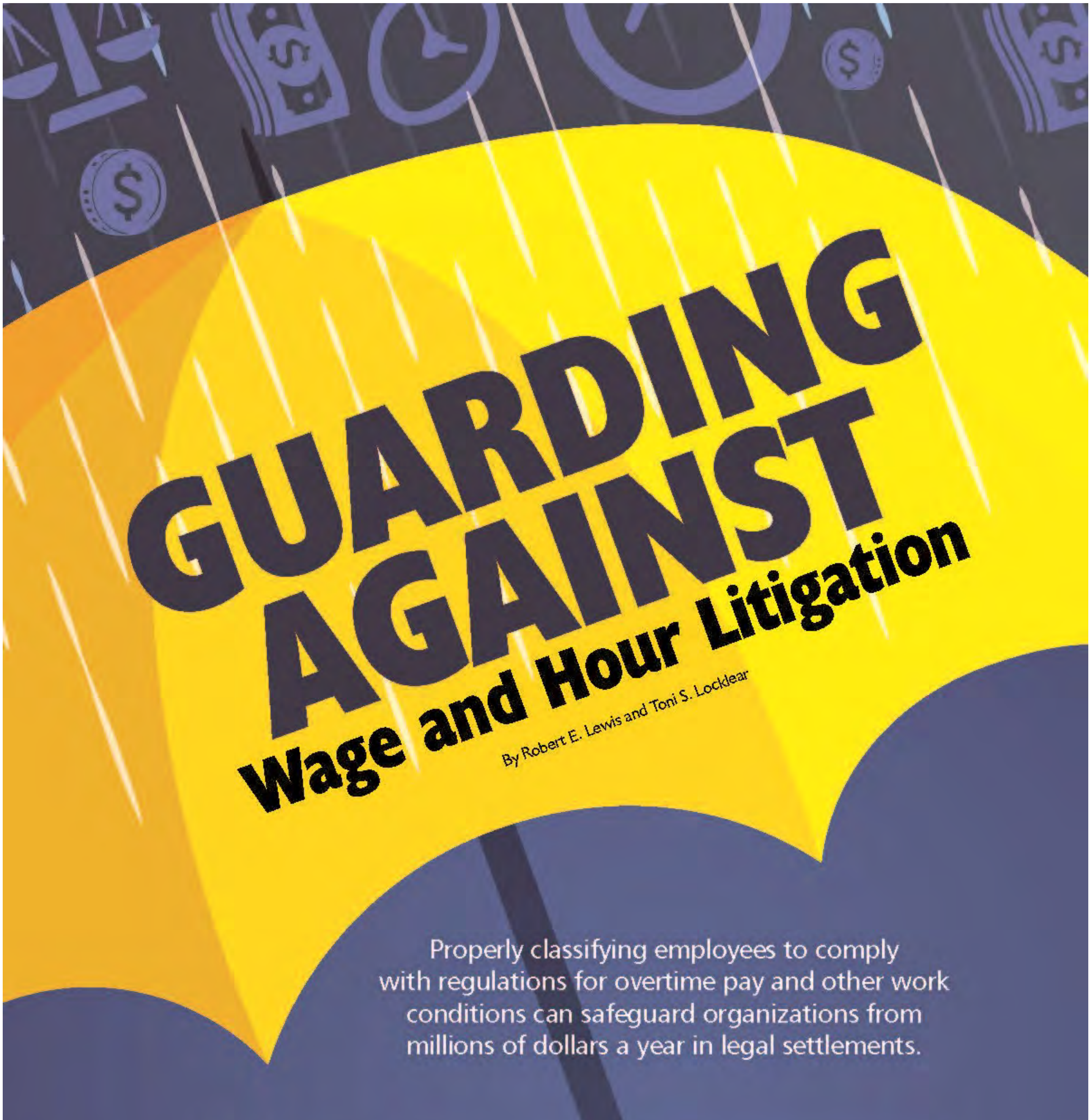

GUARDING AGAINST Wage and Hour Litigation

By Robert E. Lewis and Toni S. Locklear

Properly classifying employees to comply with regulations for overtime pay and other work conditions can safeguard organizations from millions of dollars a year in legal settlements.

Wage and hour laws — the federal and state laws that regulate overtime pay and other work conditions — present significant challenges to human resources professionals.

Class-action lawsuits related to wage-hour violations are on the rise, and payouts are reaching record amounts. From 2001 to 2012, there was a more than 500 percent increase in the number of multiple-plaintiff wage-hour lawsuits filed in U.S. federal court, according to a 2012 white paper by San Francisco-based law firm Littler Mendelson.

ON THE WEB

Ensuring equitable compensation means identifying measurable data to determine pay, the factors that impact that data for different populations and addressing differences in a defensible manner: talentmgt.com/articles/view/3485.

