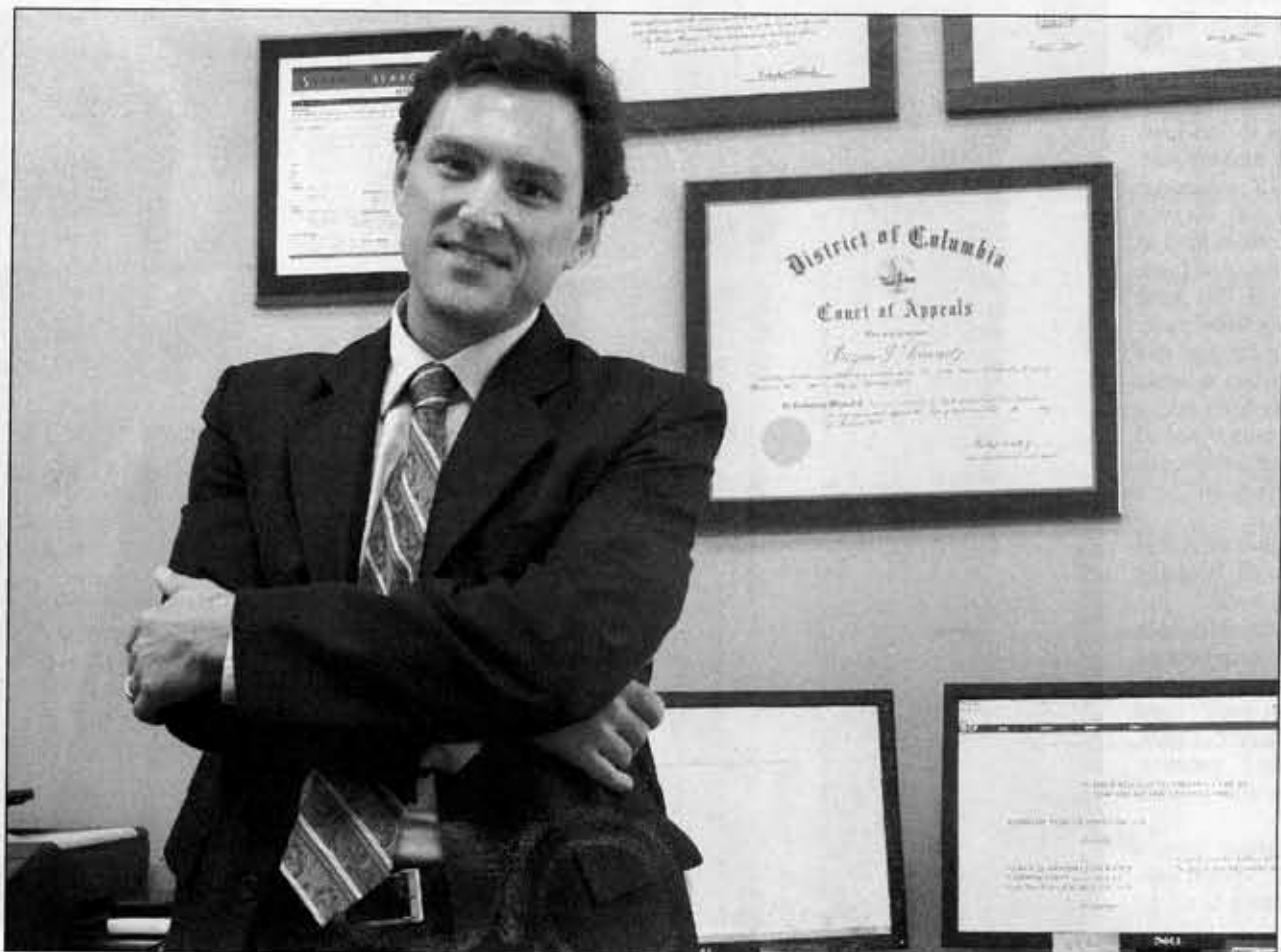


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Laura Hautala / Daily Journal

Bryan J. Schwartz, an Oakland-based attorney, said more defendants in wage-and-hour cases are declaring bankruptcy.

