

Client Termination Disaster
(and its solution)

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A large client of the PEO (more than 200 worksite employees) was experiencing financial difficulties. We knew this not because the client volunteered this information, but because the client service representative was alert and reported to PEO management "rumors" he had heard from managers and employees of the client. In addition, the client contacted a PEO human resources employee to obtain agreements with its management employees to defer wages for a limited period of time. These facts, coupled with the large payroll (and potential exposure to the PEO), moved this issue to the top of the PEO's "to do" list.

In my opinion, there were two distinct but related questions to answer: How does the PEO address the possibility the client may default on its contractual obligation to provide sufficient amounts to cover payroll, payroll taxes, insurance, and fees; and how does the PEO provide competent and accurate advice about the contemplated wage deferments and protect the PEO's interests?

I will address the latter question first. The initial inquiry was to determine if management employees were indeed exempt under the Fair Labor Standards Act (FLSA), because if they were not, they would have to receive at least the minimum hourly wage for the payroll periods in which they were agreeing to defer wages. We concluded that each employee was exempt, so we informed the client that during the deferral period, each employee should receive at least the minimum salary amount provided under the relevant FLSA exempt employee tests in effect at that time.¹ More importantly, we informed the client that each employee would have to execute a document clearly stating the terms of the deferral, the time period, and the consideration for the deferral. Moreover, it was mandatory for the client and the employee to acknowledge that this was an agreement between the client and the employee, that the PEO was not responsible in any way for the wages deferred, and that the employee explicitly waived any and all rights to seek the deferred wages from the PEO in the event that the client failed to honor the deferred wage agreement.

Second, we required the client CEO to discuss with PEO executives the conditions for the PEO's continued performance under the PEO agreement. We communicated to the client clearly our concerns and their basis, and informed the client that unless he cooperated to our satisfaction, we would invoke our contractual right to terminate the agreement effective immediately to protect our interests.² We required that the client provide further assurances it would comply, and also required that in the event of a cash shortfall the client pay at least minimum wage to its employees. It was then up to the PEO whether to continue performance under the agreement.

The PEO decided to "hang in there" for another payroll period (two weeks). Unfortunately, the client did default and eventually went out of business. The good

news is that when faced with a number of lawsuits from worksite employees claiming wages, the PEO had from the employees signed waivers and releases about the deferred wages. As a result, the only remaining issue was whether, and to what extent, the "minimum wage" agreement that was contained in each of the employees' enrollment packages (and executed by each employee) was enforceable. These factors facilitated a favorable settlement of the matter by the PEO with the worksite employees.

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¹ At the time, the "short test" for exempt status required a minimum salary of \$250 per week and the "long test" required a minimum salary of \$150. To be safe, we advised to pay the greater of the minimum salary amounts under the two tests to protect the employees' exempt status.

² The PEO agreement contained a provision that if the PEO, in its sole discretion, concluded that the client's financial position had changed materially, the PEO had the right to terminate the agreement. This is an important clause in any PEO contract (although many clients object) because of the statutory obligation imposed in many PEO licensing states that the PEO is responsible for the payment of wages irrespective of payment from the client. This is critical because in most cases wages are paid in arrears, so that the wages paid on a particular pay date are for wages earned through a date usually one week prior to the pay date. Thus, if a client informs the PEO on Wednesday that it cannot, or may not, be able to cover payroll for wages due Friday, even if the PEO invoked the clause described above immediately on Wednesday, the PEO could still have liability for wages accrued on Monday, Tuesday, and Wednesday, and potentially the prior week (and possibly through the date the employee receives notice of termination from the PEO).