

## Wage and Hour Laws: Increasing Legal Risks for Businesses

The laws governing payment of wages, overtime pay, and commissions have become a leading source of employee claims and employer liability. Mistakes in this area can be costly and penalties in Massachusetts include treble damages and potentially criminal liability against individual corporate officers. Recently, claims alleging non-payment of commissions after termination have been common, as companies have reduced their sales forces in the economic downturn. Misconceptions also abound in this area. For example, employers often assume that paying an employee on a salary basis means the employee is exempt from overtime requirements. Other common misconceptions include the practice of bi-monthly pay periods, and allowing employees to “work through lunch,” both of which may violate state law. In this edition of the Employment Law Advisor, we summarize some of the more common wage and hours issues that lead to employee claims, and we offer some tips for employers on how to avoid problems.

### Payment Of Wages at Termination

The Massachusetts Payment of Wages Act (the “Wage Act”) provides that any employee discharged from

employment must be paid his or her wages in full (including any accrued but unused vacation pay) on the date of discharge. Many employers are unaware of this provision or choose to ignore it, as it may be difficult to generate an accurate final paycheck on the employee’s last day of employment. Employers should make every effort to comply, and should not delay payment of a final paycheck for administrative reasons or until deductions for amounts possibly owed by the employee have been determined.

Even when payments are delayed by only a few days, there is a technical violation of the Wage Act which may result in treble damages and an award of attorneys’ fees. Employees are increasingly asserting such claims, often together with other claims, such as wrongful discharge. If preparing a final paycheck on the date of a termination is not practical or has been overlooked, one solution is to continue with the termination and advise the employee that the termination will be effective on a later date (when a paycheck can be available) but the employee will not need (or be allowed) to report to work during the intervening period.

An employee who leaves employment voluntarily, however, is not owed his or her final paycheck until the next regular pay period. Regardless of whether the termination is voluntary or involuntary, the final paycheck must include pay for any accrued but unused vacation.

### Commissions as Wages

The Wage Act applies to “the payment of commissions when the amount of such commissions, less allowable or authorized deductions, has been definitely determined and has become due and payable to such employee.” In other words, unless commissions are both (i) definitely determined and (ii) due and payable under the terms of the commission agreement or plan, an employer does not have to pay such commissions on a weekly, bi-weekly, semi-monthly or monthly basis, or at the time of discharge.



Because commission arrangements often vary from employer to employer, when commissions are definitely determined and due and payable depends on the terms of the commission agreement or plan and the circumstances of the situation. A common problem with commission arrangements is a lack of clarity as to how commissions are to be calculated and when they are to be paid. Since commissions become “wages” under the Wage Act when the amount of such commissions “has been definitely determined and has become due and payable to such employee,” employers should strive to avoid ambiguities. Commission plans and schedules should answer these questions: Are commissions to be based upon amounts billed, or revenue received? What is the formula for calculating commissions? What deductions are to be made? When are payments due? Are there contingencies to payment? By accurately and unambiguously setting out all of the essential terms of the commission arrangement in a written document, an employer can eliminate future areas of dispute, uncertainty and potential legal liability.

### **Pay Deferrals May Violate the Wage Act**

Postponing employee compensation may be a tempting practice, especially in a cash-strapped start-up, but doing so violates the Wage Act, which provides that all employees must be paid at least the minimum wage on a regular basis. Even if a portion of an employee’s compensation is deferred (over and above the minimum wage), this can create an unexpected problem if the employee quits or

is terminated, at which time the employee must be paid the entire balance of monies owed. Moreover, such practices can have significant negative tax implications (for example, if income is deferred until a later tax year) under recent revisions to the Internal Revenue Code.

### **Pay Period Misconceptions**

Massachusetts law governs how frequently employees must be paid, yet many employers find that they have inadvertently violated these rules. Under Massachusetts law all employees must be paid at least weekly or biweekly (every two weeks) and within six days of the end of the pay period during which wages were earned. Employers who instead pay their employees only twice a month violate these rules in two ways: (1) by paying less frequently than biweekly, and (2) by failing to pay within six days of the end of the pay period. While exempt employees may be paid semi-monthly, or elect to be paid monthly, there is no exception to the biweekly payment rule for non-exempt employees.

### **Meal Breaks**

What’s the harm if an employee occasionally “works through lunch”? It could be a violation of Massachusetts law, which provides that any employee who works more than six hours a day must be allowed at least thirty minutes unpaid time for a meal. Violation of a similar California state law resulted in a jury verdict of \$172 million (including \$115 million in punitive damages) against Wal-Mart.

Employers also must be careful to pay employees if they work during a meal break. According to the Massachusetts Attorney General, if an employee is restricted in movement during the break or if the employee must perform a job function during the break, compensation must be paid. While an employee can waive such a break, any waiver must be voluntary.

### **Misclassification as Independent Contractors**

No review of wage and hour issues facing employers would be complete without mention of the potential problems associated with use of independent contractors, as discussed in our prior ELAs (<http://www.mbbp.com/resources/employment/newsletters/ela/ela0909.pdf>). Misclassification of employees as independent contractors can result in liability and penalties for failure to pay overtime, FICA and FUTA contributions, unemployment insurance payments, and workers compensation insurance premiums, as well as subject the employer to other civil and criminal liability, including mandatory treble damages under Massachusetts law.

Amendments made to the Wage Act in 2004 make it significantly more difficult for businesses to classify workers in Massachusetts as independent contractors and comply with the Wage Act. Employers who remain uncertain about the proper classification of workers as independent contractors are advised to consult counsel.

