THE MAGAZINE OF THE LOS ANGELES COUNTY BAR ASSOCIATION

Los Angeles Lawyer

JUNE 2014 / $4

2014 Lawyer-to-Lawyer REFERRAL GUIDE

EARN MCLE CREDIT

Ethics of Following Orders
page 23

Insurance for Class Actions
page 9

Joke Stealing
page 13

Qualified Interpreters
page 44

PLUS

Colorado River QSA
page 28

TRANS-FORMING USE

Los Angeles lawyer Edward E. Weiman assesses the application of the fair use doctrine to the large-scale digitalization of books page 16

BY DAVID A. SHANEYFELT

Liability Insurance Considerations for Wage and Hour Class Actions

WAGE AND HOUR CLASS ACTIONS are among the most vexing of claims for California employers. First, they are class claims and implicate a wide, if not total, scope of the workforce. Second, they can be expensive to defend against, even if they have little merit. Third, they tend to be based not on federal law but on a wide array of claims allowed under the California Labor Code. Fourth, the claims allow for hefty fines and penalties on top of statutory damages. Fifth, they often allow for an extra year of damages, because of a longer statute of limitations allowed for claims under California law than under federal law. Finally, insurance companies tend to deny or severely limit coverage for them.

According to one estimate, several wage and hour class actions are filed in California daily.[1] It might be safe to assume that there are a fair number of reported cases addressing an insurance company's duty to defend or indemnify an employer against them under an employment practices liability insurance (EPLI) policy. However, except for a few decisions, mostly unreported, California case law is quiet on the subject.

It is nonetheless necessary for an employer facing a class action wage and hour suit to undertake its own thorough insurance coverage analysis. Counsel can perform a valuable service for a client by explaining how and why coverage exists when that is the case, as it may be in many instances. If necessary, counsel may advise an employer to file suit against the insurance company should the insurance company still deny coverage.

California courts have long recognized that an insurance company "must defend a suit which potentially seeks damages within the coverage of the policy"[2] and that "[a]ny doubt as to whether the facts establish the existence of the defense duty must be resolved in the insured's favor."[3] An insurer has a duty to defend a case in which the policy is ambiguous and the insured would reasonably expect the insurer to defend against the suit based on the nature and kind of risk covered by the policy, or if the underlying suit potentially seeks damages within the coverage of the policy.[4] All that is required to trigger a duty to defend is "a bare 'potential' or 'possibility' of coverage."[5] The determination of this duty depends "on a comparison between the allegations of the complaint and the terms of the policy."[6]

Most EPLI policies predicate coverage on the existence of an allegation that an employer committed a wrongful employment act. The policies then proceed to define the kinds of acts that meet that definition, for example, discrimination, retaliation, sexual harassment, wrongful termination, or negligence in hiring, supervision, training, or retention. An allegation that the employer failed to "create or enforce adequate workplace or employment policies and procedures" is a solid hook for landing EPLI class actions as covered claims because a classwide claim that an employer failed to pay wages or provide benefits is a demonstrably arguable allegation of the principle.

However, this is not the issue in which an insurance dispute typically arises. While EPLI policies tend to be overly general in granting coverage, they also tend to be particular in the matter of exclusions from coverage. EPLI policies invariably carve an exclusion to coverage for wage and hour claims, which insurers regard as restitution. The purpose of insurance is to cover damages or loss, not to provide restitution.[7] Damages are intended to give the victim monetary compensation for an injury to person, property, or reputation while restitution is intended to return to the victim the specific money or property taken.[8] Insurance companies argue that a suit for recovery of a wage is a claim in restitution—the employer allegedly retained the value of an employee's service without paying for it. When the employer is forced to pay that value to the employee, the employer is not sustaining loss but is returning the value for the service rendered.[9]

This distinction is important. If an employer can show a claim does not seek merely the return of value but something else that may be regarded as loss, then the concept of restitution will not apply, and the employer may recover that loss under the policy. For example, as discussed below, claims for employee reimbursement of workplace expenses under Section 2802 of the Labor Code constitute covered loss. Courts have expressly found there is no public policy bar to insuring awards allegedly based on a payment of wages.[10]

A suit for recovery of a wage often involves a claim for a fine or penalty. These amounts typically are also excluded from insurance coverage. Fines and penalties often signify a kind of intentional conduct that public policy and statute bar insuring against.[11] However, Labor Code requirements are arguably remedial, not punitive.[12] The level of intentionality required to establish liability under the Labor Code is far lower than the kind of intentionality otherwise excluded by insurance.[13]

Apart from these general prohibitions, the terms of the EPLI policy control, and these terms must be parsed to determine whether a given claim is excluded from coverage. See the table "Comparison of Labor Code Claims with Various Policy Exclusions" on page 10, which compares excerpts from actual EPLI policies of coverage exclusions for any claim under the Fair Labor Standards Act (FLSA) with the corresponding Labor Code claims.

