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'Cheeks': Restricting Private Settlements Under Fair Labor Standards Act

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Many litigants are understandably reluctant to publicly disclose the terms of their settlement agreements. An August 2015 decision by the U.S. Court of Appeals for the Second Circuit, *Cheeks v. Freeport Pancake House,* 796 F.3d 199, 2015 U.S. App. LEXIS 13815 (2d Cir. 2015), nonetheless prevents parties from voluntarily entering into private settlements of claims under the Fair Labor Standards Act (FLSA) in New York's federal district courts.[1] This article discusses certain district court decisions construing *Cheeks* and strategies employers have utilized in response to it.

Until *Cheeks*, if a wage-and-hour case was settled at a conference before one of the district courts within the Second Circuit, the parties could finalize a written settlement agreement and simply submit a stipulation of dismissal for the court's endorsement, or agree to place the material terms of their settlement on the record, which would often include, inter alia, a requirement that the parties keep their settlement confidential, and that the employee provide the employer with a broad, general release. Only in limited circumstances would parties typically choose to submit a settlement agreement for judicial approval in an individual wage-and-hour case, whereas collective or class action settlement of FLSA claims have always required court approval. *Souza v. 65 St. Marks Bistro*, No. 15-cv-327, 2015 U.S. Dist. LEXIS 151144, at **4-5 (SDNY, Nov. 16, 2015; internal citations omitted).

> The pivotal question on appeal was whether an FLSA action serves as an exception to a rule that parties may stipulate to a dismissal without the involvement of the court. The Second Circuit held that it does.

In *Cheeks*, the Second Circuit affirmed the Eastern District of New York holding that parties cannot enter into settlements of individual FLSA claims without either the approval of the district court or the Department of Labor. *Cheeks*, 796 F.3d at 200, 2015 U.S. App. LEXIS 13815, at *1.

The Cheeks case involved a restaurant server and manager who sued his employer to recover overtime wages, liquidated damages and attorney fees under both the FLSA and the New York Labor Law. See Id. at 200. After engaging in a period of discovery, the parties agreed to privately settle plaintiff's claims, and filed a joint stipulation and order of dismissal with prejudice pursuant to Rule 41(a)(1)(A)(ii) of the Federal Rules of Civil Procedure. The district court declined to accept the stipulation as submitted, concluding that the parties could not agree to a settlement of Cheeks' FLSA claims without either the approval of the district court or the supervision of the Department of Labor, and required the parties to file a copy of the proposed settlement on the public docket. See Id.

The pivotal question on appeal was whether an FLSA action serves as an exception to Rule 41(a)(1)(A)(ii)'s general rule that parties may stipulate to the dismissal of an action without the involvement of the court. The Second Circuit held that it does.

Discussing the FLSA's legislative history and unique policy considerations, the Second Circuit in *Cheeks* explained that the

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FLSA "protect[s] certain groups of the population from substandard wages and excessive hours which endangered the national health and well-being and the free flow of goods in interstate commerce." *Cheeks*, 796 F.3d at 199, quoting, *Brooklyn Savings Bank v. O'Neil*, 324 U.S. 697, 706 (1945). Recognizing the unequal bargaining power that may exist between employers and employees, the FLSA prohibits employers from engaging in certain prohibited business practices, such as overworking employees without statutorily required compensation. Indeed, courts must now police FLSA settlement agreements by overseeing an employer's unequal bargaining power, as "without judicial oversight … employers may be more inclined to offer, and employees, even when represented by counsel, may be more inclined to accept, private settlements that ultimately are cheaper to the employer than compliance with the [FLSA]." See Id. at 205, quoting, *Socias v. Vornado Realty*, 297 F.R.D. 38, 41 (EDNY, 2014).

Therefore, the Second Circuit explained, recognizing the FLSA as a statutory exception to Fed. R. Civ. P. 41 reinforces the FLSA's underlying purpose, which is to maintain fairness between the disparate parties by determining whether the proposed settlement terms are a fair and reasonable resolution to the parties' dispute under the FLSA.

