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MEMORANDUM

July 9, 1992

TO: National Association of Counties

FROM: Ronald S. Cooper

RE: The Fair Labor Standards Act's "White Collar" Exemptions in the Aftermath of Abshire and Bratt

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Two federal appellate court decisions have called into question the availability of "white collar" exemptions for large numbers of highly compensated, public employees. First, in June of 1990, the United States Court of Appeals for the Ninth Circuit held that Battalion Chiefs in California's Kern County Fire Department were entitled to back overtime pay because their salary was "subject to" potential deductions for absences from work for less than one day, even though no deductions had actually occurred. Abshire v. Kern County, 908 F.2d 483 (9th Cir. 1990), cert. denied, 111 S. Ct. 516 (1991).

Abshire presents serious problems for public employers with policies that require or permit deductions from the pay of "exempt" employees who are absent from work for less than a full

day. Because the "salary basis" test is a basic requirement for all "white collar" exemptions,[1/] such a policy would require overtime compensation for very large numbers of employees, including many who are highly paid. Liability for a failure to pay such overtime could extend back for as much as three years and could be doubled under FLSA's "liquidated damages" provision.

Just two months after the Abshire case was decided, the Ninth Circuit struck again. In Bratt v. County of Los Angeles, the court held that probation officers and child treatment counselors were not exempt administrative employees under the Act. 912 F.2d 1066 (9th Cir. 1990), cert. denied, 111 S. Ct. 962 (1991). The Bratt ruling was based on Department of Labor regulations which provide that the administrative exemption is available only to those employees whose duties are directly related to management policies or general business operations. See 29 C.F.R. § 541.2(a)(1). Because the work of probation officers and child treatment counselors involves the "day-to-day carrying out of the business' affairs, rather than running the business itself or determining its overall course or policies," the court found that the administrative exemption was not available. Bratt, 912 F.2d at 1070. The unavailability of the exemption for these employees will result in an overtime obligation requiring payment of time and one-half the employees

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[1/] These include "executive," "administrative," and "professional" and account for most employees who are exempt from the overtime requirements of the Fair Labor Standards Act ("FLSA").

regular rate of pay for all hours over forty worked in one work week.

These cases pose serious, though different, threats to state and local governments. While Abshire is potentially applicable to all white collar employees and threatens the more sweeping current exposure, its effect could be avoided prospectively by changes in leave policies. Moreover, recent regulations proposed by the Department of Labor, if finalized and judicially upheld, would go a long way towards providing a solution to the "salary basis" problem.

On the other hand, Bratt, though limited to "administrative" employees, may pose a more enduring problem. It will be difficult to restructure the duties of many classes of administrative employees (e.g., probation officers, social workers), who deliver the services of their agency to the end user, in a way that would avoid Bratt's holding. Furthermore, to date the Department has shown little interest in adopting new administrative interpretations to resolve the problem caused by the Bratt decision.

I. The "Salary Basis" Issue

A. Abshire and its Progeny

In Abshire, the chiefs argued that they were not salaried employees because a Kern County rule provided that, if they did not have accrued leave or compensatory time in a given pay period, their pay could be docked on an hourly basis for any time that they were tardy or absent from work. The County argued

that the chiefs should be considered exempt, because even though their salaries were admittedly subject to deductions for part days missed, no such deductions had ever actually been made.

The Court of Appeals rejected the County's argument. The fact that pay could potentially be reduced, the court reasoned, meant that the employees were not paid on a salary basis and were therefore not exempt from the overtime requirements of FLSA.

The holding in Abshire was based on the regulations promulgated under FLSA as well as the Department of Labor's interpretations of those regulations. The relevant regulations provide that:

> An employee will be considered to be paid 'on a salary basis' within the meaning of the regulations if under his employment agreement he regularly receives each pay period on a weekly, or less frequent basis, a predetermined amount constituting all or part of his compensation, which amount is not subject to reduction because of variations in the quality or quantity of the work performed. Subject to the exceptions provided below, the employee must receive his full salary for any week in which he performs any work without regard to the numbers of days or hours worked.

29 C.F.R. § 541.118(a) (emphasis added).

The Department of Labor has further stated that "deductions from salary of an otherwise exempt employee for absences of less than a day's duration for personal reasons, or for sickness or disability, would not be in accordance with sections 541.118(a)(2) and (3)." U.S. Department of Labor, Wage and Hour Division, Letter Ruling of January 16, 1986.

Kern County argued that a different Letter Ruling supported its position that the chiefs were "salaried" employees. That letter states, in part:

> Where an occasional deduction that is not permitted is made from the salary of an otherwise exempt employee, the exemption would be lost in that workweek when the deduction is made. However, if such deductions are regular and recurring, we would question whether the employee is actually paid "on a salary basis" and the exemption may be denied in all workweeks in which it is claimed, including those weeks when no deductions are made.

U.S. Department of Labor, Wage and Hour Division, Letter Ruling of January 15, 1986. Hence, the County contended that the chiefs should lose their salary status only for the specific weeks in which the County actually made an impermissible deduction.

The court rejected the County's interpretation, and found that the letter ruling ensures only that employers are not penalized for an inadvertent or unintentional deduction. It held, however, that where a government employer adopts a public law, ordinance, or policy rendering employees pay "subject to" deductions for absences of less than one day, there is no cause to examine the frequency with which an employer makes the deduction.

For similar reasons, the court rejected the County's argument that subsection (6) of section 541.118(a) applied to the case. Subsection 541.118(a)(6) provides:

> The effect of making a deduction which is not permitted under these interpretations will depend upon the facts in the particular case. Where deductions are generally made when there is no work available, it indicates that there was no intention to pay the employee on a salary basis. In such a case the exemption would not be applicable to him during the entire period when such deductions were being made. On

> the other hand, where a deduction not permitted by these interpretations is inadvertent, or is made for reasons other than lack of work,[2] the exemption will not be considered to have been lost if the employer reimburses the employee for such deductions and promises to comply in the future.

Again, the court found that this exception was intended to protect employers who make a one-time improper deduction and then correct their errors. The provision was held not to apply to employers that, like Kern County, adopt an express policy of deducting for part-day absences.[3]

Thus, the court concluded the Battalion Chiefs were not "salaried" within the meaning of section 541.118(a), and could not qualify as "bona fide executives" exempt from the overtime

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[2] One district court has held that where a policy allows a deduction "for reasons other than lack of work," the "window of correction" is open regardless of whether the error was inadvertent. Keller v. City of Columbus, 778 F. Supp. 1480, 1487 (S.D. Ind. 1991). But see Dole v. Malcolm Pirnie, Inc., 758 F. Supp. 899, 906 (S.D.N.Y.), rev'd on other grounds, Martin v. Malcolm Pirnie, Inc., 949 F.2d 611 (2d Cir. 1991) (. . . "[w]e believe that a better reading of the regulation would take these conditions conjunctively, requiring that the improper deductions have been made both for "reasons other than lack of work" and "inadvertently.")

[3] See also Malcolm Pirnie, Inc., 949 F.2d 611 (window of correction is not available to employers with policy of making partial-day deductions). Following Abshire, a district court in California found that the "window of correction" was unavailable where there was no evidence that the deductions were due to inadvertence or error, and also because litigation had begun. Service Employees Intern. v. County of San Diego, 784 F. Supp. 1503, 1511 (S.D. Cal. 1992). The Fourth Circuit, on the other hand, has allowed public employers to take advantage of the "window of correction" even in cases where an established policy of making partial-day deductions existed. See, e.g., Hartman v. Arlington County, 720 F. Supp. 1227 (E.D. Va. 1989), aff'd, 903 F.2d 290 (4th Cir. 1990).

provisions of the FLSA.[4] Kern County sought review of the appellate court's decision by the United States Supreme Court, which declined review.

One federal appellate court subsequently issued a decision that was more favorable to government employers, Atlanta Professional Firefighters Union, Local 134 v. City of Atlanta, 920 F.2d 800 (11th Cir. 1991). However, a number of federal trial courts have decided the issue as the Abshire court did, holding that employees whose pay is "subject to reduction" for part-day absences are not salaried, even if no deductions have actually been made.[5] While at least one trial court has declined to award overtime pay in the absence of proof that an unauthorized deduction was actually made,[6] most district court decisions handed down to date are consistent with Abshire.

