

## **What Is “Special” about Wage & Hour Class Action Mediation?**

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There is no such thing as a “cookie cutter” mediation. Nonetheless, most mediations have, among other things, the following general characteristics:

- At least four participants whose interests are not naturally aligned – Plaintiff, Plaintiff’s counsel, Defendant and Defendant’s counsel.
- Little or no genuine concern that a settlement will foster future claims.
- Some prospect of integrative, or “value adding,” resolutions.
- A rich body of applicable case law to serve as the empirical basis for risk-based claims valuation analysis.
- A virtually unrestricted free market where almost any resolution agreeable to the parties can be turned into a contract fully enforceable by the courts.

Wage & hour class action mediation, by contrast, has *none* of these characteristics.

### **1. Mediating with Only Three Participants**

All fictions aside, there are three, not four, interested participants in a wage & hour mediation. They are the defendant, its counsel, and the *counsel* for the class. Plaintiffs themselves (including the named representatives) are literally absent from the negotiation altogether, and are typically absent physically from the mediation sessions.

Any imbalance resulting from the absence of plaintiffs themselves is, in theory, “corrected” by an institutional device unique to class actions: the *fairness*

*hearing*, in which a court imposes outside boundaries on the settlement for the protection of the plaintiffs.

Nonetheless, the absence of the plaintiffs themselves is significant. The court is not, in any sense, a substitute negotiator for the plaintiffs. It simply either approves or rejects the settlement agreement, in accordance with reasonably well-established standards, after the settlement has been negotiated by plaintiffs' counsel and the defense team. The actual negotiators have a common interest in avoiding agreements so extreme that they will be either rejected by the court, or undermined by excessive "opt-outs" from the plaintiffs themselves. But subject to these outside limits, the three players at the negotiating table have an interest in maximizing two things: the portion of the settlement funds that goes to plaintiffs' counsel as approved fees; and the portion of the settlement funds available to be returned or otherwise used by the defendants.

The upshot is this: Plaintiff's counsel seek, and usually get, one third of the settlement funds as fees; amounts unclaimed by class members revert to the defendant to the extent the court permits<sup>1</sup>; and the stated settlement amounts include the resulting social security and FICA charges the company will have to bear as a consequence of the settlement – an amount that turns out to be 13.85% of the total paid to the class members. These terms are easily arrived at because those at the negotiating table can "give" each other these benefits, without cost to themselves.

The absence of the plaintiff also eliminates one of the most common challenges a mediator has to face in "ordinary" litigation – the challenge of plaintiffs resisting economically advantageous proposals because of a desire to use the courts to obtain perceived benefits that go beyond economics: retribution for perceived wrongs; public vindication; and principled refuge in the Rule of Law.

This not to say that the issues addressed in wage & hour class action mediations are entirely economic. But the non-economic issues characteristically arise from the defense side, and tend to break down into two categories. The first category is the common "principled" resistance to a fairly rigid statutory scheme that typically strikes defendants as entirely inconsistent with the statutory purpose and with common sense. Specifically, those rationally thought to be managers

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<sup>1</sup> The amount of the reversion is, of course, indeterminate at the time of the settlement itself, but can be a considerable amount. Some empirical information giving the parties guidance on the potential magnitude of the reversion is provided in *Newberg on Class Actions*, which summarizes the percentage amounts reverting to defendants in several dozen class actions Newberg had tracked. It should be noted that the continued right for the negotiating parties to make use of reversions at all is now at least seriously questionable, with the passage of amendments to Code of Civil Procedure section 384, which go into effect January 1, 2002. The likely "fix" to this problem will involve refraining from resorting to the common fund device, but the effectiveness of that "fix" has yet to be tested.

cannot be treated as exempt in California if the time they spend in identified categories of non-exempt *functions* (e.g. sales) happens to take up more than half their time. The “player-manager” may be thought of as a manager, but there will be exposure if he is paid like a manager, and that fact is a hard-to-swallow surprise for many companies.

