No. 16-911

In The
Supreme Court of the United States

CITY OF SAN GABRIEL,

Petitioner,

v.

DANNY FLORES, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF FOR THE PETITIONER

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INTRODUCTION

Parroting a half-century-old Labor Department bulletin, Respondents contend that 29 U.S.C. § 207(e)(2) does not permit employers to exclude from the baseline rate any payments made as "compensation for services"—even if such payments are entirely unrelated to an employee's actual "hours of employment." But that is the opposite of what the statute says: it expressly authorizes employers to exclude "other similar payments to an employee which are not made as compensation *for his hours of employment*." 29 U.S.C. § 207(e)(2) (emphasis added). The cash-in-lieu benefits here fit neatly within that statutory carve-out.

Respondents eschew that plain-language construction in favor of one that flouts the statute's text and structure, perpetuates discord among the circuits, and hinges on an outdated agency bulletin and a suspect narrow-construction canon. Lacking any convincing rebuttal to those points, Respondents rehash the Ninth Circuit's flawed reasoning and downplay the pressing detrimental consequences of the decision below for employers and employees. To add insult to injury, Respondents defend the conclusion that the City's alleged violation of the Fair Labor Standards Act was "willful"—even though a panel *majority* expressly stated that it would have concluded otherwise *but for* the Ninth Circuit's "off track" standard contravening this Court's precedent.

Either error alone warrants certiorari; together, they make this Court's review paramount.

ARGUMENT

I. THE NINTH CIRCUIT'S ATEXTUAL INTERPRETATION OF SECTION 207(e)(2) DEEPENS A CONFLICT ON AN ISSUE OF NATIONWIDE IMPORTANCE

A. The Courts Of Appeals Are Divided On The Question Presented

1. Respondents deny the existence of a circuit split because (they say) "[a]ll other circuits who have addressed" the scope of section 207(e)(2) "engage in substantially the same analysis." BIO 11. That assertion is incorrect, as the decision below acknowledges. Pet. App. 18a-19a. Far from reaching any consensus, the courts of appeals have developed conflicting interpretations of section 207(e)(2). Pet.

10-13. Indeed, commentators and practitioners have recognized that this case vividly "illustrates that calculation of regular rate of pay remains fraught with peril" and uncertainty. [1] That confusion—deepened by the decision below—warrants this Court's review.

Under the Ninth Circuit's view, a payment wholly unrelated to hours worked or amount of services performed (like the cash-in-lieu payments here) cannot be excluded under section 207(e)(2) so long as that payment is "compensation, regardless of whether [it] is specifically tied to the hours an employee works." Pet. App. 19a. That narrow construction conflicts with the Third Circuit's view that "payments not tied to hours of compensation" may be excluded under section 207(e)(2). *Minizza v. Stone Container Corp. Corrugated Container Div. E. Plant*, 842 F.2d 1456, 1461 (3d Cir. 1988). The Third Circuit so held despite being confronted with the Labor Department bulletin that Respondents repeatedly invoke. *Id.*

Contrary to Respondents' mistaken assertion, the Third Circuit's reasoning in *Minizza* did not focus on whether payments were compensation for services generally. BIO 14 (citing *Wheeler v. Hampton Twp.*, 399 F.3d 238 (3d Cir. 2005)). It focused instead on whether certain lump-sum payments were

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[1] *E.g.*, McGuireWoods LLP, *The Perils of Calculating Regular Rate of Pay*, LEXOLOGY (Mar. 14, 2017), https://tinyurl.com/khmhflv; Christian Schappel, *Overtime Ruling Should Make Employers Reconsider This Pay Option*, HR MORNING (Feb. 9, 2017), https://tinyurl.com/m3f3lb4.

"conditioned *on a certain number of hours* worked or on *an amount of services provided*." *Minizza*, 842 F.2d at 1462 (emphasis added). As Respondents concede, BIO 14, the Third Circuit "in *Minizza* looked for a connection between the payments and an amount of hours worked"—a "connection" that the Ninth Circuit unequivocally rejected, *see* Pet. App. 18a-19a.

Respondents are therefore incorrect in claiming that courts have "routinely rejected" the City's interpretation that payments "are excludable from the regular rate of pay if they are" unrelated "to particular hours worked." BIO 11. *Minizza* proves otherwise.

Shifting tacks, Respondents (perplexingly) suggest that *Minizza* is consistent with the decision below given the Ninth Circuit's statement that it would permit employers to exclude lump-sum payments under section 207(e)(2). BIO 14-15. That does not mitigate the conflict between the Third and Ninth Circuits. However the Ninth Circuit might treat the lump-sum payments at issue in *Minizza*, the Third Circuit would permit exclusion of the cash-in-lieu payments here, because they are "based upon the extent of the employee's utilization of available benefits" rather than "the number of hours worked or the employee's productivity." Pet. App. 59a.