In addition, many district courts, when addressing the salary basis issue, have considered factors which are not included in the Department's regulations. For example, at least two courts have found that the docking of leave accounts, when considered with other factors, may be indicative of an hourly

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[4] The decision in Abshire would be equally effective to defeat claims for the other two white collar exemptions (i.e. "professional" and "administrative").

[5] See, e.g., Zepeda v. City of San Antonio, C.A. SA-88-CA-354 (W.D. Tex. 1990); Banks v. City of North Little Rock, 708 F. Supp. 1023 (E.D. Ark. 1988); Persons v. City of Gresham, Oregon, 704 F. Supp. 191 (D. Or. 1988); D'Camera v. District of Columbia, 693 F. Supp. 1208 (D.D.C. 1988).

[6] Harris v. District of Columbia, 709 F. Supp. 238 (D.D.C. 1989).

wage system,[7] and one district court has flatly stated that "the docking of an employee's leave time for absences from work is as contrary to the notion of salaried status as the docking of base pay."[8]

Another district court recently stated that "[e]ligibility for overtime is a powerful indicator that an employee is not paid on a salary basis." Hilbert v. District of Columbia, 784 F. Supp. 922, 925 (D.D.C. 1992), motion to amend or alter judgment denied, 30 Wage & Hour Cas. (BNA) 1382 (D.D.C. 1992) (emphasis in original). In Hilbert, the court found that police and fire department personnel were not paid on a "salary basis," because by statute, they were eligible for overtime compensation which was measured by the number of hours worked. Id. at 924. The defendant argued that if eligibility for overtime was taken into consideration, many categories of employees would be non-exempt. Id. at 925. The court responded that the defendant was "overstating the case," because "police officers receive their overtime under a special statute covering only police personnel." Id. In a later opinion, however, the court stated much more broadly that "[w]hile some additional compensation beyond a salary may still be permissible, where that compensation is measured by the number of hours worked and is paid at an hourly rate, there is a clear indication that the

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[7] See Thomas v. County of Fairfax, Virginia, 758 F. Supp. 353, 366 n.24 (E.D. Va. 1991); Knecht v. City of Redwood City, 683 F. Supp. 1307, 1312 (N.D. Cal. 1987).

[8] Service Employees Intern., 784 F. Supp. at 1510.

employee is not working on a salary basis." 30 Wage & Hour Cas. (BNA) at 1383.

Finally, one court has gone so far as to state that "[a]n employer's requirement that employees work a fixed schedule and for a minimum number of hours is also inconsistent with salaried status." Morsch v. City of Los Angeles, No. CV-91-0401, slip op. at 10 (C.D. Cal. May 4, 1992). In finding that the plaintiffs, who were firefighters, were not paid on a "salary basis," the court specifically noted that they could not "absent themselves from work during the day without permission of higher authority." Id.

B. **Partial-Day Deductions for Disciplinary Reasons**

The "salary basis" regulations provide that "penalties imposed in good faith for infractions of safety rules of major significance will not affect the employee's salaried status." 29 C.F.R. § 541.118(a)(5). Safety rules of major significance include only those relating to the prevention of serious danger to the workplace, or to other employees, such as rules prohibiting smoking in explosive plants, oil refineries, and coal mines. Id.

The Department has recently reaffirmed this view, and has concluded that employees who are paid on a "salary basis" are not generally subject to disciplinary action that results in deductions from their salary, but can be appropriately disciplined in other ways. U.S. Department of Labor, Wage & Hour Division, Opinion Letter of December 24, 1991. (A copy of this letter is attached.) The Department has further stated that

"[t]he only discipline-related deduction permissible is one imposed as a penalty in good faith for infractions of safety rules of major significance." Id.[9]

In fact, one recent district court case relied, in part, on the county's civil service rules regarding suspension in finding that the employees were not salaried. Service Employees Intern. v. County of San Diego, 784 F. Supp. 1503, 1511 (S.D. Cal. 1992). The court stated that "[a]s the County's Civil Service Rules provide for a variety of causes of suspension, including many unrelated to those safety violation [sic] explicitly provided for. . . the treatment of these employees is inconsistent with salaried status as defined in FLSA." Id. There was no discussion by the court as to whether such deductions had actually occurred.

Similarly, the Morsch court stated that "an employee is not paid on a salary basis if the employee is subject to disciplinary suspensions without pay for reasons other than infractions of safety rules of major significance." Morsch, slip op. at 9 (emphasis added). To support its conclusion, the court cited 29 C.F.R. § 541.118(a)(5). This section, however, does not

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[9] In Pautlitz v. City of Naperville, the court rejected the city's "rather bloodless argument" that it had docked three police officers' pay for improperly accepting sausage sandwiches during a city festival because they had violated a "safety rule[] of major significance." 781 F. Supp. 1368, 1372, motion for interlocutory appeal denied, 1992 WL 67834 (N.D. Ill. 1992). In Klein v. Rush-Presbyterian, the court adopted the magistrate's decision which held that a nurse's disciplinary suspensions without pay for tardiness, rude behavior, and failure to provide appropriate patient care did not fall within the bounds of the "safety rules" exception to the "salary basis" requirement. 30 Wage & Hour Cas. (BNA) 1325 (N.D. Ill. 1992).

include the court's "subject to" language, but merely states that "[p]enalties imposed in good faith for infractions of safety rules of major significance will not affect the employee's salaried status." 29 C.F.R. § 541.118(a)(5). In light of Morsch and Service Employees, public employers would be wise to review existing disciplinary policies to ensure that they comport with FLSA regulations.

The "salary basis" requirements are subject, however, to the general rule that "an employee need not be paid for any workweek in which he performed no work." 29 C.F.R. § 541.118(a). Consistent with this rule, the Department has stated that an employee may be suspended for disciplinary reasons without pay for one full week without affecting the employee's exempt status. U.S. Department of Labor, Wage and Hour Division, Opinion Letter of March 29, 1991.

II. The "Production Worker" Problem

The Bratt court found that "[t]he key requirement for [the administrative] exemption. . . is that the employee's primary work be 'directly related to management policies or general business operations of his employer or employer's customers.'" 912 F.2d at 1069 citing 29 C.F.R. § 541.2(a)(1). The court, again citing the regulations, found that this type of work was related to the administrative operations of a business as distinguished from "production work." Id.

The County of Los Angeles contended that the duties of probation officers[10] did not involve "production work," but were more akin to the duties of consultants such as stock brokers or insurance claim adjusters because they were essentially "servicing" the "business" of the courts by "advising the management." Id. at 1069-70.

The court flatly rejected the County's position, finding that the "language of the regulations" foreclosed such an argument. Id. at 1070. The court reasoned that the work of the employees primarily involved the day-to-day carrying out of the business' affairs, rather than the running of the business itself or determining its overall policies.[11] As further support for its decision, the court cited two Department letter rulings that stated that juvenile and adult probation officers do not qualify for exemption as administrative employees. Id.[12]

The Ninth Circuit also rejected two broad challenges to the application of the Act to public employers. First, the County argued that the court should ignore the regulations

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[10] The County's argument focused solely on the probation workers and did not address the applicability of the regulations to the child treatment workers, who were also plaintiffs in the case. See 912 F.2d at 1070 n.1.

[11] See also Harris v. District of Columbia, 741 F. Supp. 254, 262 (D.D.C. 1990) (supervisory housing inspectors are not exempt administrative employees because housing inspections are "production work" of the Housing Inspection Branch).

[12] These and other opinion letters deny exemptions to certain categories of public employees, such as parole officers, who provide their agency's services directly to the public. See, e.g., U.S. Department of Labor, Wage and Hour Division, Opinion Letter of July 26, 1988, reprinted in Lab. L. Rep. (CCH) ¶ 31,788 at 43,242 (1989).

because they were drafted with commercial businesses in mind and are not applicable to public service. Id. While acknowledging that the regulations invoke general business terms, and that analogies between government and business are often "strained," the court nonetheless found that the regulations were "instructive" in the government context. In support of its decision, the court cited the general rule that the regulations of the Department are presumed to be valid unless shown to be erroneously in conflict with the Act itself. Id. at 1071.

