



November 27, 2017

Hon. Xavier Becerra
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Ashley Johansson
Initiative Coordinator

Dear Attorney General Becerra:

Pursuant to Elections Code Section 9005, we have reviewed the proposed statutory initiative (A.G. File 17-0036) related to private legal actions that enforce state labor laws.

BACKGROUND

California Labor Law. The California Labor Code consists of laws that employers must follow with respect to employee wages, hours, breaks, and working conditions. For example, the Labor Code specifies the state minimum hourly wage, when employees must receive overtime pay, when meal and rest breaks must be provided, what information must be included on pay stubs, and what steps employers must take to provide a safe and healthy workplace.

Employers Who Violate Labor Laws Must Pay Any Unpaid Wages and Applicable Penalties. Common violations of the Labor Code include not paying overtime, failing to pay the minimum wage, delayed payment, and unreimbursed business expenses. Although employers are responsible for providing unpaid wages to employees when the employer has violated a wage law, some Labor Code violations also carry penalties that employers must pay (in addition to unpaid wages, if applicable). For example, there is a \$250 penalty for each pay period the state's minimum wage is not met. These penalties are assessed by state agencies, typically paid to the state, and intended to improve compliance with labor law by making violations costlier for employers.

State Law Allows Employees to File Wage Claims With Labor Commissioner. One way employees may seek unpaid wages is by filing a wage claim with the Labor Commissioner's Office, which enforces state laws related to pay, hours, meal and rest breaks, employee classification, and payroll recordkeeping. (A separate state office enforces workplace health and safety laws.) In 2016, employees filed approximately 32,000 wage claims. When an employee files a claim with the Labor Commissioner, staff hold an informal conference with the employee and employer to resolve the dispute. If it cannot be resolved informally, a formal administrative hearing is held and a final determination is made. Either party may appeal the final determination to the courts. (For non-wage technical violations, such as incomplete pay stubs, employees

cannot submit wage claims and therefore must directly file a lawsuit against their employer in court. They can also file a lawsuit against their employer for wage-related violations as an alternative to filing a claim with the Labor Commissioner.)

Private Attorneys General Act (PAGA) Allows Employees to Collect Labor Code Penalties. Prior to 2004, employees could seek unpaid wages from their employer by filing a lawsuit in court to recover the wages (as they still can today), but they could not seek the additional penalties in these cases because only state agencies were authorized to assess penalties. This changed in 2004 when the state enacted PAGA, which allows employees to sue their employers to collect a share of penalties associated with the violations. (As discussed below, PAGA penalty revenues are shared between the state and the affected employees.) The intent of PAGA is to improve enforcement of the state's labor laws by offering an alternative to state-lead enforcement that could be used, for example, when the Labor Commissioner lacks the resources to enforce fully all alleged Labor Code violations.

PAGA differs from wage claims and traditional civil lawsuits in several other aspects:

- ***Lawsuits Proceed Only After State Declines to Investigate.*** Employees who wish to pursue a PAGA lawsuit against an employer must first notify the state of the alleged violation and their intent to pursue a lawsuit. If the state does not investigate or if the investigation does not lead to a citation, the employee may proceed with the lawsuit. In recent years, the state has received between 4,000 and 8,000 PAGA notices annually. Due to budgetary constraints, it has typically investigated fewer than 1 percent of these notices (additional resources were provided recently to investigate more notices).
- ***Extends Penalties to All Other Labor Code Violations.*** The PAGA allows employees to seek a penalty—\$200 per pay period per violation—for each Labor Code violation that occurred, not just for Labor Code violations that carry a specified penalty under state law.
- ***Authorizes Representative Legal Action.*** Under PAGA, employees can seek penalties for violations that affected them personally and for violations that affected other employees. For instance, if the plaintiff was not adequately paid for overtime hours, he or she could represent other employees whose overtime hours were also underpaid. In this way, PAGA cases are similar to class-action lawsuits, where individuals join one lawsuit instead of filing separate suits. Unlike class actions, however, an employee who files a PAGA lawsuit may include in the lawsuit violations that he or she did not personally suffer but that were allegedly suffered by other, represented, employees.
- ***Penalties Split Between State and Employees.*** Unlike penalties collected by the labor commissioner, penalties paid under PAGA are distributed 75 percent to the state (to be used for labor law enforcement activities) and 25 percent to the affected employees. In 2016-17, the state received about \$20 million in PAGA-related penalties.

Most PAGA Lawsuits Are Settled Before Trial. Few PAGA lawsuits go to trial. Instead, employees and employers typically reach a settlement agreement after initial legal proceedings have begun but before the trial begins. The settlement award typically includes a small penalty portion that is divided between the employees (25 percent) and the state (75 percent).

