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While wage and hour litigation has been on the radar for years now, a recent surge in litigation has pushed this issue to the forefront of employment practice concerns for both corporations and their insurers. Wage and hour litigation arises from alleged violations of laws that govern payment of minimum wages and maximum working hours of the U.S. workforce. The federal statute governing these matters is the Federal Labor Standards Act (FLSA), and many states have their own laws and regulations regarding minimum wage, overtime, and age requirements.

According to Seyfarth Shaw's 11th annual Workplace Class Action Litigation Report, wage and hour filings under the FLSA rose to 8,066 in 2014 from 7,882 in 2013. Remarkably, this was the only major category of workplace litigation to show an increase in the number of filings. In numbers recently released by Advisen, wage and hour claims account for an average of 28 percent of all employment practices liability losses. In California, these claims account for 40 percent of employment practices liability losses. In the current environment, these claims show no sign of slowing and appear to be a major exposure risk for companies in the coming years. Additionally, how and if insurers can address this growing exposure will determine if the risk of these claims can be quantified and mitigated.

Recent Wave

The influx of these claims is due to a wide range of factors that have converged over the past few years. First, in certain respects the FLSA is outdated legislation. While it was initially designed to protect employees from abuses in the work environment, it has not been updated since 2004 and can be difficult to apply to the modern workplace. Today's corporate environment is very fluid, and the Monday to Friday 9 to 5 workweek on which the FLSA was based is not always accommodating to the changes that have taken place.

Workplace innovations such as telecommuting and outsourcing have made compliance with overtime regulations increasingly difficult and cumbersome. Under the FLSA, employers are required to pay employees for all time worked — even if the employer did not specifically request the employee to work. All that is necessary for an

Wage and Hour Claims

The Rise and Impact of Increased Litigation

By Nicole Barna

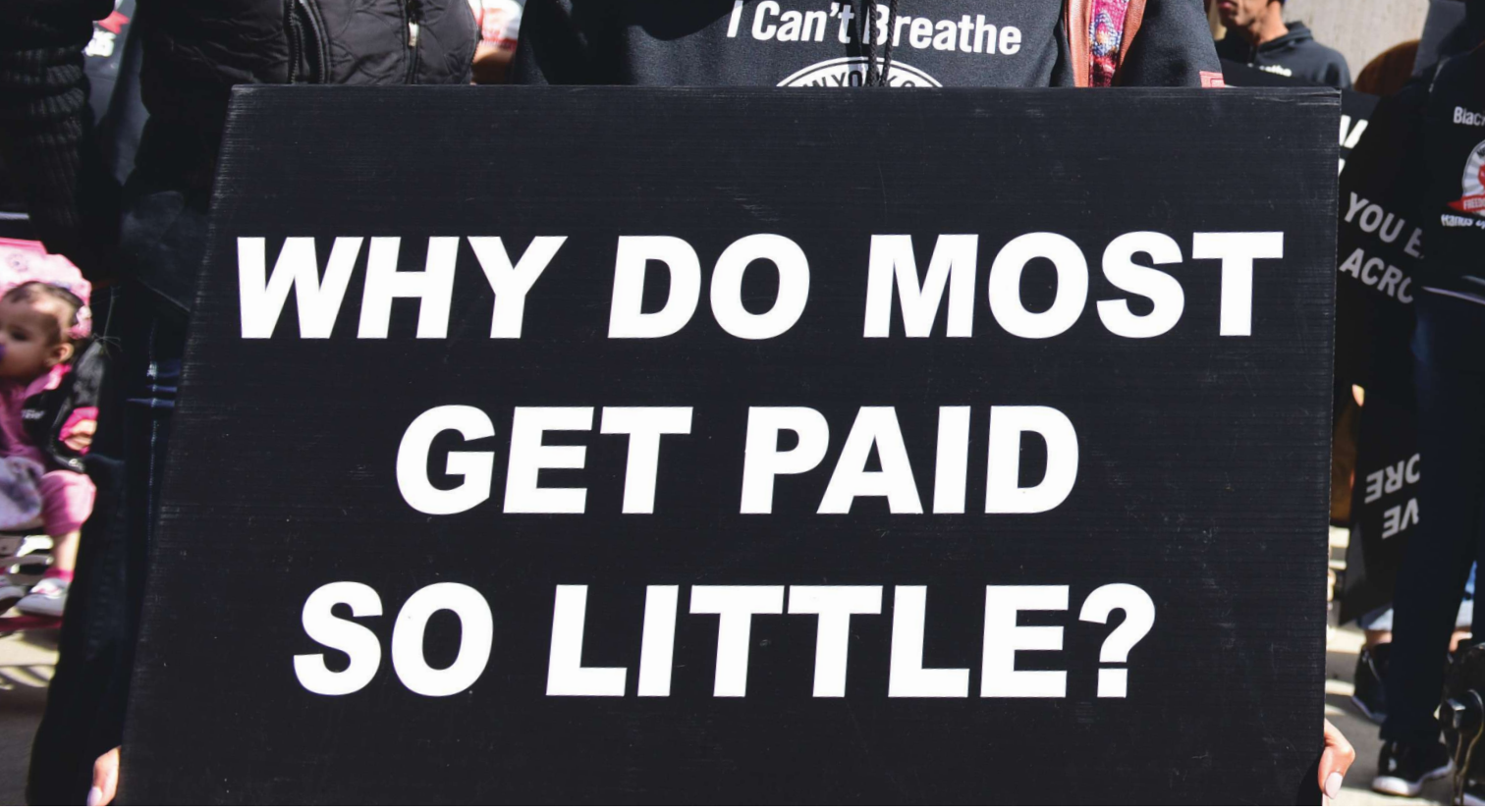
employee to have a right to be compensated is that the employer knows or has reason to believe that the employee is continuing to work, and that the employer is benefiting from that work. These standards even apply to seemingly innocuous actions, such as, employees checking their email after hours.

