IT'S THE LAW

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THE CONFUSION OVER THE NEW OVERTIME RULES

The Fair Labor Standards Act (FLSA) permits the U.S. Department of Labor to set basic standards for employers on how to compensate employees. Last year, Congress and the Bush Administration made changes to the regulations that determine which employees are eligible for overtime. These changes went into effect on January 1, 2005. Some have applauded these changes, while others have decried them. But the Federal changes are only the beginning of the problem for employers attempting to pay their employees. To understand the problem, first we need to know how the FLSA works in regards to overtime compensation.

THE OLD RULES

The general rule under the FLSA is that an employer cannot have an employee work a workweek longer than forty hours unless the employer compensates that employee a least one and one-half times his regular hourly rate. However, there are exceptions to the general rule. The main exceptions are for those employees who are "bona fide executive, administrative or professional" employees, or are employed in outside sales. But the FLSA does not define these exemptions. The Act requires the Secretary of Labor and the United States Department of Labor to create regulations to define and enforce the Act. And here is where all the confusion lies.

Before the changes made last year, an employer could classify an employee under one of the exemptions only if the job the employee performed passed one of two tests. The first test, "the short test", was the first hurdle. Under the Short test, if an employee made less than $250.00 there was no way for the employer to deny him overtime, no matter what his job entailed. But if the employee did make over $250.00, the employer could list him as exempt if he passed the "long test."

The long test focused upon the duties of the employee to determine if he was a "bona fide executive, administrative or professional."

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Under the old regulations, a bona fide executive must be involved in the management of the enterprise **and** direct two or more employees **and** have hiring or firing authority **and** has discretionary powers **and** devotes less than 20% percent of his time to work other than the management of the enterprise. There were similar provisions for administrative, professional work and outside sales. Thus in order to be classified exempt, an employee had to fit a rather narrow definition.

THE NEW RULES

The new law which is now in effect makes two major changes. First, it raises the short test salary requirement from $250.00 to $455.00 per week. This means that all employees making $11.37 an hour, or $23,660 or less cannot be denied overtime. The second change is to streamline the long test. The new rules broaden the scope of the exemptions for bona fide executives and professionals (with only minor changes for administrative workers). For example, now an employee will be considered a bona fide executive if his or her primary duty is to manage an enterprise or unit with at least two full time employees.

The new rules also clearly do not exempt manual laborers, such as plumbers, mechanics, carpenters, etc. These employees cannot be listed as exempt no matter what their pay is. Further, the new rules do not apply to police, firefighters or other "first responders".

THE STATES GET INVOLVED

The FLSA and the regulations of the US Department of Labor represent the lowest standard that a state must mandate for workers in their state. However, a state may develop its own standards if those standards are higher than those of the federal government. And this is exactly what some states, including Illinois, have done.

Illinois, in reaction to the new regulations, has passed an amendment to the Illinois Fair Labor Standards Act. The amendment tries to take what Illinois considers is the best of both the old and new federal rules. Illinois likes the higher pay threshold for the short test, so it has adopted the $455.00 minimum for exemptions. But Illinois disagreed with the streamlining of the long test so it adopted the old "long test" as the basis for exemptions for "bona fide executive, administrative or professional" employees. In Illinois, the old rules are thereby still in effect.

IF THE RULES ARE THE SAME WHY SHOULD I CARE?

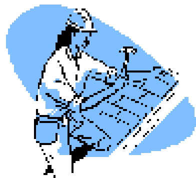
The penalties of misapplying the rules are serious. The FLSA provides for fines, imprisonment and a private right of action for aggrieved employees. If an employee is successful in a private action he is entitled to lost wages, liquidated damages equal to the amount of wages lost and attorneys' fees. Since the statute of limitations is two years, which is increased to three years for willful violations, the damages become daunting very quickly.

For example, let's start with an employee who is improperly listed as exempt, when he does not meet the criteria for any exemption. If that employee is paid a salary of $41,600 (or $20 an hour), regularly works 45 hours but is only paid for 40 hours. After a year that employer is on the hook for $7,800 in actual damages **plus** $7,800 in liquidated damages **plus** attorneys' fees. And since there is a potential for 3 years of liability, this number balloons to $23,400 in actual damages **plus** $23,400 in liquidated damages **plus** attorneys' fees. And this is for each employee misclassified. Should an employer misclassify 10 employees after three years it may be looking at a class action suit with potential damages of half a million dollars and attorneys' fees.

And it does not matter that your employees are paid a salary instead of an hourly wage. There are rules as to whether or not an employee can be given a salary as opposed to being paid hourly. If an employer fails to follow those rules, the employee will be considered an hourly employee. The statute, and the US Department of Labor, does not differentiate between salary and hourly employees. What will determine if your employees are exempt is whether or not their actual duties allow you to classify them as exempt. On an additional note, if an employer has a rule that overtime needs to be authorized, that rule must be enforced. Overtime liability

extends to employers who "suffer or permit" its employees to work overtime. If an employer does not enforce the prior authorization rule, it will be considered to have suffered and permitted the overtime, and will thus be liable.