The High Cost of Misclassification

Misclassification of employees can be extraordinarily expensive. According to Houston-based law firm Fulbright & Jaworski's "Annual Litigation Trends Survey Report," wage-hour claims are considered by attorneys to be the top area of financial exposure for companies.

Management attorney Judith Kramer with law firm Fortney & Scott in Washington, D.C., said employers found in violation of the Fair Labor Standards Act are liable for paying two years' worth of back wages — three if violations are found to be "willful" — as well as "liquidated" damages that can double the back wages owed.

That means that if an employer is found liable for $1 million in back wages, liquidated damages of $1 million can be assessed, totaling a $2 million fine.

In 2011, business technology company Oracle Corp. settled a wage-hour class-action lawsuit spurred by the company's decision to change the status of its quality assurance engineers, customer support engineers and project managers from exempt to nonexempt. According to court records, workers claimed that it did so without an examination of the work done by individual employees in these positions or a reassignment of tasks and responsibilities.

Current and former employees in these jobs charged that back pay was required for the years they were classified as exempt workers. According to news reports, the case was ultimately settled for $35 million, equating to an average payout of $14,000 per class member on record in the lawsuit. Efforts to reach an Oracle spokesman were unsuccessful.

According to plaintiffs attorney and employee advocate Laura Ho, whose firm, Goldstein, Borgen, Dardarian & Ho, brought the case against Oracle, "an appealing target [of litigation] is a company who should know better, who can afford to pay its workers and a judgment, and who can help change the industry if there is an industrywide practice that is illegal."

Attorneys Lawrence Ashe, Trish Treadwell and Paul Barsness of law firm Parker, Hudson, Rainer & Dobbs said that situations such as Oracle's can be avoided by:

- Correcting problems immediately to prevent mounting damages. Addressing issues can freeze damages and eliminate expensive punitive damages for continuing to act in violation of the FLSA after you have become aware of your misclassification.
- Reassigning tasks to ensure compliance with classification guidelines. This requires coordination among several departments to identify exempt activities and redesign jobs.
- Confirming each employee's scope of work by evaluating him or her on critical duties that qualify as exempt. This requires a job analysis that documents the importance and frequency of work activities.
- Conducting job and classification audits under the direction of counsel to ensure handbooks, policies, job descriptions and daily responsibilities are consistent.

— Robert E. Lewis and Toni S. Locklear

A recent study by NERA Economic Consulting found that employers paid out a total of $2.7 billion in wage-hour settlements between 2007 and 2012, with settlements totaling $467 million in 2012 alone.

The Fair Labor Standards Act specifies provisions that regulate minimum wage, overtime pay, child labor and record-keeping requirements. The overtime pay provision is arguably the most confusing aspect of the law — and the one that is most commonly violated.

Judith Kramer, a management attorney with law firm Fortney & Scott in Washington, D.C., said the guidance regarding who qualifies for overtime involves many gray areas and that "even the most conscientious employer can get into trouble."

Compounding the issue is the fact that these laws are often revised. The regulations were revised in 2004 and are on track to be updated once again. In March, President Barack Obama directed the U.S. Labor Department to "modernize and streamline" federal overtime regulations.

Despite the uncertainty, there are sensible approaches to avoid wage-hour difficulties. The first step is to understand what qualifies an employee as "exempt" from overtime and the issues associated with that decision.

The Meaning of 'Exempt'

The FLSA assumes all workers are eligible for overtime pay but allows companies to exempt some workers from overtime based on the specific work done in their jobs. Under federal regulations, workers who are deemed executive, administrative, professional, computer professional or outside sales employees can be exempted from overtime pay. There is no requirement that a company classify any employee as exempt. Because it is the employer's choice to classify a position as exempt, employers who do so must justify their decision.

Although many employers believe that simply paying a position on a salary basis — or labeling it a "manager" job — qualifies it as exempt from wage-hour law, that classification alone is not enough. Exemption is based on both employee compensation and work duties.

The salary-level test specifies that only salaried workers who make more than $455 per week can be classified as exempt. In general, the duties test requires that exempt workers exercise significant discretion, independent judgment and authority over decisions. Other duties-test criteria may be specific to a given exemption. Hiring and firing authority, for example, is a component of the duties test for the executive exemption.

Furthermore, the FLSA requires that exemptions occur on an individual basis — a job is not exempt; the people who perform it are — and must be based on an examination of the work as it is actually done, not based on the manager's opinion.

Challenges in Classifying Employees

Classifying employees into exempt and nonexempt categories can produce concerns for several reasons.

First, employers must create a process and documentation that justifies the claim for exemption. Human resources, finance and legal departments often have separate, sometimes overlapping, responsibilities for classifying jobs. This distribution of responsibility tends to decrease focus and diminish compliance.

Second, many workers who previously exercised broad discretion and professional judgment are now constrained by regulations — namely, the Sarbanes-Oxley Act of 2002 — or workload such that they no longer meet the criteria for exemption. Many organizations, for example, have reduced staffing levels to a point where managers often engage in nonexempt activities that may restrict the discretion and judgment they exercise.

