VEDDERPRICE

FLSA FOCUS

Wage and hour information for employers July 2006

Courts Approve Method for Calculating Overtime that Can Reduce Overtime Costs

The FLSA normally requires employers to pay nonexempt employees time and one-half their regular rate of pay for all hours worked over 40 in a workweek. Under the "fluctuating workweek" method, however, employers who meet certain requirements may pay nonexempt employees a fixed salary for all hours worked and compensate them at one-half their regular hourly rate for all hours worked over 40 in the workweek. This can mean less overtime pay for the employee and less overtime expense for the employer.

Two recent federal court decisions have upheld the fluctuating workweek method of calculating overtime. In *Tumulty v. FedEx Ground Package System, Inc.*, the U.S. District Court for the Northern District of Illinois held that FedEx Ground could use that method to pay overtime to van drivers and package deliverers. Likewise, in *Mitchell v. Abercrombie & Fitch Co.*, the U.S. District Court for the Southern District of Ohio approved the method for assistant managers of Abercrombie & Fitch clothing stores.

Before an employer can utilize the fluctuating workweek method, the following conditions must be met:

- The employee's hours must fluctuate from week to week;
- The employee must be paid a fixed salary regardless of the number of hours worked in the workweek;
- The employee must understand that his or her salary is meant to cover all hours worked;
- The salary must be large enough to ensure that the employee never falls below the minimum wage;
- The employee must receive extra compensation (in the form of "half-time") for all hours worked over 40 in a workweek.

As to the last requirement, the overtime pay is calculated by dividing the employee's weekly salary by the total number of hours worked in the workweek, to arrive at the employee's "regular rate" for that workweek. The regular rate is then divided by two to determine the "half-time rate" to be paid as extra compensation for each hour worked over 40 in that workweek. Because the employee is being paid at a half-time rate rather than the normal time and one-half rate, the fluctuating workweek method can mean overtime savings for the employer.

Vedder Price has helped clients evaluate and implement the fluctuating workweek method in a variety of workplaces. If you have questions about this

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method and whether it can effectively be utilized by your company, please contact any Vedder Price attorney with whom you have worked.

Explosion in Class Action and Collective Action Wage and Hour Lawsuits Continues

The number of class action and collective action lawsuits filed under the wage and hour laws continues to mushroom. These cases now outnumber employment discrimination class actions—a fact that would have seemed highly improbable just a few years ago. In Cook County, Illinois, alone, new wage and hour class actions are filed *every day*. There are several reasons why wage and hour claims have become so popular.

First, plaintiffs' lawyers now understand that employers routinely fall short in their wage and hour compliance efforts. Common mistakes include misclassifying employees, calculating overtime incorrectly, taking improper deductions from salaries, and improperly recording and paying for all hours worked. The latest trend involves claims that the employer failed to pay employees for so-called "preliminary and postliminary" duties or otherwise required employees to work "off the clock." Preliminary and postliminary duties are tasks done at the start or end of the workday, such as changing clothes, cleaning up, following check-in or check-out procedures, and walking to or from workstations.

> ***. . . wage and hour claims generally are easier for a plaintiff to win than an employment discrimination or wrongful termination claim.***

Second, wage and hour claims generally are easier for a plaintiff to win than an employment discrimination or wrongful termination claim. Successfully prosecuting wage and hour claims based on common employer mistakes can be as easy as shooting fish in a barrel. And, if the employees win their wage and hour claim, their lawyers' fees are paid by the employer.

Third, courts are more willing to certify a class or permit collective treatment of employees in a wage and hour case than in other types of employment cases. Because employers tend to treat large groups of employees the same with respect to wage and hour matters, it can be difficult to demonstrate that class or collective treatment is not appropriate. Class or collective claims mean greater defense costs and more risk for the employer—and more pressure to settle.

Fourth, there has been a snowball effect as news of large settlements and judgments has attracted attention and increased awareness in both employees and lawyers. The publicity surrounding the DOL's August 2004 regulations governing the white collar exemptions contributed to that awareness.

Financial Services Industry Hit Especially Hard

While most industries have experienced a significant increase in wage and hour claims, none has been hit harder than the financial services industry. Class and collective action claims against brokerage houses and banks have resulted in staggering settlements and judgments. For example, Smith Barney paid $98 million to settle claims alleging misclassification of employees and, thus, failure to pay overtime. Morgan Stanley and Merrill Lynch paid $42.5 million and $37 million, respectively, to settle similar claims. Bank of America and Countrywide Home Loans likewise paid $15 million and $30 million, respectively, to settle various wage and hour claims, including claims that account executives were misclassified and should have been paid overtime.

