

UNSETTLING DEVELOPMENTS IN THE SETTLEMENT OF WAGE & HOUR LITIGATIONS

by **Laurent S. Drogin**

It is widely understood that the vast majority of lawsuits settle before trial. From a company's perspective, early resolution ensures certainty and limits legal expense, business distraction and – of course – liability. In recent years, corporate counsel have been dealing with a massive increase in wage and hour issues, often in the form of a lawsuit, Department of Labor investigation or an in-house compliance audit.

Any attorney who has experienced a wage and hour issue learns quickly that these are thorny matters. Wage and hour cases are distinct from other types of employment claims for a variety of reasons, including the affirmative obligation they impose upon employers to apply the wage and hour laws to all employees. This differs from harassment and discrimination cases, for example, where through use of a reporting procedure an employer may be insulated from liability if an employee fails to lodge a complaint. Similarly, harassment and discrimination cases commonly involve one or perhaps a few bad actors, a limited number of aggrieved employees, and liability that is contained to a small subset of the entire workforce.

By contrast, in the wage and hour arena current and even former employees are potential economic beneficiaries when a claim is raised by a single employee acting in a representative capacity for others "similarly situated." Further, employers are obligated to comply with federal, state and local laws which are often confusing, impose differing requirements, wield harsh penalties for inadvertent errors, and are often not covered by insurance. If ever there was a case to settle quickly, it is one that involves a wage and hour claim.

One of the most curious characteristics of the Fair Labor Standards Act (FLSA), the federal law that imposes minimum wage and overtime rules, is that claims can only be formally settled through the Department of Labor or with court approval. To be approved, the court must deem the settlement to be "fair and reasonable." "Fairness hearings" are often conducted, similar to the process utilized in a traditional class action lawsuit where the court can ask questions and the plaintiff lodge objections.

Absent such approval, releases obtained in private settlements of FLSA claims (that are never litigated) are neither binding nor enforceable. Despite this, a trend is emerging in which employers receiving a demand letter with an accompanying draft complaint and an offer to negotiate a settlement before a lawsuit is ever filed. Faced with the prospect of either full-blown litigation or a quick, less expensive private settlement that kicks the risk of future litigation down a road that may or may not ever be traveled,

employers are more often availing themselves of this option. The best an employer can do in a pre-litigation settlement is to obtain a representation that the settling employees acknowledge that they have been paid for all hours worked. With this comes the hope that that, once paid, the employees will look no further and that they will not learn that they might be entitled to more money.

The trend has been caused in part by a clever and counterintuitive method being utilized by courts to dissuade the filing of “small” FLSA suits (such as those on behalf of a single or small group of employees): Courts are refusing to approve settlements. Though the logic seems backwards, concerns about obtaining court approval of a settlement reached during litigation are causing lawyers to reconsider court as an option.

As an example, assume a situation in which an employer conducts a self-audit and discovers it owes a group of employees \$100,000 for unpaid overtime covering the prior two-year period. The employer provides them with an explanatory letter and pays the overtime. Feeling content, the employees accept the money, think better of the employer, and may see no reason to involve an attorney. This is even more likely if some of the employees are undocumented, a fact neither they nor the employer are likely to want made public in a lawsuit. Although there are no releases, perhaps owing to human nature, the “found money” reduces the likelihood of future litigation.

But what if, upon receiving the check, one employee shows it to a lawyer. Or perhaps it makes its way to a lawyer because the employer is requiring the employee to sign a release in order to be paid. Seeing the admission that there was unpaid overtime in the first place, the attorney rightly concludes that the new client may also be entitled to recover liquidated damages, and that if the employer’s violation was willful the overtime calculation should extend back to the full three year statute of limitations under the FLSA (not just the two years that were paid) and six years under the New York Labor Law. This lawyer also identifies other claims the employer either did not know about or chose to ignore, such as timeclock rounding errors, improper deductions, spread of hours pay, and failure to give notices required by New York’s Wage Theft Prevention Act. The list can go on. What follows is either a demand letter with an invitation to settle or a lawsuit. If a lawsuit is filed the chances are high that it will settle before trial.