Finally, the County asserted that applying the FLSA to the probation officers would not serve the purpose of the FLSA, which, the County claimed, was directed against sweatshop labor rather than highly paid civil servants. Id. In rejecting this argument, the court noted that it would be better addressed to the Congress or the Department of Labor, rather than to the courts.[13/] Id.

[13/] Citing National League of Cities v. Usery, 426 U.S. 833 (1976), the County also argued that applying the Act to probation and child treatment workers exceeded federal powers under the commerce clause and violated the tenth amendment. Bratt, 912 F.2d at 1068. While Garcia v. San Antonio Metro. Transit Auth., 469 U.S. 528 (1985) overruled National League of Cities, the County attempted to distinguish Garcia on the ground that it involved city mass transit workers, while probation and child treatment services were more "traditional government functions." The County sought certiorari to the Supreme Court and essentially asked the Court to overturn and/or limit Garcia. On February 19, 1991, the Court denied the County's petition for certiorari. 111 S. Ct. 962.

III. Legal and Legislative Strategies for Change

A. The Department of Labor

The Department of Labor, recognizing that Abshire and its progeny threatened to destroy the fiscal integrity of state and local governments, issued proposed and interim regulations. Specifically, the Department acknowledged that governmental pay practices are designed to serve the public trust, and found that certain aspects of the salary basis regulatory requirement "are unduly restrictive when applied in the public sector." The attached interim and proposed rules address the elimination of future and existing liability, respectively.

To give prospective relief to state and local government employers, the Department issued a final interim rule, effective as of September 6, 1991, which provides that public sector employees who otherwise qualify for the § 541.118 exemption will not lose the exemption because they are subject to deductions for time away from work of less than a day. The effect of the new rule is to allow public sector employers to avoid incurring overtime liability for their salaried employees, while continuing to comply with public accountability pay systems. The interim rule also provides that deductions from public employees' pay that are not regular and recurring for absences due to a budget-required furlough will not disqualify the employees from being paid "on a salary basis" except in the workweek in which such deductions occurred. While the regulation was made effective immediately in order to forestall the accrual

of additional liability,[14] the Department nevertheless solicited comments, which were due November 6, 1991.

The issue of retroactive elimination of existing liability was addressed by the Department in a separate proposed rule that is not yet in effect. The proposed rule provides that exemption status for a public sector salaried employee could not be defeated if no deduction had ever actually been made from the employee's compensation for absences of less than one day or if the employee had been reimbursed for any such deduction.[15] Under this proposed rule, public sector employers would be free from liability attributable to improper deductions in the past as long as they met the restitution requirements.

It is not assured that the interim or proposed rules will provide relief for public employers. Though the comment period ended in November 1991, the Department has yet to adopt the proposed rule. Moreover, the prospect of court challenges raises serious questions in two respects.

First, three courts have held that the interim rule violates the Administrative Procedure Act ("APA"). Morsch, slip op. at 15; Alex v. State of California, S-89-0032, slip op. (E.D. Cal. Mar. 20, 1992); Service Employees Intern., 784 F. Supp. at 1512. In Service Employees, the court held that the interim regulation was invalid because a notice and comment period was required before its enactment. The court stated that "the only

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[14] 56 Fed. Reg. 45,824 (to be codified at 29 C.F.R. § 541.5d) (interim rule proposed Sept. 6, 1991).

[15] 56 Fed. Reg. 45,828 (to be codified at 29 C.F.R. § 541.118) (proposed Sept. 6, 1991).

sufficient justification offered" by the Department was that public employers were "facing 'enormous unforeseen liability' under the existing rule." Id. Rejecting this justification, the court noted that "[b]oth the salary basis test and its applicability to public employers has been well-settled for sometime," and that "[t]he accrual of additional liability alone is not sufficient to enact a regulation without notice and comment. . . ." Id. The Morsch and Alex cases invalidated the interim rule for essentially the same reasons.

Second, a likely threat to the proposed rule is from a court challenge to the propriety of elimination of liability with respect to past events.[16/] Courts have upheld legislation extinguishing liability under the FLSA retroactively.[17/] In the administrative context, however, the Supreme Court has held that statutory grants of rulemaking authority will not be understood to encompass the power to promulgate retroactive rules unless that power is conveyed by express terms. Bowen v. Georgetown University Hospital, 488 U.S. 204 (1988).

If the interim rule is not ultimately sustained by the courts, and if the proposed rule is not made final, the potential exposure for public employers is enormous. State and local governments would face potential liability for three years of overtime payments to many of its highest paid employees. In

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16/ See SEC v. Chenery Corp., 332 U.S. 194, 203 (1947); Addison v. Holly Hill Fruit Products, Inc., 322 U.S. 607, 619-20 (1944).

17/ See, e.g., Battaglia v. General Motors Corp., 169 F.2d 254 (2d Cir.) (upholding application of the Portal-to-Portal Act to claims pending under the FLSA), cert. denied, 335 U.S. 887 (1948).

addition, without the protection of the interim rule, employees who are furloughed for budgetary reasons for less than one week's duration would lose their exempt status.

Unfortunately, the situation at the Department regarding the Bratt case is even less encouraging. On behalf of public employers, we have sought reconsideration of the "production worker" interpretations by the Wage and Hour Division of the Department. We have been advised that we should not expect action on this request in advance of the Department's pending general reexamination of the "white collar" exemptions pursuant to 50 Fed. Reg. 47696 (1985). This notice has been pending for over six years. In April, however, as part of its "Semiannual Agenda of Regulations," the Department targeted the regulations addressing white-collar exemptions for review within the year.[18/]

We were more successful, however, in obtaining a clarification of the status of employees in "centralized" agencies (such as personnel, procurement, budget and auditing and training) that provide administrative support and services to other agencies of the government. The concern was that "administrative" employees in these centralized agencies in the public sector were not receiving treatment comparable to their counterparts in the private industry. In the attached opinion letter, the Wage and Hour Division stated that where such an agency performs support and service functions relating to the management policies or general business operations of other State

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[18/] 57 Fed. Reg. 16952, 16960 (Apr. 27, 1992).

or local government agencies, its employees who are engaged in these functions may qualify as exempt administrative employees if they meet the other requirements for the exemption.

B. The Congress

There has been a general reluctance to press Congress for relief for fear of labor union opposition. For this reason, most public employer organizations have sought solutions at the agency level. Because it is far from certain that the interim and proposed rules will ultimately remedy the Abshire problem, however, the Department itself is reportedly drafting its own version of legislation that would provide retroactive relief for public employers.

In addition, before the Labor Department issued its proposed and interim rules, Senator Seymour of California introduced a bill that addressed the Abshire problem.[19/] The content of the bill is essentially the same as that of the Department's proposed and interim regulations. The bill was referred to the Senate Labor and Human Resources Committee, but no action has been taken. On May 7, 1992, Representative Bill Lowery of California introduced legislation that is identical to the Seymour bill.[20/] Lowery's bill has been referred to the House Education and Labor Committee.

Also, on June 18, 1992, Representative Petri of Wisconsin introduced legislation that would allow public and

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19/ S. 1670, 102d Cong., 1st Sess. (1991).

20/ H.R. 5112, 102d Cong. 2d Sess. (1992).

private sector employees to retain their white-collar exemptions even where their pay is docked for absences from work.[21] The bill provides that leave accounts or pay may be docked for absences from work where the employee's accrued leave account is exhausted, or where the employee chooses to be absent without charging his or her leave account, without regard to the length of absence for which the reduction is to be made.

In the past, Congress has provided relief for employers with regard to other issues arising under the FLSA. For example, Congress recently amended the FLSA to require the Department to promulgate regulations that would permit computer systems analysts, computer programmers, software engineers, and other similarly skilled professional workers to qualify as exempt "white collar" employees. Act of November 15, 1990, Pub. L. No. 101-583, § 2, 104 Stat. 2871 (to be codified at 29 U.S.C. § 213). Congress further mandated that if such employees are paid on an hourly basis, they may still qualify as exempt if their hourly rate of pay is at least 6 1/2 times greater than the applicable minimum wage rate.

