Restrictive Covenants, RIFs, and Regular Rate: A Multi-Topic Employment Law Update

EMILY P. HARBISON
Regional Managing Partner | Houston
eharbison@fisherphillips.com
713.292.5620

LINDSAY REIMER
Partner | Houston
lreimer@fisherphillips.com
713.292.5617

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Agenda

- Reduction in Force
- Restrictive Covenants
- Regular Rate of Pay: Compliance and Pitfalls

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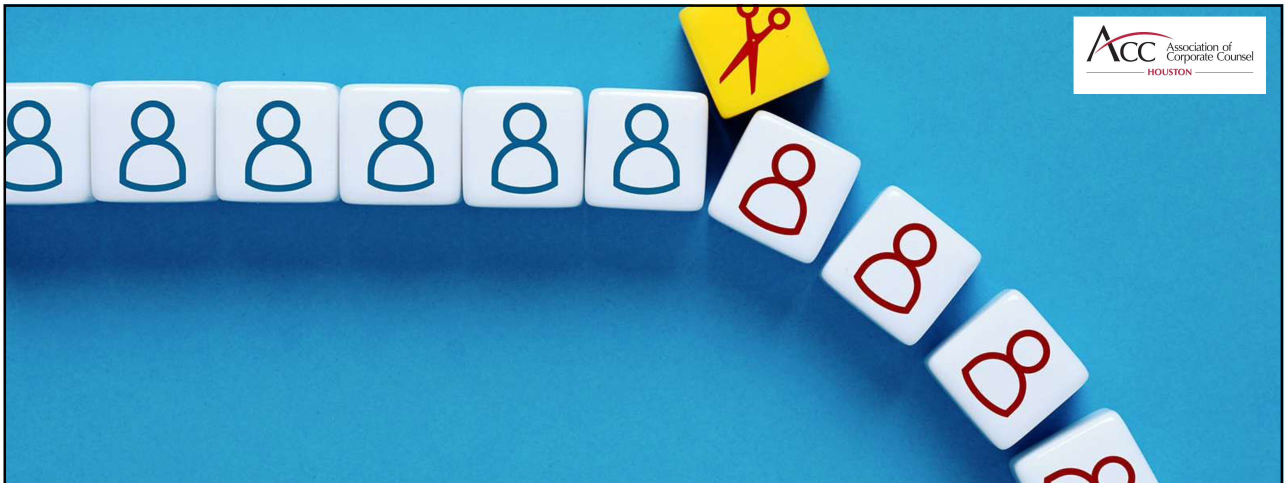

RIFs: “We’re having a RIF this week.”

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Typical Scenario Outside Counsel Sees

- The C-Suite wants to cut labor costs immediately. Or get rid of bad performers
- Department/team managers with no experience in RIFs tasked with selecting employees to meeting a cost savings number.
- Selections made rapidly under pressure.
- HR tasked with drafting severance agreements on short timeline
- Little to no time for legal review

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Problems

- No objective selection criteria. Managers making very subjective decisions.
- High risk of discrimination and/or retaliation.
  - Selected employees recently made an internal complaint
  - Selected employees just took or requested protected leave or an accommodation (FMLA, ADA)
  - Selected employees filed a workers' comp claim
- Non-compliant severance agreements
  - Timing of pay, required notice, multi-state issues

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Step 1: Plan the RIF

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Business Objectives

- Position Elimination - all employees in the affected job classification are RIFed
- Position Consolidation - some, not all, employees in affected job classification are RIFed
  - What is the criteria?
    - Tenure/seniority – most defensible
    - Performance – more subjective (evaluations v. new ratings)

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Documentation

- Business Case
  - Other cost-saving measures considered
- Selection Criteria
  - Train Managers
  - Documentation
- Selection Process

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Step 2: WARN Act Considerations

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WARN Act Considerations

- Federal WARN requires 60 days' advance written notice to employees (and others)
- Mass layoff: Employment loss at *single site of employment* during any 30-day period for either:
  - 50 employees who comprise at least 33% of active employees; or
  - At least 500 employees.
- Plant Closing: Permanent or temporary shutdown resulting in an employment loss for at least 50 employees during a 30-day period, of either:
  - A single site of employment; or
  - Facilities or operating units within a single site of employment.
  -

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Exceptions to 60-day Notice

- Unforeseeable Circumstances Exception
  - The most litigated defense
- Natural Disaster
- Faltering Company

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Who Receives WARN Notice? (Not Just Employees)

- Affected employees
- The "state dislocated worker unit"
- Chief elected official of local governmental unit where they pay most taxes
- Bargaining representative of unionized employees
- Very technical and outdated requirements. Follow regulations carefully to ensure all information is provided.

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Remote Employees

- WARN was passed in early 1990’s in response to plant closures devastating local economies.
- True “remote” or out-stationed workers were rare.
- A remote worker can be counted as an employee of a physical site for purposes of WARN if they:

  (1) report into the site;

  (2) receive assignments from the site; or

  (3) the site is the worker’s “home base.”

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WARN Available Remedies and State “mini-WARNs”

- Back pay and benefits for 60 days
- Civil penalty of $500 per day
- Attorneys’ fees
- Pay-in-lieu of notice
- Some states have “mini-WARN” statutes or other laws that could impact your RIF
  - No mini-WARN in Texas
  - New York, Illinois, California among big ones.

