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Strategy & Insights

Energy Employment Law Group

Guidance For Employers In The Energy Industry To Avoid Common Wage & Hour Traps

Through aggressive investigation and enforcement initiatives, the Department of Labor has recently intensified its scrutiny of employers in the oil-and-gas industry. Among other things, the DOL is looking for employees who have been misclassified as independent contractors, while inspecting employers' pay practices to ensure compliance with the often-Byzantine wage-and-hour laws. These investigations have resulted in some employers paying large settlements to the DOL (while enjoying unwanted media attention). Even if they don't involve your company directly, that can make your business sector—and thus your company—a target for private collective- or class-action lawsuits. To avoid these risks and ensure compliance, you need to know about three wage-and-hour traps that are common in the energy industry.

TRAP NO. 1: FAILING TO PAY OVERTIME ON TOP OF DAY RATES AND SHIFT RATES

Day-Rate Plans Come With a Common and Costly Wage-and-Hour Trap

Day-rate plans are common in the oil-and-gas industry. Mud-logging technicians, riggers, roughnecks, welders, and various other craft workers are often paid a fixed sum for each 10-, 12-, or 24-hour shift. But many employers mistakenly believe that paying their nonexempt employees a fixed day or shift rate eliminates the need to track hours or to pay overtime compensation. This is a common wage-and-hour trap.

Failing to identify and remedy this frequent mistake will make your company a potential target for class- or collective-action lawsuits and costly investigations by the DOL. Just last month, the DOL announced that an oilfield drilling company in New Mexico will pay $600,000 to its current and former mud-logging technicians after an investigation revealed that the company had paid them a fixed daily rate without overtime.

Under Both Day-Rate and Shift-Rate Plans, Employers Must Pay Overtime at "Half-Time"

In most circumstances, the Fair Labor Standards Act (FLSA) requires nonexempt employees to receive overtime at 1.5 times their "regular rate" for all hours worked over 40 in a workweek. Contrary to what many people believe, day-rate or shift-rate plans are no exception. Remember that employees may not waive their right to overtime compensation; thus, even if an employee agrees to a day rate, this will not prevent him or her from later recovering compensation for unpaid overtime hours.

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The first step in calculating overtime in a day-rate situation is to calculate the employee's regular rate. This is not difficult if the employee receives a pure day rate. In that case, the employee's regular rate is calculated by adding the employee's day-rate payments for the workweek in question, and then dividing by the total hours the employee worked that same week.

> **QUICK TIP**: Remember that under any compensation plan, a nonexempt employee's regular rate can never be less than the FLSA minimum wage or the minimum wage required under applicable state law—whichever is higher.

If the employee's work for that workweek exceeds 40 hours, then he or she must receive overtime in addition to the day rates. This overtime compensation is determined by multiplying the employee's regular rate by 0.5, and then multiplying that figure by the number of hours worked over 40 in the workweek. See 29 C.F.R. § 778.112; *Dufrene v. Browning-Ferris, Inc.*, 207 F.3d 264, 267-68 (5th Cir. 2000). The required calculations can be summarized as follows:

Overtime Pay = Total Day-Rate Compensation During Workweek ÷ Hours Worked × 0.5 × Hours Worked Over 40 During Workweek

Total Pay = Total Day-Rate Compensation During Workweek + Overtime Pay

For example, suppose that an employee's day rate is $240. Suppose further that the employee works seven days in a workweek, and works a total of 70 hours that week. The employee's pay should be calculated as follows:

Day-Rate Pay = $240 × 7 = $1,680

Overtime Pay = ($1,680 ÷ 70) × 0.5 × 30 = $360

Total Pay = $1,680 + $360 = $2,040

Why do we multiply the regular rate by 0.5 here, rather than the full 1.5? Because the day-rate payments represent straight-time compensation for all work done in the workweek—both those hours worked up to 40 and those worked over 40. For that reason, the employee is entitled only to an additional "half-time" premium for hours over 40.

Advice for Employers

If your company pays employees on a day-rate or shift-rate basis, make sure those employees are receiving additional compensation for any overtime hours they are working. In addition, make sure that the company has implemented—and is following—procedures to accurately track the employees' regular and overtime hours.