These settlements reflect a "copycat" effect in wage and hour litigation: one employer in the industry gets hit with a class or collective action wage and hour lawsuit and similar claims are filed against other employers in the industry. Retailers and hospitality industry employers have experienced a similar ripple effect.

Employers Need to Be Proactive with Wage and Hour Practices

Smart employers are not sitting idle as the tidal wave of wage and hour claims approaches. They are taking steps to ensure that their wage and hour house is in order. This requires looking backward to identify and address past mistakes, and looking forward to ensure that the company's policies and practices do not create undue risk for claims.

Proactive steps include auditing payroll practices, reviewing and updating employee classifications and job descriptions, and reviewing record-keeping and time-keeping practices.

Vedder Price has helped many clients conduct a comprehensive wage and hour audit to protect against claims. In addition to full-scale audits, Vedder Price can assist with examining the classification of particular jobs; evaluating salary deduction practices; ensuring that overtime is properly calculated; and examining "preliminary" and "postliminary" tasks and other gray areas like travel, training and on-call time to determine if they should be treated as working time. These and other steps can detect and correct a problem before a claim is filed.

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New Legislation Makes Punitive Damages Available in More Cases Under Illinois Minimum Wage Law

Under the Illinois Minimum Wage Law ("IMWL"), an employee may assign his claim to the Illinois Department of Labor ("IDOL") or file a lawsuit on his own behalf. In 2005, the Illinois Appellate Court for the First District held that punitive damages are only available when the employee assigns his claim to the IDOL. *Gelb v. Air Con Refrigeration & Heating Co.* Because the plaintiffs in that case did not assign their claims to the IDOL, the Appellate Court held that they were not entitled to punitive damages.

In response to the *Gelb* decision, the Illinois legislature passed a bill to amend the IMWL and make punitive damages available in all cases where unpaid wages are assessed. Governor Blagojovich signed the bill into law on July 14, 2006. Employers now face the prospect of punitive damages in virtually every case filed under the IMWL.

Interns, Volunteers and Charitable Workers—Employees or Not?

When can an employer allow an individual to intern, volunteer or do charitable work on behalf of the company without paying the individual as an employee? Different rules apply to each category.

Interns

In a recent opinion letter, the DOL drew the boundaries of unpaid internships under the FLSA. If each of the following factors is met, the intern is not an "employee" and therefore the FLSA will not apply:

- The training is similar to what would be given in a vocational school or academic educational instruction;
- The training is for the benefit of the intern;
- The intern does not displace regular employees, but works under their close observation;
- The employer that provides the training derives no immediate advantage from the activities of the intern;
- The intern is not necessarily entitled to a job at the conclusion of the training period; and

- The employer and intern understand that the intern is not entitled to wages for the time spent in training.

Employers must be careful with unpaid internships and ensure that all six factors set forth by the DOL are met. Perhaps the most common factor that can cause an intern to become an "employee" is when the intern performs the same type of work as the company's regular employees such that a regular employee is displaced and/or the employer derives a material benefit from the intern's work.

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Volunteers in the Workplace

The DOL and courts take a very strict approach to individuals volunteering to work without pay. Generally, an individual cannot volunteer his services to a for-profit employer in the private sector. Even if the individual has no expectation of being paid, the DOL and courts ordinarily will consider the individual an "employee" and require payment of wages in accordance with the FLSA if the individual performs services for the employer from which the employer derives an economic advantage.

Employees Volunteering for Charitable or Employer-sponsored Activities

The DOL and courts are somewhat more lenient when employees are invited to volunteer for charitable activities or public activities sponsored by their employer. In a recent opinion letter, the DOL addressed a situation where the employer had invited employees to volunteer to work a 5K and 10K race sponsored by the employer. The DOL first noted its long-standing rules on the subject:

- Time spent in work for public or charitable purposes at the employer's request, or under the employer's direction or control, or while the employee is required to be on premises, is working time and must be paid.
- Time spent *voluntarily* in such activities *outside* of the employee's normal working hours is not hours worked and need not be paid so long as the volunteer activities are not the same as or similar to the employee's regular work activities.

Applying these rules to the 5K and 10K race volunteers, the DOL said that the employer must compensate employees for the hours spent volunteering during their normal working hours or when the volunteer work performed is similar to their regular duties. However, the employer need not compensate employees for time spent performing work that is not similar to their regular duties if that work is voluntarily performed outside of their normal working hours.

