A Kitchin Legal White Paper

An Economically Rational Approach to Resolving Wage and Hour Claims In California[1]

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Employers sometimes respond to employee wage and hour claims in ways that cause them to sustain unnecessary financial loss and workplace stress. They pay more money in attorneys' fees and litigation costs than they should. They sacrifice the time and resources of key employees over the course of litigation lasting a year or more. And they expose their workforce to the stress of an on-going lawsuit, leaving employees guessing as to what is happening in the case or, worse yet, directly participating in the proceedings. People take sides.

Once litigation begins these same employers produce reams of internal documents to the employee's attorney whose singular goal is to take as much money away from the company as the law permits on behalf of as many of the employer's workers as possible. To add even more workplace stress and potential future loss to the equation, employers expose themselves to an increased risk that other employees will assert similar claims against them as they learn about the claims and the law.

All of these things can happen as a result of decisions employers make or fail to make within days of learning about an employee's wage and hour claim. Whether employers are guided by their attorneys, who generally have a financial interest in defending the claims[2], or by the employer's emotional reactions to the claims, early case management decisions have significant consequences.

In this article I examine some of the consequences that flow from decisions employers make when faced with certain kinds of wage and hour claims.[3] Using three of my firm's recent cases as examples, I show that under certain conditions the only economically rational choice is to move a wage and hour claim toward resolution as quickly as possible.

The Right Strategy for the Right Case

Within days of receiving notice of a wage and hour claim[4], an employer should begin to develop a strategic response plan based on the key characteristics of the claim.

Identifying cases that should be resolved expeditiously and confidentially is usually fairly straightforward. Such cases generally have three common characteristics: (1) the employee has asserted at least one valid wage and hour claim in court[5]; (2) the valid wage and hour claim will require the employer to pay the employee's attorney's fees at the end of the case; and (3) the employee has retained an attorney.[6]

Defending cases with these three characteristics through the litigation process generally results in poorer outcomes for an employer than can be achieved through settlement at the beginning of the case—even if the employee's claim is exaggerated.[7]

When faced with claims displaying all three of these characteristics, an employer should carefully answer three preliminary questions:

First, how much money and other resources should the employer commit to defending the claim? Though this is an obvious initial inquiry, it requires the employer to engage in a thoughtful and candid assessment of the probable costs of proceeding through various stages of the litigation process. The civil discovery process in a wage and hour claim can subject an employer to tens of thousands of dollars in attorneys' fees and costs. Is the investment appropriate?

Second, how long should the employer remain engaged in the dispute? The consequences of remaining locked in a fight with an employee are significant. Co-workers and managers will need to be interviewed. The employee's attorney will take the depositions of key employee witnesses, from supervisors to co-workers. Employees will talk about the case among themselves and with family and friends, despite instructions to the contrary. The workplace and the attitudes of current employees will be affected. Former employees will learn that a former co-worker, perhaps one who had the same duties, has sued the employer for unpaid wages. As employees learn about the claims and spend time talking with the employee and her attorneys, some of them will entertain thoughts of suing as well. Not infrequently, one or more of them will be represented by the same lawyers.

Third, how important is it to the employer to demonstrate that it will resolutely defend any similar claims and invest the time and money necessary to defeat them? Although employers are inclined to focus on deterrence, it is the least consequential of the three inquiries an employer should undertake when faced with valid wage and hour claims. The more time the employee is engaged in the fight, the more likely other employees will learn of the allegations and bring similar claims. Defending these kinds of wage and hour claims is more likely to increase the risk that the employer will be sued again than to deter others from asserting similar claims. The risk is amplified when the employer has a high turnover rate. Former employees are more likely than current employees to filed wage and hours claims against an employer.

Case Studies

The following three cases illustrate some of the consequences that flow from early decisions employers make in response to wage and hour claims. While all cases are unique in some ways, the litigation process is organized in a way that leads to similar outcomes in similar cases. Case outcomes can, therefore, be predicted if the employer understands wage and hour law and the litigation process.

Case Study 1: A Litigation Disaster

For three years, Carol worked long hours for a successful, well-established company in northern California.[8] The employer paid Carol a salary without overtime pay.

