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Using the Fluctuating Workweek Compensation Method to Reduce Overtime Expenses in Public Organizations

By C.W. Von Bergen, PhD

Modifications to the Fair Labor Standards Act promulgated by the Department of Labor as the FairPay Overtime Initiative in 2004 have produced an increasing number of workers subject to overtime payments and a concomitant increase in labor costs for public sector organizations. To adapt to this changing environment and to control employee overtime expenditures organizations may wish to examine the applicability of a relatively obscure provision of the Fair Labor Standards Act labelled the fluctuating workweek scheme. This approach becomes increasingly attractive to employers as worker overtime increases because a feature of this method is that the overtime rate due employees under this plan decreases as the number of overtime hours worked increases.

The Fair Labor Standards Act\(^1\) (hereinafter referred to as the FLSA or Act) requires that most employees in the U.S. be paid at least the federal minimum wage for all hours worked and receive overtime pay at one and one-half times the regular rate for all hours worked over 40 hours in a workweek. The FLSA became law for the private sector in 1938. The U.S. Department of Labor (DOL), which had been in existence for less than 10 years at the time, was charged with writing the rules that would detail enforcement of the FLSA. It was not until 1985 that the U.S. Supreme Court ruled that FLSA applied to local and state governments in the now-famous case of Garcia v. San Antonio Metropolitan Transit Authority (1985).\(^2\)

Defined within the Act are certain types of employees who are exempt from both minimum wage and overtime pay. These exempt categories are cumulatively referred to as the white collar exemption and the workers are called white collar employees. To qualify for such exemptions the job description must meet certain salary and job duties tests. The last major revision to the FLSA occurred some fifty years ago and during this time these duties tests became outdated resulting in uncertainty and vagueness in their application. Such ambiguity was exploited by some organizations because exempt
employees did not have to be paid overtime and could work unlimited hours. Consequently, organizations began to classify employees as exempt from overtime pay under the FLSA when, in fact and by law, the employees should have been classified as non-exempt.\(^3\) In response to such organizational action, increasing numbers of managerial, administrative, and professional employees along with significant numbers of previously classified non-exempt workers began filing high-visibility class-action lawsuits against employers for unpaid overtime claiming mis-classification under the FLSA.

As a result of this increase in lawsuits and these decades-old exemption descriptions, the Wage and Hour Division of the DOL revised the regulations relating to white collar exemptions of the Act called the FairPay Overtime Initiative (hereinafter referred to as FPOI). The purpose of the revised FLSA regulations which went into effect on August 23, 2004 was to modernize, update, and clarify the criteria for these exemptions and to eliminate legal problems that the prior regulations caused. More specifically, the regulations were said to strengthen overtime benefits and provide overtime protection for an additional 6.7 million American employees.\(^4\) Pragmatically, this meant that there were more employees subject to overtime payments within organizations and a concomitant increase in labor costs. This paper discusses the impact of the FPOI on overtime for public sector organizations and suggests the fluctuating workweek (FWW) scheme as an approach public service employers may wish to consider to reduce increased overtime costs resulting from the implementation of the FPOI.

**Revised Overtime Regulations Impact Public Sector**

The revised regulations pose hardships for state and local governments with respect to labor costs.\(^5\) Wages and salaries of personnel represent a substantial proportion of costs in most public employers and cost containment in this human resources area continues to be a key challenge in the current environment of tight budgets.\(^6\)

Organizations have tried a number of approaches to lower labor costs including downsizing, outsourcing and employee leasing, and productivity enhancements. More recently, organizations have initiated efforts to reduce employee labor expenditures through better control of overtime.\(^7\) Overtime pay for current employees is often the least costly option for employers to exercise in scheduling work assignments and has been viewed as a key “survival strategy” by many organizations.\(^8\) This is because it is often less expensive to schedule longer hours and pay overtime premiums rather than hire, train, and provide benefits for additional employees.\(^9\) These factors have lowered the point at which it is more cost effective to schedule longer hours and pay the overtime premium rather than employ additional workers.\(^10\) Consequently, organizations expanded the workweek well beyond the normal 40-hour boundary requiring overtime payments to workers not exempt from the FLSA provisions.

