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MCLE Self-Study:

The Impact of Chapter 11 Bankruptcies on Wage and Hour Class and Collective Actions

By Patricia Prince & Elizabeth Franklin

BACKGROUND ON CHAPTER 11 BANKRUPTCIES

The last few years have been some of the most economically difficult in recent history. Companies that have long been considered the backbone of the U.S. economy have not only faltered, but collapsed. Indeed, some of the largest Chapter 11 bankruptcy proceedings in U.S. history occurred in the last several years: Lehman Brothers, with pre-bankruptcy assets of $639 billion, filed September 15, 2008; Washington Mutual, with pre-bankruptcy assets of $327.9 billion, filed September 26, 2008; Chrysler, with pre-bankruptcy assets of $39.3 billion, filed April 30, 2009; General Motors, with pre-bankruptcy assets of $91 billion, filed June 1, 2009; and CIT Group, with pre-bankruptcy assets of $71 billion, filed November 1, 2009.

When a business is unable to pay its creditors or its debt, either the business or its creditors can file for protection with the federal bankruptcy court under Chapter 7 or Chapter 11 of the United States Code. Under Chapter 7, the business normally ceases operations. In Chapter 11 proceedings, the debtor typically retains control of its operations as a "debtor-in-possession" subject to the oversight of the court.[1] Chapter 11 allows the debtor-in-possession to restructure or reorganize its business.[2] A debtor may exit from a Chapter 11 bankruptcy proceeding within a few months or years, depending upon the complexity of the proceeding. The objective typically is met through the use of a bankruptcy plan, which may be proposed by any party-in-interest.[3] Some of the key features of a Chapter 11 proceeding are the acquisition of financing and loans on more favorable terms by providing new lenders first priority on earnings,[4] rejection or cancellation of contracts,[5] and protection from other litigation by imposition of an automatic stay.[6]

In bankruptcy law, an automatic stay is essentially an injunction that prevents actions by creditors and litigants (with certain limited exceptions) to collect debts from a debtor who has filed a petition for bankruptcy protection.[7]

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"The Ninth Circuit has determined that the Bankruptcy Code should be construed to permit class claims. . . . Nonetheless, allowing a class claim to proceed is within the discretion of the bankruptcy court."

The tension regarding the propriety of group proofs of claim derives from whether bankruptcy proceedings are inherently capable of handling group claims. In many ways, bankruptcy proceedings mirror the benefits provided by class and collective actions. Bankruptcy courts are empowered to divide the creditors into classes, the notice provisions in bankruptcy proceedings are similar to those required in class claims, the bankruptcy court is required to approve all settlements and dismissals, and distribution from the estate is made to all creditors who file a proof of claim.[25]

Although the main purpose of a group claim outside of the bankruptcy context is to avoid multiplicity of separate actions and the risk of inconsistent adjudications, both seem of little concern in the bankruptcy context because the bankruptcy court has jurisdiction over all claims against a particular debtor.[26] However, acquisition of this jurisdiction by the bankruptcy court raises other important issues. For example, some class or group members already may have chosen not to file individual proofs of claim and potential creditors may have received notice of the bankruptcy filing and claims bar date. If so, then a group proof of claim may, in effect, permit or encourage a "second bite at the apple."[27]

Lifting the Automatic Stay

As an alternative to filing a class proof of claim, plaintiffs may request that the bankruptcy court lift the automatic stay and allow the group claim to proceed in its original venue. Under Bankruptcy Code § 362(a), the bankruptcy court can lift the automatic stay "for cause." However, the Bankruptcy Code does not define cause. As a result, bankruptcy courts consider a variety of factors in determining what constitutes "cause."

For example, some or all of the twelve factors from *In re Curtis* (the "*Curtis* factors") have been used in a number of cases and in a variety of configurations.[28] In *Kronemyer v. American Contractors Indem. Co.*, for example, the Bankruptcy Appellate Panel for the Ninth Circuit noted that the *Curtis* factors are "appropriate, nonexclusive" factors to consider in determining whether to grant relief from an automatic stay.[29] Similarly, in *In re Sonnax*, the court listed the twelve *Curtis* factors but then went on to state that only four of the factors were relevant.[30] In *In re SCO, Inc.*, the court applied two of the *Curtis* factors, and added a third.[31]

As with the class claim analysis, determining whether to lift the automatic stay is within the discretion of the bankruptcy court. If the stay is lifted, the matter proceeds in its original venue, which may complicate and/or delay any reorganization that the debtor-in-possession attempts to have the bankruptcy court approve.

