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LEGAL

BEST PRACTICES TO AVOID VIOLATIONS OF FEDERAL AND STATE OVERTIME LAWS



Many employers are under misconceptions about which employees are required by federal and state law to be paid overtime.

Some employers wrongly believe an employee is “exempt” from the overtime law if an employee has a college degree and is paid an annual salary. However, an employer cannot avoid required overtime payments merely due to an employee’s education level or payment of a salary.

Employees, regardless of education or training, are required to be paid overtime unless BOTH parts of a two part test is satisfied:

- the employee must be paid on a salary basis above the minimum threshold required by federal and state law (and the same salary must be paid each week regardless of the number of hours worked); and
- the employee’s job duties must meet one of the exemptions from the payment of overtime.

Overtime analysis is not one-size-fits-all in the United States. While federal law establishes the federal exempt/non-exempt requirements under the Fair Labor Standards Act (FLSA), individual states also have their own overtime laws.

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Accordingly, it is critical for employers to stay informed of both the federal and state laws in the states in which they operate.

Minimum Exempt Salary

The FLSA sets the benchmark for employers at the federal level. To qualify for exemption under the FLSA, employees generally must be paid not less than \$684 per week (\$35,568 per year). However, individual states can and have established their own minimum salary requirements. For example, most New York employers must currently pay an employee at least \$1,125 per week (\$58,500 per year) to meet the minimum requirement under NY law. In California, that amount is \$1,120 per week (\$58,240 per year) for employers with 26 or more employees.

These minimum salary levels increase periodically. Employers must therefore stay up-to-date on the legal requirements for each jurisdiction where their employees work. This is particularly true in today's remote work environment, where employers may now have employees scattered throughout the country, in new states with new legal requirements.

Evaluating Employee Job Duties

Employers may still be required to pay overtime even if the employee is paid a salary at or above the minimum threshold for that state. Employers also have to demonstrate that the employee performs "exempt" duties under overtime law. The two most common exemptions are the administrative exemption and the executive exemption.

The "administrative exemption" — by far the most common — applies to employees whose primary duties: (i) are the performance of office or non-manual work directly related to the management or general business operations of the employer or the employer's customers; and (ii) include the exercise of discretion and independent judgment with respect to matters of significance.

Generally, entry level employees need to learn on the job. As a result, especially during their initial period of employment, entry-level employees may not be granted sufficient discretion and independent judgment to meet the administrative exemption. During this time, their work is being checked and double-checked, they are shadowing more senior employees to "learn the ropes" and there is a (proper) concern that they need constant supervision and correction so that work product meets both the employer's and the client's standards. As such, agencies that wish to treat these employees as exempt from overtime pay must ensure that these employees are actually exercising discretion and independent judgment on "matters of significance," and that this is their "primary duty."

The "executive exemption" applies only to managerial employees who: (i) manage either the agency or a department within the agency; (ii) customarily and regularly direct the work of at least two or more other full-time employees; and (iii) have either the authority to hire and fire other employees, or have their

suggestions given particular weight. Company management and account team leaders typically will fit within this executive exemption. However, employers should be mindful that if the primary duties of their managerial employees is client work, and not management of other employees, they may have to rely on the administrative exemption.

Risks of Misclassification

Under federal law, non-exempt employees must be paid overtime at a rate of 1.5 times their regular rate for all hours worked in excess of 40 each week. Employees who are misclassified as “exempt” (i.e. should have been eligible for overtime pay) can bring lawsuits against their employers for unpaid overtime, liquidated (double) damages and attorneys’ fees. This can result in significant monetary liability, particularly for employers with numerous misclassified employees who choose to bring their claims as class actions.

Addressing Potential Misclassification

Firms should evaluate their current employee classifications to ensure that all employees are properly classified as exempt or non-exempt, and that all entitled employees receive appropriate overtime pay. To do so, firms should work with legal counsel to conduct an exemption audit. This type of proactive audit requires the following five steps.

- Review each employee’s compensation to ensure that it meets the minimum required threshold where they work
- Identify vulnerable jobs;
- Assess each employee’s current exemption status and identify risks;
- Analyze the pros and cons of reclassification to determine the best way to minimize potential exposure; and finally;
- Implement any changes.

When implementing classification changes, a key component is to do so without raising red flags and making obvious to employees that they were not classified properly in the past. Strategies to minimize the historical misclassification risks may include only changing the exemption classification for a certain role for new hires, while promoting existing employees into clearly exempt jobs. Some firms may want to compensate employees for past overtime worked and obtain releases in order to not only cut off future liability but to clean up any existing liability as well.

In sum, the correct strategy for each employer will depend on the amount of risk, the costs associated with the changes, and the structure of their organization. But it is much better to be proactive with respect to misclassification issues. As the saying goes, “an ounce of prevention is worth a pound of cure,” and by taking these steps now, firms can avoid millions of dollars in liability which can have drastic effects on their bottom line profitability.