The 11th Circuit in *Bailey v. Titlemax* recently illustrated this standard with respect to violations caused by underreporting hours. In some jurisdictions, a defense to a claim of non-payment of overtime is that the employee underreported their hours. This is commonly known as a defense of unclean hands or *in pari delicto*. However, on appeal the *Bailey* court held that this defense may not be used if management encourages or supports this underreporting. In *Bailey*, the company either knew or should have known that overtime was owed and therefore was found liable regardless of the employees' own omissions.

FLSA Complexity

The FLSA is also complex in nature, and many organizations find it challenging to follow its rules and regulations. The Department of Labor estimates that nearly 70 percent of companies are not in compliance. Further complicating matters, the FLSA overlays various state wage and hour regulations, which only adds to the complexity that businesses face when it comes to compliance. This issue is often exacerbated when a business has operations in various states. For example, currently 29 states and the District of Columbia have a minimum wage higher than the federal minimum wage, and further, overtime regulations can vary widely from state to state.

In recent years, the government has also made FLSA enforcement a priority, which can be seen in a much more active EEOC and U.S. Department of Labor staff. The Wage and Hour division of the Department of Labor has also taken a unique tact by targeting industries as a whole, rather than relying solely on worker complaints. This change in strategy is a result of the fact that workers who are subject to "wage theft," a term for abuses of overtime and minimum wage violations, misclassifications, and non-payment of benefits, are some of the most job-insecure employees, and thus the least likely to report such violations. Using this targeted approach, last year the government recovered over $250 million in back wages



for more than 308,000 workers. Additionally, the Department of Labor is set to release revisions to the FLSA this fall, and even if the changes provide additional clarity, they will likely initially result in an uptick of litigation.

