Case Nos. 14-56421 / 14-56514

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

DANNY FLORES et al.,
Plaintiffs-Appellees/Cross-Appellants,

v.

CITY OF SAN GABRIEL,
Defendant-Appellant/Cross-Appellee.

Appeal from the U.S. District Court for the Central District of California
Case No. 2:12-cv-04884-JGB-JCG
Hon. Jesus G. Bernal Presiding

AMICUS CURIAE BRIEF IN SUPPORT OF PETITION FOR REHEARING

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I. IDENTITY AND INTEREST OF *AMICI CURIAE*

The League of California Cities (the League) is an association of 474 California cities, dedicated to protecting and restoring local control to provide for the public health, safety, and welfare of their residents, and to enhance the quality of life for all Californians. The League is advised by its Legal Advocacy Committee, comprised of 24 city attorneys from all regions of the State. The Committee monitors litigation of concern to municipalities, and identifies those cases that have statewide or nationwide significance. The Committee has identified this case as having such significance.

The California State Association of Counties (CSAC) is a non-profit corporation. Its membership consists of the 58 California counties. CSAC sponsors a Litigation Coordination Program, which is administered by the County Counsels' Association of California, and is overseen by the Association's Litigation Overview Committee, comprised of county counsels throughout the state. The Litigation Overview Committee monitors litigation of concern to counties statewide and has determined that this is a matter with the potential to affect all California counties.

The International Municipal Lawyers Association (IMLA) is a non-profit, nonpartisan professional organization comprised of local government entities, including cities, counties, and subdivisions thereof, as represented by their chief legal officers, state leagues, and individual attorneys. Established in 1935 and consisting of more than 2,500 members, IMLA is the oldest and largest association of attorneys representing United States municipalities, counties, and special districts. IMLA's mission is to advance responsible development of municipal law through education and advocacy

by providing the collective viewpoint of local governments around the country.

II. AUTHORITY TO FILE BRIEF ON BEHALF OF *AMICI CURIAE*

All parties have consented to the filing of this brief pursuant to Federal Rules of Appellate Procedure, rule 29(a).

No party's counsel authored this brief in whole or in part. No outside person or entity contributed funding for the brief.

III. THE COURT'S RULING JEOPARDIZES THE CONTINUING VIABILITY OF A SIGNIFICANT BENEFIT CONFERRED UPON PUBLIC AGENCY EMPLOYEES

This case involves a benefit that many public agency employees have enjoyed for many years, known as a "cash in lieu" or "opt out" program. In such programs, employees who can provide proof of alternative health coverage are allowed to receive all or part of the value of health benefits in cash. Such "in lieu" arrangements recognize that the cost of health benefits is one of many elements that factor into employees' total benefit packages. These arrangements recognize that employees covered by an employer's health benefits plan are receiving a valuable benefit that employees who opt out are not receiving. In such instances, many employers – unionized and non-union alike – have concluded that as a matter of parity and fairness, an employee covered by a spouse's plan should receive financial recognition for all or part of the value of the benefit that covered employees receive.[1]

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[1] Such arrangements are particularly common in "cafeteria"-style health plans arrangements – like that of the City of San Gabriel – in which the employer pays a flat, tax sheltered amount to employees as a partial offset against the price of employees' health benefits.

The panel's decision, if allowed to stand, will not just jeopardize the continuing viability of in lieu programs. In agencies that have in lieu programs, the decision will give rise to a two-tier wage structure, whereby employees who receive cash in lieu payouts will enjoy a higher overtime rate – and therefore higher compensation – than other employees who perform the exact same work. The impact will be especially acute in public safety (police and fire operations), where overtime work is frequent, necessitated by ongoing staffing shortages. Employees who cannot opt out – such as those who support their families and use the coverage for their dependents – will have a lower overtime rate solely because they do not have an alternative coverage option for themselves or their families. This outcome is discriminatory and senseless. It is in no way mandated by federal law, as the panel mistakenly concluded; and it is surely not what Congress intended in enacting the Fair Labor Standards Act (FLSA).

The decision in this case also includes a startling and unprecedented outcome: that because the in lieu cash paid to employees through the cafeteria plan is not "incidental," the plan is not "bona fide" and therefore *the entire value of the plan costs must be included in the regular rate – regardless of whether the employee actually receives the payment(s)*. There is no controlling precedent for this outcome, and the decision cites none. The panel simply makes this conclusion based on a casual assessment that the cash is not "incidental" to the cafeteria plan. This outcome is not supportable and should alone compel *en banc* review of the decision.

