PROPERLY CLASSIFYING EMPLOYEES UNDER THE FAIR LABOR STANDARDS ACT

I. REQUIREMENTS FOR EXEMPT STATUS UNDER THE FLSA

A. Determination of Exempt Status

1. Outside sales
2. Executive/supervisory
3. Professional
4. Administrative
5. Computer-related professionals

B. Salary Basis Test for "White Collar" Exempt Status

As a general rule, the FLSA mandates that employees receive time and one-half of their regular hourly rate for working more than forty (40) hours in a work week unless they are subject to a specific exemption from overtime pay eligibility. Since these exemptions deprive workers of a statutory benefit, they are narrowly construed by the courts. Consequently, it is the employer's obligation to prove that each employee classified as exempt truly is covered by a statutory exemption.

An exemption does not apply unless all statutory prerequisites are satisfied. With respect to administrative, professional and supervisory staff, employers must show that the employee in question is **paid on a salary basis** and that his or her "primary duty" is administrative, professional or supervisory in nature. Unless both prongs of the exempt status test are satisfied, the worker must receive overtime compensation after working more than forty (40) hours in a work week.

1. Analysis of the salary basis component of the exempt status test

   a. What is the "salary basis" prong of the exempt status test?

A worker is considered to be paid on a salary basis only if he or she regularly is paid, on a weekly, or less frequent basis, a predetermined amount constituting all or part of his or her compensation, which amount is not subject to reduction because of variations in the quality or quantity of the work performed. Subject to the exceptions provided below, the employee must receive his full salary for any week in which he performs any work without regard to the number of days or hours worked.

This policy is also subject to the general rule that an employee need not be paid for any work week in which he performs no work.

b. If a salaried exempt worker reports to work late or leaves early, can his or her salary be reduced because of that lost work time?

No. Payment on a salary basis means that the employer has promised to pay, at least, a fixed amount for a predetermined period of time. Late arrival at work or leaving before the end of the work day cannot result in reductions of the worker's base salary. (Of course, appropriate disciplinary action may result from unreliable attendance or other misconduct.)

c. If a salaried exempt worker takes an extended meal break, can his or her salary be reduced because of that lost work time?

No. Just like coming to work late or leaving early, missing part of a work day because of extended meal breaks cannot result in a reduction of the worker's base salary. (While the FLSA does not mandate the employer to provide lunch or dinner breaks, various State laws direct employers to provide meal breaks to certain workers, usually depending upon the number of hours worked in a day.)

d. Can any deduction be made from an employee's salary because he or she misses part of a work day?

No. If a salaried exempt employee reports to work on a work day, he or she must be paid for the entire day.

e. If the facility is closed because of a snow storm or other inclement weather, must the salaried exempt employees be paid for that work day?

Yes. An employer cannot reduce the salary of a salaried exempt employee because of the quality or quantity of work performed in any given work week. Thus, if work is not available because the store is closed (for whatever reason), then exempt workers must be paid their full salary for that work week if any work has been performed during that week.

f. Are there times when a salaried exempt worker's salary is subject to reduction because of lost work time?

Yes. Under very limited circumstances, the base salary of a salaried exempt worker can be reduced:

(1) An employee is absent for **one or more days** for personal reasons other than sickness or accident;

(2) An employee is absent for **one or more days** for sickness or accident and the deduction is in accordance with a bona fide sickness and accident plan, policy or practice;

(3) An employee is absent due to service of jury or military duty (at which time there is an off-set for military service or jury duty pay, rather than an actual salary deduction);

(4) Good faith penalties for infractions of safety rules of major significance;

(5) An employee misses an entire week of work;

(6) **Days** not worked during the first or last week of employment; and,

(7) Intermittent leaves pursuant to the Family and Medical Leave Act ("FMLA"). The FMLA specifically provides that deductions for intermittent leaves of less than one day will not violate the salary basis test (but may result in loss of exempt status under State law).

g. What Constitutes an "Infraction of a Safety Rule of Major Significance?"

