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Stealth Class Actions

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ON JUNE 21, 2004, a federal district court in San Francisco certified a nationwide class of approximately 1.6 million current and former female employees of Wal-Mart who claim sex discrimination in promotions and pay at Wal-Mart stores around the country. '*Dukes, et al. v. Wal-Mart Stores, Inc.*', No. C 01-02252 [N.D. Cal. June 21, 2004]. Although this is a noteworthy case, it is not just about sex anymore. Wage and hour collective actions now take up a significant portion of state and federal court dockets, demonstrating that this once sleepy area of the law has caught the attention of the plaintiffs' bar. While the headlines suggest that these recent class actions are won or lost in the courts, the new "action" in class actions comes from quiet demand letters that threaten employers across the country.

"Stealth class actions" are phantom lawsuits that are quietly initiated with a short, carefully crafted demand letter from aggressive, well-known class action counsel. These letters typically suggest that there is a large class action waiting in the wings, and outlines in broad strokes the areas where the organization is potentially liable. The letter closes with an offer to resolve the matter quickly and quietly at the pre-litigation phase, if the price is right. It is then up to in-house counsel to decide to settle at the outset, or risk large-scale and potentially messy class action litigation.

Why start with a demand letter rather than a formal suit? First, economics. Class actions are expensive to mount and maintain, so an up-front settlement, even if it is not for the full relief that would be available in court, is often the most cost-effective route for plaintiffs' counsel. Savvy "class" counsel also know that their leverage is highest when they can "sell" confidentiality as part of an omnibus pre-suit resolution.

How to Respond

Corporate legal departments need to recognize that these demand letters are different in kind from the ones they are used to receiving in single plaintiff cases, and that the threat they present is real. Below are some pointers on how to manage this threat in a manner that enables the company to effectively negotiate a settlement, if appropriate, while also preparing to mount a vigorous defense.

Preserve evidence -- often. Demand letters are addressed to the CEO, and may languish in his or her office for weeks before being shuffled off to another department. Equally dangerous, sometimes class action demand letters land on the desk of an unsuspecting human resources professional. Neither the CEO nor HR will typically view this type of demand letter as anything particularly urgent. But demand letters trigger the same type of legal obligations as a formal complaint, such as document retention and "legal hold" obligations of the type announced in the UBS Warburg litigations.

Although conventional wisdom has been that the duty to preserve evidence accrues upon receipt of a court complaint, courts are increasingly finding that it may accrue well before then. See, e.g., *Zubulake v. UBS Warburg LLC*, 2003 U.S. Dist. LEXIS 18771 at *9-11. For example, the court in *Zubulake* found that the defendants' duty to preserve evidence began when "almost everyone associated with Zubulake recognized the possibility that she might sue." *Zubulake*, 2003 U.S. Dist. LEXIS 18771 at *9-11. The court found that this was 22 months before the plaintiff filed her federal

court complaint and four months before she filed her Equal Employment Opportunity Commission (EEOC) charge.

The federal district court ultimately sanctioned UBS Warburg for failing to maintain e-mails germane to the case once the threat of litigation became apparent. Coincidentally, the following day, the U.S. District Court for the District of Columbia ordered tobacco giant Philip Morris to pay $2.75 million in sanctions for its own e-discovery violations, including the deletion of relevant e-mails. *U.S. v. Philip Morris*, No. 99-2496 (D.D.C. 2004).

Document and information retention obligations can be massive in scope when they pertain to, for example, every sales associate employed by a nationwide retail organization over the past five years. As *Zubulake* demonstrates, however, failure to preserve evidence under these circumstances can place the company at risk for sanctions in later litigation (which may be substantial, even if the underlying case has little merit), as well as weaken the company's substantive defenses.

As a first line of defense, therefore, legal departments should put procedures in place to deal with demand letters, just as they have with formal court complaints and agency charges. For example, a "legal hold" memo should detail a specific method by which employees should preserve potentially relevant e-mails. It is also imperative to inform the IT department of the company's newfound retention obligations. The IT department will likely have to stop or alter the company's current automatic document/e-mail deletion practice.

Line up your experts. When your company receives a demand letter that appears credible, it is time to reach out to the small universe of expert witnesses who specialize in employment class action litigation. Do not wait. If you do, you may find that plaintiffs' counsel has already contacted the one you want. Early involvement of the right experts can also help your organization evaluate its potential exposure early on.

In employment discrimination cases, there are three areas where expert evidence is generally required. First, a statistician should be retained. There are very few who are truly experienced in the area of employment discrimination pattern and practice litigation. Make sure you get one of the good ones from the start. Second, you will likely need a labor economist to address damage allegations, such as pay disparities between male and female employees or minority and non-minority employees.

Finally, and increasingly on the scene, are industrial psychologists. Plaintiffs increasingly use such experts to opine, for example, that the employer's work force is "male-dominated," and as a result, managers hold stereotypical views concerning female employees' ability to succeed. This expert may suggest that these biases are unconscious, and will contend that absent specific checks on managerial discretion, which are lacking, the discriminatory results found by the economist/statistician are virtually inevitable. For example, in *Dukes v. Wal-Mart*, the sex discrimination class action recently certified in California, plaintiffs' sociologist emphasized that the "Wal-Mart culture" was the common thread that tied together the seemingly unrelated decisions managers made throughout the nation. A company defending such allegations will need an expert to rebut these opinions.

