Jeopardizing Exemptions: Mistakes to Avoid

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A. Deductions

1. Permitted Deductions from Pay

The federal salary basis regulations provide that an employer may make certain deductions in a salaried exempt employee's pay without negating that employee's salaried status. Permitted deductions include:

Personal Absences — Deductions for personal absences from work of one day or longer are allowed. Personal absences do not include absences caused or engendered by the employer. Although the federal regulation speaks in terms of deductions for one day or longer and would seemingly allow a deduction for a day-and-a-half, USDOL and the courts have generally required that deductions for personal absences be made in one-day increments. USDOL Opinion Letter FLSA2018-14 (Jan. 5, 2018).

Sickness Or Disability — Deductions for absences due to sickness or disability lasting one day or longer are permitted if done in accordance with a bona fide plan, policy, or practice of providing compensation for loss of salary occasioned by both sickness and disability. If an employee's absence is covered by a bona fide sick leave policy, the employee's pay may be reduced in one day increments and compensation under the sick leave policy substituted for the relevant days. Thus, if sick leave benefits are provided at a level equivalent to full time pay, then this provision will often have no impact on an employee's actual pay. If sick leave benefits are provided at a fraction of an employee's regular pay, then actual pay is impacted. Moreover, employees who exhaust benefits pursuant to a bona fide sick leave or disability plan may be subject to deductions in pay even though they are not eligible for replacement compensation. *See* USDOL Opinion Letter FLSA2018-14 (Jan. 5, 2018); USDOL Opinion Letter FLSA2005-7 (Jan. 7, 2005); USDOL Opinion Letter FLSA2003-3NA (May 5, 2003).

Disciplinary Suspensions — Deductions for unpaid disciplinary suspensions of one or more full days "imposed in good faith for infractions of workplace conduct rules" are allowed under federal law. 29 C.F.R. § 541.602(b)(5). However, many states do not allow such deductions. This exception focuses on employee misconduct and not on basic performance and attendance issues. *E.g.*, *Watkins v. City of Montgomery*, *Alabama*, No. 13-11718 (11th Cir. Dec. 24, 2014).

Initial And Terminal Weeks — Deductions that result in partial payments for the initial and terminal weeks of employment are allowed. Employers need not pay exempt employees their full salary during the first and last week of employment. An unresolved issue, however, is what constitutes the terminal week of employment. Employers who suspend an exempt employee pending an investigation that ultimately results in termination should not adjust the employee's compensation for the last week during which the employee worked if the termination decision is made beyond the conclusion of that work week. The issue here is whether the employee's terminal week is the week when the employee is removed from the work site (the last week of work) or the week when the employee is notified of termination (the last week of employment).

FMLA Intermittent Leave – When an employee is eligible for intermittent leave under the FMLA, an employer may make deductions for <u>partial day absences</u> taken in accordance with that law. 29 C.F.R. § 825.206.

Week During Which an Employee Performs No Work — One of the general premises underlying the salary basis test is that an "employee need not be paid for any workweek in which he performs no work." Courts have endorsed this position when employers have shut down operations for a complete workweek and when employees have been suspended for a complete workweek. *See Paresi v. City of Portland*, 182 F.3d 665 (9th Cir. 1999) (week-long suspensions do not violate the FLSA); *Childers v. City of Eugene*, 120 F.3d 944, 946 n.2 (9th Cir. 1997) (week-long suspensions do not violate the FLSA); *Leslie v. Ingalls Shipbuilding, Inc.*, 899 F. Supp. 1578 (S.D. Miss. 1995). Note, however, that this approach is fraught with danger. If a salaried-exempt employee does *any* work (even for one-half hour) during the week-long suspension or shutdown, they must be paid for the entire workweek.

2. Prohibited Deductions from Pay

The federal salary basis regulations also identify certain circumstances where the white-collar exemptions may be lost if an employer makes deductions from an employee's established pay. Such prohibited deductions include:

Employer Shutdowns — Deductions for absences caused by the employer or its operating requirements are prohibited. USDOL Opinion Letter FLSA2009-18 (Jan. 16, 2009). Note, however, that if employers shut down operations for an entire work week, employers may choose not to pay exempt employees their entire weekly salary pursuant to the general rule that employers need not pay exempt employees for any work week in which the employees perform no work. *Leslie v. Ingalls Shipbuilding, Inc.*, 899 F. Supp. 1578 (S.D. Miss. 1995).