Deductions from a salaried exempt worker's base salary for reasons other than full day absences are so disfavored that any deduction will be scrutinized. While deductions are permitted to penalize salaried workers who violate major safety rules, the Department of Labor or a court rarely will recognize "misconduct" as satisfying this exception to the "no docking" rule. Examples of violations of safety rules that may satisfy this standard are set forth in the Wage-Hour Administrator's regulations, i.e., smoking cigarettes in an explosives factory or oil refinery. Thus, unless the infraction is of comparable magnitude (which probably will result in termination of employment, rather then a monetary penalty), docking should be avoided as a means of punishing violation of a work or safety rule.

h. If an exempt worker reports to work but leaves early because he or she is ill and then does not report to work on the following day, can a deduction be made from salary for all time missed?

No. Although it is permissible to make a deduction in an amount of a day or more for sickness or accident (so long as a bona fide sick pay plan exists), it is not proper to make such a deduction in an increment of **less than a day**. Thus, a full-day deduction is permitted for the "second" day of the illness, but the employee must be paid for the entire day when he or she reported to work and then became ill. (However, if the employee is eligible for leave under the FMLA and the employee's health care provider has certified that it is medically necessary for the employee to take "intermittent" leave, a partial day deduction may be permissible. Since this practice otherwise would violate the FLSA, any such deduction should be made with great care and after an in-depth analysis of these conflicting statutory provisions and State overtime law.)

i. What if an employee has used up all of his or her paid sick days under the sick pay plan or is not yet eligible to participate in the plan and is absent for two days, can a deduction be made for these full day absences?

Yes. As long as a bona fide sick pay plan exists, then the employer is permitted to make deductions for full day absences.

j. Can deductions be made from accrued paid time off if a salaried employee is absent for less than a complete work day?

Yes. According to the Department of Labor, but not necessarily all courts, use of accrued paid time off to "make up" for absences of less than a full day are permissible. In an opinion letter issued by the acting Wage-Hour Administrator in April, 1993, the Department of Labor stated that, "Where an employer has bona fide vacation and sick time benefits, it is permissible to substitute or reduce the accrued benefits for the time an employee is absent from work, even if it is less than a full day, without affecting the salary basis of payment, if by substituting or reducing such benefits, the employee receives in payment an amount equal to his or her guaranteed salary." However, the Department of Labor goes on to state: "Where an employee has exhausted these benefits, deductions may be made in increments of full days only for absences for personal reasons or illness. Deductions from the salaries of otherwise exempt employees for partial day absences after they have exhausted their vacation or sick time benefits have never been permitted under the Regulations. . . ." Until the Circuit Court in your area of the country or the Supreme Court rules upon this issue, "docking" of accrued paid time off when an exempt worker is absent for less than a full work day may expose the company to loss of exempt status.

k. If a salaried exempt employee were summoned for jury duty after working part of a work week, must he or she be paid for that work week?

Yes. If the salaried exempt employee works at all during any work week, then he or she must be paid the entire week's salary. An offset is permitted to account for any monies received from the court for that jury service.

l. If a salaried exempt employee is called upon to perform Reserve duty, to serve in the National Guard or to participate in other military service, must he or she be paid for that time?

Yes. If the salaried exempt employee works at all during the work week when military service begins or ends, then he or she must be paid the entire week's salary. An offset is permitted to account for any monies received for military service.

m. What is the consequence if improper deductions are made?

When an employer improperly docks an exempt employee's pay, courts and the Department of Labor conclude that the employer did not intend to compensate the employee on a "salary basis". Consequently, exempt status would be lost for that worker and for all other workers considered to have been "salaried" exempt staff. (If the deduction resulted from inadvertence and is corrected promptly after discovering the error and the employer demonstrates

that it implemented pay practices designed to avoid repetition of similar errors, the exemption may be retained. Although the regulations provide for this "window of correction", deductions from salary due to partial day absences are contrary to the intent of the salary basis test and should be avoided! There is no assurance at all that a court will recognize an employer's acts as fitting within this limited defense to loss of exempt status because of wrongful deductions.)

n. Under what circumstances will deductions from accrued paid time off result in the loss of exempt status?

In *Abshire v. County of Kern*, the Ninth Circuit Court of Appeals found that otherwise exempt employees were entitled to overtime compensation because they were not paid on a salary basis. Under the County's pay practices, employees' base salaries were docked if accrued paid time off was exhausted, i.e., after the employee had exhausted accrued paid time off (including compensatory leave), base salary would be docked. Since docking was mandatory, exempt status was lost and overtime pay was owed to this entire class of employees. This was found to be true even though none of the employees' salaries ever was docked because under the County's pay practice docking would result if accrued time off was exhausted.