Given the importance of expert testimony in class litigation, early involvement of effective experts, both consulting and testifying, is imperative. Such early involvement enables the company to identify relevant data, what needs to be retained, and the best way to analyze it. Consulting experts are particularly helpful because they can help to build a statistical model to study various employment decisions at issue without risking the discovery of results. This may give the company immeasurable leverage in settlement negotiations as it will already have defenses prepared to claims that plaintiffs' counsel may make during settlement negotiations. Further, the company will be in position to defend the case in the event a resolution is not reached, as it can use the data to defeat class certification if it proceeds to litigation.

Manage communications with employees. The threat of a class action poses another very practical problem for companies: whom to tell. The first instinct upon receiving a demand letter is often to conduct a wide-scale investigation into the merit of the claims. A wide investigation, however, often results in publication of the claims deep within the organization, possibly to otherwise unaware potential plaintiffs. Thus, be careful. There is a need to balance the instinct to investigate immediately against the desire for confidentiality. Ethical considerations also play a role. In every case, establish a control group charged with receiving information and investigating the basis of the claims. The control group should be small at the outset, consisting of senior ranking employees from legal, HR and the affected business unit. Like a widespread investigation, a large control group may very well defeat the purpose of a quiet settlement. That is, you may get your settlement, but it will not be "quiet."

As time goes by and the investigation continues, employees in the company, many of whom will be potential class members, will inevitably learn of the action. A company may find itself wanting to get its message out to rank and file employees, but beware — any such message must be carefully scripted. One way to manage the message is to prepare "talking points" for HR and managers. By controlling what is to be said in this manner, the organization can meet its ethical obligations in regard to communicating with putative class members and simultaneously protect itself against claims that it is trying to coerce potential class members to avoid the litigation or to speak directly to the company about their claims. Companies may also consider a mass communication (for example, an e-mail or intranet posting) that describes the lawsuit, issues involved and the company's position. As a general rule employers can issue mass communications to potential class members, so long as they are (a) not false or misleading and (b) contain a disclaimer indicating that the communication represents the position of the company and that no employee will be retaliated against for "participating in the litigation." Manual for Complex Litigation (Third) §30.24, at 257 (citing *Gulf Oil v. Bernard*, 452 U.S. 89, 102-04 (1981)).

Judiciously manage the data. Of course, any company trying to decide between settlement and litigation in response to a threatened class action will need to evaluate the claims raised, and prepare for litigation if necessary. It is necessary to start to identify potential class members, to assess the magnitude of potential exposure from best to worst case

scenarios, and to prepare defenses to class certification.

It is critical that these activities be done in a manner that preserves privilege. It is not unusual for human resources or business people to start generating data without counsel specifically instructing them to do so. In all likelihood, this information will not be privileged, and may be generated in a way that is potentially damaging to the company's position. As part of a company's standard response protocol, therefore, counsel should instruct human resources and other support teams to wait to generate reports and other data concerning contested claims until specifically instructed to do so. As discussed above, this is also the time to get consulting experts involved. They can help organize and generate data in ways that assist the defense to the maximum extent, all under the umbrella of privilege.

Initially, the company should interview relevant decision-makers and hear their rationale for the challenged decisions. Such interviews may give the company viable defenses that it can use to oppose class certification — for example, that the plaintiff's experience does not reflect corporate "policy," or to argue that the contested policy has a narrow effect on as limited a class of employees as possible. One goal your company should have during the investigations is to develop how processes at issue in the potential class action actually work, i.e., at what level are decisions made, what kind of HR/managerial oversight was there, what are the objective components of the decision-making. To the extent the data permits, it may also be possible to "play with the numbers" in a manner that demonstrates the weakness of plaintiffs' claims and/or theories. A consulting expert may help the company develop facts showing that income differences between men and women do not reflect gender bias, but instead reflect income, educational or experience-based disparities that pre-dated employment with the employer.

So, You Want to Settle?

If the company wants to pursue settlement, how should it proceed in the precomplaint context? As negotiations unfold, in-house counsel will want to be cognizant of the following considerations:

Tolling for trolling. Employers have leverage at the pre-suit stage. Experienced plaintiffs' counsel know that confidentiality and closure make up the real product they are selling. Do not be afraid to demand broad confidentiality concerning the plaintiffs' claims and all settlement negotiations. If the parties involved decide to pursue settlement negotiations, they will generally be protracted. As a result, plaintiffs' counsel will likely ask for an agreement tolling the statute of limitations until settlement discussions end. Although there is generally nothing wrong with entering a tolling agreement, it is important to demand that plaintiffs' counsel agree not to "troll" for new clients during settlement negotiations. Be aware, however, that if the U.S. Equal Employment Opportunity Commission (EEOC) or National Labor Relations Board gets involved, these agencies may not countenance language that amounts, in their view, to gag orders.

