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To Pay or Not To Pay: Payment of Wages under Federal Wage and Hour Law

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"These violations reflect one of the problems we've found in the oil and gas extraction industry—employees are improperly classified as exempt from the FLSA and are not paid the proper wages in accordance with federal law." - John Dumont, Director, Wage and Hour Division, Pittsburgh Office. U.S. Department of Labor, Wage and Hour Division Press Release, December 19, 2012.

The influx of oil and gas companies, and their workers, to the Marcellus Shale region has given the Department of Labor ("DOL") a new target for its enforcement efforts under the federal Fair Labor Standards Act ("FLSA"). According to the DOL, 80% of employers are not in compliance with the FLSA and perhaps to reinforce the point, the DOL's Wage and Hour Division has announced a multiyear enforcement initiative in Pennsylvania and West Virginia focused on oil and gas companies and related businesses such as tree clearing, quarries, road construction, paving, masonry, and water and stone hauling.

At its core, the FLSA requires the payment of a minimum wage (currently $7.25) and overtime (at a rate of at least one and one-half the regular rate of pay for hours worked in excess of 40 in a work week) for covered employees. Caught recently in the DOL's enforcement initiative was an oil and gas company which paid more than $187,000 to employees after a Wage and Hour investigation found that it had improperly classified those employees as exempt from overtime obligations.

That settlement may be just the canary in the coal mine for the industry. Wage and hour litigation has exploded in recent years, with federal court filings alone having increased by 300% since 2000. The top 10 settlements in 2012 totaled $292 million, including one settlement that was $99 million. And those figures do not take into consideration the millions of dollars spent by companies on legal defense fees.

The potential liabilities make it important for oil and gas companies to identify wage and hour vulnerabilities under the FLSA and troubleshoot them. Developing a sensitivity to those problems will help employers avoid the pain of a DOL investigation or a class action law suit.

Employee or Independent Contractor

The FLSA only governs the relationship between an employer and its employees. Accordingly, independent contractors are not subject to the law's minimum wage and overtime requirements, leading some employers to the conclusion that it is better to classify workers as contractors instead of employees. That distinction, though, between employee and independent contractor is often difficult to make and is ripe for litigation. For example, it is not enough for the employer simply to treat the worker as an independent contractor by having the worker sign a consulting agreement and issuing a 1099 instead of a W2.

The starting point for analysis is the definition of employee under the FLSA, but it is circular and not particularly helpful on its face: "any individual employed by an employer." That definition has been interpreted to be the "broadest" among all the acts of social legislation. Indeed, the United States

Supreme Court has stated that the FLSA's definition of employee "stretches" traditional agency law principles.

The breadth of the FLSA's coverage manifests itself in the standard employed by courts to determine whether a worker is an employee or contractor. They use the "economic realities" test, which has been construed as more liberal and expansive than the traditional right to control test used by the Internal Revenue Service or the courts in ERISA cases. The essence of the test is whether, as a matter of economic reality, the worker depends upon the business to whom the worker renders service for his continued employment.

There are six factors the court typically considers in analyzing the issue, including the company's right to control, the worker's opportunity for profit or loss depending on his skill, the worker's investment in materials or equipment, the worker's special skills, the degree of permanence of the working relationship, and the integral nature of the services provided to the employer's business. These factors must be weighed in each case and do not create an algorithm. As one court noted, while a score of 5-3 decides the winner in a baseball game, the number of factors leaning one way or another does not necessarily decide whether a worker is an employee or a contractor.

Thus, the classification of a worker as an independent contractor is a delicate matter which will be closely scrutinized by the DOL or plaintiff's attorneys for weaknesses, and may result in litigation even if the classification is correct. A position like Landman is one example of an industry job that has engendered some controversy. As such, it is important for the employer to attach the correct classification to the worker or risk considerable liability for unpaid wages.

Exempt or Non-Exempt

Assuming that the worker is an employee and falls under the coverage of the FLSA, there is another classification issue of key importance: is the employee "exempt" from the minimum wage and overtime provisions of the Act? Improper classification of employees as "exempt" is a rich resource for DOL investigators and plaintiff's attorneys.