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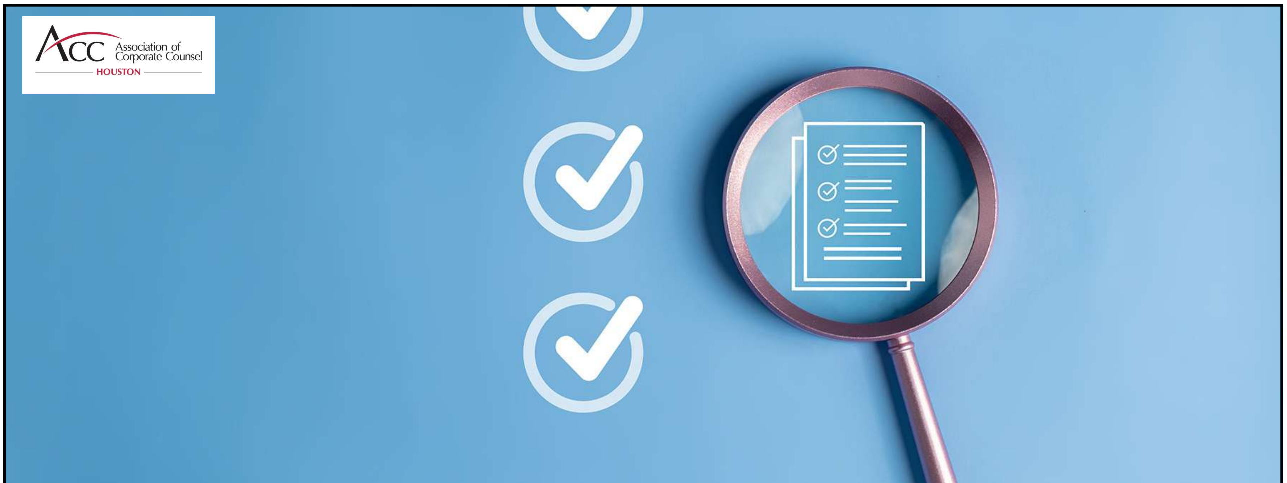

Step 3: Legal Review

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Legal Review

- Legal Risk Analysis
  - Adverse impact Analysis – conduct under privilege

Supply Chain

Total Considered: 30
Total Terminated: 10 (33.3%)

SEX

Total Males	15		
Males Terminated	4	26.6%	
Total Females	15		
Females Terminated	6	40%	Standard Deviation against females: 0.775

RACE

Total Whites	16		
Whites Terminated	3	23%	
Total Minorities	14		
Minorities Terminated	7	50%	Standard Deviation against Minorities: 1.811

AGE

Total Under 40	23		
Under 40 Terminated	5	21.7%	
Total 40 and Older	7		
40 and Older Terminated	5	71.4%	Standard Deviation against 40 and Older: 2.442

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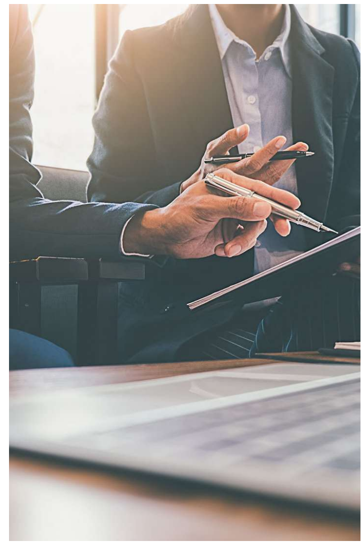
Legal Review

- Consistent with RIF goals?
- Any protected activity?
  - Pending/Previous Employment Litigation, Charges or Complaints/Whistleblower
- Impact on employees on leave?



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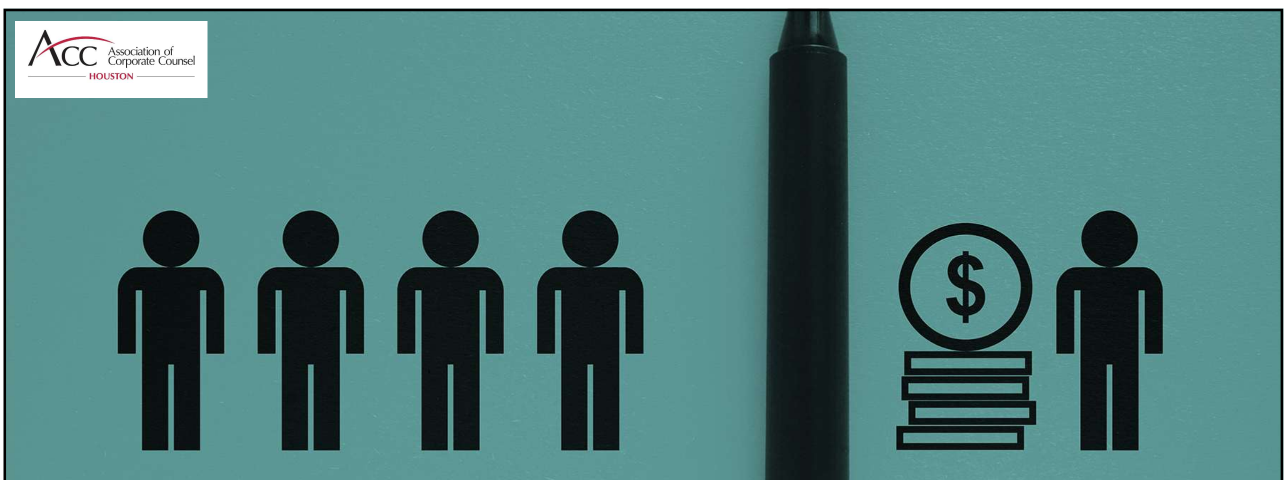

