Shale Pay

Managing The Increased Risk of Wage Issues in the Shale Plays

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THE FEDERAL FAIR LABOR STANDARDS ACT OVERVIEW

A. Minimum Wage

The federal Fair Labor Standards Act ("FLSA") is one of the earliest efforts of the federal government to regulate the workplace. Congress first adopted the FLSA in 1938 and has amended it numerous times over the years. The FLSA establishes "minimum wage, overtime pay, recordkeeping, and youth employment standards affecting employees in the private sector and in Federal, State, and local governments." *The Fair Labor Standards Act (FLSA)*, UNITED STATES DEPARTMENT OF LABOR, http://www.dol.gov/whd/flsa/(last visited July 15, 2015). It is administered and enforced by the Wage and Hour Division of the Employment Standards Administration. 29 U.S.C. § 204.

As of 2009, the federal minimum wage is $7.25; however, many states have also enacted minimum wage laws. In cases where an employee is subject to both state and federal minimum wage laws, the employee is entitled to the higher minimum wage. *The Fair Labor Standards Act (FLSA)*, UNITED STATES DEPARTMENT OF LABOR, (last visited July 15, 2015).

B. Overtime

Unless exempt, employees covered by the Act must receive overtime pay for hours worked over 40 in a workweek at a rate not less than time and one-half their regular pay rate. 29 U.S.C. § 207. The Act applies on a workweek basis. An employee's workweek is a fixed and regularly recurring period of 168 hours—seven consecutive 24-hour periods. 29 CFR § 778.105. Because overtime requirements focus on the workweek, hours cannot be averaged between workweeks. Thus, if an employee works 38 hours one week and 42 hours the next week, the employer must pay overtime for two hours in the second week even though the average number of hours worked during the two-week period is 40. 29 CFR § 778.104.

The most commonly used exemptions, referred to as the "white-collar" exemptions, apply to employees working in a "bona fide executive, administrative, or professional capacity." 29 U.S.C. § 213(a)(1). To qualify for these exemptions, the employee must satisfy certain job duties tests and receive a minimum weekly salary.

According to the DOL, to qualify for the executive employee exemption the employee must: (1) be compensated on a salary basis at a rate not less than $455 per week; (2) be managing the enterprise, or managing a customarily recognized department or subdivision of the enterprise; (3) customarily and regularly direct the work of at least two or more other full-time employees or their equivalent; and (4) have the authority to hire or fire the employees, or the employee's suggestions and recommendations as to the hiring, firing, advancement, promotion or any other change of status of other employees must be given particular weight. 29 CFR § 541.100 *Wage and Hour Division (WHD)*, UNITED STATES DEPARTMENT OF LABOR, (last visited August 25, 2015).

To qualify for the administrative exemption, the employee must: (1) be compensated on a salary or fee basis at a rate not less than $455 per week; (2) perform office or *non-manual work* directly related to the management or general business operations of the employer or the employer's customers; and (3) include the exercise of discretion and independent judgment with respect to matters of significance. 29 CFR § 541.200.

The professional capacity exemption requires the employee must: (1) be compensated on a salary or fee basis at a rated not less than $455 per week; and (2) perform work requiring advanced knowledge, defined as work which is predominantly intellectual in character and which includes work requiring the consistent exercise of discretion and judgment. Furthermore, the advanced knowledge must be in a field of science or learning and must be customarily acquired by a prolonged course of specialized intellectual instruction. 29 CFR § 541.300.

One of the most underutilized exemptions is the highly compensated employee exemption ("HCE"). A HCE earns at least $100,000 a year, exclusive or board or other guaranteed compensation, and customarily and regularly performs one or more of the exempt duties or responsibilities of an executive, administrative or professional employee. 29 CFR § 541.601. Because the employee is a high wage earner, a "relaxed" standard is applied to determine whether the employee meets the minimum burden under the white collar exemption duties standards. *Id.* Courts analyzing the HCE view it as a "safe harbor" for employers. *Anani v. CVS RX Services, Inc.*, 730 F.3d 146 (2nd Cir. 2013); *Zannikos v. Oil Inspections (USA) Inc.*, 605 F. App'x 349 (5th Cir. 2015) (finding a class of "marine superintendents," whose duties included, but were not limited to, "observing oil transfers to verify that performance was accurate, legal, and safe," and "monitor[ing] and report[ing] on transfers' compliance with Oil Inspections' safety policies and nationally recognized safety standards" exempt as highly compensated employees even though their duties primarily involved completing a checklist of activities performed by subcontractors).

