Case No. S156555

In The Supreme Court of the State of California

FRANCIS HARRIS, et al.,
Petitioners,

v.

THE SUPERIOR COURT OF LOS ANGELES COUNTY,
Respondent;

LIBERTY MUTUAL INSURANCE COMPANY, et al.,
Real Parties in Interest,

Second Appellate District, Division One
Nos. B195121/B195370
JCCP No. 4234 (*Liberty Mutual Overtime Cases*)
The Honorable Carolyn B. Kuhl

REPLY BRIEF ON THE MERITS

SHEPPARD MULLIN RICHTER & HAMPTON LLP
A Limited Liability Partnership
Including Professional Corporations
DOUGLAS R. HART, Cal. Bar No. 115673
GEOFFREY D. DEBOSKEY, Cal. Bar No. 211557
333 S. Hope Street
48th Floor
Los Angeles, California 90071
Telephone: (213) 620-1780

SHEPPARD MULLIN RICHTER & HAMPTON LLP
A Limited Liability Partnership
Including Professional Corporations
ROBERT J. STUMPF, JR., Cal. Bar No. 72851
WILLIAM V. WHELAN, Cal. Bar No. 116372
KARIN DOUGAN VOGEL, Cal. Bar No. 131768
501 West Broadway, 19th Floor
San Diego, California 92101-3505
Telephone: (619) 338-6500

Attorneys for Defendants and Real Parties in Interest

LIBERTY MUTUAL INSURANCE COMPANY
and
GOLDEN EAGLE INSURANCE CORPORATION

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San Diego, California 92101-3505
Telephone: (619) 338-6500

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I. INTRODUCTION

Contrary to plaintiffs' assertions, defendants do not ask the Court to "upend existing California jurisprudence," "tilt the playing field" of the workplace in favor of employers, or take California law in a "new direction" that is "hostile to workers." Unlike plaintiffs, defendants do not base their arguments on inapplicable canons of construction, considerations of public policy not tethered to the relevant statutory language, or speculation about the impact of a new political administration. Instead, defendants urge the Court to decide this case simply by interpreting the plain meaning of Wage Order 4-2001. To paraphrase the dissent below, plaintiffs' analysis is complex; ours is not. (See *Harris v. Superior Court* (2007) 154 Cal.App.4th 164, 196 (*Harris*).)

The issue before this Court is whether plaintiffs' work is "directly related to management policies or general business operations" of defendants or defendants' customers. (Cal. Code Regs., tit. 8, § 11040(1)(A)(2)(a)(i).) Defendants agree that the federal regulation that defines what this means (29 C.F.R. § 541.205[1]), and which Wage Order 4-2001 expressly adopted, sets forth two separate requirements.

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[1] Unless otherwise noted, all defendants' citations to federal regulations are to those regulations in effect in 2001 when Wage Order 4-2001 was adopted.

First, the work must be of a particular type, *i.e.*, it must relate to the "administrative operations of the business," as distinguished from production. Second, it must be of "substantial importance" to the management or operation of the business of the employer or the employer's customers. (See Answer Brief (AB) at p. 27.)

The work plaintiffs do as claims adjusters meets both of these requirements. The essence of plaintiffs' work involves "advising the management, planning, negotiating, [and] representing the company," the activities 29 C.F.R. § 541.205(b) defines as administrative work. Likewise, plaintiffs' work meets the substantial importance requirement because, as described further in 29 C.F.R. § 541.205(c), they are employees whose "work affects policy or whose responsibility it is to execute or carry it out." Indeed, section 541.205(c) specifically lists "claim agents and adjusters" as employees whose work can meet the test. This is hardly surprising or novel. Claims adjusters have been regarded as exempt administrative employees for more than 50 years. At a minimum, there are material questions of fact on these issues.

