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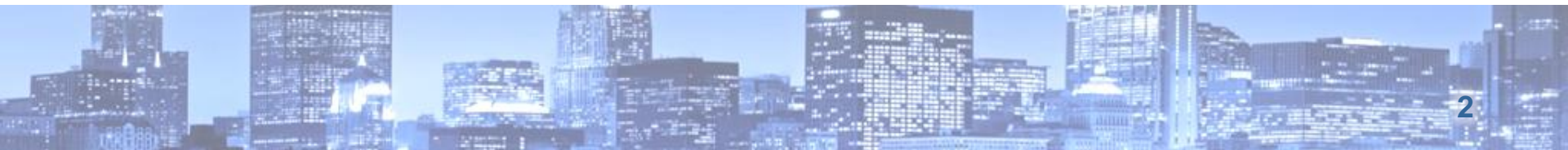
# **The Three Ways Employers Misclassify Employees – And How Your Company Can Get It Right**

Presented by: Neil H. Dishman

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# WHY MISCLASSIFICATION MATTERS

- 3,426 federal wage-hour lawsuits in 2004
- 7,046 suits last year
- There are now more wage class-actions filed than discrimination class-actions
- And that's just in federal court . . .
- USDOL: \$280M in back wages collected for 300,000 employees last year



# WHY MISCLASSIFICATION MATTERS

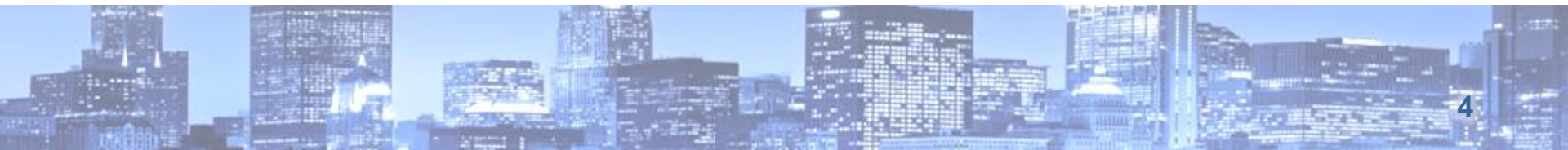
So . . . why the explosion of litigation?

- Archaic, counterintuitive laws
- Metastasizing liability
- Big penalties and mandatory fee-shifting
  - Back pay, liquidated damages, attorney's fees
  - Often inflated because no record of hours worked



# WHY MISCLASSIFICATION HAPPENS

- “Common sense”
- “The way we’ve always done it”
- “The way everybody in our industry does it”
- “It has to be salaried, or we will draw inferior talent”
- “Hey, as long as no one complains about it . . .”
- Sheer ignorance

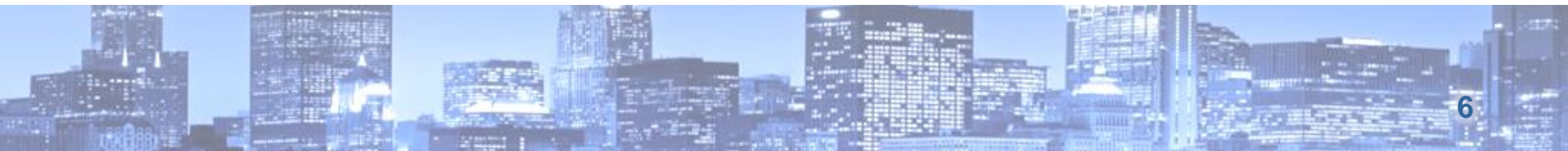


# TODAY'S GOALS

- Draw proper distinctions between:
  - Exempt vs. non-exempt employees
    - Executive
    - Administrative
    - Professional
    - Outside sales
  - Employees vs. “independent contractors”
  - Paid employees vs. unpaid “interns” or “volunteers”
- A note on federal vs. state law . . .