A number of items in the FPOI impact public sector organizations with respect to overtime considerations.\(^11\) First, the changes made to the executive exemption are likely to have a serious negative impact on public employers because many supervisors
and managers are classified as exempt and earn less than $100,000 per year requiring state and local governments to reclassify them as non-exempt and subject to overtime provisions of the FLSA. Second, the change made to the provision concerning first responders is causing concern for many public sector organizations. Specifically, the revised rules indicated that:

Police officers, detectives, deputy sheriffs, state troopers, highway patrol officers, investigators, inspectors, correctional officers, parole or probation officers, park rangers, fire fighters, paramedics, emergency medical technicians, ambulance personnel, rescue workers, hazardous materials workers and similar employees ("first responders") who perform work such as preventing, controlling or extinguishing fires or any type; rescuing fire, crime or accident victims; preventing or detecting crimes; conducting investigations or inspections for violations of law; performing surveillance; pursuing, restraining and apprehending suspects; detaining or supervising suspected and convicted criminals, including those on probation or parole; interviewing witnesses; interrogating and fingerprinting suspects; preparing investigative reports; and other similar work are not exempt under Section 13(a)(1) or the regulations and thus are protected by the minimum wage and overtime provisions of the FLSA.12

The unease generated in public employers arose because the revised regulations are less equivocal regarding such public safety employees who in some governmental units were previously classified as exempt from overtime with respect to the FLSA. Such clarification will undoubtedly guarantee overtime to an expanded number of workers and raise labor costs for public sector organizations.

Third, in the preamble to the revised regulations the DOL said "Police sergeants, for example, are entitled to overtime pay even if they direct the work of other police officers because their primary duty is not management or directly related to management or general business operations."13 The DOL's position on the issue is basically that sergeants can never be exempt. However, this position is greatly at odds with how courts have previously treated the subject.14 The courts have traditionally been more willing to find police sergeants to be exempt from overtime under the FLSA. The leading case, Auer v. Robbins (1997)15, found that several classes of police sergeants were exempt executive employees. Consequently, the regulations may cost public employers considerably more money. Indeed, the Albany Democrat-Herald reported that "...Albany police sergeants to be paid for overtime at a potential additional cost of up to $100,000 this budget year."16 And this budget increase reflects just one position in a city's budget!

Fourth, certain first responders will not be eligible for exemption under the highly compensated provision (earning more than $100,000 per year) because the highly compensated test applies only to employees whose primary duty includes performing office or non-manual work. Once again, this could lead to increased labor costs in the event of overtime for these high paid workers.

In summary, there appear to be a number of reasons why public employers should experience increased labor costs from the FPOI. This is due primarily to a greater number of positions that will be considered eligible for overtime. Thus, faced with increasing overtime costs, organizations may want to consider approaches to
reducing these expenditures. One such approach which may demand further scrutiny by public service employers involves what is called a FWW scheme. This “out of the ordinary wage plan” becomes increasingly attractive to employers as worker overtime increases because a key feature of this approach is that the overtime rate due employees under this plan decreases as the number of hours worked increases. This paper discusses the FWW method and compares it to the traditional method of calculating overtime rates and premiums. The article concludes with a discussion of limitations regarding this approach and a set of recommendations for public employers wishing to explore this relatively obscure overtime determination format.

**Traditional Overtime Payment**

Unless specifically exempted, employees covered by the FLSA must receive overtime pay for hours worked in excess of 40 in a workweek at a rate not less than time and one-half (1.5) their regular hourly rates of pay. For example, if an employee is paid $600 a week as compensation and works a work schedule of 40 hours a week, the employee’s overtime rate of pay is computed by dividing $600 by 40, then multiplying by 1.5 (= $22.50). Thus, for each hour of overtime over 40 hours a week, the employee is entitled to receive $22.50 an hour.

There is no limit in the Act on the number of hours employees aged 16 and older may work in any workweek. Additionally, the Act does not require overtime pay for work on Saturdays, Sundays, holidays, or regular days of rest. The Act applies on a purely workweek basis. An employee’s workweek is a fixed and regularly recurring period of 168 hours—seven consecutive 24-hour periods. It need not coincide with the calendar week, and may begin on any day and at any hour of the day. Different workweeks may be established for different employees or groups of employees. Averaging of hours over two or more weeks, however, is not permitted—each workweek stands on its own and not by pay period or by month or by any other period of time. Therefore, an employer cannot base the overtime hours on the total hours worked in a bi-weekly or a semi-monthly pay period. Normally, overtime pay earned in a particular workweek must be paid on the regular pay day for the pay period in which the wages were earned.

The regular rate of pay cannot be less than the minimum wage. The regular rate includes all remuneration for employment except certain payments excluded by the Act itself. Payments which are not part of the regular rate include pay for expenses incurred on the employer’s behalf, premium payments for overtime work or the true premiums paid for work on Saturdays, Sundays, and holidays, discretionary bonuses, gifts and payments in the nature of gifts on special occasions, and payments for occasional periods when no work is performed due to vacation, holidays, or illness.