The policyholder is aided in this analysis by three well-recognized insurance coverage principles. First, while the policyholder has the burden of showing that the claimed loss falls under the coverage provision, the burden shifts to the insurance company to prove that a policy exclusion applies.[14] Second, the law insists that coverage clauses be interpreted broadly to afford the greatest possible protection to the policyholder.[15] Third, exclusions must be construed "narrowly in favor of coverage."[16]

When a policy provision has no "plain and clear meaning," courts "invoke the principle that ambiguities are generally construed against the party who caused the uncertainty to exist (i.e., the insurer) in order to protect the insured's reasonable expectation of coverage."[17] "This

David A. Shaneyfelt is an attorney with The Alvarez Firm in its Calabasas office. He represented Classic Distributing in *Classic Distributing & Beverage Group, Inc. v. Travelers Casualty & Surety Company of America.*

Comparison of Labor Code Claims with Various Policy Exclusions

Common Class Action Labor Code Claims	Expressly Excluded?					
	(1)	(2)	(3)	(4)	(5)	(6)
Failure to pay daily overtime[1]	Yes	Yes	Yes	Yes	Yes	Yes
Failure to weekly overtime[2]	Yes	Yes	Yes	Yes	Yes	Yes
Failure to pay minimum wage[3]	Yes	Yes	Yes	Yes	Yes	Yes
Misclassification of employee[4]	Yes	Yes	Yes	Yes	Yes	Yes
Improper tip pooling[5]	No	No	No	Yes	Yes	Yes
Unlawful wage deductions[6]	No	No	No	Yes	Yes	Yes
Failure to pay wages when due[7]	No	No	No	Yes	Yes	Yes
Unlawful bonus plan[8]	No	No	No	No	No	Yes
Failure to pay meal breaks[9]	No	No	No	No	No	Yes
Failure to pay rest breaks[10]	No	No	No	No	No	Yes
Unlawful commission chargebacks[11]	No	No	No	Yes	No	Yes
Failure to reimburse employee expenses[12]	No	No	No	No	No	No
Failure to reimburse employee uniforms[13]	No	No	No	No	No	No
Wrongful forfeiture of vacation[14]	No	No	No	Yes	No	Yes
Failure to provide itemized wage statements[15]	No	No	No	Yes	Yes	Yes

NOTE: Column headings are as follows:

(1) "any *similar provision* of federal, state or local statutory law or common law"

(2) "*similar provisions* of any federal, state or local statutory *wage and hour* law"

(3) "the state or local *equivalent* of such statute"

(4) "any such *law that governs* wage, hour and payroll policies and practices"

(5) any law "*governing or related to* the payment of wages, including the payment of overtime, on-call time or minimum wages, or the classification of employees for the purpose of determining employees' eligibility for compensation under such law(s)"

(6) "any *similar law…regulating* wage and hour practices such as unpaid wages, improper payroll deductions, improper employee classification, failure to maintain accurate time records, failure to grant meal and rest periods, or social security benefits"

(Emphasis added to highlight distinguishing features.)

[1] LAB. CODE §510.
[2] *Id.*
[3] LAB. CODE §1194.
[4] IWC Wage Order No. 1-2001.
[5] BUS. & PROF. CODE §17200.
[6] IWC Wage Order No. 1-2001 §8.
[7] LAB. CODE §203.
[8] LAB. CODE §§221, 400-410, 3751.
[9] LAB. CODE §226.7.
[10] *Id.*
[11] LAB. CODE §221.
[12] LAB. CODE §2802.
[13] IWC Wage Order No. 7-2001 §9.
[14] 2002 DLSE ENFORCEMENT POLICIES AND INTERPRETATIONS MANUAL §15.1.4.
[15] LAB. CODE §226.

