

An HR Challenge: Finding and Fixing Overtime Misclassifications in 4 Steps

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In light of the United States Department of Labor's ("DOL") June 30, 2015 report and proposed amendments to the salary portion of the 'white collar' exemptions that would more than double the minimum salary of those exempt employees under The Fair Labor Standards Act ("FLSA"), many employers will begin taking a closer look at their employee classifications. This article generally provides advice relating to exemption audits and related corrective action; however, advice about making exempt status changes while an overtime lawsuit is pending lies beyond this article's scope; obviously, in the midst of litigation, corrective action presents tactical considerations. State wage-hour law is also not addressed here.

The FLSA requires employers engaging in interstate commerce to pay overtime compensation to non-exempt employees, for all hours over 40 that such employees work in the work week, at a rate not less than one and one-half times the employee's regular rate. Compliance requirements relating to overtime pay obligations are explained in detailed regulations promulgated by the DOL, and in DOL opinion letters which construe those regulations.

Because there are a number of FLSA overtime exemptions, and because the tests for these exemptions can be difficult to apply in practice, many employees are misclassified by businesses which have no intent of evading applicable law. In fact, a majority of employees in the American work force are non-exempt under the FLSA and DOL regulations, and thus entitled to overtime pay. So mistakes are made. And, if the proposed amendments become law, those mistakes will become even more expensive.

Of course, all companies want to avoid FLSA litigation, and HR managers, trying to keep their employers out of court, must be proactive in auditing classification decisions. In addition, job responsibilities evolve over time. Many HR exemption audits reveal situations where it is discovered that employees have been misclassified and are entitled to overtime pay. It is obviously best to "fix" this kind of problem as soon as it is discovered by HR.

Here are the steps to employ in conducting a self-critical audit and corrective plan:

Step 1: Is the employee exempt?

The starting point for any HR manager auditing possible misclassifications is a review of jobs falling in a band consisting of the lowest employer pay grades (start with the lowest exempt pay grade, and work up). These lower-paid exempt employees are typically at the greatest risk of misclassification. After identifying the exempt employees who will be subject to analysis, begin your audit by reviewing organizational charts to determine who these employees report to and whether anyone reports to them. Review employee job descriptions to determine the job's primary duties and percentages of times likely allocated to

those job duties. Then consider which exemptions are the most likely to apply to that employee. There are various exemptions, but the most common exemptions are among the so-called 'white collar' exemptions. Many employers, in particular, base exempt status determinations on the administrative and executive exemptions.

To be exempt under the administrative exemption, the employee should be: (1) compensated on a salary basis at a rate of not less than \$455 per week; (2) whose primary duty is 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 (3) whose primary duty includes the exercise of discretion and independent judgment with respect to matters of significance.

For the executive exemption, the employee should be: (1) compensated on a salary basis at a rate of not less than \$455 per week; (2) whose primary duty is management of the enterprise in which the employee is employed; (3) who customarily and regularly directs the work of two or more other employees; and (4) who has the authority to hire and fire other employees or whose suggestions and recommendations as to the hiring, firing, advancement, promotion or any other change of status of other employees are given particular weight.

Note that if the amendments to the FLSA are enacted as proposed, the salary basis test for these 'white collar' exemptions will more than double from \$455 to \$970 a week. The proposed amendments do not suggest alterations to the duties portions of these tests.

While these are the tests for the administrative and executive exemptions, note that these exemptions, and the other exemptions, are construed at length in DOL regulations, case law, and DOL opinion letters. That means management's intuitive sense about applicable legal requirements might be incorrect. If you have access to corporate attorneys, talk to your counsel about applicable exemptions if you have any doubt as to their scope and how they apply to the business. There are also some lesser-known exemptions, and counsel can assist with identifying and explaining them, so that jobs are analyzed consistent with DOL guidance.

