No. 18-55626

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

JACQUELINE F. IBARRA, an individual, on behalf of herself and all others similarly situated,

Plaintiff-Appellee,

v.

WELLS FARGO BANK, N.A.,

Defendant-Appellant.

On Appeal from the
United States District Court for the Central District of California
Case No. 2:17-cv-04344-PA-AS
The Honorable Percy Anderson

APPELLANT WELLS FARGO BANK, N.A.'S REPLY BRIEF

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

Cases

Statutes

Rules

Regulations

Other Authorities

INTRODUCTION

The district court awarded nearly $100 million to Plaintiffs after concluding that Wells Fargo violated California Labor Code section 226.7—a statute that prohibits employers from "fail[ing] to provide" employees with required breaks. Wells Fargo provided its highly compensated Home Mortgage Consultants ("HMCs") with duty-free rest breaks, and that undisputed fact should have resulted in judgment for Wells Fargo. Instead, Plaintiffs were able to prevail based on their theory that Wells Fargo violated section 226.7 because it supposedly failed to properly *pay* employees for time spent working during rest breaks. But section 226.7 only creates a cause of "action . . . for non-provision of meal or rest breaks," "*not* an action brought for nonpayment of wages." *Kirby v. Immoos Fire Protection, Inc.*, 53 Cal. 4th 1244, 1257 (2012) (emphasis added). Because Plaintiffs' theory of liability is not cognizable under section 226.7, the judgment cannot stand.

Plaintiffs attempt to cure this by arguing that this Court should affirm based on *different statutes*, which were neither briefed by the parties nor the basis for the district court's decision. They dismiss Wells Fargo's focus on section 226.7 as a mere "technical argument," and assert that Wells Fargo has suffered no "prejudice" from the judgment's reliance on that statute rather than the alternatives Plaintiffs now advance. Answering Br. at 9. But the judgment's reliance on section 226.7 resulted in a nearly *six-fold* increase in the amount of damages due to that statute's

unique remedy of "one additional hour of pay" for each violation. This is hardly a "hyper-technical argument," *id.* at 13, that can be remedied by substituting in other statutes for the first time on appeal. Plaintiffs staked their case on the wrong statute in order to obtain an outsized judgment, and that strategic choice compels reversal.

Even if Plaintiffs' claim for nonpayment of wages could be asserted under section 226.7 (it cannot), the judgment still cannot stand because the undisputed facts show that Wells Fargo paid its HMCs for every hour they worked and made no deductions from that pay after it was earned. Indeed, an HMC's hourly pay is "fully vested when received and . . . not subject to recapture by [Wells Fargo] under any circumstances." 3ER196. While Wells Fargo provided *additional* compensation to HMCs through a commissions-based formulation, that was a separate and distinct form of compensation that in no way recaptured the fully vested compensation that HMCs received for all hours worked, including all time spent taking rest breaks.

Plaintiffs' reliance on *Vaquero v. Stoneledge Furniture LLC*, 9 Cal. App. 5th 98 (2017), is misplaced because the employer in that case, unlike Wells Fargo here, did not provide employees with fully vested compensation for all hours worked, or even any hourly compensation, but instead provided "interest-free loans" that operated as a "draw" against future commissions. *Id.* at 115. By contrast, Wells Fargo's HMC pay plans provided for hourly pay that was fully vested when received

and that is never subject to recapture. There is no merit to Plaintiffs' assertion that Wells Fargo's compensation plans and the plan in *Vaquero* are "materially indistinguishable." Answering Br. at 19.

The district court's error in finding Wells Fargo liable under section 226.7 was compounded by its miscalculation of damages. Section 226.7(c) instructs a court to award an employee who is not "provided" a rest break "one additional hour of pay at the employee's regular rate of compensation for each workday" that the rest break is not provided. Yet the district court included not only the HMCs' base hourly rate of compensation, but also the incentive pay that HMCs received. That inflated the classwide damages by more than $72 million. While Plaintiffs attempt to defend this method of calculation, they have no answer for the fact that it has been rejected by five separate district judges, and is inconsistent with the statute's text and legislative history. And Plaintiffs' only defense of the district court's award of damages to 961 HMCs who never earned any commissions is an attempt to rewrite the stipulated facts that Plaintiffs agreed to in the district court.

Wells Fargo provided its employees with duty-free rest breaks that were fully compensated. The district court's contrary conclusion does nothing to advance the California Labor Code's goal of protecting workers. Instead, it provides inflated

windfalls to uninjured workers, most of whom earned substantial compensation. Accordingly, the Court should reverse and order entry of judgment for Wells Fargo.

ARGUMENT

I. California Labor Code Section 226.7 Was the Only Basis for the District Court's Judgment, and Its Unique Remedy Vastly Inflated the Damages Plaintiffs Were Awarded

The district court's judgment rested solely on California Labor Code section 226.7, which only authorizes relief where an employer "fails to provide" a required break. Because Wells Fargo indisputably provided the class members with rest breaks, there was no basis for finding Wells Fargo liable for violating section 226.7.

