra*, 2013 WL 3147019, at *8.)

were "not providing suggestions to York's business operations"].) In doing so, the trial court accepted wholesale Plaintiffs' reliance on *Bell II* and the associated argument that class members' duties were not administrative *because* their "job is to handle claims" which meant they produced "York's product" and did not "run York's business." (AA 206-210.)

This is the same blanket rule that the California Supreme Court squarely rejected in *Harris*, which condemned this "gloss to the administrative/production worker dichotomy analysis" as "superseded" by the new wage order and incorporated federal regulations:

> Such an approach fails to recognize that the dichotomy is a judicially created creature of the common law, which has been effectively superseded in this context by the more specific and detailed statutory and regulatory enactments.
>
> While it bolstered its conclusion by citing Federal Regulations former part 541.205(a) (2000), the majority [Court of Appeal Opinion] failed to adequately consider other subparts of that regulation. Such an approach violates the long-standing rule of construction that an enactment is to be read as a whole and that interpretations are to be avoided if they render part of an enactment nugatory.

(53 Cal.4th at pp. 187-188.)

Here, the trial court applied this outdated analysis despite acknowledging that *Harris* precludes such a "bright line test." (AA 224.) Indeed, under the trial court's approach, no claims adjusters who spend their time adjusting claims (instead of running the company in an executive capacity) would ever be exempt. This result would be contrary not only to *Harris* but also to decades of direct DOL guidance incorporated into California law as well as widespread industry practice.

2. The Trial Court Did Not Apply Pertinent Federal Precedent

Not only did the trial court apply the "rigid rule" foreclosed by *Harris*, but the trial court made no mention of federal law despite its incorporation and the state Supreme Court's direction to follow this "detailed guidance." Instead, the trial court adopted Plaintiffs' submission verbatim and literally wrote the incorporation of the federal regulations out of the Wage Order:

TRIAL COURT'S STATEMENT OF THE EXEMPTION	THE ACTUAL EXEMPTION
"[a] person employed in an administrative capacity means an employee whose duties and responsibilities involve either: (a)(i) The performance of office or non-manual work directly related to management policies or general business operations of his employer or his employer's customers…; and, (b) Who customarily and regularly exercises discretion and independent judgment; and… (d) Who performs under only general supervision work along specialized or technical lines requiring special training, experience, or knowledge; or (e) Who executes under only general supervision special assignments and tasks; and (f) Who is primarily engaged in duties which meet the test for the exemption." (AA 218.)	"[a] person employed in an administrative capacity means an employee whose duties and responsibilities involve either: (a)(i) The performance of office or non-manual work directly related to management policies or general business operations of his employer or his employer's customers…; and, (b) Who customarily and regularly exercises discretion and independent judgment; and… (d) Who performs under only general supervision work along specialized or technical lines requiring special training, experience, or knowledge; or (e) Who executes under only general supervision special assignments and tasks; and (f) Who is primarily engaged in duties which meet the test for the exemption. ***The activities constituting exempt work and non-exempt work shall be construed in the same manner as such terms are construed in the following regulations under the Fair Labor Standards Act effective as of the date of this order: 29 C.F.R. Sections 541.201-205, 541.207-208, 541.210, and 541.215***…" (8 Cal. Code Regs. § 11040(1)(A)(2), emphasis added.)

Instead of following this incorporated federal guidance, the trial court essentially created its own standards that contravene the federal regulations and the settled case law interpreting them.

First, the trial court determined that the claims adjusters at issue did not perform "work directly related to management policies or general business operations" of York or its customers because their work was "resolv[ing] claims" and not "advising management, determining policies" or making recommendations "regarding York's business operations." (AA 225-226.) This conclusion is completely contrary to the federal regulations incorporated into the Wage Orders, which have long made clear that the administrative exemption is "not limited to persons who participate in the formulation of management policies or in the operation of the business as a whole." (29 C.F.R. § 541.205(c) (2000).) Instead, as *Harris* details, these regulations describe "the types of duties that constitute 'administrative operations of the business'" to include "advising the management, planning, negotiating, [and] representing the company" or its customers. (*Harris*, *supra*, 53 Cal.4th at p. 188 [citing 29 C.F.R. § 541.205(b) (2000) and suggesting that the dissent at the Court of Appeal level properly surmised that these tasks are "what claims adjusters do"].)

As a result of this mistaken standard, the trial court failed to consider facts making clear that "planning, negotiating, [and] representing the company" and its customers is exactly what the claims adjusters at issue here do with the majority of their time:

- York adjusters *plan* how to handle claims, creating an investigative plan, and keeping an "action plan" for each claim, explaining "how they are going to get from the start of the file to the end of the file . . . Whether it's going to be a settlement or whether it's one to deny and take to trial . . .

they need to document and put down their thought process." (RT 971:5-16.) If matters go to trial, they create a litigation plan. (RT 972:2-13.)

- They *negotiate* with claimants and sometimes attorneys in resolving claims. (RT 380:10-17, 644:28-645:3, 646:15-26.)

- They *represent* their clients in communications with claimants, in conducting investigations, in settlement negotiations, and in hiring third party vendors. (RT 374:19-375:10, 380:10-17, 644:28-645:3, 646:15-26.) They have the authority to unilaterally settle claims within their individual settlement authority and they make recommendations to their supervisors when they believe a higher settlement range is appropriate and necessary. (RT 646:6-13; 654:15-655:1; 378:24-27; 378:2-10; 645:12-24.)

- They *advise management* for York and York's clients if they believe a claim should be settled for an amount outside their approved authority, if they believe a claim should have a reserve higher than they are authorized to set, if they identify potential subrogation rights, or if they notice any red flags indicating fraud (RT 378:2-10, 645:12-24, 754:22-26, 973:19-974:6, 670:11-20.)

Again, the DOL's regulations have long specified that "claim agents and adjusters" meet this exemption criterion. (29 C.F.R. § 541.201(c)(5) (2000).) The trial court never mentioned this regulation.

Second, the trial court applied no federal precedent to determine whether the claims adjusters "customarily and regularly exercise discretion and independent judgment" and "operate under only general supervision." Instead, the trial court relied exclusively on *Nordquist v. McGraw-Hill* (1995) 32 Cal.App.4th 555. (AA 223-224, 226.) *Nordquist* applied the 1980 version of Wage Order 11 (applicable to the broadcasting industry) to determine that a sportscaster was exempt under the same outdated standard in the 1998 Wage Order. (32 Cal.App.4th at p. 561.) The 1980 Wage

Order 11 did not expressly incorporate federal law, did not address claims adjusters, and is no longer in place.