Earnings may be determined on a piece-rate, salary, commission, or some other basis, but in all such cases the overtime pay due must be computed on the basis of the average hourly rate derived from such earnings. This is calculated by dividing the total pay for employment (except for the noted statutory exclusions) in any workweek by the total number of hours actually worked.
Fluctuating Workweek Approach

The FLSA regulations allow employers to pay non-exempt employees a fixed salary for 1) personnel scheduled to work a standard or preset number of hours each week, or 2) for individuals whose work week fluctuates in the number of hours required. More specifically, with respect to fluctuating hours, the Department of Labor's regulations provide that:

"An employee employed on a salary basis may have hours of work which fluctuate from week to week and the salary may be paid to him pursuant to an understanding with his employer that he will receive such fixed amount at a straight time pay for whatever hours he is called upon to work in a workweek, whether few or many."24

Employees scheduled to work a predetermined set of hours each week receive an overtime premium of time-and-one-half (1.5) of the employee's regular rate of pay for all hours worked in excess of 40 hours. On the other hand, employees whose work week hours vary or fluctuate can be paid in weeks in which they work more than 40 hours at a rate of half-time (.5) the employee's regular rate of pay for the extra hours "since the employee has already received straight-time compensation on a salary basis for all hours worked."25

The employer can save money in contexts where there are fluctuating work hours because it is paying the employee a salary that involves fewer administrative costs, and any overtime premiums are paid at 50% of the employee's regular rate of pay. Thus, organizations consistently having salaried non-exempt employees regularly working over 40 hours in a particular workweek, thereby incurring overtime liability, can realize substantial labor savings by implementing a FWW pay scheme. Many have referred to this pay system as "Chinese Overtime."26

This method of calculating overtime has been upheld as a valid interpretation of the Act.27 The regulations permitting this method of calculation were promulgated by DOL's interpretive bulletins. Although these bulletins are not legally binding their legal importance was established by the Supreme Court in 1942. In the case, Overnight Motor Transport Company v. Missel, the Supreme Court stated: "While the interpretive bulletins are not issued as regulations under statutory authority, they do carry persuasiveness as an expression of the view of those experienced in the administration of the Act [FLSA] and acting with the advice of a staff specializing in its interpretation and application."28 Additionally, at least one court case has upheld this use of the FWW method. In the case of Kelli K. Goodrow v. Lane Bryant, Inc. (2000) the court ruled in favor of the employer.29 In this case the employer (Lane Bryant, Inc.) had relied on the DOL's Field Operations Handbook in implementing their FWW plan in 1992. Section 32b04b(a) of that Handbook states: "If the employer to avoid weekly computations chooses to pay extra half-time based on the salary divided by 40 hours, such a method is permissible."30
Table 1: Summary of Fluctuating Workweek Rules  
(after 29 CFR 778.114)

1. Non-exempt employees must be paid a salary. Employees who are paid an hourly wage do not qualify.
2. The employee must be paid a fixed salary regardless of the number of hours worked each week.
3. In addition to their salary, employees must be paid overtime premiums for any hours worked over 40 in the workweek at the rate of 50% (.5) of the regular rate of pay for the workweek.
4. The workweek of the employee must be a fluctuating one.
5. The salary should never drop below the minimum wage.
6. There must be an understanding between the employer and the employee that the employee will be paid using the fluctuating workweek method.

Guidelines in Implementing FWW Schemes

Nevertheless, to ensure that actions relating to FWW are legally defensible in court the following conditions must be met.31 These rules are summarized in Table 1 and discussed in more detail below.

1. Non-exempt employees must be paid a salary. Employees who are paid an hourly wage do not qualify.

It is perhaps a little known fact that the FLSA does not require that employers pay non-exempt employees by the hour. It only mandates that non-exempt employees receive overtime, after forty hours of actual work. Employers may pay non-exempt employees by a salary, or per diem, or by piece rate. The overriding constant remains payment of overtime following forty hours of work. Employees who are paid an hourly wage cannot be paid using the FWW method. An hourly employee is paid at a fixed regular rate of pay (or multiple rates of pay) so his or her hourly rate of pay is never less than a stated minimum. But an employee who is paid using the FWW method has a regular rate of pay that varies. Thus, the first requirement for implementing a FWW pay system is that employees be paid a salary.