California public agencies have been caught flat footed by the decision. Because these programs entail indirect cash payments flowing through insurance programs, and there has been no direct guidance from the Department of Labor (DOL) for decades, most agencies did not think twice

about extending the benefit, and most did not foresee any increase in overtime costs associated with in lieu programs.

The timing for public agencies is dreadful. At a time when public agencies are emerging from the Great Recession, with some cautiously being able to afford modest pay increases for the first time in years, the lawsuits will now place a new tax on public sector budgets, and will shrink the amount available to increase wages and benefits, and will require individualized and expensive payroll programming efforts to accommodate the new rule.

Again, as set forth herein and in the petition filed by the City of San Gabriel ("the City"), the panel mistakenly construed the requirements of the FLSA. There is nothing in the Act that can reasonably be construed to compel the unfair and unjust outcome that would result from the panel's decision.

This case is of great importance to all California public agencies, and amici respectfully urge rehearing, particularly in light of the decision's sudden, widespread and unexpected impacts.

IV. THE PANEL'S DECISION BEGINS WITH A MISTAKEN ASSUMPTION THAT THE CITY BEARS THE BURDEN OF PROOF

The "analysis" section of the decision begins with the well-settled rule that FLSA "exemptions" are to be narrowly construed, with employers bearing the burden of proving that a claimed exemption legitimately applies. (Op. at 10.) The decision then immediately follows with an analysis of whether the regular rate "exemptions" at issue should apply.

The panel misapplied the doctrine at issue. The statute and underlying DOL interpretations concerning *the regular rate* are not FLSA *exemptions*,

and none of the authorities cited in the decision involve regular rate issues. The regular rate statute itself simply describes what should, and should not, be required to be included in the regular rate. *See* 29 U.S.C. § 207(e). Exemptions are separately contained in 29 U.S.C. section 213, and to a limited degree in other portions of section 207, and are "a matter of affirmative defense[.]" *Corning Glass Works v. Brennan*, 417 U.S. 188, 197 (1974). Section 207(e) should be construed just like any other statute, without shifting the burden to the defendant to "prove" compliance. On the contrary, it its well-established that it was plaintiffs' "burden of proving that [they] performed work for which [they] were not properly compensated." *Anderson v. Mt. Clemens Pottery Co.*, 328 U.S. 680, 687 (1946); *see also* *Berndt v. City of Los Angeles*, 621 F. App'x 368, 369 (9th Cir. 2015).[2]

The panel stated that it felt the issue in this case presented a "close" question. The panel expressly indicated that it was compelled to its outcome "in light of the command that we interpret the FLSA's exemptions narrowly in favor of the employee…." (Op. at 17.) There is no such "command" in

[2] Amici recognize that some courts, including this Court in *Local 246 Utility Workers Union of Am. v. S. Cal. Edison Co.,* 83 F.3d 292, 296 (9th Cir. 1996), have assumed without analysis that it is the employer's burden to prove compliance with the regular rate requirements. However, it is telling that in *Local 246 Utility Workers*, this Court cited only to a Supreme Court decision – *Idaho Sheet Metal Works, Inc. v. Wirtz,* 383 U.S. 190, 209 (1966) – to support its conclusion that the employer bears the burden of proof. *Wirtz*, however, did not involve the regular rate, and the Supreme Court simply cited the established rule that it is the employer's burden to prove an *exemption under 29 U.S.C. section 213*. There is no Supreme Court authority holding that it is the employer's burden to prove compliance with the regular rate. And again, other courts have simply assumed this principle without any analysis. Re-hearing should be granted to resolve this issue.

this context, and this in part explains the panel's incorrect determination in this case.

V. THE PANEL'S DECISION IS CONTRARY TO NINTH CIRCUIT PRECEDENT: CONTROLLING PRECEDENT DOES NOT REQUIRE IN LIEU PAYMENTS TO BE INCLUDED IN THE REGULAR RATE

The City of San Gabriel advanced two alternative sections of the FLSA that provide for certain pay not to be included in the regular rate. The panel incorrectly analyzed and rejected Ninth Circuit precedent.

A. 29 U.S.C. Section 207(e)(2) Permits Exclusion of the Payments at Issue

The first FLSA section relied upon by the City is 29 U.S.C. section 207(e)(2). This section permits pay to be excluded from the regular rate when such payments are:

> [M]ade for occasional periods when no work is performed due to vacation, holiday, illness, failure of the employer to provide sufficient work, or other similar cause;... *and other similar payments to an employee which are not made as compensation for his hours of employment.*

Id. (emphasis added). The panel concluded that the in lieu payments were "compensation for work," and thus could not be excluded under section 207(e)(2).

