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On the Edge

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Wage and Hour Law: Compliance and Consequences

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While many agree that some increase in the federal minimum wage makes sense, the impact of such an increase on a distressed business can be devastating. The federal minimum wage has not changed since 2009, and pressure on federal, state and local governments to increase minimum wages has increased in recent years. On Nov. 8, 2016, voters in Arizona, Colorado, Maine and Washington voted to increase their minimum wage, and 20 more states are expected to follow suit in 2017.[1] As of Dec. 31, 2016, the City of New York increased its minimum wage by 14-18 percent for most workers.[2]

Overtime rules are also controversial. On Nov. 22, 2016, the U.S. District Court for the Eastern District of Texas enjoined the Department of Labor (DOL) from implementing and enforcing changes to the Fair Labor Standards Act's (FLSA) Overtime Rule set to go into effect Dec. 1, 2016. This rule would have doubled the salary threshold for employees who are exempt from overtime pay.[3] The preliminary injunction is on appeal with the Fifth Circuit, and only time will tell what action, if any, the new administration under President Donald Trump will take.

Business Impact

Changes in wage and hour laws not only impact profitability, they may also require reorganization of human resources at both the headcount and job-description levels in order to minimize substantial litigation risk for noncompliance with wage and hour laws. As wage and hour issues have moved to the forefront of the news, DOL enforcement and private litigation have continued to expand.

The number of FLSA collective actions and state class actions has risen — such that wage and hour class and collective actions account for 90 percent of all state and federal court employment class actions filed in the U.S.[4] In 2010, the average reported settlement in the 10 largest wage and hour class and collective actions was $34 million.[5] Many of these cases are brought under both the FLSA and state law, which implicate different class-action certification standards.

This litigation increases the cost of administration of a debtor's estate, exposes the debtor's directors and officers to personal liability, and dilutes value for stakeholders, which sometimes results in a complete loss of the value of their claims. Preemptively, debtors' counsel and financial advisors can assist the debtor in identifying compliance issues by understanding the laws in the relevant jurisdiction, conducting wage and hour studies, and preparing costing models and sensitivity analyses. These analyses and models become increasingly complex for businesses with multiple locations within a state or across the nation, as wage and hour issues must be reviewed in light of applicable law, including the existence of built-in minimum wage increases.

Hot Spots for Wage and Hour Litigation

Wage and hour litigation usually involves one or more of the following issues: misclassification, "off-the-clock" work, "regular-rate" miscalculation or joint employment of personnel. Employee misclassification is a common issue because the rules defining those exempt from overtime are not

1 "Wage and Hour Division," U.S. Department of Labor, *available at* www.dol.gov/whd/minwage/america.htm (unless otherwise specified, all links in this article were last visited on Jan. 25, 2017).

2 In certain states, such as New York, the minimum wage may vary by city, county, region, size of business or industry. *See* "Minimum Wage," New York State Department of Labor, *available at* labor.ny.gov/workerprotection/laborstandards/workprot/minwage.shtm.

3 The rule increased salary requirements for exempt workers from $23,660 to $47,476 per year. *See* Wage and Hour Division, U.S. Department of Labor, *available at* www.dol.gov/whd/overtime/final2016.

4 *See* Automatic Data Processing Inc., *available at* adp.com/tools-and-resources/adp-research-institute/insights.

5 *Id.*

straightforward and require a three-prong analysis: (1) the employee must be paid a salary above a minimum threshold; (2) the salary may not be subject to impermissible deductions; and (3) the employee must perform primarily exempt work — work that meets the requirements of one of the FLSA's "duties tests" for executive, administrative, professional, outside sales, computer employees and certain retail employees.

Discussion of these tests is beyond the scope of this article, but it is important to be aware that job-level analysis of exempt employees can be time-consuming and could require outside counsel and advisors to ensure compliance. An example of widespread noncompliance is the case of *Haliburton Co*. In 2014, the company paid nearly $18.3 million after a DOL investigation found that it had made all salaried employees exempt from overtime without regard for their actual job duties, impacting 28 different positions and more than 1,000 workers.[6]

Misclassification may also occur with individuals identified as "independent contractors." In April 2016, Uber offered $100 million to settle a class action by drivers who alleged that they were improperly classified as independent contractors.[7] The tests used to define independent-contractor status vary based on applicable federal and state laws. Under the FLSA, courts look to the "economic realities" of the relationship and whether the individual is economically dependent on the supposed employer. Another good reference point might be Internal Revenue Service (IRS) Form SS-8, which the IRS uses to assess the degree of behavioral and financial control exercised over the individual and his/her relationship to the company.

