EMPLOYMENT PRACTICES LIABILITY CONSULTANT

Wage-and-Hour Audits: The Time (As Always) Is Now

By Noel Tripp, Esq.

This article discusses an essential risk management technique: an employer's preventive review (privileged, if conducted by an attorney) of its compliance with the federal Fair Labor Standards Act (FLSA) and state "wage-and-hour" laws to assess exposure to legal claims and/or agency investigation. A preemptive wage-and-hour audit can (1) identify major sources of exposure for correction and risk management and, (2) properly conducted, provide a complete or partial "good faith" defense to asserted claims.

As the number of wage-and-hour claims has exploded over the last decade-plus—many of them brought as putative class or collective actions on behalf of many workers—the importance of ensuring compliance with these laws has increased. This challenge has been compounded over the last several years by an increasingly "patchwork" body of wage, wage payment, wage notice, and paid leave laws enacted at the state and city level.

To reiterate, the goals of an audit are to

- identify and proactively address wage-and-hour exposures that could give rise to employee complaints;
- respond to changes in the law (and assess potential protective responses);
- prepare for defense of a lawsuit or agency wage and hour audit/investigation;
- demonstrate "good faith" efforts to comply with applicable law, avoid "willful" findings, and potentially support defenses preventing an assessment of liquidated damages; and
- raise stakeholders' (legal, human resources [HR], management) awareness of the importance of wage and hour compliance.

Background Regarding the FLSA and State Wage Laws

What are we auditing, exactly? Among the oldest statutory protections in employment law, the FLSA was enacted in 1938 as part of the New Deal. While it is often confusing because coverage provisions and mandates have changed, its core principles remain the same: covered employees must receive at least the minimum wage for all hours worked (currently

$7.25/hour, where it has remained since July 24, 2009) and also must receive time-and-one-half of their "regular rate of pay" for hours worked above 40 in a week.

Despite this seeming simplicity, the FLSA and state law remain a source of "gotcha" liability for employers, due to (1) the Department of Labor's (DOL) complicated and often reinterpreted regulations implementing the FLSA's overtime requirements and (2) the continued expansion of state and municipal laws, which supplement the federal "floor" provided by the FLSA. This combination creates major headaches for those with operations in many jurisdictions. In addition to setting a different minimum wage or overtime rule (such as California's daily overtime provision), state and city laws can require meal and rest breaks, so-called spread of hours payments for lengthy work days, and paid time off. The laws may also provide penalties for failure to comply with notice and record-keeping requirements.

Why Conduct an Audit: Volume of Wage Claims, Including Class and Collective Actions, Remains High and Exposures Large

The reason to conduct a wage-hour audit is simple: class and collective action lawsuits under the FLSA and state laws continue to be possibly the largest employment exposure for business. FLSA class action filings remained above 8,000 for 2016 (down slightly from the 8,954 filings in 2015, which does not include state court filings or arbitrations). Even a modest sized class or collective action—that is, one in which the named plaintiff seeks to represent 100 or so "similarly situated" current and former employees—can create exposures running into the seven figures in allegedly unpaid overtime, liquidated damages, attorneys' fees, and penalties. The FLSA and state laws, like many other employment laws, provide for statutory fee-shifting, requiring the employer to pay a prevailing FLSA plaintiff's counsel fees at reasonable hourly rates.

These figures and the potential for a large payday have not been lost on counsel for potential claimants. For example, 14 putative class actions—alleging that thousands of workers in Seattle hadn't been paid the new $15 municipal minimum wage—were filed by three Seattle law firms in February 2016, immediately after the law was upheld following legal challenges. Across the United States, the hospitality, transportation, and healthcare sectors, in particular, have been subject to endless rounds of lawsuits for more than 10 years.

The "What": Defining and Conducting the Audit

How does an employer assess its compliance with these laws? The only way, of course, is to investigate, analyze, and verify compliance. Here are some of the key considerations in undertaking and conducting that review.