Civic Responsibilities — Deductions for absences involving responsibilities such as jury duty, attendance as a witness, and temporary military leave are prohibited. Under these provisions, employers may offset any compensation employees receive for their activities against the salary employers would otherwise pay.

Partial Day Absences — Deductions for partial day absences are generally not allowed. USDOL Opinion Letter FLSA2018-14 (Jan. 5, 2018). The implicit message in the personal absence and sick leave deduction provisions is that such deductions must be made in full day increments. Deductions for partial day absences are thus generally prohibited. Note, however, that special provisions allow for partial day deductions by public employers under prescribed circumstances. 29 C.F.R. § 541.710.

Overpayment --- Deductions for overpayments may be limited with respect to exempt employees. Generally, employers may deduct from or reduce pay for non-exempt employees for the purpose of recouping overpayments. In those instances, the employer can usually reduce the pay of a non-exempt employee at its discretion (subject to state law, including wage payment laws). Where there is an overpayment of wages, the principal often may be deducted from the employee's earnings even if such deduction cuts into the minimum wage or overtime pay. An employer may not make, however, an assessment for administrative costs or charge any interest that brings the employee below the minimum wage. USDOL Opinion Letter FLSA2004-19NA (October 8, 2004). However, with respect to exempt employees, deductions for amounts overpaid pursuant to a short-term disability plan are not permitted pursuant to the salary basis test. It would be possible, though, for the employer to recover such overpayments from later disability payments, or through reductions in the employee's accumulated sick leave. USDOL Opinion Letter FLSA (July 30, 1996). Additionally, there is some suggestion that deductions for overpayment of wages would not implicate the salary basis determination.

USDOL Opinion Letter FLSA (March 20, 1998) ("The overpaid employee's status as a pilot relative to the professional exemption . . . and the [Railway Labor Act] exemption would not affect [the employer's] ability to recoup money due to it because of previous advances of wages by reducing the employee's paychecks.").

B. Reductions in Leave Banks

Federal courts have generally drawn a distinction between deductions from pay and reductions in accrued leave banks. Thus, courts interpreting the salary basis regulation have generally agreed that employers may require salaried exempt workers to use leave time to offset their partial day absences. *E.g.*, *Barner v. City of Novato*, 17 F.3d 1256 (9th Cir. 1994); *McDonnell v. City of Omaha*, 999 F.2d 293 (8th Cir.), *cert. denied*, 510 U.S. 1163 (1994). Similarly, an employer may require employees to use accrued leave time for absences due to plant shutdowns or operational concerns. USDOL Opinion Letter FLSA2009-2 (Jan. 14, 2009); USDOL Opinion Letter FLSA2009-18 (Jan. 16, 2009). This analysis applies to private employers under federal law. *Webster v. Public School Employees of Wash., Inc.*, 247 F.3d 910 (9th Cir. 2001).

An important issue that must be addressed by all employers is what happens when salaried exempt employees have exhausted their leave time and take further partial day absences. If the employer then allows for deductions from pay, the salary basis test is violated. *E.g.*, *Kinney v. District of Columbia*, 994 F.2d 6 (D.C. Cir. 1993). Moreover, at least one court has found that employers violate the salary basis test by maintaining records of negative compensatory time that an employee must pay back to the company. *See Klein v. Rush-Presbyterian-St. Luke's Medical Ctr.*, 990 F.2d 279 (7th Cir. 1993). Despite the *Klein* decision (which can be limited on its facts), employers should not run afoul of the federal salary basis test if they require reductions in leave banks but specifically assure that no deductions in pay will occur even if leave banks are exhausted. USDOL Opinion Letter FLSA2009-2 (Jan. 14, 2009); USDOL Opinion Letter FLSA2005-7 (Jan. 7, 2005).