TRAP NO. 2: FAILING TO INCLUDE BONUSES AND SIMILAR COMPENSATION IN THE REGULAR RATE

Safety bonuses, attendance bonuses, and production bonuses are common in the energy industry—particularly with employers that operate large refineries. If the bonuses are considered nondiscretionary (more on that below), then the bonuses may increase the amount of overtime pay the nonexempt employees are entitled to receive under the FLSA. If an employer fails to account for this extra amount, the employee will have a "regular rate" claim for unpaid overtime. In the past few years, the DOL has turned its attention to this common violation and has begun targeting large energy companies—particularly those in and around the Houston Ship Channel.

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The Default Rule for Bonuses: Retroactive Calculation and Payment of Additional Overtime

The FLSA refers to bonus payments as "sums paid in recognition of services performed during a given period." As a general rule, if an employer pays a bonus to nonexempt employees, then the employer is required to retroactively calculate and issue additional overtime pay.

Example No. 1: Assume an employee receives a $30 safety bonus for the week and works 60 hours during the workweek—that is, 40 regular hours plus 20 hours of overtime. To calculate the required additional overtime pay, the employer must first reduce the bonus to an hourly rate. This is done by dividing the bonus amount by the total hours worked during the workweek ($30 ÷ 60 hours = 50 cents). The rate for the additional overtime pay is one-half of this amount (50 cents x 0.5 = 25 cents). In this example, the employee is entitled to the $30 production bonus plus $5.00 in additional overtime pay (25 cents x 20 hours of overtime).

Example No. 2: Assume an employee receives a mid-year production bonus of $2,600. To calculate the additional overtime pay required, the employer must first allocate the bonus to each workweek in the period upon which the bonus is based (in this case, 26 workweeks). In this example, the employee has earned an additional $100 per workweek ($2,600 ÷ 26 workweeks). For each workweek in the period, the employer must then reduce this $100 bonus to an hourly rate by dividing the $100 by the total hours worked during the workweek. Then, the employer must repeat this calculation for each workweek in the period. For example:

Week 1: If the employee worked 50 hours in the first week, then he or she is entitled to $10 in additional overtime pay for that workweek ($100 ÷ 50 hours x 0.5 x 10 overtime hours).

Week 2: If the employee worked 60 hours in the second week, then he or she is entitled to $16.67 in additional overtime pay for that workweek ($100 ÷ 60 hours x 0.5 x 20 overtime hours).

The Exception: Discretionary Bonuses

Under the FLSA, employers are not required to pay additional overtime for discretionary bonuses, but the term "discretion" can be misleading. Generally, a bonus is considered discretionary if the employer satisfies the following three rules:

- **Discretion on whether the bonus will be paid:** The employer must maintain sole discretion on whether the bonus will be paid, and it must keep that discretion until near the end of the period upon which the bonus is based. If an employer announces in January that it will pay a bonus based on February's production numbers, then that bonus generally would not qualify as a discretionary bonus. The idea here is that the employer's announcement will induce employees to work harder or more efficiently (or in the case of a safety bonus, to work safely).

- **Discretion on how the bonus will be calculated:** The employer must maintain sole discretion on how the bonus will be calculated, and it must keep that discretion until near the end of the period upon which the bonus is based. Suppose that an employer promises to pay a bonus of 1% of sales revenue whenever it decides that its financial affairs warrant issuing the bonus. If the employer later decides to pay the bonus, it generally would not qualify as a discretionary bonus because the calculation has been set in stone.

- **Custom or practice of paying the bonus:** The Department of Labor takes the position that a longstanding practice of paying bonuses shows a lack of discretion. The DOL will generally require the employer to pay additional overtime based on such customary bonuses. According to the DOL, the analysis turns on whether there is a "custom or practice of paying a bonus with regularity sufficient to imply an understanding on the part of the employees that they will regularly receive the bonus."

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Additional Exceptions: Profit-sharing Plans, Trusts, Thrift Plans, and Savings Plans

Employers are not required to pay overtime based on bonus payments made pursuant to certain qualifying plans. Each plan has specific requirements and disqualifying factors. See 29 C.F.R. § 547.0 et seq. (setting forth requirements for thrift and savings plans); id. § 549.0, et seq. (setting forth requirements for profit-sharing plans and trusts). While a full analysis of the requirements for each such plan is beyond the scope of this paper, one common disqualifier revolves around how the payments are calculated: To qualify under this exception, the plan payments may not be based on hours worked, production, or work efficiency.

Advice for Employers

Employers should examine the nature of their bonus payments. If the bonus is something that employees have come to expect—either because it has been promised or the employer has a regular practice of paying it—then there is a good chance the bonus is nondiscretionary under the FLSA. If the bonus is nondiscretionary, the employer should ensure that retroactive overtime payments are correctly calculated and issued to the nonexempt employees receiving the bonus.