Unable to defend the application of section 226.7 to their compensation-based theory of liability, Plaintiffs urge this Court to affirm the judgment based on *different* statutes, erroneously contending that Wells Fargo will suffer no "prejudice" as a result of such a post-hoc substitution. Answering Br. at 9. But the other statutes that Plaintiffs now propose to substitute for section 226.7 do not authorize the substantial damages Plaintiffs were awarded.

In the district court, the parties agreed to narrow the issues by stipulating to class certification under Federal Rule of Civil Procedure 23(b)(3) of Plaintiffs' rest break claim under section 226.7 and their derivative Unfair Competition Law claim under Business and Professions Code section 17200. 3ER320; Opening Br. at 13.

As a result of that stipulation, the district court *expressly* "dismissed all claims except a claim for rest-period violations under California Labor Code section 226.7 and a derivative claim under California's Unfair Competition Law," including a minimum wage claim for alleged off-the-clock work. 1ER4; 3ER339 [Compl. ¶ 49]. For that reason, Plaintiffs cannot, and do not, dispute that the district court's judgment rested exclusively on a purported violation of section 226.7. Plaintiffs' strategic decision to limit their case to violations of section 226.7 forfeited any argument that the judgment can be premised upon violations of different statutes.

Given that it formed the sole basis for the district court's judgment, Wells Fargo explained in its opening brief why Plaintiffs' theory of liability was not cognizable under section 226.7. *See* Opening Br. at 23–28. Plaintiffs suggest that this is much ado about nothing, and dismiss Wells Fargo's focus on section 226.7 as merely a "technical argument that [they] sued under the wrong statute" that has not resulted in "any prejudice" to Wells Fargo. Answering Br. at 9. But section 226.7 resulted in the imposition of substantial damages that are unavailable under other statutes. For example, under California Labor Code section 1194, an employee who was not paid any wage for a ten-minute rest break would be "entitled to recover . . . the unpaid balance of the full amount of th[e] minimum wage" for those ten minutes, or $2.00. Cal. Lab. Code § 1194(a); *see* Cal. Lab. Code § 1182.12(b)(1)(C)

(minimum wage for 2019 is $12 per hour for large employers). By contrast, if an employer "fails to provide an employee" with a ten-minute rest break, section 226.7 authorizes the recovery of "one additional hour of pay," or $12.00 for someone paid the minimum wage. Cal. Lab. Code § 226.7(c). This six-fold multiplication of damages shows why this is no mere technical error.

Plaintiffs' request for this Court to "conform the pleadings" and sustain the judgment based on statutes that were never adjudicated below is also procedurally improper. Answering Br. at 18–19. Rule 15(b)(2) of the Federal Rules of Civil Procedure provides that "when an issue not raised by the pleadings is tried by the parties' express or implied consent, it must be treated in all respects as if raised in the pleadings." Fed. R. Civ. P. 15(b)(2). Conforming the pleadings under Rule 15(b)(2) would only be appropriate if, for example, "the case was tried on the theory that [an] . . . [a]greement was applicable" despite the plaintiff's "failure . . . to formally plead the existence of the [a]greement." *Dunn v. Trans World Airlines, Inc.*, 589 F.2d 408, 413 (9th Cir. 1978). Here, by contrast, Plaintiffs gave their "express consent" to *narrow* the issues presented to the district court to claims based on a violation of section 226.7.

That Wells Fargo believed that Plaintiffs' theory of liability was not cognizable under section 226.7 should come as no surprise to Plaintiffs. When

opposing Plaintiffs' motion for classwide summary judgment, Wells Fargo raised that exact argument. Further Excerpts of Record ("FER") 5–10. In their reply, Plaintiffs disputed Wells Fargo's interpretation of section 226.7, claiming that it could be violated for failures to compensate for rest breaks. FER1–4. But Plaintiffs did not ask the district court to "conform" the pleadings to the proof by reviving the already-dismissed minimum-wage and overtime claims. Plaintiffs have thus waived any argument that this Court should engage in such adjudication for the first time on appeal. *E.g.*, *Whittaker Corp. v. Execuair Corp.*, 953 F.2d 510, 515 (9th Cir. 1992).

Plaintiffs' attempt to rescue the judgment below by directing the Court to other statutes ignores the out-sized relief afforded by section 226.7 and the parties' stipulation. Their attempt to run from the only statute supporting the judgment is further proof that their section 226.7 claim fails as a matter of law.

II. Wells Fargo Did Not Violate California Labor Code Section 226.7

Wells Fargo indisputably provided class members with rest breaks during which they were not "require[d] to work." Cal. Lab. Code § 226.7(a). Plaintiffs claim that they were not *paid* for taking rest breaks, but section 226.7 only is violated where an employer has failed to *provide* rest breaks. In any event, Wells Fargo paid HMCs fully-vested wages for all time worked, including rest breaks, unlike the

employees in *Vaquero*, who received "interest-free loans" rather than hourly wages. *Vaquero*, 9 Cal. App. 5th at 115. Wells Fargo therefore did not violate section 226.7.