Before leaving the company, Carol came to believe she had been misclassified and that she was entitled to about $70,000 in unpaid overtime.[9] After she resigned from the company, she filed an overtime claim with the California Division of Labor Standards Enforcement (DLSE) demanding this amount. The company's position from the beginning was that Carol's DLSE overtime claims were valid, but exaggerated. The company chose to defend itself against the claims at the DLSE.

At the DLSE, the employer was represented by its in-house counsel who had spent a substantial amount of time preparing for the hearing, including gathering and analyzing documents, crafting a damages model and preparing witnesses. Though Carol was not represented by counsel at the DLSE hearing, the Commissioner found in her favor. The DLSE concluded that the company had misclassified her, as she alleged, but that she only was entitled to about $20,000 in wages, not the $70,000 she had claimed.

Convinced that her damage calculations were accurate and that the DLSE Commissioner had failed to properly evaluate the evidence, Carol hired Kitchin Legal to file an appeal of the DLSE decision.[10]

Before filing the appeal, we evaluated the merits of Carol's overtime claim and explored whether she could assert other claims in a Superior Court case.[11] As we expected, by treating Carol as an exempt employee, her employer had violated other California labor laws, which Carol had not presented at the DLSE. We broadened the scope of Carol's claims and asserted causes of action for unpaid overtime wages, meal period violations, rest period violations, record keeping violations, waiting time penalties, and unfair business practices in the new trial complaint. We also

added a claim for interest on the unpaid wages, which the DLSE Commissioner had ignored. We filed the case and served it on the employer.

Until it was served with the notice of appeal (i.e., trial *de novo* complaint), the employer had acted economically rational. It had conserved company resources by using in-house legal counsel to prepare for the DLSE hearing, knowing that Carol would be on her own there. The company had gathered evidence to challenge the estimates Carol presented. It presented that evidence at the hearing and convinced the DLSE Commissioner that Carol's overtime estimates were grossly exaggerated.

Once Carol's employer became aware of the appeal, however, it failed to re-evaluate its case strategy, though the case now met the three criteria for early case resolution.

· First, the employer understood that the court likely would find that it owed Carol some amount of overtime pay. Thus, Carol had presented at least one valid wage and hour claim.

· Second, the employer knew that Carol would be entitled to attorney's fees and costs of suit when she prevailed on her overtime claim at trial. The employer also knew that the value of Carol's attorneys' fees and costs would increase as the case was prosecuted.[12]

· Third, the employer now knew that Carol had hired an experienced employment attorney.

Instead of making any effort to resolve the claims when it learned about these significant changes in the status of Carol's claims, the company dug in for the long fight. It hired an outside employment lawyer, obtained a continuance of the trial date so more discovery could be taken, produced hundreds of pages of emails and internal documents, produced multiple witnesses for depositions and spent two long days taking Carol's deposition.

In its answer to the complaint and in response to written discovery, the company admitted that it had misclassified Carol as exempt from overtime. The employer also admitted that it had failed to maintain appropriate timekeeping and payroll records. By the end of the first 60 days of litigation, therefore, the only matter at issue in the case was how much money the company would be required to pay Carol at the end of a trial.

Meanwhile, we were interviewing Carol's co-workers about her claims. We were establishing friendly and resourceful relationships with other workers who had similar misclassification claims. Through formal discovery we obtained a wide variety of documents, including employment handbooks, emails relating to the employer's customers and written evidence

that the employer likely had misclassified and underpaid some of our witnesses. We even took depositions of former employees who now worked for the employer's direct competitors.

Within four months of accepting Carol's case, we were in possession of confidential information from the employer and were on a first name basis with a number of current and former employees. What began as a private wage and hour dispute between Carol and the employer was now a very public fight discussed by co-workers and competitors at parties and over lunches.[13]

One week before trial, the company finally engaged with us in serious settlement discussions.[14] According to its lawyers, the company was in a panic about the every-growing value of the attorneys' fees and costs component of Carol's wage and hour claims. By this time, Carol's attorneys' fees and costs were over $100,000 and rapidly growing.[15] The company's attorney's fees and costs likely were within the same range (if not higher) and also growing as the employer prepared for trial. Thus, in less than five months, the company had spent at least $100,000 on its own attorneys and was exposed to another $100,000 in attorney's fees and costs from Carol's lawyers.