Thus, to reach the conclusion that plaintiffs can be exempt administrative employees, the Court does not need to create a new rule or formulate a new test. For certain, the Court should not adopt the new test the Court of Appeal majority announced below, namely that administrative work is restricted to those few employees who work "at the level of policy

or general operations." This judicially-created test stands in stark contrast to the express language of the controlling regulation, which states the exemption is "*not* limited to persons who participate in the formulation of management policies or in the operation of the business as a whole." (29 C.F.R. § 541.205(c), italics added.) Instead, the only relevant test is the one set forth in Wage Order 4-2001.

II. DISCUSSION

A. The Only Test Necessary: The Plain Meaning of Wage Order 4-2001

To interpret the administrative exemption in Wage Order 4-2001, one must look first to the Order itself. When one walks through the Order's plain language, it quickly becomes apparent that claims adjusters meet the test for performing work in an administrative capacity.

Subsection 1(A)(2)(a)(i) of the Wage Order states that a person employed in an "administrative capacity" is any person whose duties and responsibilities involve the "performance of office or non-manual work directly related to management policies or general business operations of his/her employer or his/her employer's customers . . . ." Without dispute, plaintiffs perform office or non-manual work. The question is whether such work is "directly related to management policies or general business operations."

Wage Order 4-2001 expressly incorporates 29 C.F.R. § 541.205(a), which clarifies that the phrase "directly related to

management policies or general business operations" contains two required elements: (1) it describes activities relating to the "administrative operations of a business," as distinguished from "production;" and (2) it limits the exemption to persons who perform work that is of "substantial importance to the management or operation of the business."[2] Plaintiffs work in an administrative capacity because they meet both of these required elements.

1. Plaintiffs' Work Relates to the Administrative Operations of the Business

Subsections (b) and (c) of this same regulation further explain, respectively, what these two required elements mean. Subsection (b) defines the "administrative operations of the business," distinguished from "production" by subsection (a), to include the "work performed by so-called white-collar employees engaged in 'servicing' a business as, for example, *advising the management, planning, negotiating, representing the company,* purchasing, promoting sales, and business research and control." (29 C.F.R. § 541.205(b) [italics added].)

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[2] "The phrase 'directly related to management polices or general business operations of his employer or his employer's customers' describes those types of activities relating to the administrative operations of a business as distinguished from 'production' or, in a retail or service establishment, 'sales' work. In addition to describing the types of activities, the phrase limits the exemption to persons who perform work of substantial

Plaintiffs are "white-collar employees" who service defendants' insurance business in these ways. Insurance companies are paid by their customers to accept risks that the customers cannot or elect not to assume themselves. Claims adjusters assist in servicing the insurer's business by helping to control costs and liabilities associated with paying or defending against claims related to the transferred risks. In this role, adjusters usually make coverage decisions based upon their review of the insurance contract, and then act on behalf of the company to implement those decisions. Defendants' Opening Brief sets forth detailed record citations demonstrating that plaintiffs are, by any reasonable construction of the words, involved in "advising the management, planning, negotiating, [and] representing the company." (See Opening Brief (OB) at pp. 4-8, 24-25.)

For example, plaintiffs, as claims adjusters, "advise management" by acting for the company to resolve claims within their authority, and counseling the company on how to address claims outside their authority. Plaintiffs "plan" the resolution of all of these claims from beginning to end. The planning includes such things as setting reserves (which also is advisory to management), hiring and overseeing outside

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importance to the management or operations of the business of his employer or his employer's customers." (29 C.F.R. § 541.205(a).)

attorneys or investigators, and determining how to handle subrogation or fraud issues. Plaintiffs "negotiate" with claimants or their attorneys to settle claims, and then "represent" the company by either committing the company to a settlement of a claim or declining on behalf of the company to provide coverage.

Because the evidence shows plaintiffs are engaged in activities subsection (b) includes within the "administrative operations of the business," it follows they are not engaged in "production" (which subsection (a) juxtaposes to "administrative activities" but does not otherwise define). In other words, for purposes of the so-called administrative/production worker dichotomy, which presents an either/or choice, claims adjusters fall squarely on the administrative side of the line. Given the undisputed facts and the clear meaning of the words used in the Wage Order and incorporated regulation, any other conclusion would be illogical and nonsensical.