Finally, regulations are written vaguely so they apply to a wide variety of jobs. This creates disputes over what constitutes discretion and authority.

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Inadequate Reactions to Wage-Hour Concerns

The U.S. Labor Department, which administers wage-hour law, estimated in 2008 that at least 70 percent of employers are not fully compliant with federal wage-hour law. A major cause of noncompliance, according to Laura Ho, a plaintiffs attorney and partner with law firm Goldstein, Borgen, Dardarian & Ho in Oakland, California, is lack of initiative.

"Employers often just do what they have always done" and do not critically evaluate the basis for their decisions about a position's exemption from overtime pay, Ho said. She recommends that organizations take clear steps to verify employees meet the requirements.

Even employers who take steps to meet the FLSA exemption requirements can miss the mark. Some

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organizations inadvertently make decisions that affect compliance because they fail to consider fully the consequences of those decisions. One unthinking reaction to a classification concern, for instance, is simply to reclassify the employee — say, by making an exempt employee nonexempt — without changing the employee's duties or responsibilities.

Exempt employees suddenly transitioned to nonexempt status might ask why they failed to receive overtime prior to the reclassification when their work duties are unchanged. Similarly, nonexempt employees transitioned to exempt status are likely to be concerned about their loss of overtime.

Other organizations unthinkingly adopt processes that appear to address wage-hour concerns, but in reality lead to less-than-optimal decisions.

One unsatisfactory approach is to have HR or compensation representatives conduct unstructured interviews or compensation/market analyses to determine exemption status. Unstructured interviews are generally undocumented and inevitably result in inconsistencies.

Using compensation/market analyses to classify positions is also problematic, because it is essentially the equivalent of determining exemption status by looking at another company's job titles rather than examining the work as it is actually performed.

Failure to maintain records in this area is a significant risk. Employment attorneys Lawrence Ashe, Trish Treadwell and Paul Barsness with law firm Parker, Hudson, Rainer & Dobbs, headquartered in Atlanta, said that the ability to document the basis for a classification decision is the biggest concern their firm has when engaging with a client. Documentation to support exemption decisions is critical when faced with legal action or an audit by the Labor Department.

Proactive Reactions to Classification Concerns

Three key steps employers can take to significantly improve their wage-hour risk posture are conducting rigorous job analyses, establishing a governance structure to administer company policy related to exemption status and regularly auditing exemption status.

The best sources of evidence to support exemption decisions use input from employees to affirm work duties. Job analysis is the most rigorous and defensible method of determining and managing exemption classification decisions, because it uses input from the incumbents who do the work and assesses critical job components.

Using job analysis to limit wage-hour exemption risk requires determining the target of the job analysis, using multiple approaches to describe work and analyzing the data against the exemption criteria.

First, an employer must identify the positions that present the most wage-hour risk. Ho said these are typically positions that are subject to regulations that restrict the exercise of discretion, like accountants or financial roles; use technology to routinize the job, like computer technicians and software testers; or are management positions that mix exempt and nonexempt activities, like assistant store managers or team leaders.

Next, engage job experts using multiple methods to comprehensively assess the work. Conduct focus groups in which experts identify work activities and competencies. Follow up with a survey of incumbents and their direct managers to gather individual-level data and information on what, how and when work is done.

Analysis can then determine how employee time is spent on various activities, including those that may or may not allow discretion and judgment to be exercised. Not only does the job analysis provide a documented rationale for making exemption decisions, but it can also identify other sources of problems.

According to Ashe, Treadwell and Barsness, even when positions are designed to be exempt and most individuals are classified properly, some managers will undermine the classification by not permitting the employees who report to them to exercise discretion and authority. Job analysis can identify these anomalies and allow the organization to take action.

Maintaining a governance structure involving HR and other company stakeholders to administer wage-hour policy guidance is also an alternative to the uncoordinated and inconsistent approaches that characterize many companies' efforts to manage exemption decisions.

Providing company guidance in a policy manual, coupled with quality controls such as training users and monitoring decisions, are important aspects of governance. This will minimize noncompliance and facilitate accurate and consistent implementation.

Finally, regular audits of exemption status should be conducted to ensure employees are appropriately classified and there is proper evidence to support the claimed exemptions. Audits are most effective when conducted at the direction of counsel to ensure they are unbiased and are protected by attorney work product privilege.

Managing the risk associated with exemption decisions requires knowing the target job and classifying individuals appropriately. A proactive program of identifying, classifying and managing work duties, activities and responsibilities, strong audits and clear governance are crucial interventions that will generate clear and actionable data to avoid and manage exemption issues. Such a program has the added advantage of identifying critical job content and requirements, which can be used to establish a solid foundation for a variety of company HR programs. TM

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