The extensive discovery and our informal investigations had strengthened Carol's underlying claims, including the new claims we added in the Superior Court case. By the time her former employer accurately assessed its likely exposure (including its own attorneys' fees and costs, Carol's attorneys' fees and costs and the underlying damages, penalties and interest) an $80,000 exposure had become a $300,000 litigation disaster. If the company had actually defended the claims through trial, the overall fees and costs would have gone up another $50,000 or more. Just days before trial, Carol agreed to accept $215,000 in settlement of all of her claims. Adding the settlement amount to the costs already incurred by the company, it had sustained losses in excess of $300,000.[16]

The company could have predicted this disastrous outcome on the day it received notice that Carol had appealed the DLSE decision. It failed to do so because it did not evaluate and monitor its actual exposure. It did not take into account the validity of the claims, the involvement of legal counsel or the inevitable award of attorney's fees. Instead, it acted as if it the most important thing in the case was to prove that Carol had overestimated the number of hours she worked. In the end, Carol stuck with her estimates and the employer paid a settlement well in excess of her initial demand.

Case Study 2: Capping Damages, Avoiding Costs and Silencing an Angry Ex-Employee

For three years Maxwell worked as a project manager for a landscaping company in California. The company paid him a salary and classified as exempt from overtime.

Before leaving the employer Maxwell conducted online research about overtime wages. He concluded that his former employer had misclassified him and owed him a substantial amount of overtime pay. He undertook an extensive evaluation of his work schedules for a three-year period, using emails, calendars, office sign-in sheets and phone records to create a comprehensive wage loss analysis. It showed losses in the range of $140,000, including penalties and interest.

Maxwell had filed a claim with the DLSE before retaining Kitchin Legal, but based on the lack of progress there, he decided to dismiss the administrative claim and proceed directly to the Superior Court with his wage and hour claims. Before filing the lawsuit, we sent a letter to Maxwell's former employer asking for a copy his employment records. With no statute of limitation problem, we decided to wait for the employment records to arrive before filing a lawsuit against the employer.[17] Less than a month after we requested our client's records, defense counsel initiated settlement discussions, proposing a "quick in-person meeting… to dialogue a potential resolution to the wage and hour claim."

As a result of this early strategic decision, the employer's attorney effectively stopped us from contacting and interviewing employees about the misclassification. Frankly, we did not wish to do anything to discourage the employer's counsel from guiding his client to an economically-rational decision about the case.

Knowing that the employer would insist on a strict confidentiality provision in a settlement agreement, I instructed Maxwell to avoid any communication with his former co-workers about the case until we had fully explored settlement. In doing so, I preserved the monetary value of Maxwell's confidentiality.

We met with the employer and its counsel, and spent part of a day negotiating a resolution to Maxwell's claims. Confidentiality was a strict condition of the settlement, of course, and during the negotiations we were able to assure the employer than we had not yet discussed the claims with any other employees.

At the end of a relatively short day, the employer had agreed to pay my client nearly $120,000. Though the employer's owners insisted the hours Maxwell presented were grossly overestimated, the employer settled the case before it was filed and it did not suffer collateral damage to its image or to its relationships with other employees. Maxwell's case resolved quickly because the employer's attorney understood that defending Maxwell's case through trial would add between $150,000 and $200,000 in total attorneys' fees and costs. The employer's attorney also understood that regardless of the amount of money his client spent defending against the claims, the case would almost certainly settle before trial. The employer's goal was to settle the claims as quickly and as quietly as possible.[18]

The employer and its attorney made a quick evaluation of the case and accurately calculated its probable exposure to the various costs associated with litigation. First, the employer recognized that Maxwell had asserted a valid claim for overtime wages. Its shock or anger at the level of the demand did not change the fact that some amount of wages had not been paid in accordance with the law. Second, the employer knew Maxwell had retained experienced employment counsel who likely would be capable of proving what the employer already conceded to be true, that it had misclassified Maxwell as exempt from overtime wages. Third, the employer accepted the fact that if Maxwell won any wages at trial, he would be entitled to his reasonable attorneys' fees and costs which would be in the $100,000 range.