TRAP NO. 3: MISCLASSIFYING INDEPENDENT CONTRACTORS

Heightened DOL Scrutiny Focused on the Oil-and-Gas Industry

Employers in the oil patch often use independent contractor or "freelance" welders, crane operations, roughnecks, and other craft workers to provide specific skills or services that may not be available within the organization. Because the FLSA and most state wage-and-hour laws apply only to "employees," employers are not required to pay overtime to independent contractors. But the use of independent contractors can expose companies to substantial liability if not managed properly, including liability for minimum-wage and overtime violations. It can also create exposure for tax obligations, and employee benefits such as unemployment and workers' compensation.

The DOL continues to investigate the misclassification of independent contractors as part of an ongoing enforcement initiative focused on the oil-and-gas industry. Just last month, the DOL announced a settlement with a Houston company that paid approximately $700,000 in overtime back wages to roughnecks and crane operators who had been misclassified as independent contractors. In addition to the DOL, employers face the prospect of private litigation in the form of collective actions or class actions, which can also create substantial liability.

WHAT DOES THE DOL SAY? According to a recent DOL press release, "The misclassification of employees as something other than employees, such as independent contractors, presents a serious problem for affected employees, employers and to the economy. Misclassified employees are often denied access to critical benefits and protections, such as family and medical leave, overtime, minimum wage and unemployment insurance, to which they are entitled. Employee misclassification also generates substantial losses to the Treasury and the Social Security and Medicare funds, as well as to state unemployment insurance and workers' compensation funds."

The Economic Realities Test for Independent Contractors Under the FLSA

Independent-contractor agreements are valuable and meaningful, but they are not a cure-all. Simply having workers sign independent-contractor agreements, or making them acknowledge their status as independent contractors on tax forms,

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will not transform an employee into an independent contractor. In refusing to dismiss a suit against an oil-rig manufacturer, U.S. District Judge Keith Ellison recently noted that "[a] person's subjective opinion that he is a businessman rather than an employee does not change his status." See Trahan v. Honghua America, LLC, No. H-11-2271 (S.D. Tex. June 10, 2013).

To determine whether an individual is properly classified as an independent contractor under the FLSA, courts and the DOL examine the economic relationship between the parties. The questions is whether, as a matter of economic reality, the worker is economically dependent upon the company or is instead in business for himself. The answer depends on the factual circumstances, including the following non-exhaustive list of factors:

- the degree to which the company may control the manner in which the work is performed;
- the individual's opportunity for profit (or loss);
- the individual's investment in equipment or materials required for his task, or his employment of helpers;
- whether the service rendered requires a special skill;
- the degree of permanence of the working relationship; and
- whether the service rendered is an integral part of the company's business.

Because these cases hinge on so many factual determinations, winning a contractor misclassification case on summary judgment is complicated—even when you have contractor agreements in place.

QUICK TIP: Remember that different laws have different standards and tests for determining independent contractor status. The Internal Revenue Code is different from the FLSA. The FLSA is different from state anti-discrimination laws. Thus, even if a worker qualifies as an independent contractor under one law, he may still be misclassified under the FLSA. Indeed, the FLSA standard is generally regarded as the most difficult to meet.

Reducing The Risks—Steps to Ensure Proper Classification of Independent Contractors

There are a number of steps you can take to minimize the risk that your independent contractors or consultants might be deemed to be "employees" under the FLSA. Consider the following practical recommendations:

- Ensure your independent contractors control the manner and means to do the work and provide their own tools. To the extent possible, avoid providing equipment or other facilities (such as office space or company e-mail accounts) to your contractors.
- Make sure you have written independent-contractor agreements that define the scope and terms of your relationship with each independent contractor, and review those on a regular basis to ensure the reality of the work matches the written documents.
- Independent contractors should not perform the same or similar duties that your employees perform.
- Hire your independent contractors for a defined, short period of time based on the services provided or the specific project to be completed.

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- Train your employees how to interact and communicate with your independent contractors. The independent contractors should typically not take part in the same training programs as your employees, and should not receive special achievement awards or bonuses provided to employees. Managers should avoid making any statements about your contractors that suggest an employment relationship.

- If your independent contractors are supplied by a third-party company, include an indemnification provision in the relevant agreements requiring the third-party company to indemnify and defend your company against a challenge to the workers' independent-contractor status or other alleged wage-and-hour violations.

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