Scope of the Audit

For single-location employers, the "scope" question may be an easy one: qualified counsel should review the employer's wage practices for compliance with the FLSA and other compensation-related laws. For larger employers and those in multiple jurisdictions, it is important to define the scope of the review. Common topics include the following.

- **Who is ineligible for overtime pay (and sometimes minimum wage as well)—"exempt" status.** More than 30 exemptions in the FLSA apply to designated types of workers. Businesses in most industries typically can apply only four or five of the most common—the so-called white collar exemptions for qualifying executive, administrative, and professional employees. Employers must review their use of these designations; the "exemption" is an affirmative defense for which the employer bears the burden of proof.

- **Computation of overtime for those who are "nonexempt"—that is, overtime eligible.** This review has two main components. For those workers not "exempt," the employer must maintain accurate records of time worked. The first aspect thus entails determining if all "work time" is being accurately captured. Second, where overtime is worked, an audit analyzes whether the employer is calculating the "regular rate" of pay correctly under DOL rules, including accounting for commissions, bonuses, piece rate, and other payments, especially such nonhourly payments.
- **Independent contractor or "joint employer" status.** This is a highly controversial area subject to increased scrutiny from the DOL and other agencies in recent years. Employers typically do not pay overtime (or, necessarily, a minimum wage) to individuals designated as independent contractors or to individuals deemed employers of another entity (such as a franchisee or subcontractor). An audit must seek to assess the risk of a finding that individuals are "misclassified" as contractors or that the business is a "joint employer" with another entity and thus is responsible for the wage practices (and potential noncompliance) of its business partner. A detailed analysis of the National Labor Relations Board's joint employer standard was provided in the Winter 2016 edition of *Employment Practices Liability Consultant*.
- **State law issues.** As noted above, employers with operations in multiple states must confirm that employees in each jurisdiction are treated appropriately for that specific jurisdiction. An FLSA-only (i.e., federal) review of an employer's practices, coordinated through its corporate office in a particular state, will not address the wage payment, wage notice, paid sick leave requirements, etc., of various municipalities. New York's new "regionalized" minimum wage[1] is an example of the complexities of state and local issues.

Mechanics of the Audit

In conjunction with defining the scope of the review, the employer must consider who will direct and conduct the audit. The more central the role of counsel, the greater the likelihood the employer will be able to assert that the products of the investigation are protected from discovery by the attorney-client or attorney work product privileges. *Deel v. Bank of Am.,* N.A., 227 F.R.D. 456 (W.D. Va. 2005) (applying attorney-client and self-critical analysis privileges to different types of documents prepared as part of internal FLSA review and ordering disclosure of some materials but not others deemed privileged); *Lewis v. Wells Fargo & Co.,* 266 F.R.D. 433 (N.D. Cal. 2010) (same). The attorney-client privilege generally is restricted to protecting *legal* advice and communications made in confidence for the purpose of seeking such advice. The attorney work product doctrine applies to material prepared "in anticipation of litigation." The "client" (the business conducting the audit) cannot be compelled to answer "What did you say or write to the attorney?" but may not refuse to disclose relevant *facts* within its knowledge or records in its possession. Employers utilizing internal or external HR (or other nonlegal consultants) to conduct an audit likely lack these protective privileges.

Once the internal roles and the audit scope are defined, counsel should set the rules for documenting that the review is being conducted for the purposes of obtaining legal advice and/or "in anticipation of litigation." Underlying documents (payroll records, performance

[1] As of December 31, 2016, New York's minimum wage depends on the location and size of an employer's operation, separating New York City into "Large" and "Small" employers with different minimum wage requirements and then dividing the balance of the state into two additional regions, each with its own wage rate. Confused yet?

evaluations, job descriptions) are not privileged and do not so become because they are reviewed. However, markups of such documents, analyses of what they show, and other work product can be. To preserve that privilege, their creation and identification must be handled with care: the paper trail must be clear and followed consistently.

