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FAIR LABOR STANDARDS ACT'S "WHITE COLLAR" EXEMPTIONS: THE UNEXPECTED DANGER OF DISCIPLINARY SUSPENSIONS AND OTHER PERSONNEL POLICIES

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ABSTRACT

Employers regularly classify many of their highest paid executive, professional, and administrative employees as "salaried." As such, these employees receive a fixed amount of compensation and are not entitled to overtime wages in accordance with the FLSA. However, despite their exempt classification, these employees can become entitled to overtime pay if the employer utilizes certain personnel policies which have been held by the courts to be inconsistent with "salaried" status. The most common personnel policies which may entitle otherwise-exempt employees to overtime pay are: 1) unpaid disciplinary suspensions; 2) salary deductions for part-day absences; 3) accrued benefit deductions for part day absences; 4) overtime pay for additional hours worked; and 5) salary deductions for jury duty/ testifying as a witness. These personnel policies which inadvertently entitle exempt employees to overtime pay can expose the employer to potentially enormous back-pay liability.

FLSA's "WHITE COLLAR" EXEMPTIONS

The Fair Labor Standards Act (FLSA) exempts from its minimum wage and overtime provisions "any employee employed in a bona fide executive, administrative, or professional capacity" [1]. These "white collar" exemptions often include many of an employer's most highly compensated employees. A few

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examples of white collar exempt employees are: managers, supervisors, accountants, engineers, architects, human resources and marketing personnel, scientists, professors, and artists [2].

In classifying these employees as exempt, the employer gets the benefit of having employees work long hours without having to pay increased overtime for the work.

THE "SALARY BASIS" TEST

To be classified as exempt, the employee must be paid "on a salary basis" [3]. This regulation states, in relevant part:

> An employee will be considered to be paid "on a salary basis" within the meaning of the regulations 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 and 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* [3, emphasis added].

In accordance with the above regulation, an employee who is paid on a salary basis must be paid the same, predetermined amount irrespective of the actual number of hours or days worked in a given pay period. Subject to a few exceptions (discussed *infra*), an employer **may not** reduce an exempt employee's pay based on the amount of hours or days missed by the employee during that pay period.

Employers, often ignorant of this prohibition, commonly formulate personnel policies that provide for reduction in pay as a result of part or full workdays missed by their exempt employees. By doing so, employers risk exposure to potentially enormous backpay overtime liability. As discussed below, courts have regularly held that policies that tie missed hours and/or days worked with reductions in salary will take otherwise-exempt employees out of the white collar exemptions. These employees will be converted into hourly employees who will be owed retroactive overtime wages at a rate of one-and-one-half times their regular rate of pay for all hours worked above forty hours weekly.

In addition, under the applicable regulations, any exempt employee "subject to" such policies will generally be converted to nonexempt status. See [3]. As a result, policies which are inconsistent with "salaried" status, even if rarely or never implemented, expose the employer to potentially enormous, classwide liability. See [4].

Several common personnel policies have been found to violate the salary basis test and result in otherwise exempt employees being converted to nonexempt status. These personnel policies are as follows:

1. unpaid disciplinary suspensions and/or disciplinary pay deductions;
2. salary deductions for part-day absences;
3. benefit deductions for part-day absences;
4. overtime pay for additional hours worked; and
5. salary deductions for jury duty or testifying as a witness.

The following is a brief description of these personnel policies and the courts' interpretation of their impact on salaried status.

UNPAID DISCIPLINARY SUSPENSIONS— DISCIPLINARY PAY DEDUCTIONS

Many employers have personnel policies that provide for some method of progressive discipline prior to discharge. Most often included in these policies are provisions for suspensions without pay and/or disciplinary pay deductions. Such policies, when applicable to exempt employees, have regularly been interpreted as being inconsistent with salaried status [5-7]. As a result, personnel policies that provide for such suspensions or disciplinary pay-docking will most probably take all otherwise-exempt employees subject to these policies out of the exemption.

Two exceptions to this rule are worthy of note. First, the applicable regulations provide that "an employee need not be paid for any workweek in which he performs no work" [3]. The U.S. Department of Labor (DOL) and at least one federal district court have interpreted this language to mean that unpaid disciplinary suspensions **in full-week increments** are not violative of the 'salary basis' test. See [8-10]. However, any unpaid suspensions for less than a full week will jeopardize salaried status.

Second, the regulations provide that:

> Penalties imposed in good faith for infractions of *safety rules of major significance* will not affect the employee's salaried status. Safety rules of major significance include *only those* relating to the prevention of serious danger to the plant, or other employees, such as rules prohibiting smoking in explosive plant, oil refineries, and coal mines [11, emphasis added].

The regulation allows for unpaid disciplinary suspensions of any duration without jeopardizing salaried status. However, courts have uniformly construed the phrase, "safety rules of major significance" **very** narrowly. More liberal interpretations of the phrase advanced by employer's counsel have been consistently rejected by the courts. See [12-14].