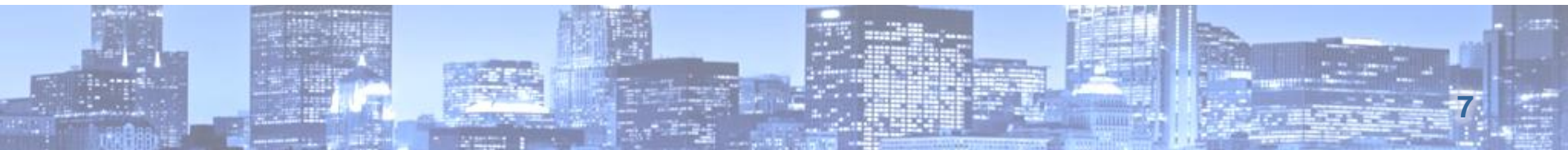
# HOUSEKEEPING

- About Neil and about Jackson Lewis
- Questions, during and after (and meet Alison Crane)
- Slides/handouts



# EXEMPT V. NON-EXEMPT

- *Everyone* gets overtime pay – unless *employer* can prove an exemption
- “Plainly and unmistakably” is the standard
- Covering the four most common – executive, administrative, professional, and outside sales exemptions
- Basics of exemptions
- Common traps



# POP QUIZ!

- Can these jobs be classified as exempt?
  - Manager of 10-employee operation in factory
  - Assistant manager of a large retail store
  - Insurance claims adjuster
  - Accounts payable manager
  - Accountant at “Big 4” firm with 3 years’ exp.
- MAYBE.
- Not one is a slam dunk to be exempt. Many are the subject of massive collective actions.



# “WHITE COLLAR” EXEMPTIONS

- The three most common – executive, administrative, and professional – have two big parts:
  - Salary Basis
  - Duties
- Outside sales exemption does not have “salary basis” requirement – only a duties test



# EXEMPT V. NON-EXEMPT: “SALARY BASIS”

- “Salary basis” means that a portion of employee’s compensation must be a fixed weekly amount that is not subject to reduction based on quantity or quality of employee’s work.
- So, no docking the employee for being late, leaving early, or doing poor work.
- Salary must be at least \$455/week (\$23,660/year)

# EXCEPTIONS TO “SALARY BASIS” RULE

## **Deductions from salary can be made for:**

- Full day absences for personal reasons, other than sickness or disability
- Full day absences due to sickness or disability if deductions made under a bona fide plan, policy or practice of providing wage replacement benefits for these types of absences

# EXCEPTIONS TO “SALARY BASIS” RULE

## Deductions from salary can be made for:

- First or last week of employment, so long as the employee is paid a proportionate share of salary for time actually worked
- Penalties imposed in good faith for violating safety rules of “major significance”
- FMLA qualifying leave for partial and full day absences
- Offset of salary for monies received for jury fees, witness fees or military pay
- Good faith full day disciplinary suspensions for violating written workplace conduct rules

# EXEMPT V. NON-EXEMPT: EXECUTIVE

- Primary duty is the management of the company or of a customarily recognized department or subdivision of the company.
- Customarily and regularly directs the work of (*i.e.*, supervises) two or more other employees.
- Has power to hire and fire employees, or recommendations about hiring, firing, and other changes of status for other employees are given particular weight.
- Customarily and regularly exercises discretionary powers.
- And, in Illinois . . .
- The employee does not devote more than 20 percent of his time to activities which are not directly and closely related to the above.

# EXEMPT V. NON-EXEMPT: EXECUTIVE

- Common problems:
  - Management is *a* duty, but not the *primary* one
  - Employee's hiring and firing power is purely theoretical
  - Employee does not really have much discretion in other matters (more on this in a bit)
  - 20% test is often a killer on this one

# EXEMPT V. NON-EXEMPT: EXECUTIVE

- Jobs commonly misclassified as exempt here:
  - Foreman
  - Crew Leader or Line Leader
  - Assistant Manager
  - Shift Manager
  - [insert name of department here] Manager
  - [insert verb or noun here] Supervisor
- Industries at particular risk:
  - Retail
  - Manufacturing
  - And the “second level up” at just about any employer

# EXEMPT V. NON-EXEMPT: ADMINISTRATIVE

- Primary duty is performing office or non-manual work directly related to management policies or general business operations of the company or the company's customers.
- Customarily and regularly exercises discretion and independent judgment.
- Does one of the following things:
  - Regularly and directly assists the proprietor of the company or another “executive” or “administrative” employee;
  - Performs under only general supervision work along specialized or technical lines requiring special training, experience, or knowledge; or
  - Executes under only general supervision special assignments and tasks.
- And, in Illinois . . . the employee does not devote more than 20 percent of his/her time to activities which are not directly and closely related to the above.