Step 4: Severance Agreements

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Severance Agreements

- Under 40 and 40 and Older Group Agreements
- 40 and Older
  - » Special requirements for waiver of claims under the ADEA in the context of an "employment termination program."
    - 45-day consideration period;
    - 7-day revocation period;
    - Advise in writing to consult an attorney
    - Information about the decisional unit

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Decisional Unit

- Job titles and ages of everyone in the "Decisional Unit" and indication of who was selected for offer of severance and who was not
  - The portion of the employer's organizational structure from which the employer chose the persons.
  - Sometimes easy.
    - – Department? Production Line?
  - What if someone was truly not considered?
  - Risk of plaintiffs' attorneys challenging the Decisional Unit as too big or too small and having the age release found invalid for all 40 and older employees

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OWBPA Disclosure

Production Department

Position	Age	Selected for Termination: Offered Severance Package	Not Selected for Termination: Not Offered Severance Package
Machine Operator I	67	X	
Machine Operator I	28		X
Machine Operator II	50	X	
Machine Operator II	19		X

- What if we need to do another round of RIFs in a couple of months?

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Severance Agreement Issues

- Any plan or policy / employment agreement?
- Do not work off old severance documents
- Updating for state laws
- Use of restrictive covenants
  - Not in Texas for non-competes
  - Superseding other agreements?

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Texas Law Considerations

- Unused PTO and Vacation Payout
  - » Policy controls if paid out or forfeited
- Final Paycheck Laws
  - » Within 6 days for involuntary termination
  - » This is separate from any separation benefit
- State or federal COBRA notice

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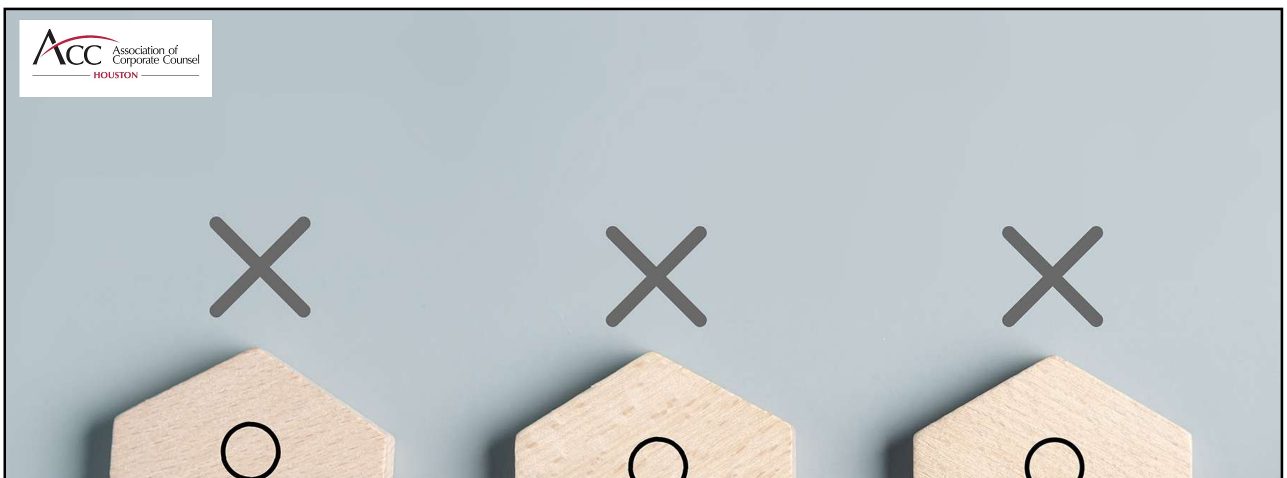

Step 5: Implementing the RIF

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Step 6: Implementing the RIF

- Timing – Probably not good to conduct right before Christmas
- Exiting employees
  - Remote employees
    - Supervisor and HR representative
    - Assume you are being recorded
  - Security Risks
    - Confidential information/trade secret concerns
    - Condition payment of severance on return of all company property.

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Maintaining Employee Morale

- Most critical part is to retain talent
- Reinforce the necessity of the layoff and getting the company on track
- Admit fault if the reason was over-hiring and work to gain trust
- Confirm no more layoffs are planned (if true) but don't make any promises.
- Implement a hiring freeze

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Restrictive Covenants

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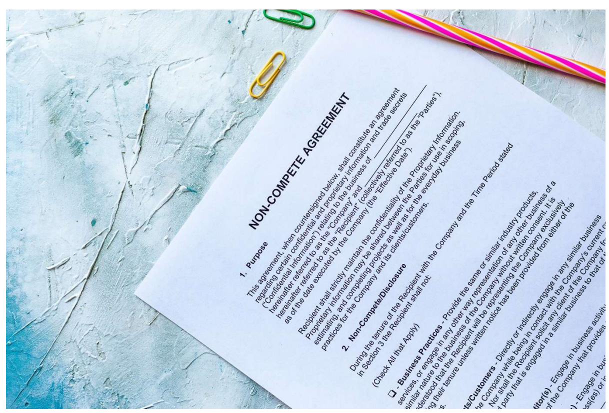
Non-Compete Basics

What is a "non-compete agreement?"