2. The employee must be paid a fixed salary regardless of the number of hours worked each week.

A second provision for adopting a legally valid FWW system is that the employee must be paid a fixed salary regardless of the number of hours worked each week. The employee has to understand that the salary is for all hours worked, whether few or many: "[T]he employee clearly understands that the salary covers whatever hours the job may demand in a particular workweek and the employer pays the salary even though the workweek is one in which a full schedule of hours is not worked."32 Since an employee who works fluctuating hours for a fixed rate of pay is supposed to get the same pay whether he or she works short or long weekly hours, the government does not permit deductions for absences of less than a week, whether for illness, personal
business or other reasons. Indeed, the disadvantage to such a system is that employees must be paid their full salary even if they work but a single hour during the week. Since a fixed salary for a FWW covers short, as well as long, weekly working hours, advantage cannot be taken of the statutory regular-rate exclusions allowed for occasional paid absences due to vacation, holiday, illness, failure to provide sufficient work, or other similar cause. For instance, if an organization decides to close on a holiday, and on the day after the holiday it also decides to close, the organization must pay employees if they are paid on a FWW basis.33

The importance of a fixed salary was reinforced in O'Brien v. Town of Agawam (2003), in which the First Circuit Court of Appeals ruled that the FWW method may not be used when employers compensate workers amounts in addition to their normal pay.34 In this case, employees were paid night shift differentials, additional pay for every hour worked beyond eight hours a day, and additional pay for every hour worked during off-duty time. The Court held that because supplementary compensation was paid, the employees' salaries were not truly "fixed" as required by the regulations. Therefore, the employer was not entitled to use the FWW method.

3. In addition to their salary, employees must be paid overtime premiums for any hours worked over 40 in the workweek at the rate of 50% of the regular rate of pay for the workweek.

A third stipulation in effecting a FWW pay method addresses compensation for work in excess of 40 hours in a workweek. Naturally, in a week in which an employee works forty (40) hours, he or she simply receives the agreed-upon fixed salary. In addition to this salary, the employee must be paid overtime premiums for any hours worked over 40 in the workweek. The overtime premium rate is 50% of the regular rate of pay for the workweek. The rationale behind this regulation is that the employee has already been paid a straight hourly rate for each hour in excess of 40, and is only due the additional $\frac{1}{2}$ pay.

Consider for example an employee who receives a fixed wage of $450.00 per week and who works 45 hours in one week and 50 hours in the next. In the first week the individual's regular rate is $10.00 ($450/45). The employee is entitled to receive $5.00 per hour ($5 \times $10.00) for the five hours worked in excess of 40 since the worker has already received straight time of $10.00 per hour for those hours. In the next week the employee's regular rate is $9.00 ($450/50). In that week the employee is entitled to receive $4.50 for each of the 10 hours worked in excess of 40. Note that for working 45 hours per week the employee received an overtime rate of $5.00 per hour and a $4.50 per hour overtime premium for working 50 hours. Paradoxically, then, the more overtime hours worked per week the lower the actual overtime pay rate. Thus, in workweeks in which the overtime is high, the regular rate will be low, and the employer will benefit from a lower per-hour overtime cost. Some employees, however, feel that such a system is inequitable because it makes employees "work overtime at a 'discounted rate.'"35

A more sophisticated example is now appropriate. Take the case of an Emergency Medical Technician (EMT) employee who worked alternating weeks of 48 hours and 72
hours and is paid a salary of $500 per week. For this individual the calculation of the biweekly pay would be as follows:

**First Week**
- Regular rate of pay ($500 / 48 hr = $10.42/hr).
- Overtime premium (0.5 x 8 x $10.42) = $41.68).
- Total pay ($500 + $41.68 = $541.68).

**Second Week**
- Regular rate of pay ($500 / 72 hr = $6.94/hr).
- Overtime premium (0.5 x 32 x $6.94 = $111.04).
- Total pay ($500 + $111.04 = $611.04).
- Hence, the employee's gross pay for the biweekly payroll period would be $1,152.72 ($541.68 + $611.04).

The cost savings to the employer in this scenario are substantial. Suppose the above employee is paid at $10.42/hr (the worker's regular rate of pay in the above example) on an hourly basis. Then the calculation would be as follows:

**First Week**
- Total regular wages ($10.42/hr x 40 hr = $416.80).
- Overtime premium (1.5 x 8 x $10.42 = $125.04).
- Total pay ($416.80 + $125.04 = $541.84).

**Second Week**
- Total regular wages ($10.42/hr x 40 hr = $416.80).
- Overtime premium (1.5 x 32 x $10.42 = $500.16).
- Total pay ($416.80 + $500.16 = $916.96).

Thus, the total gross pay for the biweekly payroll period would be $1,458.80 ($541.84 + $916.96). An employer that uses the FWW method for this employee saves $306.08 ($1458.80 - $1152.72) every two weeks, or a total of $7,958.08 per year—a considerable savings to the employer!