As a result of the courts' consistently narrow interpretation, this regulatory safe harbor is of limited utility to employers.

SALARY DEDUCTIONS FOR PART-DAY ABSENCES

Employers frequently establish personnel policies that provide for the docking of salary for part-day absences from work for personal reasons. A common example would be an absence of a couple of hours from work for a doctor's appointment. While an employer often implements such a policy with the goal of greater flexibility for its workforce, courts have consistently held that pay-docking for part-day absences is a clear violation of the salary basis test [4, 7, 15].

It should be noted that the applicable regulations provide that an employer may reduce the salary of exempt employees for absences of a **full** day or more when the absences are for personal reasons [16]. Therefore, it is only reductions for absences of less than one day that are violative of the salary basis test.

In 1992, the DOL, largely in response to the *Abshire* decision, issued a new regulation that expressly allows **public-sector** employers to dock wages of otherwise-exempt employees for partial day absences without jeopardizing the exempt status of these employees [17]. However, the DOL declined to include private-sector employers in the new regulation.

BENEFIT DEDUCTIONS FOR PART-DAY ABSENCES

Many employers have policies that provide for reducing exempt employees' accrued sick, vacation, or personal leave time based on absences of less than one day for personal reasons. In such situations, the personnel policy will often **not** allow for salary-docking but will permit charging accrued benefit time for such absences.

The issue is less clear than with a salary-docking policy, and courts are split on whether this practice jeopardizes salary basis status. The critical inquiry is whether the court defines "compensation" broadly to include accrued benefit time or limits the definition to the amount received in the employee's paycheck.

Several courts have held a policy that provides for charging part-day absences to accrued benefit time, like docking salary, takes otherwise-exempt employees out of the exemption [18-20].

The district court in *County of San Diego* articulated its rationale as follows:

> the docking of an employee's leave time for absences from work is as contrary to the notion of salaried status as the docking of base pay. In both instances, the employee's compensation is reduced as a direct consequence of the quantity of hours worked. Such a reduction is entirely inconsistent with salaried status [20, at 1510].

However, other federal courts have refused to extend the definition of salary to include accrued benefit time [21-23]. In these cases, the courts have applied a narrow interpretation of the term compensation and have restricted it to cash or salary.

HOUR-FOR-HOUR OVERTIME PAY

Employers frequently have a policy that provides for additional compensation in the form of overtime pay or compensatory time off to exempt employees as a reward for their long hours and hard work. As a general rule, such a policy will not presumptively violate the salary basis test. However, courts will closely scrutinize how the additional compensation is **calculated.**

If the amount of the additional compensation is directly tied to the number of hours worked, on an hour-for-hour basis, this may jeopardize salaried status, and the employer will be liable for overtime for all hours worked above forty per week [15, 18]. These courts reasoned that payment of overtime to exempt employees "must not bear a direct causal relationship to the quality or quantity of the work performed" [18, at 360].

However, other federal courts have determined that payment of additional compensation, even when calculated on an hour-for-hour basis, does not disqualify otherwise-exempt employees from salaried status [21, 24, 25].

DEDUCTIONS FOR JURY DUTY AND ABSENCE TO BE A WITNESS

Another common practice is for employers to deduct from salary or accrued benefit time from exempt employees who are called for jury duty or miss work in order to testify as witnesses. The applicable regulations make clear that deductions may not be made for such absences. However, the employer is permitted to offset any money received by the employee as jury or witness fees for those week(s) against the amount paid to the employee without violating the salary basis test [18, 26, 27].

EMPLOYER'S LIABILITY

As noted above, the DOL's interpretive regulations provide that an employee will be considered paid on a salary basis if:

> he regularly receives each pay period on a weekly, or less frequent basis, a predetermined amount . . . which amount is not *subject to* reduction because of variations in the quality and quantity of the work performed [3, emphasis added].

The majority of federal circuit courts have interpreted this language to mean that an employer's implementation of a policy that is inconsistent with salaried status, even if rarely or never actually applied, will jeopardize the exempt status of all otherwise-exempt employees subject to the policy [4, 6, 7, 12].

The application of the "*subject to*" regulatory language results in potentially enormous, classwide liability for an employer even when an impermissible personnel policy is rarely if ever utilized. Representative of the huge backpay liability that may be owed to otherwise-exempt employees was the Second Circuit's *Malcolm Pirnie* decision [4]. In that case, the employer had instituted a policy whereby an employee absent from any fraction of a workday would have a *pro rata* amount deducted from his/her weekly salary or charged to his/her accrued benefit time. This policy applied to, among others, over four hundred highly compensated accountants, architects, engineers, scientists, and supervisors classified as exempt by the company.

In applying the policy, the employer had deducted a grand total of **$3,269.78** from twenty-four different employees over the course of the nineteen months that the policy was in place. The court held the company liable to **all** four hundred exempt employees *subject to* the policy. The district court awarded overtime backpay of **$515,455.50**, exclusive of interest and attorney's fees.

