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A Five-Figure Paycheck and Six-Figure Annual Compensation is Not Enough to Avoid the FLSA's Overtime Requirements

The United States Supreme Court issued a recent opinion that highlights the pitfalls employers face if they fail to properly pay their employees who would otherwise be exempt from overtime. The case pointed out the employer's failure in paying a highly compensated executive employee a daily rate, thereby entitling the employee to overtime, despite him otherwise qualifying for an overtime exemption.

The Federal Labor Standards Act ("FLSA") is the federal law which mandates, in part, that most employees will receive overtime pay for hours worked in excess of 40 hours each week. In contrast, numerous categories of employees are "exempt" employees, i.e., exempt from the FLSA's overtime requirements, such as those who are exempt executives because they hold a high-level or supervisory position. Yet, although the actual duties of the employee are most often the critical factor in deciding if an employee is truly "exempt," to be considered an "exempt" employee, the employee must meet all three of the following factors: (1) the "salary-level" test, (2) the "salary-basis" test, and (3) the "duties" test for one of the recognized overtime exemptions.

The Supreme Court's recent decision in Helix Energy Solutions Group, Inc., et al. v. Michael J. Hewitt, provides a reminder of the courts' stringent application of the "salary-basis" test. In that case, the often-litigated third exemption, over the employee's duties, was not in dispute. Rather, Michael J. Hewitt worked for Helix Energy Solutions Group for three years, typically working 12-hour days, seven days a week for several 28-day periods. Hewitt received a paycheck every two weeks and was paid through a daily-rate basis with no overtime compensation. During his three-year employment, Hewitt's daily-rate ranged from $963 per day to $1,341 per day, eventually amounting to over $200,000 annually. Following his termination, Hewitt sued for overtime pay. Helix argued Hewitt was not owed any overtime because he was exempt as an executive.

The employee Hewitt agreed that he met the "salary-level" and "duties" tests of the exemption, but denied that he satisfied the "salary-basis" test. Under the FLSA, an employee will meet the salary-basis test "if the employee regularly receives each pay period on a weekly, or less frequent basis, a predetermined amount constituting all or part of the employee's compensation, which amount is not subject to reduction because of variations in the quality or quantity of the work performed." In essence, an employee must be paid a set amount regardless of hours worked. Here, the Court held that Hewitt did not meet the salary-basis test for several reasons.

First, the Court determined that because Hewitt was paid a daily rate, he was never paid "without regard to the number of days" he worked, as required to meet the "salary-basis" test. Rather, his weekly pay was always determined precisely by the number of days he worked. The Court reiterated that to meet the "salary-basis" test, as long as an employee works at all during any single week, an employer must ignore the total number of days worked and pay the predetermined weekly amount. Helix had argued that, because of the high compensation he was paid, i.e., $1,341 per day, the employee was always paid more than the required minimum of $684 per week. In other words, even if he worked one day, the employee would be paid above the statutory minimum, such that he should be considered to have been paid on a salary basis. The Court rejected Helix's argument by reasoning that the term "basis" as used in the law "refers to the unit or method for calculating pay, not the frequency of its distribution" through paychecks. As such, it was irrelevant that the employee actually received an amount of pay that would have satisfied the test, because he did not receive that amount through the proper "basis" – that is, a predetermined salary. Simply put, he was paid by the day, and not technically guaranteed a weekly amount, thereby meaning he was not paid on a salary basis.

Second, the Court recognized that the regulatory structure of the FLSA, through 29 C.F.R. § 541.604(b), sets forth the methods by which an employee may meet the "salary-basis" test even when the employee is paid a daily rate. The relevant section permits an employer to satisfy the test by paying earnings "computed on an hourly, a daily or a shift basis…if the employment arrangement also includes a guarantee of at least the minimum weekly required amount paid on a salary basis regardless of the number of hours, days or shifts worked, and a reasonable relationship exists between the guaranteed amount and the amount actually earned." The Court determined, and Helix agreed, that it did not meet the requirements of this section. However, Helix attempted to argue that this provision does not apply to cases of "highly compensated employees," such as Hewitt, and thus should not be considered in this case.

The Court rejected this argument, explaining that although Hewitt met the FLSA's definition of a "highly compensated employee," his status as such is relevant only to the "duties" test. Specifically, whereas, an employee meeting the executive exemption must ordinarily perform all of the several duties outlined by the law to be considered exempt, a "highly compensated employee" need only meet one of the several duties. Accordingly, the Court explained that an employee's status as "highly compensated" has no impact on the salary-basis test.

Third, the Court held that a "clear textual directive," which it deemed existed here, overrides any policy arguments against holding that the salary-basis test can never apply to daily-rate workers such as Hewitt. The Court was not convinced by arguments that the decision would give windfalls to high earners, disrupt and increase costs of industry operations, or impose significant retroactive liability.

The decision serves as a reminder of the importance to conduct a careful and thorough exemption analysis for every employee, and the expensive consequences for misclassifications. Hewitt, typically working 84-hour weeks, paid at a rate of up to $1,341 per day, is entitled to a large payment of unpaid overtime for his three-year employment. This is despite the fact Hewitt was paid enough to meet his exemption and that there was no dispute that he was exempt as an executive, at least as far as his duties were concerned. As the Court made clear, employees must also be paid on a permissible basis to meet an exemption.

In addition to paying unpaid overtime, employers are subject to fines under the FLSA for misclassifications. Although not addressed in this case, employers must also consider applicable state laws in analyzing an employee's exempt status. Some states have more stringent requirements than the federal requirements. Moreover, some states, such as New Jersey, have far greater penalties for misclassifications – with employers subject to liquidated damages of 200 percent, amounting to three times the overtime due.

If you have questions about whether or not your employees are exempt under applicable federal or state laws, please contact Meghan O'Brien at 856-354-3060 or mobrien@archerlaw.com, or Peter Frattarelli at 856-354-3012 or pfrattarelli@archerlaw.com.

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