2. Plaintiffs Perform Work of "Substantial Importance"

The second part of the administrative capacity test, whether plaintiffs perform work of "substantial importance to the management or operation of the business of [their] employer or [their] employer's

customers," is further explained by subsection (c) of 29 C.F.R. § 541.205.[3] In light of the plain language of that subsection, the majority's invented test limiting administrative work to that "performed at the level of policy or general operations" must be reversed. (See *Harris, supra*, 154 Cal.App.4th at p. 177.) Wage Order 4-2001 is clear: work of substantial importance is "*not* limited to persons who participate in the formulation of management policies or in the operation of the business as a whole." (See 29 C.F.R. § 541.205(c) [italics added], expressly incorporated in the Wage Order.) It also includes employees whose work "affects policy or whose responsibility it is to execute or carry it out." (*Id.*) Indeed, the Wage Order defines "administrative capacity" in terms of duties that are directly "*related to*" management policies or general business operations – a much different and broader test than "at the level of." (*Id.*)

Plaintiffs' work fits squarely within this definition, and yet again, the plain language of the regulation removes any doubt as to whether claims adjusters work in an administrative capacity. Subsection (c)(5) specifically lists "claim agents and adjusters" as examples of persons whose work is of "substantial importance." The majority's contrary conclusion contradicts the plain language of the operative test.

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[3] The concluding phrase "or the employer's customers" makes irrelevant plaintiffs' attempt to distinguish adjusters who work for an employer whose

Both the majority and the plaintiffs disregard the actual language of subsection (c) – that "employees whose work is directly related to management policies or to general business operations include those [whose] work affects policy or whose responsibility is to execute or carry it out" – by calling it, respectively, "regrettable" and "not a model of spectacular draftsmanship." (See *Harris*, 154 Cal.App.4th at p. 562 and AB at p. 30). Those cavalier nullifications of the regulatory language violate the Supreme Court's oft-repeated injunction to "give meaning to every word of a statute if possible [and to] avoid a construction making any word surplusage." (*Big Creek Lumber Co. v. County of Santa Cruz* (2006) 38 Cal.4th 1139, 1155.)

The conclusion that plaintiffs perform work of substantial importance also comports with the evidence, which shows the work plaintiffs do is significant to the defendants' businesses. (See OB at pp. 4-8.) Unlike the situation in *Bell v. Farmers Ins. Exch.* (2001) 87 Cal.App.4th 805, 828 (*Bell II*), where the employer admitted its employees' responsibilities were "routine and unimportant," the duties performed by plaintiffs are anything but. For example:

- The plaintiff claims adjusters' primary role is to protect the insurance company's purse strings. When claims are made, the

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principal business is *not* that of claims handling. (See AB at p. 33.)

insurer must either pay or defend against the claim. The adjuster is charged with controlling costs by coordinating the company's defense and by deciding or recommending when and how much to pay.

- In certain adjuster teams, the average claim value authorized by the adjuster exceeds $100,000. However, even adjusters with relatively lower levels of independent authority have the discretion to spend millions of dollars of their employer's funds each year to resolve claims.

- Even when settlements are not paid directly because the adjuster decides the company should deny a claim, the adjuster's decisions as to fault or liability affect the legal rights and obligations of the company.

In summary, the plain language of Wage Order 4-2001 sets forth the applicable test to determine whether employees work in an administrative capacity. The Wage Order defines the type of work that is considered administrative in nature. Claims adjusters perform this type of work. The Wage Order further defines those types of employees who perform work of substantial importance to their employers and expressly

lists claims adjusters as one such type of employee.[4] Given the foregoing, claims adjusters clearly work in an administrative capacity and cannot be categorically deemed to fall squarely on the production side of the administrative/production worker dichotomy.

B. Brief Responses to Plaintiffs' Ancillary Arguments

In an attempt to justify the majority opinion's aberrant test for what constitutes administrative work, plaintiffs stray into arguments based on inapplicable policy and rhetoric. In the face of the plain language of the Wage Order, plaintiffs' ancillary arguments are simply wrong.