So what should employers do? Employers should audit their overtime rules, employees' duties and classifications. Additionally, employers should publish clear rules to prohibit overtime without prior authorization and enforce those rules.



MINORS NO LONGER ALLOWED TO WORK "ON OR ABOUT ROOFS"

The US Department of Labor issued a final rule which expands the current ban of minors from roofing occupations to all work performed "on or about a roof." The new regulation goes into effect on February 14, 2005. The previous regulation only prevented minors from working in "roofing operations." Under the old regulation, roofing operations did not include gutter and down spout work; the construction of the sheathing or base of roofs; or the installation of television antennas, air conditioners, exhaust and ventilating equipment, or similar appliances attached to roofs. But the newer expanded regulation prohibits minors from performing any work "on or about a roof."

The regulation defines "on or about a roof" to include all work performed in close proximity to a roof. This definition includes "carpentry and metal work, alterations, additions, maintenance and repair, including painting and coating of existing roofs; the construction of the sheathing or base of roofs (wood or metal), including roof trusses or joists; gutter and down spout work; the installation and servicing of television and communication equipment such as cable and satellite dishes; the installation and servicing of heating, ventilation and air conditioning equipment or similar appliances attached to roofs; and any similar work that is required to be performed on or about roofs."

In the preamble, the DOL used the example of a window washer and a worker who was going to the roof to make clothing racks as examples of the types of injuries this regulation is attempting to prevent. Additionally, the Department pointed to deaths of minors in falls while they were installing roofing trusses.

The regulation has a single exception for apprentices or student-learners.

SUPERVISORY EMPLOYEES BEWARE — INDIVIDUAL LIABILITY UNDER FEDERAL & STATE LABOR STATUTES

Seemingly every year an employer is faced with new state and sometimes federal laws further protecting the rights of employees. Faced with more employment laws, it is no coincidence that employment related lawsuits are at an all-time high. More troubling yet is that some state and federal courts are extending liability beyond the corporate entity and holding individuals liable for employment law violations. This article is a summary of individual liability under federal and state employment laws.

FAMILY MEDICAL LEAVE ACT ("FMLA")

The FMLA requires businesses with fifty (50) or more employees to grant up to twelve (12) weeks of unpaid leave a year to allow workers to care for seriously ill family members, give birth or adopt a child, or recover from their own serious health conditions. Employees who are on paid or unpaid leaves of absence are counted toward the threshold as long as there is a reasonable expectation that they will return to active employment.

Managers and supervisors of the employer may be held personally liable for violations of the FMLA. The Northern District of Illinois extended FMLA liability to those who

controlled, in whole or in part, the employee's ability to take a leave of absence and return to his/her position. In a case entitled Freeman v. Foley, the court concluded that although the supervisors were not directors or officers of the corporation, they still exercised sufficient control over the employee's ability to take a leave of absence. A jury returned a verdict of $58,000.00 against the employer and individual supervisor.

FAIR LABOR STANDARDS ACT ("FLSA")

The central aim of the FLSA is to prescribe certain minimum standards of living necessary for health, efficiency and general well-being and to prescribe certain minimum standards for working conditions. Under the FLSA, job titles do not determine personal liability, but rather the focus is on whether the individual had control over the violation. The Seventh Circuit Court of Appeals, which hears appeals arising out of decisions rendered by the Federal Court of the Northern District of Illinois, held that an individual may be liable under the FLSA if the individual had supervisory authority over the complaining employee and was partially responsible for the alleged violation. Additionally, an officer of a corporation can be jointly and severally liable if he/she has operational control over significant aspects of the corporation's day-to-day functions.

NATIONAL LABOR RELATIONS ACT ("NLRA")

The purpose behind the NLRA is to strengthen the cooperation and cordial relationship between an employer and his employees by conferring certain affirmative rights and enumerated restrictions on employers and employees. The provisions of the NLRA apply to any person acting as an agent of an employer, directly or indirectly. For instance, a supervisor may be personally liable if he/she has the authority to do the following: 1) hire; 2) transfer; 3) suspend; 4) lay-off; 5) recall; 6) promote; 7) discharge; or 8) discipline other employees. In most instances, only a supervisor, manager or officer of a corporation will be considered an agent of the employer. Personal liability may also extend to an outside consultant whom the employer had enlisted to perform any of the above referenced duties.

Not all federal employment statutes are read to impose personal liability on a corporation's employees. For instance, federal courts in Illinois have held there is no individual liability under the Americans with Disabilities Act, the Age Discrimination in Employment Act, and Title VII of the Civil Rights Act (sex and race discrimination). In any event, employers should take the time to train and inform their managerial and/or supervisory employees on the basic principles and parameters of the above referenced federal labor laws.

The same personal liability issues arise in Illinois employment law statutes. Individuals may be personally liable for violations of the Illinois Wage Payment and Collection Act ("IWPAC"). Under the IWPAC, an employee can bring a civil lawsuit to recover wages owed against corporate officers or agents who knowingly permitted the corporation to violate the IWPAC. For example, an Illinois court entered judgment in the amount of $73,690.00 against the chief operating officer of a company who was in charge of the company's payroll checks and controlled corporate disbursements.