### 4. The workweek of the employee must be a fluctuating one.

A fourth demand for adopting a legally defensible FWW program is that the workweek indeed be one that fluctuates. The federal regulations do not establish a requirement as to the degree of fluctuation in hours that must occur, but they do state that typically the salary is paid to employees who do not customarily work a regular schedule of hours. Under this method, the salary is intended to compensate the employee at a straight time rate for whatever hours are worked during the workweek. The interpretation of the requirement that the workweek be a fluctuating one has been addressed in the courts. The CFR states the following: "[T]he employee clearly
understands that the salary covers whatever hours the job may demand in a particular workweek and the employer pays the salary even though the workweek is one in which a full schedule of hours is not worked. Typically, such salaries are paid to employees who do not customarily work a regular schedule of hours and are in amounts agreed to by the parties as adequate straight-time compensation for long workweeks as well as short ones, under the circumstances of the employment as a whole.36

There are, however, several incorrect assumptions with respect to a FWW.37 The first assumption that is often made regarding FWWs is that the employee has to work both long and short workweeks. In fact, the method is most often used in situations where that occurs. EMT workers frequently work short weeks as well as long ones, depending on the circumstances. The method has also been used to pay country club workers who are employed year-round and work long hours during the summer and shorter hours during the winter. In those cases, the employer pays overtime premiums during the summer when activity is higher and avoids paying any overtime at all during the winter when play is slower.38

This assumption, however, is incorrect. In the case of *Flood v. New Hanover County* (1997) the court cited a May 16, 1966, opinion letter of the DOL's Wage and Hour Division that had determined that where employees worked fixed, alternating workweeks of 43 and 41-hour schedules, the workweek was a fluctuating one.39 Therefore, the FWW method can be used in cases where employees always work overtime but the workweek fluctuates.

A second incorrect assumption is that the workweeks have to be irregular.40 In *Flood v. New Hanover County* (1997) the workers were actually on a fixed schedule. They worked alternating days, 24 hours on and 24 hours off, with 4 days off at the end of the cycle. This meant that an employee worked 48 hours during one workweek and 72 hours in the next workweek. The court ruled that although the schedule was fixed, the workweek still fluctuated, and, therefore, the FWW method could be used.

Similarly, the District Court for South Carolina found in *Roy v. County of Lexington, S.C.* (1998) that it “is not necessary for regular hours to be sporadic for the regulation to be applied; it is sufficient that the regular hours vary from one workweek to another.”41 In this case EMT employees' schedule of 24.5 hours on-duty followed by 47.5 hours off-duty was deemed a fluctuating number of hours. Additionally, *Griffin v. Wake County* (1998) established that work hours must fluctuate but does not require an unpredictable schedule.42

A third erroneous assumption asserts that if employees' workweeks are always in excess of forty hours the FWW does not apply.43 The argument is that if an employer pays a salary to employees who never work less than forty hours, then the methodology should not apply because it allows the circumvention of the time and on-half provisions in 29 U.S.C. § 207. However, two court cases, *Evans et al. v. Lowe's Home Centers, Inc.* (2004) and *Condo v. Sysco Corp.* (1993), disagreed with such an argument.44 Finally, as determined in *Aiken v. County of Hampton* (1997), there is no requirement that the hours worked actually fluctuate above and below forty.45
5. The salary should never drop below the minimum wage.

A fifth prerequisite for a FWW compensation procedure is stated in the CFR as follows: "The ‘fluctuating workweek’ method of overtime payment may not be used unless the salary is sufficiently large to assure that no workweek will be worked in which the employee’s average hourly earnings from the salary fall below the minimum hourly wage rate applicable under the Act." For instance, in the case of Flood v. New Hanover County (1997) the workers were actually scheduled to work 72 hours in one workweek. Based on the then current federal minimum wage of $5.15 an hour, the minimum salary would have to be $370.80. It should be noted that the Code refers to the employee’s earnings from the “salary”, not his or her total pay. Consequently, the overtime premium cannot be included in determining whether or not the salary is sufficient.

With the exception of California, the FWW method can be used in all other states. Employers, therefore, must be sure that the salary is sufficiently large that the employee’s regular rate of pay is never less than the state minimum wage.

6. There must be an understanding between the employer and the employee that the employee will be paid using the fluctuating workweek method.

A final condition for a FWW pay design is the mutual understanding between the employer and worker regarding the FWW procedure that will be used for paying the employee. It has to be made clear to the employee that the salary is meant to pay for all hours worked. That means that the employee’s regular rate of pay will fluctuate each workweek depending on the number of hours worked. If the employee is paid a salary of $350 per week and works only 35 hours, then the regular rate of pay for that week is $10 per hour. If, however, the employee works 48 hours in the next week, then the regular rate of pay for that week would be $7.29 per hour. Since the regular rate of pay changes each week, the employee is, in effect, paid straight time for all hours worked.