After reviewing applicable job descriptions, organizational charts, and noting which exemptions are candidates for consideration, interview managers of the employees to find out what the employees are *actually* doing. Just because an employee is hired to do an exempt job does not mean the employee is really doing an exempt job. Bear in mind that underperformers can cause FLSA liability problems. If an employee who is supposed to be performing an exempt job is underperforming (e.g. paralyzed by indecision, or not well-respected enough to be included on hiring decisions), the employee may not be exempt. The law looks at what the employee actually does, not what the employee is supposed to do, in deciding whether an exemption applies.

After analyzing whether the actual job duties fall under one of the exemptions, and upon reflection, whether any other exemptions should be considered, you should determine how confident you are in the asserted exemption. If the exemption feels "iffy," the facts will most certainly play out even worse in a courtroom after extensive discovery. The FLSA is narrowly construed against the employer and in favor of finding an employee non-exempt. If you are not convinced the employee is exempt, you should assume that neither a judge nor a jury will be convinced as well.

If you are not sure whether an exemption is applicable, discuss the situation with your employer's counsel. If counsel concludes that the position is exempt, you can use your attorney's self-critical audit letter to prove good faith and defeat liquidated (double) damages and an additional year to the statute of limitations (two years instead of three) if there is a subsequent lawsuit. If the self-critical audit letter reveals the employees have been misclassified, the letter is privileged, protected from discovery. Although the expense of using attorneys is always a consideration, attorney involvement in exempt status audits can be a win-win approach.

Step 2: Questions for HR to Consider when Evaluating the Results of an Overtime Audit

After you have conducted your audit, there are a number of questions that HR should consider when evaluating options. Some of these questions are posed below. Critical analysis of the information elicited by these questions can assist you in deciding how to evaluate the results of your audit.

For example, give some thought as to whether the employees are actually working overtime. If the employees are not working overtime, or much overtime, there is less of a concern. Can you estimate the possible financial exposure presented by the misclassification? What kind of records does the employer maintain? Does the employer already keep track of hours? Should the employer start keeping track of certain exempt employees' hours and/or implement a no-hours-over-40 rule for some exempt staff? However, note a direction to employees not to work over 40 hours can create its own problems when

employees think the employer means “work off the clock” or lower level supervisors suggest, without HR approval and in spite of handbook provisions, that the employer really wants staff to “work off the clock.”

HR may need to convert the employee to an hourly wage that is lower than their annualized salary. This could create morale issues, but with the right person delivering the news, it is possible that the employee will understand that he or she will still be making the same amount given the projected overtime hours. *Caveat*, be careful in lowering the hourly rate after an employee complains about his pay to avoid retaliation claims.

In analyzing the audit results, also consider how many employees are affected. How big is the employer’s classification problem? Are a few employees misclassified or the masses? Are employees with similar duties classified the same?

You will also want to consider whether reclassification is going to affect employee morale. Employees like the idea of freedom and prestige that is often associated with exempt positions. In reality, however, many employers still require exempt employees to keep some sort of regular working hours. Most employees want to be exempt. Employees may believe reclassification to non-exempt status is undesirable. You should also consider whether the reclassification puts the business in a competitive disadvantage in the industry.

When there is resistance to a change in classification on the ground of cost, you should get management to think through the risks associated with not making a change. Litigation is expensive. Think an insurance policy covers misclassification claims and that the employer’s liability will be limited to the retention? Check the policy carefully. Most EPLI policies exclude FLSA misclassification claims.

Step 3: What to do when Management has decided not to Reclassify

If management makes a decision to stick with an exempt classification, what steps can you appropriately take, as an HR manager, to support that classification?

First, consider whether it is possible to limit employee work in the job classification to 40 hours per week. Eliminating overtime hours eliminates possible exposure for a misclassification. If overtime is required in the job, consider whether it should be monitored by requiring prior management or HR approval.

You should review employee job descriptions associated with the classification. Do they accurately reflect the employee’s duties? Do they need to be updated so that important primary job functions are highlighted? Remember, courts and DOL look to the actual job duties the employee performs, so it is the business reality which is critical, not the job description, but it is helpful in the event of litigation or a DOL audit if the job description is as accurate as possible.