# EXEMPT V. NON-EXEMPT: ADMINISTRATIVE

- Common problems:
  - Bachelor's degree + office job  $\neq$  exempt
  - Not “directly related to” management or general operations; production, not management
  - Independent judgment and discretion!
    - Evaluating and choosing among different courses of action
    - Not mere application of skill, even great skill

# EXEMPT V. NON-EXEMPT: ADMINISTRATIVE

- Jobs commonly misclassified as exempt:
  - People who report to someone who fits this exemption, such as low-level HR, accounting, IT
  - Administrative assistants
  - And . . . the dreaded . . . “everyone in the office is salaried.”
- Industries at particular risk:
  - Any white-collar business or department
  - Financial services

# EXEMPT V. NON-EXEMPT: PROFESSIONAL

- Primary duty is the performance of work requiring knowledge of an advanced type in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction
- OR
- Primary duty is the performance of work requiring invention, imagination, originality or talent in a recognized field of artistic or creative endeavor.
- And:
- Consistent exercise of discretion and judgment
- Work predominantly intellectual and varied in character
- And, in Illinois . . . the employee does not devote more than 20 percent of his/her time to activities which are not directly and closely related to the above.

# EXEMPT V. NON-EXEMPT: PROFESSIONAL

- Common problems:
  - Degree not “advanced” enough
  - Discretion and judgment (again)

# EXEMPT V. NON-EXEMPT: PROFESSIONAL

- Jobs commonly misclassified as exempt:
  - Junior accountants
  - Junior engineers
  - Social workers
  - Paralegals
- Industries at particular risk:
  - Professional firms, particularly CPA firms
  - Social-service/humanitarian agencies

# EXEMPT V. NON-EXEMPT: OUTSIDE SALES

- No “salary basis” requirement
- Just two duties required:
  - Primary duty of making sales or of obtaining orders or contracts for services or for the use of facilities; and
  - Customarily and regularly engaged away from the employer’s place or places of business
- Inside salespeople very difficult to make exempt. Only in retail setting, and then only under strict conditions.

# EXEMPT V. NON-EXEMPT: A NOTE ABOUT I.T. EMPLOYEES

- Federal law has a couple of specific exemptions for various types of IT professionals – but Illinois law does not.
- In Illinois, must squeeze them into the administrative exemption, or make them non-exempt.
- Under either law, “help desk” ≠ exempt.

# EMPLOYEE V. INDEPENDENT CONTRACTOR

- Another pop quiz!
- Is this person an independent contractor?
  - Highly skilled/experienced professional
  - Approached company seeking “contract work”
  - Negotiated and signed “Independent Contractor Agreement”
  - Both company and worker always intended for this to be a contractor relationship
  - Paid on a 1099



# EMPLOYEE V. INDEPENDENT CONTRACTOR

- Answer: who knows?
- And that's the problem. Parties' intent and agreement is only one factor out of many.
- What matters is whether worker meets any statutory definition of "employee." If he/she does, it doesn't matter what was intended or agreed.

# EMPLOYEE V. INDEPENDENT CONTRACTOR

- Many different tests:
  - IRS
  - DOL
  - EEOC
  - Unemployment
- But they are mostly the same. And common sense does actually help here.

# EMPLOYEE V. INDEPENDENT CONTRACTOR

- Four key questions:
  - Does this person have a meaningful opportunity for profit or loss?
  - Does this person have a legit business?
  - Is this person's function ancillary to your business, rather than primary?
  - How much control does company exercise over the performance of the work?