PARTICULAR ISSUES IN WAGE AND HOUR CLASS OR COLLECTIVE CLAIMS

Settlement Issues

Wage and hour class and collective claims are time-consuming and costly. Indeed, the significant cost of such litigation can often push a company toward bankruptcy, particularly in economically difficult times. When confronted with the possibility of bankruptcy, a company has to determine whether to litigate a group claim or attempt to settle it. As noted by the Seventh Circuit, the decision to certify a class action often creates an "intense pressure to settle," especially when a defendant may be faced with bankruptcy if it loses at court after deciding to litigate the merits against the entire class.[32]

Equally difficult is determining how to value such claims if the parties decide to settle rather than litigate. To the extent that a class has been certified and/or the bankruptcy court allows a group proof of claim to proceed, plaintiffs' counsel has an obligation to ensure that all putative class members' rights are protected in any agreed-upon settlement.[33] On the other hand, the value of such

that a D&O policy with exclusionary FLSA language did not exclude all types of wage and hour claims.[45]

Proceeds from an insurance policy may be the only real asset owned by a bankrupt company. Thus, creditors are likely to try to prevent payments from being made under such policies, particularly where the policy not only covers the individuals, but the entity, as well. Such payments may reduce aggregate limits for all coverages, including entity coverage, thereby diminishing the value of the bankruptcy estate.

CONCLUSION

Wage and hour class actions comprise almost one third of all class and collective actions. In addition, the cost of wage and hour class and collective actions continues to rise. The top ten private wage-and-hour settlements paid or agreed to in 2009 under the FLSA totaled $363.6 million, an increase of 43.9% over 2008.[46] In addition, the current recession has caused a similar increase in Chapter 11 bankruptcy proceedings. Both of these areas are complex and when they overlap, as they sometimes do, the legal issues can be fraught with complications. Labor and employment attorneys and bankruptcy lawyers should work closely with one another when these areas overlap to provide clients practical and effective representation.

ENDNOTES

1. 11 U.S.C. §§ 1107(a) and 1108.
2. *Id.*
3. 11 U.S.C. § 1121(a)-(c).
4. 11 U.S.C. § 364(c)(1).
5. 11 U.S.C. § 365(a).
6. 11 U.S.C. § 362(a).
7. 11 U.S.C. § 362(a); H. Rep. No. 95-595, at 340-44 (1977); *In re Conejo Enterprises, Inc.*, 96 F.3d 346, 351 (9th Cir. 1996).
8. 11 U.S.C. § 362(a); H. Rep. No. 95-595, at 340-44 (1977); (often more appropriate to permit proceedings to continue in their place of origin, when no great prejudice to the bankrupt estate would result).
9. 11 U.S.C. § 362(a)(1).
10. 2-38 Collier Bankruptcy Practice Guide § 38.01 (A. Resnick, H. Sommer, rev. 15th ed. 2010).
11. *In re Robbins,* 964 F.2d 342, 345 (4th Cir. 1992) (automatic stay gives bankruptcy court opportunity to harmonize interests of both debtor and creditors while preserving debtor's assets for repayment and reorganization).
12. Fed. R. Civ. P. 23(b).
13. The collective actions referred to in this article are claims brought under the Fair Labor Standards Act.
14. *Clesceri v. Beach City Investigations & Protective Servs.*, 2011 U.S. Dist. LEXIS 11676, *10 (C.D. Cal. 2011).
15. *Id.*
16. *Ervin v. OS Restaurant Servs., Inc.*, 632 F.3d 971, *2 (7th Cir. 2011).
17. 623 F.3d 743, 761-62 (9th Cir. 2010).
18. *In re Firstplus Fin., Inc.*, 248 B.R. 60, 71 (Bankr. N.D. Tex. 2000).
19. *See, e.g., In re Bally Total Fitness of Greater N.Y., Inc. (Bally I),* 402 B.R. 616, 620 (Bankr. S.D.N.Y. 2009) ("courts may exercise their discretion to extend FRCP 23 to allow the filing of a class proof of claim"); 3 Collier on Bankruptcy, 362.07[3][a], at 362-84 (L. King, rev. 15th ed. 2003) ("Relief may also be granted when necessary to permit litigation to be concluded in another forum, particularly if the nonbankruptcy suit involves multiple parties or is ready for trial").

