

Federal Wage Law prohibits recouping amounts overpaid to exempt employees under bonus plan

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A recent opinion by the U.S. Court of Appeals for the Sixth Circuit demonstrates how the loss of exempt status for one employee can result in significant liability for unpaid overtime – not just for that employee, but for all employees in the same classification. Unfortunately, an employer who recouped overpaid amounts under a bonus plan to exempt employees learned this lesson the hard way.

Specifically, in *Baden-Winterwood v. Life Time Fitness, Inc.*, a group of plaintiffs claimed that the employer's policy retaining the right to recoup amounts it overpaid to employees under a bonus program violates the salary basis test for exempt employees under the Fair Labor Standards Act (FLSA), 29 U.S.C. § 201, *et seq.* Under the FLSA, employees who (1) perform specific kinds of duties and (2) are paid in specific ways (including on a salary basis) are exempt from overtime pay. All others must receive time and one-half their regular rate of pay for all hours actually worked over 40 in a work week.

It is the employer's burden to prove that the employee is exempt. To be paid on a salary basis, the employee must regularly receive each pay a "predetermined amount constituting all or part of the employee's compensation, which amount is not **subject to** reductions because of variations in the quality or quantity of the work performed." 29 C.F.R. § 541.602(a)(emphasis added).

Because the regulations under the FLSA were revised effective Aug. 23, 2004, the court separated the plaintiffs' claims into two groups: those arising before Aug. 23, 2004 and those arising on or after that date. The pre-August 2004 claims were subject to a test provided by the U.S. Supreme Court in *Auer v. Robbins*, which denies exempt status, not only if there is an actual practice of making deductions based on variations in quality or quantity of work performed, but also where a policy creates a "significant likelihood" of deductions.

During the pre-August 2004 period, the defendant company had a policy, which provided that if certain performance indicators dropped below 80 percent and bonus payments had been made in previous months, the employer had the "right to reclaim the amount of previous payment by reducing future semi-monthly guarantee payments" (i.e., salary). Based on the clear wording of the plan and the fact that the defendant had made actual deductions in 2005 under a similarly worded policy, the Sixth

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Circuit found that all of the plaintiffs subject to this plan were non-exempt between Jan. 1, 2004 (when the plan took effect) and August 23, 2004 under the *Auer* test. Therefore, the defendant company was held liable to all of the employees subject to the bonus plan for overtime pay during that period.

Next, the court analyzed the plaintiffs' claims under the new regulations. The defense argued that, while it made deductions in 2005, it was recouping earlier overpayments and not because of the quality or quantity of work performed. While the court agreed that it had the right to recoup overpayments, it could not do so by dipping into the plaintiffs' guaranteed salaries.

However, the court found that these were not deductions resulting from an irregular salary advance or a payroll mistake and "there is no support for the contention that the FLSA allows for the reduction of guaranteed pay under a purposeful, incentive-driven bonus compensation plan." Such incentives were based on the quality and quantity of the employees' work. Therefore, the deductions were improper under the salary basis test.

Under the new regulations, the defendant company was again held liable for overtime pay to all of the "employees in the same job classification working for the same managers responsible for the actual improper deductions," but only for the pay periods when the improper deductions were made.

The cost of improper deductions can be tremendous when they result in the loss of exempt status and liability for overtime pay. In addition to the FLSA, Michigan employers need to be concerned with state laws controlling the payment of wages and sales commissions. Before an employer adopts a policy to recoup overpayments or actually deducts amounts from employee wages, they should consult with an experienced employment attorney.

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