1. Defendants' Citations to Federal Law Are Valid and Compelling

Plaintiffs criticize defendants for relying on "federal law, particularly federal cases decided after Wage Order 4-2001 was adopted," and argue defendants do not give enough importance to the DLSE Opinion letters. (See, e.g., AB at pp. 26–28.) Plaintiffs' criticisms are unfounded.

Defendants rely on federal law because the plain language of Wage Order 4-2001 requires as much, by specifically incorporating particular federal regulations. For the same reason, opinions by federal courts interpreting these regulations, as the regulations existed when Wage

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[4] As other examples of administrative employees, the regulations also list executive secretaries and administrative assistants, bank cashiers, stock

Order 4-2001 became effective, are a legitimate and critical part of the analysis.

This was so even before the Wage Order expressly incorporated the federal regulations. California law has for half a century recognized the legitimate "use of federal authorities as an aid to interpretation of the administrative exemption of [Wage Order 4]." (*Bell II, supra*, 87 Cal.App.4th at p. 814.) The reason for this long-time reliance on federal authority is that when the IWC first included the phrase "administrative, executive, or professional" in Wage Order 4 in 1957, it "plainly borrowed" the phrase from parallel language under federal law. (See *id.*)

The IWC's stated goal in issuing Wage Order 4-2001 of promoting "uniformity of enforcement" between state and federal law further validates the historical practice. (See Statement As to Basis, Vol. 5, Tab 62, p. 1292.) The inescapable conclusion is that the IWC intended the federal regulations it made part of Wage Order 4-2001 to be read the same way under state and federal law. The U.S. Department of Labor (DOL), the agency authoring the regulations, has repeatedly and for decades stated that claims adjusters can be exempt administrative employees. The same is true

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brokers, statisticians, and tax consultants. (See 29 C.F.R. §§ 541.201(a) and 541.205(c), (d).)

of the opinions of federal courts interpreting the regulations, as they existed when Wage Order 4-2001 became effective.[5]

If California courts are to respect the mandate of the IWC, they must acknowledge that for generations federal courts and the DOL have spoken with one voice: insurance claims adjusters can be exempt administrative employees. As the Ninth Circuit Court of Appeals recently observed, "[f]or more than 50 years, the Department of Labor has considered claims adjusters exempt from the Fair Labor Standards Act's overtime requirement." (*Miller v. Farmers Insurance Exch. (In Re Farmers Ins. Exch.)* (9th Cir. 2007) 481 F.3d 1119, 1124.) Not one federal court has reached the opposite conclusion.[6]

Contrary to plaintiffs' urgings, uniformity between federal and state law on this point is not undermined by the federal policy allowing states to enact laws providing greater protections to employees, or by California's

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[5] Contrary to plaintiffs' claims, all of the federal cases defendants cite on this point interpret the regulations as they existed when Wage Order 4-2001 became effective – regardless of the dates of the opinions.

[6] As set forth in detail on pages 28–33 of defendants' Opening Brief, the Ninth Circuit's conclusion has also been adopted by the Fifth and Seventh Circuit Courts of Appeal. The Ninth Circuit's decision in *Bratt v. County of Los Angeles* (9th Cir. 1990) 912 F.2d 1066, which was decided long before *In re Farmers Insurance Exchange, supra,* and did not involve insurance claims adjusters, does not undercut the unbroken line of insurance adjuster cases.

practice of sometimes doing so. Certainly, as this Court noted in *Ramirez v. Yosemite Water Co.* (1999) 20 Cal.4th 785, 794, either the Legislature or the IWC can provide greater protections for employees under California law. The critical point is that neither the Legislature nor the IWC did so here. Instead, in the Wage Order, the IWC both copied and directly incorporated federal law, while at the same time plainly endorsing "uniformity of enforcement" under state and federal law. For all of plaintiffs' rhetoric about how California wage and hour law *can* deviate from federal law, they do not and cannot cite to one difference between the California and federal administrative capacity tests.[7]