# EMPLOYEE V. INDEPENDENT CONTRACTOR

- Bad signs:
  - You are contractor's only customer
  - Contract is with a person, rather than with a business entity
  - You provide training
  - You provide tools, equipment, office space
  - Outsiders would assume the person is your employee
  - Contractor does same type of work as employees
  - Contractor used to be your employee, before you "outsourced" the position

# EMPLOYEE V. INDEPENDENT CONTRACTOR

- Why you need to get this right:
  - IRS withholdings
  - Worker's compensation
  - Overtime
  - Minimum wage
  - Unemployment taxes
- Two special notes about unemployment:
  - Contract with person or with entity?
  - Very often the genesis of a dispute . . . and an audit

# EMPLOYEE V. INTERN

Intern? Trainee? Not unless six things are true:

- (1) The training is similar to that which would be given in a vocational school;
- (2) the training is for the benefit of the trainees or students;
- (3) the trainees or students ***do not displace regular employees***, but work under close observation of regular employees;
- (4) the employer that provides the training ***derives no immediate advantage*** from the activities of the students - the employer's ***operations may actually be impeded***;
- (5) the trainees or students are not necessarily entitled to a job at the conclusion of the training period; and
- (6) the employer and the trainees or students understand that the trainees or students are not entitled to wages for the time spent in training.

# EMPLOYEE V. INTERN

- Bottom line: what is the company's motivation for providing this "internship"?
  - Is it altruistic, almost like community service?
  - Or is it to "get some old projects done"?
- A final note: beware "volunteers" in the non-profit world

# NOW WHAT?

- *DO A SELF AUDIT.*
- Now you know where the trouble is likely to be. Go find it. And fix it. Before the DOL or a plaintiff's attorney does it for you.
- Why?
  - The U.S. Department of Labor (“DOL”) estimates 70% of employers are not in compliance with FLSA
  - Wage-hour litigation is fast becoming (if it is not already) the most dangerous area for employers
  - Risk of catastrophic class-actions higher here than anywhere else

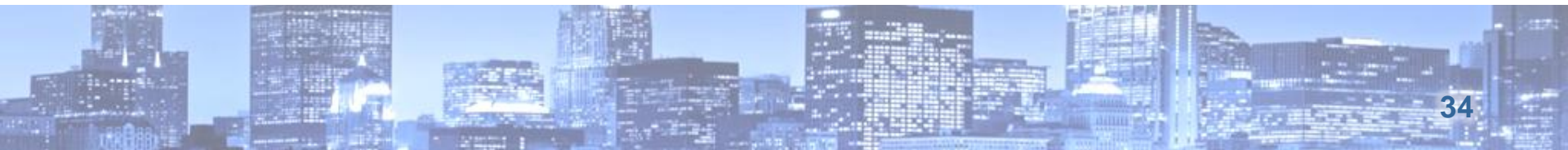


# OVERCOME INTERNAL OBJECTIONS TO A SELF-AUDIT

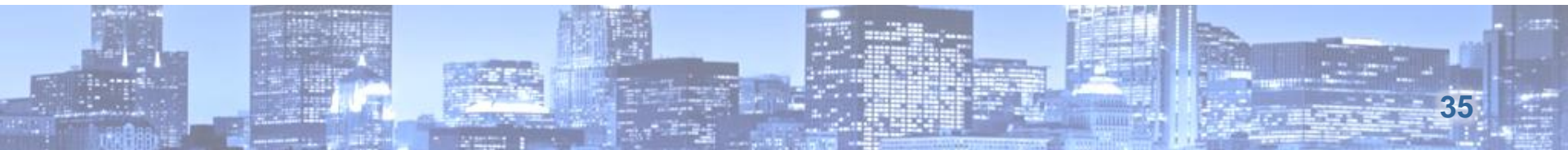
- The excuses you will hear, or may even tell yourself:
  - “We’ve never been sued on this before.”
  - “Our entire industry does it this way.”
  - “This is obscure stuff – our employees don’t know about it.”
  - “Making these changes will upset employees and increase our chances of getting sued.”
  - “It will cost too much.”
- Finally, a dirty trick . . . the specter of individual liability.

# CONSIDER USING OUTSIDE COUNSEL FOR SELF-AUDIT

- Audit will ordinarily be protected by the attorney-client privilege.
- Reliance on attorney's advice can create "good faith" defense in subsequent lawsuit.
- The "plaintiff's-eye view" can be invaluable.



# TIME FOR HAPPY HOUR



# THANK YOU!

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