## **2. The Defendant’s Need to Deter Future Claims**

Then there is the second form of defendant resistance to otherwise attractive settlement opportunities. This one is born of a genuine dilemma: the company concludes it cannot “turn managers into foremen” without losing the critical work incentives or esprit-de-corps or “company culture” that it concludes comes with classifying class members as exempt; but to “buy off” the class action claim through settlement *without* also turning class members into non-exempt workers for the future would be to inspire, by that act, endless waves, every three or four years, of new wage and hour claims. These claims would come from new employees who are not collaterally estopped or otherwise bound by the class action judgment supporting the settlement. It would also come from its current employees, class members, who have a basis to argue their release can only apply to past “wrongs,” but cannot release the continuing “wrongs” that take place after the release is entered into. Such companies are sorely tested take their chances at trial to escape the dilemma. The prominence of that question is an unusual hallmark of wage & hour mediations. And much of the focus of mediations I have handled has involved finding creative solutions to this very dilemma.

## **3. The Absence of Integrative Bargaining Opportunities**

While there is a need to find creative techniques to subdue extraordinary needs for deterrence that wage & hour defendants will often have, there is a curious absence of opportunity to employ another form of creativity – that of finding integrative (rather than purely distributive) resolutions to the dispute. With one obvious exception<sup>2</sup>, the “Jack Sprat” non-monetary exchanges that are the special joy of mediators – where parties give what’s cheap to get what’s dear, and thereby optimize the likelihood, as well as the quality, of the resolution – are not to be found in this arena.

The reason is not that negotiators in this specialty are not creative, but simply that the inherent nature of class actions virtually eliminates any prospect that the form of any exchange will be anything other than money. Specifically,

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<sup>2</sup> The exception is the ability of retail store defendants to stretch the size of the settlement pot by offering merchandise coupons as a part of the settlement package. Such defendants “give” at wholesale cost, but get credited at retail value.

one stricture of class actions is that similarly situated class members be treated uniformly, and the only uniform needs the members will have is the presumptively universal need for money. As a result, the nature of class action bargaining is heavily distributive, not integrative.

#### **4. The Absence of a Rich Body of Case Law to Support Risk-Based Claims Valuation Analysis**

It is a bit of an irony that a field which is so tilted toward distributive bargaining is also one in which mediators are essentially deprived of a major tool used to facilitate such bargaining – a substantial body of actual outcomes at trial in analogous cases to provide a realistic assessment of the actual risk of trial, and therefore the reasonable settlement value of a release. Because the large volume of wage & hour class actions is historically new, and because so few that do exist go to trial, little such evidence of likely outcomes in fact exists.

What girds the negotiation in the absence of that evidence? It is four things. First, the statutory scheme in this area is fairly administrable, and results are arguably more predictable for this reason even in the absence of extensive actual results.

Second, there is an extensive and ever increasing body of evidence of actual *class certification* decisions, and the factors relevant to class certification decisions in wage & hour actions are more closely related to the ultimate issues at trial than they are in other actions (compare, for example, securities fraud class actions, where the class certification issues have almost nothing to do with the significant issues at trial).

Third, some narrowing of the range of potential settlement is achieved by the fact that extreme low ball offers typically are not made, even preliminarily, because both sides know (or can be reminded) that there is a certain threshold that will not survive a fairness hearing, nor sustain the plaintiff's counsels basic need to preserve reputation in the context of a settlement record that (unlike the settlement of individual claims) is *always public*.

Finally, and perhaps most importantly, parties tend to be guided by a kind of “market price” for these claims – settlements tend to fall within a fairly well defined band established by publicly available information of what *other* cases have settled for relative to the total potential exposure in the case.

What is notable is that, given the fairly strict and administrable standards of liability set forth in the statutes, the market price of the claims is probably materially *below* the amounts that a standard risk-based discounted claims

valuation analysis would yield. This probably makes sense in light of the various incentives of the participants. Defendants need attractive offers (relative to exposure) to overcome both non-economic resistance factors as well as the lack of extensive palpable evidence of trial results. Defense counsel, paid hourly, have, if anything, an economic advantage to honor the client's resistance, as well as reputational and self-fulfillment benefits to keeping at least some quota of cases to try. Plaintiffs' counsel, particularly specialists in demand, reach a certain threshold where the economically optimal course is to declare the offered amount to be enough and free up their time to fry another fish. And that threshold, in turn, need be no greater than a respectable outcome as compared only to the settlement market price itself. The Court, for its part, is institutionally loath to second-guess the norm, and institutionally dependant on most large cases settling in any event. Finally plaintiffs, themselves, are, for all practical purposes, absent from the process. They can opt out, and thereby preserve the right to bring claims on an individual basis, but the value of individual claims is rarely enough to warrant the transaction costs.