The Ninth Circuit has previously said that the key question for this last clause (payments to an employee which are not made as compensation for his hours of employment) is whether the compensation is for "work." *Local 246 Utility Workers*, 83 F.3d at 295. And this is precisely where the panel erred, because in lieu cash is not "paid" for *work*; it is paid to equalize overall compensation when a spouse or significant other provides alternative

coverage. Work is not the triggering criterion – the insurance status of a spouse or significant other is the triggering criterion.

The panel's reading of this exclusion eviscerates the intent underlying section 207(e)(2). Anything of *any* value received by an employee could, of course, be construed as compensation "for work" because, but for the employment relationship, the compensation would not be paid. Indeed, this is the test apparently adopted by this panel. (Op. at 16 ("we focus our inquiry on whether a given payment is properly characterized as 'compensation'…").) But the test is not whether an employee receives something of value that could be construed as "compensation" – the test is whether the remuneration is directly linked to working, or not working, and this was recognized in the *Local 246 Utility Workers* decision cited by the panel. *Local 246 Utility Workers*, 83 F.3d at 295.

In lieu benefits are not paid for working; again, they are paid as a way to be fair to employees, so that all employees receive the same compensation regardless of dependent status. It does not matter if an employee works in a particular pay period; it only matters if the employee can show proof of alternative coverage. The panel thus misapplied *Local 246 Utility Workers*, and rehearing should be ordered on this ground alone.

The panel also acknowledged a split among the circuits regarding this issue. The panel rejected the reasoning of the Third Circuit, which affirmed exclusion from the regular rate certain lump sum payments that were made

to induce employees to ratify a labor agreement. (Op. at 15.)[3] This split in authority is yet another basis for rehearing the petition in this case.

It is axiomatic that courts should construe statutes to avoid absurd and unjust outcomes. *See, e.g., Johnson v. U.S.*, 529 U.S. 694, 706 n.9 (2000). Here, the panel has construed the regular rate statute to compel a two-tier wage structure in the event of opt out programs, where employees who perform the same work, and work side by side, have different overtime rates solely because some have dependents, and some do not. Of course, employers could simply eliminate opt out programs, but that in itself would create disparate compensation based solely on whether employees have dependents, because again, the employee with more dependents would receive more compensation by way of richer health benefit coverage.

Again, the underlying rationale of opt out programs is parity and fairness. There is nothing in the FLSA that could reasonably be construed to undermine this rationale, and to force employers to adopt benefit programs that deliver unequal benefits.

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[3] The distinction that payments made in *Minizza v. Stone Container Corp. Corrugated Container Div. E. Plant*, 842 F.2d 1456 (3d Cir. 1988) were "to secure employees' ratification of a collective bargaining agreement[,]" and therefore not compensation for work performed, is not a realistic distinction. (Op. at 15.) The cash in lieu compensation in this case, and in the case of most public agencies in California, is negotiated in the collective bargaining process; if negotiations to secure an agreement inform what is or is not compensation for work, serial litigation over the reasons behind the provision of in lieu compensation will be an inevitable result of the panel's decision. The more important point in *Minizza* is whether the payments are "conditioned on a certain number of hours worked or on an amount of services provided" – which in this case, they are not. *Minizza*, 842 F.2d 1462.

B. 29 U.S.C. Section 207(e)(4) Permits Exclusion of the Payments at Issue

The City alternatively argued that the in lieu payments could be excluded based on 29 U.S.C. section 207(e)(4). The panel adopted a narrow reading of this section, and concluded it did not apply. The panel's analysis was incorrect.

Section 207(e)(4) provides that payments made irrevocably to a trustee or third persons pursuant to a bona fide plan for accident, or health insurance or similar benefits may be excluded from the regular rate. The panel's narrow reading is inappropriate, as this statutory language was enacted in the Fair Labor Standards Amendments of 1949, well before "Flexible Spending Plans" and cafeteria plans were even in place. Statutes must be read to effectuate the intent of Congress, not rigidly in a manner that ends up frustrating Congressional intent.

Here, a narrow reading of the statute ends up disqualifying payments made in conjunction with cafeteria plans where the plans are not in a trust or where the plans are administered by the employer, and not a third party. There is no legitimate reason to adopt such a narrow reading of the statute. Obviously, the intent of this section is to exclude payments made directly for insurance-related purposes, and that is precisely what San Gabriel offered here.