A. Section 226.7 Does Not Create a Remedy for Failure to *Pay* for Rest Breaks

Plaintiffs contend that section 226.7 can be violated for failures to compensate employees for time spent on rest breaks. They are wrong.

The plain language of section 226.7 imposes a remedy for failure to satisfy one, specific obligation—the failure to "provide" a rest break. Opening Br. at 23–28. An employer violates section 226.7 if it "require[s] an employee to work during" a rest break. Cal. Lab. Code § 226.7(b). If an employer does so, it has "fail[ed] to provide" the rest break, and is therefore liable for "one additional hour of pay." *Id.* § 226.7(c). While California courts have recognized that the wage orders "define the scope" of the obligation to provide rest breaks, Answering Br. at 16, that does not mean that section 226.7 is violated for failure to comply with all aspects of the wage orders. Rather, section 226.7 is focused on the provision of rest breaks under the wage order, not on matters of compensation. Section 226.7's legislative history likewise confirms that conclusion. *See* Opening Br. 25–26.

The California Supreme Court's interpretation of section 226.7 also shows that the statute is violated only for the failure to provide a rest break. *See* Opening Br. 24–25. Most significantly, in *Kirby*, the Supreme Court noted that, "[w]hen an

employee sues for a violation of section 226.7, he is suing because an employer has allegedly 'require[d] [the] employee to work during [a] meal or rest period mandated by an applicable order of the Industrial Welfare Commission.'" *Kirby*, 53 Cal. 4th at 1255 (citing Cal. Lab. Code § 226.7). Therefore, "[n]onpayment of wages is not the gravamen of a section 226.7 violation. Instead, subdivision (a) of section 226.7 defines a legal violation *solely* by reference to an employer's obligation to provide meal and rest breaks." *Id.* at 1256 (emphasis added).

While *Kirby* also acknowledged that the rest breaks referred to in section 226.7 are "IWC-mandated," Answering Br. at 17, that does not change the nature of what section 226.7 prohibits—that is, it "prohibits employers from requiring employees to work during an IWC-mandated rest or meal period." *Kirby*, 53 Cal. 4th at 1251–52. And Plaintiffs ignore the context of *Kirby*'s reference to the IWC's mandate, which makes clear that "Section 226.7, subdivision (a) prohibits employers from requiring employees to work during an IWC-mandated rest or meal period." *Id.* Only if there is a violation of that subdivision does "subdivision (b) provid[e] the remedy" in the form of an additional hour of pay. *Id.* at 1252.

Most district courts have also agreed with Wells Fargo's interpretation of section 226.7. *See Munoz v. Giumarra Vineyards Corp.*, No. 09-cv-0703, 2013 WL 2421599, at *2 (E.D. Cal. June 3, 2013); *Torres v. Wells Fargo Bank, N.A.*, No. 15-

cv-2225, 2017 WL 1380505, at *3 (C.D. Cal. Mar. 21, 2017); *Cole v. CRST, Inc.*, 317 F.R.D. 141, 146 (C.D. Cal. 2016). Plaintiffs argue that these cases are distinguishable because they involved different factual circumstances. Answering Br. at 16–17 & n.3. But the *legal* reasoning of these decisions all point in the same direction: section 226.7 is violated only where rest breaks are not provided, not when they are provided but allegedly not compensated correctly.

The sole case Plaintiffs have identified supporting their interpretation of section 226.7 cannot be reconciled with the text of the statute or *Kirby*. *Amaro v. Gerawan*, No. 1:14-cv-00147, 2016 WL 4440966 (E.D. Cal. Aug. 23, 2016), held that the "in accordance with" requirement of section 226.7 requires compliance with all rest-period related obligations. *Id.* at *3. But that interpretation both ignores that the "in accordance with" language is limited by the word "provide," and runs afoul of *Kirby*'s teaching that "[n]onpayment of wages is not the gravamen of a section 226.7 violation." 53 Cal. 4th at 1256.

Plaintiffs also rely on *Vaquero*, but the Court of Appeal there did not mention, let alone resolve, whether section 226.7 is violated where an employer has failed to pay for rest breaks. Opening Br. at 27. There is no indication in the *Vaquero* opinion that the employer ever raised the issue that the plaintiffs' theory was cognizable only as a minimum wage claim. As such, *Vaquero* is of no help to Plaintiffs, as "cases

are not authority for propositions not considered therein." *Roberts v. City of Palmdale*, 5 Cal. 4th 363, 372 (1993).

Because the plain language of section 226.7, reinforced by the interpretation of the California Supreme Court, forecloses Plaintiffs' theory of liability, judgment should be entered for Wells Fargo.