Although the CFR does not require that the understanding between the employer and employee be in writing, a written statement to employees is preferable because it provides the employer with a basis for defending the use of the method. For instance, in the case of Kelli K. Goodrow v. Lane Bryant, Inc. (2000), the plaintiff argued that she had not been properly informed of how the method of payment worked. The defendant, however, was able to show that they had provided each new employee a memorandum explaining the method of payment. Table 2 provides an example of a written agreement explaining the FWW method.

It should also be noted that the word “understanding” is used rather than “agreement.” In one case, Griffin v. Wake County (1998), involving EMT workers the plaintiffs argued that they had not agreed with the use of the FWW method of payment. The court, though, agreed with the defendant that mere employee notification, not agreement, was all that was required to implement a FWW plan. The county had held mandatory meetings with all of their workers to explain the plan, and all employees had to sign statements that they understood the plan.
Table 2: Example of a Fluctuating Workweek Agreement

[Before signing this agreement you may wish to contact your legal advisor to ensure your understanding of this agreement.]

I hereby acknowledge that I am being paid a fixed weekly salary that covers the straight time portion of all hours worked in the workweek, whether they are many or few. I further understand that under this agreement I will be paid an additional half time overtime premium for each hour worked over forty (40) in any seven (7) day period as specified by the Fair Labor Standards Act. In accordance with Federal law the additional half time rate will be calculated by dividing my weekly salary into the total number of hours worked to arrive at the hourly rate, then dividing the hourly rate in half to calculate the half time rate.

Acknowledged by:

______________________________________________
(Employee)

______________________________________________
(Representative)

Dated this __________ day of ________________ 20__

Additional Issues

The Need for a Signed Agreement

Under the DOL regulations, a written acknowledgement between the employee(s) and an organization is not required. The most crucial element is that there be a “clear and mutual understanding” between the employee and the organization. Distribution of a FWW policy coupled with the signing of an acknowledgement form that indicates the employee has received the policy will constitute a sufficient “understanding” between the employer and the employees. The signed acknowledgement form in and of itself should be “prima facia” evidence of the requirement of “understanding”.

By unilateral action, an employer can therefore institute an arrangement which by words or conduct may be impliedly accepted by an employee. Thus, an employee who continues to work after a FWW arrangement as been instituted may imply his or her acceptance by continuing to work and thus may enter into an implied-in-fact agreement.50

It is crucial that employers who wish to utilize this mechanism examine any offer letters that may have been given to affected employees and/or review the agreement between the organization and the employee(s) at the time of hire. If, for example, an offer letter specifies that the employee is being hired at a certain salary “for a forty hour week;” then that agreement, made at the time of hire, has “converted” that employee into an hourly worker and the employer may not avail itself of the FWW method. To the
contrary, if the offer letter contains language stating that the employee is hired at a certain salary for any and all hours worked during the week, then the employer is able to use the FWW method.

The Issue of Deductions

As stated above, the quid pro quo that enables employers to pay overtime at half-time (0.5) instead of time and one-half (1.5) is that the employee receives his or her full salary in any week in which he or she does some work. Clearly, non-exempt hourly paid employees who take a day off for sickness or personal business (or who come in late or leave early) may be docked. There is a key difference on this issue for employees paid under the FWW method. The DOL’s Wage and Hour division has issued several opinion letters addressing the issue of absence from work and deductions in a situation where an employer is using the FWW method of payment. The agency has consistently stated that an employer may charge partial or full day absences against paid time-off allotments without invalidating its fixed pay/FWW arrangement, but cannot make actual deductions from the guaranteed salary. The FLSA provides that a worker’s regular rate of pay is determined based upon “all remuneration” paid to the employee for work performed during a given week (29 U.S.C. § 207(e)). Payments for shift differentials, hazardous duty pay, bilingual pay, special assignment pay, educational incentive pay, sick pay buy back, and meal allowances are examples of specialty pay types that must be included in the regular rate of pay (Acton v. City of Columbia, MO 2004).

Furthermore, under the Family and Medical Leave Act of 1993 (FMLA) employers that pay according to the FWW rule,

“...during the period in which intermittent or reduced schedule FMLA leave is scheduled to be taken, may compensate employees on an hourly basis and pay only for the hours worked, including time and one-half the employee’s regular rate for overtime hours. The change to payment on an hourly basis would include the entire period during which the employee is taking intermittent leave, including weeks in which no leave is taken. The hourly rate shall be determined by dividing the employee’s weekly salary by the employee’s normal or average schedule of hours worked during weeks in which FMLA leave is not being taken. If an employer chooses to follow this exception from the FWW method of payment, the employer must do so uniformly, with respect to all employees paid on a FWW basis for whom FMLA leave is taken on an intermittent or reduced leave schedule basis. If an employer does not elect to convert the employee’s compensation to hourly pay, no deduction may be taken for FMLA leave absences.”