The District Court of Nevada, in *Benzler v. Nevada*, took the logic of the *Abshire* ruling even further and found that deductions from accrued time off (regardless of potential docking of base salary) resulted in loss of exempt status. In pertinent part, the District Court ruled, "Like docking base pay, docking compensatory time and accrued leave indicates the non-salaried status because the employee's compensation is reduced on account of the amount of work done."

In *Barner v. City of Novato*, the Ninth Circuit Court of Appeals retreated somewhat from its ruling in *Abshire* and held that, "In the absence of an expressed policy subjecting an executive or administrative employee's pay to reduction for absences of less than one day, deducting accrued leave time is not conduct which puts the employee outside the applicable exemption."

o. What is the effect of the deductions made pursuant to the Family and Medical Leave Act for absences of less than a full work day, upon exempt status?

As noted above, under the FMLA, an employer may have to grant a leave of absence under the FMLA on a partial-day basis (rather than an ongoing basis). The FMLA permits "The employer to make deductions from the employee's salary for any hours taken as intermittent or reduced FMLA leave within a workweek without affecting the exempt status of the employee. . . ." The following quandary exists: If a doctor’s appointment is needed for a "serious health condition,” the FMLA's provision permitting an employee to suffer a wage deduction does not result in loss of exempt status. In contrast, however, if the employee misses part of a work day for a condition not covered by the FMLA, and the employer makes a deduction from the base salary, then loss of exempt status would result.

C. White Collar Exemptions Under The FLSA

1. Exempt status standards

a. "Executive" exemption

To be considered an exempt "executive" employee, an individual must meet all of the following criteria:

(1) The person's primary duty is the management of:

(a) An enterprise in which the person is employed (e.g., a branch office); or,

(b) A customarily recognized department or subdivision thereof (e.g., sales department).

(2) He or she customarily and regularly directs the work of two or more full-time employees (or their equivalent).

(3) He or she has authority to hire or fire other employees or effectively recommend hiring, firing, promotion or similar actions.

(4) He or she customarily and regularly exercises independent judgment and discretion.

(5) He or she does not devote more than 20% (40% in retail operations) of the hours worked during the work week to activities which are not directly and closely related to the performance of executive (non-exempt) work in a retail or service enterprise.

(6) He or she is paid on a salary basis at a rate of not less than $155 a week. If the subject individual is paid on a salary basis at a rate of $250 or more per week, only the first two prongs of the test must be satisfied, i.e.:

(a) The employee's primary duty is the management of the enterprise of a recognized department; and,

(b) The employee regularly supervises the activities of two or more employees.

b. "Administrative" exemption

To be considered exempt as an "administrative" employee, an individual must satisfy the following criteria:

(1) The employee's primary duty is the performance of office or non-manual work directly related to implementation of

management policies or the general business operations of the employer or the employer's customers.

(2) He or she customarily and regularly exercises discretion and independent judgment.

(3) He or she is either:

(a) An executive or administrative assistant who regularly and directly assists a proprietor or an employee employed in a bona fide executive or administrative capacity; or,

(b) A staff employee who, under only general supervision, performs work along specialized or technical lines requiring special training, experience or knowledge.

(4) He or she does not devote more than 20% (a 40% limitation applies to retail operations) of his or her hours worked in the work week to activities that are not directly and closely related to the performance of the foregoing type of work in a retail or service enterprise.

(5) He or she receives payment on a salary or fee basis at a rate of not less than $155 a week. If an employee is compensated on a salary basis at a rate of $250 or more per week, only the first two parts of the test need to be satisfied, i.e.:

(a) The employee's primary duty is office or non-manual work directly related to management of the employer's business; and,

(b) The employee exercises discretion and independent judgment.

(6) This exemption generally does not apply to executive secretaries or other clerical aides.

c. "Professional" exemption

An individual employed in a "professional" position will be exempt from the overtime pay provisions of the FLSA if the following test is satisfied:

(1) The employee must have as his or her primary duty either (a) work requiring knowledge of an advanced type in a field of science or learning; (b) original and creative work in an artistic filed; or (c) teaching, tutoring, instruction or lecturing in the activity of imparting knowledge as a teacher certified or recognized as such in the school system or

educational establishment or institution by which he or she is employed.

