The Metropolitan
Corporate Counsel®

www.metrocorpcounsel.com

Volume 14, No. 10 October 2006

Proper Payroll Practices Continue To Challenge Employers Large & Small

Barbara Hoey

KELLEY DRYE & WARREN LLP

National retailer Sears, Roebuck & Co. recently paid $15 million to settle a federal class action lawsuit where it was accused of failing to pay overtime to 16,000 service technicians for time they spent traveling to work assignments, in violation of the Fair Labor Standards Act ("FLSA"). A federal court just certified a class action challenging the "exempt" status of 450 managers of FedEx Kinko's. A number of large securities firms like Merrill Lynch, Smith Barney and Bear Stearns have also been forced to pay huge settlements, to resolve class actions alleging that they failed to pay overtime to their retail brokers.[1] Likewise, companies like CVS, Wal Mart, Home Depot, Starbucks and Pizza Hut have either settled or have been forced to defend their payroll practices in FLSA class actions.[2] Unfortunately, these cases are not an anomaly: in 2006 wage and hour suits continued to proliferate and these cases are on the agendas of plaintiffs' attorneys, union attorneys, and regulatory agencies alike. Virtually every industry has been "hit" with a wage/hour class action. What is happening and how can you avoid becoming a "victim" of this epidemic?

The FLSA class actions over the recent years generally fall into two broad categories, and in neither category is the employer intentionally ignoring overtime obligations or refusing to properly compensate employees. The pattern which continues to emerge is companies who believe they are in compliance with applicable law, but run afoul because of unknown or "hidden" issues within their compensation system.

Barbara Hoey

The first category of cases are the "misclassification" cases. Here, the employer classifies a particular category of workers as "exempt" – most typically as "managers" – when the employees in reality do not meet the criteria for the managerial exemption. That is the issue in most of the class actions in the retail industry. The second category of cases involve employers who are accused of not paying for all "time worked" by their non-exempt employees Again, these cases by and large do not involve companies which are intentionally failing to pay overtime to their employees. The companies know the workers are "non-exempt," and entitled to overtime. They are also keeping track of hours and paying overtime, *when* they believe overtime pay is required. That is the key issue – is the employer actually capturing all of the hours the employees are working? The problems occur when the employer does not properly account for all of those hours worked.

It is not always obvious to the employer what time must be "counted" as "hours worked." In the Sears' case, it employed service technicians who performed in-home repairs on appliances and electronics. Most of the technicians worked from home. Sears used a remote dispatch system, which required the technicians to download at home information about their daily work assignments, before traveling to their first job of the day. However, Sears did not deem technicians to have started their workday (and thus did not pay them), until they arrived at their first scheduled job. It thus did not pay for the time spent traveling from home to the first job site.

A group of technicians objected to this pay practice. They claimed that their workday began from the time they were required to download their work assignments using the home dispatch system, and that Sears failure to pay for the time they spent traveling from home to their first scheduled job violated the FLSA. Eventually, this turned into a class action lawsuit, involving claims by thousands of employees in multiple states, seeking back pay.

Under FLSA regulations and the "Portal to Portal Act," "commuting time" is generally not compensable "working time." 29 C.F.R. § 785.35. Such commuting time is considered "incidental" to the employee's daily work activity, and thus is

***Barbara Hoey** is Co-chair of the Labor & Employment Practice Group of Kelley Drye & Warren LLP residing in the New York City office.*

Please email the author at bhoey@kelleydrye.com with questions about this article.

not considered working time. Indeed, the Second Circuit in New York, has held that – even when an employee spends hours "commuting" from home to jobsites, that time is generally not compensable. *See Kavanaugh v.Grand Union*, 192 F.3d 269 (2d Cir.1999). Likewise, and more recently, the Tenth Circuit held that an employer was not required to pay oil rig employees who also spent hours traveling to their jobs, carrying equipment and paperwork for that "travel" time. *Smith v. Aztec Well Servicing Co*., 2006 U.S. App. Lexis 23189 (10th Cir., 2006).

However, once an employee has "clocked in" or reported for work, the time spent traveling to a worksite may under certain circumstances be deemed working time. 29 C.F.R. § 785.35. The Sears situation was a close case. While Sears steadfastly maintained that its employees' downloading work assignments via the home dispatch system did not constitute the equivalent of "clocking in," it agreed as part of the settlement to alter its pay policies. This case should be of particular interest to any employer which, like Sears, has non-exempt employees who work from home or "clock in" remotely before going out to their work assignments.[3] Employers with workers who fit into that category must make sure they are paying from the first point the employee begins working. [4]

Commuting time is not the only challenge facing employers in properly accounting and paying employees for "all hours worked." As an example, in February 2006, a chain of funeral homes paid over $4 million dollars to settle claims that it wasn't paying employees for work done after normal hours. The employer was paying "flat rates" or "bonuses" for the extra work – but these rates were not based on the hours the employees actually worked. Again, the employer never intended to violate the law – but did – because non-exempt employees generally must be paid based on hours worked. Likewise, in July 2006 a school was found liable for overtime to instructors, who were working extreme hours but without the school's actual knowledge. *Fletcher v. Universal Technical Institute*. M.D. Fla. (6/15/06). The court held that the employer could not avoid liability for overtime by "issuing rules prohibiting" overtime or saying it "didn't know" the employees were working late. If the employee works and the employer has "constructive knowledge" of the work – it was required to pay the overtime. That is in fact the law.

