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What You Need to Know About the FLSA

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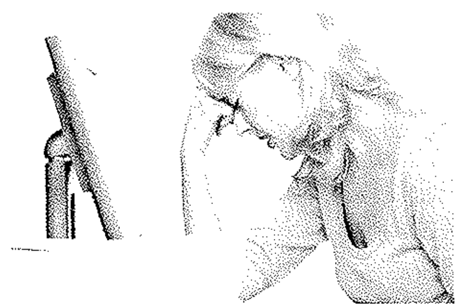
The Fair Labor Standards Act (FLSA) was enacted in 1938 to provide for the establishment of fair labor standards in employment in and affecting interstate commerce. Important things to know about the FLSA is that it generally requires employees be paid a minimum wage of $7.25/hour, and overtime at the rate of 1 1/2 times the hourly pay rate for all hours exceeding 40 hours a week.

Employers are required to maintain and preserve payroll and timekeeping records for each employee, including name in full as used for social security recordkeeping purposes, home address including zip code, date of birth, sex and occupation in which employed, time of day and day of week on which the workweek begins, regular hourly rate of pay and indicate the basis on which payment is made (e.g., hourly, daily, weekly, commission, salary), hours worked each workday and total hours worked each week, total daily or weekly straight-time earnings for overtime hours recorded, total additions to or deductions from wages paid each pay period, total wages each pay period, date of payment and pay period covered by the payment.



Each employer is required to post a notice explaining the Act in conspicuous places where employees work. Records are to be preserved for at least 3 years (in some cases 2 years) and be available for inspection within 72 hours after notice. Importantly, most of these records are also required to be maintained by the employer for employees who are exempt from minimum wage and overtime pay.

Exemption Under the FLSA

There are 5 major exemptions to the FLSA for "white collar" workers. The FLSA exempts bona fide executive, administrative, professional, outside sales, certain computer employees and highly compensated employees (over $100,000) from its minimum wage, overtime and timekeeping requirements. **The burden is on the employer, not the employee, to prove the applicability of exemptions.** The exemptions generally focus on the primary duties of the exempt employees.

One requirement for these exemptions is the employee must be paid at least in part on a salary basis. The minimum salary amount is generally $455 per week. Being paid on a salary basis requires the employee receive a pre-determined amount of compensation each pay period that is not subject to reduction regardless of the number of days or hours worked. Salary deductions are allowed for whole day absences due to personal reasons other than sickness or disability. Deductions are allowed for whole day absences due to sickness or disability (including work related accidents) if done in accordance with a bona fide plan, policy or practice providing compensation for salary loss due to such sickness or disability. Deductions are also allowed as a penalty for infractions of safety rules of major significance, unpaid disciplinary suspensions imposed in good faith for infractions of workplace conduct rules, such as sexual harassment, violence, drug or alcohol violations, or violations of the law. Deductions can also be made for a vacation allowance, sick leave bank, or other paid time off (PTO). **An actual practice of an employer making improper salary deductions results in the loss of the exemption.**

The Department of Labor (DOL) and state agencies, such as the Texas Workforce Commission (TWC), have inspection and enforcement authority, and can conduct audits of the employer and determine whether minimum wage and overtime violations have occurred, collect unpaid wages and OT on behalf of employees, and assess penalties and fines against the employer. If there is a misclassification issue such as paying as an independent contractor when the person should be treated as an employee, the Internal Revenue Service (IRS) will not be far behind.

Who is an independent contractor?

It depends on what law and agency is involved. The IRS test focuses on three main factors:

1. behavioral control;
2. financial control; and
3. relationship of the parties.

This differs from the 7-factor "economic realities" test used by the DOL to enforce the FLSA. Many states have adopted different tests. The TWC uses the common law 20 factor test.

Trend of Increasing Audits and Assessments

Given the current economic climate in which federal and state agencies are underfunded and looking for a source of funding, audits and assessments of employers, including target industries which use daily or weekly pay rates, are more commonplace than ever. The US Chamber has warned wage and hour litigation is on the rise, including collective (class) actions, which is overtaking other types of workplace litigation.

Settlements of wage and hour cases between 2007-2012 totaled about $2.7 billion, with $467 million in 2012, with employers paying on average $4.8 million per case for collective actions. Since 2007, the DOL has conducted over 150,000 wage and hour investigations that have resulted in findings of 110,000 violations. More than 75% of these cases included back wages, with 11% including additional penalties.

Most wage and hour cases are based upon employers misclassifying employees in one of two ways:

1. labeling nonexempt employees as exempt; or
2. classifying workers as independent contractors instead of employees.

Where an employer misclassifies and fails to pay or withhold required payroll taxes for an employee, federal and state agencies can assess back taxes, crippling penalties and interest against the employer, particularly where the employer's entire workforce is mistakenly labeled as independent contractors.

Wage and hour cases currently outpace all other forms of workplace litigation (Tweet this). They have become the preferred choice of underemployed plaintiff's attorneys, because they are simple to prove if the employer has failed to keep proper records, and plaintiff's counsel can recover attorneys' fees if they prevail. While these cases can be filed on behalf of individual employees, they are now being brought as collective class actions, increasing the financial risk and attorneys' fees the employer may have to pay. More importantly, collective actions are hard to settle because a court or the DOL must approve any settlement, since an employee cannot privately agree to release their wage and hour claims against the employer.