Applying this outdated case, the trial court concluded that the claims adjusters here lack sufficient discretion because the "discretion that the class members possessed in performing their job duties pertains to claims files themselves, not to York's business overall." (AA 226.) The trial court acknowledged that it was effectively re-casting the "superseded" administrative–production analysis. (*Ibid* ["Much like the administrative–production dichotomy, this element requires that discretionary decision-making be at the level of the employer's management policies or general business operations."].)

This is not the law. Under pertinent federal regulations (as incorporated into the Wage Order), the administrative exemption requires that employees "exercise of discretion and independent judgment" and have the associated "authority or power to make an independent choice, free from immediate direction or supervision." (29 C.F.R. § 541.207(a).) While "the kinds of decisions normally made by persons who formulate or participate in the formulation of policy" would satisfy this test, the regulations plainly "*do not require the exercise of discretion and independent judgment at so high a level*." (29 C.F.R. § 541.207(d) (2000), italics added.) Instead, the test can be satisfied by "contact persons who are given reasonable latitude in carrying on negotiations on behalf of their employers." (*Ibid.*) "[R]equir[ing] that claims adjusters' activities occur 'at the level of management policy or general operations' to qualify as administratively exempt . . . is a 'judicially created' gloss that was

invalidated in *Harris I* on the ground that it failed to give full effect to the governing federal regulations." (*Bucklin*, *supra*, 2013 WL 3147019, at *7.)

Third, the trial court again contravened federal law in concluding that the claims adjusters here lack sufficient discretion and freedom from supervision because they interacted or met with their supervisors on "a daily basis"; were "supervised with regard to their working hours"; and were subject to "procedures," "guidelines" and "claims file audits." (AA 226-231 [focusing in large part on York's Quality Assurance Guide].)[6] Incorporated federal regulations and federal case law make clear that these factors do not support the trial court's conclusion.

The trial court cited no authority to support its novel standard that the claims adjusters here were "subject to substantial scrutiny," as opposed to general supervision, simply because they "interacted on a daily basis" with their supervisors on pending claims. (AA 229-230.) Federal law holds otherwise. (*Bucklin*, *supra*, 2013 WL 3147019, at *15 [adjusters exempt even though certain decisions required supervisory oversight because adjusters still "were expected to offer a reasoned recommendation" for the action"]; *Robinson-Smith*, *supra*, 590 F.3d at p. 894 [freedom from immediate supervision "does not necessarily imply that the decisions made by the employee must have a finality that goes with unlimited authority and a complete absence of review"].)

Indeed, even where a supervisor "regularly speaks" to the employee, federal courts have found that fact alone insufficient to override the application of the administrative exemption. (*Maddox v. Cont'l Cas. Co.*

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[6] The court acknowledged "that York did establish that class members ultimately acquired special training, experience, or knowledge." (AA 213.)

(C.D. Cal. Dec. 22, 2011) 2011 WL 6825483, at *7 [“Although Plaintiff’s supervisor regularly spoke to Plaintiff about the status of his accounts, conducted periodic meetings, and audited Plaintiff’s files, those activities do not constitute more than general supervision.”]; *Robinson-Smith*, *supra*, 590 F.3d at p. 895 [fact that some adjusters “routinely called” their supervisors when they sought “non-minor” concessions did not change adjusters’ exempt status]; *Bucklin*, *supra*, 2013 WL 3147019, at *16 [“supervisorial oversight” in the form of 12–day, 30–day, 60–day, and 180–day reviews, quarterly audits, productivity reports and supervisorial “diaries” to track the completion of specific tasks amounts to only “general supervision”].)

Similarly, pertinent law makes clear that there is nothing inappropriate (or even uncommon) about an employer setting expectations about the number and schedule of hours exempt adjusters will work. When the DOL enacted the clarifying 2004 regulations, it stated that employers, “without affecting their employees’ exempt status . . . may require exempt employees to work a specified schedule.” (*See* 69 Fed. Reg. at p. 22178 [stating this would “*continue to be* permissible under the new rules”].) “There is no support in the case law for the proposition that requiring salaried employees to make up time missed from work due to personal business is inappropriate.” (*Cowart v. Ingalls Shipbuilding, Inc.* (5th Cir. 2000) 213 F.3d 261, 265].)

And, while York and its clients do have policies, procedures, and best practices, including the Quality Assurance Guide or QAG, federal law is clear that the requirement that claims adjusters consult with such practices, manuals or guidelines “does not preclude their exercise of

discretion and independent judgment." (*Cheatham*, *supra*, 465 F.3d at p. 585; *Roe-Midgett*, *supra*, 512 F.3d at p. 875 ["[I]ndependent judgment is not foreclosed by the fact that an employee's work is performed in accordance with strict guidelines."]; *McAllister v. Transamerica Occidental Life Ins. Co.* (8th Cir. 2003) 325 F.3d 997, 1001 [claims coordinator exempt employee, even though she had to follow detailed claims manuals]; *cf. In re United Parcel Serv. Wage & Hour Cases* (2010) 190 Cal.App.4th 1001, 1026 [holding that because the "modern workplace is a regulated workplace," an employee does not lose exempt status "because an employer requires adherence to regulations, guidelines or procedures"].)

Here, the evidence established that all adjusters at York "have authority to settle cases and make payments for 5 thousand to 25 thousand without seeking management's approval," and that they all have "authority to utili[ze] client funds typically held in escrow by York to pay vendor expenses up to a discretionary check limit, typically in the range of $5,000 to $25,000 per expense, without seeking a supervisor's approval." (RT 869, 892.) When acting on behalf of their clients, adjusters not only have the potential to expose the insurers to legal liability (RT 868:13-16), they also control a significant amount of the insurer's funds. (RT 869:5-7; 892:7-11.)

The law is clear that claims adjusters with this level of autonomy are exempt. (*Roe-Midgett*, *supra*, 512 F.3d at p. 869 [finding exempt adjusters who settle claims of up to their limit of authority and whose supervisors "need not formally approve the actual amount of settlement or underlying estimate, though they informally review an [adjuster's] work for errors"); *Farmers*, *supra*, 481 F.3d at p. 1132 [finding exempt claims adjusters who

have discretion to settle claims within settlement authority]; *Smith*, *supra*, 590 F.3d at p. 895 [finding exempt claims adjusters who have full authority to settle claims within their limits as long as they can justify their decision on the facts of the claim and within established guidelines or prior practice]; *McAllister*, *supra*, 325 F.3d at p. 1001 [claims coordinator exempt employee where she had authority to settle claims up to predetermined limits].)