After the FMLA leave period ends, the employer is free to restore the employee’s original FWW pay practice.
Recently, however, the DOL has modified its position on the deductions issue. Now, an employer may deduct hours from an employee’s bank of vacation or sick hours and charge an FWW employee for absences from work for such hours. Significantly, should an employee exhaust his or her banks of vacation or sick hours, the employer may not make a cash deduction from a FWW employee for a partial or full-day work absence.  

**State Law Concerns**

Nearly every state has its own wage-hour and overtime statutes. Employers must always comply with both the federal and state law and are bound by whichever is stricter (i.e. more favorable to workers). For example, New Jersey, by opinion letter, recognizes the validity of the FWW method. In contrast, a California appeals court ruled in *Skyline Homes, Inc., et al. v. Department of Industrial Relations, et al.* (1985) that this method of paying overtime was not valid. Thus, the employer must research the law of the particular state(s) in which it is located, to ascertain the legality of this method in a particular jurisdiction.

**Bonus and On-Call Considerations**

The FLSA provides that a worker’s regular rate of pay is determined based upon “all remuneration” paid to the employee for work performed during a given week. Payments for shift differentials, hazardous duty pay, bilingual pay, special assignment pay, and educational incentive pay are examples of specialty pay that must be included in the regular rate of pay. However, certain types of bonus payments are excluded from this calculation:

“As used in this section, the ‘regular rate’ at which an employee is employed shall be deemed to include all remuneration for employment paid to, or on behalf of, the employee, but shall not be deemed to include... (3) sums paid in recognition of services performed during a given period if either, (a) both the fact that the payment is to be made and the amount of the payment are determined at the sole discretion of the employer at or near the end of the period and not pursuant to any prior contract, agreement, or promise causing the employee to expect such payments regularly; or (b) the payments are made pursuant to a bona fide profit sharing plan... meeting the requirements of the Administrator set forth in the appropriate regulations which he shall issue, having due regard among other relevant factors, to the extent to which the amounts paid to the employee are determined without regard to hours of work, production or efficiency...”

Employers must also be careful with bonuses. Discretionary bonuses are excluded from regular salary while nondiscretionary bonuses—such as hiring, production or quality bonuses or a bonus system that is announced in advance—must be included in the regular pay rate when calculating employee overtime entitlement.
Standby or on-call pay is common in public agencies, particularly among police officers who get called to testify in court and public works employees who need to be available for repairs at any hour of the day. Payments made to employees for being on **unrestricted standby** or on call time must be included in the employees' regular rate of pay.\(^5\) Correct computation of the regular rate of pay requires that the on-call amount be included with the compensation for normally scheduled hours for that workweek to determine the regular rate of pay. Whether an employer must pay for on-call time depends on the facts. Factors that are considered in determining whether on-call time must be treated as compensable work hours include the following: the average number of emergency calls the employee responds to during the on-call period; the time in which the employee has to be at the work site after being called in; whether an employee is subject to discipline for missing or being late to a call-back; the extent to which an employee is able to engage in other activities while on-call; and geographical restrictions on employee movements.\(^6\) Employees do not have to be paid if they simply are asked to provide information on where they can be reached if the employer needs them.

### Non-exempt Salaried Employees Paid Once or Twice a Month

While there is no federal provision requiring employers pay workers on a certain frequency, state laws may order a prescribed occurrence. For example, under the Texas Payday Law non-exempt employees must be paid at least twice per month, i.e., biweekly or semimonthly.\(^6\) Thus, the discussion about monthly salaries will not apply to non-exempt employees in Texas or other states with a similar provision. Notwithstanding such prohibitive state regulations for non-exempt salaried employees who are paid either twice per month or monthly, the payments must be reduced to their workweek equivalents in order to arrive at the regular rate of pay. Once the workweek equivalent is known, then the general rule for weekly salaries can be applied. There are two main ways for an employer to compute overtime pay for salaried employees paid once or twice per month.\(^6\) The first method involves computing the workweek equivalents:

1. **Semimonthly salary**—multiply the salary times 24 to get the annual equivalent, then divide that figure by 52 to get the workweek equivalent. Then apply the general rule of 29 C.F.R. §778.113(a) to arrive at the regular rate. Or,
2. **Monthly salary**—multiply the salary by 12 for the annual equivalent, then divide that figure by 52 to get the workweek equivalent. Then apply the general rule of 29 C.F.R. §778.113(a) to arrive at the regular rate.