C. **The Supreme Court**

Recent changes in the make-up of the Supreme Court offer reason to be optimistic about the Court as a vehicle for relief. While it remains unlikely that the Court will vote soon

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[21] H.R. 5443, 102d Cong., 2d Sess. (1992).

to overturn Garcia,[22] a majority of justices are proponents of using a "plain statement rule" to protect federalism. For example, in a more recent case, the Court acknowledged that the Age Discrimination in Employment Act applies where the state is the employer, but held that it should not be read to cover state judges because Congress did not make it "unmistakably clear" that judges are covered by the Act. Gregory v. Ashcroft, 111 S. Ct. 2395 (1991).

The "plain statement rule" acknowledges that the States retain substantial sovereign powers under the constitutional scheme, and that the Congress should not be deemed to have interfered with these powers unless its intention to do so is unmistakably clear in the language of the statute. Accordingly, where a statute is ambiguous as to its application to state and local governments, the Court "will not attribute to Congress and intent to intrude on state governmental functions. . . ." Id. at 4719.

Thus, if state and local governments can organize around the "right" FLSA case, there is a good chance that the justices can be persuaded to grant certiorari and limit the application of the FLSA to state and local governments. In particular, recent lower court decisions which construe the FLSA as essentially denying exempt status to highly paid professional employees could easily be characterized as "intrusive." Even

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[22] See supra note 13. Also, in a recent decision addressing the limitations imposed by the Tenth Amendment on federal legislation, the Court expressly declined to reconsider Garcia. New York v. United States, No. 91-543, slip op. at 13 (U.S. Jun. 19, 1992).

though it is clear that the FLSA applies to state and local governments, many of the most intrusive applications, such as Bratt and Abshire, are not the result of clear Congressional mandates. They are inferences drawn by courts and administrators from vague statutory language. The Court's current plain statement rule could, with only minor expansion, be construed to forbid such inferences.

U.S. Department of Labor

Employment Standards Administration
Wage and Hour Division
Washington, D.C. 20210

DEC 24 1991

Ms. Sharon Hirsch
National Association of State
Personnel Executives
Iron Works Pike
P.O. Box 11910
Lexington, Kentucky 40578-1910

Dear Ms. Hirsch:

You will recall that at your Albany meeting last summer, I promised to provide your organization with an explanation of the effect of disciplinary deductions under Regulations, 29 CFR Part 541. I regret the delay in providing this information but think that you will still find it useful.

As I explained in my remarks, the only deductions which may be made from an employee's compensation without affecting the "salary basis" of payment are found in §§ 541.118(a)(2), (3), and (5) of the Regulations (copy enclosed). The only discipline-related deduction permissible is one imposed as a penalty "in good faith for infractions of safety rules of major significance." As explained in § 541.118(a)(5), safety rules of major significance embrace those intended to prevent serious danger to the facility or other employees, including prohibitions against smoking in explosive plants, oil refineries, and coal mines. The Department of Labor has also construed this language to cover penalties imposed for violations of industrial security regulations promulgated by the Department of Defense.

The effect of making impermissible disciplinary deductions from "salaried" employees is discussed in § 541.118(6). Where a one-time disciplinary deduction is made, the exemption will not be considered to have been lost in all workweeks <u>if</u> the employer reimburses the employee for such deduction <u>and</u> agrees to not take any such impermissible deduction in the future. Where disciplinary deductions not permitted by the Regulations occur on a regular and recurring basis (e.g., because of an employer's policy), we would question whether such employees, including all of those in the "class" or "category" of employees affected by such deductions, are actually paid on a salary basis and the exemption may be denied in <u>all</u> workweeks.

I would again emphasize that these rules are not intended, and should certainly not be construed, to prevent employers from taking appropriate disciplinary action with respect to their employees. Rather, these rules effect a long-standing interpretation of employment practices that typically distinguish

those employees who are paid "on a salary basis" from those who are not. That is to say that those employees who are paid "on a salary basis" are not generally subject to disciplinary action that results in deductions from their salary, but are and can be appropriately disciplined in other ways.

I trust that the above discussion fulfills my commitment. Please let me know if you have any further questions in this matter.

Sincerely,

John R. Fraser
Acting Administrator

Enclosure

cc: Tracy Zorpette

federal register

Friday
September 6, 1991

Part VIII

Department of Labor

Employment Standards Administration, Wage and Hour Division

29 CFR Part 541

Exemptions From Minimum Wage and Overtime Compensation Requirements of the Fair Labor Standards Act; Public Sector Employers; Interim Rule

DEPARTMENT OF LABOR

Employment Standards Administration; Wage and Hour Division

29 CFR Part 541

Exemptions From Minimum Wage and Overtime Compensation Requirements of the Fair Labor Standards Act; Public Sector Employers

AGENCY: Wage and Hour Division, Employment Standards Administration, Labor.

ACTION: Interim final rule; request for comments.

SUMMARY: These interim final regulations relative to governmental pay practices under Regulations, 29 CFR part 541, contain revised criteria for exemption from the minimum wage and overtime compensation requirements of the Fair Labor Standards Act (FLSA) for executive, administrative, and professional employees. The purpose of this revision is to provide an exception from certain provisions requiring payment "on a salary basis" applicable only to public sector employees.

DATES: Effective Date: The interim final rule is effective on September 6, 1991.

Comments are due on or before October 7, 1991.

ADDRESSES: Submit written comments to John R. Fraser, Acting Administrator, Wage and Hour Division, Employment Standards Administration, U.S. Department of Labor, room S-3502, 200 Constitution Avenue, NW., Washington, DC 20210. Commenters who wish to receive notification of receipt of comments are requested to include a self-addressed, stamped post card.

FOR FURTHER INFORMATION CONTACT: J. Dean Speer, Director, Division of Policy and Analysis, Wage and Hour Division, Employment Standards Administration, U.S. Department of Labor, room S-3508, 200 Constitution Avenue, NW., Washington, DC 20210; telephone (202) 523-8412 (this is not a toll-free number).

SUPPLEMENTARY INFORMATION:

I. Background

Since the enactment of the FLSA in 1938, Congress and the Supreme Court have each periodically acknowledged the special circumstances of, and the different treatment to be accorded to, governmental employers and employees under the FLSA, as distinguished from employment in the private sector.

The regulations governing exemption from the requirements of the Act for employees who are "executive, administrative, professional * * *" generally require that such employees meet regulatory standards with respect to both their duties and their compensation. Compensation must be greater than the amount specified in the regulations, and must be "on a salary basis." These matters are defined and explained in 29 CFR part 541. These regulations were adopted prior to the extension of FLSA coverage to public employees and, therefore, make no distinction between public and private employment.

In administering the FLSA in the public sector [1], the Department has become aware that few public employers compensate employees in a manner that meets the "on a salary basis" requirement for exemption under the current regulation. Governmental payroll systems commonly prohibit paying employees for time not actually worked. Systems of leave in the public sector (as often is the case in the private sector) are generally relied on as the exclusive method to permit employees who might otherwise not be compensated for periods of absence to avoid reduction of compensation in connection with such absences.

The Department initially attempted to address this problem by means of an enforcement policy, adopted by the Wage and Hour Division on January 9, 1987. The policy, which is still in effect, provides that the Division, will not deny exemption pursuant to section 13(a)(1) of the FLSA to an otherwise exempt executive, administrative, or professional employee in the public sector whose pay is reduced by deductions for absence(s) of less than a day for personal reasons, or because of illness or accident, because the employee does not have, or has exhausted available paid leave for such absence(s). This policy applies only where applicable State or local law, in effect before April 15, 1986, prohibits payment to employees for such absences which are not covered by paid leave.

The Wage and Hour Division's 1987 enforcement policy does not affect the rights of public employees to file private lawsuits under section 16(b) of the FLSA. Since the U.S. Supreme Court's decision in *Garcia* v. *San Antonio Metropolitan Transit Authority*, 469 U.S. 528 (1985), there have been numerous lawsuits by public employees to recover overtime pay. The courts in these cases have approached the construction of the regulations in different fashions, and have reached differing results.