Even prior to the *Cheeks* decision, courts in the Second Circuit that had reviewed FLSA settlement agreements had routinely rejected any request for confidentiality of the settlement terms, deeming them against public policy because they "prevent the spread of information about FLSA actions to other works…who [could] then use that information to vindicate their own statutory rights." *Weng v. T&W Rest.,* 15-cv-08167, 2016 U.S. Dist. LEXIS 83217, at **11-12 (SDNY, June 22, 2016), quoting *Lopez v. Ploy Dee*, 2016 U.S. Dist. LEXIS 53339, 2016 WL 1626631, at *3 (SDNY, April 4, 2016).

Non-Disparagement Clause

Since *Cheeks*, courts within the Second Circuit have scrutinized proposed FLSA settlement agreements and evaluated them for any terms that are not fair and reasonable. In addition to rejecting any confidentiality provisions, courts have not approved settlement agreements dismissing FLSA claims which contained a non-disparagement clause unless it contained a carve-out for truthful statements to others regarding the facts underlying the employee's claims and/or the employee's experience in litigating his/her case. As with confidentiality provisions, non-disparagement clauses that lack a carve-out for truthful statements contravene the remedial purpose of the FLSA and are not fair and reasonable. *Martinez v. Gulluoglu,* No. 15 Civ. 2727, 2016 U.S. Dist. LEXIS 5366, at *2 (SDNY, Jan. 15, 2016).

> One strategy that employers may exercise preemptively, prior to any wage and hour claims that may arise, is to incorporate an arbitration provision into their employment agreements with employees, requiring that any FLSA claims brought by any employee be arbitrated.

General Releases

Since *Cheeks*, courts in this circuit have also routinely rejected FLSA settlement agreements containing full general releases requiring employees to waive essentially any claim that he/she may have against any defendant, including, but not limited to, unknown claims and claims that have no relationship whatsoever to wage/hour issues, holding that such sweeping provisions are not fair and reasonable. *Martinez*, 2016 U.S. Dist. LEXIS 5366, at **3-4. In this regard, employers are not entitled to use money spent to settle an FLSA claim to leverage a release from liability unrelated to the FLSA. The only release provision that is permissible under an FLSA settlement is one that is not only mutual, but does not extend beyond the claims and/or facts at issue in that particular action. See Id. at 5.

Fees and Public Access

Another consideration that courts in the Second Circuit remain cognizant of in evaluating the fairness of an FLSA settlement agreement is when an attorney fees provision is included. Courts will analyze any attorney fees provision provided for in an FLSA settlement using, at their discretion, either the lodestar method to determine the reasonableness of the fees requested under the circumstances or by awarding a "percentage of the fund." *Weng v. T&W Rest.,* 2016 U.S. Dist. LEXIS 83217, at *8, quoting *Lopez v. Ploy Dee*, 2016 U.S. Dist. LEXIS 53339, 2016 WL 1626631, at *4.

Although the overwhelming trend is to award a percentage of the fund, in any event, courts will be guided by factors including: "(1) counsel's time and labor; (2) the case's magnitude and complexities; (3) the risk of continued litigation; (4) the quality of representation; (5) the fee's relation to the settlement; and (6) public policy considerations." Id.; see also *Fujiwara v. Sushi Yasuda,* 58 F.Supp.3d 424, 435 (SDNY, 2014).

Under the "percentage of the fund" method, except in extraordinary cases, courts will decline to award fees representing more than one-third of the settlement amount if no other factors suggest that such a fee is unreasonable.[2] *Florex v. Food Express*

Rego Park, Inc., 2016 WL 386042, at *3 (EDNY, Feb. 1, 2016). Indeed, courts within the Second Circuit believe that a fee in excess of one-third of the settlement amount disserves the FLSA's interest in fairly compensating injured employees. *Zhang v. Lin Kumo Japanese Rest.,* 2015 U.S. Dist. LEXIS 115608, at *11. Nevertheless, a "percentage of fund" contingency fee agreement can encourage early settlement of a case, which, so long as the fee falls within an acceptable range, may result in a higher award for counsel than counsel would otherwise obtain under a lodestar analysis. *Weng v. T&W Rest.,* 2016 U.S. Dist. LEXIS 83217, at **9-10.

