DOL Defines 'Reasonable Relationship' Between Exempt Employees' Guaranteed Salary and Actual Earnings

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The Department of Labor issued an opinion letter that provides guidance to employers paying exempt employees an hourly wage or other extra compensation in addition to a guaranteed weekly salary. *See* U.S. Department of Labor, Wage and Hour Div., Opinion Letter (Fair Labor Standards Act), FLSA2018-25 (Nov. 8, 2018) ("Opinion Letter"). Fair Labor Standards Act ("FLSA") regulations allow an employee to meet the FLSA's salary basis requirement even if there is a difference between an employee's actual earnings and the guaranteed weekly salary provided there is a "reasonable relationship" between the two. The Opinion Letter provides that for there to be a "reasonable relationship" between an employee's guaranteed weekly salary and actual earnings, then his or her actual earnings may not exceed 1.5 times the guaranteed weekly salary.

FLSA Salary Basis Requirement

The FLSA requires that most employees be paid at least the federal minimum wage for all hours worked and overtime pay at time and one-half the regular rate of pay for all hours worked over 40 hours in a workweek. However, the FLSA provides an exemption from both minimum wage and overtime pay for employees employed as bona fide executive, administrative or professional employees.

To fall within the executive, administrative or professional exemption, the FLSA generally requires that an employee meet, among other things, the salary basis standard under 29 C.F.R. § 541. An employee is considered paid on a "salary basis" if the employee regularly receives pay on a weekly or less frequent basis of a "predetermined amount constituting all or part of the employee's compensation," which is generally not subject to reduction based on the quantity or quality of that work. 29 C.F.R. § 541.602.

An employer may also compensate an employee for hours worked beyond the normal workweek—in addition to the predetermined salary—without violating the salary basis requirement so long as the employee receives a guaranteed salary of at least the standard salary level and "a reasonable relationship exists between the guaranteed amount and the amount actually earned." 29 C.F.R. § 541.604. For example, in addition to guaranteed salaries, some companies pay exempt employees an hourly rate if the employees work more than 40-hours during a week. If a "reasonable relationship exists between" the guaranteed salary and the employee's actual earnings when the hourly pay is included, this compensation arrangement is FLSA compliant.

For employers with these alternative compensation arrangements, a previously unanswered question was: What difference between guaranteed weekly salary and actual earnings is reasonable under the FLSA?

Clarification of "Reasonable Relationship" Standard

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The November 8, 2018 Opinion Letter clarifies the "reasonable relationship" standard under the FLSA's salary basis requirements. The regulations provide that, for a guaranteed weekly salary of $500, usual weekly earnings of $600 to $750 would be reasonably related to the guaranteed weekly salary. 29 C.F.R. § 541.604.[1] Accordingly, the Opinion Letter provides that a 1.5-to-1 ratio of actual earnings to guaranteed weekly salary was the upward limit of a "reasonable relationship" under the FLSA's salary basis requirement.[2]

The Opinion Letter also provides clarity regarding the relevant time period for determining if this 1.5-to-1 ratio is met if an employee's hours and earnings fluctuate widely from week-to-week. For example, an employee's actual and predetermined earnings could be the same during a company's slow season (a 1-to-1 ratio) but spike to much greater than a 1.5-1 ratio during busier times. Addressing this issue, the Opinion Letter states that averaging an employee's actual weekly earnings over an annual period is a reasonable method for calculating usual earnings to determine whether an employee meets the "reasonable relationship" standard.[3] Although the Opinion Letter notes that this is not the only reasonable method of calculation, it does not provide alternative methods.

What Does the Opinion Letter Mean for Employers?

Fortunately, the Opinion Letter provides a bright line for employers who pay certain exempt employees both a salary and additional compensation. Considering the Opinion Letter, employers that claim the FLSA's executive, administrative or professional exemption for employees and pay those employees hourly or other wages on top of a predetermined salary should examine the extent to which those employees' guaranteed weekly salaries differ from their actual earnings. Employers should use the following formula to determine whether there is a "reasonable relationship" between the employee's guaranteed weekly salary and actual earnings:

$$\frac{\text{Annual Average of Actual Weekly Earnings}}{\text{Guaranteed Weekly Salary}} \leq 1.5$$

If the ratio of actual earnings and guaranteed weekly salary is less than or equal to 1.5, then, according to the Opinion Letter, the employer is compliant with the FLSA's salary basis requirement. If an employee's actual earnings exceed 1.5 times his or her guaranteed weekly salary, then the employer risks losing the ability to claim the executive, administrative or professional exemption for that employee. In this latter situation, the employer should analyze why the ratio is askew and change the employee's compensation arrangement in a way that satisfies the test.

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[1] Employers may be wondering why the DOL places a cap on what employees may earn in addition to a guaranteed weekly salary. By capping the amount that actual earnings may deviate above guaranteed earnings, the DOL incentivizes employers to increase guaranteed salaries as market forces push employee earnings upwards.

[2] The DOL also cites caselaw in the Opinion Letter to support this ratio. *See Brown v. Aleris Specification Alloys, Inc.*, 2016 WL 1183207, at *2, *4 (N.D. Ind. Mar. 28, 2016) (finding a "reasonable relationship" when employee's actual earnings did not exceed approximately 1.4-times the guaranteed salary); *Haas v. Behr Dayton Thermal Prods., LLC*, 2008 WL 11351383, at *13

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(S.D. Ohio Dec. 22, 2008) (finding a “reasonable relationship” when actual earnings were approximately 1.3-times the guaranteed salary).

[3] Employers must calculate this annual average on an employee-by-employee basis. The Opinion Letter states that calculating the average earnings for a job classification or group of employees may not yield accurate usual earnings for each employee.

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