Class-action settlement principles to take with you into mediation

How much do they really pay? The details determine the true gross dollar value of employment settlements

BY BRYAN SCHWARTZ

It is the day we are all waiting for: Game Day. Today is the day all of your client-building, discovery-grinding, certification-motion-filing efforts have precipitated: mediation.

Your firm has spent 1,246.7 hours on the case so far, but everything will happen in these 12 hours. By the end of the day, you are so emotionally exhausted from the mediator pounding on you, and so happy to have the mediator come in with a number that you can tolerate, that you walk out with a pending mediator's proposal that only says the gross dollar value of the global settlement. Perhaps you leave the mediation with a handshake agreement but without nailing down the details of the Memorandum of Understanding (MOU).

Oops. The devil was in those particular details. It turns out the $5 million they wanted to pay was really $5 million *reversionary,* so they really expect to pay closer to $2.5 million. It turns out that as part of that $2.5 million they expect your clients and the class to pay the employer's payroll taxes on the back wages owed. So now it is more like $2.3 million. It appears now that they expect the class definition to encompass about twice the number of people you thought were in the class, so the people *you* thought you were representing are only getting $1.15 million. Turns out they expect for that $1.15 million to have your clients execute a general release (in California, a Civ. Code, § 1542 waiver) that might impact other valuable claims you have not even contemplated in your lawsuit – further devaluing what is actually being paid regarding the claims you actually brought. For them, each of these terms is "non-negotiable." Suddenly, you have a settlement that is unsettled. Back to the drawing board.

Everyone who has negotiated a class-action settlement has probably had some term he or she forgot to address at mediation, or in the MOU, that returned in drafting the "final" agreement as a big headache and put the deal at risk. I have. I have thought, at many class-action mediations, "I wish I had a checklist so I would remember all the key terms." Here it is, summarized as follows:

Non-reversionary settlement

Whether or not your class-action settlement needs a claims process (e.g., if it is a federal Fair Labor Standards Act (FLSA) case that requires plaintiffs to opt-in under 29 U.S.C. §216(b)), you need to know how much the employer really plans to pay. A common defendant pitch during a class-action mediation is for a "reversionary" settlement, where the defendant will recoup any amount not claimed during a claims process. Among other disadvantages, this puts the parties' interests during the settlement administration process in conflict – instead of aligning them, with all parties hoping for maximum participation (or, as defendants would see it – the maximum number of releases). We want the class to participate fully and recover as much as possible. Defendants will want the same sweeping release of the class members' claims, with as much of the settlement fund as possible unclaimed and thus reverting to the defendants. It is intuitive – they want to pay less, for more. Do not let them.

The judiciary is attuned to the pitfalls of the reversionary settlement. The Federal Judicial Center publishes "Managing Class Action Litigation: A Pocket Guide for Judges" (available online), which explains:

> A reversion clause creates perverse incentives for a defendant to impose restrictive eligibility conditions and for class counsel and defendants to use the artificially inflated settlement amount as a basis for attorney fees.

In this vein, California and federal courts have been articulating a distaste for reversionary settlements for years, especially where the attorneys try to claim fees as a percentage of the whole fund, rather than the actual pay-out, and where all the class members' claims are released, whether they get paid or not. (See, e.g., *Kakani v. Oracle Corp.* (N.D.Cal. June 19, 2007) 2007 WL 1793774) (Alsup, J.). *Cf. Glass v. UBS Financial Services, Inc.* (9th Cir. 2009) 331 Fed.Appx. 452, 456 (reversionary settlements generally "problematic").) Some courts have unequivocally rejected all reversionary settlements, as a matter of policy. (See, e.g., the Alameda County Superior Court Complex Division's former Guidelines for Preliminary Approval of Class Action Settlements ("The Court will not approve a settlement that contains a reversion to a defendant.").) Courts evaluate, at a minimum,

the real cash value of a settlement to class members and how much the case was discounted for settlement purposes – which is difficult to do at preliminary approval, when an unknown portion of the settlement fund will revert to defendants. (See *Kullar v. Foot Locker Retail, Inc.* (2008) 168 Cal.App.4th 116.)

Instead of reversion to defendants, the Federal Judicial Center proposes that the unclaimed funds be allocated pro rata to those participating, based upon their initial allocations, i.e., someone getting $1,000 in the initial allocation will receive $2 of the unclaimed funds for every $1 received by a class member whose initial allocation was $500. This can be done in a second payment, or (more cost-effectively) by increasing the allocations before the initial distribution. Unclaimed funds may also go to a suitable *cy pres* recipient.