'tie-breaker' rule of construction against the insurer stems from the recognition that the insurer generally drafted the policy and received premiums to provide the agreed protection."[18]

Exclusions under *California Dairies*

The coverage of California wage and hour claims under EPLI policies is nearly absent among reported cases. With the exception of a case from Kansas,[19] only one reported case exists—*California Dairies, Inc. v. RSUI Indemnity Company*[20]—and that case (a federal case) offers only some help in determining which claims are covered and which are not. The U.S. District Court for the Eastern District of California examined which of seven causes of action fell within an insurance policy's exclusion for claims alleging a violation of the FLSA "or any similar provision of federal, state or local statutory law or common law."[21] The FLSA regulates minimum wage, overtime pay, equal pay, and child labor.

In contrast, the Labor Code regulates far more extensive matters than those involving minimum wage or overtime pay. The Labor Code is unique among state labor codes elsewhere, which are typically coextensive with the FLSA. Insurance companies, however, write policies on a national basis and do not write exclusions simply for the California Labor Code. Consequently, policyholders are treated to the kind of language *California Dairies* addressed in which courts must determine whether or not Labor Code claims are similar to the FLSA.

In a methodical analysis of each of the claims, the court concluded that four causes of action were excluded from coverage, because the Labor Code provisions on which they were based were similar to the FLSA: 1) failure to pay minimum wage, 2) failure to pay regular and overtime wages, 3) failure to provide mandated meal periods or pay an additional hour of wages, and 4) failure to provide mandated rest periods or pay an additional hour of wages.[22] The court also concluded that three causes of action were not excluded from coverage, because the Labor Code provisions on which they were based were not similar to the FLSA: 1) Section 2802: failure to reimburse employees for workplace expenses (in that case, costs incurred for company-required uniforms), 2) Section 226(a): knowing and intentional failure to provide itemized wage statements, and 3) Sections 201-02: failure to pay wages due at termination.[23]

Nevertheless, *California Dairies* is of limited precedent because the decision was appealed to the Ninth Circuit Court of Appeals and affirmed on other grounds in an unpublished decision.[24] Other grounds were

based on a different policy exclusion—the insured versus insured exclusion typically found in director and officer insurance policies, which the policy at issue was.

Moreover, the employer in *California Dairies* had to make the losing argument that the claims arose under specific policy language that defined an EPLI wrongful act as an "[e]mployment-related misrepresentation to an Employee," or, alternatively, a "[f]ailure to provide or enforce adequate or consistent organizational policies or procedures relating to employment."[25] The Ninth Circuit found no coverage to exist, in part because the underlying wage claim alleged no misrepresentations and nothing organizational about the workplace policies and procedures at issue—a modifier usually not found in EPLI policies. Conversely, a different employer found a basis for coverage under similar language because of the specific allegations in the complaint—the wage and hour plaintiff alleged that the employer had disseminated false information regarding whether employees were eligible for overtime wages, which was tantamount to a claim for an "employment-related misrepresentation."[26] While *California Dairies* is useful for analytical purposes, the decision is of limited application because of the facts and policy language at issue.

Three other cases, although unreported, shed some light on these issues. The court in *Classic Distributing & Beverage Group, Inc. v. Travelers Casualty & Surety Company of America*[27] ruled that wage statement claims fall within a policy's exclusion for claims under any law "governing or related to the payment of wages, including the payment of overtime, on-call time or minimum wages, or the classification of employees for the purpose of determining employees' eligibility for compensation under such law(s)."[28] Comparing *Classic Distributing* with *California Dairies* reveals that a policy excluding claims based on laws governing or related to the payment of wages will exclude a wage statement claim whereas a policy that excludes claims based on laws similar to the FLSA will not.

An unreported decision from the Central District, *TriTech Software System v. U.S. Specialty Insurance Company*,[29] offers a similar analysis in reliance on *California Dairies* to apply a policy's FLSA exclusion to Labor Code claims for overtime and for unpaid meal and rest breaks. Unfortunately, the court does not explain why such claims are similar to FLSA claims, when, arguably, they are distinct—the FLSA imposes no requirements for unpaid meals or rest breaks.[30]

Finally, in another unpublished decision, *SWH Corporation v. Select Insurance Company*, an insurance company argued that its exclusion for "similar provisions of any federal, state or local statutory law or common law" served to exclude a variety of claims under the Labor Code.[31] The court of appeal found this exclusion to be impermissibly vague and ambiguous, as there was no reason to think it was intended to exclude all claims under the Labor Code. Accordingly, the employer was entitled to prove that certain aspects of the class action settlement obtained with the plaintiff were covered under the employer's EPLI policy.

