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SPECIAL FEATURE

The wage and hour audit: do it now, or pay later

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Now is the time for a wage and hour audit. It is the great idea that everyone seems to agree is a great idea, but that almost no company actually does.

Unfortunately, however, procrastination is becoming increasingly risky: The U.S. Department of Labor has recently promised greater enforcement activity; wage and hour claims are increasing significantly; and recent settlements, fines and damages awards are costing companies — and their executives — millions upon millions of dollars.

On Sept. 2, Labor Secretary Hilda L. Solis said, “Beginning this year and into 2010, I am hiring an additional 250 new wage and hour investigators so we can continue to effectively monitor wage and hour violations.” True to her word, the U.S. Department of Labor has been hiring additional investigators. As she has made clear, “strong enforcement remains at the top of [her] agenda.”

In addition, more wage and hour claims are being filed, including more collective actions, and more wage claims in single-plaintiff litigation. This is due to a variety of factors, including more sophisticated plaintiffs’ attorneys (who are cobbling together

big lawsuits based on patterns of small alleged violations, because they can generate huge collective damages — and attorneys’ fees), and changes in the law, such as Massachusetts’ mandatory treble damages law, and the Great Recession (former employees can’t get jobs, so they sue).

So, companies that have not recently done a wage and hour audit — covering issues from job classifications to overtime, from meal breaks to tip pooling, from donning and doffing to payroll records — need to do it now.

And they should protect the confidentiality of the audit to the greatest extent possible, pursuant to the attorney-client privilege, by having experienced counsel involved.

The wage and hour audit should address a long list of issues under federal and state law, including the requirement to pay overtime in accordance with federal law and the laws of each state in which the company has employees. This raises myriad issues, most of which are described below — along with a brief summary of recent cases that show the real and significant risks of getting it wrong.

Overtime

The federal Fair Labor Standards Act (“FLSA”) requires employers to pay overtime to employees who work more than 40 hours per week, unless the employees fall within certain specific exemptions. Many state laws have similar requirements, although employers must be careful to identify sometimes subtle but significant differences among various state laws.

Generally, employees are exempt from the FLSA’s overtime requirements only if certain salary and job-duty requirements are met. To qualify as exempt, the employee must be paid on a salary basis, at least \$455 per week, or \$23,660 per year. Accordingly, an employee earning a salary of less than \$455 per week is automatically non-exempt and enti-

tled to overtime (after 40 hours worked), regardless of the employee’s job duties.

Assuming the salary test is met, the FLSA and enabling regulations set forth “duties tests” or guidance for each of the exempt categories. The regulations describe the test for each category and include numerous examples. Briefly, the three basic exemptions — administrative, executive, and professional — can be summed up as follows:

- **Executive:** The executive exemption, in addition to requiring that employees direct the work of two or more employees, includes a requirement that employees have the authority to hire, fire, or promote, and/or that the employees’ recommendations pertaining to hiring, firing, or promotions are “given particular weight.”
- **Administrative:** An administrative employee must perform office or non-manual work related to management and business operations, while exercising discretion and independent judgment with respect to matters of significance.
- **Professional:** To qualify for a professional exemption, the employee must perform work requiring advanced knowledge customarily acquired by a prolonged course of specialized intellectual instruction.

Each exemption involves a fact-specific inquiry, which must be made on a case-by-case basis for each job. Moreover, to make the wage and hour audit more difficult, the exemptions can vary significantly under state law as compared to federal law.

In addition, while job duties evolve over time, job descriptions often remain in a drawer unchanged — which can create significant problems in the event of litigation or a DOL audit.

As a result of all of these factors, misclassification is common. Therefore, a careful review of actual job duties, job descriptions

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and applicable federal and state law is absolutely necessary to minimize the risks.

Misclassified as exempt

When an employer improperly classifies an employee (or entire class of employees) as exempt, and fails to pay overtime, the consequences can be dramatic. The details are tedious and too numerous to list here, but they are incredibly important: If the employer gets it wrong, the employer will owe significant back pay, attorneys' fees and interest.