Fourth, the trial court's erroneous legal standard for analyzing whether claims adjusters performed exempt tasks necessarily also infected its analysis of the Wage Order's temporal requirement—which requires that exempt employees spend a majority of their time on exempt tasks or "work that is directly and closely related to exempt work and work which is properly viewed as a means for carrying out exempt functions." (8 Cal. Code Regs. §§ 11040(1)(A)(2)(f), 11040(2)(N).) In fact, there is no evidence that class members spent any meaningful amount of time doing anything *other* than adjusting claims (i.e., the various functions listed above that qualify for the administrative exemption). Undisputed testimony showed that claims adjusters spend the "majority" or at least "75 percent" of their time adjusting claims. (RT 987:4-23; see also AA 210.)

D. While the Case Must at Least Be Remanded, this Court Should Direct Judgment for York Because, Under the Correct Legal Standard, the Uncontroverted Testimony Establishes the Exemption.

Because the trial court ignored incorporated federal law, the judgment must at a minimum be vacated and remanded for a new trial. (*Harris*, *supra*, 53 Cal.4th at p. 187 [remanding case where lower court applied an outdated standard instead of considering "all of the relevant

aspects" of the federal regulations]; see also *Ramirez*, *supra*, 20 Cal.4th at pp. 802-803 [because the trial court's application of an exemption "was tainted" by the application of an improper standard, it was unclear if the trial court properly resolved key "factual discrepancies" and "remand to the trial court is the most appropriate disposition."].) The trial court's award of civil penalties for unpaid overtime wages and for failure to pay earned wages (AA 15), which assumes Plaintiffs' entitlement to overtime wages, must necessarily be vacated as well.

But here, because there is no dispute about the actual tasks that claims adjusters performed, this court may "independently review the application of the law to [those] undisputed facts." (*People ex rel. Dept. of Motor Vehicles v. Cars 4 Causes* (2006) 139 Cal.App.4th 1006, 1012, citations omitted.) That analysis demonstrates that York is entitled to judgment as a matter of law.

The 2004 regulations require (a) office or non-manual work "directly related to the management or general business operations of the employer or the employer's customers" (29 C.F.R. § 541.201(a)); (b) "exercise of discretion and independent judgment with respect to matters of significance" (*id.* § 541.202(a)); and (c) "authority to make an independent choice, free from immediate direction or supervision" (*id.* § 541.202(c)).

The 2004 regulations provide just six such illustrations of prototypical administrative employees, and the very first example listed is that of "[i]nsurance claims adjusters … [who] work for an insurance company or other type of company." (29 C.F.R. § 541.203(a); *Clark v. Centene Co. of Tex., L.P.* (W.D. Tex. 2014) 44 F.Supp.3d 674, 684 ["[i]nsurance claims adjusters have a special place in FLSA jurisprudence,

as shown by the prominent placement of insurance claims adjusters as the first example in the regulations of employees who are generally administratively exempt. This special treatment no doubt explains many of the cases holding claims adjusters exempt," citing 29 C.F.R. § 541.203(a)].)

These regulations clarify that claims adjusters are exempt under this standard so long as their duties merely "include activities such as interviewing insureds, witnesses and physicians; inspecting property damage; reviewing factual information to prepare damage estimates; evaluating and making recommendations regarding coverage of claims; determining liability and total value of a claim; negotiating settlements; and making recommendations regarding litigation." (29 C.F.R. § 541.203(a); see also 69 Fed. Reg. at p. 22144 [these are the "typical duties of an *exempt* claims adjuster," italics added].)

The uncontroverted evidence at trial establishes beyond dispute that York claims adjusters perform precisely these functions:

- **Interviewing insureds and witnesses:**
    - RT 372:5-18 (adjusters would "speak with independent witnesses, if there were any available")
    - RT 373:22-27 (as part of adjusters' "investigation" they "take statements from witnesses" and "from parties")
    - RT 375:27-376:4 (adjusters "determine from whom to take recorded statements" from reviewing the file and "[i]f there were witnesses, then .... [w]e would contact the witnesses, the parties involved.")
    - RT 933:9-13 (adjusters "have to interview claimants, insureds, ... managing brokers ... managing general agents, brokers, clients, attorneys, physicians")

- RT 1044:21-28 (adjusters "should interview all witnesses" and are trained to "[c]onduct a proper investigation, including interviewing people")

- **Reviewing factual information to prepare damage estimates:**

  - RT 754:10-21 (an "initial reserve" is "set when the file is opened based on the information [the adjuster has] at the time ... as to what the value of the claim might be," until "the facts develop throughout the investigation" and then the "reserve is updated to appropriately reflect the actual settlement value of the claim")

  - RT 933:1-9 (adjusters "make a determination on . . . the value of [a] claim" and "have to set reserves")

  - RT 1281:9-20 (adjusters would "go about setting the reserves" based on "the result of their investigation" and "their evaluation of the claim")

  - RT 1295:23-1296:2 (adjusters need to "update[]" their "reserve evaluation based on any damage estimates" received to "make sure these claims reflect the proper exposure")

  - RT 1339:16-1340:5 (after files are "initially opened with a one dollar reserve" adjusters are to set an "initial reserve" based on "the initial results of [the adjuster's] investigation" and an "understand[ing of] what the potential damages are")

- **Evaluating and making recommendations regarding coverage of claims:**

  - RT 374:19-375:10 (adjuster responsibilities include "mak[ing] sure [insured] had the proper coverage")

  - RT 749:4-13 (adjusters "verif[y] coverage" that "it does exist" and "the amounts of coverage that are available, the vehicles that are covered if it's an auto claim, the properties that are covered if it's a general liability claim")

- RT 968:14-969:6 (adjusters to perform “proper coverage evaluation,” which includes confirming the insured, the dates of policy, the dates of loss, an evaluation of the “definition of who is an insured” as well as “applicable exclusions” or “endorsements”)

- RT 1001:12-21 (adjusters “have to determine if it’s a covered loss to begin with” by doing a “coverage analysis”)

- RT 1282:18-1283:18 (adjusters “update[e] their file notes” as they get more information and “update their coverage evaluation”

- **Determining liability and total value of a claim:**

    - RT 373:8-374:12 (“part of an adjuster’s responsibility is to assess liability before writing a check” including “do[ing] an investigation,” “tak[ing] statements from witnesses,” “tak[ing] statements from parties,” “weigh[ing] the evidence,” “try[ing] to figure out if the liability picture makes sense,” and “consider[ing] whether there was comparative negligence”)

    - RT 652:12-19 (adjusters “would decide whether [they] thought there was liability or no liability” and “evaluate a claim to put a number on it”)

    - RT 1259:13-1261:1 (describing final “liability evaluation based on the entire investigation of that claim,” and if adjuster “feel[s] there is liability and there is an amount to be paid and that is within my authority, I'm settling, paying, and closing that claim”).

