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WAGE AND HOUR

Building Litigation Firewalls With a Wage-and-Hour Audit

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Special to the Legal

If, as Benjamin Franklin famously said, an ounce of prevention is worth a pound of cure, then it is no wonder employers are conducting wage-and-hour audits in record numbers. Wage-and-hour claims continue to outpace all other types of workplace litigation, and show no signs of abatement. In fact, according to the Federal Judicial Center, wage-and-hour claims under the federal Fair Labor Standards Act (FLSA) have increased more than 500 percent since 1990. Employers also are finding themselves increasingly embroiled in government enforcement activity—the U.S. Department of Labor's (DOL) Wage and Hour Division, for example, recovered nearly a quarter of a billion dollars in back wages in fiscal year 2013 on behalf of more than 260,000 workers. And, as if all of that were not challenging enough, legislators and regulators are busy crafting new laws and regulations, amending old ones, and focusing on new compliance initiatives.

Employers have responded accordingly. Rather than adopt a passive approach, many have elected to audit wage-and-hour practices proactively to measure compliance with existing laws and take affirmative steps, where appropriate, to better position their organizations for the inevitable. Far better to learn of potential compliance issues by way of an audit rather than a lawsuit, right?

A typical wage-and-hour audit defies description. Like the famous marshmallow-man character Gozer in the 1984 movie "Ghostbusters," it can take any chosen form. Either for cost-containment reasons or due to specific concerns that are limited to discrete issues and practices (or even a specific business unit or a particular class of employees), an

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audit can be a very focused review. Of course, the scope may widen based on preliminary findings or other factors, and a broader inquiry often buys greater peace of mind. Depending on the nature of the workforce, an audit could involve analysis of any one or more of the following areas—or even individual aspect(s) of the following areas:

- **Analysis of worker classifications.**

A classification audit typically aims to determine whether: (1) exempt employees' primary duties fall within one or more of the exemptions from overtime and/or minimum-wage obligations recognized by the FLSA or relevant state law; (2) exempt employees are actually paid on a "salary basis," which is a condition precedent to exempt status in almost all circumstances; (3) independent contractors are treated like employees to such an extent that a risk of joint employer status (i.e., for wage-and-hour liability) may attach; and/or (4) unpaid interns and/or volunteers are properly classified and not entitled to wages or other compensation for their unpaid efforts.

Although the job duties contained in a written job description should meet the pertinent requirements of state and federal law pertaining to exempt status, evaluation of written materials alone is generally insufficient to confirm that employees properly are classified as "exempt." In reviewing written job descriptions, it is crucial to determine whether the written job descriptions reflect the primary duties actually being performed by employees in that classification. Assessing whether independent contractors, volunteers and unpaid interns are classified properly likewise can be a fact-intensive exercise. Independent contractor status, for example, depends to a large extent on the employer's degree of control over the individual worker, as well as the scope of work responsibilities and the degree of oversight and supervision. By comparison, the motivation and mindset of volunteers is directly at issue because unpaid volunteers must perform work for civic, charitable or humanitarian reasons and further must do so without expectation or receipt of more than nominal compensation for services rendered. Similarly, unpaid interns must gain valuable experience comparable to that which would occur in an educational environment and employers should derive no immediate advantage from their work activities.

- **Assessment of potential exposure for off-the-clock work.**

While it is impossible to eliminate all risk of litigation bottomed on allegations of off-the-clock work, there are certain steps that can and should be taken to reduce that risk and ensure that such work is neither permitted nor

encouraged. The stakes are high, because alleged failure to pay nonexempt employees for all hours "worked" is by far the most common source of class and collective action wage-and-hour litigation.