By acting rationally and quickly the employer capped its exposure to damages and kept its workforce out of the fray.

Case Study 3: Defending the Right Case

Andres worked as a bartender in a local hotel for several years. The hotel paid him more than minimum wage and he never worked overtime. He claimed, however, that he had rarely been permitted to take a 30-minute meal break and was never permitted to take uninterrupted rest breaks during his shifts. After interviewing another hotel employee about the hotel's meal and rest break practices, Kitchin Legal agreed to prosecute meal and rest break claims against the employer on behalf of Andres.

We made a demand for our client's employment records and placed the hotel on notice of the claims. Within a couple of weeks, the hotel produced the appropriate employment records. With no settlement overtures from the employer, we filed a lawsuit in the Superior Court seeking penalty wages for meal and rest break violations on behalf of Andres, plus interest, attorneys' fees and costs. We then began the formal and costly process of gathering evidence

through the discovery process. (The parties are permitted to send a large number of written questions and demands for documents to the other side and to take depositions of witnesses. This discovery process can last for months and cost tens of thousands of dollars.)

The employer's position was that Andres had not been denied a single meal or rest break. It had various policies in place that appeared to abide by California law. It argued that Andres chose not to take breaks so he could hold onto more of the tip money for himself. Thus, the case did not meet the first requirement for early settlement: the employer did not believe Andres had made a valid claim for unpaid wages.[19]

All of the parties were betting on the outcome of two cases that were pending in the California Supreme Court relating to employee breaks and an employee's right to attorneys' fees for successfully prosecuting claims for meal and rest breaks. While Andres's case was pending, the Court issued its decisions in both of these cases. Each one established, or clarified, labor laws that, in the context of Andres's claims, heavily favored Andres' employer.

In *Brinker Restaurant Corp. v. Superior Court* 53 Cal.4th 1004 (2012), the California Supreme Court held that employers are not required to guarantee that their employees take meal and rest breaks. Employers are only required to make the breaks available to their employees. The hotel's policies and practices appeared to meet the requirements described by the Supreme Court.

In the second case, *Kirby v. Immoos Fire Protection, Inc.* 53 Cal.4th 1244 (2012), the California Supreme Court held that an employee is not entitled to attorneys' fees for successfully prosecuting meal and rest break claims. The Supreme Court held that attorneys' fees are available only in wage and hour cases that involve the failure to pay minimum or overtime wages. Penalty wages, the Court explained, are neither minimum wages or overtime wages and, consequently, Labor Code provisions permitting an award of attorneys' fees in certain wage and hour cases do not apply.

Andres was left with fiercely contested meal and rest break claims that had limited value and no risk to the employer of an award of attorneys' fees to him. To no one's surprise, we settled Andres's meal and rest break claims shortly after these two cases came down. Though the employer was required to pay for its own attorneys' fees, which likely were in the $20,000 range, plus a settlement in the amount of $15,000, its decision to defend the case appears reasonable and economically rational.

The hotel defended the case because it did not meet the criteria for early case settlement. From the beginning, the employer did not believe Andres had presented a valid wage and hour claim. Further, though Andres was represented by counsel in the case, this fact turned out

to be of little consequence. After *Kirby v. Immoos Fire Protection, Inc.* was decided, the employer knew that its damages were limited and that Andres would not be entitled to attorneys' fees. The employer appears to have made the right choices.

A Few Words about Litigation Strategy and Anger Management

It can be difficult for an employer, particularly a smaller one, to come to terms with the costs and ancillary risks it faces when an employee asserts a wage and hour claim against it. With the right advice, however, an employer can make accurate predictions about probable outcomes, and make choices that protect itself. If an employer can accurately assess these costs and risks, it can respond to these kinds of claims in ways that protect it from additional financial loss and help it avoid unnecessary future risks. Fortunately, an employer should be able to make the right choices about case management and resolution in these kinds of cases soon after a claim is made.

In wage and hour litigation experienced lawyers on both sides of a dispute evaluate cases in similar ways. They assign similar values to claims and predict similar outcomes. (Kitchin Legal, for example, uses the same damages models whether representing employers or employees.) At times, however, a represented employer will make litigation decisions that seem to serve no other purpose than to increase its costs and risks. Sometimes poor litigation choices appear to be driven by the employer's attorneys who will earn higher fees staunchly defending a case than settling it. A company should insist that its attorneys articulate a sound reason to subject the company to the costs, rigors and risks of defending a wage and hour claim. If the attorneys cannot do so to the employer's satisfaction, then it is time to find new counsel.