B. Wells Fargo Paid Class Members for All Time Spent Taking Rest Breaks

Separate and apart from the inapplicability of section 226.7 to the stipulated facts of this case, the judgment should also be reversed because Wells Fargo did, in fact, provide paid rest periods in accordance with Wage Order 4. *See* 8 Cal. Code Regs. § 11040(12) ("Authorized rest period time shall be counted as hours worked for which there shall be no deduction from wages."). HMCs did not clock out during rest breaks, so rest break time was counted as hours worked, and Wells Fargo paid HMCs for all time worked without deductions for rest time.[1]

[1] Plaintiffs suggest that California law requires Wells Fargo to "include a separate line item for rest break pay in its commission reports or in the wage statements it provide[s]." Answering Br. at 24. There is no such requirement. Rather, the only obligation is for an employer to "count[]" time spent on rest breaks "as hours worked from which there shall be no deduction from wages." 8 Cal. Code Regs. § 11040 (12)(A). That is what Wells Fargo did here.

Wells Fargo's compensation plans do exactly what even Plaintiffs concede is permissible under California law—they "pay their commissioned sales employees a base hourly rate for all hours worked (including rest breaks and any other non-income-generating work time) and then add[s] a commission-based pay structure on top of that." Answering Br. at 10. Indeed, the hourly wages Wells Fargo paid to HMCs were "fully vested when received and . . . not subject to recapture by [Wells Fargo] under any circumstances." 3ER196. Plaintiffs say that calling wages fully vested does not make it so, and in their view, Wells Fargo's plans provide that the wages may be "recouped" from "earned" commissions. Answering Br. at 22–23. The plans say no such thing.

When and how wages are earned is a matter of contract, *see Koehl v. Verio, Inc*, 142 Cal. App. 4th 1313, 1330 (2006), and the compensation plans at issue here were the contracts governing HMCs' compensation. Those plans expressly provide that "commission" or "Incentive Pay" is "not earned with the funding of each loan that generates commission credit," but only after the "completion of the calculation and verification period" and "after all the conditions set forth in the [pay] Plan are met." 3ER275. Given that the parties' contracts expressly state that commissions are not "earned" until the completion of the commission calculation under a defined formula, there is no basis for the Court to hold instead that that the HMCs actually

"earned" the monthly commission credit and then had their wages "deducted" from it after it was earned. To the contrary, the plans state that hourly pay is "fully vested" (i.e. earned) when received and "not subject to recapture." This reality was also reflected on the wage statements, which show hourly wage payments every pay period and no deduction or reversal of those hourly wage payments. *E.g.*, 3ER300.

Plaintiffs cite no authority for the proposition that a court may disregard the parties' contractual agreement as to how wages are earned. Instead, they focus on "commission reports," which are merely monthly summaries of commission-related data that HMCs received after the end of each month. 3ER197, 291–98. Those reports, Plaintiffs note, refer to HMCs' hourly pay as an "advance" and use "net due" to describe the ultimate amount of earned commission. Answering Br. at 23–24. According to Plaintiffs, this shows that the hourly wages were "deducted" from earned commissions. *Id.* But the use of the phrase "net due" actually shows that commissions were not earned until *after* the calculation was finalized. In other words, the commission report simply illustrates how earned commissions were calculated; it does not show deductions of HMCs' fully vested hourly pay from their earned commissions.

There is no support in the record for Plaintiffs' assertion that Wells Fargo "deducted" hourly pay from earned commissions. In fact, the word "deduction" is

not used in any of Wells Fargo's compensation plans for HMCs. "Deductions" has a particular meaning under California law because "various provisions of the Labor Code, and regulations issued thereunder, . . . prohibit[] deductions from an employee's stated wage to cover certain of the employer's business costs." *Prachasaisoradej v. Ralphs Grocery Co.*, 42 Cal. 4th 217, 222 (2007). Like the employer in *Ralphs Grocery*, Wells Fargo did not "create an expectation of or entitlement to" any particular incentive compensation, and "then take deductions or contributions from that wage." *Id.* at 223. Rather, the "entitlement to incentive compensation payments, and the amounts thereof, arose only under a formula" that incorporated various factors, including the hourly wages paid to HMCs. *Id.* Under California law, an employer's use of such a formula does not constitute a deduction from earned compensation, as the California Supreme Court held in *Ralphs Grocery*.

Plaintiffs are also wrong that the use of the term "advance" necessarily means that the hourly pay was a "draw" from future commissions. Answering Br. at 23. A "draw against commissions" is a payment of a sum representing "commissions to be earned at a future date." DLSE Enforcement Manual § 34.2 (2002). By contrast here, as the compensation plans make clear, these payments reflected compensation for all hourly wages and were fully vested when received. 3ER196. In fact, the offer letters Wells Fargo used to establish HMCs' employment terms during the class

period provided that "[a]dvances *are fully earned based on hours worked* and any other paid time," and that they were "referred to as advances because they are taken into account when *determining* the amount of your earned commissions"—not because they were a *deduction* from earned commissions. 3ER207 (emphasis added); *see also* 3ER194. While, in other contexts, the word "advance" might be a synonym for a "draw" by representing earnings that are contingent and would later be deducted from earned commissions, the record here shows that HMCs' hourly pay was fully vested and not subject to recapture in the future. Opening Br. 10–11.

