THE NATIONAL
LAW JOURNAL
DAILY UPDATES ON WWW.NLJ.COM THE WEEKLY NEWSPAPER FOR THE LEGAL PROFESSION MONDAY, MAY 21, 2007 ALM

IN FOCUS

LABOR & EMPLOYMENT

Structuring effective FLSA audits

In-house and outside counsel can partner on wage-and-hour reviews under Fair Labor Standards Act.

By Jon Stoler and Stephen Goulet
SPECIAL TO THE NATIONAL LAW JOURNAL

SINCE THE U.S. DEPARTMENT of Labor revised the Fair Labor Standards Act (FLSA) regulations pertaining to overtime exemption status in 2004, wage-and-hour class action litigation has spiked dramatically. Indeed, plaintiffs' attorneys have targeted nearly every industry, and employers of nearly every size, seeking to take advantage of the somewhat nebulous exemption definitions and the passive misclassifications of employees that result. Because prophylactic internal audits seem rather daunting and may produce unfavorable results, many employers have stuck their heads in the sand, hoping to escape millions of dollars in potential liability.

But many have been caught. Even a superficial glance at the headlines reveals that within the last year, one of the world's largest computer and software manufacturers settled a class action brought by information technology employees for $65 million, a national supermarket chain settled a class action brought by 7,000 current and former employees for $53.3 million and one of the nation's leading investment banks settled a class action by its brokers for $98 million. Typical claims include failure to pay overtime, impermissible off-the-clock work and failure to provide appropriate meal and rest periods.

This financial gamble is an unnecessary one, however. Carefully structured internal wage-and-hour audits can identify problems before they are identified in court. Internal audits also have ancillary benefits, such as minimizing negative publicity, reducing potential legal fees attributable to litigation and avoiding certain statutory penalties in the event of a lawsuit. A comprehensive and efficient internal wage-and-hour audit can be achieved through the effective partnership of in-house and outside counsel and can produce results that dependably pinpoint areas of vulnerability and mitigate risk.

Of course, an effective wage-and-hour audit and reliable classification results can be had only if in-house and outside counsel work together meaningfully. Of paramount importance is outside counsel's familiarity with the client's business—a familiarity that extends beyond mere industry knowledge and penetrates into the practices and ongoing business concerns. If properly established, this relationship will only continue to flourish throughout the audit process, as outside counsel regularly confers with their in-house partners at all stages of the process. Embarking on the audit process with the relationship thus established, outside counsel will be better able to alleviate the client's concerns and help the client realize its goals. Moreover, working with outside counsel from the inception may permit the client to preserve attorney-client privilege throughout the process.

Perhaps most critical to the development of any such strategies or goals is an understanding of the law itself. The FLSA generally requires employers to pay an overtime premium to employees for all hours worked in excess of 40 in a given work week. However, the "white-collar" regulations accompanying the FLSA provide for exemptions from the overtime pay requirement. Employees falling within the executive, administrative, professional, computer and outside sales exemptions, and receiving their wages on a "salary basis," are not entitled to overtime. Each of these exemptions is duty-based; that is, it depends upon the types of work performed by each employee. Problematically, the regulations phrase the duties necessary for exemption in amorphous terms incapable of ready application: "exercise of discretion and independent judgment," "requiring knowledge of an advanced type" and "application of systems analysis techniques," to name a few.

The lesser-known provisions of the FLSA and its state law counterparts address issues such as daily overtime, meal periods, rest periods, recordkeeping requirements and similar items. These issues are also amenable to detection during a well-formulated and strategically implemented internal wage-and-hour audit.

Preparatory partnership

Owing to the duty-based focus of the FLSA regulations, an internal audit will generally necessitate a detailed inquiry into the actual job duties performed by each employee subject to the review. In many cases, this is no small task, particularly when supporting documentation is outdated or unavailable. Accordingly, in-house and outside counsel must make some initial decisions that will direct the scale, direction and cost of the review. Consideration must be given to the scope of the review, the degree of outside and in-house participation, internal preparation, the sources of information, remedial measures and the time-frame for completion. Due to their singular knowledge of the company, in-house counsel are distinctly situated to answer these inquiries and direct the appropriate focus of the audit.