The Second Circuit's *Malcolm Pirnie* decision points up the enormous backpay liability that can result from seemingly insignificant violations of the salary basis test.

In addition, the FLSA provides that an employer "shall be liable" **not only** for the unpaid overtime wages, but also for "an additional equal amount as liquidated damages" [28]. In order to avoid these double damages, the employer must advance a 'good faith' defense which shows: 1) subjective good faith, and 2) objectively reasonable grounds for believing it was acting in compliance with the provisions of the FLSA [14]. The second prong of this standard is extremely difficult to satisfy and "[d]oubled damages remain the norm, while single damages are the exception" [29].

The application of the *subject to* language, in combination with the double damages rule, make each violation of the salary basis test potentially catastrophic to an employer.

LEGISLATIVE DEVELOPMENTS

In response to the exposure resulting from such hypertechnical violations of the salary basis test, employer groups and their supporters in Congress have introduced legislation that would eliminate or substantially alter the salary basis requirement for overtime exemptions. *See* The Workplace Leave Fairness Act, introduced by Representative Thomas Petri (R—Wisconsin) and Robert Andrews (D—New Jersey) and The Work and Family Integration Act, introduced by Senator John Ashcost (R—Missouri).

CONCLUSION

While employers are justified in classifying most of their highly compensated workers as white collar employees, and thus exempt from the overtime rules of the FLSA, they should monitor their payroll practices with respect to exempt employees to ensure they have not endangered their exempt status. A failure to do so exposes those employers to potentially catastrophic backpay liability if any of their personnel policies are inconsistent with the salary basis test. Unwary employers run the risk of liability to **all** their exempt employees for double overtime damages if they "fail" the salary test.

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ENDNOTES

1. 29 U.S.C. § 213 (a)(1) (1988).
2. See 29 C.F.R. § 541 (1994).
3. 29 C.F.R. § 541.118(a) (1994).
4. *Martin v. Malcolm Pirnie*, 949 F.2d 611 (2d. Cir. 1991) *cert. denied* 113 S.Ct. 298 (1992).
5. *Klein v. Rush-Presbyterian-St. Luke's Medical Center*, 990 F.2d 279 (7th Cir. 1993).
6. *Hurley v. Oregon*, 26 F.3d 392 (9th Cir.) (1994).
7. *Shockley v. Newport News*, 997 F.2d 18 (4th Cir. 1994).
8. DOL Letter Ruling, March 29, 1991.
9. DOL Letter Ruling, September 10, 1992.
10. *Mueller v. Thompson*, 2 Wage & Hour Cas. 2d. (BNA) 327 (W.D.Wis. 1994).
11. 29 C.F.R. 541.118(a)(5).
12. *Avery v. City of Telladega*, 24 F.3d 1337 (11th Cir 1994) (policemen leaving the scene of an apparent suicide, excessive force used against a prison inmate).
13. *McGrath v. City of Philadelphia*, Wage & Hour Cas. 2d (BNA) 551 (E.D.Pa. 1994) (failure to salute when in uniform, refusal to obey orders from a senior officer).
14. *Yourman v. Dinkins*, 826 F.Supp 736 (S.D.N.Y. 1993) (refusal to report for drug testing, theft of agency property).
15. *Abshire v. County of Kern*, 908 F.3d 483 (9th Cir. 1990) *cert. denied* 498 U.S. 1068 (1991) ("Subjecting an employee's pay to deductions for absences of less than a day, including absences for as short as an hour, is completely antithetical to the concept of a salaried employee.")
16. 29 C.F.R. §541.118(a)(3).
17. 29 C.F.R. §541.5(d).

18. *Thomas v. County of Fairfax*, 758 F.Supp 353 (E.D.Va. 1991).
19. *Benzler v. Nevada*, 804 F.Supp 1303 (D.Nev. 1992).
20. *Service Employees International Union, Local 102 v. County of San Diego*, 784 F.Supp 1503 (S.D.Cal. 1992).
21. *York v. City of Wichita Falls*, 944 F.2d 236 (5th Cir. 1991).
22. *McDonnell v. City of Omaha*, 999 F.2d 293 (8th Cir. 1993) *cert denied* 114 S.Ct. 1188 (1994).
23. *Barner v. City of Novato*, 17 F.3d 1256 (9th Cir. 1994).
24. *Paulitz v. City of Naperville*, 781 F.Supp. 1368 (N.D.III. 1992).
25. *Masters v. Huffington*, 800 F.Supp 363 (S.D.W.Va. 1992).
26. 29C.F.R.§541.118(a)(4).
27. *Fleming v. Carpenters/Contractors Cooperation Committee, Inc.*, 834 F.Supp 323 (S.D.Cal. 1993).
28. 29 U.S.C. § 216(b) (1988).
29. *Walton v. United Consumers Club, Inc.*, 786 F.2d 303, 310 (7th Cir. 1986).

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