C. Payment of Additional Compensation

The salary basis regulations require that white collar exempt employees be paid all or part of their compensation on a salary basis. Federal law expressly allows compensation in addition to an exempt employee's guaranteed base salary. USDOL Opinion Letter 2020-2 (Jan. 7, 2020). The payment of bonuses or commissions in addition to a base salary amount is consistent with the salary basis requirement. *See Hogan v. Allstate Ins. Co.*, 361 F.3d 621 (11th Cir. 2004) (finding that insurance agents who received a guaranteed minimum plus commissions fell within the administrative exemption). Although there was once some dispute as to whether salaried exempt employees may be paid additional compensation on an hour-for-hour basis, *e.g.*, *Brock v. Claridge Hotel & Casino*, 846 F.2d 180 (3d Cir.), *cert. denied*, 488 U.S. 925 (1988), it is now clear that payment of straight-time or overtime wages to salaried exempt employees is permissible under the FLSA. *See Boykin v. The Boeing Co.*, 128 F.3d 1279 (9th Cir. 1997); *Fairris v. City of Bessemer*, 252 Fed. Appx. 309, 2007 WL 3120313 (11th Cir. Oct. 25, 2007). However, the "reasonable relationship" rule at 29 C.F.R. § 541.604 acts as a limit on such extra compensation where it is paid on an hourly, daily or shift basis. Section 541.604 generally allows an employer to "provide an exempt employee with additional compensation without losing the exemption or violating the salary basis requirement, if the employment arrangement also includes a guarantee of at least the minimum weekly-required amount paid on a salary basis." However, the reasonable relationship rule acts to limit the amount that can be paid in addition to the guaranteed salary. While no firm ratio has been established, a 1.5:1 ratio between the extra compensation and the guaranteed salary has been deemed to be reasonable. USDOL Opinion Letter FLSA2018-25 (November 8, 2018). A ratio above 1.5:1 may violate the reasonable relationship rule and result in the employee being treated as an hourly, non-exempt employee. *See Rachid Chakir, et al., Plaintiffs, v. BA Research Int'l, LP, et al., Defendants*, No. H-10-2850, 2011 WL 13248862 (S.D. Tex. July 15, 2011) ("An example of an unreasonable relationship is this: a guarantee of $455 per week—an implicit $12.50 per hour—when the nurses are paid $50 per hour."). However, if the employee is "highly compensated," *e.g.*, makes enough to qualify for the highly compensated employee exemption, the reasonable relationship rule may not apply. *Anani v. CVS RX Services, Inc.*, 730 F.3d 146 (2d Cir. 2013).

D. Furloughs and Other Reductions in Pay and Hours

As noted above, furloughs will not impact exempt status so long as the furlough is for an entire work week or a multiple thereof. However, if an employee performs any work during the furlough period, he or she must be paid his or her full salary.

The issue of reducing work weeks and/or hours worked with a corresponding reduction in salary is more opaque. As a general rule, employers may reduce the work week or the number of hours to be worked, with a corresponding reduction in salary, during a given week.

It goes without saying that such reductions should be prospective and not retroactive and should not reduce the salary for that week below the statutory minimum. Importantly, any such reductions should not be a reaction to short-term business needs, nor should they be recurrent. Reductions done on a day-to-day or week-to-week basis will be closely scrutinized and are likely to run afoul of the salary basis requirement.

A leading case is *In re Wal-Mart Stores, Inc.*, 395 F.3d 1177 (10th Cir. 2005). There, the employer paid exempt pharmacists a salary, but it sometimes reduced their base hours and correspondingly reduced their salaries. The court approved the practice relative to the issue of salary basis because the changes were not so frequent as to make the salary the functional equivalent of an hourly wage. In that case, the court determined that the employer rarely reduced salaries and the practice was not designed to circumvent the salary basis requirements of the FLSA. The court cited with approval several DOL opinion letters which permitted similar reductions. In one, DOL approved of an aerospace employer's plan, in an effort to reduce costs after already extensive layoffs, to have five four-day workweeks per year, with a corresponding reduction in salaries for exempt employees. USDOL Opinion Letter FLSA (Nov. 13, 1970). In another, a mental health provider proposed, in response to reductions in state spending, to reduce the work week from 40 to 32 hours with a commensurate reduction in pay. The DOL opined that such a reduction will not defeat an otherwise valid exemption. USDOL Opinion Letter FLSA (March 4, 1997).