In-house and outside counsel should consider one of three approaches when determining the appropriate scope of the classification review: a companywide review, a review of all employees within a particular subdivision of the company or a review of all employees within a particular job title or group of job titles irrespective of corporate location. Quite obviously, a companywide review will require the commitment of more time and resources, but will provide the most complete results. A smaller, focused review may be finished more quickly with less operational disruption, but may leave some stones unturned. In-house counsel, intimately acquainted with their company's unique situation, and outside counsel, equipped with experience gleaned from previous classification reviews, should work together to determine a fitting approach.

For larger reviews—those involving more than a few hundred employees—in-house counsel should consider independently assembling a team of attorneys, human resource professionals and/or other staff to serve as outside counsel's informational depot. The size of the in-house team will necessarily vary with the breadth of the undertaking, but those chosen should have more than a fleeting familiarity with the company's payroll and personnel practices. The team members will also play a critical liaison role, retrieving necessary information from the supervisors and other personnel with first-hand knowledge of employee responsibility, who may otherwise be hesitant to cooperate with outside attorneys.

Such an in-house team can perform vital preparatory functions prior to the focused review as well. It can help ensure that the job titles of all employees within the scope of the review accurately reflect the role the employees perform. Thus, employees with

Jon Stoler is a shareholder in the labor and employment group in Heller Ehrman's New York office. Stephen Goulet is the senior managing director and general counsel of Tullett Prebon Holdings Corp., with responsibility for the oversight of all legal, compliance and human resources matters in North and South America. Brian Murphy, an associate in the labor and employment group in Heller Ehrman's New York office, provided significant contributions to the article.

substantially similar job duties should be included in the same job title. Initially, outside counsel can concern themselves with the duties associated with a particular role rather than the duties performed by each employee.

Once the table has been set for the review, outside counsel may begin working with in-house counsel to assemble the mass of documentation necessary to perform an effective audit. At a minimum, the in-house team should be prepared to produce employee rosters featuring wage information, current exemption status, job titles, departments or subdivisions thereof, and hire dates. It should also be prepared to turn over job descriptions that accurately correlate with job titles and organization tables that reflect the most recent iteration of company personnel.

As with nearly any legal undertaking, the document and informational requests will play a critical role in directing the focus of the inquiry. For instance, on the basis of documentation alone, experienced outside counsel should be able to make swift and proper classification recommendations based upon the salary information reflected in employee rosters or the executive status illustrated by tables of organization. Outside counsel can also eliminate lower-level staff positions from further review on the basis of their presumably nonexempt classification.

While the in-house team's assistance to outside counsel is indeed critical at the preliminary stages of the review, it is also essential at the advanced stage. Complete and useful documentation is often lacking, job descriptions were never developed, or tables of organization were never updated. Even when documentation does exist, it is only as helpful as it is accurate. A job description torn from a manual of what a "financial officer" should do carries little weight in determining what the financial officers at the client company do. Accordingly, an effective review demands that outside counsel dig further, with the in-house team leading the way.

An audit will generally necessitate an inquiry into actual job duties.

The in-house team is in the unique position of facilitating a vital exchange of information between outside counsel and the managerial employees who hold an intimate knowledge of the day-to-day responsibilities of the employees in their charge. Outside counsel will come to depend on the in-house team for scheduling interviews, hosting conference calls and obtaining responses to questionnaires or responsibility checklists. Outside counsel will also rely on the in-house team to perform the unenviable task of emphasizing the importance of the task and reminding those with information to produce it in an accurate and timely fashion.

From the synthesis of this information, from a review of Department of Labor opinion letters and court decisions and from their own experience, outside counsel should be able to offer classification status recommendations for the employees subject to the review. In-house counsel and outside counsel can discuss in advance the most effective means of presenting the information, be it by memorandum, charts or simple discussion. The recommendations, by themselves, lack sufficient bite, however. The entire review is all for naught without implementation of the proposed changes.

Partnering in the remedy

With the audit process seemingly at an end, it would appear that the in-house team is free and clear. However, it is at this critical stage when outside counsel will depend most greatly on in-house support. Implementation of the recommended changes presents perhaps the greatest pitfalls for an employer vying for compliance. A great deal depends on whether in-house counsel prefers to remedy identified issues retroactively or prospectively.