As the district courts within the Second Circuit now require parties to obtain judicial approval of FLSA settlements, a presumption of public access applies. To overcome this presumption, "the parties must make a substantial showing of need for the terms of their settlement to contain a confidentiality provision." *McCall v. Brosnan Risk Consultants*, 14-CV-2520 (JS)(SIL), 2016 U.S. Dist. LEXIS 51338, at *3 (EDNY, April 15, 2016), quoting, *Mosquera v. Masada Auto Sales,* No. 09-CV-4935, 2011 U.S. Dist. LEXIS 7476, at *2 (EDNY, Jan. 25, 2011).

If the presumption is not overcome, the courts in this circuit have considered the following additional factors in determining whether a proposed settlement is fair and reasonable: "(1) the plaintiff's range of possible recovery; (2) the extent to which the settlement will enable parties to avoid unanticipated burdens and expenses in establishing their respective claims and defenses; (3) the seriousness of the litigation risks faced by the parties; (4) whether the settlement agreement is the product of arms' length bargaining between experienced counsel; and (5) the possibility of fraud or collusion." *Lazaro-Gareia v. Sengupta Food Servs.*, 2015 U.S. Dist. LEXIS 167991 at *2 (SDNY, Dec. 15, 2015), quoting, *Wolinsky v. Scholastic,* 900 F.Supp.2d 332, 335 (SDNY, 2012).

Employer Strategies

Employers have adjusted FLSA settlement agreements after *Cheeks* in several ways to offer certain protections to themselves. Several courts in the Southern District have held that a mutual release of claims is acceptable, as it ensures that "both the employees and the employer are walking away from their relationship up to that point in time without the potential for any further disputes." See *Souza v. 65 St. Marks Bistro,* No. 15-cv-327 (JLC), 2015 U.S. Dist. LEXIS 151144, 2015 WL 7271747, at *5 (S.D.N.Y. Nov. 6, 2015); see also *Lola v. Skadden,* No. 13-cv-5008 (RJS), 2016 U.S. Dist. LEXIS 12871, at **4-5 (SDNY, Feb. 3, 2016).

Moreover, where an employee asserts any additional non-FLSA claims (irrespective of their nature) against an employer, the settling parties can propose a bifurcated settlement structure, pursuant to which the parties would publicly file a settlement agreement with respect to the FLSA claim for court approval, and execute a separate settlement agreement with respect to the non-FLSA claims, which would remain confidential and not require the court's approval under *Cheeks*. See, e.g., *Abrar v. 7-Eleven,* 14-cv-6315 (ADS), 2016 U.S. Dist. LEXIS 50416, at *3 (EDNY, April 14, 2016) (approving a proposed bifurcated settlement structure); see also *Panganiban v. Medex Diagnostic & Treatment Ctr.,* 15 Civ. 2588, 2016 U.S. Dist. LEXIS 29158, at *8 (EDNY, March 7, 2016; holding that a settlement without FLSA claims need not be subject to the court's review).

One strategy that employers may exercise preemptively, prior to any wage and hour claims that may arise, is to incorporate an arbitration provision into their employment agreements with employees, requiring that any FLSA claims brought by any employee be arbitrated. In this regard, courts have held that FLSA claims are arbitrable. *Moton v. Maplebear,* 15 Civ. 8879 (CM), 2016 U.S. Dist. LEXIS 17643, at *17 (SDNY, Feb. 9, 2016), accord, *Bynum v. Maplebear,* 15-cv-6263, 2016 U.S. Dist. 17644, at *31 (EDNY, Feb. 12, 2016) (JBW). In fact, *Cheeks* would only apply if court approval of an arbitration award is sought. *Moton v. Maplebear*, 15 Civ. 8879 (CM), 2016 U.S. Dist. LEXIS, at *25.

Nevertheless, requiring judicial scrutiny of settlement agreements may serve as a potential roadblock to a party's willingness to engage in meaningful settlement negotiations of any FLSA claims, as the inability to maintain its confidentiality and intense judicial scrutiny may create tension between the underlying policy of the FLSA and the judicial policy of settlement promotion.

1. The Fair Labor Standards Act (FLSA) establishes uniform national wage and hour standards. 29 U.S.C. §§206 and 207.

2. The lodestar calculation is used as a "'cross check' on the reasonableness of the requested percentage." *Fujiwara v. Sushi Yasuda*, 58 F.Supp.3d at 435, quoting *Goldberger v. Integrated Resources,* 209 F.3d 43, 50 (2d Cir. 2000).