If that warning isn't enough to get an employer's attention, these recent awards should be:

- In August 2009, Cintas Corp. agreed to pay \$22.75 million to delivery drivers nationwide, after allegedly misclassifying them as exempt and failing to pay overtime.
- In October 2009, IBM Corp. agreed to pay \$7.5 million to approximately 6,000 technical support employees who were allegedly misclassified as exempt under various state laws.
- In September 2009, Staples Inc. was ordered to pay more than \$7.3 million in back pay, liquidated damages and attorneys' fees for failing to pay overtime to 343 employees who were misclassified as exempt.
- In August 2009, Kaiser Permanente agreed to pay \$1.4 million to settle overtime claims brought by approximately 200 project managers who had been allegedly misclassified as exempt under the FLSA.
- In February 2009, Excel Insulation Co. and its corporate officer were de-barred from public construction projects for one year and agreed to pay \$661,000 in back pay and fines owed under Massachusetts law for failing to pay the prevailing wage, failure to pay overtime, and failure to maintain proper payroll records.

Misclassified as an independent contractor

Employers sometimes get into trouble for failing to pay overtime by misclassifying employees as independent contractors. This risk is particularly high in Massachusetts, where the Independent Contractor Law severely restricts the use of independent contractors, but the independent contractor

analysis is generally fact specific under federal and state law and can also vary from state to state.

Under federal law, an employee is dependent on the business which he or she serves, as distinguished from a person who is engaged in business of his or her own. Among the factors considered significant, but not determinative, in examining whether an individual is an independent contractor or an employee are: the nature and degree of control by the principle, the alleged contractor's opportunity for profit and loss, and the amount of the alleged contractor's investment in facilities and equipment.

Under Massachusetts law, an individual performing any service shall be considered an employee *unless*: 1) the individual is free from control and direction in connection with the performance of the service; 2) the service is performed outside of the usual course of business of the employer; and 3) the individual is customarily engaged in an independently established trade, occupation or business of the same nature as that involved in the service performed. As a result, the audit of an independent contractor requires detailed analysis under federal and state law.

Classification mistakes can be very costly, like a California residential cleaning service that, in August 2009, was ordered to pay \$3.5 million in back pay, liquidated damages and fines for improperly classifying 385 of its workers as independent contractors. Further, in October 2009, after failing to comply with the court's order to pay damages, the owners of the company were jailed for four days.

Under the FLSA, only certain paycheck deductions are allowed: If an employer makes improper deductions, the affected employees will be deemed "non-exempt" and entitled to overtime. In August 2008, a grocery store was found liable for \$25 million in back pay (for overtime) after it improperly docked the salaries of approximately 400 managers for hours not worked during the workweek, and therefore lost the exemption.

Failure to pay OT

Sometimes a company knows that its employees are non-exempt, but the compa-

ny fails to keep track of the hours worked or otherwise fails to pay overtime at the required one-and-one-half times the regular rate of pay for all hours worked over 40 hours in the work week (or as otherwise required by state law). The companies that fail to pay overtime must later pay back pay, *plus* liquidated damages, interest, attorneys' fees and fines.

In January 2009, several television networks (including Fox Broadcasting, American Broadcasting Company Inc. and CBS Broadcasting) and producers agreed to pay \$4 million total to settle claims that they failed to pay overtime and provide required break periods.

And two car-wash companies and their corporate officer agreed to pay approximately \$220,000 in back pay and interest, and approximately \$8,000 in fines, in a consent judgment entered with the DOL's Wage and Hour Division.

When an employee works for two different companies that are related, such as two subsidiaries of the same parent, the employees' hours may need to be combined and overtime may have to be paid for hours worked over 40 hours in a work week for the two companies combined.

In July 2009, Partners Healthcare agreed to pay \$2.7 million in back pay for overtime to 700 employees who were working for more than one Partners-affiliated hospital during the same week. Partners brought the issue to the attention of the DOL after recognizing that it may have violated the FLSA.

Under the FLSA, there are complicated regulations governing the calculation of an employee's regular rate of pay for purposes of determining overtime pay. For example, attendance bonuses and other non-discretionary payments must be included in employees' regular rate of pay and therefore should be included in overtime pay calculations.

It doesn't pay to procrastinate on a wage-and-hour audit, and failing to act quickly and effectively could instead result in a big pay day for plaintiffs' attorneys. In the next issue, we will take a look at state law wage-and-hour "traps."

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