EXEMPT VS. NON-EXEMPT EMPLOYEES

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The notion that employees must be paid at least the minimum wage and time and a half for overtime is familiar to most employers. However, the source of these obligations and their ramifications are often not so familiar. The purpose of this seminar presentation is to provide an overview of federal and Illinois law governing wages and hours.

The federal wage and hour statute is the Federal Fair Labor Standards Act (FLSA), which sets federal minimum wage and overtime pay standards. 29 U.S.C. §201 et seq. The FLSA established a federal minimum wage (since September 1, 1997) of $5.15 per hour. 29 U.S.C. §206(a)(1). As to overtime pay, the FLSA requires that employees be paid time and one-half their regular hourly rate for all hours worked in excess of forty hours for the work week.

The Act provides 40 hours as the maximum number of hours that an employee may work for an employer in any workweek without receiving additional compensation at not less than one and one-half times employee's regular rate. 29 U.S.C. §207(a) The Act does not require compensation for hours worked in excess of 8 hours per day. 29 C.F.R. §778.102 There are several different industries that allow for a longer workweek in computing overtime. For example, public agency employee's overtime is not computed until after 216 hours. 29 U.S.C. §207(k)(1) Another example is that of a pieceworker, an employee employed on a piece-rate basis, their regularly hourly rate of pay is computed by adding together the total earnings for all the workweek from piece rates and other sources (production

bonuses) and waiting time or other hours worked. This sum is then divided by the number of hours worked in a week to yield the pieceworker's regular rate for that week. Overtime is the paid sum equivalent to one-half the regular rate of pay multiplied by the number of hours worked in excess of 40 in a week. 29 C.F.R. §778.111

IV. EXEMPT VS. NON-EXEMPT

A. Effect of Exempt vs. Non-Exempt Status

1. Covered Employers

"Employer" is defined broadly as any person acting directly or indirectly in the interest of an employer in relation to an employee. The FLSA, generally applies to any employer with a gross annual sales or business of $500,000 or more. It applies to schools, most hospitals or other health care entities, and all governmental entities regardless of size. Labor unions are not covered by the FLSA. 29 U.S.C. §203

More than one business entity may be considered an employer. Where an employee performs work which simultaneously benefits more than one employer or performs work for two or more employers during the workweek, the employers are generally considered joint employers if: there is an arrangement between the employers to share the employees' services; one employer is acting directly or indirectly in the interest of other employer; or one employer is controlled by the

other or both are under common control so that they may be considered the employer of the same employee.

2. Covered Employees

All individuals employed by a covered employer are covered employer are covered by the FLSA, although certain employees are exempt from some or all of the statutory requirements, such as: executives, professionals, and administrators; bona fide volunteers; independent contractors; prisoners; employees subject to the Motor Carrier Act; elected officials and their personal staff; and political appointees and their legal advisors. Employees covered by the FLSA are entitled to the FLSA's protections at any time they are working as long as the employer knew or had reason to know of the work.

a. Volunteers

When determining whether a person is a volunteer rather than an employee, the Department of Labor considers who receives the benefits of an individual's work, how long it takes to render the services, and whether the services are typical volunteer activities. Employers who perform work typically considered "volunteer" work at their employer's request or direction are not considered "volunteers." 29 C.F.R. §785.44 Employers may pay the volunteers for their expenses, provide reasonable benefits and a nominal fee without risking their status as volunteers.

B. Defining Types of Exemptions

Exemptions from coverage of the FLSA are either determined by an employee's activities or are establishment-wide or industry-wide. Two of FLSA's most important employee exemptions apply to "white-collar" employees (executive, administrative and professional) and to outside salesman. 29 U.S.C. §213(a)(1) These employees are exempt from the minimum wage and overtime pay but not the equal pay provisions of the FLSA. The determination of whether an employee falls within this exemption category is largely factual in nature, based upon the employee's salary, duties and responsibilities.