In contrast, the DOL does not have a specific definition for an independent contractor aside from "one who engages in a business of his own." *Independent Contractor*, UNITED STATES Department OF LABOR, (last visited August 4, 2015). Thus, the problem becomes when an independent contractor starts to look more like an employee. And recently, the DOL has declared that, in their opinion, almost all individuals working for a company are "employees" unless they show otherwise. David Weil, *Administrator's Interpretation No. 2015-1,* UNITED

STATES DEPARTMENT OF LABOR (August 4, 2015), http://www.dol.gov/whd/workers/ Misclassification/AI-2015_1.htm.

II.
INCREASED FOCUS AND LITIGATION IN THE OIL AND GAS INDUSTRY FOR "MISCLASSIFICATION"

The DOL and plaintiffs lawyers have targeted the oil and gas industry for over five years. At first, many companies relied on the historical treatment of workers' categories as a defense to claims of overtime and independent contractor status. The courts quickly dispensed with any notion that historical treatment of workers would serve as an excuse or defense for improperly paying employees. As an example of the focused efforts, the DOL has collected back pay for over 4,000 energy industry workers in the last few years in states with the most oil and gas drilling, including Texas, Oklahoma and North Dakota. Dave Fehling, *Feds Target Oil and Gas Industry for Underpaying Workers*, STATE IMPACT, (June 24, 2014, 6:30 AM), https://stateimpact.npr.org/texas/2014/06/24/feds-target-oil-gas-industry-for-underpaying workers. Back pay for these workers reached nearly $6.7 million, accounting for a third of all such settlements by all types of industries nationwide. *Id.*

In December 2014, the DOL announced that employers engaged in natural gas extraction in the Marcellus Shale region of Pennsylvania and West Virginia agreed to pay $4,498,547 in back wages to 5,310 employees. *U.S. Department of Labor Targets the Oil and Gas Industry for Wage-Hour Compliance*, VORYS, http://www.vorys.com/publications-1479.html (last visited July 27, 2015). In both cases, the DOL found violations of improper payment of overtime, including failure to include production bonuses in the regular rate of pay. *Id.* The DOL further found that salaried employees had been "misclassified" as exempt, hourly employees had not been paid for the off-the-clock work, and in some cases, employees had been paid a flat rate without regard to the number of hours worked. *Id.* Thus, one of the main issues the oil and gas industry is facing is the use of independent contractors and whether they are considered employees. *Id.*

III.
DETERMINING INDEPENDENT CONTRACTOR STATUS

The Department of Labor ("DOL"), Internal Revenue Service ("IRS"), the Equal Employment Opportunity Commission ("EEOC"), and most recently, the National Labor Relations Board ("NLRB"), will investigate and often challenge a company's classification that a worker is an independent contractor instead of an employee. *Id.* According to the John DuMont, district director for the DOL's Pittsburgh office, oil and gas firms tend to improperly label their workers as independent contractors, which allows the companies to avoid paying overtime. Anya Litvak, *Oil, Gas Firms Scrutinized to Monitor Labor Practices*, THE PITTSBURGH POST-GAZETTE (Aug. 4, 2013, 4:00 AM), http://www.post-gazette.com/businessnews/2013/08/04/oil-gas-firms-scrutinized-to-monitor-labor-practices/stories/201308040230. "The technique, investigators and experts say, has become ever more common as small companies seek to gain contracts in an intensely competitive market by holding labor costs down." Naveena Sadasivam, *For Oil and Gas Companies, Rigging Seems to Involve Wages, Too*, PROPUBLICA (Sep. 25, 2014, 10:02 AM), http://www.propublica.org/article/for-oil-and-gas-companies-rigging-seems-to-involve-wages-too.