A starting point for analyzing the exemption issue is to begin with the assumption that every employee in the company is covered by the FLSA's minimum wage and overtime obligations, from the president to the mail room clerk. The task, then, for the employer is to find an exemption from coverage that might apply to its employees.

The FLSA provides a multitude of exemptions to and exceptions from its minimum wage and overtime requirements. Employers are allowed to make initial determinations as to whether employees fall within one of these exemptions or exceptions or are subject to the general overtime rule. No specific application or certificate is necessary. Companies, however, have the burden of proving that their employees actually fall within any claimed exemption.

Some exemptions are industry- or job-specific, but the most important, and often most troublesome, exemptions to the minimum wage and overtime requirements under federal law are the so-called "white-collar" exemptions. The FLSA provides exemptions for "any employee employed in a bona fide executive, administrative, or professional capacity."

To qualify for the executive, administrative, or professional exemptions, employees must satisfy a minimum compensation requirement and both a duties test and a salary basis test. When evaluating whether these tests are satisfied, an employer should consider both its formal policies and job descriptions and its actual practices. If either policies or practices fail to meet the required tests, the exemption may be lost.

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The minimum compensation requirement for the white-collar exemptions is $455/week (annualized to $23,660), which means that an employee must be paid at least $455 a week to qualify for the exemption. If paid at least that amount, the employee must also satisfy both the duties test and the salary basis test.

Regarding the duties test, the employee needs to perform certain tasks which have been deemed consistent with the exemption sought. For example, an executive employee must have the primary duty of management, supervise two or more full-time employees, and have the authority to hire or fire (or determine the status of) other employees. An administrative employee must have a primary duty of performing office or non-manual work directly related to the management or general business operations of the employer or the employer's customers, must exercise discretion and independent judgment on matters of significance, and cannot be a production worker or a blue collar worker. There are two types of professional employees, learned and creative. Both must exercise discretion and independent judgment. A learned professional must also do work requiring advanced knowledge in a field customarily acquired through prolonged instruction, while a creative professional must do work requiring invention, imagination, originality, or talent in a recognized artistic or creative field.

In addition to satisfying the duties test, the company must also pay the employee on a salaried basis (although in some instances, the company may pay a fee that satisfies the minimum compensation requirements in lieu of a salary). Payment on a salary basis involves more than simply payment of a salary. The salary basis test requires that a white-collar exempt employee be paid a predetermined amount, on a weekly or less frequent basis, that is not subject to reduction because of variations in the quality or quantity of work performed.

The salary basis test rests on two basic premises. First, employees must receive their full salary for any week in which they perform any work without regard to the number of days or hours worked. Second, employees need not be paid for any work week in which they perform no work.

One of the biggest areas of dispute involves deductions from salary. Improper deductions will destroy salary basis, and result is the DOL (or a court) treating the employee as non-exempt and therefore owed a minimum wage and, importantly, overtime for hours worked in excess of 40 in a given work week.

The deduction rules are intricate, but a basic principle is that partial day absences are typically not permitted. Thus, if a salaried employee only works a half-day, the employee must typically be paid for the entire day. On the other hand, full-day deductions are permitted in limited circumstances, such as for personal absences, absences due to sickness or disability if the deductions are taken in coordination with a bona fide plan, policy or practice of providing compensation for loss of salary, or disciplinary suspension.

Issues involving exemptions, exempt duties, and salary basis provide fertile ground for DOL investigators and plaintiff's attorneys. Accordingly, employers must be especially cognizant of their rights and responsibilities under the FLSA.

Other Vulnerabilities

For employers with non-exempt employees, wage and hour issues arise in a variety of circumstances and in a multitude of manners. A frequently litigated area is hours worked; in particular, whether certain activities are compensable. Questions about compensation for travel or training time are often raised and prove difficult to answer at times. Another prominent issue in is off-the-clock work. Off-the-clock claims arise when an employer performs an activity before or after his shift. Sometimes that activity is on site, but other times it is performed offsite (often in the home). The employer needs to determine whether that activity is work, and how much to pay the employee for that activity if it is work.