Plaintiffs also want this Court to ignore the views of the agency that drafted the regulations in favor of a conclusory opinion written by a staff attorney for California's DLSE (at the request of the plaintiffs in *Bell*, which was pending in the trial court at the time). The DLSE's opinion purports to analyze the administrative/production worker dichotomy – a tool that springs exclusively from the federal regulations. As plaintiffs concede, these letters are not binding interpretations of California law (and certainly

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[7] The administrative exemption is narrower under California law than under federal law in an area not relevant to the plain language interpretation of "administrative capacity." Under California law, an exempt administrative employee must be engaged more than 50% of his or her time in exempt duties. (Compare Cal. Labor Code § 515(e) with 29 C.F.R. § 541.700 (2004).)

not of the federal regulations) and the DLSE no longer provides them in connection with pending litigation. (See AB at p. 17.) In the past, California courts have often disagreed with the views expressed in DLSE opinion letters. (See OB at p. 54.) The Court has no reason to rely on the DLSE opinion letters here, where the letters purport to analyze federal regulations; directly contravene the position of the DOL (the author of the regulations) and thus of the IWC (which called for uniformity of enforcement); contradict generations of federal jurisprudence; and conflict with the plain language of Wage Order 4-2001 and the incorporated regulations.

2. Plaintiffs' "Day-to-Day" Job Duties Nonetheless Constitute Administrative Work

Plaintiffs create a distorted image by referring to themselves as "line workers," and claim they are not administrative employees because they "play no role in hiring or firing, determining pay levels, discipline or accounting." (AB at p. 3.)[8] To continue the menial depiction, they cite the

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[8] Plaintiffs' record citations are problematic. Three examples will suffice. First, plaintiffs sometimes improperly extrapolate testimony from one witness, working in one particular job function, to all insurance adjusters in both companies. (See, e.g., Pl. Exh., Vol. 4, pp. 1178–1180 and Pl. Exh., Vol. 5, pp. 1201–1202.)

Second, plaintiffs truncate evidence for effect. To argue that defendants "overwork" their claims adjusters, for example, plaintiffs cite an orientation document which states: "You will NEVER be 'done' in this job" (AB at p. 25), but delete the last three sentences: "Burnout is not good for you, your family or the Company. When you need help, ASK FOR IT. Do not be a hero." (Pl. Exh., Vol. 4, p. 1035.)

majority's characterization of their work ("investigating," "negotiating," etc.) as being "day-to-day," presumably to give the false connotation their work is routine and unimportant. (See AB at pp. 20–21.) Plaintiffs contrast this portrayal of their work with the majority's view that only employees who work "at the level of policy or general operations" work in an administrative capacity. (AB at pp. 3, 16.)

If the administrative exemption were limited to those few employees who perform work at a policy-making level, the regulations would not have contemplated that the administrative work in a company may be voluminous, making it "necessary to employ a number of employees in some of these categories." (29 C.F.R. § 541.205(c)(6).) Further, the regularity with which an employee performs his or her work (*e.g.*, day-to-day) does not make work that is administrative any less so. (*Cf.* Labor Code § 515(e), requiring an exempt administrative employee to be engaged more than 50% of his or her time in exempt duties.)

Plaintiffs do not have to make policy, or even operate the business as a whole, to do administrative work. As discussed at length

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Third, plaintiffs try to minimize their level of authority by falsely creating the impression defendants use auditors to review each file. Instead, defendants conduct certain reviews of a small percentage of files of already settled claims only once or twice a year. (See, e.g., Vol. 1, Tab 11, pp. 122–123; Vol. 1, Tab 15, p. 148.)

above, the plain language of the Wage Order is not so limited and the majority opinion erred in requiring as much. Instead, 29 C.F.R § 541.205(c) includes within the exemption employees who, like plaintiffs, perform work that "affects policy or whose responsibility it is to execute it or carry it out."