- Umbrella term for post-employment restrictive covenants, including:
  - Customer non-solicitation (recommended)
  - Employee non-solicitation (recommended)
  - Supplier/vendor non-solicitation (possible)
  - Non-competition (optional)

Where are non-compete covenants usually found?

- Employment contracts
- Standalone contracts (NDAs)
- Equity agreements/ERISA plans



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Primer on Texas

Texas Uniform Trade Secrets Act (TUTSA)

- Identical to other states' uniform acts
- Nearly identical to DTSA

Purpose of Agreements

- Under the Covenants Not to Compete Act (CNC), covenants are meant to "to protect the goodwill or other business interest of the promisee"

Covenants Must be Reasonable

- Under CNC, covenants must be "reasonable" as to time, geographical area, and scope of activity to be restrained
- Translation: essentially "protectible interest," i.e., restraints are necessary to protect the company's confidentiality information or trade secrets from being used or disclosed against the company and/or to benefit a competitor

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State Bans or Restrictions on Non-Competes

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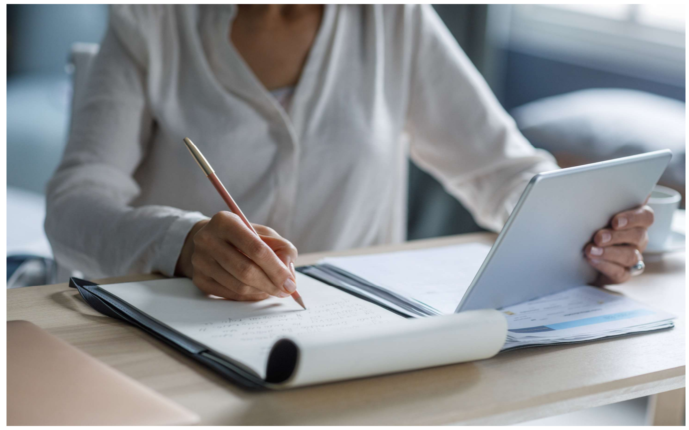
Action Items to Protect Business

- Review non-compete agreements for state-law compliance, suitability for industry and employees, and locations of remote employees
- Secure confidential information and trade secrets
- Update policies, procedures, and employee handbook



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Non-Compete Practice Recommendations

- List the non-compete agreement in the offer letter as a condition of employment, send the agreement as part of the pre-employment packet, and *ensure the employee returns a signed agreement*
- (A) Include non-compete agreements as part of annual HR audit and (B) during due diligence or post-transaction audits after acquisitions/mergers
- Tailor covenants to employees' position, duties, and responsibilities
- For existing employee, ensure employee is given *new confidential information* after signing
- In mandatory venue clauses, choose business-friendly county or stay silent
- Ensure separation agreement reaffirms non-compete covenants
- *Reevaluate and update* non-compete agreements periodically
  - Remember: No actual damages until after reformation and potential fees claim by employee

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Trade Secret Practice Recommendations

- Confidential information should be separated into buckets and access should be granted only to those who need to know
- Customer-facing employees should not have access to all customer information or lists of all customers, only those they service
- Employees should not be allowed to use personal devices, especially USBs, for company business
  - Agreement/policy
  - Easy IT fix to require encrypted company-issued USBs
- If employees are allowed to use personal devices, confidentiality agreement should include provision allowing access to devices
  - Or require app that allows company access to wipe device upon separation

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Trade Secret Practice Recommendations (Cont'd)

- Use keystroke monitoring software to monitor employees' use and transmission of confidential information
- Retain and/or image employees' company devices and emails following separation
- Conduct exit interview
  - Ask about confidential information
  - Require employee to search for and return all physical and electronic files
  - Require employee certification that everything has been returned

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Regular Rate Fundamentals

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Why the Regular Rate Matters

- The FLSA requires overtime at 1.5× the "regular rate of pay" — not simply 1.5× the base hourly wage. When employers calculate overtime using only base pay and ignore other compensation, the underpayment compounds across every overtime hour worked, often for years.

Class Action Risk

- FLSA collective actions and state class actions routinely allege regular-rate miscalculation as a standalone or add-on theory

Liquidated Damages

- Employees who prevail typically recover double damages — equal amount in liquidated damages on top of back pay

3-Year Lookback

- Willful violations extend the statute of limitations to three years, dramatically increasing exposure

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What Is the Regular Rate of Pay?

The Legal Definition

Under the FLSA, the regular rate is the actual hourly rate an employee receives — not just the base wage. It includes **all remuneration for employment** paid to or on behalf of the employee, except amounts excluded by statute. 29 U.S.C. § 207(e).
Overtime must be paid at **1.5× the regular rate** — not 1.5× the base hourly rate.

The Core Formula

- Step 1: Add all includable compensation earned in the workweek.
- Step 2: Divide by total hours worked that week.
- Step 3: Calculate overtime using the regular rate

⚠ An employee earning $20/hr base who also receives a $200 nondiscretionary bonus in a 50-hour week has a regular rate *higher* than $20/hr — and overtime must be recalculated.