The theory underlying the focus on independent contractors is the belief that when employers improperly classify employees as independent contractors, the employees may not receive important workplace protections such as the minimum wage, overtime compensation, unemployment insurance, and worker's compensation. David Weil, *The Application of the Fair*

Labor Standards Act's "Suffer or Permit" Standard in the Identification of Employees Who are Misclassified as Independent Contractors, UNITED STATES DEPARTMENT OF LABOR (July 15, 2015), http://www.dol.gov/whd/workers/Misclassification/AI-2015_1.htm. Moreover, the DOL contends that misclassification results in "lower tax revenues for government and uneven playing field for employers who properly classify their workers." *Id.*

A. Economic Realities Test

To determine whether a person is considered an employee or an independent contractor, the DOL and the IRS use entirely different tests. The DOL does not focus on whether the employee is under the "control" of a particular company, but instead on the "economic realities" of the working relationship. *United States v. Silk*, 331 U.S. 704 (1947). Simply put, if an individual works primarily for one company, the DOL will likely consider the individual an employee.

The five part test looks at: (1) the degree of control exercised by the alleged employer; (2) the extent of the relative investments of the putative employee and employer; (3) the degree to which the 'employee's' opportunity for profit and loss is determined by the 'employer;' (4) the skill and initiative required in performing the job; and (5) the permanency of the relationship. *Brock v. Mr. W Fireworks, Inc.*, 814 F.2d 1042, 1043 (5th Cir. 1987). In addition, courts "focus on whether, as a matter of economic reality, the worker is economically dependent upon the alleged employer or is instead in business for himself." *Hopkins v. Cornerstone Am.*, 545 F.3d 338, 343 (5th Cir. 2008).

It is the company's obligation to prove that the worker was independent from the company. In 2010, the DOL issued a notice of proposed rulemaking indicating that it will amend its recordkeeping requirements to require employers to conduct an analysis of any position for which the worker is not counted as an employee, showing that under the economic reality test, the worker is not in the company's employment. In addition, the company will have to show that it informed each such worker of its analysis and of the worker's rights under the FLSA.

When an alleged employer provides "specific direction for how workers, particularly low-skilled workers, are to perform their jobs, courts have weighed the control factor in favor of employee status." *Montoya v. S.C. C.P. Painting Contractors, Inc.*, 589 F. Supp. 2d 569, 579 (D. Md. 2008). Courts have further held that a provision of written instructions and procedures on how to complete a job also indicates employee status. *See Schultz v. Capitol Int'l Sec., Inc.*, 466 F.3d 298, 307 (4th Cir. 2006) (finding an eight-page standard operating procedure document outlining job tasks indicative of employee status). Furthermore, supervision does not need to be constant to establish an employee-employer relationship. *See Brock v. Superior Care, Inc.*, 757 F.2d. 1376, 1383-84 (3d Cir. 1985) ("An employer does not need to look over his workers' shoulders every day in order to exercise control.").

B. <u>New DOL Administrative Interpretation Sheds Light on the Independent Contractor Analysis</u>

On June 15, 2015, under Administrator's Interpretation No. 2015-1, the Department of Labor issued new guidance on the independent contractor relationship. A copy of the guidance is attached. Significantly, the guidance stresses the DOL's strong viewpoint that independent contractors must not have a long-standing relationship with the employer. In other words, if the independent contractor is primarily employed by a company, then he/she is an employee of that company.

> **Example 1**: A registered nurse who provides skilled nursing care in nursing homes is listed with Beta Nurse Registry in order to be matched with

> clients. The registry interviewed the nurse prior to her joining the registry, and also required the nurse to undergo a multi-day training presented by Beta. Beta sends the nurse a listing each week with potential clients and requires the nurse to fill out a form with Beta prior to contacting any clients. Beta also requires that the nurse adhere to a certain wage range and the nurse cannot provide care during any weekend hours. The nurse must inform Beta if she is hired by a client and must contact Beta if she will miss scheduled work with any client. In this scenario, *the degree of control exercised by the registry is indicative of an employment relationship*.
>
> **Example 2**: In contrast, another registered nurse who provides skilled nursing care in nursing homes is listed with Jones Nurse Registry in order to be matched with clients. The registry sends the nurse a listing each week with potential clients. The nurse is free to call as many or as few potential clients as she wishes and to work for as many or as few as she wishes; the nurse also negotiates her own wage rate and schedule with the client. In this scenario, *the degree of control exercised by the registry is not indicative of an employment relationship*.

