7th Clarifies Overtime Damages For Misclassified Employees

Insights
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Courts and litigants have struggled over how to figure overtime due to an employee who was misclassified as exempt and who was paid a fixed salary for his or her hours worked. The federal Fair Labor Standards Act requires that non-exempt employees be paid 1.5 times their regular hourly rates for hours worked over 40 in a workweek.

However, for a misclassified salaried employee, satisfying this requirement necessitates a couple of threshold determinations. First, the regular hourly rate must be derived indirectly and after-the-fact, because the employee was not paid on an hourly basis.

Second, a court must decide how this rate will be used in computing back-pay for hours worked over 40 in a workweek: Is the employee due 1.5 times this rate for those overtime hours, or is the correct approach to calculate overtime premium by multiplying those hours times *one-half* of the regular rate? The answer depends upon whether the employee's salary is seen as having been his or her straight-time pay only for the first 40 hours, or instead for *all* hours worked. If the salary covered only the first 40 hours, the employee has received no pay for the overtime hours and is owed 1.5 times the rate. But if the salary was the employee's straight-time compensation for all hours worked in a workweek, including overtime hours, then the employee is due only the half-time overtime premium. How this gets resolved can have tremendous significance in situations – such as class actions – involving large numbers of overtime hours.

The U.S. Court of Appeals for the 7th Circuit (Illinois, Indiana, and Wisconsin) recently weighed-in on this in *Urnikis-Negro v. American Family Property Services*, 2010 WL 3024880 (August 4, 2010) (opinion below). The plaintiff was misclassified as exempt under the FLSA's administrative exemption, was paid a fixed salary, and worked varying numbers of hours each workweek (usually far exceeding 40). In fashioning its overtime award, the lower court followed an approach taken by several federal appellate courts and relied upon the U.S. Labor Department's longstanding interpretive rule known as the fluctuating workweek calculation ("FWW") (29 C.F.R § 778.114(a)). *See*, *e.g.*, *Clements v. Serco, Inc.*, 530 F.3d 1224, 1230-31 (10th Cir. 2008); *Valero v. Putnam Assoc. Inc.*, 173 F.3d 35, 39 (1st Cir. 1999); *Blackmon v. Brookshire Grocery Co.*, 835 F.2d 1135, 1138-39 (5th Cir. 1988). The lower court figured a regular rate by dividing the employee's weekly salary by her total hours worked in the workweek, and then calculated her overtime premium by multiplying one-half of that rate times her overtime hours worked in the workweek. The employee asked the 7th Circuit to overturn this, contending that the FWW method was inappropriate to her situation.

The 7th Circuit agreed that the lower court was wrong to rely upon the Labor Department's FWW method as the basis for calculating overtime owed in a misclassification case, concluding that the interpretive rule is forward-looking and is not a remedial measure. It noted the rule's reference to "a clear mutual understanding" between the employer and the employee, which contemplates a before-the-fact agreement on this method where the employee is paid a fixed salary. The circuit also observed that the rule speaks of the employee contemporaneously receiving overtime compensation. In a misclassification situation, the parties have no such mutual understanding, and there is no contemporaneous overtime payment, because the employer has treated the employee as exempt.

Nevertheless, the 7th Circuit concluded that the lower court reached the correct outcome. It said that, in the case of a misclassified employee paid a fixed salary to work varying numbers of hours, the regular rate is determined by dividing all of the hours worked in the workweek into the salary for that workweek. Because the resulting regular rate represents straight-time pay for *all* the workweek's hours (including overtime ones), the employee is owed the product of multiplying one-half of the regular rate (*i.e.*, the "half" of "time and one-half") times the total overtime hours. The circuit relied upon the U.S. Supreme Court's decision in *Overnight Motor Transportation Co. v. Missel*, 316 U.S. 572 (1942), in which the Supreme Court used this approach under analogous circumstances. The Supreme Court noted in *Missel* that its method was consistent with longstanding Labor Department guidance.

Urnikis-Negro represents a principled approach to determining overtime for a misclassified employee. It avoids the temptation to utilize FWW as a justification, even though the Labor Department's interpretive rule uses the correct arithmetical computation. Rather, the decision is grounded upon binding Supreme Court precedent, which itself relied upon longstanding, historical guidance from the Labor Department. In following this clearly correct approach, the circuit was adhering to the guiding general principle on the regular rate, which states: "The regular hourly rate of pay of an employee is determined by dividing his total remuneration for employment (except statutory exclusions) in any workweek by the total number of hours actually worked by him in that workweek for which such compensation was paid." 29 C.F.R. Section 778.109. *Urnikis-Negro* provides useful clarification and guidance for employers on a computational issue of potentially enormous practical impact in assessing potential exposure in misclassification cases.

EDITOR'S NOTE: *Urnikis-Negro* also cited with approval the Labor Department's Opinion Letter No. FLSA2009-3 (Jan. 14, 2009), which was a response to a 2007 Fisher Phillips opinion request. Fisher Phillips did not invoke FWW in its request, but the Labor Department nonetheless predicated its favorable answer upon those principles. Our request and the reply can be accessed below.

2007 Opinion Request.pdf (69.15 kb)

Back-Pay Opinion Letter 01 14 09.pdf (310.29 kb)

Urnikis-Negro v. American Family Property Services.pdf (252.87 kb)

Related People

Joel W. Rice
Partner
312.580.7810
Email