

AVOID THE CALAMITY OF WAGE AND HOUR CLAIMS

Managing the Risk of Employment Litigation

ECONOMIC conditions in the U.S. have had a major impact on every aspect of employment. Wages have been depressed, benefits cut, and supply chain relationships disrupted. However, the recession has led to one significant increase in economic activity—litigation involving employment conditions. Lawsuits range from discrimination in hiring to wrongful termination. One trend that should have all organizations on alert is the increase in wage and hour lawsuits. They are increasing in number as individual claims and seem to be outpacing all other types of workplace class action litigation. The increase comes as more workers are laid off during the recession and as independent contractors who have had close relationships with organizations seek legal remedies.

Employment-related lawsuits usually contain multiple allegations. Often, wage and hour claims are part of suits relating to wrongful termination or discrimination. Such lawsuits typically revolve around allegations that hourly workers eligible for overtime are misclassified as exempt in violation of the Fair Labor Standards Act (FLSA) and other laws. Claims sometimes involve independent contractors who allege that they should be classified as employees for benefits and employment protections.

Increased Enforcement and Awareness

The harsh reality of the economy may not have been the only trigger for increased litigation. Wage and hour lawsuits have been an escalating threat to employers over the past decade. Alterations made to the FLSA in 2004, which originally intended to clarify definitions, increased awareness among workers and the attorneys who represent them. The U.S. Department of Labor and certain state labor departments have stepped up enforcement efforts in recent years. This has not only resulted in more fines, but also in precipitating individual and class action civil lawsuits.

FLSA rules—the basic federal rules governing minimum wage and

overtime pay—appear straightforward, but actually provide little guidance and no certainty of treatment. Defining work hours can be a challenge, and distinguishing exempt from nonexempt employees can be complex. In addition, the Internal Revenue Service (IRS) rules regarding who qualifies as an independent contractor rather than an employee are based on common law principles that often are relied on beyond their legal significance.

The Risk of Misclassifying Employees as Independent Contractors

Organizations have many reasons for contracting out for services, ranging from a reduced head count to actual reductions in benefits to a supposed decreased carbon footprint. However, misclassifying employees as outside contractors can result in significant problems with the IRS.

There is increased vigilance from the IRS and other regulators about the misclassification of workers. Proper classification depends on many factors, including how much control or direction an employer wields over the independent contractor. Employees are entitled to benefits and legal protections. Organizations, however, are not required to withhold income taxes from independent contractors or pay Social Security or Medicare taxes for them. Independent contractors also are not covered by many labor protections, including minimum wage and overtime laws, and unemployment or workers' compensation insurance. In the past many workers were willing to be classified as independent contractors, trading the legal and benefit protections for higher income, but as some were cut from funding, they often argued that they were misclassified.

The IRS has guidelines on incorrectly classifying a worker that can lead to steep penalties and increased scrutiny. The federal government estimates that between 1996 and 2004 it lost an estimated \$34.7 billion in tax revenue due to the misclassification of workers as independent contractors. A recent IRS study suggested that employers can

reduce their labor costs by as much as 30 percent by classifying employees as independent contractors. The current dichotomy in the federal government between protecting employees from unfair labor practices and encouraging employers to increase competitiveness by lower costs is likely to lead to even more confusion and conflict, as well as fines, penalties, and litigation.

A Broad Categorization of Employees as Exempt Can Result in Litigation

Once it has been determined that a worker is indeed an employee, that employee might be classified as exempt from the minimum wage regulations, overtime regulations, and various other wage and hour provisions. For an employee to be considered exempt, the specific employment position, work duties, and wages must meet the rigorous requirements set forth by the FLSA. Some states also have criteria for who can and cannot be considered exempt. In almost all circumstances when federal and state laws differ, the employer must follow the rule that is most advantageous to employees. If a state has any specific wage and hour regulations, properly applying them is essential to avoid unnecessary claims. Failure to comply with either set of regulations may result in penalties and set the firm up for employee litigation.

Improperly applying wage and hour rules include such common errors as not appropriately paying for work time beyond the legal standard, making improper deductions from pay, not including compensation for preparatory and concluding activities for the employment position, and improperly accounting for training time, travel time, and meal and rest periods.

To protect against legal actions, worker classifications should be reviewed and updated regularly and workplace due process procedures should be established and publicized so that workers can bring any grievances to the attention of managers. Employers should investigate and respond to all grievances promptly to minimize the risk of further employee dissatisfaction and possible legal action.

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Challenge to Insurance Coverage

Some insurers have stopped writing defense coverage for wage and hour claims by deciding that they are a business risk rather than a traditional employment risk. Insurers have regarded wage and hour liability as a largely uninsurable risk because the incidents are perceived as resulting from deliberate and illegal acts, as opposed to negligence.

Despite recent evidence of negligence being the primary driver in many cases, most insurers have shied away from covering this liability in their employment practices liability insurance (EPLI) policies. That is not the case with the coverage provided by Schinnerer. Schinnerer's EPLI policy defines a wage and hour claim as:

Any Claim alleging violation of a state, local or federal law (including the applicable provisions of the FLSA other than the Equal Pay Act) or any state, local or federal regulations governing the payment of wages (including but not limited to the payment of overtime, on call time,

rest periods, and minimum wages) or the classification of employees for the purposes of determining employees eligibility for compensation or other benefits.

And although no policy covers the actual payment in relation to such claims, the Schinnerer policy does cover the defense costs.

Minimizing Wage and Hour Claims

All organizations should be prudent in recognizing that in times of financial distress, employee lawsuits are likely to rise. This is especially true with employees who have been or expect to be terminated, as well with independent contractors who recognize that they should be counted, compensated, and protected as employees. Efforts to minimize the risk of regulatory action and individual or class action lawsuits include the following:

- Review pay practices to determine whether you are in compliance with the FLSA and other laws and regulations.

- Remind managers that they are accountable for the proper management of wage and hour compliance.
- Make sure employees are properly classified as exempt (someone who is typically not paid overtime) or non-exempt (someone that is generally entitled to overtime).
- Treat complaints on wage issues just as seriously as you would harassment or discrimination employment issues.
- Never retaliate against someone that makes a complaint for wage and hour issues.
- Develop strong policies on pay practices and employee hours and enforce policies strictly and consistently.

Employment practices lawsuits—including those claiming relief from wage and hour violations—have become an unforeseen calamity for employers across all industry sectors, and a new challenge for non-profit risk managers.

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