Once those rules having been established, the designated law firm and/or client resources can begin compiling the underlying documents and providing them to auditing counsel. The nature of the review will dictate this process. For example, if auditing the employer's pay practices as to nonexempt (overtime-eligible) employees, the goal will be to pull a meaningful sample of records reflecting hours worked and wages received by employees covering different business units, job titles, and compensation structures. If auditing exempt status, the auditor may begin with a report reflecting the employer's exempt employee population, including the employees' job titles and compensation level/band. Together, auditor and client drill down in the areas of concern.

The Deliverable

Before beginning an audit, determine what will be done once it is completed. Is the employer seeking simply advice or an update on where it stands? Is it prepared to make immediate changes on the basis of the advice it receives? All of these questions bear on whether the initial audit findings should be reduced to a (hopefully privileged) writing. As discussed below, the FLSA's good faith defense can be based on a reliance on counsel—however, asserting such reliance likely entails waiver of the attorney/client privilege. The possibility of waiver should be discussed before such a writing is created (to say nothing of transmitted).

Where a written report is deemed appropriate, consider including

- a description of investigative process, including the document preparation, data analysis, legal evaluation, and other protocols established and used during review;
- a detailed summary of facts determined in the review and the sources thereof;
- an analysis of applicable federal, state, and local wage and hour laws and interpretations (including ambiguities or uncertainties in the law);
- a legal opinion as to whether there are compliance deficiencies;
- an analysis of legal defenses regarding "look back" corrective action;
- recommendations of corrective action and/or other risk management strategies; and
- possible preventive actions if changes are necessary (such as arbitration agreements).[2]

The FLSA's Good Faith Defenses

Another important consideration in any audit is the review's interplay with the FLSA's two statutory defenses: (1) a complete defense to liability based on reliance "in good faith … on any written administrative regulation, order, ruling, approval, or interpretation … or any administrative practice or enforcement policy" of the DOL[3] and (2) a defense to the FLSA's 100 percent liquidated damages provision where the employer establishes that the violation was "in good faith and that he had reasonable grounds for believing that his act or omission was not a violation [of the FLSA]."[4] The term liquidated damages under the FLSA is "something of a misnomer," as the award is not considered a penalty but "compensation to the employee occasioned by the

---

[2]The potentially crucial role of arbitration agreements with class and collective action waivers in risk management in this area should be noted, though it is outside this article's purview. The enforceability of such agreements is the subject of a consolidated appeal currently pending before the Supreme Court in *National Labor Relations Bd. v. Murphy Oil USA* (No. 16–307), *Epic Sys. Corp. v. Lewis* (No. 16–285), and *Ernst & Young LLP v. Morris* (No. 16–300).

[3]29 U.S.C. § 259.

[4]29 U.S.C. § 260.

delay in receiving wages." *Bowrin v. Catholic Guardian Soc'y,* 417 F. Supp. 2d 449 (S.D.N.Y. Mar. 6, 2006), quoting *Herman v. RSR Sec. Servs. Ltd.,* 172 F.3d 132 (2d Cir. 1999). As such, "double damages are the norm, single damages the exception." *Pavia v. Around the Clock Grocery, Inc.,* 2005 U.S. Dist. LEXIS 43229 (E.D.N.Y. Nov. 15, 2005), quoting *Reich v. Southern New Eng. Telcoms. Corp.,* 121 F.3d 58 (2d Cir. 1997).

Audits provide an opportunity for employers to receive legal advice and direction regarding DOL pronouncements, which can be used to assert these defenses in subsequent litigation. Until the Second Circuit's recent ruling in *Chowdhury v. Hamza Express Food Corp.,* 2016 U.S. App. LEXIS 21870 (2d Cir. Dec. 7, 2016), 100 percent liquidated damages under both the FLSA and state law could be awarded cumulatively, rather than only one such award being appropriate for a violation.