In contrast, the DOL recently determined an employer's hours reduction program to be contrary to the salary basis requirement. The employer, in some instances, required employees to take time off due to short-term business needs (low patient census). DOL disapproved of the scheme because it derived from short-term needs and the operating requirements of the employer's business. The reductions in salary, reasoned DOL, were due to day-to-day or week-to-week determinations of the employer's operating requirements. USDOL Opinion Letter FLSA2009-14 (Jan. 15, 2009).

To summarize, reductions in salary that correspond with reductions in hours of work will not defeat an exemption unless a direct reaction to short-term business needs or when the reduction is used to circumvent the salary basis requirements. USDOL Opinion Letter FLSA2020-2 (Jan. 7, 2020).

E. Fee Payments

Administrative and professional employees may be paid on a fee basis. A fee, generally speaking, is an agreed-to sum for a single job regardless of the amount of time it takes to complete the job. It resembles a piecework rate, but a fee differs in that it is paid for a kind of job that is unique rather than for a series of jobs repeated indefinitely and for which payment on an identical basis is made over and over again. Payments based on the number of hours or days worked and not on the accomplishment of a single task are not considered fees.

Determining what is and what is not a fee may be difficult. Consider two cases, each which involve similar payment schemes. In *Elwell v. University Hosp. Home Health Care Servs.*, 76 F.Supp.2d 805 (N.D. Ohio, 1999), the court held that the defendant was not compensating the plaintiff on a fee basis within the meaning of 29 C.F.R. §541.313 (which was where the former fee regulation was codified). The plaintiff was required to travel to patients' homes to administer nursing care and was paid on a per visit basis. She was also compensated at an hourly rate of pay for attending required meetings and during on call duty. The pay per visit arrangement paid the plaintiff an agreed sum for each patient she visited, as well as for related activities, including travel time, documentation time and discussions with medical and health personnel, the patient, and the patient's family. Evidence showed that the employer did not pay the plaintiff an agreed sum regardless of time spent on a particular task, but used time estimates for a flat payment amount with an enhancement by an hourly rate if a visit took over two hours. In a decision consistent with opinion letters which hold that a "per visit" payment is not a fee, the court held that the payment was not a fee. The court considered the nature of plaintiff's job and determined that her performance varied from day to day but she was basically doing the same nursing care depending on the needs of the patient. Consequently, the court found that the performance of the job, while it may have differed from day to day, was not unique.

However, in *Fazekas v. Cleveland Clinic Foundation Health Care Ventures, Inc.*, 204 F.3d 673 (6th Cir. 2000), the court held that home healthcare nurses paid on a per visit basis were paid a fee. The plaintiffs were required to make at least 25 patient visits and be on call at least 15 hours per week, and each nurse was compensated on a per visit basis. Each nurse received a different fee based upon the extent of each visit. The nurses received $30 for each home visit when not on call and $32 per visit when on call. The nurses received $37 for each home visit requiring any infusion therapy and $50 for each initial assessment of a new patient. These payments included compensation for all attendant transportation and administrative duties connected with the actual visits themselves. The court found that various factors contributed to making each patient's course of treatment unique, stating, "[I]t appears to us that the work performed during each home health care visit, given the number of different circumstances unique to each patient's treatment plan, …, is closer to the work performed by a singer, …, or that of an illustrator, …, than it is to the payments for "piecework" described in the regulations as payments not on a fee basis." *Id*. at 679. The court stated that not all home healthcare nurses perform unique duties or provide unique services, but that based on the facts, the home healthcare nurses at issue had unique occupations and concluded that the fee per visit compensation fit within the meaning of fee basis.

F. Additional Job Duties

An employee who is deemed exempt is not exempt "for life." Rather, the employee's job duties may develop or change over time in such a manner as to affect the employee's exempt status. Employers should be cognizant of changes in job duties and consistently evaluate positions relative to the "primary duty" requirement for white collar exemptions. The primary duty rule requires that the employee's primary duty be the performance of exempt work. A duty is primary if it is the principal, main, major, or most important of the employee's duties. Factors to consider include relative importance of the exempt duties; the amount of time spent performing exempt work; the employee's relative freedom from direct supervision; and the relationship between the employee's salary and the wages paid others for the non-exempt work.