    - RT 1289:28-1290:17 (adjuster is “responsible for plac[ing] a value on the injury ... based on their evaluation of the medical records” and “recent awards or jury verdicts or settlements of cases” from “their prior claims”)

    - RT 1398:19-21 (adjusters “exercise discretion in determining ... value of damages”)

- **Negotiating settlements:**
  - RT 380:13-17 (adjuster "[e]xercised discretion to negotiate settlement[s]")
  - RT 644:28-645:3 (adjusters "negotiate bodily-injury settlements at York")
  - RT 744:26-745:1 (claims adjusters perform "investigation, evaluation, negotiation, and settlement of claims")
  - RT 753:19-754:6 (adjusters "need to properly evaluate the claim, determine in terms of dollars what their offers are going to be, what their negotiation strategy is going to be, and then proceed to negotiate the claim")
  - RT 1398:19-26 ("adjusters would exercise discretion in ... resolving cases")
- **Making recommendations regarding litigation:**
  - RT 772:3-14 (if claim "goes to litigation," adjuster may "monitor the trial ... for the carrier ... recommend settlement ... suggest certain defense postures")
  - RT 865:21-24 (plaintiff introducing evidence that adjusters "provid[e] litigation management")
  - RT 971:27-972:13 (because "many ... files go into suit and . . . the biggest expense for insureds, clients, carriers, are legal fees ... it's incumbent upon the adjuster to help manage that process")
  - RT 976:9-15 (adjusters "are responsible for making sure that the litigation ... goes forward properly")

Because these duties "track" those duties specified in section 541.203(a), "that says it all," and establishes that the adjusters are exempt as a matter of law. (*Farmers*, *supra*, 481 F.3d at pp. 1124, 1129.) In *Farmers*, the plaintiffs argued that they were not exempt because they were

"merely engaged in the 'day-to-day carrying out of the business affairs rather than running the business itself.'" (*Id*. at p. 1131.) The Ninth Circuit rejected these arguments and found that under section 541.203(a), claims adjusters are exempt if they perform *some* of the duties listed in the regulation, regardless of settlement authority and even if supervisor approval is required. (*Id*. at pp. 1129-1130 [the regulations do "not require the adjuster to perform each and every activity listed"].) Because the record showed that the claims adjusters did perform the listed duties, the appellate court reversed the trial court's bench trial decision and directed entry of judgment for the employer. (*Id*. at p. 1135; see also *Tsyn v. Wells Fargo Advisors* (N.D. Cal. Feb. 16, 2016) 2016 WL 612926, at *7 [finding employees exempt and noting that the *Farmers* court found claims adjusters exempt even though "they were supervised and used computer software to help estimate claims"].)

This straightforward analysis not only complies with the letter of the incorporated regulations, but it also serves the DOL's stated purpose to provide a clear standard to "reduce the likelihood of litigation over employee classifications because both employees and employers will be better able to understand and follow the regulations." (See 69 Fed. Reg. at p. 22125.) Similarly, the IWC incorporated the federal regulations into California's current Wage Order in order "to promote uniformity of enforcement." (Statement as to Basis, § 1, *supra*, https://www.dir.ca.gov/iwc/statementbasis.htm.)

In short, the federal regulations incorporated into the Wage Order, which the trial court ignored, now directly address exempt status of claims adjusters in an effort to provide clarity and uniformity. Because the record

makes clear that the adjusters here spend a majority of their time performing the very duties that render them exempt under this standard, the trial court's judgment should be reversed and judgment should be entered in favor of York.

II. THE TRIAL COURT DEPRIVED YORK OF ITS CONSTITUTIONAL RIGHT TO A JURY TRIAL

A. Standard Of Review

Whether a party is entitled to a jury trial is a "pure question of law" that this Court reviews de novo. (*Cairo v. Offner* (2005) 126 Cal.App.4th 12, 23.) Wrongful denial of a jury trial "constitutes a miscarriage of justice requiring reversal of the judgment." (*Frahm v. Briggs* (1970) 12 Cal.App.3d 441, 444.)

B. A Plaintiff Cannot Circumvent the Defendant's Jury Trial Right By Pleading Both Legal and Equitable Claims

Article I, Section 16 of California's Constitution guarantees the right to a jury trial in any civil action at law. The right should be "zealously guarded by the courts" and, in case of doubt, the issue "should be resolved in favor of preserving a litigant's right to trial by jury." (*DiPirro v. Bondo Corp.* (2007) 153 Cal.App.4th 150, 176.) "[T]he legal or equitable nature of a cause of action ordinarily determined by the mode of relief to be accorded," and an action for damages is one at law. (*Raedeke v. Gibraltar Sav. & Loan Ass'n* (1974) 10 Cal.3d 665, 672.)

Where a plaintiff has pled both equitable and legal claims, the "general rule" is that "a joinder of equitable and legal claims cannot deprive a party of a right to a jury trial." (*American Motorists Ins. Co. v. Superior Court* (1998) 68 Cal.App.4th 864, 873.) An exception to this rule exists for

situations in which a plaintiff pleads *mutually exclusive* legal and equitable remedies but subsequently makes an election of remedies, such that "there need not be a trial on both the legal and equitable remedy[,]" as "resolution of one renders the other moot." (*Walton v. Walton* (1995) 31 Cal.App.4th 277, 293; accord *Nwosu v. Uba* (2004) 122 Cal.App.4th 1229, 1245 [plaintiff had no jury-trial right where it pled "a case of mutually exclusive claims where trial of equitable issues … eliminate[d] the need for a jury trial." [citation].) But where, as here, a plaintiff seeks "cumulative legal and equitable remedies that are not mutually exclusive," and declines to make an election of remedies, the right to a jury trial on the legal claims "cannot be defeated by severance of the equitable claim[s]" for trial without a jury. (*Walton*, *supra*, 31 Cal.App.4th at p. 293.)

