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PERSPECTIVE

The Complications of Overtime Exemption Laws in a Service Economy

“Hello, I’m Ronald Reagan speaking for General Electric. At General Electric, you know, ‘progress is our most important product.’ But, all progress must have a starting point. All great human enterprises begin at a frontier. The pioneering of hostile lands...the mushrooming of the Atomic Age with its mixed blessing of destruction and construction...the rolling back of space frontiers beyond the planets to the stars...and the beginning of the information-handling revolution. All these had — a common starting point — a frontier of progress.”



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The joyful mid-20th century tone of Ronald Reagan’s address to the sales force of General Electric (at the 1961 National Sales Meeting) could produce disturbing litigation results these days. Many have commented that in the 21st century, the United States is becoming primarily a service economy, and the product delivered

by many companies, is therefore, service.

For employers engaged in wage and hour litigation, defining the “product” that an enterprise exists to sell has become a key point in proving that someone is exempt from overtime laws under the most confusing and broadly used exemption — the Administrative Exemption. Winning or losing these cases often depends upon the employer’s characterization of its “product.” Such a characterization can be particularly complicated for a service business, rather than a manufacturing enterprise.

Two recent California cases with contrasting results highlight this dangerous area of law and fact, particularly for technology companies. In *Eicher v. Advanced Business Integrators, Inc.*, 151 Cal.App.4th 1363 (2007) and *Combs v. Skyriver Communications, Inc.*, 159 Cal. App.4th 1242 (2008) an individual employee sought unpaid overtime compensation from his former employer. Eicher prevailed and Combs lost, but the cases proceeded on the same theory: that each employee had been erroneously categorized as an exempt “administrator” of the company, and the company was therefore liable for years of unpaid wages, attorney’s fees, and penalties.

Michael Eicher was a senior consultant who provided customer service and training on software. Mark Combs was a manager of capacity planning and a director of network operations. Each man relied heavily on the argument that he was involved in producing the product that his company marketed (a nonexempt position) and not in administering the business (an exempt function). Eicher successfully argued that his work was production: “He regularly engaged in the core day-to-day business of ABI — that is, implementing the ABI MasterMind



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product at customer venues and supporting the customers, whether at the customer venues or in the ABI office.”

Combs similarly argued that Skyriver's "product" was Internet connectivity, and that for the majority of his workweek he ensured network connectivity, the delivery of the product to his employer's customers. But in the case of Combs, the court concluded that he was exempt, and that his job functions involved high-level problem solving in the context of a startup company. As the *Eicher* court astutely remarked, whether someone is an "exempt administrative employee presents a mixed question of law and fact."

Most companies find that the administrative exemption is difficult to apply, even though there is a supposedly clear definition provided by the California Division of Labor Standards Enforcement (DLSE), which enforces California's wage and hour laws, and lists the key mandatory points for the exemption in Section 52.1 of the Enforcement Policies and Interpretations Manual (the Manual). In general, the duties of an exempt administrative employee must involve office or non-manual work directly related to management policies or general business operations; must include the exercise of discretion and independent judgment; and must require only general supervision.

Case law makes it clear that exempt administrators are those whose primary duty (more than half the employee's working time) is administering the business affairs of the enterprise rather than producing the product — whether services or goods — the enterprise exists to market. For example, producers of television news shows have been found to be nonexempt because they were engaged in "production" work. Similarly, claims adjusters in an insurance company have been found to be nonexempt production workers because they were engaged in the core day-to-day business of the insurance company.

Many of the older cases deal with manufacturing settings, in which the line between those who produce the "product" and those who operate the infrastructure of the business is much clearer than it is in a service company.

The federal regulations, which are now integrated within the California administrative exemption, are instructive in this regard. Section 52.2 of the Manual explicitly states: "The IWC Orders provide that for purposes of the Administrative exemption, activities constituting exempt work and nonexempt work shall be construed in the same manner as such terms are construed in the following regulations under the Fair Labor Standards Act *effective as of the date of this order*: 29 CFR [Sections] 541.201-205, 541.207-208, 541.210, 541.215."

The regulations to which the Manual refers are not in the current Code of Federal Regulations. The old federal regulations that are cited above are worth reading to help California employers in analyzing jobs they wish to classify as exempt under the administrative exemption. The older regulations are included as an addendum to the Manual and can be reviewed on the DLSE Web site.

The following risk factors in the California statutes should be factored in when a company looks at its classification criteria for workers who have been considered exempt administrators:

There is an increased risk of class actions in the wage and hour area if aggressive plaintiffs' lawyers determine that groups of highly paid, similarly situated individuals have not been compensated properly.

There is a three-year statute of limitations (and in some cases a four-year statute of limitations), so actions for unpaid overtime compensation would be timely with respect to paydays going back at least three years prior to commencement of the action.

Under California Labor Code Section 1194, for example, in a civil action for overtime compensation, the employee is entitled to recover "interest thereon" and "reasonable attorney's fees."

Section 558 of the California Labor Code sets up a system of civil penalties and citations for employers "or any other

person acting on behalf of an employer" who has violated wage and hour laws, creating potential personal liability for managers.

If employees previously classified as exempt are found to be nonexempt, they may make additional claims for unpaid meal period and rest break penalties in California. Such penalties include one hour of pay for missing a meal break and an additional hour of pay if either one or both breaks were missed on any day of work.

If a company undertakes a review of employee classifications, the process should be organized cautiously. It is a good practice to conduct such an analysis with the advice of counsel to cloak much of the review in the attorney-client privilege. Be aware that California Labor Code Section 206.5 prohibits (and criminalizes) any attempt to require the execution of a release "on account of wages due." Thus, working in a sensitive and cooperative way with affected employees to arrive at good estimates of hours worked will be important.

Be aware also that reclassifying employees who have long been considered exempt to nonexempt status can create awkward situations in which employees feel their work is being devalued. While they may make more money because they will be eligible for overtime, they now will be required to fill out time cards, adhere to strict meal break times, make up missed hours of work and obtain approval to work beyond the regular work hours. The way these messages are communicated to employees can affect morale significantly and therefore should be carefully thought out and executed.

Conducting an analysis and potentially reclassifying employees may appear to be a daunting task. But with some careful review, planning and execution, problems can be resolved and risks can be minimized.

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