Respondents fare no better in harmonizing the Ninth Circuit's approach with that of other circuits. Although Respondents stress that the Sixth and Seventh Circuits do not permit employers to categorically exclude payments not "measured by" hours an employee works, BIO 11-12, they conveniently omit that both circuits join the Third

Circuit in holding that section 207(e)(2) allows employers to exclude payments unrelated to hours worked or amount of services provided. Pet. 11-12.

In *Reich v. Interstate Brands Corp.*, the Seventh Circuit recognized that payments that "do not depend at all on when or how much work is performed" could be excluded under section 207(e)(2). 57 F.3d 574, 578 (7th Cir. 1995). Likewise, the Sixth Circuit in *Featsent v. City of Youngstown* held that bonuses for unused sick leave could be excluded under section 207(e)(2) because they were "unrelated to *** compensation for services and hours of service." 70 F.3d 900, 905 (6th Cir. 1995). Because the cash-in-lieu payments are entirely unrelated to the hours worked or amount of services rendered by an employee, they would be excludable under the Sixth and Seventh Circuit's construction of section 207(e)(2).[2]

The same would likely hold true in the Eighth and Tenth Circuits. Pet. 12-13 & n.2. In *Acton v. City of Columbia*, for example, the Eighth Circuit reasoned that unused sick-leave payments could not

[2] Respondents contend (BIO 12-13) that the decision below aligns with the First Circuit's decision in *O'Brien v. Town of Agawam*, 350 F.3d 279 (1st Cir. 2003). *O'Brien* held that payments for an employee's length of service, even if not "literally paid on an hourly basis," were not excludable. *Id.* at 296. But that case also confirmed that section 207(e) "reflects Congress's focus on 'hours actually worked in the service and at the gain of the employer.'" *Id.* (quoting *Plumley v. Southern Container, Inc.*, 303 F.3d 364, 370 (1st Cir. 2002)). That focus on "hours actually worked" is at odds with the Ninth Circuit's approach. And even if *O'Brien* fell on the Ninth Circuit's side of the conflict, that would only reinforce the need for review.

be excluded under section 207(e)(2) because they "necessarily require[] employees to work more days than they are required" and therefore are "tantamount to payment for services rendered." 436 F.3d 969, 979 (8th Cir. 2006). The Tenth Circuit reached the same conclusion, reasoning that "sick leave buy-backs are compensation for additional service or value received by the employer, and are analogous to attendance bonuses." *Chavez v. City of Albuquerque*, 630 F.3d 1300, 1310 (10th Cir. 2011). For both courts, the overriding question was whether the payment bore a relationship to services rendered or hours worked by an employee. Cash-in-lieu payments concededly have *no* relationship to hours actually worked or services actually rendered.

The upshot of this checkerboard circuit precedent is that the courts of appeals have failed to coalesce around a consistent reading of section 207(e)(2). As *amici* make clear, that enduring tension among the circuits breeds intolerable uncertainty for public and private employers across the country in offering benefit programs—to the detriment of their employees.

2. Unable to refute that troubling disarray, Respondents argue that this Court's review is premature because no other circuit has specifically addressed whether cash-in-lieu payments may be excluded under section 207(e)(2). BIO 15. That myopic reformulation of the question presented does not alleviate the entrenched conflict on the pure legal question actually (and cleanly) presented: whether section 207(e)(2)'s "other similar payments" clause permits exclusion of payments entirely unrelated to an employee's "hours of employment."

There is no reason to leave that important question of statutory interpretation unanswered on the chance that another circuit might confront the same cash-in-lieu program in a future case. Although the decision below addressed the excludability of cash-in-lieu payments, its reasoning applies more broadly to all types of payments. As *amici* explain, the decision below will have dramatic consequences on the "excludability of a whole host of other compensation policies used by countless companies" across the country. Chamber Br. 19-20.

Moreover, even as to the narrower subset of cash-in-lieu programs, this Court's immediate review is warranted. Confronted with the palpable risks and costs occasioned by the decision below—including the imposition of additional liability based on a willfulness finding, *see* pp. 12-13, *infra*—employers will abandon cash-in-lieu and other similar programs altogether rather than gamble on a future circuit split. IMLA Br. 12-14. In the short time since the decision below, that consequence can already be seen. *See* pp. 8-9, *infra*. Consequently, the Ninth Circuit's decision might well constitute the last word on whether cash-in-lieu payments may be excluded under section 207(e)(2) for a huge number of employers, and denying certiorari to allow further percolation would merely insulate it from review.