Litigating and Settling

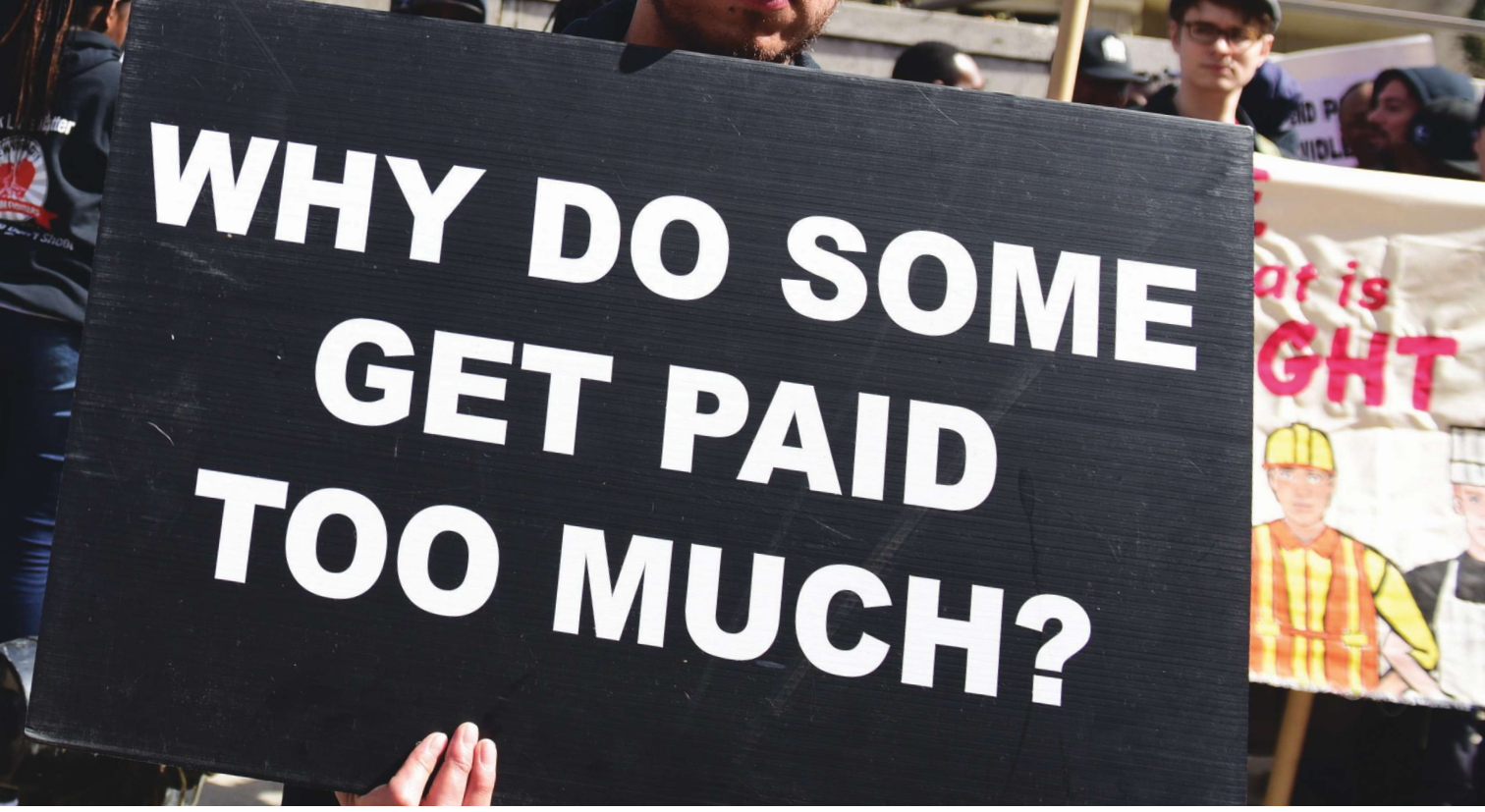
Wage and hour matters are also very appealing actions to plaintiff's attorneys. Wage and hour cases often take the form of class actions, and certifying a wage and hour class action lawsuit is easier than in other areas of employment practices liability. Wage and hour class actions are subject to a lenient conditional certification standard that does not follow the traditional certification paradigm of Fed. R. Civ. P. 23.