(2) The employee's work must require the consistent exercise of discretion and judgment.

(3) The employee's job duties must be (a) predominantly intellectual and varied in character as opposed to routine mental, manual, mechanical or physical work; and, (b) of such a character that the output produced or the result accomplished cannot be standardized in relation to as given period of time.

(4) Time spent in activities that are not "an essential part of and necessarily incident" to professional duties may not exceed 20% of the employee's weekly hours worked.

(5) The employee must receive payment on a salary or fee basis at a rate of not less than $170 a week.

(a) The salary requirements need not be met in the case of an employee (i) who holds a valid license or certificate permitting the practice of law or medicine or any of their branches and is actually engaged in the practice thereof; (ii) holds the requisite academic degree for the general practice of medicine and is engaged in an internship or resident program pursuant to the practice of medicine or any of its branches; or, (iii) who is employed and engaged as a teacher.

(b) Professional employees who are employed on a fee basis for less than a normal 40-hour week must be compensated at an hourly rate of not less than $5.15.

(c) These figures represent the hourly rate at which such employees would ordinarily be compensated to reach the minimum salary rate, based on a 40-hour week, to qualify for the exemption.

(6) Professional employees who are paid a salary of at least $250 weekly may qualify for exemption if they meet either of these abbreviated tests:

(a) Their primary duty consists of the performance of work either requiring knowledge of an advanced type in a field of science or learning, or teaching, including work that requires the consistent exercise of discretion and judgment; or,

(b) Their primary duty consists of the performance of work in a recognized field of artistic endeavor, including work that requires invention, imagination or talent.

d. "Computer-related occupation" exemption

A highly skilled individual employed in the computer field who is paid on an hourly basis will be exempt from the overtime provisions of the FLSA if the following test is satisfied (added by section 2105(a) of the Small Business Job Protection Act of 1996, effective August 20, 1996):

(1) Employee must be compensated at a rate of not less than $27.63 an hour, if compensated on an hourly basis. Such employee may be exempt without regard to the basis of his compensation (e.g., salary or hourly wage).

(2) Employees who qualify for this exemption are highly skilled in computer systems analysis or programming. To qualify, the employee's primary duties must consist of one or more of the following:

(a) The application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software, or system functional specifications;

(b) The design, development, documentation, analysis, creation, testing, or modification of computer systems or programs, including prototypes, based on and related to user or system design specifications;

(c) The design, documentation, testing, creation, or modification of computer programs related to machine operating systems; or,

(d) A combination of the aforementioned duties, the performance of which requires the same level of skills.

II. CORRECTING FLSA MISTAKES

A. Wrongful Deductions from Salary

1. Statutory interpretation.

a. 29 C.F.R. § 541.118(a) provides in pertinent part:

"an employee will be considered to be paid 'on a salary basis' . . . if under his employment agreement he regularly receives each pay

> period on a weekly, or less frequent basis, a predetermined amount constituting all or part of his compensation, which amount is not subject to reduction because of variations in the quality or quantity of the work performed."
>
> The regulations further provide:
>
> "Where deductions are generally made when there is no work available, it indicates that there was no intention to pay the employee on a salary basis. In such a case the exemption would not be applicable to him during the entire period when such deductions were being made. *On the other hand, where a deduction not permitted by these interpretations is inadvertent, or is made for reasons other than lack of work, the exemption will not be considered to have been lost if the employer reimburses the employee for such deductions and promises to comply in the future.*"

29 C.F.R. § 541.118(a)(6).

2. Auer v. Robbins.

The United States Supreme Court, in *Auer v. Robbins*, 519 U.S. 452 (1997), enunciated a two-part test to determine when an employee should be denied exempt status. First, the employee must meet the "salary basis test" delineated in 29 C.F.R. § 41.118(a). See *Auer*, 519 U.S. at 455. Second, the employee's duties must be of an executive, administrative, or professional nature. Id.