"Just say no" to reversion

In 2009, I wrote an article called "Death to the Reversionary, Claims Made Settlement" (http://bryanschwartzlaw.blogspot.com/2009/12/death-to-reversionary-claims-made.html), and I have made this issue regarding reversion the first debate I have in every class-action mediation since that time. Simply put, though opposing counsel and the mediators almost always try to push the reversionary settlement, I say up front: I will not agree to one. Defendants may object (particularly in the FLSA context) that they should not have to pay the same amount regardless of the number of settlement participants. They may object that the lack of a reversion will provide a "windfall" to the participants. But, it turns out, companies principally care what they will have to pay ultimately for the release of the claims alleged in the suit. As to the windfall, there is none. You are compromising from full relief in agreeing to your settlement, and the pro rata increase to allocations only gets the participating class members a little closer to the claimed full relief.

Mediators will usually admonish you that they cannot get you the same amount in a non-reversionary, "all-in" settlement – and my response is to say that I understand the number may be lower – but, it will be a real value to the class, and, perhaps most importantly, defendants and plaintiffs' counsel will be aligned in trying to achieve maximum participation in the settlement. Once defendants have agreed to pay the full amount with no possibility of reversion, they will have no motivation at all to discourage participation, and will not be lukewarm or neutral about participation, either. On the contrary, defendants will cooperate enthusiastically in encouraging *everyone* to participate for the same $2M they are paying, since the money is all spent and none is reverting to them. They may send communications to the class – apart from the notice – urging everyone to participate in the fair settlement you have negotiated, reassuring absent class members that no retaliation will befall anyone who does. They will provide phone numbers and e-mails for follow-up by the administrator and class counsel. I have averaged over 80 percent affirmative opt-in rates in non-reversionary settlements – and have achieved up to 94 percent participation.

This term – "all-in" or "non-reversionary" – needs to be part of any mediator's proposal or MOU because, more than any other (other than the gross dollar value of the settlement), it is a term that cannot be left to negotiate later.

Employer pays his own payroll taxes

If your settlement involves back wages, then it involves payroll taxes. Do not be surprised that the employer's vision of a "global" settlement includes the notion that *your clients will pay the employer's taxes*. Yet, an employer is required to withhold taxes from wages pursuant to 26 U.S.C. §§ 3102(a) and 3402(a), and to pay an employer's share of FICA pursuant to § 3111. The same is true under FUTA, 26 U.S.C. §§ 3301, *et seq.* The Internal Revenue Service Web site advises employers that they must "withhold part of Social Security and Medicare taxes from your employees' wages and . . . pay a matching amount *yourself*." The guidance further states that employers must pay the federal unemployment tax (FUTA) "only from [their] own funds" and that "[e]mployees do not pay this tax or have it withheld from their pay." (See http://www.irs.gov/businesses/small/article/0,,id=172179,00.html.)

Do not let your defendants shift their duty to your clients. Ultimately, the employers' attorneys' are principally or only interested in the bottom line – how much will the client have to write a check for – and you should be clear that the check includes the employer's own share of its taxes separate from and in addition to the class relief – e.g., the $500,000 settlement is really for $517,255.56, since one-third of the class-members' payments were W2 wages, regarding which the employer must pay federal and state unemployment taxes (FUTA and SUTA), Social Security and Medicare taxes, and FICA. Courts note favorably where the employer covers its share. (See, e.g., *Rosenburg v. International Business Machines Corp.*, 2007 WL 2043855, at *3 (N.D. Cal. July 12, 2007).) Being clear on this term at every step of the process will put a lot more money in your clients' and the class members' pockets – anywhere from 5-15 percent more.

A final note on point – particularly important if defendants have any solvency issues: make sure the full amount to cover the employer's share is deposited in trust or secured by a letter of credit at the *same time* as the overall settlement amount, because the settlement administrator will not mail any checks until the amount is there, and – irrespective of your agreement – if the employer has not put forward its share of the taxes, it will come out of the class-members' settlement (or your fees, or be deducted from the *cy pres* remainder) when it comes time for disbursement.

Mediation checklist – Top 20 negotiation points

____ 1. Non-reversionary – full fund allocated to class members filing claims (if any claims process is needed)

____ 2. Employer pays its share of payroll taxes – prevent a hefty portion of common fund from covering the employer's tax bill

____ 3. Scope of release – limited to claims arising from relevant allegations, except as to those provided enhancement payments for general release

____ 4. Timing of employer deposit of funds (including employer's share of payroll taxes) into QSF – as soon as possible, esp. if there are solvency issues. Or, letter of credit.