Privilege Considerations Relating to Good Faith

The attorney/client privilege cannot be both "sword" and "shield." Employers invoking the good faith defenses discussed above must be prepared for the plaintiffs to assert, in response, that the privilege has been waived by placing the employer's "state of mind" at issue. *Maar v. Beall's, Inc.,* 2017 U.S. Dist. LEXIS 29016 (S.D. Fla. Feb. 27, 2017) (ordering waiver and production of privileged documents based on assertion of good faith defense). In other words, an employer asserting the good faith defense has (it can be argued) asserted "his good faith belief in the lawfulness of his conduct, [which] is relied upon in support of [the] claim of defense." *Scott v. Chipotle Mexican Grill, Inc.,* 67 F. Supp. 3d 607 (S.D.N.Y. 2014). Privileged communications relating to that conduct may constitute "legal advice that [the] party received [which might rebut] … its claim of good faith belief." While the employer may contest such an assertion and the scope of any required waiver, disavowing any reliance on the communications at issue, this response must be anticipated, and litigation may be too late. The right time to assess the good faith defense is before and during your privileged wage-hour review.

Cost of a Wage and Hour Audit

As vital as a wage-hour law audit is to compliance and risk management, the percentage of employers electing to conduct such a review on a periodic or even a "one-off" basis remains relatively low. One likely issue is cost or perceived cost. Employers are justifiably hesitant to embark on a project potentially requiring hundreds of attorney hours to review job descriptions, performance evaluations, new hire documentation, and pay records. However, conducting a cost-effective, risk-reducing audit on an efficient basis is one of the hallmarks of a knowledgeable wage-hour attorney. Counsel and the employer must work collaboratively to

- establish a budget and corresponding scope of work, including
  - —the subject matter to be reviewed,
  - —the depth of the factual analysis to be conducted,[5]
  - —the laws at issue in the review, and
- efficiently allocate work (document gathering, document review, analyses) between firm and client resources.

Where possible, the parties should work together to establish a fixed, flat, capped, or other alternative fee arrangement to provide price certainty to both sides. See, generally, "No More Baby Steps," by Amy Miller (*The American Lawyer;* Dec. 1, 2009) (discussing Pfizer's innovative approach to alternative fee arrangement purchasing of legal services).

[5]For example, while a legal opinion regarding the exempt status of a particular position can only be rendered after careful, fact-intensive review of the position at issue, obvious areas of concern often can be identified without such a "deep dive."

Conclusion

Businesses continue to struggle with wage-hour compliance. Wage litigation is the largest and among the most common exposures they face. Such losses remain, for many businesses, uninsurable. The best cure is compliance, which can only be achieved after a thorough, privileged review of current practices. *EPLiC*

Noel P. Tripp *is a principal in the Long Island office of Jackson Lewis P.C. Since joining Jackson Lewis as a summer associate in May 2005, he has practiced exclusively in employment law and, early in his career, was involved in matters pending before federal and state courts and administrative agencies covering the entire gamut of employment-related matters. His principal focus is the defense of class and collective action lawsuits under federal and state wage-and-hour laws, including both "white-collar" misclassification actions as well as actions brought on behalf of hourly employees seeking to recover unpaid minimum, regular, and overtime wages, amounts unlawfully deducted from wages, unpaid commissions, and gratuities. He previously served as Coordinator for Jackson Lewis's wage-and-hour blog. He has spoken about wage-and-hour matters to the American Translators Association, the Women's Bar Association of New York, the New York County Lawyers Association, the New York City Bar Association, and other industry and professional associations, and he is a frequent speaker on wage-and-hour topics at Continuing Legal Education and Human Resources certification seminars, as well as Jackson Lewis's popular Long Island Breakfast Series.*

Mr. Tripp is a graduate of Dartmouth College (A.B. 1999) and Fordham Law School (J.D. 2006).

He can be reached at (631) 247–4661 or by email at trippn@jacksonlewis.com.