Some courts have found the exemption to be inapplicable for the sole reason that the public entity's pay practices did not meet the "on a salary basis" requirement. Construing the existing regulations, some courts have held that employees under a pay system which requires that deductions be made when the employee is absent and has no leave are not paid "on a salary basis" even where no such deductions have occurred. In these circumstances the "salary basis" requirement is not met because the employee's compensation was subject to deductions for absences of less than one day when all accumulated leave was exhausted. See, *e.g.*, *Abshire* v. *County of Kern*, 908 F. 2d 483 (9th Cir. 1990) cert. denied, 111 S.Ct. 785, rehearing denied, 111 S.Ct. 1541 (1991); *Banks* v. *City of North Little Rock*, 708 F. Supp. 1023 (E.D. Ark. 1988); *D'Camera* v. *District of Columbia*, 693 F. Supp. 1208 (D.D.C. 1988); *Hawks* v. *City of Newport News, Va.*, 707 F. Supp. 212 (E.D. Va. 1988).

On the other hand, some courts have considered that even in the above-described circumstances a salary was not subject to deduction where there was no evidence that the employee's pay was ever reduced, that only actual and not "theoretical" deductions could invalidate the salary basis of compensation, and that rare instances of docking pay for absences of less than a day did not defeat the exemption (except in a workweek in which deduction was made). See, *e.g.*, *Atlanta Professional Firefighters Union* v. *Atlanta*, 920 F. 2d 800 (11th Cir. 1991); *Harris* v. *District of Columbia*, 709 F. Supp. 238 (D.D.C. 1989); and *DC Nurses Assn.* v. *District of Columbia*, 29 WH Cases 868 (D.D.C. 1988). Some courts have also allowed application of the "correction" provisions at 29 CFR 541.118(a)(5) to preserve exempt status in cases where the public employer made "inadvertent" deductions from pay for absences of less than a day when leave was exhausted, reimbursed the affected employee for such deductions, and promised future compliance. See *e.g.*, *Hartman* v. *Arlington County, Va.*, 720 F. Supp. 1227 (E.D. Va. 1989), aff'd. 903 F. 2d 290 (4th

[1] With respect to Federal employees, as provided in section 4(f) of FLSA, DOL administers the Act for employees employed in the Library of Congress, United States Postal Service, Postal Rate Commission, and the Tennessee Valley Authority; the Office of Personnel Management (OPM) administers FLSA with respect to all other employees of the Federal government except certain Congressional employees. See 29 U.S.C. section 204(f), Reorganization Plan No. 2 of 1978 (92 Stat. 3781), and section 6 of the Fair Labor Standards Amendments of 1989 (Pub. L. 101-157). Thus, the reference to Federal government employees in this rulemaking extends the revision to those Federal employees with respect to whom DOL is authorized to administer the Act.

Cir. 1990); *Fire Fighters Local 2141* v. *City of Alexandria, Va.*, 720 F. Supp. 1230 (E.D. Va. 1989), aff'd., 912 F. 2d 463 (4th Cir. 1990); *Hankins* v. *City of Chesapeake*, 25 WH Cases 1399 (E.D. Va. 1988); *Chadwick* v. *City of Norfolk, Va.*, 29 WH Cases 1607 (E.D. Va. 1988); and *Sarver* v. *City of Roanoke, Va.*, 29 WH Cases 1442 (W.D. Va. 1988).

The Department has been considering (and continues to consider) a variety of possible changes to the regulations governing the exemption for bona fide executive, administrative, and professional employees, including the particular requirement in the public sector that such employees be paid on a salary basis.

In the meantime, these diverging judicial interpretations and accompanying confusion have developed, resulting in the exposure of governmental employers to potentially enormous and generally unexpected back wage liabilities to employees, some of whom would clearly be exempt if duties and amount of compensation alone were examined. Such unforeseen liabilities could seriously threaten the fiscal integrity of State and local governmental agencies, and could seriously disrupt widespread pay practices that were designed and intended to serve the public trust and were established long before State and local government employees were subject to the Fair Labor Standards Act.

State and local government jurisdictions have varied pay policies. Some of these pay policies are based on constitutional or statutory provisions while others are derived from regulations or policies that have evolved over the years. These pay systems are generally premised on the concept—based on principles of public accountability—that governmental employees should not be paid for time not worked, and that there is a need to be accountable to the taxpayers for the expenditure of public funds.

For these reasons the Department is of the view that public sector pay systems must be analyzed differently from, because they are significantly distinguishable from, private sector pay systems. In the Department's judgment, certain aspects of the existing "salary basis" regulatory requirement for exemption are unduly restrictive when applied in the public sector. These aspects are not, in the Department's judgment, valid indicators in the public sector of the *bona fides* of a claimed exemption under section 13(a)(1). State and local governments are thus inappropriately deprived of the opportunity to apply the section 13(a)(1) exemption to their employees who would otherwise be properly exempt.

While the Department is continuing its overall review of the full range of issues raised by the public comments submitted on its advance notice of proposed rulemaking of November 19, 1985 (50 FR 47896), it is undertaking this separate rulemaking on the specific issue of application of the "salary basis" of payment for public sector employees. As discussed below, it is considered necessary to issue an interim final rule so as to stem any accrual of additional liability to State and local governments while consideration is given to the comments received on the rule.

II. Paperwork Reduction Act

This regulation contains no reporting or recordkeeping requirements.

III. Summary of the Rule

A new § 541.5d is being added that provides that an otherwise exempt public sector employee who is paid according to a pay system that requires the use of paid leave and, absent the use of paid leave, reduces the employee's pay for absences of less than one workday, will not be disqualified from exemption due to such pay system. This rule also provides that the exemption will not be defeated by deductions from salary caused by budget-required furloughs, which are not regular and recurring, except in the workweek in which such a deduction occurs.

Executive Order 12291

This rule is not considered to be a "major rule" within the meaning of Executive Order 12291, in that under the status quo, most public employers consider otherwise-exempt employees to be exempt, notwithstanding public sector pay systems under which their pay is subject to deductions for absences of less than one day. Furthermore, under current Department of Labor enforcement policy, the exemption would generally not be denied by the Department to such employees. Therefore the rule is not likely to result in: (1) An annual effect on the economy of $100 million or more; (2) a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; or (3) significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic or export markets. Therefore, no regulatory impact analysis is required.

Regulatory Flexibility Analysis

The Department has determined that this rulemaking will not have a significant economic impact on a substantial number of small entities. This conclusion is based on the fact that under the status quo, most public employers consider otherwise-exempt employees to be exempt, notwithstanding public sector pay systems under which their pay is subject to deductions for absences of less than one day. Furthermore, under the current Department of Labor enforcement policy, the exemption would generally not be denied by the Department to such employees. In addition, because no notice of proposed rulemaking is required for the rule under 5 U.S.C. 553(b), the requirements of the Regulatory Flexibility Act pertaining to regulatory flexibility analysis do not apply to this rule. See 5 U.S.C. 601(2).

Publication as an Interim Final Rule

Application of the salary basis test to State and local government employees may result in denial of the exemption to thousands of such employees who have been considered exempt by their employers. The Department considers it inappropriate that public sector employees be denied the exemption because they fail to meet the "on a salary basis" test under pay systems imposed by law, regulation or public policy that were established pursuant to principles of public accountability even before extension of the Act to such employees. Such application could well result in enormous, unforeseen liability of such governments and may threaten their fiscal integrity. For these reasons it has been determined that an interim final rule is appropriate to forestall accrual of additional liability while the Department receives and considers comments in the preparation of any final rule which would be determined to be appropriate. Accordingly, the Secretary finds, pursuant to 5 U.S.C. 553(b)(3)(B), that prior notice and public comment are contrary to the public interest.

For the same reasons, the Secretary also for good cause finds, pursuant to 5 U.S.C. 553(d)(3), that this rule cannot be published 30 days before its effective date.

Document Preparation

This document was prepared under the direction and control of John R. Fraser, Acting Administrator, Wage and Hour Division, Employment Standards Administration, U.S. Department of Labor.

List of Subjects in 29 CFR Part 541

Labor, Minimum wages, Overtime pay, Salaries, Teachers, Wages.

Accordingly, part 541 of title 29 of the Code of Federal Regulations is amended as set forth below.

Signed at Washington, DC, on this 3rd day of September 1991.

Lynn Martin,

Secretary of Labor.

Samuel D. Walker,

Acting Assistant Secretary for Employment Standards.

John R. Fraser,

Acting Administrator, Wage and Hour Division.