Defense and Indemnity Potentially Available

The various distinctions among exclusions can mean the difference between some coverage or no coverage. If some coverage exists, the employer may at least be entitled to a defense of the class action, and that defense must extend to all claims in the suit, covered and noncovered.[32]

The duty to defend is especially relevant to those EPLI policies that promise a sublimit for coverage of wage and hour suits. For instance, a policy might offer $1 million in general defense and indemnity of EPL claims, and a $100,000 sublimit solely for defense of wage and hour claims. To the extent an employer can show that some of the class claims do not fall within the wage and hour exclusion, the employer will be entitled to $100,000 for the defense of narrowly defined wage claims but up to $1 million for defense of all claims falling outside this narrow definition.

Indeed, an employer might well justify entitlement to indemnity for many claims as well. The remedies available under the Labor Code are extensive and may be covered as loss under an EPLI policy. In *Classic Distributing*, for example, the court rejected the insurance company's argument that the remedy allowed under Section 2802 of the Labor Code—for employee reimbursements—is uninsurable restitution. The court ruled that the remedy "is more akin to damages than restitution," because "[i]t would be difficult to characterize the employer's payment as 'restoring' anything given that the plaintiff can recover only if he establishes that his purchases were 'necessary,' that he was not reimbursed by employer, and that his 'costs' were 'reasonable.'"[33] The requirement for such affirmative proof "sweeps Section 2802 awards outside any plausible reading of the words 'return' or 'restore.'"[34]

Also, simply because many Labor Code provisions refer to relief as a penalty does not mean that relief is a penalty excluded from coverage. For example, the Labor Code provides multiple remedies for wage statement claims. One provision, Section 226(e), allows the employee to recover amounts "not to exceed an aggregate penalty" of $4,000, plus costs and attorney's fees. Another provision, Section 226.3, authorizes a civil penalty of $250 per employee per violation. But the former provision is more in the nature of a liquidated damage, not a penalty, in which case insurance should cover it.

Such a distinction is recognized in other areas of the Labor Code where, for example, damages for meal and rest breaks under Section 226.7 are deemed wages and not penalties for purposes of determining which statute of limitations applies.[35] In fact, the remedies under the Labor Code, which afford individual employees with private remedies (though called penalties), are distinct from the uninsurable penalties of city ordinances,[36] uninsurable fines imposed through criminal conviction, or civil proceedings prosecuted by the state in the exercise of its police power and regulatory authority.[37]

Finally, two other claims commonly appearing in wage and hour class actions are claims under Section 17200 of the Business and Professions Code and claims under the Private Attorneys General Act (PAGA).[38] The former claim is typically added because it piggybacks onto other Labor Code claims and alleges the claimed statutory violation constitutes unfair competition under Section 17200. Because Section 17200 is governed by a four-year statute of limitations, Section 17200 claims that follow Labor Code claims effectively turn a three-year statute of limitations into a four-year statute of limitations. While no damages can be awarded under Section 17200, attorney's fees can be awarded under PAGA when the plaintiff is shown to have vindicated "an important right affecting the public interest."[39] Thus, a plaintiff's success in proving a classwide claim under Section 17200 will justify an award for attorney's fees under PAGA. In that case, while PAGA fines and penalties might not be regarded as damages or loss under an EPLI policy, an award of attorney's fees under PAGA can be and would be covered along with any other attorney's fee award under some other provision of the Labor Code.

It is important for employers and their attorneys to parse an EPLI policy carefully and to compare its language against allegations in class action wage and hour complaints. Doing so can mean the difference between coverage for the defense, and possibly indemnity, or no coverage whatsoever. ■

---

[1] Litigating California Wage & Hour and Labor Code Class Actions (12th ed. 2012), *available at* http://www.seyfarth.com/uploads/siteFiles/practices/LitigatingCaliforniaWageandHourClassActions2011.pdf.

[2] Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 275 (1966).

[3] Montrose Chem. Corp. v. Superior Court, 6 Cal. 4th 287, 299-300 (1993).