Put differently, a *defendant*'s jury-trial right cannot be defeated through the simple device of the plaintiff pleading cumulative equitable and legal claims. Holding otherwise would eviscerate the Constitution's jury-trial guarantee—particularly in light of the Legislature's enactment of broad equitable remedial statutes like the UCL, which overlap significantly with traditionally legal remedies. As our Supreme Court has observed:

> The right to a trial by jury cannot be avoided by merely calling an action a special proceeding or equitable in nature. *If that could be done, the Legislature, by providing new remedies and new judgments and decrees in form equitable, could in all cases dispense with jury trials, and thus entirely defeat the provision of the Constitution. The Legislature cannot convert a legal right into an equitable one so as to infringe upon the right of trial by jury.* The provision of the Constitution does not permit the Legislature to confer on the courts the power of trying according to the course of chancery any question which has always been triable according to the course of the common law by a jury.

(*People v. One 1941 Chevrolet Coupe* (1951) 37 Cal.2d 283, 299, italics added.)

C. The Trial Court Erroneously Deprived York of a Jury Trial

The complaint asserted causes of action for unpaid overtime under the Labor Code, equitable relief under the UCL, and penalties under PAGA. (AA 191-193.) There is no question that the first cause of action for unpaid overtime under the Labor Code is an action at law that must be tried to a jury. (See *Eicher v. Advanced Bus. Integrators, Inc.* (2007) 151 Cal.App.4th 1363, 1376 [describing recovery for unpaid overtime under Labor Code as "damages"].) The Labor Code claim is cumulative, and *not* mutually exclusive of the UCL and PAGA claims, because it affords remedies different from and beyond what is authorized under those statutes. But on plaintiff's request, the trial court decided that, because the complaint also raised equitable issues, it could "try the equitable issues first." (RT 256:26-257-7.) The court then conducted a bench trial and awarded *legal* remedies under Labor Code section 1194(a).

First, the court awarded "damages" (AA 216, 222), a quintessentially legal form of relief available under Labor Code section 1194(a), but not under the UCL or PAGA. (See *Korea Supply Co. v. Lockheed Martin Corp*. (2003) 29 Cal.4th 1134, 1144 ["A UCL action is equitable in nature; damages cannot be recovered."]; *Achal v. Gate Gourmet, Inc*. (N.D.Cal. 2015) 114 F.Supp.3d 781, 805 [PAGA "was not enacted as a means of recovering damages"]).

Second, the trial court awarded prejudgment interest on those damages under Labor Code section 1194(a). (AA 15, 217.) "[T]he UCL

does not authorize an award of prejudgment interest." (*M&F Fishing, Inc. v. Sea-Pac Ins. Managers, Inc.* (2012) 202 Cal.App.4th 1509, 1538.)

Third, the trial court awarded both statutory attorney's fees under Labor Code section 1194(a) and alternative common fund attorney's fees of "25% of the total judgment," the vast majority of which was attributable to Labor Code damages. (AA 94, 100.) By contrast, "[a]ttorney fees are not recoverable under the UCL." (*People ex rel. City of Santa Monica v. Gabriel* (2010) 186 Cal.App.4th 882, 889.)

In short, the court tried and awarded legal relief on the plaintiffs' Labor Code claim without a jury. Plaintiffs made no election of remedies; rather, the trial court fashioned a novel hybrid action that allowed Plaintiffs to mix and match distinct legal and equitable causes of action without the procedural and substantive constraints that would have otherwise governed them. Though Plaintiffs could have sought restitution and penalties under their equitable causes of action, they could not have recovered the legal remedies of damages, pre-judgment interest, or the attorney's fees. Under the Labor Code, they would have been able to pursue such legal remedies, but they would have been subject to a shorter limitations period than under the UCL,[7] and they would have had to prove their case to a *jury*. Under the Plaintiffs' procedure as adopted by the trial court, Plaintiffs impermissibly got the best of both worlds.

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[7] A UCL claim is subject to a longer limitations period—four years—than a claim under Labor Code section 1194(a). (*Cortez v. Purolator Air Filtration Prods.* (2000) 23 Cal.4th 163, 178-179.) Here the Court awarded "damages" reaching back to 2004, four years before commencement of the action. (AA 73-75.)

In defense of this approach, the trial court stated "the preference has been expressed by the higher courts is that the equitable issues be tried first." (RT 257:2-4; cf. *Hoopes v. Dolan* (2008) 168 Cal.App.4th 146, 157 [noting "California's preference for the trial of equitable issues before legal issues," which "produced a number of cases in which bench resolution of equitable issues … curtailed or foreclosed legal issues"].) But this procedural "preference" applies only where (a) plaintiffs have pleaded "mutually exclusive" legal and equitable claims such that an "election of remedy may be compelled" (see *Walton*, *supra*, 31 Cal.App.4th at pp. 292-293; *American Motorists*, *supra*, 68 Cal.App.4th at p. 784; *Nwosu*, *supra*, 122 Cal.App.4th at p. 1245); or (b) the defendant has interposed an equitable *defense* to legal claims and seeks to vindicate that defense in a court trial (see *Hoopes*, *supra*, 168 Cal.App.4th at p. 163). Neither is the case here.

Of the three cases relied upon by the trial court (RT 256:26-257:1), two (*Hodge v. Superior Court* (2006) 145 Cal.App.4th 278 and *Raedeke*, *supra*, 10 Cal.3d 665) merely confirm that the plaintiff can obtain its factfinder of choice by making an election of remedies to pursue *only* legal or *only* equitable claims. In *Hodge*, the plaintiff initially pled causes of action under the Labor Code and the UCL. (145 Cal.App.4th at p. 281-282.) After the trial court properly required submission to a jury, which hung, the Plaintiff dismissed the Labor Code action in order to secure a bench trial. The Court of Appeal concluded that a jury trial was not required since the sole remaining cause of action was under the UCL. (*Id.* at p. 282.) In *Raedeke*, the opposite happened—the plaintiff originally pled both legal and equitable claims, and then "made an election of remedies in

order to secure a trial by jury" and dropped their equitable claims. The Supreme Court confirmed that plaintiffs could secure a jury trial in this manner. (10 Cal.3d at pp. 670-672.) Here, however, the plaintiffs never made an election, and instead obtained legal remedies without a jury trial.

