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Proper classification under the Fair Labor Standards Act: Time to prepare for more wage & hour litigation

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On March 13, 2014, President Obama held a signing ceremony and issued a memorandum to the Secretary of Labor requesting—or instructing—that the Department of Labor (DOL) "modernize" and "streamline" the current "white-collar" exemptions from overtime compensation under the Fair Labor Standards Act (FLSA). President Obama said at the ceremony that he intended "to simplify the system so it's easier for employers and employees alike." The DOL previously indicated that it intends to roll out the proposed revisions to the regulations in November 2014. They have since said the revised regulations will not come out in proposal form until 2015. Regardless of when they come out, the revisions will have a significant impact on every workplace. Savvy employers will take steps now to protect against any potential future litigation.

White collar exemptions

The FLSA requires that employers ordinarily pay their employees time and one-half for work exceeding 40 hours in a week.[1] The Act provides an exemption from overtime for persons "employed in a bona fide executive, administrative, or professional capacity."[2] This is known as a "white collar" exemption. Generally, each of the white collar exemptions have elements that an employee must satisfy before he/she can be considered exempt under that category.

One of the requirements for the white collar exemption is that the employee earn at least $455 per week, or $23,660 annually, on a salary or fee basis. An employer pays on a salary basis when it pays a regular, predetermined amount to an employee each pay period that makes up all or part of the employee's total compensation. The salary cannot vary because of variations in the quality or quantity of work performed. The employee must receive the full salary for any week in which the employee performs work, without considering the number of days or hours the employee worked. There are exceptions to this general rule for disciplinary and certain other absences.

For professional and administrative employees (but not executive employees), an employer may meet the salary or fee basis test by paying an agreed-upon sum (the fee) for a single job regardless of the time required for its completion. Payments based on the number of hours or days worked are not considered payments on a fee basis. If the fee would be equal to or greater than the $455 per week threshold on an annualized basis, the professional or administrative employee satisfies the salary or fee basis test.

Likely impact of expected revisions to white collar regulations

The impact of the President's instruction and the coming revisions to the regulations will have a significant effect on employers. First, there is general speculation that the DOL will

increase the current minimum salary that an employee must earn in order to be considered as an employee that is exempt from overtime compensation. Right now, the minimum salary is $23,660 per year, or $455 per week. It is expected that the DOL will increase that figure, perhaps going as high as $50,000 per year. This means more employees will be eligible for overtime compensation.

The second impact on employers comes with less speculation. The changes in the regulations—whatever they are—will lead to publicity about the rights of employees and, ultimately, will lead to increased attention by employees and plaintiffs' attorneys alike. When the white-collar regulations were last revised in 2004, there was a significant spike in the number of new FLSA claims filed in court. From 2004 to 2007 the number of new FLSA suits filed rose 40% over that three-year period.[3] FLSA collective action claims (similar to a class action claim where many employees are aggregated to assert a claim) also grew dramatically from 2004 - 2007, when claims went from 1,094 cases filed to 2,167 cases filed in 2007.[4] That 98% increase in collective action claims over the three-year period is a good indicator of what is likely to come in future years.

What is an employer to do? Conduct an internal audit of classifications

Employers that prepare for these changes to the FLSA now will be in a better position to keep employees from litigating. It will also put them in a better position to defend against any claims employees may bring. Be careful, however, that your preparation does not open the company up to even greater liability.

The first step is to conduct an audit of your employee classifications. Employers can conduct the audit now and time it so any implementation of changes necessitated by the audit can be rolled out during the publicity and hype surrounding the proposed and final regulations.

Employers are always cautious to conduct an audit because it could—perhaps likely would—expose potential mistaken classifications and require the company to either pay employees for overtime hours already worked and/or any potential future overtime hours. This is, of course, a potential and likely effect of conducting an audit. That risk must be balanced, however, against the risk that those same employees you would have found were due overtime talk to an attorney—and eventually file a collective action against the company. A collective action would expose an employer to double damages, a longer statute of limitations and attorney's fees. At the end of the day, the employees are entitled to proper overtime compensation if they are non-exempt under the law.

Another common concern of employers is that an audit will draw attention to an issue where attention is not desirable. This, too, is a legitimate concern. No employer wants to wave the red flag while telling employees: "We may have mistakenly underpaid you, but we're going to check now!"

The best time for waving that flag (as hard as it may be) is going to be as the proposed and final regulations are issued. There will be massive amounts of media attention surrounding the President's changes that make more employees eligible for overtime compensation. If an employer makes changes to classifications during that media frenzy—even if the changes were driven by a past mistaken classification rather than the new, forward-looking regulations—it is less likely to draw the attention of the employees.

As publicity ramps up about President Obama's efforts to make more employees qualify for overtime compensation, a properly timed audit can be a winning strategy for an employer.

Conducting the audit: attorney-client privilege

Plaintiffs' attorneys salivate over internal audits of exempt/non-exempt classifications. An internal audit that is discoverable can be used as evidence of a willful violation of the FLSA, which lengthens the statute of limitations from two to three years. The strongest protection against an audit becoming fodder for plaintiffs' attorneys is the careful use of the attorney-client privilege to protect the audit itself. Engaging human resources staff or consultants to conduct the audit without the involvement of legal counsel will not allow the company to avail itself of the attorney-client privilege. An attorney should be involved.

The strongest way to use the attorney-client privilege is to involve outside counsel in the process. Generally, it is easier to assert the attorney-client privilege when outside legal counsel are involved; due to the many "hats" that inside counsel wear, including often participating in and providing business advice, the privilege can become more complicated to assert and defend when only inside counsel are involved.

Individual state laws

Employers may be required, as if often the case in employment law matters, to consider individual state laws that differ in some way from federal law. In Wisconsin, for example, there are nuances between state and federal law that date back to 2004 when changes were made with the white-collar exemptions at the federal level. Wisconsin chose not to incorporate those changes. Wisconsin has made some changes to its state law to bring it in tandem with federal law (e.g., the change in Wisconsin law regarding recording hours

for exempt employees), but it still has a long way to go. In the meantime, employers must carefully consider individual state law and how it may differ from federal law.

Conclusion

With change comes opportunity for employers. Those taking advantage of the opportunity will budget for the likely increase in the number of employees who are no longer exempt due to an increase in the required minimum salary. Wise employers will also engage counsel to conduct a properly thought-out audit of their classifications to determine what, if any, changes need to be made. These changes can be rolled out during the media frenzy that is sure to come with the DOL's proposed and final regulations on white collar exemptions from the FLSA.

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[1]29 U.S.C. § 207(a)(1).

[2]29 U.S.C. § 213(a)(1).

[3]Jocelyn Allison, Hotbed of FLSA Claims to Continue in Low Economy, Law360 (Nov. 13, 2008).

[4]Id.

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