Litigation involving "off the clock" work and "regular rate" calculations has also increased. Off-the-clock wage litigation can include allegations of nonpayment for time "donning and doffing" uniforms and protective gear, security checks and time spent uploading programs.[8] Regular-rate litigation typically includes allegations of failure to pay minimum wages or overtime due to the exclusion of certain wages, pay differentials, commissions, bonuses and perquisites from the employee's regular rate of pay. Regular-rate litigation can also involve claims by piecemeal workers or employees paid at blended rates for different jobs worked.[9]

Joint employment is another source of litigation for companies hiring personnel through staffing companies or labor contractors.[10] Joint-employment litigation has touched franchisors in disputes over whether a franchisor is liable for failures of its franchisees to properly pay their employees. In *Ochoa v. McDonald's Corp*.,[11] the franchisee's employees could not establish franchisor joint-employment liability under a "control theory" (control of day-to-day operations), but they were allowed to proceed past summary judgment against McDonald's under an "ostensible agency theory," as the court found that they may have reasonably believed they worked for McDonald's because they wore McDonald's uniforms, served McDonald's food in McDonald's packaging and received paperwork with the McDonald's name and logo.

Managing Existing Wage and Hour Litigation in Bankruptcy

While class action certification is used sparingly in bankruptcy cases,[12] a bankruptcy filing may materially alter class action litigation, including wage and hour cases. Not only does the defendant/debtor receive the benefit of the automatic stay under § 362, but the Rule 23 analysis might be materially altered. For example, if a company files a bankruptcy petition on the eve of class certification, the ability of the putative class to receive class action certification might be diminished, given that the bankruptcy process itself is a collective action where hundreds or thousands of claims are resolved in any given case.

In addition to requiring the putative class to satisfy the Rule 23 requirements, bankruptcy courts consider a nonexhaustive list of factors prior to granting or denying a Rule 7023 motion, including (1) the benefits of proceeding as a class versus the cost of class litigation; (2) any undue delay or complication in administering the bankruptcy estate, which might be caused by class litigation; (3) the timeliness of the Rule 7023 motion; and (4) whether proceeding as a class is superior to the ordinary bankruptcy-claims process.[13] Additional considerations include whether the class members received notice of the claims bar date,[14] whether the class was certified pre-petition,[15] the sufficiency of the bases for the claims, an adequate definition of the class members, the estimated claim amounts, the appropriateness of class division into subclasses, and the temporary allowance of the claim and voting rights.

Consider *In re Pac. Sunwear of Cal. Inc*.,[16] a case in which thousands of former employees successfully asked the bankruptcy court to forego the ordinary process for administering claims and

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6 "Halliburton Pays Nearly $18.3 Million in Overtime Owed to More than 1,000 Employees Nationwide After U.S. Labor Department Investigation," DOL News Release, *available at* www.dol.gov/opa/media/press/whd/WHD20151647.htm.

7 The California district court declined to approve the settlement, stating that it did not sufficiently compensate class members. *O'Connor, et al. v. Uber Techs. Inc., et al.*, Case No. 13-cv-03826-EMC, and *Yucesoy, et al. v. Uber Techs. Inc., et al.*, Case No. 15-cv-00262-EMC. The cases are ongoing.

8 *IBP Inc. v. Alvarez*, 546 U.S. 21 (2005); *Mitchell v. JCG Indus. Inc.*, 745 F.3d 837 (7th Cir. 2014); *Integrity Staffing Solutions Inc. v. Busk*, 135 S. Ct. 513 (2014); and *Waine-Golston v. TWEAN*, 2013 WL 1285535 (S.D. Cal. March 27, 2013).

9 *Lopez v. Genter's Detailing Inc*., 511 Fed. App'x. 374 (5th Cir. 2013).

10 *Schultz v. Capital Int'l Sec. Inc*., 466 F.3d 298 (4th Cir. 2006) (example of "horizontal" joint employment), and *Zheng v. Liberty Apparel Co*., 355 F.3d 61 (2d Cir. 2003) (example of "vertical" joint employment).

11 133 F. Supp. 3d 1228 (N.D. Cal. 2015).

12 *In re Ephedra Prod. Liab. Litig*., 329 B.R. 1, 5 (S.D.N.Y. 2005) (citing cases and stating, "These cases make clear that bankruptcy significantly changes the balance of factors to be considered in determining whether to allow a class action and that class certification [might] be less desirable in bankruptcy than in ordinary civil litigation") (internal quotations omitted).

13 *In re Circuit City Stores Inc*., 439 B.R. 652, 658 (E.D. Va. 2010), (citing *In re Computer Learning Ctrs. Inc*., 344 B.R. 79, 92 (Bankr. E.D. Va. 2006)); *aff'd in part on other grounds sub nom., Gentry v. Siegel*, 668 F.3d 83 (4th Cir. 2012).

14 *In re Musicland Holding Corp*., 362 B.R. 644 (Bankr. S.D.N.Y. 2007).

15 *Id.*

16 No. 16-10882 (LSS), 2016 Bankr. LEXIS 2976, at *1 (U.S. Bankr. D. Del. Aug. 8, 2016).

instead use the class action process, based in part on issues that are specific to California law. The court certified the employees' class proof of claim based on three primary factors: (1) the potential class members had been intentionally excluded from receiving notice of the claims bar date; (2) the claimants sought certification under Rule 7023 early in the case; and (3) the claimants' theories included a claim under the California Labor Code Private Attorneys General Act, a representative-type claim not requiring class certification.