PART 541—DEFINING AND DELIMITING THE TERMS "ANY EMPLOYEE EMPLOYED IN A BONA FIDE EXECUTIVE, ADMINISTRATIVE, OR PROFESSIONAL CAPACITY (INCLUDING ANY EMPLOYEE EMPLOYED IN THE CAPACITY OF ACADEMIC ADMINISTRATIVE PERSONNEL OR TEACHER IN ELEMENTARY OR SECONDARY SCHOOLS), OR IN THE CAPACITY OF OUTSIDE SALESMAN"

1. The authority citation for part 541 continues to read as follows:

Authority: 29 U.S.C. 213; Public Law 101-583, 104 Stat. 2871; Reorganization Plan No. 6 of 1950 (3 CFR 1945-53 comp. p. 1004); Secretary's Order No. 13-71 (3 CFR 8733).

2. A new § 541.5d is added to subpart A of part 541 to read as follows:

§ 541.5d Special Provisions Applicable to Public Sector Employers (Federal, State and Local Governments)

(a) A Federal, State or local government employee ("public employee") who otherwise meets the requirements of § 541.118 shall not be disqualified from exemption under §§ 541.1, 541.2, or 541.3 of this part on the basis that such employee is paid according to a pay system established by statute, ordinance, regulation or public policy under which the employee accrues personal leave and sick leave and, absent the use of such accrued leave (because the leave has been exhausted or by the employee's choice), requires the public employee's pay to be reduced ("leave without pay") for absences, for personal reasons or because of illness or injury, of less than one work-day.

(b) Deductions from a public employee's pay that are not regular and recurring for absences due to a budget-required furlough shall not disqualify the employee from being paid "on a salary basis" except in the workweek in which such deductions occurred.

[FR Doc. 91-21341 Filed 9-5-91; 8:45 am]

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September 6, 1991

Part IX

Department of Labor

Employment Standards Administration,
Wage and Hour Division

29 CFR Part 541

Exemptions From Minimum Wage and Overtime Compensation Requirements of the Fair Labor Standards Act; Public Sector Employers; Proposed Rule

DEPARTMENT OF LABOR

Employment Standards Administration; Wage and Hour Division

29 CFR Part 541

Exemptions From Minimum Wage and Overtime Compensation Requirements of the Fair Labor Standards Act; Public Sector Employers

AGENCY: Wage and Hour Division, Employment Standards Administration, Labor.

ACTION: Notice of proposed rulemaking, request for comments.

SUMMARY: The Department of Labor proposes to revise the regulations governing exemption from minimum wage and overtime compensation under the Fair Labor Standards Act (FLSA) for executive, administrative and professional employees in the public sector. This proposal would allow governmental entities to restore eligibility for exemption under the rules governing payment "on a salary basis" at 29 CFR part 541, § 541.118(a)(6), for otherwise-exempt public employees subject to pay systems that provide for the use of paid leave and, when accrued leave is not used, result in deductions from pay for absences of less than one work-day.

DATES: Comments are due on or before October 7, 1991.

ADDRESSES: Submit written comments to John R. Fraser, Acting Administrator, Wage and Hour Division, Employment Standards Administration, U.S. Department of Labor, room S-3502, 200 Constitution Avenue, NW., Washington, DC 20210. Commenters who wish to receive notification of receipt of comments are requested to include a self-addressed, stamped post card.

FOR FURTHER INFORMATION CONTACT: J. Dean Speer, Director, Division of Policy and Analysis, Wage and Hour Division, Employment Standards Administration, U.S. Department of Labor, room S-3506, 200 Constitution Avenue, NW., Washington, DC 20210; telephone (202) 523-8412 (this is not a toll-free number).

SUPPLEMENTARY INFORMATION:

I. Background

Since the enactment of the FLSA in 1938, Congress and the Supreme Court has each periodically acknowledged the special circumstances of, and the different treatment to be accorded to, governmental employers and employees under the FLSA, as distinguished from employment in the private sector.

The regulations governing exemption from the requirements of the Act for employees who are "executive, administrative, professional [illegible]" generally require that such employees meet regulatory standards with respect both to their duties and their compensation. Compensation must be greater than the amount specified in the regulations, and must be "on a salary basis." These matters are defined and explained in 29 CFR part 541. These regulations were adopted prior to the extension of FLSA coverage to public employees and, therefore, make no distinction between public and private employment.

In administering the FLSA in the public sector [1] the Department has become aware that few public employers compensate employees in a manner that meets the "on a salary basis" requirement for exemption under the current regulation. Governmental payroll systems commonly prohibit paying employees for time not actually worked. Systems of leave in the public sector (as often is the case in the private sector) are generally relied on as the exclusive method to permit employees who might otherwise not be compensated for periods of absence to avoid reduction of compensation in connection with such absences.

The Department initially attempted to address this problem by means of an enforcement policy adopted by the Wage and Hour Division in January 1987. The policy, which it still in effect, provides that the Division will not deny exemption pursuant to section 13(a)(1) of the FLSA to an otherwise exempt executive, administrative, or professional employee in the public sector whose pay is reduced by deductions for absence(s) of less than a day for personal reasons, or because of illness or accident, because the employee does not have, or has exhausted available paid leave for such absence(s). This policy applied only where applicable State or local law in effect prior to April 15, 1986, prohibits payment to employees for such absences which are not covered by paid leave.

The Wage and Hour Division's 1987 enforcement policy does not affect the rights of public employees to file private lawsuits under section 16(b) of the FLSA. Since the U.S. Supreme Court's decision in *Garcia* v. *San Antonio Metropolitan Transit Authority*, 469 U.S. 528 (1985), there have been numerous lawsuits by public employees to recover overtime pay. The courts in these cases have approached the construction of the regulations in different fashions, and have reached differing results.

Some courts have found the exemption to be inapplicable for the sole reason that the public entity's pay practices did not meet the "on a salary basis" requirement. Construing the existing regulations, some courts have held that employees under a pay system which requires that deductions be made when the employee is absent and has no leave are not paid "on a salary basis" even where no such deductions have occurred. In these circumstances the "salary basis" requirement is not met because the employee's compensation was subject to deductions for absences of less than one day when all accumulated leave was exhausted. See, *e.g.*, *Abshire* v. *County of Kern*, 908 F. 2d 483 (9th Cir. 1990) *cert. denied*, 111 S.Ct. 785, *rehearing denied*, 111 S.Ct. 1341 (1991); *Banks* v. *City of North Little Rock*, 708 F. Supp. 1023 (E.D. Ark. 1988); *D'Camera* v. *District of Columbia*, 693 F. Supp. 1208 (D.D.C. 1988); *Hawks* v. *City of Newport News, Va.*, 707 F. Supp. 212 (E.D. Va. 1988).

On the other hand, some courts have considered that even in the above-described circumstances a salary was not subject to deduction where there was no evidence that the employee's pay was ever reduced, that only actual and not "theoretical" deductions could invalidate the salary basis of compensation, and that rare instances of docking pay for absences of less than a day did not defeat the exemption (except in a workweek in which deduction was made). See, *e.g.*, *Atlanta Professional Firefighters Union* v. *Atlanta*, 920 F. 2d 800 (11th Cir. 1991); *Harris* v. *District of Columbia*, 708 F. Supp. 238 (D.D.C. 1989); and *D.C. Nurses Assn.* v. *District of Columbia*, 29 WH Cases 868 (D.D.C. 1985). Some courts have also allowed application of the "correction" provisions at 29 CFR 541.118(a)(6) to preserve exempt status in cases where the public employer made "inadvertent" deductions from pay for absences of less than a day when leave was exhausted, reimbursed the affected employee for such

[1] With respect to Federal employees, as provided in section 4(f) of FLSA, DOL administers the Act for employees employed in the Library of Congress, United States Postal Service, Postal Rate Commission, and the Tennessee Valley Authority; the Office of Personnel Management (OPM) administers FLSA with respect to all other employees of the federal government except certain Congressional employees. See 29 U.S.C. 204(f), Reorganization Plan No. 2 of 1978 (92 Stat. 3783), and § 8 of the Fair Labor Standards Amendments of 1989 (Pub. L. 101-157). Thus, the reference to Federal Government employees in this rulemaking extends the revision to those Federal employees with respect to whom DOL is authorized to administer the Act.

deductions, and promised future compliance. See, e.g., *Hartman* v. *Arlington County, Va.*, 720 F. Supp. 1227 (E.D. Va. 1989), *aff'd*, 903 F. 2d 290 (4th Cir. 1990); *Fire Fighters Local 2141* v. *City of Alexandria, Va.*, 720 F. Supp. 1230 (E.D. Va. 1989), *aff'd*, 912 F. 2d 463 (4th Cir. 1990); *Hankins* v. *City of Chesapeake*, 29 WH Cases 1339 (E.D. Va. 1988); *Chadwick* v. *City of Norfolk, Va.*, 29 WH Cases 1407 (E.D. Va. 1988); and *Sarver* v. *City of Roanoke, Va.*, 29 WH Cases 1442 (W.D. Va. 1989).