Rather, the FLSA provides for a unique process where certification is analyzed at two distinct stages in the litigation process. The first conditional certification has a low threshold and all that is usually required is substantial allegations that the purported class was subject to the same policy or plan. As most companies have standardized practices that are applied throughout their workforce, this is usually not difficult to demonstrate. This lenient standard was recently bolstered by the Second Circuit in *Roach v. T.L. Cannon Corp.,* when it held that a wage and hour case may still be certifiable as a class action even if damages must be calculated on an individual basis.

This low bar for initial class certification can result in a class action that by any objective standard has no chance of success, dragging out for years. This prospect of drawn-out litigation can push defendants to settle claims early. Also contributing to early settlement is the fact that the FLSA is governed by standardized guidelines that make violations easier to prove and simpler to litigate for plaintiff's attorneys. Claims can be resolved without expensive depositions or waging costly discovery wars. Overall, from a cost-benefit point of view, these cases can be a boon for plaintiff's attorneys. One demand letter, a quick mediation and plaintiffs can walk out with millions.

Not only is the number of claims on the rise, the monetary amount associated with resolving these matters can be extremely large. Seyfarth's report puts the top 10 private settlements entered into or paid on wage and hour class-action lawsuits in 2014 at $215.3 million, and in 2013 at $248.45 million. These high numbers are largely the result of the FLSA's extremely harsh liquidated damages provision, which can often result in huge exposures.

In 2012, Novartis Pharmaceutical paid $99 million to settle a wage and hour class-action lawsuit brought by its outside sales representatives who alleged that they were owed unpaid overtime wages as they had been wrongly classified as exempt rather than non-exempt employees. In *Shallin et al v. Payless Shoesource, Inc. et al*, Payless chose to save future litigation costs and settle a claim made by former store managers alleging they had been misclassified as exempt under the FLSA for $2.9 million. Most recently, FedEx agreed to pay $228 million to settle a California class action brought by drivers who alleged they were misclassified as independent contractors. While there is some indication that the costs of resolving these actions is leveling off, these



settlements make clear that the exposure presented by wage and hour claims is far from over.

A Possible Solution

This growth of FLSA litigation is coupled with the fact that most companies find themselves woefully underinsured or completely uninsured for these types of claims. Standard Employment Practices Liability Insurance policies generally exclude coverage for wage and hour claims on the basis of the frequency and severity of these claims, as well as the principle that wrongfully withheld wages were traditionally considered to be uninsurable. Challenges to these exclusions typically only succeed when the complaint also includes a covered employment practices allegation, and even still payments are then largely limited to defense costs.

New products have emerged in recent years that are specifically designed to address the risks presented by wage and hour claims. Companies should be taking a hard look at their FLSA exposure to determine if the purchase of such wage and hour coverage is a prudent business decision. Companies should note that it is very unlikely these risks are covered under any traditional employment practices or professional liability policy.

If coverage specific to wage and hour claims is purchased, companies need to be aware of the unique risks that are presented with respect to reporting and managing these claims. It is of the utmost importance that this new coverage is communicated throughout the risk management department and/or to those tasked with the responsibility for handling claims in-house to ensure that claims are properly reported under policy provisions. The only notice of these claims may be a demand letter from plaintiff's attorney, and such items must be promptly reported to ensure notice requirements are not violated.

With these same considerations in mind, insurers must be equally aware of the challenges that wage and hour claims present. When it comes to traditional employment practices liability policies, insurers should be clear and consistent with respect to their coverage positions for such claims and make sure insureds are made aware of the limitations of their coverage in a timely fashion. If an insurer provides wage and hour coverage, the company's wage and hour compliance program should be carefully vetted and controls such as regular audits and reviews encouraged. From a claims perspective, examiners should be even more diligent in requesting regular updates from insureds with respect to both pending and forthcoming wage and hour claims to determine if any patterns are emerging that could suggest greater exposures.

As this trend of wage and hour claims is likely to continue, companies are well-advised to allocate resources towards ensuring FLSA compliance, and evaluating the need for insurance to mitigate the risk of these claims. As important, insurers also need to recognize this potential exposure and attempt to provide responsive products and ensure that these unique claims are properly handled once reported.

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