[4] Foster-Gardner, Inc. v. Nat'l Union Fire Ins. Co. of

Pitt., 18 Cal. 4th 857, 869 (1998).
[5] Montrose, 6 Cal. 4th at 300.
[6] Scottsdale Ins. Co. v. MV Transp., 36 Cal. 4th 643, 654 (2005).
[7] Bank of the West v. Superior Court, 2 Cal. 4th 1254 (1992) (ruling that restitution ordered under the Unfair Business Practices Act is uninsurable).
[8] Bowen v. Massachusetts, 487 U.S. 879, 893 (1988); *see also* Aerojet-General Corp. v. Superior Court, 211 Cal. App. 3d 216, 231 (1989) ("[R]estitution is the return of something wrongfully received").
[9] *See, e..g.*, Cortez v. Purolator Air Filtration Prods., 23 Cal. 4th 163. 177-78 (2000) (ruling that §17200 of the Business and Professions Code authorizes orders to repay earned wages as a restitutionary remedy).
[10] BLaST Intermediate Unit 17 v. CNA Ins. Cos., 674 A. 2d 687 (Pa. 1996).
[11] INS. CODE §533.
[12] SWH Corp. v. Select Ins. Co., 2006 Cal. App. unpub. LEXIS 8694 (Cal. App. Sept. 28, 2006).
[13] Shell Oil Co. v. Winterthur Swiss Ins. Co., 12 Cal. App. 4th 715 (1993).
[14] MacKinnon v. Truck Ins. Co., 31 Cal. 4th 635, 648 (2003); Royal Globe Ins. Co. v. Whitaker, 181 Cal. App. 3d 532, 537 (1986).
[15] Reserve Ins. Co. v. Pisciotta, 30 Cal. 3d 800, 808 (1982).
[16] Spangle v. Farmers Ins. Exch., 166 Cal. App. 4th 560 (2008).
[17] Powerine Oil Co., Inc. v. Superior Court, 37 Cal. 4th 377, 391 (2005) (internal quotes omitted); *see also* CIV. CODE §1654.
[18] Minkler v. Safeco Ins. Co. of Am., 49 Cal. 4th 315, 321 (2010).
[19] Payless Shoesource, Inc. v. Travelers Cos., Inc., 569 F. Supp. 2d 1189 (D. Kan. 2008).
[20] California Dairies, Inc. v. RSUI Indemnity Co, 617 F. Supp. 2d 1023 (E.D. Cal. 2009).
[21] *Id.* at 1029.
[22] *Id.* at 1039-44.
[23] *Id.* at 1044-48.
[24] California Dairies, Inc. v. RSUI Indem. Co., 462 Fed. Appx. 721 (9th Cir. 2011).
[25] *Id.* at 722-23.
[26] Professional Security Consultants, Inc. v. U.S. Fire Ins. Co., 2010 WL 4123786 (C.D. Cal. 2010).
[27] Classic Distributing & Beverage Group, Inc. v. Travelers Cas. & Surety Co. of Am., 2012 WL 3860597 (C.D. Cal. Aug. 29, 2012), vacated by settlement at 2012 WL 5834570 (C.D. Cal. Nov. 06, 2012).
[28] *Id.* at *9.
[29] TriTech Software Sys. v. U.S. Specialty Ins. Co., 2010 WL 5174371 (C.D. Cal. 2010).
[30] *See also* Big 5 Corp. v. Gulf Underwriters Ins. Co., No. CV 02-3320 WJR(SHx), 2003 U.S. Dist. LEXIS 27209, at *9 (C.D. Cal 2003) (tentative ruling that a claim for overtime under the Labor Code is similar to the same claim under FLSA).
[31] SWH Corp. v. Select Ins. Co., 2006 Cal. App. unpub. LEXIS 8694 (Cal. App. Sept. 28, 2006).
[32] Buss v. Superior Court, 16 Cal. 4th 35, 61 (1995) (An insurer's duty to defend even one claim in a complaint extends to all claims in the complaint, even to those that are not otherwise covered under the policy.).
[33] Classic Distributing, 2012 WL 3860597, at *8 (citing CIV. CODE §2802(c)).
[34] *Id.* at *8.
[35] Murphy v. Kenneth Cole Prods., 40 Cal. 4th 1094 (2007).
[36] Bullock v. Maryland Cas. Co., 85 Cal. App. 4th 1435, 1448-49 (2001).
[37] Jaffe v. Cranford Ins. Co., 168 Cal. App. 3d 930, 934-35 (1985).
[38] LAB. CODE §§2698 *et seq.*
[39] Walker v. Countrywide Home Loans, Inc., 98 Cal. App. 4th 1158 (2002).