David Weil, *Administrator's Interpretation No. 2015-1*, UNITED STATES DEPARTMENT OF LABOR (August 4, 2015), http://www.dol.gov/whd/workers/Misclassification/AI-2015_1.htm.

The Administrator's Interpretation is not "law," but will be used as guidance by the courts, particularly when applying the economic realities factors. These factors are explored in the Interpretation in some detail and are analyzed in an inquiry format:

(1) Is the Work an Integral Part of the Employee's Business? *Is the work the part of the primary work of the business, regardless if it is performed full-time, away from the employer's premises or by hundreds of individuals?*

(2) Does the Worker's Managerial Skill Affect the Worker's Opportunity for Profit or Loss? *The ability to work more hours and the amount of work available from the company have nothing to do with profit and loss. Instead, a worker's decision to hire others, purchase materials and rent or lease space weigh heavily in the risk associated with managerial skill that affects profit and loss.*

(3) How Does the Worker's Relative Investment Compare to the Employer's Investment? *Investing in tools is not necessarily a business investment, especially if it is to perform particular work for a particular company. For instance, rig welders investment in equipped trucks was inadequate compared to the hundreds of thousands of dollars investment by the drilling companies.*

(4) Does the Work Performed Require Special Skill and Initiative? *The fact that a worker is skilled, especially if those skills are technical and used to perform the work, is not necessarily indicative of independent contractor status. More important are skills associated with running an independent business, such as initiative and judgment. For instance, a technically skilled carpenter that works primarily for one company and is told which jobs to perform and materials to use, is an employee.*

(5) Is the Relationship between the Worker and the Employer Permanent or Indefinite? *A worker who is truly in business for him or herself will eschew a*

permanent or indefinite relationship with an employer and the dependence that comes with such permanence or indefiniteness.

(6) What is the Nature and Degree of the Employer's Control? *The courts will analyze the nature and degree of control, not why the company exercised control. If the nature of the business requires a company to exert control, then the individuals are employees.*

As a result of this standard, the DOL considers most workers employees under the FLSA's broad definitions. *Id.* The very broad definition of employment under the FLSA as to "suffer or permit to work" and the Act's intended expansive coverage for workers must be considered when applying the economic realities factors to determine whether a worker is an employee or an independent contractor. *Id.* No single factor including control should be overemphasized. *Id.* Instead, each factor should be considered in light of the ultimate determination of whether the worker is really in business for him or herself (and thus an independent contractor) or is economically dependent on the employer (and thus is its employee). *Id.* The factors should be used as guides to determine economic dependence. *Id.*

IV.
PROPOSED AMENDMENTS TO THE FAIR LABOR STANDARDS ACT REGULATIONS

With one notable exception (the Portal to Portal Act), each of the amendments to the FLSA in past years have resulted in an expansion of its scope. The 2015 proposed amendment is no exception. On July 6, 2015, the DOL announced a proposed rule that would extend overtime protections to nearly 5 million white collar workers within the first year of its implementation. *The Fair Labor Standards Act (FLSA)*, UNITED STATES DEPARTMENT OF LABOR. A sixty-day comment period on the proposed regulations expires on September 5, 2015.