Calculation of overtime rates is another area of scrutiny. Overtime is calculated as time and one-half of the "regular rate." If an employee is paid $10.00/hour, and that hourly wage is all the employee receives, the regular rate is $10/hour. The overtime rate, then, is $10 times 1.5, or $15.00. However, if that same employee receives other forms of compensation, such as bonuses, commissions, or other incentive payments, these amounts must often be included when calculating the regular rate. Thus, if the employee works 50 hours at $10/hour, but also receives an agreed-to $100 production bonus, the regular rate is not $10/hour, but rather $12/hour ($500 in hourly wages, plus the $100 bonus, divided by 60 hours worked). That makes the overtime rate $18/hour.

Employers often neglect to include these additional payments when calculating regular and overtime rates, which makes it an area of concern for any company being investigated by the DOL. A key question for the employer to ask is whether the additional payment is discretionary or non-discretionary. If non-discretionary, like a bonus for productivity that is set forth in the company manual or in the employee's offer letter, it must typically be included in the regular rate. Truly discretionary payments may usually be excluded from the regular rate calculation, but the difference between discretionary and non-discretionary is often hard to discern and ends up as a common source of law suits.

Recordkeeping

If the DOL investigates an employer for wage and hour compliance, or if the employer is sued under the FLSA, they will ask to review the employer's payroll records. Importantly, the FLSA requires the employer to keep wage and hour records, including information regarding the employee, the work week, the hours worked each day, the basis of pay, the regular rate, straight time and overtime compensation, deductions and additions to wages, the applicable pay period, the wages paid each pay period, and the date of payment.

An employer has a duty to assure that these records are detailed and accurate. This duty may not be delegated to employees. Thus, policies regarding time entry, reporting of time, and following posted schedules are helpful but are not a defense to claims for uncompensated hours. Neither are policies that prohibit unauthorized work or overtime. Likewise, time cards or time records by themselves are not necessarily sufficient evidence of hours actually worked.

Under federal law, employers must maintain most records for three years, although some source documents and other basic information may be discarded after two years. Even though the FLSA allows employers to discard some source materials after two years, employers should maintain all records for three years if this is practicable. Because the statute of limitations on legal claims may run for three years, rather than two, it is important for employers to maintain source materials to defend against possible wage claims. These materials may include records created or signed by the employee.

If employers fail to maintain required (or accurate) records, then courts shift the burden of proof in subsequent litigation. Essentially, courts allow employees to provide generalized and unsubstantiated testimony as to the hours they believe they worked and require that employers disprove the testimony. Thus, a court or jury may award damages even though the measure of damages is imprecise. Accordingly, it is vital for the employer to keep accurate and complete records, both to satisfy FLSA recordkeeping requirements and to provide a defense to claims for unpaid wages.

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Federal or State Law

The discussion in this article has focused on federal law, but most states have their own wage and hour laws. In many instances, state wage and hour laws provide the employee the same level of protection as does the FLSA, and impose the same obligations on the employer. However, in some instances, the state law is more generous to the employee and more restrictive of the employer. In those instances when state and federal laws diverge, the company is required to comply fully with both laws.

A simple example is the minimum wage. The federal minimum wage is $7.25/hour, but if the state (or local municipality) imposes a higher wage, the higher wage must be paid. Thus, an employee in Ohio must be paid at least $7.85/hour, which is the state minimum wage. Accordingly, it is crucial for companies to be familiar not only with the federal wage and hour laws, but the wage and hour laws of those states where their employees work.

Federal and state wage and hour laws pose compliance challenges for employers, and given the prominence of the oil and gas industry in the Marcellus Shale region and the targeted enforcement efforts of the Department of Labor, that challenge is magnified. Prudent employers need to be cognizant of the multiple ways wage and hour issues present themselves, and must be vigilant in their efforts to comply. In this case, an ounce of prevention is truly worth more than a pound of cure.

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