In Carol's case several factors came together to create a predictably bad outcome for the employer. The poor litigation decisions were encouraged by the CEO of the company who could not come to grips with the actual costs and risks his company was facing. Several times during the course of litigation, the company's counsels made it a point to tell us that the CEO was "outraged," "disappointed" and "angry." If the employer's attorneys were encouraging litigation under these circumstances, then they too share blame in the poor outcome.

In Maxwell's case the employer set aside its anger and placed a higher value on its money and time than on its desire to prove that Maxwell had exaggerated his overtime hours. It paid a large settlement to Maxwell—though not as much as he had initially demanded—to avoid costs and risks that were higher and, at least potentially, more damaging to the company.

In Andres's case the employer fought the claims for all the right reasons. Though it paid a small settlement and incurred attorneys' fees defending the case, it had reasonable confidence in its ability to defend itself against the claims at trial and was not so worried about claims by other employees that it needed to immediately silence Andres with a confidentiality agreement. Though many co-workers learned about the litigation, a confidentiality provision in the settlement agreement between the parties has stopped Andres from telling others about the settlement outcome. Months have passed since the litigation ceased and no other cases have been filed against the hotel. The hotel's early case management decisions were sound.

Finally, I am not suggesting that any employer simply hand money to any employee who makes a valid claim for wages, regardless of the amount demanded. Even the strongest wage and hour claim is subject to risks. The employee must prove the claim and, if successful, must enforce the judgment. All of that takes time and money. The employee's counsel is assessing risk as she readies the case for litigation, and generally does not know precisely how the employer and its counsel view liability and damages. An attorney who understands how the employee's counsel measures and responds to these risks will be in the best position to use that knowledge to exploit the anxieties and uncertainties the employee and her counsel face as they move forward with the claim. By selecting the right cases for early resolution and then using its understanding of the risks inherent in the litigation process to its advantage, an employer should be able to avoid the worst outcomes in wage and hour litigation.

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[2] If an employer's attorneys are compensated on an hourly basis, they have an incentive to devote more time on the case. Of course, other incentives are also at play, including the desire to maintain a strong relationship with the client and to comply with the ethical mandates governing the representation.

[3] "Wage and hour" claims are those that relate to the payment of wages and the provision of other benefits of employment that are either imposed on the employer by law or established by contract between an employer and employee.

[4] Included in the category of wage and hour claims are those claims made by an employee directly to the employer, claims asserted through any process established by contract or by a collective bargaining agreement, claims asserted through a governmental administrative process, such as the U.S. Department of Labor or the California Division of Labor Standards Enforcement, demands for

non-judicial arbitration and cases filed in the United States District Courts and California Superior Courts.

[5] By "valid," I mean a claim that the employer or its legal advisors believe has validity. For example, the employer knows that some days the employee worked more than 8 hours, but was only paid for 8 hours. The employer knows the employee's claim for overtime wages is a valid one.

[6] Under California law employees are entitled to their attorneys' fees if they prevail at trial in court or, generally, in binding arbitration. Employees are not entitled to attorneys' fees if they seek their wages through an administrative process at the California Division of Labor Standards Enforcement or the U.S. Department of Labor. *Sampson v. Public Parking Service 2000 Com., Inc.* 117 Cal.App.4th 212,223 (2004); and *Bell v. Farmers Ins. Exch.* 115 Cal.App.4th 715, 746 (2004).

[7] Settlement of such cases does not require the employer to pay the full amount the employee demands. In almost every case, the employer will be in a position to negotiate the demand down in value.

[8] The names used in this article are pseudonyms and the settlement amounts have been slightly modified to protect the confidentiality of the settlement processes.

[9] Carol's DLSE charge was limited to a claim for overtime pay. She was not aware that she was entitled to interest on unpaid wages. The DLSE Commissioner did not to advise Carol of the right to interest and did not include interest in the DLSE award. Carol also was unaware of other claims she was entitled to assert at the DLSE, including claims for denied meal and rest breaks.

