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How to Avoid Emerging Wage & Hour Risks: Exempt or Non-Exempt, Contractor Liability & Minimum Wage Hikes

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The Onslaught Continues...

- Wage and hour cases continue to flood the courts. During the yearlong period ending March 31, 2014, approximately 8,126 lawsuits were filed seeking relief under the federal Fair Labor Standards Act (“FLSA”). In the prior year, the number was 7,764. This upward trend dates back several years and shows no sign of relenting. These figures don't account for the numerous wage and hour cases filed in state courts, under state laws.

FLSA Requires Payment Of Overtime And Minimum Wage

- The FLSA requires that most employees be paid at least the federal minimum wage for all hours worked and overtime pay at time and one-half the regular rate of pay for all hours worked over 40 hours in a workweek.
- However, the FLSA provides exemptions from both minimum wage and overtime pay for employees employed as bona fide executive, administrative, professional and outside sales employees, and certain computer employees. To qualify for exemption, employees generally must meet certain tests regarding their job duties and be paid on a salary basis at not less than \$455 per week.

“White Collar” Exemptions:

- Administrative
- Executive
- Professional
- Outside Sales

Salary Basis Test

- Employees generally must be paid at not less than \$455 per week on a salary basis. These salary requirements do not apply to outside sales employees, teachers, and employees practicing law or medicine. Exempt computer employees may be paid at least \$455 on a salary basis or on an hourly basis at a rate not less than \$27.63 an hour.
- Being paid on a “salary basis” means an employee regularly receives a predetermined amount of compensation each pay period on a weekly, or less frequent, basis. If the employer makes deductions from an employee’s predetermined salary, i.e., because of the operating requirements of the business, that employee is not paid on a “salary basis.”
- Deductions from pay are permissible when an exempt employee: is absent from work for one or more full days for personal reasons other than sickness or disability; for absences of one or more full days due to sickness or disability if the deduction is made in accordance with a bona fide plan, policy or practice of providing compensation for salary lost due to illness; to offset amounts employees receive as jury or witness fees, or for military pay; for penalties imposed in good faith for infractions of safety rules of major significance; or for unpaid disciplinary suspensions of one or more full days imposed in good faith for workplace conduct rule infractions. Also, an employer is not required to pay the full salary in the initial or terminal week of employment, or for weeks in which an exempt employee takes unpaid leave under the Family and Medical Leave Act.

Administrative Exemption

- To qualify for the administrative employee exemption, all of the following tests must be met:
- The employee must be compensated on a salary or fee basis (as defined in the regulations) at a rate not less than \$455 per week;
- The employee's primary duty must be the performance of office or non-manual work directly related to the management or general business operations of the employer or the employer's customers; and
- The employee's primary duty includes the exercise of discretion and independent judgment with respect to matters of significance.

Zeltser v. Merrill Lynch & Co., **S.D.N.Y. No. 1:13-cv-01531**

- On May 12, 2014, a federal judge preliminarily approved a \$6.9 million settlement between Merrill Lynch & Co. and at least 500 field financial advisers regarding claims that they were misclassified as exempt from overtime pay.

Executive Exemption

- To qualify for the executive employee exemption, all of the following tests must be met:
 - The employee must be compensated on a salary basis (as defined in the regulations) at a rate not less than \$455 per week;
 - The employee's primary duty must be managing the enterprise, or managing a customarily recognized department or subdivision of the enterprise;
 - The employee must customarily and regularly direct the work of at least two or more other full-time employees or their equivalent; and
 - The employee must have the authority to hire or fire other employees, or the employee's suggestions and recommendations as to the hiring, firing, advancement, promotion or any other change of status of other employees must be given particular weight.

Professional Exemption

- To qualify for the learned professional employee exemption, all of the following tests must be met:
- The employee must be compensated on a salary or fee basis (as defined in the regulations) at a rate not less than \$455 per week;
- The employee's primary duty must be the performance of work requiring advanced knowledge, defined as work which is predominantly intellectual in character and which includes work requiring the consistent exercise of discretion and judgment;
- The advanced knowledge must be in a field of science or learning; and
- The advanced knowledge must be customarily acquired by a prolonged course of specialized intellectual instruction.
- To qualify for the creative professional employee exemption, all of the following tests must be met:
- The employee must be compensated on a salary or fee basis (as defined in the regulations) at a rate not less than \$455 per week;
- The employee's primary duty must be the performance of work requiring invention, imagination, originality or talent in a recognized field of artistic or creative endeavor.

Outside Sales Exemption

- To qualify for the outside sales employee exemption, all of the following tests must be met:
- The employee's primary duty must be making sales (as defined in the FLSA), or obtaining orders or contracts for services or for the use of facilities for which a consideration will be paid by the client or customer; and
- The employee must be customarily and regularly engaged away from the employer's place or places of business.