Even if exempt status is available to a particular employee because of his or her duties, circumstances may warrant denial of such status, namely, deductions from an employee's salary inconsistent with 29 C.F.R. § 541.118. In *Auer*, the Supreme Court held an employee will lose exempt status "when employees are covered by a policy that permits disciplinary or other deductions in pay 'as a practical matter.'" Id. at 461. This criterion is met, the Court held, "if there is an actual practice of making such deductions or an employment policy that creates a 'significant likelihood' of such deductions." Id. A finding of "significant likelihood" requires the existence of a "clear and particularized policy – one which effectively communicates that deductions will be made in specified circumstances." Id.

The Court, however, clarified this point stating that, "where a deduction not permitted by [the salary basis test] is inadvertent, or is made for reasons other than lack of work, the exemption will not be considered to have been lost if the employer reimburses the employee for such deductions and promises to comply in the future." Id. (quoting 29 C.F.R. § 541.118) (alteration in original). The Court interpreted this provision to allow minimal infractions of 29

C.F.R. § 541.118, to excuse an employer from liability for overtime pay under the FLSA. The Court also found the regulation failed to address the timing of reimbursement. Nothing in the statute, according to the Court, requires immediate repayment, and the employer is entitled to preserve the employee's exempt status as long as it complies with the corrective provision in 29 C.F.R. § 541.118(a)(6). Id. at 463-64.

3. Cases Following *Auer*.

a. *Ahern v. County of Nassau*, 118 F.3d 118 (2d Cir. 1997).

In *Ahern*, a group of high-ranking police officers sued their employer, the Nassau County Police Department, alleging FLSA overtime violations. See *Ahern*, 118 F.3d at 119. Although the Police Department failed to pay the plaintiffs overtime for a two-year period, it argued that police officers fell within the "bona fide executive exemption." Id.

The Second Circuit discussed the Supreme Court's holding in *Auer* and set forth the two ways exempt status can be lost: either through an actual practice of making deductions, or by implementing an employment policy that creates a significant likelihood that deductions will be made. Id. at 121. According to the Court, it was clear that an "actual practice" of making deductions did not exist. Id. In applying the significant likelihood test, the Court noted that while the plaintiffs' employment manual did state that deductions could be made from the salaries of employees in their class, the plaintiffs could not demonstrate the manual communicated such deductions would in fact be made in specified circumstances, a requirement for satisfying the "significant likelihood" test. Id. at 122. As the Court pointed out, "the plaintiffs could not point to any rule that stated that if they committed a specific infraction, their pay would be docked. And this is what we read *Auer* to require." Id.

b. *Graziano v. Society of the N.Y. Hospital*, 1997 U.S. Dist. LEXIS 10203, at *1 (S.D.N.Y. July 16, 1997), vacated on other grounds, 1997 U.S. Dist. LEXIS 15926, at *1 (S.D.N.Y. Oct. 13, 1997).

In *Graziano*, plaintiffs claimed they were owed overtime wages under the FLSA from their employer, the Society of New York Hospital. The defendants argued the plaintiffs were exempt because they met both the duties and salary-basis tests. See *Graziano*, 1997 U.S. Dist. LEXIS at *1-2.

The Court, applying the *Auer* test, focused on the "significant likelihood" prong because the parties stipulated that no actual deductions had been made. Id. at *3-4. In *Auer*, the Supreme Court stated that if a policy on its face applies to both exempt and non-exempt employees alike, the policy does not "effectively communicate" that the deductions in question will apply to the exempt employees and does not operate to change their status. In applying the *Auer* standard, the Court held that proof the policy in question actually applied to plaintiffs was necessary. Id. at *4-5. Finding none, the Court held that the plaintiffs' contentions fell short of the "significant likelihood" threshold required by *Auer*. Id. at *5.

c. *Hernandez v. City of Santa Ana*, 1998 U.S. App. LEXIS 929, at *1 (9th Cir. Jan. 21, 1998).

Workers filed suit seeking back overtime pay under the FLSA. After the District Court ruled in their favor, the Ninth Circuit vacated the decision, in part, holding that since the employer could suspend workers without pay for periods of less than one week as a disciplinary measure, they did not qualify for exempt status under the FLSA. Hence, they were eligible for overtime compensation. See *Hernandez*, 1998 U.S. App. LEXIS at *2.