Small businesses face big trouble in employee suits

By Laura Hautala
Daily Journal Staff Writer

When small business owners Soraya and Patrick Aughney faced allegations of wage-and-hour violations from their employees last year, they opted for an unusual defense: bankruptcy. According to one of their attorneys, it was a choice between that or losing their company, the valet parking service Certified Parking Attendants LLC. "That class claim would have destroyed the business," said David N. Chandler, their Santa Rosa-based bankruptcy lawyer. The plaintiffs were parking attendants who claimed unpaid overtime and meal-and-rest breaks as well as misappropriated tips. Combined with other claims, the action could have cost the Aughneys millions of dollars in back-wages and penalties. *James Robert Mortland III et al. v. Certified Parking Attendants LLC et al.*, CIV1000135 (Marin Super. Ct., filed Jan. 11, 2010). Chandler is up-front about the fact that he used bankruptcy to avoid the plaintiffs' class claims, which have been dismissed in state court and federal bankruptcy court. The named plaintiffs are now filing individually as creditors in the bankruptcy.

Bryan J. Schwartz, the Oakland-based lawyer for the plaintiffs, said he has seen small businesses take such a tack several times. "There's always a moment of truth: will they engage or pull the tablecloth out from underneath?" he said.

Bankruptcy is only the most dramatic in a range of tactics small businesses use to avoid wage-and-hour lawsuits. And while class actions might seem like a problem limited to bigger, wealthier employers like Wal-Mart Stores Inc and Costco Wholesale Corp., a substantial number of small businesses face these complaints, too.

In fact, while large corporations present deeper pockets, attorneys for employees and companies alike agree that small businesses are more likely to violate labor laws, leading to debilitating penalties.

Some 1,300 employment class actions have been filed in California since 2010, according to Keith A. Jacoby of Littler Mendelson PC, who estimates that a quarter to a third of them

were filed against small, private companies. Littler Mendelson tracks employment lawsuit numbers by surveying the filings recorded by Courthouse News Service and LexisNexis's Courtlink database.

Even a business with a single location can be a target, Jacoby said. If some workers decide to sue a high-turnover business such as a 60-employee restaurant, "250 [class members] might be big enough for a class action," he said.

Jacoby said he doesn't recommend the bankruptcy technique Chandler used. "You're just trading one problem for another," he said. But he did say small businesses often have to place money in escrow and enter a multi-year payment plan when they lose class actions.

To avoid such a result, small businesses rely on a variety of legal, insurance and human resource services to avoid making big employment law mistakes or to cover court costs when they

Wage claims prompt more small businesses to choose bankruptcy

Continued from page 1

do.

For companies that can afford it, such as tech startups with venture capital backing, an ounce of prevention can save millions of dollars in liability.

One such liability is misclassifying workers as independent contractors when they should be employees, which can make employers vulnerable to expensive meal-and-rest claims and IRS enforcement. For this reason, many startups contract with outside companies to handle their human resources and payroll work.

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— David N. Chandler

Business insurance also can help buffer companies from claims of harassment, retaliation, wrongful termination and discrimination. "[Insurance] has become more important ever since the economy took a dip, because people had to be let go," said Lou Moreno, Senior Vice President of Heffernan Insurance Brokers in Menlo Park.

But insurance will only go so far when it comes to wage-and-hour claims, which make up between 80 percent and 90 percent of California's employment class

actions, according to Littler Mendelson. While employment liability policies cover attorneys fees, the company is on its own to pay back wages and penalties. Moreno said many insurers that do cover attorneys fees for wage-and-hour claims generally won't do so in California because the risk of litigation in the state is much higher.

Small businesses without venture backing, like Certified Parking Attendants, do not typically carry these insurance policies. And without human resource departments or legal advice, they try to avoid class actions with any information available.

"They will rely on free Chamber of Commerce materials, and those are very good, but wage-and-hour law is about technical compliance," said Jacoby, who represents both small and large employers.

Schwartz puts it more strongly, saying these businesses often operate in a "lawless environment," relying on their workers' ignorance of the law to avoid paying legally mandated wages.

For the Aughneys, filing for Chapter 11 bankruptcy protection for their business and Chapter 13 bankruptcy protection to shield their personal assets has allowed them to stay in business.

The legal trick was to keep the employees from filing their claims in bankruptcy court until 180 days after they stopped working for the valet service, thus eliminating the special consideration given in bankruptcy court to wages owed to recent employees.

"You've got to stall them on class certification until the 180-day priority period runs out, and then you drop them into bankruptcy," Chandler said, "and then you're driving the bus."

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