Understand what you are buying. Beware. If the company's goal is to dispose of an action quickly and quietly, a private settlement may be an appropriate option. The settlement of a threatened class-wide claim without court involvement, however, does not bar future litigation on the same claim (except to the extent individual releases are obtained). This may leave lingering, unresolved claims lurking in the background. A company could ink a deal on Monday and be sued in court on Tuesday based on the exact same allegations. If the company's goal is to ensure full closure and to prevent the reoccurrence of a class action threat, therefore, a private settlement may not be the best vehicle.

If the company wants more closure on threatened claims, it will have to go public at some point and seek court approval of the settlement. There are strategies and tactics for accomplishing this as quietly as possible, but notice of the proposed settlement will have to be sent to all potential class members and a court will have to hold a fairness hearing before approving the settlement. This strategy will not necessarily work with Fair Labor Standards Act (FLSA) or Age Discrimination in Employment Act collective actions, which follow an "optin" procedure, and thus bind only those employees who have formally sought to join the suit. Depending on the nature of the suit, an outside agency also may have to get involved. For example, in FLSA litigation an employee may not waive his or her right to back pay and other relief absent approval from a court or the U.S. Department of Labor. Similarly, because a privately negotiated release of claims will not bind the EEOC, it may be necessary to involve the EEOC in settlement negotiations if the company wants to close out any possibility of future litigation. Common settlement provisions. During settlement negotiations of class-wide employment claims, plaintiffs' counsel often make requests beyond monetary demands, some of which may even help a company prevent future claims. For example, changes to the company's existing job posting processes may be demanded. Plaintiffs may demand ongoing independent equity studies to determine if the company is determining pay, job grades and promotions on a nondiscriminatory basis.

Structural changes may be required as a condition of settlement if disparities are found. These may include the creation of an ombuds office to resolve independent employee complaints;[1] and the creation of "affinity groups" of similarly situated employees, including the provision of meeting space and other resources that allow members to communicate about common issues. Plaintiffs may even demand that the company retain an industrial psychologist to review and make recommended changes to job applications, performance appraisal forms and other human resources policies.

Although these requests may appear taxing and burdensome, they are all subject to negotiation. The company's goal should be to ensure that any agreements regarding ongoing monitoring or systemic changes have a minimal impact on the company's day-to-day operations. Moreover, companies should strive not to surrender day-to-day decision-making or control to outsiders, expert or not, as a condition of any settlement.

Where is the EEOC? The EEOC rarely walks

[1] For example, in settling a nationwide class action asserting claims of race discrimination with both private plaintiffs and the EEOC, the Abercrombie & Fitch retail chain agreed to create a new "diversity" office, and to modify its workplace complaint procedures.

away from class actions (threatened or actual) without making programmatic changes to the employer's existing workplace policies. If the EEOC is involved, expect the agency to be less focused on money than a private plaintiff would and more focused on implementing programmatic changes (like affinity groups, pay equity studies and structural changes discussed above). A company may need to go the extra mile on programmatic relief to ensure the EEOC's cooperation in endorsing a favorable monetary settlement.

Preventative Strategies

There are proactive measures that corporate legal departments can initiate to make sure that their case is not the next one featured on "bigclassaction.com." The best strategy is to be proactive: determine whether your company's statistics and policies are a harbinger of class certification and take corrective steps now rather than in response to a threatened or actual claim. In-house counsel would be well-advised to do the following:

- In a privileged fashion, become familiar with your employment statistics and the inferences that can be drawn from them;
- If your company already has that familiarity, examine your policies regarding hiring, promotion and pay — again in a privileged fashion — to assess whether modifications can be made so that they do not appear to rely too much on subjective criteria;
- Adopt or modify a job posting system so that job openings and promotional opportunities (or more of them) are publicized internally;
- Conduct a systematic assessment in a privileged fashion of potential barriers to the advancement of individuals in protected classifications;
- Adopt an appeals process for decisions denying promotions or pay raises; and
- Audit your pay practices to ascertain whether employees are appropriately classified, and assess whether exempt employees are being paid for all hours worked, and overtime, if applicable.
- Draft policies to fill in any gaps.

Why open up this potential can of worms? Four reasons:

(1) To identify and correct problems. Even if it does not keep your company out of court, a demonstrably proactive approach at the corporate level will nevertheless assist you in keeping the issue of punitive damages from being sent to a jury or incurring liquidated damages in wage and hour litigation based on "willful violations of law." It may also make your organization a less attractive candidate for a stealth class action threat.

(2) To promote good employee relations. Employee satisfaction and retention will increase if employment policies are viewed as non-discriminatory and legally sound.

(3) To enhance the bottom line. Staying out of the headlines and/or defeating a large class certification attempt could enhance the company's share price, and the implementation of preventative measures decreases the cost of employment practices liability insurance. And do not forget about legal fees saved, which are not insignificant in the context of potentially large-scale, nationwide class actions.

(4) To arm your company with a better settlement posture, and a better body of evidence should the case proceed to litigation.