The other main way to pay overtime based on semimonthly or monthly salaries is to calculate it on the basis of an established basic rate.\(^5\) 29 C.F.R. 548.3(a) provides that the employer and employee may agree that the regular rate shall be determined by dividing the monthly salary (or semimonthly salary times 2) by the number of regular...
working days in the month and then by the number of hours of the normal or regular
workday. Of course, the resultant rate in such a situation may not be below the
statutory minimum wage. Further requirements for such an established regular rate are
found in 29 C.F.R. 548.2.

Summary and Conclusions

The thrust of this paper is that a FWW scheme can be a significant labor cost-saving tool
for public sector employers. Notwithstanding the potential benefits of this method,
FWW has not been utilized as often as might be expected. There are several reasons. In
order to implement this system, the federal regulations require that the employee be
informed that his or her base salary is meant to cover all hours worked and that he or
she will be compensated at a half-time rate for overtime. In addition, this system
penalizes employers who have employees that work less than 40 hours in a week
because the employee is due a fixed base salary each week regardless of hours worked.
If work is slow, and the employee is only working 25 or 30 hours per week, the fixed
salary must still be paid. Thus, the FWW scheme is only a cost-saving method for those
organizations that regularly have employees work more than 40 hours in a week.
Additionally, because employees have to be informed of the payment method, many
employers shy away from the FWW system because of the problems it sometimes
causes with employee morale and employee retention.64 Furthermore, the calculation
of the “regular rate” upon which all overtime is based will change every week.
Therefore, the employer must either assign these computational tasks to an employee
or buy/devise a software program to accommodate the necessary calculations. These
administrative challenges sometimes cause employers to shy away from implementing
this method.

Balanced against these problematic concerns is the distinct advantage of being
able to pay half-time, instead of time and one-half, overtime. Public service
organizations who employ, to take one example, significant numbers of first
responders/public safety personnel, and who incur significant overtime expenses, may
enjoy substantial budgetary savings. Additionally, by classifying employees as non-
exempt salaried workers public service employers may lower their exposure to high-
visibility class-action lawsuits for unpaid overtime that increasingly result in significant
amounts of bad publicity, jury awards, and multimillion-dollar settlements. Such suits
are particularly expensive because there is a strong presumption in favor of doubling
damages and in many cases Courts apply provisions allowing for double damages.55
Finally, there is the positive employee relations gained through employee perception
of their job as a “white collar,” as opposed to a blue collar, position.66

Nevertheless, because of the complex and “out of the ordinary” nature of the
FWW rules, organizations should obtain professional legal and human resources
guidance if they are considering this method of determining employee pay.
Circumstances specific to a particular employer will dictate whether the benefits
outlined can be realized.
Notes


12 29 CFR § 541.3(b).


18 Most states have laws expanding the basic coverage of the FLSA. Courts look at the state standard if it is most favorable to the employee. Exceptions to the basic FLSA rule are also narrower under state laws. For example, in California, time and a half is paid not only for hours over 40 in a week but eight in a day or from hours one through eight on a seventh consecutive.
day of work. Double time is paid after 12 hours in a day or eight hours on a seventh consecutive day of work. In any event, working more than 72 hours a week is prohibited. Other states also give protections beyond FLSA, though not to the same extent as California.


24 29 C.F.R. § 778.114(a).

25 29 C.F.R. § 778.114(b).


31 29 CFR § 778.114(c).

32 Ibid.


36 29 CFR § 778.114(c).


39 Flood v. New Hanover County, 125 F. 3d 249, (4th Cir., 1997).


42 Griffin v. Wake County, 142 F.3d 712 (4th Cir. 1998).


46 29 CFR 778.114(c).

47 Flood v. New Hanover County, 125 F. 3d 249, (4th Cir., 1997).


49 Griffin v. Wake County, 142 F.3d 712 (4th Cir. 1998).


53 29 CFR § 825.206.


57 29 U.S.C. § 207(e).

58 Ibid.

59 29 C.F.R. § 778.223.


61 Texas Payday Law, Labor Code Title 2, § 61.011(b) (Tex 1993).

62 29 C.F.R. 778.113(b).

63 See U.S.C. § 207(g)(3); 29 C.F.R. § 548.


65 Overnight Motor Transportation Co. v. Missel, 316 U.S. 572 (1942), at 581; Walton v. United Consumers Club, Inc., 786 F.2d 303, 310 (7th Cir. 1986).

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