____ 5. Administrator costs – outside of general fund

____ 6. Any accrued administrator costs if settlement fails – employer's responsibility

____ 7. Allocation of payments – 1/3 wages, 1/3 interest, 1/3 penalties (or 50/50)

____ 8. Injunctive relief – Change position classification? Change disputed pay practice? Change discriminatory policy? Make independent contractors *really* independent contractors.

____ 9. Attorneys' fees – clear sailing at one-third? 25 percent benchmark? lodestar?

____ 10. Costs – capped safely above anticipated costs

____ 11. Enhancements – presumptive $5K? More?

____ 12. PAGA allocation – 1 percent of amount distributed to class?

____ 13. Class definition – commensurate with employees included in class as pled, for same time-period, ending at preliminary approval, ID approximate number of employees in class

____ 14. Blow-up provision – 10 percent? Small class (under 100) – 10 people?

____ 15. Timing of "final settlement agreement" after MOU and preliminary approval motion – within a month.

____ 16. Settlement administration – 90 days to opt in? NCOA database? E-mail addresses? Reminder postcard? Reminder phone calls/e-mails? Dispute procedures? Settlement allocation formula: left to Plaintiffs' counsel. Opt-out/objector procedures clear.

____ 17. Press release – no confidentiality

____ 18. *Cy pres* – Plaintiffs choose

____ 19. Settlement Web site – relevant docs must be made available online

____ 20. "Effective date" = date of final approval = 10 days before date of distribution

— **Bryan Schwartz**

Scope of class and release

Make sure it is clear what you are, and are not, negotiating. While it is commonplace for representative plaintiffs receiving enhancements to sign a broad release of claims – and indeed, such a release provides some justification for their enhanced payments – the class-members' release should be narrowly drafted to impact only the claims raised in the suit or, at a maximum, those which could have been raised in a suit premised on the same facts pled. If it is a wage/hour settlement, there is no reason your class members should be releasing, e.g., their disability discrimination claims, to get their back wages with penalties and interest. The *Kakani* decision and a host of federal and state authorities (in California, see *Trotsky v. Los Angeles Fed. Sav. & Loan Assn.* (1975) 48 Cal.App.3d 134, and cases following it) reaffirm the basic principle that, class members should be compensated based upon the claims they are releasing.

In the same vein, make sure the class period (in California, four years before the complaint was filed, and through preliminary approval, frequently) and job titles encompassed in the settlement are mutually understood – yours would not be the first case in which defendants tried to sweep additional class members into an all-in settlement who you never contemplated sharing in the relief. Do not permit defendants to

water down the settlement payments by doubling the size of your class – those encompassed in your complaint should be those benefiting from the settlement, or, defendants should pay more to compensate the additional class members.

Timing of payment

Particularly with a financially shaky employer (or any company, especially a closely held one, where bankruptcy is a ready option), make sure the money (including, as noted above, the employer's share of any payroll taxes) is *in the bank.* In circumstances involving a small or otherwise potentially insolvent employer, make the timing of the deposit into a Qualified Settlement Fund – where it becomes unreachable by the defendant, even perhaps in the event of a bankruptcy claw-back – a core condition of an MOU, or request that it be part of a mediator's proposal. Having the money in the bank also helps avoid delay in negotiating additional settlement documents like the final settlement agreement and class notice/claim form, any joint motions, etc. If the money has been paid, the employer has no reason to drag its feet (i.e, it is no longer accruing interest on the money in its bank after the settlement amount has been fully paid). If the employer does not have the wherewithal to put all the money in the external trust account immediately, find out when it will be there (within 10 days of the signing of the MOU? within five days of preliminary approval? 30 days before the final approval hearing?), and/or require the employer to provide a letter of credit from a viable financial institution, guaranteeing that all the money will be there when it is required.

Also, generally, your clients and the class members want to get paid as soon as possible, so there is no justification for a settlement term that conditions the disbursement of payments on the expiration of time for appeals, if no one properly objected or even expressly opted-out of the agreement. Such inaction only drags out an already long process for your class members.

Failure of settlement

You have not even consummated the settlement but you should nonetheless contemplate it failing. Namely, what number or percentage of opt-outs will "blow up" the settlement? Choosing too small a number or percentage is highly risky – 10 percent is appropriate. Moreover, insist on a provision that the employer will own any administration costs incurred before the settlement failed – another good reason to have the settlement fund amount deposited early.

