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Revisiting the Overtime Morass: Special Exceptions to Non-Exempt Status and Methods of Computation

by Thao Tiedt

Because of special exemptions under both the Fair Labor Standards Act (FLSA) and the Washington Wage and Hour Laws, certain employees, who would normally be non-exempt and entitled to overtime, are no longer eligible for overtime. These exceptions are strictly construed so it is important to know and meet each and every element of the exception. The most often used exceptions are the “retail or service establishment” exception and the computer related occupation exception.

The Retail or Service Establishment Exception

In order to meet the retail or service establishment exception, Section 207(i) of the FLSA and RCW 49.46.130(3), the following elements must be present:

1. The company is a retail or service establishment in that 75% of its annual dollar value of sales of goods or services (or both) are not for resale and are recognized as retail sales in the industry. See 29 CFR 779.411. An automobile dealership is a classic example of a retail establishment because it provides both goods in the form of vehicles and service in the form of vehicle maintenance and repair.

2. The person in question is an employee and the employee’s regular rate of pay is in excess of 1 ½ times the federal *and* state minimum wage for every hour the employee works, whether regular time or overtime.

3. More than 50% of the employee’s total compensation is in the form of *commissions* on the sales from goods and services. It is important if you want to use the retail or service establishment exception that all non-salary or hourly wage paid to the employee is paid under a commission plan, not a bonus plan. Be specific in your terminology. It is wise to have all commission plans in writing and signed off by both the manager and the employee. We advise you to have the commission plan plainly state how the “nut” against which the commission percentage will be taken is computed and when and how charge backs will be made.

The employee need not actually be a traditional salesperson in order for you to use the retail or service establishment rule as long as the majority of his or her compensation is based on a percentage commission of the establishment’s sales from retail goods or services.

Computer Related Occupation Exception—Confusion Reigns

Under the FLSA, a special exception from overtime exists for computer systems analysts, computer programmers, software engineers, and other computer related positions who:

1. Are compensated on a salary or fee basis of not less than \$455 per week, or if compensated at an hourly rate, at a rate no less than \$27.63 per hour; and

2. Are employed as a computer systems analyst, computer programmer, software engineer or similarly skilled worker in the computer field performing, as his or her primary duty (determined by emphasis on the character of the employee's job as a whole):

- a. The application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software or system functional specifications; or
- b. The design, development, documentation, analysis, creation, testing or modification of computer systems or programs, including prototypes, based on and related to user or system design specifications; or
- c. The design, documentation, testing, creation, or modification of computer programs related to machine operating systems; or
- d. A combination of the above duties, the performance of which requires the same level of skills.

Under Washington law, there is no special exception for computer related occupations. Instead, Washington has chosen to consider the high level computer related occupations as exempt under the general exception for professionals. See WAC 296-128-535. Washington uses very similar definitions of the skilled areas as the FLSA listed in 2 a-d above but goes even further. They require the employees to be highly skilled, earn at least \$27.63 per hour and have:

- a. A high degree of theoretical knowledge and understanding of computer system analysis, programming and software engineering; *and*
- b. The ability to practically apply that theoretical knowledge and understanding to highly specialized computer fields; *and*
- c. Generally attained the necessary level of expertise and skill to qualify for an exemption through a combination of education and experience in the field; *and*
- d. Consistently exercised discretion and judgment in the application of their special knowledge as opposed to performing purely mechanical or routine tasks; *and*
- e. Been engaged in work that is predominantly intellectual and inherently varied in character as opposed to work that is routinely mental, manual, mechanical, or physical.

The Washington law does not require the person hold a degree but the exception does not apply at all unless the person works at a level of skill which allows him or her to generally work independently and without close supervision.

Our observations are that Washington employers routinely ignore the possibility of overtime if the employee with computer related duties functions at all like the requirements of the FLSA. Our further observation is that these employers are ignoring Washington law at their peril. **Remember, the employee can choose to apply whichever law is more favorable to the employee. The employer does not get to choose.**

Computation of Overtime

The traditional drill is that overtime is paid at time and one-half for every hour over forty hours. However, there are some exceptions to that tradition:

The fluctuating work week rule provides that if, at the time of hire or at the time of a promotion to a different position, you and the employee agree that the employee will receive a salary which compensates him or her for all hours worked, no matter how many or how few, you only need to pay half time for overtime. The "time" is already paid in the salary. See CFR Sec. 778.114. Washington has adopted the same rule. This method of computation is useful when an employee, such as one in accounting, has an ebb and flow in their work.

The net result of the fluctuating work week rule is that more overtime reduces the actual per hour amount of the overtime. For example, Jane is on the fluctuating work week overtime plan. She is paid a salary of \$5000 per month. In the last week of the month, she works 45 hours. You divide her salary by four (to get a weekly salary), then divide that amount by 45 to get her “regular rate”, then divide that by 2 to get the overtime rate. Here, \$5000 divided by 4=\$1250, divided by 45=\$27.78 divided by 2=\$13.89. Jane would earn 5 x \$13.89=\$69.44 in overtime. If she had worked 50 hours, \$1250 divided by 50=\$25, divided by 2=\$12.50 so Jane would earn \$1.39 per hour less for each hour of overtime by working more overtime. If Jane were not on the fluctuating work week rule, her overtime rate for 45 hours would be \$27.73 x 1.5= \$41.67. The company saves a substantial amount on her overtime by using the fluctuating work week rule. This method of overtime is popular with large chains of small stores, for example, where the store manager isn’t exempt because he or she doesn’t spend enough time on managerial tasks but the company wants the manager to work a lot of hours.

Warning: This agreement must be in writing and signed by the employee at the time of hire or promotion. The agreement should include an example of how this method of overtime is computed. The original of the document should be retained in the employee’s personnel file. Also remember that the salary covers not just more than 40 hours but also *less* than 40 hours, so if the employee works less than forty hours in a week (not including a week that is short because of a paid holiday) but none of the short hours are in a full day increment, you must still pay the full salary.

Also, remember that overtime is paid only after 40 *worked* hours. Vacation, sick leave, paid holidays, and any other paid leaves do not count towards 40 worked hours in a week. For example, if an employee works 4 ten hour days and then gets 10 paid hours of holiday, the employee is not entitled to any overtime. Be sure you separate out on time sheets or time cards time that is worked time and time that is paid for some other reason. The burden of proving the exception is always on the employer.