C. *Vaquero* Is Readily Distinguishable Because It Involves "Interest-Free Loans" Rather than Fully Vested Hourly Pay

Plaintiffs primarily rest their defense of the judgment on a strained analogy to *Vaquero* that ignores the central rationale of that decision. Unlike the employer in *Vaquero*, Wells Fargo did not make deductions against *earned* compensation. *See Vaquero*, 9 Cal. App. 5th at 117. Under the *Vaquero* plan, the only mechanism for earning pay was through a commission that was set as a percentage of certain sales, so employees were effectively paid on straight commission. *Vaquero*, 9 Cal. App. 5th at 103, 114–15. The *Vaquero* employees never received a paycheck that paid them for hours worked at an hourly rate. Instead, the *Vaquero* plan merely contained a mechanism to *loan* employees money that they had not yet earned. As the Court of Appeal explained, these "interest free loans" were thus "not

compensation at all" for any time worked, including rest breaks. *Vaquero*, 9 Cal. App. 5th at 115.

By contrast, the Wells Fargo compensation plans at issue here provided hourly wages for all time spent on rest breaks that were "fully vested when received and . . . not subject to recapture by [Wells Fargo] under any circumstances." 3ER196. Although hourly pay "is taken into account in calculating net commissions/incentives," Wells Fargo did not have "the right to recover any hourly pay back from any employee." *Id.* Fully vested compensation, not subject to recapture, is the opposite of "interest-free loans." In fact, the compensation plans state that if an HMC terminates employment following a month in which net commissions were negative, Wells Fargo has no right to require the HMC to repay the deficit. 3ER275.

Plaintiffs are also wrong that the *Vaquero* plan and Wells Fargo's plans were both "designed so the hourly rate floor would not have any actual effect on the income of any competently performing commissioned sales employee." Answering Br. at 10. To the contrary, 20% of class members *only* received hourly compensation. Opening Br. at 44 (citing 1ER13). Nor is there any record support for the suggestion that Wells Fargo expected that incentive pay would be "dwarfed" by commissions, as Plaintiffs contend. Answering Br. at 4. Certainly, highly

productive employees have much larger commissions, and, like most employers, Wells Fargo preferred for employees to be productive, but there is no evidence that there was any set expectation as to the relative size of hourly wages and incentive pay.

Because Wells Fargo's compensation plans are materially distinct from the plan in *Vaquero*, this Court should reject Plaintiffs' reliance on that decision.

D. *Vaquero* Was Wrongly Decided and Should Not Be Followed.

Even if it were on point, the Court should decline to follow *Vaquero*, as it represents a mistaken interpretation of California law.

The Court of Appeal in *Vaquero* held that commissioned employees must receive "separate compensation for rest periods." 9 Cal. App. 5th at 102. But no statute imposes such a requirement, and Wage Order 4 merely requires that there "be no deduction from wages" for rest breaks. 8 Cal. Code Regs. § 11040(12)(A). Rather than ground this supposed requirement in the California Labor Code or Wage Order 4, *Vaquero* relied on another Court of Appeal decision, *Bluford v. Safeway Stores*, 216 Cal. App. 4th 864 (2013), which involved employees paid a piece-rate, not a commission. *Vaquero*, 9 Cal. App. 5th at 108. Significantly, *Bluford* turned on the fact that the employer there had adopted an "activity-based compensation system" but none of the various "fixed rates were applied to rest periods." 216 Cal.

App. 4th at 872. By contrast, under the compensation system at issue here, there was a "fixed rate" of approximately $12 per hour which applied to all hours worked, including time spent taking rest breaks. Opening Br. at 34.

Plaintiffs ask this Court to ignore the California Legislature's decision to codify *Bluford*'s "separate compensation" requirement only for employees paid a piece-rate, without codifying a similar requirement for employees paid on commission. Answering Br. at 30. Of course it is true, as Plaintiffs note, that legislatures may implement reforms "one step at a time." *Id.* But the California Legislature's decision to codify *Bluford*'s "separate compensation" requirement only for piece-rate workers shows that it understood *Bluford* as tethered to the unique circumstances of piece-rate compensation systems. By contrast, *Vaquero* viewed *Bluford* as establishing a generally applicable "separate compensation" requirement that applied equally to commission systems.

Plaintiffs also try to defend *Vaquero* by suggesting that it was part of a line of cases holding that commissioned employees must be provided with compensation for all hours worked. Answering Br. at 31. But the two federal district court decisions they cite did not address compensation for rest breaks; instead, they involved only claims based on an alleged failure to pay the minimum wage. *See Balasanyan v. Nordstrom, Inc.*, 913 F. Supp. 2d 1001, 1008 (S.D. Cal. 2012);

Tokoshima v. Pep Boys Manny Moe & Jack of Cal., No. 12-cv-4810, 2014 WL 1677979, at *6 (N.D. Cal. Apr. 28, 2014).