Nature of the payments

Will the payments to class members be considered all wages (subject to a W2), half wages-half interest/penalties (subject to a 1099), or one-third each for wages, penalties, and interest? This is one area where your view and the defendants' may converge: they do not want to pay more wages (leading to a larger employer payroll tax burden), and your client would rather not have deductions taken. Settlement administrators, however, are becoming more attuned to this issue, and no one wants an IRS or state tax audit. Moreover, some argue that in the long term it is better for clients to be paid wages because they ultimately (perhaps on retirement) will receive the benefit of the employer's payroll tax contributions. Regardless of your strategy, this issue should be addressed at mediation.

Injunctive Relief

Though it goes beyond the scope of this article to describe all of the possible forms of injunctive relief that could be part of your settlement, such should be outlined in the MOU or mediator's proposal explicitly – do not assume that defendants paying a settlement regarding a wage/hour misclassification class action will reclassify the position at issue (though, they should!) unless it is explicitly provided by your agreement. When the injunctive relief is agreed upon, ensure that defendants are prepared to assist in quantifying the value of that relief, so you can use the information in describing to the court at preliminary and final approval, and in seeking your fees, the real value of your settlement. Also, seek to specify a timeline for compliance and a monitoring mechanism, if needed, from the outset.

Attorneys' Fees – Costs – Enhancements

Once a settlement becomes "all-in," and defendants are paying the entire amount regardless of the level of participation by the class, they will have little incentive to oppose the fees, costs, and enhancements you think are appropriate. Still, it is important to agree in advance what amounts defendants will not oppose as to each, with a further agreement that any amounts not approved by the court go to the class, and do not revert to defendants. Bring your lodestar and documentation of all fees-costs to the mediation to assist in the negotiations.

California PAGA allocation

If you have a Labor Code case and you have not exhausted or pled the California Private Attorneys General Act (PAGA), defendants may yet want a PAGA release – which will necessitate you exhausting PAGA and agreeing to amend the complaint to include PAGA, by stipulation. I see no reason to oppose adding and releasing PAGA claims, if you are settling the underlying wage claims – certainly from defendants' perspective, it is reasonable that they would be expecting to buy peace and not want to have to address a separate suit alleging PAGA claims arising from the same underlying violations after your settlement is done. If they raise a PAGA amendment and waiver, you must determine how much of the class-members' portion of the common fund to allocate to PAGA – knowing that 75 percent of this amount will have to be sent to the Labor Workforce Development Agency (LWDA). Most attorneys are allocating only a small amount to PAGA claims in their settlements, but this should be agreed upon, since some defendants will want a more

substantial allocation to avoid any protest from the court or LWDA. I believe the latter is extremely uncommon, and as yet, I believe there to be no published case law establishing the need for a large PAGA allocation in a settlement.

Settlement administration process and *cy pres*

Try to agree on a settlement administrator (assuming you decide to use one) or that defendants will allow you to establish and maintain all relationship with the administrator. Seek payment of the administration costs separately from the common fund amount. Agree on such concepts as: the length of time to opt-into the agreement – again, all parties will favor a longer (e.g., 90 days) opt-in period if the settlement is non-reversionary, to ensure maximum opportunity for participation; the means of finding and following up with the class (reminder postcard, National Change of Address database search, distribution to e-mail addresses, reminder phone calls); a process for disputing allocations by class members, which requires defendants' full cooperation (since they tend to own the relevant information for resolving the dispute); opt-out/objection procedures; a Web site about the settlement (do not tell class members they can go to the courthouse to seek relevant case documents if they want more information); and the means of communication of the settlement to the public (press release v. limited confidentiality). On the subject of confidentiality, do not let defendants assume that confidentiality is part of your deal (especially for non-profits, this can be a deal-breaker), or that keeping your deal quiet has no price.

Defendants should delegate to plaintiffs' counsel the task of discerning an appropriate settlement allocation formula among class members – and probably will be indifferent, assuming it is an all-in settlement.

Finally, reach agreement with defendants on the appropriate *cy pres* designee if, after the settlement checks are distributed (with initially unclaimed funds being added pro rata to the checks of those filing claims), any funds remain undisbursed (i.e., if checks are uncashed after a discrete period of time, e.g., 60 days). Defendants may allow you to choose unilaterally, but regardless, keep in mind recent jurisprudence requiring *cy pres* designees to relate to the purpose of the underlying suit. (See, e.g., *Dennis v. Kellogg Co.* (9th Cir. 2013) 697 F.3d 858, 865.) Funds in an employment suit should go to the Impact Fund, Legal Aid Society-Employment Law Center, NELA Institute, FAIR, or some other organization dedicated to workers' rights, and not to the metropolitan opera (unless you are representing opera singers!).


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