Beware the Salary Basis Requirement for Exempt Employees

Most employers know that an employee must meet certain "duties" tests to qualify for the white collar exemptions—executive, administrative and professional. It is important not to overlook another requirement for these exemptions: the employee must be paid on a "salary basis." This means that the employee generally must receive the same fixed amount of salary regardless of the quantity or quality of work performed in the workweek. The salary basis requirement can be understood as a general rule with seven exceptions.

General Rule: An exempt employee must be paid his full salary for any workweek in which he performs any work.

Exception No. 1—Full-Day Absence for Personal Reasons: Deductions from pay may be made when the employee is absent from work for one or more full days for personal reasons (other than sickness or disability, which is addressed in Exception No. 2). So,

if the employee is absent for two full days for personal reasons, the employer may deduct two full days' worth of salary. On the other hand, if the employee is absent for a day and a half, the employer may only deduct the one full day's worth of salary—partial-day deductions from pay are not permissible.

Exception No. 2—Full-Day Absence for Sickness or Disability: Deductions from pay may be made for absences of one or more full days due to sickness or disability if the deduction is made pursuant to a bona fide plan, policy or practice of providing compensation for absences due to sickness or disability. Once the employee exhausts his entitlement to sick/disability time, the employer may continue to make deductions from pay for full-day absences due to sickness or disability. So, if an exempt employee exhausts sick time and then takes additional full days off due to illness, the employer may deduct those days of pay from the employee's salary. As with Exception No. 1, partial-day deductions from pay are not permissible.

Exception No. 3—Deductions from Leave Accounts: An employer may make full- or partial-day deductions from an employee's leave time or vacation time. For example, if an employee who normally works Monday through Friday takes off work at noon on Thursday and all day Friday, the employer may charge one and one-half days against the employee's vacation time. The employee would still receive his full salary for the week, but his accrued vacation time would be reduced by a day and a half. If this same employee had no accrued vacation time left to cover the absence, the employer could still "charge" the time to the employee's vacation time, thus leaving a negative balance.

Exception No. 4—Deduction for Violation of Safety Rule: Deductions from pay may be made in any amount (including partial days) as penalties imposed in good faith for infractions of safety rules of major significance.

Exception No. 5— Full-Day Absence for Violation of Workplace Conduct Rule: Full-day deductions from pay may be made for unpaid disciplinary suspensions imposed for infractions of workplace conduct rules (such as violation of a harassment policy).

Exception No. 6—Initial or Terminal Week of Employment: An employer is not required to pay the full salary in the initial or terminal week of employment. The employer may pay a proportionate part of the employee's full salary for the time actually worked in these workweeks.

Exception No. 7—FMLA: An employer is not required to pay the full salary for weeks in which an exempt employee takes unpaid leave under the FMLA. In those workweeks, the employer may pay a proportionate part of the employee's full salary for the time actually worked. This may include partial-day deductions.

DOL Addresses Salary Basis Issues

Two recent DOL opinion letters addressed the salary basis requirement. In the first letter, the DOL said that an employer could not take deductions from an exempt employee's salary as a fine for damaging or losing company equipment, such as laptop computers and cell phones.

In the second letter, the DOL said that an employer could require its exempt employees to work a certain number of hours per workweek and could discipline the employees if they failed to make up any hours they missed. However, the DOL said the employer could not dock an employee's salary for the missing hours of work even if the employee failed to make up those hours; the employee would only be subject to discipline, albeit including termination.

VEDDER, PRICE, KAUFMAN & KAMMHOLZ, P.C.

Vedder, Price, Kaufman & Kammholz, P.C. is a national, full-service law firm with approximately 225 attorneys in Chicago, New York and Roseland, New Jersey. The firm combines broad, diversified legal experience with particular strengths in labor and employment law and litigation, employee benefits and executive compensation law, occupational safety and health, general litigation, corporate and business law, commercial finance, financial institutions, environmental law, securities, investment management, tax, real estate, intellectual property, estate planning and administration, health care, trade and professional association and not-for-profit law.

Questions or comments concerning the Bulletin or its contents may be directed to its Editor, Thomas M. Wilde (312/609-7821), or the firm's Labor Practice Leader, Bruce R. Alper (312/609-7890), or the Managing Shareholder of the firm's New York office, Neal I. Korval (212/407-7780), or in New Jersey, John E. Bradley (973/597-1100).

Chicago
222 North LaSalle Street
Chicago, Illinois 60601
312/609-7500
Fax: 312/609-5005

New York
805 Third Avenue
New York, New York 10022
212/407-7700
Fax: 212/407-7799

New Jersey
Five Becker Farm Road
Roseland, New Jersey 07068
973/597-1100
Fax: 973/597-9607

www.vedderprice.com