Courts will approve settlements only if they are deemed “fair and reasonable,” based on the application of several factors that are not self-defining. “Fair and reasonable” is a vague and elusive concept, especially when you take the complaint in one hand and the settlement terms in the other. Due to “kitchen sink” pleadings, where every claim under the sun is brought – often “on information and belief” - the settlement terms rarely bear strong resemblance to the causes of action pled and damages sought in complaint.

Stated simply, where the complaint seeks X and the parties are agreeing to settle for a small percentage of X, attorneys now run a greater risk that increased scrutiny will result in the court rejecting the settlement as failing the fair and reasonable test. If so, the parties are stuck in a litigation they want to end. This risk is keeping some cases from ever being filed. In rejecting settlements, courts have several tools at their disposal and here is how they are using them:

Rule 68 Offers of Judgment

Rule 68 of the Federal Rules of Civil Procedure is a settlement incentive tool. Applied to FLSA cases, it permits a defendant to offer the plaintiff the opportunity to enter a judgment against it for a self-specified amount (that may be inclusive or exclusive of plaintiffs’ legal fees). If declined, and the plaintiff does not recover a judgment for more than the amount offered, then the plaintiff may not recover costs incurred after the date of the rejected offer. Note that a plaintiff would still be entitled to recover all reasonable attorneys’ fees, even those incurred after rejection of the Offer of Judgment.

In practice, an accepted Rule 68 offer rarely results in the actual entry of a judgment. Typically it will result in a negotiated settlement agreement and the filing of a voluntary Stipulation of Dismissal pursuant to Rule 41 of the Federal Rules of Civil Procedure. But since courts must approve FLSA settlements, what if the judge refuses to “So Order” the Stipulation of Dismissal until studying the settlement terms to ensure they are fair and reasonable? Alternatively, what if the Offer of Judgment is accepted and the judge refuses to enter the judgment, out of concern that the offer was not fair and reasonable? If it is not easy to end a lawsuit – even on consent – plaintiffs’ attorneys may think twice about bringing smaller cases in court.

Confidentiality Clauses

The settlement of a lawsuit involving a single or several plaintiffs (as opposed to larger class or collective actions) would ordinarily contain a provision requiring the plaintiffs to keep the terms of the settlement confidential. An employer would want, if not insist on, confidentiality to prevent settling plaintiffs from alerting current and former coworkers that they, too, could be owed money. Courts are now rejecting the inclusion of such clauses because they run counter to the FLSA's intent of ensuring that employees are properly paid. Depending on the facts and circumstances, confidentiality may be a deal breaker, without which employers would not settle.

On the other hand, settlement of potential claims prior to the filing of a lawsuit can include confidentiality requirements. Even if such provisions might be unenforceable, employees receiving checks are more likely to abide by confidentiality provisions fearing unforeseen consequences. And if such employees see no economic benefit for themselves, they have less incentive to risk violating a confidentiality provision simply to alert others who may also have claims.

Releases

When court approval of an FLSA settlement is sought, there is nothing prohibiting the defendants from obtaining releases from settling plaintiffs. However, courts are now rejecting settlements where the releases extend beyond those claims actually raised in the complaint. Thus, an employer seeking to obtain a broad general release covering all employment-related claims may have to pay additional consideration or accept a narrower release. If a broad release was a material term of the settlement, a court's failure to approve it may place the entire settlement in jeopardy. In settlements reached outside of court a broad general release may have the prophylactic effect of giving employees a sense of closure, meaning they are less likely to pursue additional claims.

Explain "Fair and Reasonable"

Perhaps the most powerful strategy courts are using is to compare the settlement terms to the claims made in the complaint. For example, courts are often dissecting settlement terms and inquiring as to why certain claims are being heavily

compromised and/or how settlement monies are being allocated among plaintiffs. This returns us to the "fair and reasonable" concept.