B. The Scope Of Section 207(e)(2) Is Of Significant National Importance

Respondents speculate that the decision below will be of limited consequence. BIO 22-24. But Respondents' naked speculation is no match for the phalanx of *amici*—including a broad array of state

and local associations of public employers as well as the world's largest private business organizations—who confirm that this case raises recurring questions of exceptional national importance. IMLA Br. 7-15; Chamber Br. 20-22.

Based on extensive first-hand experience, *amici* have confirmed that the decision below "will have profoundly negative consequences for employers and employees." Chamber Br. 20. Employers—particularly public-sector entities offering cash-in-lieu benefits—will face unpredictable overtime liability, increased administrative costs, and "a wave of lawsuits." IMLA Br. 6. Some of those deleterious effects have already come to pass: "in the state of California alone, there are now over thirty lawsuits pending against public-sector employers" offering cash-in-lieu or similar benefits. IMLA Br. 6 n.2; Pet. 23 n.4.

Respondents (citing nothing) hypothesize that employers might opt to retain or modify their benefits programs. BIO 23. That unsubstantiated guesswork defies commonsense and is contradicted by *amici*, which explain why employers will discontinue cash-in-lieu programs in the wake of the decision below. Chamber Br. 20-21; IMLA Br. 12-13. But even if employers choose to keep their plans and make adjustments "to offset potential increased overtime costs," such adjustments will not be "very minor" (as Respondents posit). BIO 23. As a case in point, Tuolomne County sharply curtailed its cash-in-lieu program after the Ninth Circuit's ruling. IMLA Br. 13 n.7. Slashing benefits in that manner "would have a major impact on *** employees," who would lose significant portions of their pre-tax income, IMLA Br.

13-14, all because the Ninth Circuit unfairly punishes employers for conferring generous benefits on their employees.

Respondents dismiss those negative consequences as overblown, citing the relatively low damages (before the willfulness multiplier) awarded by the district court. BIO 22. But the limited nature of retrospective damages *to just these individual plaintiffs in this single action* in no way diminishes the significant consequences the decision below has on employers and employees nationwide in all future cases—and, relatedly, on the decision whether to continue benefit programs at all.

C. Respondents' Reliance On A Labor Bulletin Cannot Salvage The Merits

On the merits, Respondents hardly confront section 207(e)'s unambiguous statement that "other similar payments *** not made as compensation for *** hours of employment" may be excluded from the regular rate of pay. 29 U.S.C. § 207(e)(2). After quoting the statute, Respondents skip immediately to what they deem an "important *** premise" of the analysis: that cash-in-lieu benefits are compensation for services. BIO 16-19. That "premise" rests not on the statutory text, but an unauthoritative Labor Department bulletin disallowing any exclusion for "compensation for services." 29 C.F.R. § 778.224(a). Not only does that interpretation collide with other agency guidance permitting exclusion of certain cash-in-lieu payments, *see* DOL Field Operations

Handbook § 32d03h,[3] it also guts section 207(e)(2)'s "other similar payments" clause. After all, every payment or benefit employees receive as a result of employment is a form of "compensation."

Accordingly, it is Respondents, not the City, who are "insert[ing] words into the statute that are not there" (and deleting words that are). BIO 19. That sleight-of-hand—*i.e.*, substituting the words of a 1968 bulletin (which lacks the force of law) for the words that Congress chose—impermissibly rewrites section 207(e)(2). At a minimum, the Solicitor General should be invited to express his views as to whether the Labor Department bulletin is all Respondents purport it to be.

Although Respondents invoke the narrow-construction canon to justify the decision below, BIO 16, that canon cannot do the work of Congress. Tellingly, Respondents offer no reason why the canon should not be declared "a relic of a bygone era that has been causing mischief in the lower courts for years," Chamber Br. 3—precisely as it did in this "close" case, Pet. App. 13a.[4]

Equally unavailing is Respondents' assertion

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[3] https://www.dol.gov/whd/FOH/FOH_Ch32.pdf (cash payments "clear[ly]" made "in lieu of [bona fide] fringe benefits" "may be excluded from the regular rate").