The second category of cases – the "mis-classification" cases – seem to continue to bedevil employers. In the retail sector, large chain stores are an obvious victim because of the sheer number of managers. However, it is not just the large chain which is at risk. Any retailer – whether you have 5 or 500 stores – should periodically examine the actual duties of its managers. Have someone in upper management spend a few hours at the stores each month, just observing operations to make sure the managers are spending the majority (over 30%) of their time on "managerial" duties. If she is not – then staffing of the facility needs to be re-vamped so that the manager is truly "managing."

The problem doesn't only exist in retail – if you are in a service industry, you too must be concerned with whether your managers are really "managers."

Avoiding wage and hour lawsuits should also be of paramount importance to employers with non-union employees. Unions are looking for ways to organize the unorganized. Their latest tactic is to generate and bankroll class action wage and hour suits on behalf of an employer's non-union workforce. As a prominent union attorney pointed out during a recent American Bar Association panel discussion on employee class actions: "The goal is that the lawsuit, for the benefit of the employees, will make the employees more amenable to the union's organizing efforts."

In August 2004, the United States Department of Labor issued new regulations regarding the so-called white collar exemptions of the FLSA. Those regulations dramatically altered the analysis an employer must undertake to determine whether an employee is exempt or non-exempt under the overtime requirements of the FLSA. The regulations are not a model of clarity. If a group of employees you are now claiming as professional or executive or administrative employees no longer fits within that exempt status, the back pay and liquidated damages potential can be costly and damaging to your organization's credibility as an enlightened management. That's when union lawyers come knocking.

The best way to avoid these types of pitfalls is corrective action *before* you are hit with a lawsuit. Auditing your payroll practices for compliance with federal and state wage and hour laws, and taking action to fix any potential problems is essential in this climate. You can and should be aware of whether your non-exempt employees are being properly paid and whether employees classified as "exempt" are properly classified.

The following are some notable "hot spots" to examine where potential FLSA claims are:

Are "exempt" employees truly performing "exempt" duties (i.e., managerial, professional or administrative duties)? Are your managers spending the majority of their time managing or stocking shelves?

• Are exempt employees being paid on a salaried basis?

• Are you capturing and recording all of the hours your non-exempt staff are actually working?

• Do you have a rule which "prohibits overtime?" Is that rule being enforced? Are those who work overtime in violation of the rule nonetheless compensated for those hours ?

• Are you properly compensating for time spent at company meetings, required prep work and other "pre-shift" or "post-shift" work?

• If non-exempt employees are permitted (or required) to work from home or remote locations – how are you keeping track of their work time?

• Are non-exempt employees paid when they continue working after the end of a shift, in order to finish other assignments?

• How are you calculating overtime? Do you know how to compute the employee's "regular rate"?

A review of these and other relatively simple issues now could save you thousands or even millions of dollars later, and thus is well worth the effort.

---

[1] BNA Daily Labor Report, *9/13/06. Smith Barney (now part of Citigroup) was reported to have paid $98 million dollars to its brokers, who were allegedly mis-classified.* BNA Daily Labor Report, *5/25/06. Merrill Lynch agreed to pay $37 million to settle the overtime claims by California brokers in California.* BNA Daily Labor Report *8/11/05. UBS paid $89 million to settle a similar class in February 2006 and in March Morgan Stanley paid $42.5 million in a settlement.* BNA Daily Labor Report. *5/25/06.*

[2] *Pizza Hut just agreed to pay $12.5 million dollars to settle an action alleging that it "mis-classified" its managers.* BNA Daily Labor Report, *7/10/2006. A chain in the South, "Family Dollar Stores", paid $19 million to settle claims by their managers that they were "mis-classified".* BNA Daily Labor Report, *3/7/2006.*

[3] *The only comparable group for whom this would not be an issue are outside sales employees. Generally , outside* sales *employees are exempt from overtime requirements. Outside service technicians, however, are not.*

[4] *Similarly, in* Twiddle v. RKE Trucking Corp.; *(S.D.Ohio, 2006) a district court found that time spent by truck drivers on trip preparation, company meetings, pre-trip truck inspections and other tasks was compensable working time.*