Challenges of Wage and Hour Litigation

Certain challenges of wage and hour litigation are illustrated by the FLSA collective action, *Monroe v. FTS USA LLC*.[17] The jury verdict in the collective's favor was appealed on issues of the timing of collective certification and the "similarly situated" standard, use of "representative sampling" to limit discovery, the burden of proof and sufficiency of evidence, among other issues.[18] The majority opinion affirmed the district court's certification of the collective action and found sufficient evidence to support the jury's verdict.

The 11-page dissent questioned whether the plaintiffs were "similarly situated," suggesting that sub-classes of plaintiffs should have been formed. The dissent also questioned the appropriateness of "representative proof of liability," where evidence given by certain plaintiffs is used to prove liability for the class/collective. The dissent noted that during discovery, the defendants found that the representative employees who were deposed were not representative of their peers. The defendants filed multiple motions seeking to decertify the class as not "similarly situated" and preclude representative proof at trial, but they were denied by the court.

Compare the verdict in *Monroe* to the ruling in the hybrid FLSA/Rule 23 case of *Griffith v. Fordham Financial Management Inc*.[19] In this case, the plaintiffs were granted conditional collective-action certification for alleged FLSA violations in 2013. A subsequent motion in 2015 for class certification under Rule 23 for New York Labor Law violations was denied. After denial of the Rule 23 class, the defendant moved to decertify the collective action. The court granted the motion to decertify the collective action, finding (among other things) that the misclassification dispute was not capable of resolution by class-wide proof because the plaintiffs worked for the defendants over different non-overlapping periods under different policies and on varying work schedules under different agreements. The court stated there was "little difference" between the commonality test under Rule 23 and the "similarly situated" test under the FLSA. The plaintiffs were allowed to proceed on an individual basis.

These cases show the variations of interpretation regarding class certification issues existing between jurisdictions and even within a particular court.

Impact of Wage and Hour Litigation on Causes of Action and Confirmation

Causes of action requiring solvency analyses are complicated by the existence of, or potential for, wage and hour litigation. The Bankruptcy Code defines "insolvent" as the "financial condition such that the sum of such entity's debts is greater than all of such entity's property, at fair valuation," exclusive of certain property.[20] Following the Code's definitions, "debt" is a liability on a claim, including the "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal equitable, secured or unsecured."

Estimates of the value of these claims must be made and supported, including an analysis of the probability that the claim will become a liability in the future.[21] Loss accruals under Generally Accepted Accounting Principles (GAAP) are not necessarily the appropriate value to use in a solvency analysis, as only "probable" and reasonably estimable losses are required to be included in the financial statements. The filing of a suit or formal assertion of a claim does not automatically require a loss accrual under GAAP.

To estimate the value of wage and hour claims, one should consider the composition of the class, including dates of employment/termination, job classifications, the date(s) that the claim(s) arose, any claimed violation(s), and the identification of employees who fail to "opt in" to the collective action or "opt out" of the class action.[22] It is also important to identify policy changes after the solvency date and consider the likelihood of penalties, fines and liquidated damages. If the existing litigation is a collective action, the analysis should consider the likelihood of post-petition "serial lawsuits" by employees who "opt out." Post-petition claims may also arise if the debtor is not in compliance with federal and state wage and hour laws, or if disgruntled employees deem restructuring changes to be discriminatory or inconsistent with the law, even if they are not.

The impact on plan development and confirmation might be significant, including risks of new lawsuits and investigations, increased administrative costs, corporate transaction and financing ramifications, and increased complexity of the budgeting process (*i.e.*, job-description level restructuring, impact on worker flexibility, and different wage and hour laws in multiple jurisdictions). Plan confirmation might also be complicated by dilution or loss of creditor claims and/or class-voting rights given as a result of the temporary allowance of class claims.

Conclusion

When advising a distressed business or debtors in chapter 11, knowledge of wage and hour laws and adequate due diligence is important to managing existing litigation and making informed decisions. Failure to do so can result in significant costs to the client and/or estate. abi

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17 2014 WL 4472720 or 763 F. Supp. 2d 979 (W.D. Tenn. 2011).
18 815 F. 3d 1000 (2016), *cert granted and judgment vacated*, 137 S. Ct. 590 (2016).
19 2016 WL 354895 (S.D.N.Y. Jan. 28, 2016).

20 These definitions are similar to the Uniform Voidable Transactions Act.
21 *In re Xonics Photochemical Inc.*, 841 F.2d 198, 200 (7th Cir. 1988).
22 FLSA collective actions require employees to "opt in," in contrast to Rule 23 class actions under which employees can "opt out" of the class and pursue claims individually. The "opt in" rate for collective actions is between 15 and 30 percent.