

# Employers Face Increasing Worker Classification Pressure

By **Paul DeCamp and Michael Kun**

For more than 80 years, federal law has provided a general right to premium pay for working overtime hours, originally just for covered employees, then later for employees of covered enterprises.

The laws of more than 30 states contain a comparable requirement, though in some instances differing in the particulars.

This presumptive right to the overtime premium is, of course, subject to the familiar exemption construct whereby individuals whose employment satisfies one or more of the dozens of exempted categories fall outside the premium pay requirement.

Many of the most significant employment law battles over the past three decades have focused on whether certain groups of workers satisfied the criteria for an overtime exemption, resulting in businesses spending billions of dollars on judgments, settlements and defense costs.

Think pharmaceutical sales representatives, insurance claims adjusters, financial advisers, mortgage loan officers, insurance and bank underwriters, automotive service advisers, various types of drivers, and more.

Hardly a week goes by without reports of seven-figure verdicts or settlements involving challenges to exempt status.

Deciding whether to classify workers as exempt may become even more challenging for businesses in the coming years.

It remains to be seen whether courts will apply the U.S. Supreme Court's 2018 ruling in *Encino Motorcars LLC v. Navarro*,<sup>[1]</sup> adopting a "fair reading" interpretive principle for exemptions under the Fair Labor Standards Act, to exemptions arising under state law.

In addition, it seems likely that the Biden administration will increase significantly the minimum salary for the executive, administrative and professional exemptions, thereby forcing many employers to decide whether to increase salaries or to reclassify workers to nonexempt.

A separate set of disputes has arisen during that same time period regarding whether employers have correctly paid overtime premiums to their salaried nonexempt employees.

There are several different ways to pay overtime to salaried workers, and questions regarding the availability of the fluctuating workweek method have spawned numerous class and collective actions, as well as regulatory and statutory modifications.

For instance, in *Chevalier v. General Nutrition Centers*,<sup>[2]</sup> the Pennsylvania Supreme Court in 2019 ruled that the state's overtime regulations do not incorporate the federal fluctuating workweek concept.



Paul DeCamp



Michael Kun

Meanwhile the U.S. Department of Labor last year rejected the Wage and Hour Division's interpretation from 2011 and, inter alia, adding Title 29 of the Code of Federal Regulations, Part 778.114(a)(5), which expressly allows for employees paid via the fluctuating workweek to receive bonuses, commissions and other nonsalary payments without rendering unavailable the fluctuating workweek overtime calculation.[3]

Apart from lawsuits, employers have devoted countless hours of internal legal, human resources and executive time — not to mention expended countless millions of dollars on outside counsel fees — weighing the risks posed by classifying workers as exempt or maintaining the salaried nonexempt classification.

Given the risk, the time and the expense, it's tempting to ask: Why not just make everybody hourly?

Why do businesses continue to treat some employees as overtime-exempt, or pay nonexempt employees a salary, rather than just pay everyone on an hourly basis?

In our experience helping clients navigate these issues — and we emphasize that these are our own observations and not the result of any formal surveys or other quantitative assessments — the answer seems to be at least threefold: (1) employee preference for exempt status, (2) employee preference for receiving a salary and (3) the business advantage of predictable labor costs.

### **On balance, employees seem to prefer being exempt if given the choice.**

In most organizations, exempt status tends to correlate with positions with higher pay, more generous benefits and greater prestige than nonexempt roles.

People who have the option of moving from a nonexempt position to an exempt role ordinarily choose to take the exempt position — and make that choice with no hesitation.

This is so because, in addition to higher pay, exempt positions often offer access to further training and development opportunities, which in turn make further promotion and career progression possible.

Employers are more willing to provide these opportunities when doing so does not involve an hourly expense.

Another aspect of exempt status that many workers value quite highly is the freedom from punching a clock or otherwise having one's working time scrutinized on a minute-by-minute basis.

Being accountable for one's overall job performance, without having to worry about clocking in too early or too late, or taking a mandatory rest period, or eating a meal at the required time and for the required duration, makes people feel respected and valued.

Hourly pay reinforces two unfortunate perceptions in the workplace. First, it serves as a reminder that one's work is, at least to a certain extent, fungible with the work of others, and that a worker functions as just a cog in the machine.

Second, it functions as a divider between the workers who get hourly pay and the bosses who do not. These perceptions can be especially corrosive with respect to individuals performing the types of work that at least arguably fall within the scope of the overtime

exemptions built into federal and state law.

We certainly do not mean to suggest that employee choice trumps legal requirements. Where the law dictates that an employee is overtime-eligible, compliance is not optional.

But where exempt classification is a plausible option, far more often than not the worker will prefer to be treated as exempt. At least until the employee encounters trouble, retains a lawyer and decides to seek additional money for work already performed.

The reality is that nobody ever has to take an exempt job. There are a lot fewer exempt positions than nonexempt positions in our economy, and it is usually much easier for a worker to qualify for and to obtain a nonexempt role than an exempt one.