1. "White Collar" Exemptions

The exemptions for "white collared" employees are the most common FLSA exemption and also a common source or problems for employers. Employees who qualify as executives, administrators, professionals, and outside salespeople under tests set out in the regulations to the FLSA are exempt from minimum wage and overtime requirements.

The FLSA tests are based upon an employee's duties and salary. A common misconception is that salaried employees are exempt from the FLSA. Payment on a salary basis is generally necessary to establish a white collar exemption, although not all salaried employees are exempt.

Another common violation occurs when employers treat employees as exempt based upon their job titles. Employers frequently attempt to claim an exemption for employees who hold inflated titles.

The burden falls upon the employer to prove that an employee is exempt. Herman v. Palo Group Home, Inc., 976 F.Supp 696 (W.D. Mich. 1997). Courts generally narrowly construe exemptions against the employer seeking to assert them. Auer v. Robbins, 117 S. Ct. 905 (1997)

The "short tests" for the white collar exemptions, applicable to employees paid on a salary basis of at least $250 per week, are listed below:

a. Executive Exemption

Employees are exempt as executives if their primary duty consists of managing the enterprise in which they are employed or managing a customarily-recognized department or subdivision of the enterprise. 29 C.F.R. §541.1.

"Managing" includes duties such as hiring, firing, directing and evaluating employees, setting rates of pay, determining work techniques, and determining appropriate levels of supplies and merchandise. 29 C.F.R. §541. The rule of thumb for determining a "primary duty" is whether the duty occupies at least 50% of an employee's time. 29 C.F.R. §541.103 The employee must also customarily and regularly direct the work of two or more employees. "Two or more employees" means two or more full-time employees or their equivalent, such as one full-time

employee and two part-time employees who together work 80 hours per week. 29 C.F.R. §541.105

b. Administrative Exemption

Employees are exempt under the administrative exemption if their primary duty consists of office or nonmanual work which is directly related to the employer's management policies or general business operations and requires the exercise of discretion and independent judgment. 29 C.F.R. §541.2

The administrative work must not be of a routine or clerical nature but must be of substantial importance to the management or operation of a business. 29 C.F.R. §541.205 Bookkeepers, secretaries and clerks are not exempt because they are viewed as "production" workers rather than policy makers. Tax experts, credit managers, account executives, brokers, sales research experts and personnel directors are typical examples of employees who would be considered exempt. However, this is not an exhaustive list.

c. Professional Exemption

Employees are exempt as professionals if they customarily exercise discretion and independent judgment and their primary duty consists of one of the following:

1. Work requiring advanced knowledge in field of science or learning customarily acquired by a long course of specialized study. 29 C.F.R. §541.3(a)(1) This is not limited to occupations traditionally recognized as "professional."

2. Work that is original and creative in character in a recognized field of artistic endeavor and the result of which depends primarily on the invention, imagination, or talent of the employee. 29 C.F.R. §541.3(a)(2)

3. Teaching in a school system, educational establishment or educational institution, including teachers of skilled or semi-skilled trades. 29 C.F.R. §541.3(a)(3)

4. Work requiring theoretical and practical application of highly-specialized knowledge of computer system analysis, programming, and software engineering. 29 C.F.R. §541.3(a)(4)

The usual minimum salary requirement of $250 does not apply to doctors, lawyers, teachers, and outside salespeople.

d. Outside Sales People

Employees are exempt as outside salespersons if:

1. They customarily and regularly are engaged away from the employer's place of business in making sales of goods and services, or in obtaining orders or contracts for services or use of facilities; AND

2. The time the salespersons spend engaged in work other than outside sales does not exceed 20% of the hours worked in the workweek by other nonexempt employees who perform the same type of nonexempt work. Work incidental to sales such as writing sales reports or planning an itinerary is considered

exempt work for purposes of this exemption. Inside sales and clerical warehouse activities are considered non-exempt work. 29 C.F.R. §541.500-541.508

e. Combination Exemptions

Where an employee performs work which is considered exempt under more than one exemption, the work may be "tacked" together to create a combination exemption. The employee must meet the stricter of the requirements for nonexempt work. 29 C.F.R. §541.600

2. Determining The Exemption

To determine whether an employee is exempt under one of white collar exemptions, more than just the employee's job title must be examined. An employer must analyze the actual duties, responsibilities and salary of the employee.