The Department has been considering (and continues to consider) a variety of possible changes to the regulations governing the exemption for bona fide executive, administrative, and professional employees, including the particular requirements in the public sector affecting how employees may be paid on a salary basis. (Interim final regulations implementing a special "salary basis" rule for public sector employers are being published separately this date in the Federal Register, to be codified at 29 CFR 541.5d.)

In the meantime, these diverging judicial interpretations and accompanying confusion have developed, resulting in the exposure of governmental employers to potentially enormous and generally unexpected back wage liabilities to employees, some of whom would clearly be exempt if duties and amount of compensation alone were examined. The payment of such unforeseen liabilities could seriously threaten the fiscal integrity of State and local governmental agencies, and could seriously disrupt widespread pay practices which were designed and intended to serve the public trust and were established long before State and local government employees were subject to the Fair Labor Standards Act.

For these reasons the Department is of the view that public sector pay systems must be analyzed differently from, because they are significantly distinguishable from, private sector pay systems. In the Department's judgment, certain aspects of the existing "salary basis" regulatory requirement for exemption are unduly restrictive when applied in the public sector. State and local governments are thus inappropriately deprived of the opportunity to apply the section 13(a)(1) exemption to their employees who would otherwise be bona fide exempt.

While the Department is continuing its overall review of the full range of issues raised by the public comments submitted on its advance notice of proposed rulemaking of November 19, 1985 (50 FR 47696), it is undertaking this separate rulemaking proposal on the specific issue of measures that could be taken by public employers to restore the exempt status of public employees who would otherwise have been exempt but for pay systems calling for deductions (i.e., where no actual deductions are made and where actual deductions made are reimbursed) inconsistent with the "on a salary basis" requirement for public sector employees.

This proposal would operate in conjunction with the Department's newly-published interim final rule regarding salary basis in the public sector. (See the interim final rule published separately this date in the Federal Register, at 29 CFR 541.5d.) The proposal would, in essence, provide that employees previously subject to deductions under a pay system that now passes muster under § 541.5d, and, with respect to whom actual deductions have been reimbursed, shall be restored to exempt status under § 541.118(a)(6). As with the existing § 541.118(a)(6), this provision deals with a situation which has arisen unexpectedly when some parts, but not all essential parts, of the regulatory requirements for exemption have been met with respect to public sector employees. Unlike the existing § 541.118(a)(6), which deals primarily with occasional "inadvertent" deductions from the pay of employees who are generally paid in a "salary basis" structure, this provision would deal with the effect of past deductions made by virtue of a pay system that may otherwise have resulted in a complete disallowance of the exemption.

The Department seeks comments on all aspects of this proposal, in particular drawing the attention of commenters to legal and other considerations regarding: (1) The retroactive aspects of the proposal; and (2) the fairness of the proposal, both to employers and employees.

II. Paperwork Reduction Act

This regulation contains no reporting or recordkeeping requirements.

III. Summary of the Rule

The rule provides that eligibility for the exemption under the requirement that employees be paid "on a salary basis" will not be defeated in the case of governmental entities that either: (1) Made no deductions from pay for absences of less than one work-day before the effective date of new regulations promulgated at 29 CFR 541.5d (i.e., September 6, 1991), or (2) reimburse otherwise-exempt public employees for deductions from pay made for absences, for personal reasons or because of illness or injury, of less than one work-day that occurred before the effective date of § 541.5d.

Executive Order 12291

This rule is not considered to be a "major rule" within the meaning of Executive Order 12291, in that under the status quo, most public employers consider otherwise-exempt employees to be exempt, notwithstanding public sector pay systems under which their pay is subject to deductions for absences of less than one day. Furthermore, under the current Department of Labor enforcement policy, the exemption would generally not be denied by the Department to such employees. Therefore the rule is not likely to result in: (1) An annual effect on the economy of $100 million or more; (2) a major increase in costs or prices for consumers, individual industries, federal, state, or local government agencies, or geographic regions; or (3) significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic or export markets. Therefore, no regulatory impact analysis is required.

Regulatory Flexibility Analysis

The Department has determined that this rulemaking will not have a significant economic impact on a substantial number of small entities. The Secretary has certified to this effect to the Chief Counsel for Advocacy of the Small Business Administration. This conclusion is based on the fact that under the status quo, most public employers consider otherwise-exempt employees to be exempt, notwithstanding that under some public sector pay systems the pay of employees is subject to deductions for absences of less than one day. Furthermore, under current Department of Labor enforcement policy, the exemption would generally not be denied by the Department to such employees.

Document Preparation

This document was prepared under the direction and control of John R. Fraser, Acting Administrator, Wage and Hour Division, Employment Standards Administration, U.S. Department of Labor.

List of Subjects in 29 CFR Part 541

Labor, Minimum wages, Overtime pay, Salaries, Teachers, Wages.

Accordingly, part 541 of Title 29 of the Code of Federal Regulations is proposed to be amended as set forth below.

Signed at Washington, DC, on this 3rd day of September 1991.

Lynn Martin,

Secretary of Labor.

Samuel D. Walker,

Acting Assistant Secretary for Employment Standards.

John R. Fraser,

Acting Administrator, Wage and Hour Division.

PART 541—DEFINING AND DELIMITING THE TERMS "ANY EMPLOYEE EMPLOYED IN A BONA FIDE EXECUTIVE, ADMINISTRATIVE, OR PROFESSIONAL CAPACITY (INCLUDING ANY EMPLOYEE EMPLOYED IN THE CAPACITY OF ACADEMIC ADMINISTRATIVE PERSONNEL OR TEACHER IN ELEMENTARY OR SECONDARY SCHOOLS), OR IN THE CAPACITY OF OUTSIDE SALESMAN"

1. The authority citation for Part 541 continues to read as follows:

Authority: 29 U.S.C. 213; Public Law 101-583, 104 Stat. 2871; Reorganization Plan No. 6 of 1950 (3 CFR 1949-53 comp. p. 1004); Secretary's Order No. 13-71 (3 CFR 8755).

2. The text of existing § 541.118(a)(6) is proposed to be renumbered as paragraph (a)(6 (i) and a new paragraph 541.118(a)(6)(ii) is proposed to be added to part 541 to read as follows:

§ 541.118 Salary basis.

(a) * * *

(6) * * *

(ii) If a Federal, State or local government (i.e., public sector) employer's pay system is as described in § 541.5d, and either:

(A) the public employer has made no actual deductions from the pay of otherwise-exempt public employees for absences, for personal reasons or because of illness or injury, of less than one work-day before the effective date of § 541.5d (i.e., September 6, 1991); or,

(B) The employer reimburses any otherwise-exempt public employees for deductions from salary that were made for absences, for personal reasons or because of illness or injury, of less than one work-day occurring before the effective date of § 541.5d (i.e., September 6, 1991);

then eligibility for exemption for public employees who otherwise meet the requirements of § 541.118 and who were subject to such pay system will not be defeated for failure to pay "on a salary basis."

* * * * *

[FR Doc. 91-21342 Filed 9-5-91; 8:45 am]

BILLING CODE 4510-27-M

U.S. Department of Labor

Employment Standards Administration
Wage and Hour Division
Washington, D.C. 20210

Mr. Bradford E. Southworth
Immediate Past President
National Association of State
Personnel Executives
Personnel Administrator
Office of Personnel Administration
One Capitol Hill
Providence, Rhode Island 02908-5860

Re: Concerns about 29 CFR Part 541 raised by the National Association of State Personnel Executives (NASPE)

Dear Mr. Southworth:

This refers to your letter of January 18; our meeting on March 8; my follow-up telephone discussions with your organization's attorney, Ronald S. Cooper, in late April; his May 3 letter to me; and your June 18 letter to Secretary Dole. Your June 18 letter refers to a formal response that you felt should have been forthcoming in April. I called Mr. Cooper in April expressly to respond to the issues you raised earlier, as he acknowledged in his May 3 letter to me. I apologize for any misunderstandings that may have occurred when I communicated with your attorney rather than directly with you.