A useful (but not dispositive) rule of thumb is the 50 percent test—is the employee performing 50 percent or more exempt work? If so, the employee will generally satisfy the primary duty requirement. Keep in mind, though, that the 50 percent rule of thumb is a guideline, and there may be instances where an employee performs significantly less exempt work than 50 percent and still be exempt.

Occasional, infrequently recurring tasks that are non-exempt in nature but cannot practically be performed by non-exempt employees will be considered exempt work if they are considered the means for an exempt employee to carry out his or her exempt work.

G. The Need for Accurate Records

The USDOL has adopted regulations that address recordkeeping requirements. *See* 29 C.F.R. Part 516; 29 C.F.R. §§ 785.46 to .48. When adopting time recording policies and procedures, employers should consider both what is legally permissible and what is necessary to minimize the likelihood and severity of class litigation.

The types of records that must be maintained by employers are set forth in great detail in 29 C.F.R. Part 516. These records include information regarding the employee, the work week, the hours worked each day, the basis of pay, the regular rate, straight time and overtime compensation, deductions and additions to wages, the applicable pay period, the wages paid each pay period, and the date of payment.

An employer has a duty to assure that these records are detailed and accurate. 29 C.F.R. § 785.13. This duty may not be delegated to employees. Thus, policies regarding time entry, reporting of time, and following posted schedules are helpful but are not a defense to claims for uncompensated hours. Neither are policies that prohibit unauthorized work or overtime. Likewise, timecards or time records by themselves are not necessarily sufficient evidence of hours actually worked. 29 C.F.R. § 785.48.

Under federal law, employers must maintain most records for three years, 29 C.F.R. § 516.5, although some source documents and other basic information may be discarded after two years, 29 C.F.R. § 516.6. Even though the FLSA allows employers to discard some source materials after two years, employers should maintain all records for three years if this is practicable. Because the statute of limitations may not run after the two-year period, it is important for employers to maintain source materials to defend against possible wage claims. These materials may include records created or signed by the employee that can be used for impeachment purposes.

If employers fail to maintain required (or accurate) records, then courts shift the burden of proof in subsequent litigation. Essentially, courts allow employees to provide generalized and unsubstantiated testimony as to the hours they believe they worked and require that employers disprove the testimony. *E.g.*, *Anderson v. Mt. Clemens Pottery Co.*, 328 U.S. 680 (1946). Thus, a court or jury may award damages even though the measure of damages is imprecise. *E.g.*, *Reich v. Stewart*, 121 F.3d 400 (8th Cir. 1997).

IV. Correcting and Avoiding Problems

A. Correcting Improper Deductions

Even if an employer makes improper deductions in violation of the salary basis test, USDOL has established a window of correction that provides two avenues to avoid the loss of exempt status. First, if deductions "are either isolated or inadvertent," an exemption is not lost if the employer reimburses the employees for any improper deductions. 29 C.F.R. § 541.603(c). Second, if an employer has a clearly communicated policy prohibiting improper deductions and includes a complaint mechanism, reimburses employees for any improper deductions, and makes a good faith commitment to comply in the future, the employer will not lose the exemption unless the employer "willfully violates the policy by continuing to make improper deductions after receiving employee complaints." 29 C.F.R. § 541.603(d).

B. Tips to Avoid Salary Basis Issues

Employers should always expect to pay salaried exempt employees their full salary for any work week during which they engage in any work. Reductions in salary should not occur unless explicitly and unambiguously allowed.

An employer should be very cautious with any deductions from pay. Any incremental work (even for one-half hour) during a period of deduction will require payment of the employee's entire salary.

Employers should establish an overriding policy that explicitly states that no other employment policy shall be construed to allow any act, including any deduction from pay, that is inconsistent with or would defeat the salary basis of payment for exempt employees. The Ninth Circuit found that an employer may use such an overarching policy as a defense to establish that instances when deductions in pay do occur are incidental and not the policy or practice of the employer. *Hackett v. Lane County*, 91 F.3d 1289 (9th Cir. 1996).