Hoopes (*supra*, 168 Cal.App.4th 146), the third case cited by the trial court (RT 256:26-257:1), involved an equitable *defense*. There, the plaintiffs sought a jury trial on the legal issues, and the defendant interposed an equitable defense. (168 Cal.App.4th at pp. 150-151.) The Court of Appeal noted the "preference" for trying the equitable defense first, but explained that "'[t]he historical reason for this procedure'" is that "'[i]f a defendant at law had an equitable defense, he resorted to a bill in equity to enjoin the suit at law, until he could make his equitable defense effective by a hearing before the chancellor.'" (*Id.* at p. 157, citation omitted.) That rationale has no application where (as here) a defendant prefers simply to proceed at law and vindicate its jury-trial right.

By contrast, California courts have repeatedly held that procedural convenience cannot defeat the defendant's constitutional right to a jury trial where, as here, plaintiffs have chosen to pursue cumulative legal and equitable remedies without making an election to pursue only the equitable remedy. (See *Walton*, *supra*, 31 Cal.App.4th at p. 293; accord *Hutchason v. Marks* (1942) 54 Cal.App.2d 113, 118 [holding that, where plaintiff pleaded legal and equitable claims that are not mutually exclusive, "[a]s to the issues of fact arising out of that [legal] item, a trial by jury would be a matter of right"]; *Wisden v. Superior Court* (2004) 124 Cal.App.4th 750, 754-758 [jury-trial right applied to legal action for fraudulent conveyance

even though it was brought alongside equitable claim].) The trial court's failure to abide by that rule here necessitates reversal.

III. PLAINTIFFS DID NOT PRESENT SUBSTANTIAL EVIDENCE TO SUPPORT THE TRIAL COURT'S CLASS-WIDE FINDING OF LIABILITY OR DAMAGES

Reversal is required for the independent reason that the *only* evidence introduced at trial regarding the hours worked by absent class members—an essential element for both liability and damages—was Dr. Steward's hearsay testimony regarding the anonymous survey.

A. Standard of Review

"A judgment must be supported by substantial evidence in light of the whole record." (*People v. Jones* (1990) 51 Cal.3d 34, 313.) "'[T]he word "substantial" … cannot be deemed synonymous with "any" evidence.'" (*DiMartino v. City of Orinda* (2000) 80 Cal.App.4th 329, 336.) Rather, substantial evidence "'must be reasonable in nature, credible, and of solid value; it must actually be "substantial" proof of the essentials which the law requires in a particular case.'" (*Ibid.*)

B. Dr. Steward's Testimony Regarding Class Members' Unreliable Anonymous Survey Responses Does Not Constitute Substantial Evidence Supporting the Judgment

To recover on a claim for unpaid overtime, "the employee has the burden of proving that he performed work for which he was not compensated," i.e., that he actually worked in excess of 40 hours a week. (*Hernandez v. Mendoza* (1988) 199 Cal.App.3d 721, 727; see also Labor Code §§ 510, subd. (a); 1194, subd. (a).) Once such liability is proven, the plaintiff must then prove the amount of damages. (See *ibid*; Cal. Civil Jury

Instructions 2702 [listing as separate elements "That [plaintiff] worked overtime hours" and "The amount of overtime pay owed.")

Unlike some other wage-and-hour defendants, York did not have a policy requiring all class members to work overtime, and the uncontroverted evidence showed that several class members never worked more than 40 hours a week. (*Ante*, 22; compare, e.g., *Martinez v. Joe's Crab Shack Holdings* (2014) 231 Cal.App.4th 362, 368-369 [exempt employees all were "expected to work a minimum of 50 hours per week"].) Thus, as an essential element of their liability case, Plaintiffs had to introduce evidence showing that all class members worked overtime. Plaintiffs sought to carry that burden by relying entirely on Dr. Steward's testimony. But Dr. Steward did nothing more than aggregate survey responses by class members who knew their responses would be (a) used as evidence in a proceeding in which they had a direct financial stake; and (b) anonymous and never be subject to verification or cross-examination. That evidence is not remotely "reasonable[,] … credible, [or] of solid value." (*DiMartino*, *supra*, 80 Cal.App.4th at p. 336.)

In *Duran*, the California Supreme Court warned that "statistical methods such as sampling" must be "employed with caution." (59 Cal.4th at p. 41.) As courts long have recognized, two of the greatest risks associated with surveys are "lack of sincerity" and "faulty memory" on the part of survey respondents. (*Pittsburgh Press Club v. United States* (3d Cir. 1978) 579 F.2d 751, 758.) Those concerns are magnified when respondents are assured their answers will never be questioned. Yet, over York's repeated objections, the trial court simply ignored these problems. (See AA 220-221.)

First, the trial court ignored the unreliability inherent in permitting Dr. Steward to opine on the basis of hearsay statements from claimants who were aware of their significant financial interest in the outcome of the litigation. (See *Duran*, *supra*, 59 Cal.4th at p. 43 ["Self-interest may motivate class members to act in ways that will maximize the class award."].) Here, class members stood to receive tens to hundreds of thousands of dollars in damages depending on their answers. (See AA 84-86 [awarding individual damages of up to $322,032, including damages of over $100,000 each for 19 class members].) During the telephonic surveys, the same claims administration firm that sent class members the notice of the case (and processed opt outs) expressly told respondents that the survey was undertaken at the behest of their counsel, and then asked questions that bore directly on how much money they could recover from York. (*Ante*, 21-22.) Neither Plaintiffs nor the trial court cited any case law supporting this deeply flawed approach.[8] And, Dr. Steward did nothing to address the issue:

> Q: In your mind, Doctor, do you segregate out cases in which there is a potential for financial gain as opposed to one where there is not when you conduct a survey?
>
> A: Um, that's not an approach that I will—that is not part of the approach, no.

(RT 591:5-9.)

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[8] Although some courts have admitted survey responses into evidence, they have done so only where respondents are not parties to the litigation and have nothing to gain or lose based on their answers—such as, for instance, to prove consumer confusion in trademark actions. (E.g., *Zippo Mfg. Co. v. Rogers Imports, Inc.* (S.D.N.Y. 1963) 216 F.Supp. 670, 682-683.) Such cases provide no support for the trial court's approach here.