Notable examples of recent wage and hour settlements and verdicts include:

- Rite Aid Corporation agreed to a $20.9 million settlement in a misclassification case involving 9400 employees, including $7 million in attorneys' fees;
- First Republic Bank paid more than $1 million in a DOL settlement for improperly treating employees as exempt;
- Prudential Insurance Company agreed to pay $1.02 million to settle FLSA claims of just 22 employees;
- Novartis Pharmaceuticals Corporation settled a class action brought by current and former sales representatives for $99 million, including $27 million in attorneys' fees;
- A $12.9 million settlement in October 2012 for wage and hour violations that exotic dancers at an adult entertainment club were incorrectly treated as independent contractors.
- A $1.24 million settlement in January 2013 involving a class of Apple & AT&T mobility customer service representatives;
- A $3.75 million class action settlement in 2011 for 265 truck drivers misclassified as independent contractors;

- A $1.47 million verdict in August 2013 from a DOL lawsuit against an Ohio cable company who misclassified 250 cable installers; and
- On October 13th, 2013, the DOL announced that Belton, Texas based High Performance Ropes of America was convicted of one felony count of making false statements and ordered to pay over $165,000 in overtime back wages and liquidated damages to 31 employees, fined $12,100 in penalties and received a court-ordered fine of $10,000. The owner, plant manager and office manager were also convicted on separate felony counts.

The IRS has found that 15% of employers misclassified workers, and that the problem affects millions of workers nationwide. (Tweet this) A DOL study concluded that 10-30% of employers audited by states misclassified their workers. The cost to state and federal governments from lost revenue is enormous:

- A DOL study found that if only 1% of employees nationally were misclassified, the loss in unemployment insurance revenue would be nearly $200 million annually;
- The GAO estimated that in 2006 alone, the federal government lost $2.7 billion in unpaid taxes due to misclassification.
- States reported losing $5-20 million in unpaid taxes due to misclassification

With so much lost revenue at stake, federal and state agencies have made it a priority to find violations and penalize non-compliant employers.

Related Initiatives

The DOL announced in 2011 its "Misclassification Initiative" by entering into memorandums of understanding (MOUs) with the IRS to share information regarding employee misclassification, and with 14 states, while actively pursuing MOUs with other states.

Since implementing this initiative, the DOL has increased collections by 80%, recovered more than $9.5 million in back wages, and doubled the number of back pay awards to misclassified workers. The DOL's FY2013 budget includes $14 million to help identify worker misclassification, with $10 million in grants to assist states, and $4 million for DOL Wage and Hour Division investigators. The DOL's FY2014 budget request will continue these line items requests.

Since announcing its "Questionable Employment Tax Practice" (QETP) initiative, the IRS has entered into MOUs with 37 state agencies to share the results of employment tax audits. Under this program, states have found over 7,000 workers incorrectly classified as independent contractors, reclassified more than $1.3 billion in wages, assessed almost $21 million in penalties through use of information obtained from federal tax audits through mid-2011. The IRS has also assessed almost $23 million in taxes on employers based on state referrals under QETP.

Government misclassification audits don't prevent private class actions which present "low hanging fruit" to plaintiff's counsel, forcing the employer to fight on 2 fronts, a state or federal investigation and a class action.

Effect of the Affordable Care Act

Finally, if that wasn't enough, the employer mandate provisions of the Affordable Care Act (ACA/"Obamacare") take effect in 2014, and will increase the risk and potential liability for employers.

Under the ACA, large employers with 50 or more employees must offer health insurance to their employees or face a penalty. The penalty can be up to $2000 per uncovered worker beyond the employer's first 30 employees. Since employers don't offer health insurance to their independent contractors, an employer can face similar penalties in the event coverage is not offered to a misclassified independent contractor who later purchases insurance on an exchange.

Preventing Non-Compliance

While the FLSA was enacted to protect "blue collar" workers from being taken advantage of by their employers, FLSA investigations, audits and litigation can become a literal "house of horrors" for employers and industries found to be

in non-compliance. It is essential to maintain proper records, and to properly classify the workers of an employer. The failure to do so can be an expensive or business closing event for noncompliant employers.

The best practice is to have an experienced attorney in this field review employer records to insure proper compliance and documentation is kept.

About the Author:

Steven E. Clark, founder of Clark Firm PLLC in Dallas, concentrates his practice on business and commercial litigation, construction, employment and labor law, and general civil litigation.

Mr. Clark is an author of Texas Employer Law Forms (ALM) and contributing author to Texas Employment Law (James Pub.). He is also a Texas Super Lawyer® in Labor and Employment Law, and a member of the American Bar Association, the Dallas Bar Association, and the State Bar of Texas. Mr Clark received his B.A. and his J.D., with honors, from the University of Houston.

Mr. Clark will be presenting on "Employment Matters in the Construction Industry" at the Real Estate Development and Construction Law seminar in Dallas next month.

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