## Loss of Exempt Status Through Improper Salary Deductions

Most employers understand that under the Fair Labor Standards Act (“FLSA”) and Massachusetts law all employees must be paid overtime (time and a half) for any hours worked over forty in one week, unless the employee is exempt from such requirements under the FLSA. To be exempt under the FLSA’s so-called “white collar” exemptions, an employee: (1) must be paid on a “salary” basis of at least \$455 per week; and (2) must be classified as an executive, administrative, professional, computer professional or outside sales employee on the basis of the specific job duties he or she performs. Evaluating whether an employee meets the criteria for exemption based on his or her job duties is difficult enough, as it involves a fact-specific inquiry concerning the employee’s day-to-day activities. However, the first test — being paid on a salary basis — is sometimes overlooked by employers, and failure to meet this test will also result in loss of exempt status.

Payment of wages on a “salary” basis means that an employee regularly receives a predetermined amount of compensation each pay period regardless of variations in the quantity or quality of an employee’s work. In other words, an employee is paid the same salary regardless of whether he or she works 30 hours or 50 hours in a pay period and regardless of whether his or her performance is excellent or poor/deficient. If an employer fails to pay “salaried” employees properly, exempt status will be lost and the employer

may be obligated to pay overtime for the entire class of employees involved.

This means, for example, that an employer may not make deductions from an employee’s predetermined salary because of the operating requirements of the business, such as lack of work. Similarly, employers may not make deductions from pay of exempt employees for partial day absences.

There are some exceptions to the general rule that employees must be paid their full salary for any week in which they perform work. Deductions from pay of exempt employees are permissible for:

- absences of one or more full days for personal reasons other than sickness or disability;
- absences of one or more full days due to sickness or disability if the deduction is made in accordance with a bona fide plan, policy or practice of providing compensation for salary lost due to illness;
- offsetting amounts employees receive as jury or witness fees, or for military pay;
- penalties imposed in good faith for infractions of safety rules of major significance;
- unpaid disciplinary suspensions of one or more full days imposed in good faith for workplace conduct rule infractions;
- the initial or terminal week of employment; or
- weeks in which an exempt employee takes unpaid leave

under the Family and Medical Leave Act.

As noted, deductions from an exempt employee’s salary generally may not be made for partial day absences, whatever the reason (although partial day deductions may be made from an employee’s accrued paid time off hours in certain circumstances). Some employers have incurred liability for having a practice of making improper deductions from salary. Employers may reduce this risk by (1) establishing a clearly communicated policy prohibiting improper deductions and including a complaint mechanism, (2) reimbursing employees for any improper deductions, and (3) making a good faith commitment to comply in the future. If these steps are followed, the employer will not lose the exemption unless the employer willfully violates the policy by continuing the improper deductions after receiving employee complaints.

## Salary Payment Does Not Guarantee Exempt Status

A common misconception is that payment of a salary results in exemption from the overtime requirements of the FLSA. As discussed above, in order to be exempt from overtime payments, the employee must be paid on a salary basis and the employee’s job responsibilities must also fall within one of the exempt categories, including the “white collar” executive, administrative and professional employee exemptions, and the computer and outside sales employee exemptions. Many salaried employees do not qualify for any

exemption from overtime obligations, and relying solely upon whether an employee is paid a salary in categorizing them as exempt or non-exempt will almost certainly result in misclassifications.

Note that under the FLSA an exception to the salary basis requirement applies to “computer employees.” Generally, to qualify as an exempt computer employee a worker must have a primary duty that consists of:

- the application of systems analysis techniques and procedures to determine hardware, software or system functional specifications;
- the design, development, documentation, analysis, creation, testing or modification of computer systems or programs based on and related to user or system design specifications;
- the design, documentation, testing, creation or modification of computer programs related to machine operating systems; or
- a combination of the foregoing.

An employee who meets the duties test can be exempt if he or she is paid on a salary basis of at least \$455 per week or is compensated on an hourly basis of not less than \$27.63 an hour.

### **Risks of Misclassification Under the FLSA and Massachusetts Law**

Failure to properly classify an employee as exempt or non-exempt carries substantial risks. Employees who should have been classified as

non-exempt will be owed overtime pay (plus interest) for all hours worked in excess of forty per week, going back up to three years. Furthermore, possible penalties for violation of the FLSA include liquidated damages (payment of twice what is owed), attorneys’ fees, and litigation costs. Massachusetts law provides for mandatory treble damages. Employers are also prohibited from retaliating against employees for asserting claims under the FLSA or Massachusetts law.

Further, employers are required by law to keep accurate records of the time worked by employees. Because employers frequently do not keep track of exempt employees’ hours, if such employees turn out to be misclassified and are owed overtime, the employer often is unable to provide a record of the time actually worked by the employees. In this situation it becomes very difficult to prove that an employee is not exaggerating his or her overtime wage claim.

### **Individual Liability**

For Massachusetts employers, the Wage Act imposes liability not only upon the business itself but also upon the President and Treasurer of the employer and any “officers or agents having the management of such” employer.

### **Wage and Hour Audits**

Employers that are concerned that their pay practices may not be in full compliance with federal and state laws should consider conducting a wage and hour audit. Such an audit,

often performed by employment counsel, can be useful in identifying misclassifications and other compliance problems in the wage and hour area -- before the employer becomes the subject of a complaint or agency investigation.

Our experience is that almost every audit uncovers areas of non-compliance that, left uncorrected, expose the employer (and corporate officers) to wage and hour law liability.

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