As the Supreme Court noted in *Duran*, "[a] sample that includes even a small number of interested parties can produce biased results." (59 Cal.4th at p. 43; see also *Pittsburgh Press Club, supra*, 579 F.2d 751, 759 [reversing judgment based on expert testimony regarding survey data where survey respondents were "interested in the litigation, were told the precise nature of the litigation and the purpose of the survey," and "consequently knew which responses would be helpful to [plaintiffs], and conversely, which would be harmful"]; *Lutheran Mut. Life Ins. Co. v. United States* (8th Cir. 1987) 816 F.2d 376, 379 [survey of insurance company's agents found unreliable where respondents were "informed … that the information solicited 'could affect the company financially'"].) The situation here is worse than in *Pittsburgh Press Club* or *Lutheran Mutual*: the survey respondents were class members with pending claims for money damages in the very case for which their responses were sought.

Second, the anonymous nature of the survey compounded the risk of insincerity by assuring the class members that, despite their financial interest, they would be shielded from cross-examination or any other verification method. Such anonymity makes a survey "unreliable as there is no way to identify who submitted the information and allow the Defendant a chance to cross examine those persons." (*Schrieber v. Federal Express Cor*p. (N.D. Okla. Mar. 18, 2010) 2010 WL 1078463, at *4; *Crumpacker v. Kan. Dep't of Human Res.* (D. Kan. June 10, 2004) 2004 WL 1846146, at *4 ["The court is at a loss to see how" anonymous survey responses "can possibly be admissible."].) Indeed, Dr. Steward could not explain how an anonymous survey of self-interested class members would have the same level of accuracy as a non-anonymous one. (RT 537:24-

538-5.) York's inability to cross-examine class members was particularly damaging in light of many class members' facially inflated responses—estimating that they worked 16-hour days for years on end. (*Ante*, 22; AA 169.)

Third, the flawed survey approach gave class members who worked little or no overtime strong incentive not to respond at all. The Supreme Court in *Duran* cautioned about such "nonresponse bias." (59 Cal.4th at p. 43.) "A sample *must* be randomly selected for its results to be fairly extrapolated to the entire class," and such randomness is absent where certain class members "ch[o]ose not to respond to the survey." (*Ibid*, italics added.) That is because if these "opt-outs represent mainly low-value claims or plaintiffs with no valid claim, the sample results will be unfairly inflated," an error whose "impact … is magnified when the biased results are extrapolated to the entire population." (*Ibid.*)

Fourth, the survey asked respondents to state their average work hours going back as far as nine years, creating the risk of unreliable answers based on "faulty memory" that are nonetheless shielded from further testing and cross-examination. (See, e.g., *Pittsburgh Press Club*, *supra*, 579 F.2d at p. 759 [excluding survey evidence where respondents were asked about events "which had taken place many years ago"].) The survey did not ask questions that could have tested the accuracy of respondents' recollections, such as asking for estimates of time respondents spent on other activities. (AA 244-251; RT 1093:16-1095:2.) Indeed, Dr. Steward admitted he had no idea of the basis for class members' answers:

> Q: Did you determine from where the class members derived their historical information regarding hours worked by them?

A: No.

(RT 519:26-28.)

For these reasons, Dr. Steward's testimony regarding the anonymous survey responses was not substantial evidence supporting the judgment. Because Plaintiffs introduced no *other* competent class-wide evidence of hours worked for purposes of liability or damages, reversal is required. (See *Plastic Pipe & Fittings Ass'n v. Cal. Bldg. Standards Comm'n* (2004) 124 Cal.App.4th 1390, 1407 ["unreliable" testimony of a single witness cannot constitute substantial evidence supporting judgment].)

The U.S. Supreme Court's recent opinion in *Tyson Foods, Inc. v. Bouaphakeo* (Mar. 22, 2016) ___ S.Ct. ___, 2016 WL 1092414, provides further support for this conclusion. Under both California and federal law, the question of whether and when statistical sampling or representative proof may be used to establish a defendant's *liability*—as opposed to the amount owed in damages—has for many years been an open issue. *Duran* suggested that "the use of sampling to prove an employer's *liability*," as opposed to the amount of damages, is impermissible under California law. (59 Cal.4th at p. 41, italics in original; accord *Hernandez*, *supra*, 199 Cal.App.3d at pp. 726-727.) In *Tyson*, the U.S. Supreme Court concluded that statistical or survey evidence may sometimes be used to establish a defendant's liability—but *only* where that evidence "is otherwise admissible" and "could … sustain[] a reasonable jury finding" as to liability "in each employee's individual action," outside the class-action setting. (2016 WL 1092414, at *8, 11.) This Court need not reconcile the apparent tension between *Duran* and *Tyson* here because even under the more lenient *Tyson* standard, the trial court erred.

For the reasons stated above, Dr. Steward's testimony was not remotely sufficient to sustain the trial court's finding of liability as to the 118 class members for whom the anonymous survey constituted the *sole* evidence of hours worked. Nor would Dr. Steward's testimony have been "otherwise admissible" in each class member's individual action against York. (*Tyson*, *supra*, 2016 WL 1092414, at *11.) "A survey conducted to record the recollections of survey respondents is hearsay." (*People ex rel. Lockyer v. R.J. Reynolds Tobacco Co*. (2004) 116 Cal.App.4th 1253, 1269.) As such, the survey responses were inadmissible to prove the truth of the matter asserted—i.e., the number of hours worked by each respondent. (Evid. Code § 1200, subd. (a)-(b).)

The evidence was not admissible to explain the basis of Dr. Steward's expert testimony either. Dr. Steward's *only* knowledge of class members' hours worked came from reviewing the survey responses provided to Heffler. But an "expert may not serve as a mere conduit for the admission of otherwise inadmissible hearsay." (*I-CA Enters., Inc. v. Palram Americas, Inc*. (2015) 235 Cal.App.4th 257, 286; accord, e.g., *People v. Coleman* (1985) 38 Cal.3d 69, 92 [expert "may not under the guise of reasons [for his opinion] bring before the jury incompetent hearsay evidence"];[9] *Korsak v. Atlas Hotels*, *Inc.* (1992) 2 Cal.App.4th 1516, 1525-1526 [similar].)