Illinois courts have yet to address whether personal liability can be imposed for violations of the Equal Pay Act of 2003. The Equal Pay Act of 2003 ("EPA") prohibits employers from paying a man more for performing the same or similar work as a woman, unless the wage difference is based on seniority, merit, quantity or quality of production, or another valid factor other than gender. Although Illinois courts have not addressed the issue, federal courts have determined that the federal counterpart of the Equal Pay Act does allow for personal liability if the employee had supervisory authority over the complaining employee and was responsible for the alleged violation.

Whether or not personal liability attaches to violations of federal and state labor law statutes depends upon the conduct and knowledge of the supervisor and/or managing employee. To reduce the likelihood of personal liability, employers should consult with their Human Resources administrators or their attorney before acting.

ADDITIONAL INSURED ENDORSEMENTS

Most general contractors require subcontractors to name the general contractor as an additional insured on a general liability policy. Then, when an injured employee of the subcontractor files a tort claim against the general contractor, the general contractor makes a "targeted tender" to the subcontractor's insurance company thereby declining coverage under the general contractor's own insurance.

In response to targeted tenders, insurance companies began restricting the coverage they provide to additional insureds by limiting coverage to cases where the complaint alleges imputed liability. Thus subcontractors' insurance companies are limiting coverage for additional insureds to cases where the tort claim seeks to hold the general contractor indirectly liable for the negligence of the subcontractor.

In turn, some general contractors are requiring subcontractors to obtain endorsements that provide "primary" coverage for the general contractors. Subcontractors' insurance companies attempt to avoid targeted tenders through policy provisions requiring additional insureds to tender tort claims to all available insurance.

In a recent case, an Illinois Appellate Court ruled that there was no coverage for a general contractor as an additional insured since the tort claim filed by the subcontractor's employee did not allege imputed negligence against the general contractor. American Country Insurance Co. v. James McHugh Construction Co., (1st Dist. Dec. 4, 2003).

In this case, James McHugh Construction Co. was the general contractor, Spectrum Stone was a subcontractor.

After an injury, Marciano of Spectrum Stone filed a direct negligence claim against McHugh Construction and McHugh Development (collectively "McHugh"). There were no allegations seeking to hold McHugh liable for any negligence of Spectrum.

The contract between McHugh and Spectrum required Spectrum to have McHugh named as an additional insured on the general liability policy of Spectrum and the coverage for McHugh was to be "primary."

Spectrum's liability insurer, American Country Insurance Co. (American Country"), at Spectrum's request, listed McHugh as an additional insured, however, the American Country policy limited coverage for the additional insured to cases of imputed liability for the acts or omissions of the named insured, specifically excluded coverage for bodily injury caused by the additional insured and required the additional insured to tender tort claims to any other available insurance carrier.

McHugh sent the Marciano complaint to American County as a targeted tender. American Country demanded that McHugh also trigger coverage under its own liability policy. McHugh rejected the American Country demand.

American Country filed a complaint seeking a declaratory judgment that it owed no duty to defend or indemnify McHugh because Marciano's complaint alleged only direct negligence by McHugh.

A Cook County Judge granted American Country's motion for summary judgment, and denied McHugh's targeted tender, ruling American Country has no duty to defend or indemnify McHugh. The appellate court affirmed the County Judge's ruling.

The appellate court noted that an insurer's duty to defend, which is much broader than its duty to indemnify, is generally determined by comparing the allegations of the underlying complaint against the insured to the language of the insurance policy. If the facts alleged in the underlying complaint fall even potentially within the policy's coverage, the insurer is obligated to defend its insured, even if the allegations are groundless, false or fraudulent. In determining the insurer's duty to defend, the allegations in the underlying complaint must be liberally construed in favor of the insured. Additionally, if a provision of the insurance policy can reasonably be said to be

ambiguous, that provision will be construed in favor of the insured.

McHugh argued that it was entitled to coverage under the American Country policy because of the possibility it could be held liable for negligence of Marciano's employer, even though the tort claim did not allege any negligence by the subcontractor. The Court rejected the argument.

The appellate court found that Marciano's complaint alleged only direct negligence against McHugh. Accordingly, it did not trigger a duty to defend. In particular, Marciano alleged that McHugh erected or caused to be erected the scaffolding from which he fell; that McHugh failed to warn him of the danger posed by the scaffolding; that McHugh failed to properly inspect, manage and supervise the job site, that McHugh failed to provide adequate safeguards to prevent injury; and that these acts or omissions proximately caused his injury.

Such allegations take the Marciano complaint outside the protection of American Country's endorsement to Spectrum and place it squarely within the exclusion that makes American Country's policy inapplicable to allegations of "bodily injury" or "property damage arising out of any act or omission of the additional insured(s) or any of their employees."

The court ruled the additional insured endorsement at issue does not cover the direct negligence of McHugh, the additional insured. Therefore, McHugh is not entitled to a defense.

While this ruling did not decide whether the "tender to others" provision stopped McHugh from making a targeted tender, general contractors and subcontractors would be prudent to review their contract provisions with their insurance broker and the insurer to avoid an unpleasant result.

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