Christopher v. GlaxoSmithKline Beecham Corp., 6/18/12

- Supreme Court finds that outside sales exemption applies to pharmaceutical sales representatives whose primary duty is “to obtain nonbinding commitments from physicians to prescribe their employer’s prescription drugs in appropriate cases.”
- Uses a functional approach: is the employee’s function to achieve the sale of their employer’s products or services in the manner allowed in that industry, regardless of whether the employee actually consummates a transfer of property?

Computer Employee Exemption

- To qualify for the computer employee exemption, the following tests must be met:
- The employee must be compensated either on a salary or fee basis (as defined in the regulations) at a rate not less than \$455 per week or, if compensated on an hourly basis, at a rate not less than \$27.63 an hour;
- The employee must be employed as a computer systems analyst, computer programmer, software engineer or other similarly skilled worker in the computer field performing the duties described below;
- The employee's primary duty must consist of:
 - 1) The application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software or system functional specifications;
 - 2) The design, development, documentation, analysis, creation, testing or modification of computer systems or programs, including prototypes, based on and related to user or system design specifications;
 - 3) The design, documentation, testing, creation or modification of computer programs related to machine operating systems; or
 - 4) A combination of the aforementioned duties, the performance of which requires the same level of skills.

Highly Compensated Employees

- Highly compensated employees performing office or non-manual work and paid total annual compensation of \$100,000 or more (which must include at least \$455 per week paid on a salary or fee basis) are exempt from the FLSA if they customarily and regularly perform at least one of the duties of an exempt executive, administrative or professional employee identified in the standard tests for exemption.

Don't Forget about State Wage and Hour Law

- Some states have more generous wage and hour law and different exemptions.
- Many states and municipalities are raising their minimum wages exponentially.

President Obama's Initiative

- Regulations last updated under president George W. Bush
- Obama and Perez want to close a “loop-hole” in the FLSA
- In March 2014, White House sent memo to the DOL directing it to reform the current white collar exemptions to increase the number of persons entitled to overtime.

Changes coming

- Memo was not specific about what changes to make
- Likely targets: executive exemption duties test and salary thresholds
- What else?

What can we do to prepare?

- Regulations will be issued in draft “proposed” form, anyone can comment on them. This will provide a chance for you to prepare.
- Look at who you’re classifying as executives.
- Analyze how an increase in the salary amount would affect the classification of your workforce.

Can I Correct Misclassifications?

- If you find an error, particularly if the misclassification was clear, consider paying back-pay representing the previous two years of overtime pay (the FLSA's statute of limitations is generally two years, but three for willful violations).
- Reclassified employees may consult a lawyer and consider suing to obtain pay for past overtime, so paying the back pay can help prevent the matter from proceeding to litigation (which could result in an award of liquidated damages in an amount equal to the back pay).
- Get a signed employee acknowledgement of the payment back pay can allow you to offset such payments against any liability in the event of litigation.

Some help From the DOL and Courts

- Several courts have said that reclassification does not establish that the employee was misclassified, or that any violation was willful. *Clarke v. JP Morgan Chase Bank*, 2010 WL 1379778 (S.D.N.Y., March 26, 2010).
- Under DOL regulations, an employer does not lose an exemption by paying overtime to an exempt employee. 29 C.F.R. § 541.604(a).

Avoiding Liquidated Damages

- How to show subjective good faith and a reasonable basis for belief you are in compliance with wage and hour laws.

Independent Contractors – How Do I Tell Them From Employees?

- ABC Test
- FLSA “economic reality” test
- IRS 20-factor test

ABC Test – Independent Contractor If:

- the provider of the services was free from the recipient's control and direction in connection with the performance of those services;
- that the services were performed outside of the recipient's usual course or place of business; and
- that the provider is customarily engaged in an independently established trade, occupation or business of the same nature as the services provided to the recipient.

“Economic Reality Test” – Independent Contractor Considers:

- The extent to which the services rendered are an integral part of the principal's business.
- The permanency of the relationship.
- The amount of the alleged contractor's investment in facilities and equipment.
- The nature and degree of control by the principal.
- The alleged contractor's opportunities for profit and loss.
- The amount of initiative, judgment, or foresight in open market competition with others required for the success of the claimed independent contractor.
- The degree of independent business organization and operation.

IRS 20-Factor Test

1. Level of instruction
2. Amount of training
3. Degree of business integration
4. Extent of personal services
5. Control of assistants
6. Continuity of relationship
7. Flexibility of schedule
8. Demands for full-time work
9. Need for on-site services
10. Sequence of work
11. Requirements for reports
12. Method of payment
13. Payment of business or travel expenses
14. Provision of tools and materials
15. Investment in facilities
16. Realization of profit or loss
17. Work for multiple companies
18. Availability to public
19. Control over discharge
20. Right of termination

Why Does It Matter?

- Can Terminate ICs Freely
- Overtime/Minimum Wage Liability
- Tax Liability
- Liability For Their Actions
- Workers Compensation

Paul Johnson Drywall Inc.

- On May 19, 2014, the DOL announced that Paul Johnson Drywall Inc. agreed to pay \$600,000 in back wages, damages, and penalties to settle a sub-contractor's alleged misclassification of workers as independent contractors instead of employees.