Plaintiffs also argue they are not administrative employees because they are supervised by "others playing the actual administrative role," and they do not perform tasks such as "hiring," "firing," and "disciplining" other employees. (See AB at p. 3.) The roles and tasks distinguished by plaintiffs, however, are the roles and tasks usually filled by employees who instead fall within the scope of the executive exemption. (See Wage Order 4-2001, § 1(A)(1).) Plaintiffs' argument thus highlights one of the serious flaws in their position and the majority's opinion: both conflate the administrative exemption with the executive exemption. The result is the effective elimination of the administrative exemption as it has been applied since its inception, not only for claims adjusters but also for all other types of employees traditionally considered administrative as opposed to supervisory or executive. To paraphrase the Ninth Circuit, the Court should not apply a test that so clearly would "frustrate the purpose and spirit of the entire exemption." (*Webster v. Pub. Sch. Employees of Wash., Inc.* (9th Cir. 2001) 247 F.3d 910, 916.)

3. The Dichotomy Adds No Value to This Analysis

The parties have spilled much ink at every stage of this litigation arguing about the meaning, applicability and utility of the administrative/production worker dichotomy. After defendants filed their Opening Brief, a California Court of Appeal joined the chorus of courts giving no real credence to the dichotomy. (See *Combs v. Skyriver Communications, Inc.* (2008) 159 Cal.App.4th 1242, 1259-1261 (court of appeal held trial court properly refused to apply the dichotomy in determining the plaintiff's work was administrative under Wage Order 4-2001).)

As even its defenders note, the dichotomy is at best an analytical tool that may be of assistance to a court when a job falls squarely on the production side of the line. (See OB at pp. 38–41.) If nothing else, the lengthy, convoluted and strained analysis of both the majority opinion here and plaintiffs' brief make it clear that claims adjusters cannot be said to fall squarely on the production side. Were it otherwise, plaintiffs would not have had to resort to arguments involving inapplicable canons of statutory construction, extraneous considerations of public policy, and changing presidential administrations. Plainly, the dichotomy is of little or no utility to the analysis in this case. Instead, the Court should simply apply the plain meaning of the Wage Order and the incorporated regulations.

4. The Class Should Be Decertified

Finally, plaintiffs argue that even if the Court finds the dichotomy is not dispositive, class certification is still appropriate in light of this Court's opinion in *Sav-On Drug Stores, Inc. v. Superior Court* (2004) 34 Cal.4th 319. (AB at pp. 43–44.) The trial court disagreed. Instead, it expressly stated that unless the dichotomy is dispositive, there were "significant variations in the duties of various class members" that made class certification inappropriate. (Vol. 6, Tab 72, p. 1469.) It was on that basis, because "individual inquiries might be necessary to assess each class member's exempt status," that the court decertified the class for the period after the effective date of Wage Order 4-2001 (when it found the dichotomy was not controlling). (Vol. 6, Tab 72, p. 1469.)

Accordingly, if the Court concludes, as defendants submit it should, that the dichotomy is not dispositive before or after Wage Order 4-2001, it should remand to the trial court with instructions to decertify the class in its entirety.

III. CONCLUSION

The majority's opinion cannot be correct. In limiting the administrative exemption to employees who work at the level of policy or general operations, the opinion reaches a conclusion that contradicts the express language of Wage Order 4-2001, more than 50 years of authority under federal law, and the IWC's stated intent of promoting uniformity of

enforcement with federal law. Applying its erroneous new test, the majority held that not one of defendants' hundreds of claims adjusters, working for two different companies in 39 separate job classifications, does administrative work – even though one of the federal regulations that is now part of California law lists "claim agents and adjusters" as examples of employees who work in an administrative capacity.

Given the breadth of the class in this case and all of the different types of adjusters and different kinds of policies and coverages handled by this class, the majority opinion below means that no claims adjuster in California could ever qualify as an administrative employee. At the same time, claims adjusters in the entire rest of the country can be exempt administrative employees under the identical regulatory language. On this point of law, the goal in California is that its law should be enforced the same as in the rest of the nation. The time has come for this Court to set the matter right.