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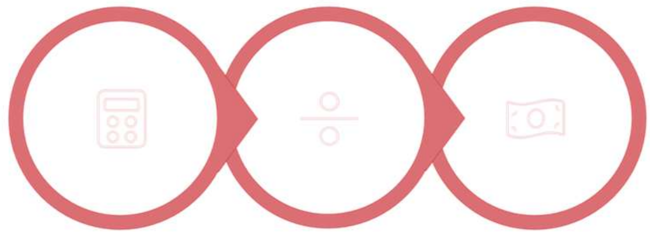
How the Math Works: A Simple Example

- Even a modest non-discretionary bonus can meaningfully increase an employee's regular rate — and create retroactive exposure for every overtime hour in the bonus period.



Total Earnings | **Divide Hours** | **OT Owed**

Example: A manufacturing employee earns **$20.00 per hour**, works **50 hours** in a workweek, and earns a **$500 production bonus** for that same week. Because the bonus is part of the employee's pay for the week, it must also be included when calculating overtime. The bonus increases the employee's regular rate by **$500 ÷ 50 hours = $10.00 per hour**. Since the employee worked **10 overtime hours**, the employer owes an additional **one-half of that hourly increase** for each overtime hour:
$10.00 × 0.5 × 10 overtime hours = $50.00. The employer already paid overtime based on the employee's **$20.00 hourly rate**.

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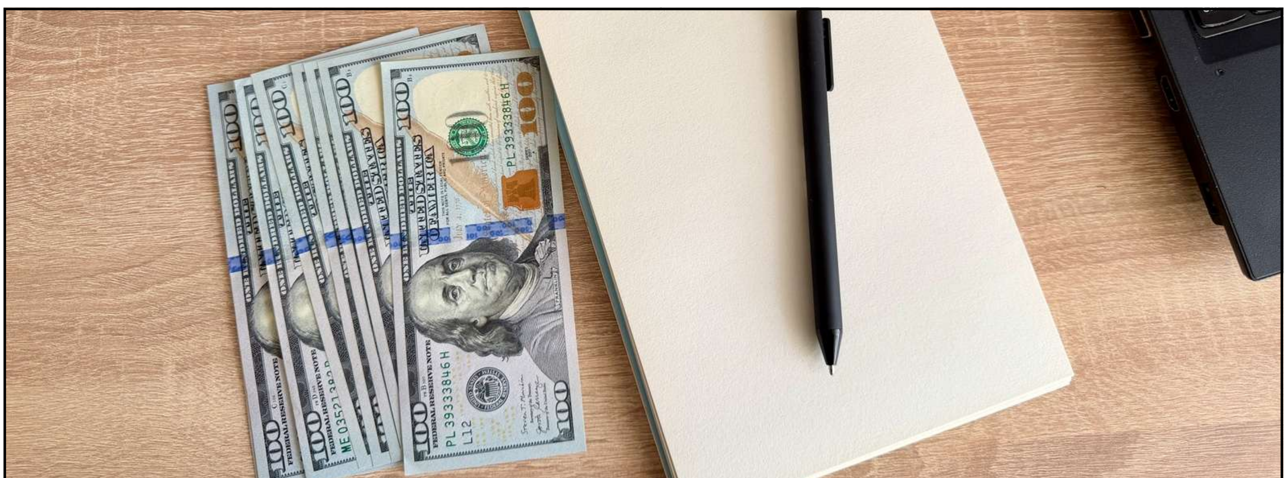

HIGHEST RISK AREA

Bonuses: The Single Biggest Regular-Rate Exposure

More regular-rate litigation arises from bonus miscategorization than any other source. The critical question is not what you call the bonus — it is whether the employee had a reasonable expectation of receiving it at the time the work was performed.

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Discretionary vs. Non-Discretionary Bonuses

- The distinction controls everything. Non-discretionary bonuses must be included in the regular rate and require retroactive overtime recalculation for the bonus period. The label the employer assigns is legally irrelevant.

✓ Discretionary (Excluded)

- Employer retains sole discretion over payment and amount
- Not pursuant to any contract, agreement, or promise
- Not announced or implied in advance
- Decision made at or near the end of the period

Example: A year-end "surprise" holiday bonus paid at the CEO's whim, with no prior announcement

✗ Non-Discretionary (Included)

- Based on a formula, target, or announced criteria
- Tied to productivity, attendance, safety, or performance
- Promised in offer letters, handbooks, or plan documents
- Paid consistently — creating employee expectation

Example: A quarterly production bonus, safety bonus, or retention bonus paid per a written plan

⚠ Calling a bonus "discretionary" in a plan document does not make it so. Courts look at actual practice, not labels.

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The Nondiscretionary Bonus Rule

- The FLSA's critical dividing line: if an employer promises or leads employees to expect a bonus based on meeting defined criteria, it is nondiscretionary — and it must be included in the regular rate. The label on the bonus does not control.

Attendance Bonuses

- Paid for perfect or near-perfect attendance over a defined period. Because the criteria are objective and known in advance, these are nondiscretionary — even if called "discretionary" in policy.

Productivity Bonuses

- Tied to units produced, cases handled, or performance metrics. Nondiscretionary. Common in manufacturing, healthcare, and field services.

Safety Bonuses

- Paid for achieving safety goals (e.g., zero recordable incidents). Nondiscretionary if criteria are pre-announced — highly common in energy and construction.

Retention Bonuses

- Paid for staying employed through a defined period. Nondiscretionary. Must be allocated back over the retention period and OT recalculated. Common in healthcare and energy.