Finally, Plaintiffs ask this Court to infer that the California Supreme Court fully embraced *Vaquero* when it declined to review the Court of Appeal's decision. But the California Supreme Court's denial of review is "not to be regarded as expressing approval of the propositions of law set forth" in the *Vaquero* opinion. *DiGenova v. State Bd. of Educ.*, 57 Cal. 2d 167, 178 (1962). And because *Vaquero* is inconsistent with prior California Supreme Court precedent and legislative history, there is "convincing evidence that the California Supreme Court would" reject the *Vaquero* decision, and this Court should do the same. *Carvalho v. Equifax Info. Servs., LLC.*, 629 F.3d 876, 889 (9th Cir. 2010).

III. The District Court's Calculation of Damages Conflicts With the Plain Language of California Labor Code Section 226.7, the Weight of Authority, and Sound Public Policy

Because Wells Fargo indisputably provided duty-free rest breaks to all of the HMCs within the class, it fully complied with California Labor Code section 226.7, and the Court should direct entry of judgment for Wells Fargo. But even if the Court were to hold that Wells Fargo violated section 226.7, it should order a substantial reduction of the nearly $100 million judgment because the district court also erred in calculating damages under section 226.7.

If an employer has violated section 226.7, it is required to "pay the employee *one additional hour of pay* at the employee's *regular rate of compensation* for each workday that the meal or rest or recovery period is not provided." Cal Lab. Code § 226.7(c) (emphasis added). As Wells Fargo has explained, the statutory language tethers the phrase "regular rate of compensation" to the phrase "one additional *hour* of pay," thereby creating an "hour[ly]" remedy for the failure to provide a rest break. Opening Br. at 37. And because the statute explicitly references hourly compensation, there is no basis to conclude that other unenumerated forms of compensation—such as commission-based pay—should be included in calculating an employee's premium pay. Given the statute's "clear and unambiguous" language, the Court need go no further than the statutory text. *E.g.*, *Lungren v. Deukmejian*, 45 Cal. 3d 727, 735 (1988).

Plaintiffs resist this straightforward reading of the statute, and ignore that section 226.7 creates an "hourl[y]" remedy by defining the regular rate of compensation as "one additional hour of pay." Indeed, they do not spend *any* of their twenty-six pages addressing the calculation of damages seriously contending with the text of section 226.7. Plaintiffs' various attempts to justify a departure from the statutory text and the weight of authority all fail to persuade.

Plaintiffs argue that the phrase "regular rate" is a "term of art" under federal and state *overtime* law that is understood to include all components of an employee's compensation," not just the hourly rate. Answering Br. at 37–40, 44–46. Because federal and state overtime laws use similar language as the meal- and rest-break laws, Plaintiffs reason that the Court should interpret the phrase "regular rate of compensation" in section 226.7(c) to include all forms of an employee's compensation. *Id.* at 37–40. But Plaintiffs' argument elides the critical, operative phrase in section 226.7—"one additional hour of pay," which provides the statutorily-defined measure of the employee's "regular rate of compensation."

Plaintiffs' argument reads "one additional hour of pay" out of the statute and renders it superfluous, contrary to the traditional rules of statutory construction. *Imperial Merchant Servs., Inc. v. Hunt*, 47 Cal. 4th 381, 390 (2009). Moreover, Plaintiffs' efforts to direct this Court to other statutes to interpret section 226.7(c), Answering Br. at 38, 44–46, is a red herring because the text of the statute at issue itself explains that "regular rate of compensation" means "one additional hour of pay." There is no need for the Court to rummage around in other sections of the California Labor Code in search of an analogous provision when section 226.7(c) provides the answer.

Plaintiffs also urge the Court to ignore the plain language of section 226.7(c) because the legislative history of section 226.7(c) and the administrative record of the Wage Orders supposedly demonstrate that the phrase "regular rate of compensation" was intended to have the same meaning as the phrase "regular rate of pay" (which is used in the minimum wage provisions of the California Labor Code). Answering Br. at 40–43. Plaintiffs contend that the Legislature used the phrase "regular rate of compensation" in section 226.7(c) merely to track the language used by the IWC in the Wage Orders, and that the meaning of "regular rate of compensation" can therefore only be derived by considering intent of the IWC. Although they recognize that the Wage Orders, like section 226.7, use the phrase "regular rate of compensation," Plaintiffs argue that the IWC really intended for the phrase "regular rate of compensation" to take on the meaning that "regular rate of pay" is given under the minimum wage laws. As evidence for this proposition, Plaintiffs contrast the text of the Wage Order itself, which uses the phrase "regular rate of compensation," with a passage in the IWC's "Statement as to the Basis," which uses the phrase "regular rate of pay." Answering Br. at 43.