There are two parts to the proposed amendment: (1) increasing the salary level to an amount equal to the 40th percentile of earnings for full-time salaried workers, and (2) preventing the new salary from becoming outdated by installing a mechanism that would automatically update the salary level on an annual basis either by using a fixed percentile of wages or the consumer price index. Arnold & Patterson, *Department of Labor Releases Proposed FLSA Overtime Rules Changes; Final Rule Expected to Impact Millions*. Currently, the salary level threshold, which the DOL updated in 2004, stands at $23,660 per year or $455 per week. Michael Arnold & George Patterson, *Department of Labor Releases Proposed FLSA Overtime Rules Changes; Final Rule Expected to Impact Millions*, THE NATIONAL LAW REVIEW (June 30, 2015),http://www.natlawreview.com/article/department-labor-releases-proposed-flsa-overtime-rules-changes-final-rule-expected. This salary level threshold serves as the best single test of exempt status, and will now double to an equivalent of $50,440.00 or $970 per week in 2016. Simply put, employers will be required to pay every salaried employee at least $50,440.00 in order to avoid overtime payments, regardless of the white collar exemption that is utilized. In addition, the highly compensated employee exemption would increase from $100,000 per year to approximately $122,148.

The proposed rule from $455 per week to $970 per week would expand the number of people eligible for overtime from about 8% of the salaried workforce to about 40%. Gian-Franco Melendez, *Making Sense of the Proposed Overtime Regulation*, CRISTAL HANENIN (July 7, 2015, 1:00 PM), http://www.chfloridalaw.com/Blog/2015/July/Making-Sense-of-the-Proposed-Overtime-Regulation.aspx. According to the DOL, increasing the salary threshold automatically "will tend to keep employees who spend significant amounts of time on non-exempt duties from becoming exempt simply because their salary increases keep pace with inflation or with the economy generally." Arnold & Patterson, *Department of Labor Releases Proposed FLSA Overtime Rules Changes; Final Rule Expected to Impact Millions*.

A. <u>What the Proposed FLSA Regulations Mean for Employers</u>

The proposed salary level increase to $50,440 is substantial and employers will need to consider the impact that this proposal will have on their bottom line. Doug Hass & Staci Rotman, *The New FLSA Regulations: What Changed, What Didn't, What's Next for Employers*, Franczeck Radelet (June 30, 2015), http://www.franczek.com/frontcenter-New_FLSA_Regulations_2015.html. The Department's Wage and Hour Division estimates that 10.9 million workers will no longer qualify as exempt based on the new salary level. Thus, "[e]mployers are well-advised to consider an effective communication plan—one that includes a properly tailored message to affected (and possibly unaffected) employees regarding their overtime eligibility, proper timekeeping policies (including regarding the use of electronic devices) and information on whether their pay, work schedule, and other benefits have been affected." Arnold & Patterson, *Department of Labor Releases Proposed FLSA Overtime Rules Changes; Final Rule Expected to Impact Millions*.

In addition to this proposed change, the DOL is also requesting input on (1) whether nondiscretionary bonuses (which are the most frequently awarded) should be included in calculating the exempt compensation standard; (2) whether the duties test for white collar exemptions should be modified; and, (3) procedures for a mechanism to automatically adjust the yearly and weekly salary standards for the white collar exemptions. Of import is the fact that the DOL may now issue regulations on these topics even those actual proposed regulations have not been issued, because of the "logical growth" doctrine. Under this doctrine, additional regulatory language may be added to the proposed rules as long as the public has been put on notice that the topic is under consideration.

After the 60-day comment period, the DOL will issue draft final regulations, taking into account the public's comments. Because the DOL gave employers only 120 days to comply with the 2004 rules, it estimated the DOL will provide the same or shorter period for the 2015 proposed amendment. Hass & Rotman, *The New FLSA Regulations: What Changed, What Didn't, What's Next for Employers*. As a result, a preliminary audit of exempt positions is necessary as soon as the final regulations are released in order to determine whether they would be impacted by the proposed changes and whether any potential duties test changes could similarly impact things. The exemption audits should be conducted under direction of legal counsel to preserve privilege and avoid creating dangerous discovery for use by plaintiffs' attorneys.

V. CONCLUSION

Under the FLSA, employers should be aware of their worker's employment status and the relationship they have with one another. While many employers themselves are not aware they are misclassifying their workers, the DOL has continuously brought successful enforcement actions against those employers. Thus, the employer should look at how much control they have over their worker, including their tasks, schedule, and even dress code.