Common Employer Mistake: Labeling a bonus "discretionary" in the employee handbook while announcing it at the start of the quarter with specific performance targets. That announcement converts it to nondiscretionary.

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More Bonus Types: Sign-On, Referral & Spot

Sign-On Bonuses

- True sign-on bonuses are generally excluded from the regular rate because they are paid to induce acceptance of employment rather than as compensation for work performed. However, a payment labeled a "sign-on bonus" must be included in the regular rate if, in substance, it compensates employees for hours worked, productivity, efficiency, attendance, or continued service rather than merely accepting employment.

Referral Bonuses

- Generally excludable when paid for recruiting outside the employee's regular job duties. If recruiting is part of the employee's regular responsibilities, inclusion may be required.

Spot Bonuses

- Awarded spontaneously for exceptional individual performance. Excludable only if the decision to award and the amount are both genuinely at management discretion after the work is performed, and no prior promises were made.

Hypothetical: A hospital system awards a $500 "spot bonus" every month to the top-performing floor nurse based on patient satisfaction scores. Because the criteria are objective and recurring, this is almost certainly nondiscretionary — regardless of what the policy calls it.

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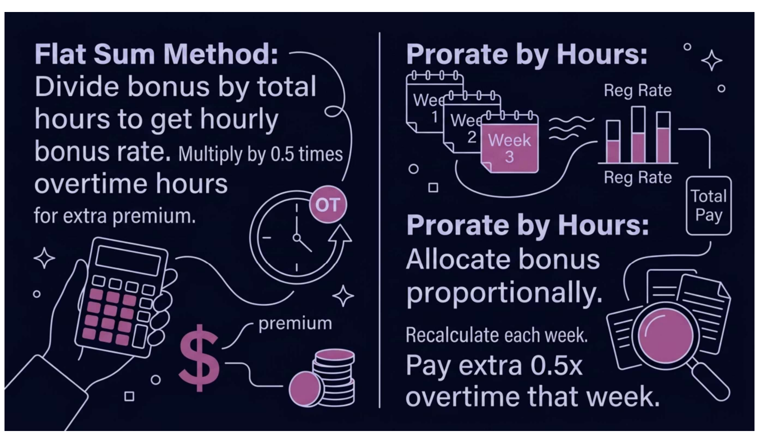
Allocating Non-Discretionary Bonuses: The Mechanics

- Once a bonus is classified as non-discretionary, the employer must recalculate the regular rate for every workweek in the bonus period and pay the additional half-time premium for each overtime hour. There are two accepted methods.



The regulations recognize more than one permissible allocation method. The flat sum approach is simpler administratively. Whichever method is used, it must be **consistently applied** and documented in the compensation plan.

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INDUSTRY FOCUS

Commissions & the Regular Rate

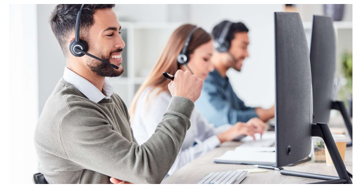
Commission earnings are remuneration for employment and must be included in the regular rate. The challenge is timing — commissions are often calculated after the workweek in which they are earned, requiring retroactive recalculation.

Retail & Insurance

- Sales associates earning commissions on weekly sales must have those commissions folded into the regular rate for any overtime week. Many retailers pay the commission as a lump sum the following pay period without recalculating OT.

Real Estate & Mortgage

- Loan officers and brokers classified as non-exempt who earn transaction-based commissions present significant risk when working overtime — a common fact pattern in mortgage origination and title companies.



Call Centers & Technology

- Inside sales teams paid base plus commission frequently work more than 40 hours. If the commission is non-discretionary (tied to sales targets), it must be included when recalculating OT for the relevant period.

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Shift Differentials & Premium Pay

Shift differentials — extra pay for working nights, weekends, or holidays — are among the most **overlooked** sources of regular-rate exposure. Because they are built into the payroll system, errors are systematic and affect every eligible employee every week.

What Must Be Included

- Night shift / evening shift differentials
- Many weekend or holiday premium pay (when paid as a flat add-on to the hourly rate)
- Hazard pay and environmental differentials
- Charge nurse or lead differentials in healthcare
- On-call and callback pay for time actually worked (subject to premium exclusions applying)

The § 207(e)(5)–(7) Safe Harbor

- Premium pay for work on holidays or weekends *can* be excluded from the regular rate only if it meets one of three narrow statutory conditions — including being paid at 1.5× the bona fide rate for the same work. Most shift differential programs do **not** qualify for this exclusion.

Industries most affected: Hospitals and health systems (charge differentials, weekend warrior programs), manufacturing plants (second/third shift), hotels and casinos (holiday premiums), and logistics hubs (overnight warehouse operations).

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On-Call & Standby Pay

Whether on-call or standby time must be included in the regular rate depends on whether the time itself is **compensable hours worked**. If the on-call time is compensable, any payments for it become part of the regular-rate calculation.

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Is the On-Call Time Compensable?

- Apply the *Skidmore/Armour* factors: freedom to use time for personal activities, geographic restrictions, frequency of calls, and ability to trade shifts. Highly restricted on-call = compensable time.

2

If Compensable: Regular-Rate Impact

- Any stipend or flat payment for being on-call divides across total compensable hours that week — including the on-call hours — increasing the regular rate and the OT premium owed for all OT hours.