When employees file lawsuits, the employee’s attorney will point to the most menial job duties associated with the position to make the point that the employee is non-exempt. One way to soften such an argument, or eliminate it altogether, is to reassign clearly exempt duties to the job at issue, so that the work associated with the position is as responsible as possible.

Consider asking employees to submit self-evaluations, either as part of your classification review, or as part of your annual performance evaluation process, where employees describe their most responsible duties and the percentage of time allocated to those duties. If this review is helpful, ask employees to sign and date those self-evaluations. The employees will want a raise and/or bonus, and the employer will find few menial tasks listed by the employee as part of the survey. This is not going to be dispositive in the event of litigation, but it can be helpful evidence. The credibility problems it creates for the employee has the potential to produce a faster and more inexpensive resolution.

Step 4: What to do when Management has decided to Reclassify

As with all things in life, timing matters. Reclassification of exempt personnel following an HR audit takes effort and a well-conceived game plan.

The first big question is when to make the switch. HR could tie the reclassification to annual reviews, pay increases or bonuses. Don’t have one of those in the near future? Does the employer give raises and bonuses at the same time each year? If it makes business sense, why not switch the bonus to a midpoint between the annual evaluations. It would give the employer a reason to have the reclassification discussion with the employees, while at the same time handing the employees money in form of a bonus. And, separating the timing of the bonus from annual pay raises might be championed as rewarding employees more than once a year. Employers could also tell employees that it is time to change the compensation structure.

Bear in mind that you will need to communicate the reclassification. Do not admit an employee was classified incorrectly! In

addition, PLEASE do not make such a statement to the misclassified employee. Also, DON'T put this news in an email, or even in a business communication to senior management. Those emails will probably be discoverable in the event of litigation.

HR can explain to employees that the laws are vague and HR is making a few changes with regard to overtime pay to make sure the employee is being treated fairly. HR can say something vague like it wants to make sure that employees are rewarded for their hard work. But DON'T admit non-compliance.

There will be employee questions. If the same person is not delivering the news to all, there should be a memo or written notes indicating talking points. If management is communicating the news to staff, then HR should help prepare managers/supervisors regarding questions that can reasonably be anticipated under the circumstances.

Just like with timing, delivery is also important. The spokesperson should be a "people person" with well established good social skills. Do not send the office curmudgeon to deliver the news to employees. It should be delivered by someone who is respected, someone with social and emotional intelligence, and someone who is "plain old nice." Happy employees who believe they are being treated fairly and respected are less likely to seek legal advice, which in turn can result in litigation.

Here is a big question: what approach does the business want to take regarding payment for past overtime hours worked by the employees? In considering this question, HR should find out whether the misclassified employees have been asking for past overtime compensation. Are all of the employees going to want past overtime if there is a decision to pay someone who has complained? How much is owed to the single employee and/or all misclassified employees? How arguable is it that the employee was actually exempt?

Don't try to negotiate some kind of overtime settlement with staff, where employees sign a release. In the Eleventh Circuit (Florida, Georgia & Alabama), an employer and an employee cannot privately resolve a disputed wage claim and execute a binding settlement agreement. An employer would need court approval or the Department of Labor to supervise the settlement for it to be binding. These are typically not viable options, unless there is a pending lawsuit (this article doesn't address strategy under such circumstances).

Some businesses ask employees to sign short releases when they have decided to pay back overtime, even though management and HR knows the releases are unenforceable. I don't recommend that approach. If you take that approach, some would argue you are really just tricking your employees, and acting in bad faith.

One approach for payment of past overtime hours worked is to pay back overtime in an unobtrusive manner. With this approach, back overtime is simply included in the pay check as a line item, without much or any explanation, other than possibly a very short truthful memo indicating that an employer audit has indicated prior unpaid compensation due to the employee, and that the business is paying what was found due and owing in connection with the audit. This can be a good approach in situations where little overtime has been worked, and not much needs to be paid. Obviously, the greater the payment, the more there is a need for an explanation.

Good luck with your audits and dealing with misclassifications.