Yet workers continue to seek out exempt jobs. Worker preference for exempt status is an important consideration for employers in hiring and retaining talent, and it is a big part of why exempt status remains a popular choice for employers notwithstanding the potential legal headaches.

### **Employees ordinarily prefer receiving a salary rather than hourly pay.**

As a general matter, hourly workers receive pay for only the specific amount of time that they work, while salaried employees receive the same fixed amount of pay regardless of fluctuations in their hours.

Salaried nonexempt workers also receive additional pay if their hours cross an overtime threshold.

For workers, this difference between hourly pay and salary relates to overall economic security. Most salaried workers seem to take comfort in knowing what their cash flow will be from month to month.

This consistent pay stream allows salaried workers to engage in more effective budgeting and retirement planning.

Hourly workers, by contrast, are subject to fluctuations in workload from week to week. This can mean room for significant financial upside if work gets particularly busy, but it can also mean lighter paychecks for slow weeks.

The potential for pay to fluctuate downward puts hourly workers at greater risk of facing a temporary inability to pay current bills.

Of course, salaried workers also face the risk of job loss, furloughs, pay cuts and the like in the event that their employer faces hard times. But because of the rules governing salaried employment, employers are ordinarily quicker to reduce working hours for hourly employees than to take steps that reduce pay for salaried individuals.

If anything, during hard times employers that find themselves having to cut hours for hourly employees may nevertheless look for ways to assign some of the work those people would have performed to the salaried staff.

Particularly for risk-averse employees, the knowledge that there will be a constant, knowable stream of income each month eliminates a source of stress and worry.

Payment on a salary basis provides a measure of economic security lacking in hourly pay, and it operates as a kind of buffer protecting workers from suffering economic hardship in the face of short-term workload reductions.

The peace of mind that a salary provides to employees increases employee demand for salary pay, which in turn exerts pressure on employers to pay employees a salary when possible.

**Exempt status and salaried nonexempt status help employers plan better for labor costs.**

Budgets are, of course, important not only for workers but for businesses. Anticipating and planning for labor costs can be among the most important activities a business undertakes.

In particular, failing to budget sufficient funds for payroll can put a company into a severe financial crisis, just as failing to pay a worker's earned wages can create serious hardship for the worker.

With salaried employees, a business knows in advance what it will have to spend on those employees over the course of a month, a quarter or a year.

There may be opportunities to provide raises, bonuses or other incentives if the employee or the company perform particularly well. But the salary ordinarily defines the minimum financial commitment that the business will have to the employee, and this enables the employer to plan for that expense.

Pay for hourly employees can vary considerably, particularly if workloads change significantly throughout the year. In theory, this type of challenge should work itself out in the long run, as a period of high workload typically results in higher revenue, at least at some point down the road.

But there is often a significant lag between when an employer experiences a spike in demand for hourly labor and when the business receives dollars in the door relating to that specific labor.

This can cause cash shortages for the business that, depending on the financial well-being of the employer, can strain resources, choke off other business opportunities, or even result in insolvency, including job losses for the workers.

Being able to set and to adhere to a labor budget, whether at the level of an individual manager or department or for an entire division or enterprise, is critical for many businesses. Having workers on salary, especially when those workers are exempt, provides the sort of cost stability that businesses typically seek.

Critics of exempt status normally paint a picture of a greedy employer trying to cheat its employees by demanding more work without more pay, caricaturing exempt roles as a scam for businesses to bully workers into laboring for free rather than earning overtime pay for their hard work.

But that criticism misses the mark as it fails to explain why exempt roles remain in such high demand, even as nonexempt positions remain available and unfilled.

If exempt status were such a bad deal for employees, why would so many of them choose

exempt roles? Ultimately, the benefits to workers and employers alike will continue to make exempt status an attractive classification.

The same is true for salaried nonexempt work. The employees who hold these roles are, in our experience, normally office workers, many of whom have a college degree, who may just miss the cut for exempt status. These individuals value the safety net that a salary provides, as well as the status associated with being salaried rather than hourly.

In the end, not everybody wants the work experience to feel like a factory assembly line. Those workers who want to be hourly, and who desire overtime eligibility, will have ample opportunity to obtain that type of employment. But for the rest of us, exempt status and payment on a salary basis are here to stay.

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*Paul DeCamp and Michael Kun are members at Epstein Becker Green.*

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[1] Encino Motorcars, LLC v. Navarro, 138 S. Ct. 1134, 1142 (2018).

[2] Chevalier v. Gen. Nutrition Ctrs., Inc., 220 A.2d 1038 (Pa. 2019) (concluding that Pennsylvania's overtime regulations do not incorporate the federal fluctuating workweek concept).

[3] Fluctuating Workweek Method of Computing Overtime, 85 Fed. Reg. 34,970 (June 8, 2020) (rejecting Wage and Hour Division interpretation from 2011 and, inter alia, adding 29 C.F.R. §778.114(a)(5), which expressly allows for employees paid via the fluctuating workweek to receive bonuses, commissions, and other nonsalary payments without rendering unavailable the fluctuating workweek overtime calculation).