3

If Not Compensable: Still Check

- Even if the on-call time itself isn't compensable, callback pay for hours actually worked during the on-call period typically *is* included in the regular rate — don't overlook it.

Industries most exposed: Hospitals and emergency care (physician on-call stipends for non-exempt staff), utilities and energy (field technicians on rotating on-call schedules), and IT managed services (after-hours support staff).

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Piece-Rate & Individual Incentive Pay

Piece-rate compensation — where workers are paid per unit produced — is common in manufacturing, agriculture, and food processing. The regular-rate calculation for piece-rate workers follows a specific method that many employers handle incorrectly.

Correct Piece-Rate Overtime Calculation

- Total piece-rate earnings ÷ total hours worked = regular rate. Overtime premium = 0.5 × regular rate × OT hours. This is the **additional** half-time premium only — the straight-time portion is already embedded in piece-rate earnings.

Common Mistakes

- Paying 1.5× the piece rate for overtime pieces — overpays but still miscalculates if blended with other compensation
- Failing to include production bonuses on top of piece rates when recalculating the regular rate
- Using the minimum wage as the regular rate for piece workers who earn above minimum wage
- Ignoring the impact of quality bonuses paid periodically

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Team Incentives, Revenue-Sharing & Gainsharing

Group-based incentive programs are increasingly common — and frequently mishandled for regular rate purposes.

Team Incentives

- Payments based on team or department performance metrics. These are nondiscretionary if criteria are pre-announced. Each individual's share must be allocated back to workweeks and OT recalculated. Complex when team membership shifts mid-period.

Revenue Sharing

- Common in professional services and transportation. Payments tied to company or division revenue are includable unless structured as a profit-sharing plan excluded under § 207(e)(4) — which requires DOL-compliant plan terms and applies only to *true* profit-sharing arrangements.

Gainsharing Plans

- Plans that pay employees a share of cost savings or productivity gains (common in manufacturing and energy). Includable unless meeting specific § 207(e)(4) criteria. Many employer "gainsharing" programs do not qualify for the exclusion and create silent regular rate exposure.

Compliance Tip: Before launching any group incentive plan, have counsel review whether the payments will be includable in the regular rate and build a retroactive reconciliation mechanism into payroll.

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Travel Pay, Per Diem & Allowances

Travel Pay

- Time spent traveling for work during normal working hours (e.g., driving between job sites) is compensable work time. Pay for that time is includable. Commute time generally is not — but the line blurs in field services and construction where workers travel from home to different job sites daily.

Per Diem Arrangements

- Per diem payments that *genuinely* reimburse actual and reasonable expenses (meals, lodging) are excludable. But flat per diem amounts that exceed any reasonable approximation of expenses paid without substantiation of actual expenses are treated as compensation — and are includable in the regular rate. Common issue in construction and energy.

Cell Phone, Tool & Vehicle Allowances

- Some fixed allowances paid as a set dollar amount per week — regardless of actual expenses — are generally includable. True reimbursements tied to actual business costs with substantiation are excludable. The IRS accountable plan rules provide a useful compliance benchmark.

Expense Reimbursements

- Payments that exceed documented actual expenses become wages. Employers who pay a $150/week "tool allowance" when actual tool wear costs $60/week have created $90/week of additional includable compensation — multiplied across every overtime week.

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Key Statutory Exclusions: What You Can Legitimately Leave Out

Understanding the exclusions is just as important as understanding inclusions. Properly structured compensation programs can legitimately reduce regular-rate exposure — but the exclusions must be earned, not assumed.

Exclusion Category	What Qualifies	Common Pitfall
▪ Discretionary Bonuses § 207(e)(3) ▪ Bona Fide Expense Reimbursement § 207(e)(2) ▪ Benefits Plan Contributions § 207(e)(4) ▪ Premium Pay for Non-OT Hours § 207(e)(5)–(7) ▪ Vacation / Holiday / Sick Pay § 207(e)(2)	▪ True surprise bonuses with no prior promise, formula, or announcement ▪ Reimbursements that reasonably approximate actual expenses incurred ▪ Employer contributions to bona fide health, retirement, or benefit plans ▪ Qualifying premium pay paid at ≥1.5× the bona fide rate for the same work ▪ Payments for hours not worked — PTO, bereavement, jury duty	▪ Any prior communication about criteria converts it to non-discretionary ▪ Flat per diems exceeding actual costs — the excess is wages ▪ Cash-in-lieu-of-benefits payments are typically included, not excluded ▪ Shift differentials below 1.5× or structured differently do not qualify ▪ Lump-sum PTO cash-outs on termination may be treated differently by state law

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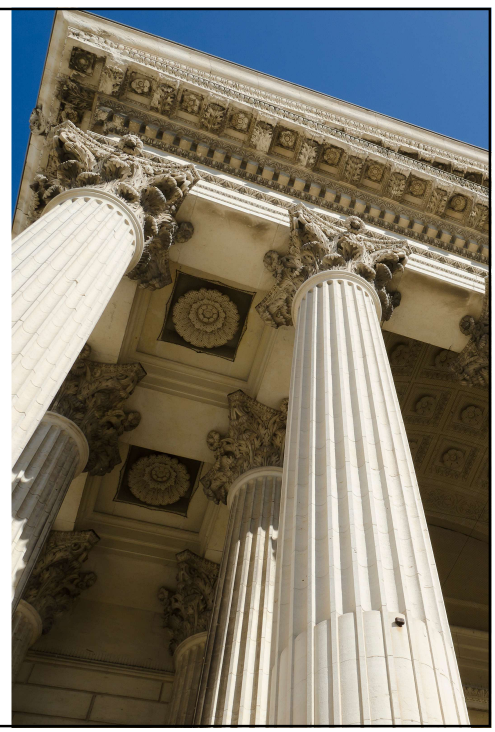
SECTION IV

Recent Litigation Trends

Regular rate collective actions are among the fastest-growing wage-and-hour claims — and plaintiffs' attorneys have refined their discovery strategies to maximize class size and damages.