"The desire to avoid costly and protracted litigation that could derail a Chapter 11 reorganization puts tremendous pressure on companies to settle wage and hour class and collective claims."

MCLE Specialty Credit in Ethics:

Attorney-Client Communications Lose Privileged Status—On Client Work Computers and at Your Local Coffee Shop

By Anne Giese

Anne Giese is a Senior Attorney for SEIU Local 1000, representing state employees in labor and employment rights and administrative law matters, and in appellate and state court litigation involving constitutional and complex statutory issues. Ms. Giese also teaches courses on Employment Law and the American Labor Movement for U.C. Davis in its Extension Program. Ms. Giese is a member of the Labor & Employment Law Section's Executive Committee.

If you are an attorney who represents employees, by the time you finish reading this article, you should change at least one aspect of your law practice: only e-mail your clients using their personal e-mail addresses. For convenience and other reasons, you may have communicated with your clients on occasion using their work e-mail addresses, but a recent decision by the California Court of Appeal for the Third District will cause you to strike that practice from your routine. According to the court, if your client uses a work computer and a work e-mail account to read your communications, their privileged and confidential status may be lost. More importantly, the State Bar views it as an ethical obligation of attorneys to take appropriate steps to maintain clients' confidential information, even cautioning against public wireless internet (wi-fi) use.[1] Both the recent court of appeal decision and the State Bar ethics opinion are examined below.

In *Holmes v. Petrovich Development,* Plaintiff Gina Holmes worked for Petrovich Development Company, LLC. She filed a lawsuit against Paul Petrovich and his company for sexual harassment, retaliation, wrongful termination, violation of the right to privacy, and intentional infliction of emotional distress.[2] She claimed, among other things, that she was harassed and retaliated against because of her pregnancy.[3] When she felt she could no longer endure the treatment, Ms. Holmes quit her job.[4] While she was still working, however, she and her attorney communicated on a few occasions using her work e-mail account.[5]

Although the court's decision deals primarily with the legal aspects of her harassment, retaliation and constructive termination case (particularly whether she stated viable claims), it also announces a clear rule on the discoverability of attorney-client e-mails sent on employer e-mail systems.[6] The discovery process in this case led to the disclosure of a couple of errant e-mails between attorney and client on the employer's computer system.[7] The e-mails themselves were far from any proverbial "smoking gun," but they were somewhat damaging and the attorney did not want them disclosed. The trial court disagreed, and ultimately so did the appellate court.[8]

After summary adjudication was granted on her discrimination, retaliation, and wrongful termination claims, and the jury entered a defense verdict on the remaining causes of action, Holmes pinned her hopes on an appeal.[9] She argued that the trial court erred in granting defendants' motion for summary adjudication, and that the jury's verdict must be reversed due to evidentiary and instructional errors.[10] One such error, she claimed, was the admissibility of the attorney-client e-mails.[11] The court of appeal disagreed and affirmed the judgment.[12]

The appellate court found that e-mails Holmes and her attorney exchanged did not constitute "confidential communication between client and lawyer" within the meaning of Cal. Evid. Code § 952.[13] Critical to this decision was the fact that Holmes used a company computer to send the e-mails.[14] The court viewed three facts as dispositive to this loss of privilege:

> 1) Holmes had been told of the company's policy that its computers were to be used only for company business and that employees were prohibited from using them to send or receive personal e-mail;
>
> 2) she had been warned that the company would monitor its computers for compliance with this company policy and thus might "inspect all files and messages . . . at any time;" and
>
> 3) she had been explicitly advised that employees using company computers to create or maintain personal information or messages "have no right of privacy" with respect to that information . [15]