The Supreme Court vacated the decision and remanded it for reconsideration in light of its holding in *Auer*. The Ninth Circuit, on remand, found that *Auer* did not effect its prior holding. Id. The Ninth Circuit was able to distinguish *Auer* on the basis that, in *Auer*, the Police Manual did not "effectively communicate" that pay deductions were an anticipated form of punishment. In *Hernandez*, however, the Ninth Circuit found a "significant likelihood" that such disciplinary sanction would be applied to these workers. Unlike in *Auer*, it was possible to draw a clear inference that the appellees were vulnerable to application of the disciplinary policy, i.e., the Charter contained a "clear and particularized" disciplinary policy which set out the specific circumstances in which pay deductions will be made. Id. at *6.

d. *Moser v. Pizza Hut of Am., Inc.*, 1998 U.S. Dist. LEXIS 6256, at *1 (W.D. Va. Apr. 9, 1998).

The plaintiff, a store manager, alleged that Pizza Hut failed to pay her time-and-one-half for overtime worked. During that time, she was forced to use sick and vacation pay to make up for partial day absences. See *Moser*, 1998 U.S. Dist. LEXIS 6526 at *17-20. The Court discussed the standard set forth in *Auer*, but found that plaintiff's salary was not subject to wrongful deductions because she did not allege her pay was reduced for partial day absences. In fact, she conceded Pizza Hut never reduced her pay or threatened a pay reduction for partial day absences. See *Moser*, 1998 U.S. Dist. LEXIS 6256 at * 19-20.

e. *Danesh v. Rite Aid Corp*., 39 F.Supp. 2d 7 (D.C. Cir. 1999).

The plaintiff sued Rite Aid for failing to pay overtime under the FLSA. Rite Aid argued the Supreme Court's decision in *Auer* meant that, "a single infrequent improper deduction is insufficient to defeat exempt status." According to the *Danesh* court, the defendants were transforming the Court's treatment of an exceptional case into "general rule." *Danesh*, 39 F.Supp. at 11. The Court held Rite Aid offered no evidence to show that the deductions in Danesh's pay occurred under unusual circumstances that negate an actual practice of making such deductions, thus distinguishing *Auer*. Id.

The defendants also argued that under the "window of correction" rule, they were entitled to restore Danesh's status as a salaried employee by correcting any deductions. The Court rejected this argument, finding that in *Auer*, "inadvertence" or "reasons other than lack of work" were permissible grounds for corrective action, but in the present case, the deductions

were not inadvertent; the evidence showed the deductions were based on the number of hours worked.

B. Releases Are Not Binding

FLSA claims can be settled only in Court proceedings or with the supervision of the U.S. Department of Labor. *Brooklyn Savings Bank v. O'Neill*, 324 U.S. 697 (1945); 29 U.S.C. § 216(c). Similarly, a release signed by an employee, even for consideration, will not waive claims for liquidated damages. *D.A. Schultz v. Gangi*, 328 U.S. 108, 112-14 (1946).

1. Three requirements must be met before voluntary payment can be a defense to an employee suit (FLSA, Sec. 16(c), 29 U.S.C. 216(c)):

   a. Employee must voluntarily agree to accept the payment.

   b. Payment agreed upon must be made in full.

   c. Payment must be made under the supervision of the Wage-Hour Administrator.

2. Wage payments that are not supervised by the Administrator are not a valid defense in an FLSA wage suit unless the facts tend to show payment in full in accordance with the statutory requirements.

3. Employees can try to use a "release" in an effort to confirm hours worked, but when providing general release agreements to clients, be certain they understand that that FLSA wage claims are **not** waived.

4. Workers' acceptance of DOL supervised back pay payments in the absence of a lawsuit settles their claims. Rejection of that offer of payment does not bar suit. E.g., *Harrell v. S.D. Bell Dental Mfg.*, 110 F.Supp. 538 (N.D. Ga. 1953). In contrast, once the DOL sues, its settlement of that case covers all workers in the class at issue. 29 U.S.C. § 216(c).

C. Revise Handbook/Policy Manual to Eliminate FLSA "Violations"

Eliminate wrongful salary deduction.

1. Inclement weather.

2. Jury/military service.

3. Partial work week suspensions.

4. Fines or deductions for lost badges, equipment or other disciplinary reasons.