

CFO

October 1, 2006

Pain-and-a-Half

By John Goff

What's behind the startling rise in overtime lawsuits? Confusion, collusion, and a dash of retribution.

File it under "No good deed goes unpunished." Two years ago, when the Department of Labor revised the Fair Labor Standards Act (FLSA), the intent was to clear up confusion regarding overtime pay. Instead, the always-thorny matter of who qualifies for overtime pay was made worse, not better, and a slew of lawsuits have resulted. In some cases it appears that companies knowingly violated the rules in an effort to aggressively reduce labor costs, but others may find themselves on the wrong side of the law despite their best efforts to obey it.

A pending class-action case against Lowe's, in which employees allege that they were not properly compensated for working additional hours, is widely seen as a sign of things to come. Disputes about who is owed overtime pay — and how much — have created a booming market in employment litigation. Sam Smith, a managing partner at Tampa-based Burr & Smith, says his firm sees overtime suits outnumbering discrimination suits by nine-to-one.

While some high-profile cases, such as a 2002 verdict in favor of Wal-Mart employees, have hinged on managerial misconduct, the complexity of the FLSA and a welter of state laws often result in honest mistakes. Last year, for example, Farmers Insurance Exchange ended up paying around \$52 million in back pay after a judge found that the company had incorrectly assessed the overtime status of claims adjusters. Marquee corporations including IBM and JP Morgan face wage-and-hour lawsuits that, while varying in their particulars, share one common theme: employees claim they were incorrectly branded as being ineligible for overtime pay. "The federal overtime law is confusing for many employers," says Penny Morey, managing director at CBIZ Human Capital Services. "Even HR professionals don't always understand it, so line managers are even less likely to follow it correctly."

Straw Bosses and Legmen

There's little doubt the FLSA was due for an update. Enacted during FDR's Administration, the act still included references to job titles like keypunch operator, legman, and straw boss. "There was a sense that the FLSA was a New Deal relic with no relevance," says Joseph Baumgarten, a partner at Proskauer Rose. "It did not address a modern service economy."

The DoL's revisions included changes to the job-duties tests — the first substantial overhaul of the guidelines in 55 years — that attempt to clarify which workers are exempt (that is, not eligible for overtime) and nonexempt (overtime-eligible). Generally speaking, salaried workers who are professionals, highly educated, or who perform true managerial functions are not entitled to overtime. The mere fact that an employee is "salaried," however, does not necessarily make the worker exempt, hence the need for a series of tests (essentially an analysis of the skills and duties of a given position) to see which employees fall into which classification.

In updating the FLSA, officials at the DoL conceded that their own investigators found it difficult to decipher the law. The agency also acknowledged that confusing and antiquated regulations had allowed "unscrupulous employers to avoid their overtime obligations." But rather than reduce

complaints, the revisions increased employee awareness about the rights of salaried workers. "When the DoL revised the wage-and-hour regulations, it galvanized people's sensitivity to them," explains Baumgarten. "Employees started asking themselves, 'Why haven't I been paid overtime?'"

The numbers tell the tale. According to the Administrative Office of the U.S. Courts, there were more than 4,000 FLSA-based civil suits filed last year. That's a nearly 50 percent increase over the number of wage-and-hour cases filed in 2003 — the year before the DoL revised the law. "The day the new regs came out," recalls Albert J. Solecki Jr., a partner in the labor employment practice at Goodwin Procter, "you could go online and find 20 advertisements from plaintiff's side law firms eager to explore potential overtime violations."

Some of the trouble stems from a common misconception that if an employee is salaried, overtime pay goes out the window. Given that many employees ask to be salaried (perceiving it as a status-booster) and managers are often happy to comply (seeing it as a way to save money), a potential problem may balloon until a lawsuit comes along to pop it.

Some employers try to dance around the issue by giving salaried workers lofty titles that suggest plenty of managerial discretion, when in fact the employee has none. But Solecki notes that "the first thing the DoL will do when evaluating whether an employee is properly classified as exempt or nonexempt is look at the employee's job description and the actual tasks the employee performed — not the job title."

Another common misstep is the creation of special accommodations for an employee, such as flexible work hours or trading comp time for extra hours worked. Even though the arrangements often benefit the employee, as Bill Coleman, chief compensation officer at Salary.com, notes, "they don't override the Fair Labor Standards Act."

OT on the QT

Unfortunately, say employment experts, it's nearly impossible for senior executives to spot such agreements. "A CFO isn't really in a position to see off-the-clock time," says John E. Thompson, partner at Fisher & Phillips. "Only a supervisor is in a position to see it." Sometimes supervisors choose not to see it. Off-the-clock arrangements tend to boost productivity, which makes a supervisor look good.

The existence of a firm corporate policy seems to make little difference. Raj Ganesan, director of corporate performance at a leading business consultancy, estimates that about 80 percent of the companies he deals with have rigorous wage-and-hour policies. But those policies are often violated at lower to middle levels. And even senior managers may adopt a "don't ask, don't tell" attitude.

Some plaintiff's attorneys say the labor squeeze is even more insidious. They contend that some companies compare the cost of potential litigation to the cost of paying time-and-a-half for thousands of workers, and decide to risk litigation. One plaintiff's attorney litigated a case in which the defendant ended up paying \$7.5 million to the plaintiffs. The suit's class, however, made up only about 15 percent of all employees who were actually entitled to the back pay. The lawyer reckons the overtime pay owed to all eligible workers topped \$50 million. "Even if a company is caught," he concludes, "it may not have to pay as much in court as it would if it had paid the overtime in the first place."

As larger settlements are handed down, and as more suits proceed, the equation may change. In May, Citigroup's Smith Barney brokerage unit agreed to pay nearly \$100 million to settle claims that the investment bank had failed to pay current and former brokers overtime. And the IBM suit, which affects tens of thousands of workers, could result in a massive payout. In the complicated matter of exempt versus nonexempt, no company, it seems, is exempt from risk.