For these reasons, the Court should direct the trial court to reinstate its order denying plaintiffs' motion for summary adjudication. In addition, because the plaintiffs' motion for class certification was based on the erroneous premise that the dichotomy could be outcome-determinative

on the issue of liability in this case, the Court should also direct the trial court to decertify the class in its entirety.

Dated: June 3, 2008

SHEPPARD, MULLIN, RICHTER & HAMPTON LLP

By _____
DOUGLAS R. HART
Attorneys for Defendants and Real Parties in Interest
LIBERTY MUTUAL INSURANCE COMPANY and
GOLDEN EAGLE INSURANCE CORPORATION

CERTIFICATE OF WORD COUNT

(Cal. Rules of Court, Rule 8.504 (1)(d))

The text of this Reply Brief on the Merits consists of 4,194 words, including all footnotes, as counted by the computer program used to generate this brief.

DATED: June 3, 2008

SHEPPARD, MULLIN, RICHTER & HAMPTON LLP

By _____
DOUGLAS R. HART

Attorneys for Defendants and Real Parties
LIBERTY MUTUAL INSURANCE COMPANY
and
GOLDEN EAGLE INSURANCE CORPORATION

PROOF OF SERVICE
STATE OF CALIFORNIA, COUNTY OF SAN DIEGO

I am employed in the County of San Diego; I am over the age of eighteen years and not a party to the within entitled action; my business address is 501 West Broadway, Suite 1900, San Diego, CA 92101.

On **June 3, 2008**, I served the following document(s) described as

REPLY BRIEF ON THE MERITS

on the interested party(ies) in this action by placing true copies thereof enclosed in sealed envelopes and/or packages addressed as follows:

See attached list.

☒ **BY MAIL:** I am "readily familiar" with the firm's practice of collection and processing correspondence for mailing. Under that practice it would be deposited with the U.S. postal service on that same day with postage thereon fully prepaid at San Diego, California in the ordinary course of business. I am aware that on motion of the party served, service is presumed invalid if postal cancellation date or postage meter date is more than one day after date of deposit for mailing in affidavit.

☒ **STATE:** I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Executed on **June 3, 2008**, at San Diego, California.

Yvette Moller

SERVICE LIST

Ira Spiro, Esq. Katherine J. Odenbreit, Esq. Justian Jusuf, Esq. Spiro Moss Barness LLP 11377 W. Olympic Blvd., 5th Floor Los Angeles, CA 90064-1683 Telephone: (310) 235-2468 Facsimile: (310) 235-2456	Co-Counsel for Petitioners, Plaintiffs, and Real Parties in Interest
Steven W. Pepich, Esq. COUGHLIN STOIA GELLER RUDMAN & ROBBINS LLP 655 West Broadway, Suite 1900 San Diego, CA 92101 Telephone: (619) 231-1058 Facsimile: (619) 231-7423	Co-Counsel for Petitioners, Plaintiffs, and Real Parties in Interest
Timothy Cohelan, Esq. COHELAN & KHOURY 605 C Street, Suite 200 San Diego, CA 92101-5305 Telephone: (619) 595-3001 Facsimile: (619) 595-3000	Co-Counsel for Petitioners, Plaintiffs, and Real Parties in Interest
Michael L. Carver Law Offices of Michael L. Carver 1600 Humbolt Road, Suite 3 Chico, CA 95928-8100 Telephone: (530) 891-8503 Facsimile: (530) 891-8512	Co-Counsel for Petitioners, Plaintiffs, and Real Parties in Interest
Ronald A. Reiter Supervising Deputy Attorney General Consumer Law Section Office of the Attorney General 455 Golden Gate Avenue, Suite 11000 San Francisco, CA 94102 Telephone: (415) 703-5500	Attorneys for Non-Party, State of California
Consumer Law Section Los Angeles District Attorney 210 West Temple Street, Suite 1800 Los Angeles, CA 90012-3210 Telephone: (213) 974-3512 Facsimile: (213) 974-1484	Attorneys for Non-Party, County of Los Angeles