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Decoding Settlement Process For FLSA Claims At 2nd Circ.

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For years, attorneys representing clients in Fair Labor Standards Act litigation have confronted a vexing problem: Having agreed on their own to resolve a dispute over wages owed under the FLSA, how can they make their agreement enforceable without going through the time and expense of getting a federal judge to sign off on it? This quandary arises because many courts interpret decades-old U.S. Supreme Court precedent to require that either the U.S. Department of Labor or a court approve the terms of any FLSA settlement before it is effective. The rule is intended to prevent employers from economically coercing employees into bargain settlements at rates of compensation below what the statute requires. But it also adds a significant layer of complexity to claims that employers often believe are of dubious quality and involve only a few thousand dollars in potential liability.

A few years ago, enterprising lawyers in the Second Circuit believed they had found a way around this problem — if a settlement was reached after a FLSA complaint had been filed, the parties would stipulate to a dismissal with prejudice under Federal Rule 41(a)(1)(A) and avoid the need for court review. That technique was rejected by the Second Circuit in Cheeks v. Freeport Pancake House Inc.[1] as incompatible with the judicially created rule regarding court approval. They now have come forward with a new strategy — upon reaching an agreement, the defendant agrees to serve a Rule 68 offer of judgment on the plaintiff, which is accepted and filed with the court. The resulting judgment is then entered by the clerk with no judicial involvement.

Has this latest stratagem created an alternative to obtaining formal court approval of a FLSA settlement? That question has divided New York federal district courts over the past two years. It will be resolved when the Second Circuit hears the appeal in Mei Xing Yu v. Hasaki Restaurant Inc.[2] in the coming months.

Not Your Typical Settlement Process: Resolving Claims Under FLSA

The cause of these procedural contortions are two 70-year-old Supreme Court cases. The first, Brooklyn Savings Bank v. O'Neil,[3] held that, when there is no dispute as to whether an employee is entitled to liquidated damages in a specific amount, the employee cannot privately waive his right to those damages. The court's conclusion was based on two related concerns. The first was that employers could use the superior economic position to get employees to effectively bargain away their right to liquidated

damages, which would encourage employers to commit violations in the first instance. The second was that by doing so, unscrupulous employers would obtain an unfair advantage over their competitors. In such a world, employers could pay substandard wages, make employees sue them for the difference, and settle without penalty with the few that did bring suit by paying only the amount they were required to pay in the first instance.

The second Supreme Court case, D.A. Schulte Inc. v. Gangi,[4] reached a similar conclusion in the context of disputes overage coverage. Gangi held that an employee could not privately settle a bona fide dispute as to whether they were covered by the FLSA, relying upon the same employee-protection and competitive advantage principles announced in Brooklyn Savings Bank. However, Gangi did not completely close the book on private settlements. For example, it expressly declined to decide whether such compromises would be unenforceable where, for example, a dispute existed over hours worked or the appropriate rate of compensation.

From these two cases, most courts have concluded that a settlement of FLSA claims must be approved by a court or the DOL as "fair" to be enforceable. This view largely has prevailed since the Eleventh Circuit's decision in Lynn's Food Stores Inc. v. U.S. Department of Labor,[5] which held that private settlement agreements with unrepresented employees could not be enforced unless they had such approval. Although the Fifth Circuit has since held that private waivers may not be unenforceable in all contexts,[6] the rationale of Lynn is the prevailing view in many federal courts.

The Search for Alternatives: How We Got to Mei Xing Yu

The settlement approval requirement typified by Lynn can be inconvenient for both employees and employers alike. At its most onerous, it (literally) makes every attempt to fix a potential FLSA violation a federal case. If an employer discovers it has underpaid an employee, it cannot obtain repose from the employee by simply tendering the unpaid sums and obtaining the employee's agreement that the claim has been satisfied. It can only obtain the desired repose by involving the DOL or court system in the process. In addition to being an awkward process to resolve what may sometimes be a trivial dispute, the employer may have concerns that the public nature of court proceedings will encourage other employees to bring claims.

The process can be equally unpalatable to employees. Private settlements allow employees to get their payment within days. When court approval is required, the timing of payments is much less predictable. The court approval process also adds significant costs to the settlement process — filing and attorneys' fees among them — that may (or may not) be borne equally by the parties. While these additional burdens may seem trivial in a collective action alleging systemic FLSA violations, they are a much more practical concern in cases involving a few hundred dollars in unpaid wages.