Often, wage and hour settlements are heavily negotiated and are like the proverbial "sausage" in that no one actually wants to see them being made. Courts, though, are asking for the recipes and holding attorneys accountable for what they place on the plate. Sometimes there are good and valid reasons for compromising or abandoning claims. For example, if the potential exposure is so great that it would force a business to close; or if there are significant legal issues that might swing the exposure between two extremes, a compromise is in order.

Envision a scenario where a plaintiff's lawyer commences a "small" FLSA lawsuit but comes to learn that due to employee turnover, lost records and previously unknown violations, the actual exposure is exponentially larger than originally thought. This can easily happen, especially where a short-term employee brings FLSA claims on behalf of a collective group without realizing the extent of prior turnover or that prior time and pay records may no longer exist. So what was thought to be small case is materially larger. Imagine further that, in the same case, it is alleged that the employer failed to provide employees with the wage notice required by the New York Wage Theft Prevention Act.

A settlement is negotiated where the wage notice claim is being settled for zero, as the employer demonstrated that it did, in fact, provide the required notices. Here, the judge might ask how such a claim came to be filed on behalf of a class in the first place. In other words, did plaintiffs' counsel conduct a sufficient investigation of the facts required by Federal Rule 11 before he or she signed and filed the complaint? If not, the threat of sanctions looms.

Next, assume that the remaining claims are being settled for a sum-certain. More often, judges are requiring the attorneys to disclose the range of exposure (best case and worst case scenarios) and to explain the negotiation process – the making of the sausage – that led to agreement on terms. This is not to suggest that wage and hour settlements are conspiratorial. However, the "fair and reasonable" standard gives judges wide berth to challenge the negotiation process and outcome, with the viability of the settlement hanging in the balance.

Is ADR the wave of the future?

Practitioners looking for court-approved settlements now have incentive to demonstrate that the settlement negotiations were the product of arm's length negotiations. The most effective tool is to settle before a United States Magistrate Judge, which is always an option available to litigants in federal court. Since the court is essentially overseeing and participating in the settlement process, it stands to reason that approval will be granted.

Private mediators may also be used; the concept being that a well-established and highly regarded mediator lends an imprimatur of integrity to the settlement process and provides the type of oversight intended to impress the court that the settlement is fair and reasonable. We have yet to see a case where a court has requested more information from or about the mediator. But we can envision situations where the precise role and efforts of the mediator could arouse a court's interest (or suspicion), thereby subjecting the settlement to a more exacting scrutiny.

Nor have we seen a case where the parties have arbitrated a wage and hour case with a prevailing plaintiff seeking to confirm the arbitrator's award. Imagine a situation where a demand letter is sent. Instead of litigating in court, the parties agree to arbitrate on behalf of 15 co-employees. On the day of the arbitration the parties agree to settlement terms. The arbitrator, whose award cannot be set aside for errors of fact or law, issues a "Consent Award" in accordance with the agreed-upon settlement terms. The parties jointly move to have the award confirmed. Must the court adhere to the "great deference" standard that accompanies arbitral awards, or can the court reject the award and refuse to confirm it unless a fairness hearing is held? Worse, can the court sua sponte direct the parties to show cause as to why the

award should not be vacated absent demonstrable proof that it represents a "fair and reasonable" settlement of the dispute? For the moment these are rhetorical questions, however, it is easy to view these scenarios as fast-approaching on the horizon.

Conclusion

Wage and hour cases have inundated the court system for several years and courts are paying closer attention to proposed settlements. Practitioners have discovered that keeping cases out of court is sometimes a better alternative: Court dockets ease; employees obtain partial but prompt relief and need not waive existing rights, employers avoid becoming entangled in expensive and time consuming litigation and hopefully correct improper pay practices. Whether these results actually fulfill the purpose of the FLSA can be debated. Of course, the best way to avoid your client finding itself on the bottom of a caption or in receipt of a demand letter is to stress the need for diligent compliance with the wage and hour laws from the outset.

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