Determining whether nonexempt employees are permitted or encouraged to work off-the-clock typically requires the audit team to take the following steps: (1) define exactly what time qualifies as "hours worked" for a particular class of employees; (2) determine whether employees are permitted (or worse, incentivized) to perform preliminary work before their shift start-time, postliminary work after their shift end-time, or other compensable work during unpaid breaks or off-shift time (e.g., while not on the worksite); and (3) identify any other factors that may result in the systemic underreporting of time (e.g., departmental protocols or policy statements that discourage employees from incurring overtime, which could be interpreted mistakenly as discouraging employees from reporting all time worked).

"Hours worked" should include all compensable activities that occur during the "continuous workday" as defined by DOL regulations, which might include time spent "donning" and "doffing" work attire/equipment at the beginning or end of the workday; site-to-site travel time; or even time spent syncing electronic devices at home. "Hours worked" also should include any off-shift work performed, assuming the knowledge or tacit approval of supervisors. Break time is compensable time, assuming the break is of insufficient duration for the employee to make effective use of that time for his or her own purposes (note that DOL regulations provide that breaks of less than 20 minutes duration must be paid and bona fide meal periods of 30 minutes or longer where an employee is completely relieved of duty need not be compensated). Likewise, any occasion where an employee is engaged to wait is compensable time, as opposed to those who are merely waiting to be engaged (picture a store clerk reading a book, waiting for a customer to enter the store, as opposed to an employee carrying a pager while at home or on break). Like the analysis of worker classifications, the off-the-clock work inquiry is more applied research than theory, and will require the audit team to understand exactly what job duties are being performed, at what times, and by whom.

• Review of pay practices.

Payroll practices that undercompensate employees can lead to expensive fines and penalties as well as class and collective action litigation—even in the absence of any specific intent. Frequent culprits include rounding policies and calculation of the regular rate of pay for nonexempt employees, and/or misplaced reliance on third-party electronic payroll software to ensure compliance in these areas. The audit team's review of payroll practices also should ensure compliance with applicable document-retention requirements because documents that do not exist, but should exist, can and will be used against you in a court of law. Moreover, strong documentation (including electronic records) can be an essential ally in defending wage-and-hour litigation should it arise.

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• Privilege considerations and methodology.

The issue of attorney-client privilege is thorny in the context of an audit. It is essential that the issue be addressed at the start of any audit to ensure privilege protection to the maximum extent feasible, because to the extent an audit detects violations any written audit report could be used against an employer in a subsequent lawsuit. Accordingly, most employers elect to engage counsel (either inside or outside counsel) to conduct the audit, invoke the attorney-client and attorney work-product privileges, and thus shield many—although potentially not all—audit-related communications from discovery.

Invocation of the privilege comes with a price, however. To avoid liquidated (double) damages under the FLSA, a defendant must prove that it had a "reasonable" or "good faith" belief that its actions were FLSA-compliant, and evidence of good-faith reliance on an audit conducted by qualified legal counsel could help establish the defense. The defense is unavailable, however, unless the privilege is waived. Additionally, counsel who participate in an audit may become fact witnesses, and therefore unable to represent the company as trial counsel.

It also is essential at the outset of an audit to determine an appropriate audit methodology. Although the audit team should focus on the practical realities of the work being performed, it should not be a foregone conclusion that subordinate-level (particularly nonexempt) employees be interviewed or even made aware of the audit. While employee interviews would undoubtedly increase the validity of the audit findings, the word "employee" is also synonymous with "potential claimant." Accordingly, there is substantial risk involved. Employers should, therefore, consider carefully whether to interview only managers who administer the policies as opposed to those affected by the policies and practices, or consider other ways to gather the factual information necessary to ensure compliance.

AUDIT IS A VITAL STEP

Although there is no "magic bullet" in the wage-and-hour context, an audit is a vital step employers can take to reduce exposure to a large (and potentially uninsured) financial risk in the form of a DOL investigation and/or class and collective action litigation. Though the word "audit" might carry an ominous association—particularly around April 15—a wage-and-hour audit, properly conducted, just might help employers sleep better at night. •

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