## **5. Role of the Mediator**

It helps immensely for the mediator to have substantive familiarity with the rhythms and restrictions of class actions generally, and specific familiarity with the rights and duties of employers regarding wage and hour matters. That is the environment in which the mediator is applying his or her skills. But the mediator's primary contributions come from the use of more general "process skills" to anticipate, analyze and avert impasse in the negotiation process. Those skills are not unique to wage & hour mediations.

Some taste of the actual process of analyzing and averting impasse may be provided by an actual example of an email I sent to defendant's counsel to overcome an impasse in a wage & hour class action I was mediating. The text – attached as "**Attachment 1**" – has been left in its raw form, with one exception: all names appearing in the original have been made generic so as to fully protect confidentiality. The case settled shortly after the email was sent.

# Attachment 1

To: Defense Counsel

From: Jay McCauley

Here are my observations:

1. On the numbers front, we are making progress. Defendant's initial bid of \$200,000 turned out to be large enough to prevent immediate impasse; her bid induced Plaintiff's counsel to move from his initial demand (\$1.53 million) to \$1.3 million. Defendant [acting through its in-house counsel] then responded by making a reasonable counter (\$515,000, \$165,000 of which must be "in kind") and combining that counter with a strong message -- we cannot be talking seven figures, and we greatly prefer keeping an "in kind" component. Plaintiff's counsel responded to the reasonable counter by honoring the message: His current bid is \$980,000, of which fully \$200,000 can be "in kind". Moreover, we are not hearing Plaintiff's counsel say his current offer is the final offer. Translation: there is a good prospect we can get out for an amount materially less than \$780,000 in cash plus certificates (whose costs are indeterminate but substantially less than \$200,000).

2. Nonetheless, Defendant's representative then balked. In fact, she ended the mediation even before waiting to hear the portion of the \$980,000 that could be allocated "in kind" to gift certificates. That is *way* before taking some steps to find out what Plaintiff's counsel's declared final number would be. It is *way way* before we could then truly explore potential "extenders" available in the class action context to meet plaintiff's demand with ultimately less cash outlay. And it is *way way way* before we had progressed far enough for me to make use of an assortment of closing techniques to bridge any remaining gaps.

3. The reason she balked was not that her client needs the case to settle at her last offer (\$350,000 cash plus \$165,000 in certificates) before it will reap substantial net benefits from settlement. Even using Defendant's own premises, the risk discounted value of a release and class action bar to it is over \$1.8 million, and the litigation cost savings is several hundred thousand dollars beyond that. Even if Defendant were to accept the current offer (not to say it should; in fact, in need not and therefore should not), it would reap, by its own premises, a net savings on the order of \$1.5 million, compared to the full cost of going to trial. Further negotiation would only improve on that.

4. Nonetheless, it is *understandable* that she would balk. Her comfort zone is pure position bargaining. Cases can settle resorting to that mode only, but they put inordinate pressure on the bargainer to "display resolve" by being impatient. Moreover, we can make progress in the position bargaining mode only "iteratively" -- by the incremental movement in the ritual of horse-trading. There are good reasons for this --

they all relate to the underlying social psychological phenomenon of reactive devaluation. But the bottom line is that if you ask the other side in a position-bargaining context whether their bottom line is "X" you will always get the answer "No," regardless of what the truth is. Moreover, cases almost always settle for amounts below the amount the plaintiff would have said his bottom line was if asked.

5. But here is the real rub: If a defendant whose only tool is to "display resolve" asks such a question and gets the answer "No," that person has few options other than to disband the settlement discussion, as the only way available in that context to "display resolve." That's pretty much what happened at the end of the mediation session yesterday. The danger of that question is part of the reason why I always emphasize that I don't want to get into bottom lines, even in the otherwise "safer" context of a private communication in caucus with me.