Retroactive remedies of misclassifications will result in a short-term financial outlay, but it may prevent a more significant expenditure in the future. Moreover, such an approach is endorsed by the Department of Labor. Financial considerations aside, however, three issues affecting dollar amounts become immediately apparent. First, how far back should an employer go in terms of back payments? A logical approach would account for the statute of limitations, which under federal law is generally two years. See 29 U.S.C. 255(a). But the federal statute of limitations may be expanded to three years for "willful" violations. Moreover, state statutes of limitations may be even longer. Outside counsel can advise in-house counsel as to the potential applicability of the various statutes of limitations based on the nature of the violations to be remedied, but, ultimately, in-house counsel must determine the company's response.

In-house and outside counsel can also work to ensure compliance.

Second, on what basis are awards of back pay to be made? Employers seeking to remedy overtime violations will, in most instances, be confronted with a dearth of records upon which to rely. Because the FLSA does not require employers to keep records of hours worked by exempt employees, most employers will not have overtime records for those who have been misclassified. While requesting good-faith estimates by the employees themselves may have an empowerment value, such estimates are hardly likely to have any basis in fact. Instead, accurate estimates can be developed by outside counsel working with in-house counsel to "reconstruct" hours worked over the relevant time period through interviews, work histories, computer log-ons, building ID swipes and other available information.

Last, yet perhaps most critically, is whether an employer can secure a release of claims from an employee in exchange for the back payment. Any employer would reasonably expect to be insulated from future claims by virtue of its voluntary payment of potential damages arising from such claims. Unfortunately, the FLSA precludes such waivers. Accordingly, employers seeking to do the "right thing" may run the risk of lighting a match in the minds of one or more disgruntled current or former employees and could very quickly have a lawsuit on their hands. Although the damages are likely to be offset by any back payments voluntarily made, employers nevertheless face significant costs in terms of potential penalties and legal fees. Outside counsel can assist an employer with mitigating this possibility by providing training to in-house team members, developing talking points to those responsible for communicating the classification changes and awarding the back payments, and generating any other documentation that will assist with a smooth transition.

Alternatively, some employers may seek to cut off the accrual of potential liability on a prospective basis only. This may consist of a classification change from exempt to nonexempt (so that employees earn overtime) or an increase in exempt duties to bolster the exemption status of an employee or group of employees. While this approach may not be advisable because of the precarious legal situation it leaves an employer in for at least the duration of the statute of limitations, it does not require an immediate and potentially unpredictable financial outlay. Employers opting for the prospective remedy are particularly vulnerable to future lawsuits and, thus, outside counsel's expertise is indispensable. Experienced outside counsel can work with the in-house team to develop a communication strategy that will manage expectations and assuage the potential for a lawsuit. At the very least, outside counsel's efforts in this regard may serve to negate any inference of "willful" misclassifications, reducing the statutory window of liability, and may evidence the "good faith" necessary to overcome the FLSA's liquidated damages clause. See 29 U.S.C. 260.

In-house and outside counsel should also work together to ensure continued compliance, though the policing responsibilities ultimately rest with in-house counsel. Preventative measures such as regular training for managers and human resource professionals, checklists for exemption changes owing to promotions or transfers, and rigorous record-keeping protocols can keep the issue fresh and stave off future problems. In-house counsel should consider alternative financial safeguards, such as the use of arbitration agreements or the implementation of a fluctuating workweek. Because each client is different, there is no magic formula for compliance. Accordingly, in-house and outside counsel must work together to determine the most fitting approach.

Internal wage-and-hour audits can indeed be a time-consuming and laborious process. However, effective partnering of in-house and outside counsel will produce important benefits, placing the client in a more advantageous position than when the process began. Problems once hidden and undetected can be exposed, and, in most cases, swiftly remedied. In the instances when problems mature into litigation, an established partnership developed from the audit process arms the client with an outside counsel uniquely prepared to anticipate and favorably resolve disputed issues. This relationship need not end: indeed, the familiarity and trust established through the audit process may provide the foundation for an effective partnering between in-house and outside counsel on various other issues for years to come. NLJ