



U.S. Department of Labor Emphasizes Enforcement of Fair Labor Standards Act Classifications: Are Your Employees Correctly Classified?

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As employers are acutely aware, properly classifying employees under the federal Fair Labor Standards Act ("FLSA") presents many challenges. Exempt categories are numerous and complex and may inadvertently be jeopardized when seemingly unrelated employment actions are taken (such as payroll deductions). Determining whether to classify an individual as an "employee" or "independent contractor" requires an intense fact-specific analysis of up to 20 different factors established by different government agencies. In the face of such classification challenges, the U.S. Department of Labor's Wage and Hour Division ("DOL") recently announced that its goal is to emphasize compliance to replace what it has described as a "catch me if you can" system. A series of recent wage and hour settlement agreements into which the DOL entered with employers early this year seems to suggest that the DOL is making good on its promise and also highlight the high monetary costs that can come with FLSA misclassification.

The DOL's stepped-up enforcement measures emphasize the importance for employers to ensure that employees are properly classified under the FLSA. To this end, employers should take note of common employer misclassification errors and review and evaluate current employee classifications to ensure they are in compliance with the FLSA.

Common Employer Misclassification Errors. Although by no means an all-inclusive list, the following are some examples of errors employers commonly make when classifying employees under the FLSA.

- **Classifying all salaried employees as exempt from the FLSA's wage and hour provisions.** Being paid on a salaried basis is a requirement for many of the FLSA's exempt classifications, but the mere fact alone that an employee is paid a salary, no matter how large, does not in and of itself mean that s/he is exempt from the FLSA's wage and hour provisions. Each exempt category (*e.g.*, executive, administrative, professional, outside sales employees, commissioned sales employee, etc.) has its own specific test, and the job duties for each employee receiving a salary must be evaluated in order to conclude whether the exemption applies.
- **Classifying employees as exempt or non-exempt based primarily on their job title.** Under the FLSA, employment positions, not job titles, must be classified accurately. To this end, an employee's job title is no more a definitive determining factor than is the simple fact that an employee receives a salary, as described above. An employee, for example, may be given the title of "manager" or "assistant manager" though his or her job duties do not entail the type of managerial duties required for an FLSA exemption to apply. An employee's job duties and responsibilities, not just his or her job title, must be evaluated to ensure proper classification.
- **Classifying as exempt any individual who works in sales or is paid on a commission.** The FLSA exemption applicable to salespersons applies only to employees who are engaged in "outside sales," such as at customers' places of business. In contrast, the exemption does not apply to any employee engaged in sales at any of the employer's places of business, nor does it apply to salespersons who conduct sales by mail, telephone or the Internet. Likewise, the FLSA considers employees who are paid on a commission basis generally to be non-exempt and thus subject to overtime pay *except* when they receive more than half their compensation in the form of commissions at a "retail or service establishment."

- **Classifying an employee as an independent contractor.** An individual is not properly classified as an independent contractor merely because the parties agree to such a classification. Instead, the difference between an independent contractor and an employee is determined by a number of factors, including the nature of the relationship, the degree of control retained by the employer and the permanency of the relationship, among others. Employers generally do not have to withhold or pay any taxes on payments to independent contractors, making them an attractive option to employers. Misclassification, however, has far reaching and costly consequences, ranging from penalties to class action lawsuits for unpaid benefits and overtime.

The High Costs of Misclassification. Employers that fail to properly classify employees under the FLSA's wage and hour regulations face substantial risk. The FLSA contains a penalty provision that allows employees in some circumstances to recover twice their actual back wages and automatically entitles prevailing employees to recover their attorneys' fees. Misclassifying an employee as an independent contractor may additionally result in tax penalties. These items, in addition to the general costs that come with defending against wage and hour actions, can turn even a "minor" FLSA violation into an extremely expensive problem. With the DOL's recently announced intention to focus on enforcement, the risk that non-compliant employers will incur these liabilities will no doubt increase. This projection, of course, does not account for employer liabilities resulting from private party actions, the impact of which cannot be discounted. According to the law firm Seyfarth Shaw's annual report on workplace class action litigation, in 2009 the 10 largest private wage and hour settlements totaled nearly \$364 million, 44 percent more than the 10 largest settlements in 2008. Of more specific note to Washington employers, Washington was included on that firm's list of nine states with the most significant growth in wage and hour litigation.

An Employer's Bottom Line: Take Time to Thoroughly Evaluate FLSA Classifications. The DOL's heightened enforcement efforts, in addition to the rising number of wage and hour lawsuits in Washington, demand that employers take FLSA compliance seriously. Employers should make sure that their employee classifications are reviewed and updated regularly. In light of the complexities surrounding FLSA classifications, employers wishing to review and/or reclassify their employee classifications may wish to consult legal counsel.

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