6. Cutting into it a little deeper, the real question is, "What caused Defendant's representative to feel that the only course available to her mid-day yesterday was to take the course she did." The answer is that it was a predictable response to the bind that she was apparently in. She was not the ultimate decision-maker. She had finite authority limits, and had apparently already bargained to the point where she was close to them. Those authority limits were pre-set by persons who were less informed than she could become in the process of the mediation itself. But because those who set her limits were not present, the limits could not be adjusted, even marginally, in response to new information inconsistent with the assumptions they were working with when they set those limits. For those in control, dissonant information may lead to comfortable adjustment beyond one's original plans. For those not in control, dissonant information can only lead to discomfort of the sort the person is helpless to do anything about. One manifestation of the fix Defendant's Counsel was in -- and we would see it with anybody in that fix -- is that she would be impatient with new information even if it would rationally lead to an adjustment of the original authority in the client's own interest. New information would be, to her, essentially beside the point because there is not anything she can do about it anyway. Moreover, even appearing to pay too much attention to it would impair the perceived effectiveness of the only tool she was given under the circumstances -- to "display resolve."

7. As we know, several of the premises she had apparently earlier supplied the client as the basis for their decision setting fixed authority limits are either improbable or flat wrong: That the "BB" case is analogous, and no other settled case known to her is analogous; that there is a discernable difference between big cases and little cases on an settlement amount per class member basis; that class actions are akin to private settlements, where a plaintiff's counsel might be tempted to sell a small fish cheaply, looking to a confidentiality clause to protect his reputation and ignoring the constraints that a judge at a fairness hearing would be using to block such settlements in any case; that there are no special risks to a defendant in a wage and hour class action case, such that all jury trials are about equally risky, meaning (presumably) that all jury cases, from med mal to securities fraud to wage & hour, should be expected to settle for about the same percentage of the ultimate potential damage exposure; that there are no "soft

dollar" components potentially available other than an in-kind distribution, such that there is no measurable value in such things as a reversion term; that it is possible to bargain for "terms" and still somehow set up a common fund necessary for a class action settlement, etc. Presumably, she now knows better. But we can't expect the decision-maker will, or at least will not as well as if a decision-maker had participated directly.

8. I think the case should settle. I would like to see if we can remove structural impediments to that happening. Best alternative: direct involvement of a decision-maker vested with the discretion to adjust limits consistent with his own ongoing assessment of the company's best interests in light of the actual alternatives it faces. I can work to adjust schedule, including weekends, if that course appeals to you. Next best alternative: work with Defendant's Counsel for her to work with client to insure at least that the decisions they make are well informed, at best that she get a little more elastic authority so as to capture opportunities in the client's interest.

9. Highest on list -- the extraordinary premise that a reversion has no discernable value. We can't pinpoint its exact value, but no successful business would say that it therefore has no value. My own assessment is that its value may well be upwards of a third of the total settlement cost. Put another way -- with a reversion, a \$900,000 settlement may be had for about \$600,000 of client cost. And that is not the only "extender." It is, however, the biggest, and it is the one that puts the most time pressure on us. Quite simply: IT CANNOT BE RESORTED TO IF THE FAIRNESS HEARING TAKES PLACE AFTER THE JANUARY 1, 2002 STATUTORY CHANGE TO CCP SECTION 384 GOES INTO EFFECT, so we are already at the "11th hour" given the lead time needed to document a settlement and conduct a fairness hearing on it. We are not without some means of assessing the potential value of the reversion term. *Newberg on Class Actions* presents some empirical evidence of return rates of class action forms for various class actions; I think it is in volume 9 of his treatise. The formula for the value of the reversion clause, of course, is  $(A-B) \times C$ , where A equals the total settlement amount (including "in kind" value), B equals the attorney fee component (e.g. 33% of total), and C represents the percentage of the common fund not claimed by the absent class members (which would have to be 50% to achieve my \$600,000 estimate above).

10. Call me when you can. Hopefully these observations may make the discussion more efficient, which I recognize to be important given the extraordinarily busy schedule we are trying to relieve you of.

Best regards,

Jay

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