This argument makes little sense. Although the "Statement as to the Basis" sets forth the IWC's "explanation of how and why the [IWC] did what it did," *Small v. Superior Court*, 148 Cal. App. 4th 222, 232 (2007), nothing in that document

states that the IWC intended the phrase "regular rate of compensation" in the Wage Orders to take on the same meaning as the phrase "regular rate of pay." Indeed, the most Plaintiffs can say is that the phrase "regular rate of pay" was used a handful of times throughout the seventy-six page "Statement as to the Basis." That is hardly evidence that the term "regular rate of compensation" in section 226.7 and the Wage Orders should take on the same meaning as "regular rate of pay."

More fundamentally, nothing in the legislative history of section 226.7 itself suggests a different interpretation of "regular rate of compensation" than that dictated by the statute's text. To the contrary, the critical language referencing an "hour[ly]" remedy appears throughout the legislative history, and all other indications in the legislative history support Wells Fargo's interpretation of the statutory text. *See, e.g.*, Dkt. 18, Ex. D at 9.

Even though five judges have rejected Plaintiffs' reading of section 226.7(c), Plaintiffs urge this Court to follow a single district court decision that adopted their interpretation. Answering Br. at 46–49. As for the five decisions going the other direction, Plaintiffs claim they are "not persuasive" because those courts found it significant that the statute uses the phrase "regular rate of compensation" rather than the "regular rate of pay." Answering Br. at 47–49. But the fact that these courts examined the text of section 226.7(c) is exactly what makes them persuasive. For

example, in *Frausto v. Bank of Am. Nat'l Ass'n*, No. 18-cv-01983, 2018 WL 3659251 (N.D. Cal. Aug. 2, 2018), the court examined the text of section 226.7(c) and relevant authorities and concluded that "no California law" requires the inclusion of "all bonuses earned" on top of the employee's "straight time rate" when calculating meal-and-rest-break penalties under section 226.7. *Id.* at *5. Following this conclusion, the court rejected, due to the difference in statutory language, the plaintiff's argument that "regular rate of compensation" in section 226.7 should be given the same meaning as the phrase "regular rate of pay" in section 510. *Id.*

Wert v. U.S. Bancorp, No. 13-cv-3130, 2014 WL 7330891 (S.D. Cal. Dec. 18, 2014), followed a similar analytical pattern, first homing in on the "plain language of §§ 226.7 and 510," which did "not suggest that the phrase 'regular rate of compensation' is synonymous to and may be used interchangeably with 'regular rate of pay.'" *Id.* at *4. Only after considering the plain language of those statutes did the Court conclude that the California Legislature's choice of different language was "meaningful" since "[t]he legislature had the opportunity to define awards under §§ 226.7 and 510 in the same manner, but it chose not to." *Id.* at *5. *Brum v. MarketSource, Inc.*, No. 2:17-cv-241, 2017 WL 2633414, at *4–*5 (E.D. Cal. June 19, 2017), *Van v. Language Line Services, Inc.*, No. 14-cv-03791, 2016 WL 3143951 (N.D. Cal. June 6, 2016), and *Bradescu v. Hillstone Restaurant Group*,

Inc., No. 13-cv-1289, 2014 WL 5312546, at *8 (C.D. Cal. Sept. 18, 2014), are all in accord.

Plaintiffs' lone case, *Studley v. Alliance Health Care Servs., Inc.*, No. 10-cv-00067, 2012 WL 12286522 (C.D. Cal. July 26, 2012), has been expressly rejected by two courts, which "decline[d] to follow it" because its "reasoning [was not] persuasive." *Wert v. U.S. Bancorp*, 2015 WL 3617165, at *3 n.3 (S.D. Cal. June 9, 2015); *see also Brum*, 2017 WL 2633414, at *4–*5. This Court should do the same. The court in *Studley*, like Plaintiffs here, failed to grapple with the operative "one additional hour of pay" language in section 226.7(c) and, consequently, effectively read that language out of the statute. Further, the assertion in *Studley* that there is no "authority indicating that the phrase 'regular rate' ought to be used differently in section 226.7 than in section 510," *Studley*, 2012 WL 12286522, at *4, rings hollow in light of the steady stream of decisions, post-*Studley*, that have rejected its analysis and conclusion.

Plaintiffs also ask this Court to ignore the troubling consequences of the district court's interpretation of section 226.7(c). These include arbitrarily assigning a higher value to the rest breaks of employees who earn more in incentive compensation, penalizing employers who choose to provide incentive compensation, and creating administrative problems for employers whose mixed

compensation plans pay employees at different intervals. Opening Br. at 39–41; Cal. Emp't Law Counsel & Emp'rs Grp. Amicus Br. at 24–28; Cal. Mortg. Bankers Ass'n Amicus Br. at 6–9.