The court took pains to distinguish Holmes' e-mails, sent on her employer's computer system, from electronic communications covered by Cal. Evid. Code § 917(b).[16] That provision, the court said,

work." This is directly analogous to averaging commission wages specific to ***selling*** to pay for time spent on ***non-selling*** work. *Armenta's* holding has been applied in subsequent cases involving averaging in different contexts, illustrating that the prohibition applies equally to other pay plans—like piecework (paid by product) and commission (paid by sale).[19]

EMPLOYERS' OPTIONS WHEN SALES WORKERS ALSO PERFORM NON-SELLING TASKS

Under the law outlined above, non-exempt sales employees must be paid at least minimum wage by a method ***other than commissions*** for time spent on non-selling tasks. Several options exist for employers that require salespeople to do other work besides selling:

- **Pay a base wage of at least the statutory minimum**

The simplest solution is to pay commission workers a base wage or salary of at least the minimum wage. In *Steinhebel v. Los Angeles Times*, [20] subscription sellers challenged the employer's policy of "charging back" commissions when buyers cancelled before a set time had passed, claiming this resulted in unpaid labor. The court held that because the sellers were paid minimum wage as a base whenever they were not earning commissions, ". . . the minimum hourly wage serves as his or her compensation for time spent."[21]

- **Hire hourly workers to perform non-selling tasks**

Employers may hire individuals to perform non-selling labor, so that the commission employees may focus on sales. These non-selling workers are generally paid an hourly wage to handle tasks like cleaning, display, and stocking, thus leaving commission employees free to concentrate on selling.

- **Apportion tasks to properly pay employees for each type of work**

Employers have one other option: pay commissions for work that satisfies Cal. Lab. Code § 204.1, and pay a different type of wage for other work. Managerial misclassification cases like *Sav-On Drug Stores, Inc. v. Superior Court*[22] provide guidance on how this can be implemented (on an individual or class basis) through a three-step process: (1) create a finite list of tasks performed and conduct the two-prong analysis to categorize each as selling or non-selling; (2) track the amount of time spent on each category of task; and (3) pay employees accordingly (usually by two methods, such as commissions plus hourly wages). This may seem daunting, but for employers who choose this route, it is essential if exploitation of workers and the concurrent risk of liability are to be avoided.

CONCLUSION

Commission compensation is a legally-sanctioned pay system that may be advantageous for both employers and employees when lawfully structured and applied. It can also, however, be treacherous for those unaware of the limitations imposed by Cal. Lab. Code § 204.1, the prohibition against wage averaging, and other legal pitfalls. Employers who choose a commission plan must understand the legal boundaries, especially if they require commission salespeople to perform non-selling tasks.

ENDNOTES

1. Cal. Lab. Code § 200 defines "wages" to include ". . . all amounts for labor performed by employees of every description, whether the amount is fixed or ascertained by the standard of time, task, piece, commission basis, or other method of calculation."
2. Other legal issues may arise under commission pay plans, including: (1) timely payment of wages under Cal. Lab. Code § 204; (2) illegal deductions under Cal. Lab. Code § 221 (including deductions to pay wages for time spent on non-selling work); (3) unlawful return policies; (4) breach of contract or fraud claims resulting from promises not kept or employment terms concealed; (5) paystub violations under Cal. Lab. Code § 226; (6) uncompensated rest breaks; and (7) violations of Cal. Bus. & Prof. Code § 17200.
3. (Emphasis added.) "Although section 204.1 applies specifically to employees of vehicle dealers . . . we agree that the statute's definition of 'commission' is more generally applicable." *Ramirez v. Yosemite Water Co.*, 20 Cal. 4th 785, 803 (1999).
4. Employment contracts generally govern such things as commission rates, when commissions are earned, and return policies. However, provisions that are illegal, unconscionable, contrary to public policy, or otherwise undermine statutory rights are unenforceable. See Cal. Lab. Code § 219 (". . . no provision of this article can in any way be contravened or set aside by a private agreement, whether written, oral, or implied"); Cal. Civ. Code § 3513 (". . . a law established for a public reason

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