In *I-CA Enterprises,* for example, an expert sought to opine about the defendant's financial condition on the basis of a report that included information gathered from an interview. (235 Cal.App.4th at pp. 285-286.)

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[9] Disapproved of on other grounds by *People v. Riccardi* (2012) 54 Cal.4th 758, 820.

Because the expert's testimony was "derived directly, and apparently solely from the [report]," and because the expert "had no other competent basis to testify about [the defendant's] net worth or financial condition, any testimony on those subjects would result in the inadmissible [report] being introduced to the jury through [the plaintiff's] expert. This is precisely what the law does not allow." (*Id.* at p. 286.) Similarly, in *Garibay v. Hemmat* (2008) 161 Cal.App.4th 735, the court rejected expert testimony about the facts of a particular medical procedure because the expert's knowledge of those facts was derived entirely from inadmissible hearsay. (*Id.* at p. 743.) Likewise here: it was impermissible for Dr. Steward to serve as a conduit for the inadmissible hearsay that formed the sole basis for his "opinion" regarding the hours worked by class members.

In short, even assuming survey evidence can sometimes establish a defendant's class-wide liability, that evidence must still be admissible and substantial. Here, it was neither (let alone both), and because there was no *other* evidence about class member overtime, York plainly suffered prejudice. Reversal is required.

C. The Trial Court's Judgment Impermissibly Awards Damages to Class Members Who Admitted They Worked No Overtime

A court's role is "limited 'to providing relief to claimants, in individual or class actions, who have suffered, or will imminently suffer, actual harm.'" (*Tyson*, *supra*, 2016 WL 1092414, at *15 [Roberts, C.J., concurring] [quoting *Lewis v. Casey* (1996) 518 U.S. 343, 349]; accord, e.g., *B.W.I. Custom Kitchen v. Owens-Illinois, Inc.* (1987) 191 Cal.App.3d 1341, 1350 [even if class-action plaintiffs prove a violation of the law, they "still must prove that class members suffered the 'fact of damage,'

'impact,' or 'injury' as a consequence of that violation"].) In *Tyson*, the Supreme Court recognized the problem posed by an award of damages to uninjured class members based on statistical or survey evidence, but concluded the issue was not yet ripe there because "the damages award has not yet been disbursed, nor does the record indicate how it will be disbursed." (2016 WL 1092414, at *12.)

This case poses the exact problem identified but deemed unripe in *Tyson*. Here, the trial court entered a plan of distribution that resulted in all but one class member receiving an award of damages. (*Ante*, 23; AA 84-86 (Judgment, Ex. E).) Yet six class members who responded to Heffler self-reported that they never worked *any* overtime hours. (*Ante*, 22; AA 169-171, 161.) The exact number of uninjured class members is almost certainly much higher, given that nearly half of class members (57 out of 122) did not respond, and those who did were both self-selecting (creating bias risk) and assured anonymity such that they could inflate their claims. (*Ante*, 59.)

At the very least and as in *Tyson*, remand is required to instruct to determine whether there is a "way[] of distributing the award to only those individuals who worked more than 40 hours" (2016 WL 1092414, at *12), and to reconsider, in light of that question and the answer to it, whether class certification is appropriate.

IV. THE TRIAL COURT ERRED IN AWARDING PENALTIES FOR NOT INCLUDING VACATION AND SICK TIME IN WAGE STATEMENTS

Whether Labor Code section 226 requires vacation and sick time information in wage statements is a pure question of statutory interpretation

reviewed de novo. (*Morgan v. United Retail Inc*. (2010) 186 Cal.App.4th 1136, 1142.)

Despite acknowledging that Labor Code "section 226(a) does not explicitly require vacation and sick time to be listed on wage statements" (AA 232), the trial court awarded $309,000 in civil penalties on the ground that York's pay statements did not include that information. (AA 232-233.) The trial court's reasoning was vacation and sick time is encompassed within section 226(a)'s requirement that wage statements set forth "gross wages earned." (AA 232.) The trial court cited no authority for this proposition. There is none. The purpose of section 226 is to allow employees to readily ascertain "[t]he amount of the gross wages or net wages paid to the employee during the pay period …." (Labor Code § 226, subd. (e)(2)(B)(i).) Even though it is earned by the employee during the course of employment, vacation pay is not actually "paid" to the employee at the time it is earned. (*Suastez v. Plastic Dress-Up Co*. (1982) 31 Cal.3d 774, 779.) Rather, unused "vested vacation time" must be paid at the time of termination. (Labor Code § 227.3.) Accordingly, courts addressing the issue have uniformly held that section 226 does not require vacation time to be set forth in wage statements. (See, e.g., *Garibaldi v. Bank of Am. Corp.* (N.D. Cal. Jan. 15, 2014) 2014 WL 172284, at *7; *Heinzman v. Home Depot U.S.A., Inc.* (C.D. Cal. Jan. 20, 2011) 2011 WL 12817699, at *1 [dismissing claim for penalties, finding plaintiff "failed to plead a § 226(a) violation that would plausibly entitle him to relief because § 226(a) did not

require Home Depot to include earned vacation hours in the itemized wage statements that it provided to its employees"].)[10]

CONCLUSION

Contrary to long-accepted industry practice and precedent, the trial court determined that York's claims adjusters are not exempt. The trial court reached this outlier decision by applying a now-rejected legal standard, ignoring clear and controlling regulations and judicial precedent, denying York its right to a jury trial, and then making a class-wide finding of liability and damages based solely on highly unreliable anonymous survey evidence. The judgment should be reversed, and judgment entered in York's favor—or, alternatively, at a minimum, the judgment should be vacated and the case remanded for a new trial governed by a correct interpretation of relevant law.

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[10] Similarly, during the relevant class period, California law contained no requirement that employers display accrued sick time. Effective January 1, 2015, after the class period here has closed, California law was changed to require employers to provide such notice on the wage statement or another notice. Even under this new law, however, section 226 penalties are not available for violations of this rule. (See Labor Code § 246, subd. (h) ["The penalties described in this article for a violation of this subdivision shall be in lieu of the penalties for a violation of Section 226."].)

DATED: April 6, 2016

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

Pursuant to rule 8.204(c) of the California Rules of Court, I hereby certify that this brief contains 13,934 words, including footnotes. In making this certification, I have relied on the word count of the computer program used to prepare the brief.

DATED: April 6, 2016 *<u>/s/ Malcolm A. Heinicke</u>*