Plaintiffs attempt to justify that result by arguing that Wells Fargo should pay higher rest-break premiums to HMCs who generate more in commissions because "that is how regular-rate calculations work in the overtime context," and they assert that it would not be administratively burdensome to include all forms of compensation under section 226.7 because that already happens with respect to overtime pay. Answering Br. at 49–51. Neither argument has merit. Plaintiffs' analogy to overtime pay is inapt, since California's wage laws and meal-and-rest-break laws serve different purposes. Unlike wage laws, "[s]ection 226.7 is not aimed at protecting or providing employees' wages," but "is primarily concerned with ensuring the health and welfare of employees by requiring that employers provide meal and rest periods as mandated by the IWC." *Kirby*, 53 Cal.4th at 1255. Thus, unlike California's overtime laws—which are designed to ensure employees are properly compensated for their time—there is no reason that the value of an employee's meal or rest break would be tied to the amount of commissions he or she generates. Answering Br. at 51. This is especially true here, where section 226.7(c)

itself assigned a consistent value to an employee's break (namely, "one additional hour of pay").

As for logistical difficulties, Plaintiffs overlook that when section 226.7 is violated, an employer must "immediately" pay the amounts due under the statute. *Murphy v. Kenneth Cole Prods., Inc.*, 40 Cal. 4th 1094, 1108 (2007). By contrast, overtime pay is due each pay period, which permits an employer to determine the amount of incentive compensation earned in the relevant pay period and use the figure in determining overtime pay. Given that critical distinction, there is no foundation to Plaintiffs' suggestion that an employer can simply use the methods it employs in determining overtime compensation in order to comply with section 226.7.

Plaintiffs also argue that, even if the Court were to conclude that the "regular rate of compensation" under section 226.7 only includes the base hourly rate, the HMCs' "regular rate of compensation" in this case is not the base rate of $12 per hour because "those payments are just an advance on commissions" that are "subject to deduction from the employee's future commissions." Answering Br. at 51–54. But that is factually incorrect, since an HMC's hourly pay is "fully vested when received and is not subject to recapture by [Wells Fargo] under any circumstances." 3ER196. An HMC's commission-based pay is, in other words, a separate and

additional source of income, and Plaintiffs should not be permitted to conflate these two distinct forms of pay in order to inflate the damages award.

IV. The Award of Damages to 961 Uninjured Class Members Violates Article III, Due Process, Rule 23, and the Rules Enabling Act

The district court's decision to award damages to 961 class members who never earned any commissions—and are thus uninjured because they could not have "reimburse[d]" Wells Fargo "at least some portion of the hourly pay, which included rest-break payments, through later-earned incentives," 1ER13—violates Article III, due process, Rule 23, and the Rules Enabling Act. Opening Br. at 44–47. Plaintiffs do not take issue with these legal authorities, but instead contend that Wells Fargo's argument "lack[s] evidentiary foundation" because Plaintiffs now disagree with a fact to which they stipulated: "Wells Fargo's expert has identified 961 of the 4,481 class members . . . [whose] only compensation . . . was hourly pay." 3ER179. Specifically, Plaintiffs assert that: (1) they did not agree to this fact, and (2) "[n]o expert report or underlying payroll data was submitted to support Wells Fargo's contentions." Answering Br. at 55–57.

Plaintiffs' efforts to rewrite—after entry of judgment—the stipulation to which they assented to below should be rejected. The only evidence in the record is that 961 class members never received any commissions, and thus, even under Plaintiffs' theory, they were paid for rest breaks and have no claim at all. Although

Plaintiffs try to manufacture an inconsistency between the stipulation and the Notice of Breakdown of Judgment, their argument misreads the stipulation. Answering Br. at 55. Plaintiffs read the stipulation as stating that "961 HMCs never received more in commissions than in advances" and then note that the Notice of Breakdown of Judgment shows that only *404* HMCs received more in commissions than in advances. Answering Br. at 55. But the stipulation states that 961 class members "never earned any commissions or other non-discretionary pay" *at all*, 3ER179—not that the 961 HMCs "never received *more in commissions* than advances."

While Plaintiffs purported to disagree as to the *legal effect* of this stipulated fact—namely, that "no damages should be awarded to class members who never earned any commissions or other non-discretionary pay beyond that hourly rate," 3ER179—nowhere did they purport to disagree with the underlying *fact* that 961 of 4,481 class members did not receive any commissions; nor did they endeavor to present contrary evidence. This stipulation is binding. *See Christian Legal Soc'y Chapter of the Univ. of Cal., Hastings Coll. of the Law v. Martinez*, 561 U.S. 661, 676–78 (2010) (holding that "factual stipulations are formal concessions . . . that have the effect of withdrawing a fact from issue and dispensing wholly with the need for proof of the fact" (quotation marks and citation omitted)).

CONCLUSION

The Court should reverse the judgment and order that judgment be entered in Wells Fargo's favor. Alternatively, the Court should vacate the damages award and order the district court to enter a judgment reflecting the proper damages calculation.

Dated: February 4, 2019

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CERTIFICATE OF COMPLIANCE

I certify pursuant to Federal Rules of Appellate Procedure 32(a)(7)(C) that the attached brief is proportionately spaced, has a typeface of 14 points, and contains 6,873 words.

Dated: February 4, 2019

s/ Theodore J. Boutrous, Jr.
Theodore J. Boutrous, Jr.

CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system on February 4, 2019.

I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

Dated: February 4, 2019

s/ Theodore J. Boutrous, Jr.
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