[10] An appeal of a DLSE order entitles the employee and the employer to a new trial—a trial *de novo*—in the Superior Court of California under Labor Code § 98.2. The court is required to hear the claims as if the DLSE had never issued its order. It is in all respects a new trial and the courts schedule these trials on an expedited basis. Unlike the DLSE process, an action in court entitles the successful claimant to attorney fees and costs from the employer.

[11] In *Murphy v. Kenneth Cole Productions*, 56 Cal.Rptr.3d 880 (2007), the California Supreme Court ruled that claimants could assert additional, timely claims in a § 98.2 appeal.

[12] In *Vo v. Las Virgenes Municipal Water District*, (2000) 79 Cal.App.4th 440, the court upheld an award of attorneys' fees and costs were more than 12 times the value of the underlying damages. In *Harman v. City and County of San Francisco* (2007) 158 Cal.App.4th 407, the ratio was 33 to 1. Kitchin

Legal has filed several motions for attorneys' fees in these kinds of cases and has never had a single hour reduced by a court as unreasonable.

[13] In the middle of the case, I received a call from a former client who told me he learned about the case at a party attended by current and former employees, including employees of the company's main competitor. He did not know my client, but lots of people were following the case now.

[14] As the trial date approached, the employer issued two Code of Civil Procedure § 998 offers to settle the case. Section 998 penalizes a party who rejects a settlement offer and then fails to obtain a judgment in excess of the offer at trial. The employer's section 998 offers of settlement, which were meant to resolve every claim, including the claim for attorneys' fees and costs, were each well below the value of the attorney's fees and costs themselves, rendering the section 998 offers ineffective.

[15] During the last week or so, I had been working 8 hours or more a day preparing exhibit binders, summarizing deposition transcripts, coordinating schedules with trial witnesses, preparing my opening statement and outlining my closing argument. I made it a point to remind the employer's in-house counsel about the fees and costs in wage and hour cases.

[16] At one point during negotiations, the company was so desperate to resolve the claims and stop the parties from incurring additional attorneys' fees and costs that it was forced to negotiate against itself, that is, to increase its settlement offer twice before Carol made a compromise move.

[17] Unless we are facing a statute of limitations issue, we typically wait until we obtain the client's employment file before filing a lawsuit because we sometimes see other labor law violations memorialized in the file.

[18] Confidentiality provisions in wage and hour settlements are standard.

[19] The employer undoubtedly weighed the fact that Andres had legal counsel, the third of the three case selection characteristics. But, it appeared that the employer and its attorneys concluded that any lawyer in California would have an uphill fight proving that the company had denied Andres his breaks. I too understood that this case was going to be difficult and would turn of the credibility of several key witnesses.

Author's Biography

Patrick R. Kitchin is a graduate of The University of Michigan Law School and has practiced in California since 1992. He has offices in San Francisco.

Patrick represents individuals and large classes of employees in wage and hour cases. Patrick also represents employees in discrimination, harassment, retaliation and wrongful termination cases in both state and federal courts. Patrick also advised start-ups and small companies regarding their employment policies, helping them to understand the complex legal requirements of California and federal labor laws.

Since 2002 Patrick has represented large classes of retail employees in several cutting-edge wage and hour class action lawsuits. According to retail and employment law experts, his class action lawsuits against Polo Ralph Lauren, Gap, Banana Republic and Chico's led to substantial changes in the retail industry's labor practices across the U.S. Articles about his work on behalf of retail employees have appeared in hundreds of publications around the world, including the *Wall Street Journal*, *New York Times*, *Washington Post* and *San Francisco Chronicle,* as well as on television and radio networks in the U.S. and Europe.

Patrick is a regular contributor to *Today's Workplace,* a Workplace Fairness Blog http://www.todaysworkplace.org/ and has discussed employment and consumer issues on Public Radio stations across California. He is an active member of the San Francisco and Alameda County bar associations, and currently serves as chairperson of the Alameda County Bar Association's Labor and Employment Section Executive Committee. Patrick is ranked "A-V®" by Martindale-Hubbell®, its highest peer-review rating for legal knowledge, skill and ethics.

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