VI. THE PANEL'S DECISION TO HOLD THE CITY'S PLAN AS NOT BONA FIDE IS ARBITRARY AND UNSUPPORTED

One of the most troubling aspects of the decision is the holding that the City's plan is not "bona fide" and therefore *all* of the City's contributions to the plan must be counted toward the regular rate, *regardless of whether the employee could possibly receive the money in cash.*

The Court's analysis relies on a DOL interpretation that when a cafeteria plan provides cash in lieu payments that are only "incidental," then the plan is bona fide. 29 C.F.R. § 778.215(a)(5). Rejecting a 20% "incidental" threshold that the DOL used in an earlier letter opinion, the Court then casually assessed the City's percentage and concluded that forty percent or more paid in cash is not incidental. It appears that the Court relied exclusively on the percentage of cash payouts to conclude that the payments were not "incidental."

In applying the "incidental" test, the panel misapplied the meaning of the word "incidental." "Incidental" in this context can and should be read to mean incidental to the purpose of the plan, not incidental to the amount of payments made. This Court recently held that liquidated damages under the FLSA are not punitive despite their "incidental deterrent effect" – a holding explicitly grounded on the purpose of those damages, not upon the amount of those damages. *Avila v. Los Angeles Police Dep't*, 758 F.3d 1096, 1105 (9th Cir. 2014). The question of whether something is "bona fide" is the question of whether it is genuine or authentic, and this is a question of purpose, not of percentages. That is precisely what is at issue in San Gabriel – the purpose of the plan is to provide insurance benefits; the cash in lieu feature permits an equalization of compensation for those who do not have dependents or utilize those benefits.

Even adopting some percentage-basis test, the opinion provides no meaningful guidance to employers. It is not clear at what percentage cash payments cease to be incidental, nor is it clear whether this percentage is to be assessed per-employee (as regular rate calculations themselves must be) or in the aggregate, nor whether it is to be assessed per workweek (as regular rate calculations themselves must be) or across some other measure of time.

The actual amount of cash payments inevitably varies across time, and the result is a standard whereby a plan may be bona fide in some circumstances, but not in others – an unmanageable outcome for employers and employees.

Causing all contributions to a cafeteria plan to be included in the regular rate appears punitive, unworkable, and unwarranted. Rehearing should be granted on this ground alone.

VII. THE NINTH CIRCUIT'S DEFINITION FOR WILLFULNESS IS DIRECTLY CONTRARY TO SUPREME COURT PRECEDENT

Amici share the concern of the City of San Gabriel that the willfulness test applied in the Ninth Circuit is in direct conflict with Supreme Court precedent. Willfulness means more than mere negligence; it must entail some degree of recklessness. *See McLaughlin v. Richland Shoe Co.,* 486 U.S. 128 (1988). As noted in the concurring opinion by Judge Trott, although the panel felt compelled to follow the decision in *Alvarez v. IBP, Inc.,* 339 F.3d 894 (9th Cir. 2003), the *Alvarez* decision is in conflict with Supreme Court precedent. *Alvarez* held that if an employer was "on notice" of the FLSA, and took no affirmative action to comply, this necessarily entailed willfulness. Judge Trott correctly pointed out that willfulness requires more, and that the Ninth Circuit's precedent was creating a mere negligence standard. For this separate and independent reason, rehearing should be granted.

VIII. CONCLUSION

The panel's decision has taken the public agency community by surprise. Numerous lawsuits have already been filed, with more undoubtedly on the way. The Court should step back, re-hear this case, and conduct a more rigorous analysis.

The decision in its present form should not be allowed to stand.

Respectfully submitted,

Dated: June 27, 2016

RENNE SLOAN HOLTZMAN SAKAI LLP

/s/ Arthur A. Hartinger

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CERTIFICATE OF COMPLIANCE

I certify that this brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because it contains 2,824 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii). This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionately spaced typeface using Microsoft Word 2016, 14 point Times New Roman.

Dated: June 27, 2016

RENNE SLOAN HOLTZMAN SAKAI LLP

/s/ Arthur A. Hartinger

ARTHUR A. HARTINGER

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 June 27, 2016.

Participants in the case are registered CM/ECF users and will be served by the appellate CM/ECF system.

Dated: June 27, 2016

RENNE SLOAN HOLTZMAN SAKAI LLP

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