Perhaps motivated by these concerns, several attorneys in the Southern and Eastern Districts of New York began to settle FLSA cases in the early 2010s by filing notices of voluntary dismissal with prejudice under Rule 41(a)(1)(A). The advantage of using Rule 41 was that it resulted in a court dismissal with prejudice without the need for court approval. Some courts balked at this tactic, concluding that the process violated the principles articulated in Brooklyn Savings Bank and Gangi, but others approved. The Second Circuit resolved these conflicting decisions in Cheeks, noting that Rule 41(a)(1)(A) expressly stated that its provisions were "[s]ubject to … applicable federal statutes" and that the FLSA (and its attendant settlement approval requirements) was one such statute. In doing so, the Cheeks panel noted concerns about private FLSA settlements that went beyond the overreach identified in Brooklyn Savings Bank and Gangi. In addition to these issues, it added examples of overly broad release agreements,

restrictive covenants and excessive attorneys' fees to the parade of potential horribles. These examples "illustrate[d] [that] the need for such employee protections, even where the employees are represented by counsel, remains."[7]

The Next Big Thing: Rule 68

No longer able to rely on Rule 41(a)(1)(A), attorneys came up with a new device — Rule 68. After settling a FLSA claim, the defendant in the lawsuit would serve a Rule 68 offer of judgment on the plaintiff for the total amount of the settlement. The plaintiff would then accept the offer and file it with the court. Judgment would subsequently be entered, with no need for court intervention.

Unlike Rule 41, Rule 68 does not include an express carve-out if an applicable statute imposes additional requirements. The rule requires that a court clerk "must … enter judgment" upon the filing of an accepted offer. This textual difference was conclusive for many district courts, which concluded that they were obligated to enter judgment on an accepted Rule 68 offer under the terms of the rule, regardless of the Second Circuit's decision in Cheeks.[8] Others district courts disagreed, holding that the same concerns of unscrupulous employers and unequal bargaining power applied equally to settlements effectuated under Rule 68 as those under Rule 41.

The decision in Mei Xing Yu typifies the latter approach. It found that the assertion that "Rule 68 is, by its terms, mandatory and leaves no room for judicial scrutiny of an accepted offer" did not survive "closer scrutiny."[9] It noted various contexts in which courts continued to scrutinize settlement offers under Rule 68, such as in cases where minors are parties to the agreement or certain statutory claims are asserted. It also concluded that the animating principles articulated in Cheeks applied equally to settlements effectuated under Rule 68. "In short," it held that "although Cheeks may not apply a fortiori to a Rule 68 FLSA settlement given its reliance on the language of Rule 41, its reasoning — combined with the fact that Rule 68 is not always, as the majority of courts in the circuit have assumed, mandatory — compels the conclusion that parties may not evade the requirement for judicial (or DOL) approval by way of Rule 68."[10]

Noting the conflict that exists between district courts in the Second Circuit on the issue, the district court in Mei Xing Yu certified its decision for interlocutory appeal. The Second Circuit granted the petition for interlocutory review on Oct. 23, 2017 and likely will require the case to be fully briefed by early 2018.

The Rule 68 strategy faces significant obstacles on appeal. The evils of disparate bargaining power and unscrupulous settlement terms do not appear to disappear when Rule 68 is the vehicle for settlement. Although Rule 68's mandatory language indisputably differs from Rule 41's, this may not be enough to carry the day in the face of these concerns. As noted in Mei Xing Yu, this language may not be absolute. And even if it is, the Second Circuit may look to the Rules Enabling Act's proscription that federal rules of procedure may not "abridge, enlarge, or modify a substantive right" and conclude that it makes no difference.[11] If it finds that the FLSA substantively prohibits private settlements without court approval, Rule 68 may go the way of Rule 41 in the Second Circuit — a clever idea to solve a real problem for many that could not overcome the abuses of a few.

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[1] 796 F.3d 199 (2d Cir. 2015).

[2] 319 F.R.D. 111 (S.D.N.Y. 2017). On Oct. 23, 2017, the Second Circuit accepted interlocutory appeal of the district court's order requiring the parties to submit their settlement agreement for review, notwithstanding the parties' filing of an accepted offer of judgment under Rule 68. See Mei Xing Yu v. Hasaki Rest., Inc., 874 F.3d 94 (2d Cir. 2017).

[3] 324 U.S. 697 (1945).

[4] 328 U.S. 108 (1946).

[5] 679 F.2d 1350 (11th Cir. 1982).

[6] See Martin v. Spring Break No. 83 Prods., LLC, 588 F.3d 247 (5th Cir. 2012) (upholding private settlement of FLSA claims between employer and employees' union representative).

[7] 796 F.3d at 207.

[8] See, e.g., Arenzo v. Big B World Inc., 317 F.R.D. 440 (S.D.N.Y. 2016). Some district courts expressed misgivings about this approach even while approving such judgments. See Baba v. Beverly Hills Cemetery Corp., No. 15-CV-5151 (CM), 2016 WL 2903597 at *1 (S.D.N.Y. May 9, 2016) (stating the "Rule 68 Offer of Judgment procedures give clever defendant employers an aperture the size of the Grand Canyon through which they can drive coercive settlements in [FLSA] cases without obtaining court approval").

[9] 319 F.R.D. at 113.

[10] 319 F.R.D. at 116.

[11] 28 U.S.C. § 2072(b).