C. Independent Contractors

1. Under Federal Law

Courts use an "economic realities" test to determine whether workers are independent contractors under the FLSA. They look to several factors: permanency and exclusivity of the relationship; degree of control exercised by the alleged employer; skill and initiative required; relative investments of the employee and the alleged employer; and the degree to which the worker's opportunity for profit is determined by the alleged employer. Krause v. Cherry Hill Fire Dist. 13, 969 F.Supp 270 (D.N.J. 1997).

2. Under Illinois Law

The Minimum Wage law defines an employee as "any individual permitted to work by an employer in an occupation..." 820 ILCS 105/3(d). Although it is unlikely that a minimum wage dispute will arise with an independent contractor, keep in mind that the Minimum Wage Law also has an overtime provision, 820 ILCS 105/4a, which requires pat at time-and-one-half for over 40 hours in a week. No case law addresses who is an employee or an independent contractor under the Minimum Wage Law. Companies should be aware of the tests applied under other state statutes, and they should pay particular attention to the "economics realities test" used under the federal Fair Labor Standards Act, since the FLSA addresses the same topics as the Illinois Minimum Wage Law.

D. Salary Requirements for Exemptions

An employer must meet the duties for the white collar exemptions and demonstrate the employee is paid on a "salary basis". To be paid on a salary basis an employee must regularly receive each pay period a predetermined amount constituting all or part of his or her compensation. 29 C.F.R. §541.118(a). The employee must receive his or her full salary for any week in which he or she performs any work regardless of the number of days or hours worked. Improper deductions from an employee's salary may destroy the exemption.

1. Deductions

Deductions from salary for absences of less than a full day will generally destroy the exemption. 29 C.F.R. §541.118

Deductions which will destroy the exemption include:

a. Deductions caused by the employer, i.e. when there is no work;

b. Deductions based upon the employee's quantity or quality of work;

c. Deductions for jury duty, attendance as a witness, or temporary military leave (except to the extent the deductions are to offset payments to the employee from these activities);

d. Deductions for absences less than a day;

e. Deductions for disciplinary reasons, except violations of safety rules of major significance pertaining to serious danger to the plant.

Deductions which do not destroy the exemption include:

a. Deductions when the employee is absent for a day or more for personal reasons other than sickness or accident;

b. Deductions when the employee is absent over a day for medical reasons made under a policy for paid leave.

The Department of Labor takes the position that employers may require employees to use paid leave for absences of less than a day without jeopardizing the employees' salaried status.

2. Subject to Deductions

Employers sometimes have disciplinary programs which impose suspensions or fines for rule violations. If this type of pay docking is applied to exempt employees, the employees will lose their salaried status and will no longer be exempt.

The United States Supreme Court recently resolved this issue of when an employer's pay docking will destroy the white-collar exemption in Auer v. Robbins, 117 S.Ct. 915 (1997). In Auer, the Supreme Court accepted the position urged by the Secretary of Labor that exempt status must be denied under the salary-basis test when employees are covered by a policy that permits disciplinary or other deductions in pay "as a practical matter." Courts after Auer have followed Auer and held that an employer's actual practice or significant likelihood of pay docking determines the applicability of the exemption.

3. Ability to Make Corrections

Department of Labor regulations to the FLSA permit employers to correct pay docking mistakes. A salaried employee does not lose his or her exempt status when an impermissible deduction is made and the employer corrects the violation. The employer must reimburse the employee and promise to comply in the future. 29 C.F.R. §541.118. This is known as the "window of correction."

The court in Auer did not address whether the window of correction could be applied in cases of recurring violations.

4. "Extras"

Employers may pay "extras" such as bonuses or commissions in addition to the guaranteed salary as long as the employee receives the minimum guaranteed amount of $250 for each week the employee performs any work. 29 C.F.R. §541.118