[4] At most, Respondents contend that the City waived any challenge to the question of whether the canon applies to a definitional provision like section 207(e)(2). BIO 16-17 n.1. Putting aside the lack of the City's obligation below to raise issues controlled by this Court's precedent, the continuing validity and scope of that canon is a purely legal issue that this Court may revisit in interpreting section 207(e)(2).

that the City's purportedly "absurd" reading of section 207(e)(2) would render section 207(e)(4) meaningless. BIO 21. The City's faithful adherence to the statutory text yields neither absurdity nor surplusage. As the Ninth Circuit acknowledged, Pet. App. 20a-21a, a payment may be excludable under multiple subsections of the FLSA, so it matters not whether payments could potentially be excluded under section 207(e)(4) as well as 207(e)(2). *Cf. Reich*, 57 F.3d at 578 ("Doubtless the subsections of [section 207(e)] are not mutually exclusive[.]"). If anything is "absurd," it is Respondents' interpretation of section 207(e)(2), which—contrary to Congress's intent—harms employers and employees, and benefits only Respondents individually.[5]

[5] Contrary to Respondents' contention, BIO 24-25, the City does not seek to inject an independent question presented on the Ninth Circuit's section 207(e)(4) ruling. Rather, the City argues only that, as a logical matter, the Ninth Circuit's "section 207(e)(4) ruling that the plan is not 'bona fide'" must "necessarily fall[] if its interpretation of section 207(e)(2) is corrected." Pet. 20. The Ninth Circuit found that the City's plan was not "bona fide" because more than 40% of its contributions to the plan were cash-in-lieu payments. If those payments are excludable, it would make no sense to treat the City's non-cash plan contributions as non-excludable under section 207(e)(4). Pet. 19-20. Regardless, the Court could simply instruct the Ninth Circuit to reconsider the issue on remand if it reverses on section 207(e)(2).

II. THE NINTH CIRCUIT'S WILLFULNESS STANDARD FLOUTS THIS COURT'S PRECEDENT

Respondents offer no persuasive reason to delay this Court's review of the Ninth Circuit's legal standard—which a majority of the panel labeled "off track"—for willful violations of the FLSA (among other statutes). Pet. App. 38a (Owens, J., concurring, joined by Trott, J.). The Ninth Circuit's departure from this Court's precedent makes the issue independently cert-worthy, Pet. 29-31, particularly given the "profound[] unfair[ness]" that will be visited on employers, Chamber Br. 21-22.

Rather than dispute the issue's importance, Respondents assert that the Ninth Circuit's standard and the "in the picture" test discredited in *McLaughlin v. Richland Shoe Co.*, 486 U.S. 128 (1988), are "quite distinct" because, prior to *McLaughlin*, an employer who attempted to ascertain compliance with the FLSA still could have engaged in willful conduct. BIO 27. That framing misses the point: the question here is whether the City acted recklessly because it did *not* take steps to ascertain compliance with the FLSA. The Ninth Circuit's affirmative answer, grounded in the notion that the City was "on notice of its FLSA requirements," Pet. App. 35a (citation and quotation marks omitted), is no different from imposing willfulness liability based on an awareness that the FLSA was "in the picture," *McLaughlin*, 486 U.S. at 132-133. Respondents suggest as much in asserting that the Ninth Circuit would find recklessness whenever "an employer who knows where to look to determine its obligations under the FLSA *** refuses to look there." BIO 27.

This case demonstrates that the Ninth Circuit's willfulness test—which (like other circuits) unremarkably captures actual recklessness, BIO 28-29—also improperly reaches mere negligence or less culpable conduct. Citing only the innocuous finding that "[a]t some time prior to 2003, the City designated its cash-in-lieu *** payments as 'benefits'" and did "not revisit[] its designation," Pet. App. 9a, Respondents cast the City as having acted with "cavalier indifference," BIO 27-28 & n.3. In reality, the City had no reason to doubt or revisit its benefits designation because "[f]or decades, public employers organized their affairs" as the City did "in reliance on the plain language of the statute." IMLA Br. 4-5; Pet. App. 36a (agreeing that there was no contrary authority). It follows that the City's purported failure to "see whether [controlling] authority existed," Pet. App. 36a, could be deemed a willful FLSA violation only if the Ninth Circuit resurrected the watered-down legal standards rejected in *McLaughlin*.

At bottom, Respondents' assertion (BIO 29) that the result in this case would be the same under *McLaughlin* is squarely refuted by the separate opinion from two of the panel members. That opinion underscores the incompatibility between Ninth Circuit precedent and *McLaughlin*, and declares that the no-willfulness finding would have been affirmed *but for* that outlier precedent. Pet. App. 38a-40a. A better vehicle is hard to imagine. The decision below thus all but invites this Court's review of the Ninth Circuit's willfulness standard in this consequential case.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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