

Exempt employees and the reasonable relationship test

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In Opinion Letter FLSA 2018-25, issued in November 2018, the acting administrator of the U.S. Department of Labor's Wage and Hour Division addressed the requirement in 29 C.F.R. Section 541.604(b) that a "reasonable relationship" must exist between an exempt employee's guaranteed amount paid on a salary basis and the amount actually earned by the exempt employee.

Paid hourly, daily or by shift

The reasonable relationship requirement exists so an employer may compute an exempt employee's earnings on an hourly, daily or shift basis without the employee losing exempt status or the employer violating the salary basis requirement.

In essence, when an employer compensates exempt employee on an hourly, daily or shift basis, a reasonable relationship must exist between the amount of compensation per week guaranteed to the employee and the amount of compensation the employee usually earns per week.

The reasonable relationship requirement has been an enforcement policy of the WHD for over 40 years.

Without the reasonable relationship, the salary basis test could be circumvented by an employer that guarantees an exempt employee the minimum weekly salary—currently \$455 per week—but actually compensates the employee based on an hourly, shift or day rate. The employee's actual compensation would thus vary based on the quantity of work performed, which would violate the salary basis requirement for exemption.

Opinion letter facts

The opinion letter addressed the following situation:

Exempt professional employees of an engineering firm receive a guaranteed weekly salary of \$2,100. The salary is based upon a rate of \$70 per hour for 30 hours, which is the minimum number of weekly hours usually worked. Employees who work in excess of 30 hours in a workweek are paid at \$70 per hour.

Predicting the number of hours an employee may work per week is "virtually impossible." Employees' average weekly compensation range from \$1,793 to \$3,761, with an overall weekly average for all employees of \$2,721.

Reasonable ratio of 1.5-to-1

The opinion letter looks to the current regulations for an example of an acceptable reasonable relationship. Section 541.604(b) recognizes the existence of a reasonable relationship between a guaranteed weekly salary of \$500 and usual weekly earnings that vary from \$600 to \$750 per week. The opinion letter states that the

ratio of \$750 to \$500 per week, or 1.5-to-1, constitutes a reasonable relationship under the regulation.

Opinion Letter FLSA 2018-25 concludes that usual weekly earnings of up to \$3,150 per week bear a reasonable relationship to the guaranteed weekly salary of \$2,100 per week because they have a ratio of 1.5-to-1.

However, it continues that a weekly compensation amount of \$3,761 does not satisfy the reasonable relationship test because it exceeds the 1.5-to-1 ratio of actual earnings to guaranteed weekly salary.

The opinion letter acknowledges that the regulation does not specify the 1.5-to-1 ratio as an “absolute maximum permissible ratio” of reasonableness. However, it states that where actual or usual earnings are approximately 1.8 times the guaranteed weekly salary, the guaranteed weekly salary “materially exceed” the permissible ratio of the regulation.

The letter also relies on a 2016 federal district court case in which the hourly earnings of an employee’s usual earnings did not exceed his guaranteed salary by more than 30%. In that case, the examples of usual earnings to guaranteed weekly salaries relied upon by the court yielded ratios of 1.4 and 1.3.

When earnings fluctuate

The opinion letter also clarifies how an employer should compute employees’ usual earnings when their weekly hours vary, making their earnings unpredictable.

It is acceptable to compute the average weekly earnings for employees across a calendar year, because a year “should ordinarily provide ample representation of variations in an employee’s earnings and hours.”

However, the computation of average weekly earnings should be made on an employee-by-employee basis, as opposed to using a group of employees or a job classification. Such a group-based computation may not accurately reflect the average weekly earnings of each individual employee within a group or job classification.

Key takeaways

This is a narrow topic, but it is an important one for employers that guarantee a certain salary to exempt employees whose compensation is based on an hourly, shift or daily rate. The opinion letter strikes a balance between these two amounts so the employee’s exempt status is not jeopardized.

It nonetheless takes a conservative or literal reading of the current regulation and lays down a ratio of approximately 1.5-to-1 of usual earnings to guaranteed earnings as the outer limit of the reasonable relationship test.

There may be disagreement regarding this ratio, but employers may find it reassuring that the WHD believes it is reasonable.

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