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Regular Rate Collective Actions: What Plaintiffs Target

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Why These Cases Are Filed

Regular rate cases are attractive to plaintiffs' firms because they are:

- Formulaic: Damages are calculated from payroll records — no individualized injury analysis required
- Collective-friendly: The same payroll policy affects hundreds or thousands of employees simultaneously
- Document-driven: Employers' own records establish liability
- High-value: Liquidated damages double the exposure

Common Plaintiff Allegations

- Nondiscretionary bonuses excluded from regular rate
- Shift differentials omitted from OT calculations
- On-call and standby pay not included
- Per diem amounts exceeding actual expenses treated as excludable
- Piece-rate workers underpaid on OT calculations
- Retention bonuses not allocated and recalculated

⚠ **Discovery Red Flag:** Plaintiffs' counsel will request all bonus plan documents, payroll system configurations, HR policy manuals, and supervisor communications. Informal email announcements about bonuses are frequently the most damaging documents in these cases.

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What Plaintiffs' Lawyers Look For in Discovery

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Payroll System Configuration

- Whether the system is programmed to include all compensation types in the OT calculation — or whether it uses a fixed hourly rate regardless of additional pay. A mismatch between pay codes and OT calculation logic is a primary discovery target.

Bonus Plan Documents & Communications

- All written bonus plans, manager emails, team announcements, and HR communications are requested. The goal: find any communication that told employees what they needed to do to earn the bonus — converting it from discretionary to nondiscretionary.

Historical Payroll Data

- Plaintiffs analyze weeks with both overtime and bonus/premium pay to identify the gap between what was paid and what the FLSA required. Statistical analysis across thousands of pay records allows them to build aggregate damages quickly.

Policy Uniformity

- If the same policy applied company-wide, a single named plaintiff can anchor a nationwide or statewide collective — dramatically expanding potential liability and settlement leverage.

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What to Take Back to Your Organization

Regular-rate compliance is not a one-time fix — it requires ongoing coordination between legal, HR, and payroll to ensure that new compensation programs are reviewed before they are launched.

Why These Cases Are Filed

- Identify every bonus, incentive, or supplemental pay program. For each one, ask: have we communicated criteria to employees? If yes, it is almost certainly non-discretionary — and your payroll system needs to account for it when calculating overtime.

Common Plaintiff Allegations

- Any flat per diem that is not tied to actual expenses — or that routinely exceeds IRS per diem rates — is at risk. Travel nurse programs, field technician stipends, and construction crew allowances deserve immediate attention.

Common Plaintiff Allegations

- The biggest compliance failures happen when HR or finance designs a new incentive program without legal review. Establish a standing protocol: any new form of pay for non-exempt employees gets reviewed for regular-rate implications before rollout.

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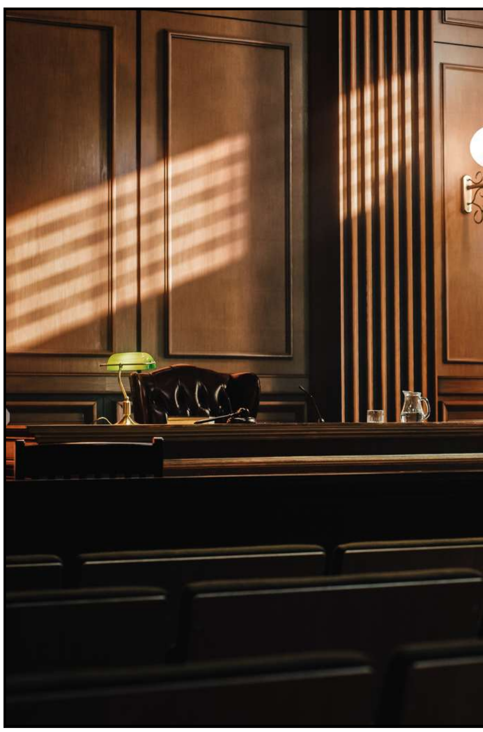

Final Thought: The Cost of Inaction

"Regular rate errors are almost never intentional — but they are almost always avoidable. The employer who audits proactively controls the outcome. The employer who waits for a complaint lets plaintiffs' counsel control it instead."

Proactive Audit

- Employer controls scope, remediation, and privilege. Cost is fixed and manageable. Exposure is quantified and contained before litigation.

Reactive Defense

- Plaintiffs define the class and the damages period. Discovery is broad and expensive. Liquidated damages double the exposure. Attorneys' fees shift to the employer on a prevailing-plaintiff standard.

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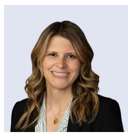
LINDSAY REIMER



Questions?

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Thank you.

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