In my telephone conversation with Mr. Cooper, I explained that most of the issues you raised were closely related to the general regulatory issues that the Department of Labor (Department) is considering in its ongoing review of Part 541. As you know, those issues are uncommonly difficult.

We are presently able, however, to respond to one of your particular concerns.

You were concerned that present interpretations do not treat like situations in the private and public sectors similarly. I informed Mr. Cooper in this connection that I would issue an opinion letter clarifying the status of employees in "centralized" agencies that provide support and services to other agencies of the government.

This letter provides that opinion by clarifying an earlier statement on the subject.

The Department's position regarding the application of Part 541 -- especially the application of the administrative employee exemption to State and local government employees -- is discussed in detail on pages two and three of the enclosure to Secretary Dole's July 27, 1989 letter on this issue to various State Governors. The enclosure notes that:

> [W]here employees of a State or local government agency are performing activities that carry out the ongoing mission and day-to-day functions of the agency -- rather than its management policies <u>or the management policies of the State or political subdivision (such as an agency devoted to personnel activities for the entire local government)</u> -- such activities cannot be viewed as the type of duties contemplated by the Regulations for exemption.

(Emphasis added.)

You have inquired about central agencies that provide services such as personnel (as mentioned in the enclosure), procurement, budget and auditing, and training. In our opinion, where such an agency performs support and service functions relating to the management policies or general business operations of other State or local government agencies, employees who are engaged in its day-to-day functions may qualify as exempt administrative employees if they meet all of the other requirements for exemption. <u>See</u> 29 CFR 541.2 & 541.205.

The basis for this opinion is that such employees are engaged in the management policies of the State or political subdivision as a whole. The administrative exemption, as you suggest, should be available to them to the same extent that it is available to employees who perform such functions for private organizations and businesses.

Of course these and all of the requirements of Part 541.2 must be applied case-by-case. Thus, an employee should not automatically be considered exempt merely because he or she works for a centralized agency such as a personnel or budget agency.

I hope that the foregoing discussion has clarified the Department's position relative to the application of the administrative employee exemption. If you have any further questions, please do not hesitate to contact me.

Sincerely,

ORIGINAL SIGNED
SAMUEL D. WALKER
Samuel D. Walker
Acting Administrator

Enclosure

cc: Ronald S. Cooper, Esq.

Enclosure

The FLSA Administrative Exemption Generally

An exemption from the minimum wage and overtime provisions of FLSA applies to those employed in a bona fide executive, administrative, and professional capacity, as defined and delimited in Regulations, 29 CFR Part 541. The FLSA specifically grants the Secretary of Labor statutory authority to define and delimit the exemption by regulations, subject to the provisions of the Administrative Procedure Act.

An employee may qualify for exemption as a bona fide administrative employee if all the pertinent tests relating to duties, responsibilities and salary, per section 541.2 of the Regulations, are met. Pursuant to sections 541.2(e)(2), an employee who is paid at least $250 per week on a salary or fee basis may qualify for exemption as a bona fide administrative employee if the employee's primary duty consists of the performance of office or nonmanual work directly related to management policies or general business operations of the employer or the employer's customers, and the employee's work requires the exercise of discretion and independent judgement.

Legislative History

Although FLSA has been amended a number of times since its enactment in 1938, section 13(a)(1) has not been substantially changed. The 1961 Amendments to FLSA did modify the exemption for employees in retail and service establishments by providing a greater tolerance for the amount of time which could be spent in nonexempt work before the exemption was lost. In 1966, when FLSA was extended to cover employment in schools and certain other public and private institutions, section 13(a)(1) was also broadened to include, specifically, academic administrative personnel and teachers in elementary and secondary schools. When FLSA was extended to most other Federal, State and local government workers in 1974, no changes were made in section 13(a)(1).

The legislative history of the 1974 Amendments to FLSA indicates that Congress intended to cover "virtually all non-supervisory government employees" and "all employees (except professional, executive and administrative personnel who are exempted under section 13 of the law) in all civilian branches of the Federal Government" (see Fair Labor Standards Amendments of 1974, H.R. Rpt. 913, 93rd Cong., 2d Sess. at 27-28 (1974)). However, in recognition of the special employment situations of fire-fighting and law enforcement personnel, the 1974 Amendments provided a partial overtime pay exemption for such personnel under section 7(k).

Finally, in 1985, no changes were made in section 13(a)(1) when FLSA was specifically amended to change certain provisions as they apply to State and local government employees, as well as to provide relief from liability during an adjustment period subsequent to the decision of the Supreme Court in Garcia v. San Antonio Metropolitan Transit Authority (Garcia), 469 U.S. 528 (1985). However, the 1985 Amendments did allow governmental entities under certain circumstances to provide their employees compensatory time-off in lieu of cash overtime compensation, and did include more generous compensatory time provisions for public safety and emergency response personnel engaged in activities such as law enforcement. Thus, the Congress took specific action to recognize special State and local government employment situations, but took no action to modify the application of the executive, administrative, and professional exemption of FLSA to the public sector.

Application of Regulations, Part 541

The Regulations governing application of this exemption (Part 541) have remained largely unchanged since originally promulgated in 1940, except to incorporate statutory changes. In 1950, the administrative exemption duty tests were changed to require that administrative employees had to have as their primary duty work related to management policies or general business operations.

Activities contemplated by the Regulations as being "directly related to management policies or general business operations" of an employer are those related to the administrative operations of a business, as distinguished from the basic tasks of employer's business, i.e., the "production" work, or -- in the case of a public employer -- the mission and function of the agency. The

exemption is limited to persons who perform work of substantial importance to the management or operation of the business of their employer or employer's customers, and includes "white collar" employees engaged in "servicing" a business or public agency. Examples of such activity include personnel administration, labor relations, research, planning, or assisting a management official in carrying out the executive or administrative functions of that official.

Administrative employees need not participate in the formulation of management policies or the operation of the business or agency as a whole, but include employees who affect policy or have the responsibility to execute it or carry it out -- that is, employees who plan or direct the implementation of such policy. They include persons who carry out major assignments in the operation of the business or agency, or whose work affects operations to a substantial degree. In general, then, "administrative employee" refers to a person who is engaged in staff functions as opposed to the line functions of an employer.

In determining whether a public employee's activities are "directly related to management policies or general business operations" of the employer, it is essential to consider the nature of the mission and functions of the government agency. In general, where employees of a State and local government agency are performing activities that carry out the ongoing mission and day-to-day functions of the agency, rather than its management policies or the management policies of the State or political subdivision (such as an agency devoted to personnel activities for the entire local government), such activities cannot be viewed as the types of duties contemplated by the Regulations for exemption. Where such an employee's primary duty consists of such nonexempt work, the employee cannot be found to be qualified for exemption as a bona fide administrative employee under section 541.2 of the Regulations, and must be paid in accordance with the minimum wage and overtime pay provisions of FLSA.

Department of Labor Enforcement Policy

Since the Supreme Court's 1985 decision in Garcia, the Department's policy has been to provide all possible assistance and guidance to State and local governments with respect to their new obligations under FLSA. Moreover, enforcement activities have been confined to responding to complaints from public employees, and such investigations will continue to be conducted. In any investigation in which it is determined that violations of the provision of FLSA have occurred, the Department makes every effort to obtain voluntary compliance with the law. If that can not be achieved through negotiation, and it is determined that litigation should be instituted, a suit is not filed unless at

least 30 days written notice has first been given that the employment practices are in violation of FLSA.
It is also important to note that where the Department has not filed suit, an employee has a right under section 16(b) of FLSA to independently file suit to recover back wages as well as liquidated damages, attorney fees, and court costs.

To date, litigation involving the application of section 13(a)(1) to specific classes of administrative employees in the public sector has been sparse but has supported the Administrator's opinion on the application of the administrative employee exemption. In the private sector the case law on this issue also comports with the Administrator's opinions on the administrative exemption.