Most Employees' Attorneys Paid on Contingency Fee Basis. Attorneys representing employees filing PAGA lawsuits are compensated in different ways. One of the most common ways is through a contingency fee agreement in which an attorney receives a certain share of the total trial or settlement award for the employees. The share is often one-third, but may be higher or lower depending on the agreement.

PROPOSAL

Prohibits Contingency Fees in PAGA Lawsuits. The measure prohibits the attorneys who represent employees in PAGA lawsuits from seeking compensation through contingency fee agreements.

Requires That Employees Pay Their Attorneys on a Capped Hourly Basis. Under the measure, attorneys could only be paid on an hourly basis, without regard for the amount that is ultimately recovered by the employees in a PAGA lawsuit. The measure also caps the hourly rate at 150 percent of the rate charged by the State Attorney General for legal services provided to state entities. Currently, this cap would equal \$255 per hour for attorneys and \$180 per hour for paralegals.

Places Limits on PAGA Lawsuits. The measure seeks to restrict the scope of PAGA lawsuits (such as the number of employees represented and the number of violations claimed) by requiring that the employee who brings suit has “personally suffered an actual injury” under each labor code violation included in the lawsuit. Additionally, the measure seeks to limit the scope of information that can be obtained through the lawsuit’s discovery process. Specifically, the employee filing the lawsuit could only obtain information about other employees in their same job classification and at the same business location, thereby narrowing the number of potential additional employees that could be represented in a PAGA lawsuit.

Changes the Distribution of PAGA Penalties. The measure changes the distribution of PAGA civil penalties by increasing the proportion allocated to employees to 50 percent (from 25 percent) and decreasing the proportion allocated to the state to 50 percent (from 75 percent).

FISCAL EFFECTS

Estimating the fiscal effects of this measure is subject to considerable uncertainty, as such effects would depend on how employers and employees respond to the measure and how state and federal courts interpret its provisions. In general, the measure would reduce the economic viability of PAGA lawsuits by limiting how much the employees’ attorney could recover and by limiting the number of employees that could be represented in each lawsuit (thereby reducing the amount of penalties that could be collected). We believe that these provisions would likely result in far fewer employees and attorneys choosing to file PAGA lawsuits. The following assessment of the measure’s fiscal effects are based on that assumption.

Reduced State Trial Court Costs on Net. This measure would impact state trial court workload in various ways. On the one hand, workload could be reduced. For example, requiring attorneys be compensated on an hourly basis and capping such pay could result in fewer employees and attorneys choosing to file lawsuits. Additionally, the restrictions on the scope of PAGA lawsuits could potentially simplify the cases that are filed. On the other hand, this reduction could be offset to some degree because the restrictions on the scope of a single PAGA lawsuit could potentially result in more individual PAGA lawsuits being filed. For example, employees in different position classifications or locations might choose to file separate PAGA cases. On net, however, we think that the measure could result in reduced state trial court costs that would likely be in the millions of dollars annually, but could reach the low tens of millions of dollars annually. Resources freed up by the reduction would likely be redirected to other trial court activities.

Likely Substantially Reduced State Revenues From PAGA Penalties. In 2016-17, the state received about \$20 million in PAGA penalties from out-of-court settlements and trial awards. These payment amounts received by the state have grown notably in the past several years. Under this measure, the state would likely receive reduced PAGA penalties because fewer cases would be filed and because the cases that would be filed would likely represent fewer employees and therefore fewer penalty assessments than under current law. In addition, the measure reduces the share of penalties collected that go to the state from 75 percent to 50 percent. These provisions would therefore likely result in reduced penalties available to fund labor law enforcement up to the low tens of millions of dollars annually.

Likely Minor Net Impact on State Administrative Costs to Enforce Labor Laws. The measure would likely increase the number of wage claims received by the Labor Commissioner because some employees who would have been plaintiffs in PAGA lawsuits might instead file wage claims. As a result, the Labor Commissioner's Office would likely require additional resources to adjudicate this new workload. On the other hand, fewer PAGA notices would need to be reviewed and investigated by state staff if a reduced number of PAGA lawsuits are filed each year. These newly available staff resources could potentially be redirected to other priorities. These effects would be offsetting to some degree. Overall, the measure likely would have a minor net impact on state administrative costs related to labor law enforcement. To the extent that there are net costs, such costs would likely be funded by fees on employers.

Summary of Fiscal Effects. This measure would have the following major fiscal effects:

- Net reduction in state trial court costs that would likely be in the millions of dollars annually, but could reach the low tens of millions of dollars annually.
- Reduction in state revenue used for labor law enforcement potentially up to the low tens of millions of dollars annually.
- Likely minor net impact on state administrative costs to enforce labor laws.

Sincerely,

Mac Taylor
Legislative Analyst

Michael Cohen
Director of Finance