

NEW STATE REGULATIONS ON EXEMPT

The Washington Department of Labor & Industries (L&I) recently adopted a new “salary basis” regulation to clarify what requirements must be satisfied with respect to an executive, administrative or professional employee’s salary in order to ensure that the employee is exempt from state minimum wage and overtime requirements. This regulation, which became effective February 21, 2003, was developed by L&I in response to a recent Washington State Supreme Court case addressing salary deductions, *Drinkwitz v. Alliant Techsystems, Inc.*, 140 Wn.2d 291 (2000).

As discussed in detail below, the new regulation provides specific rules and guidance to Washington employers with respect to (1) what deductions may be made from exempt executive, administrative and professional employees’ salaries; (2) what deductions may be made from such employees’ personal leave banks, including compensatory time, PTO, sick leave and vacation leave; and (3) what “window of correction” is available to employers to correct improper deductions under certain circumstances. The regulation also includes specific provisions that addresses certain salary, leave bank and furlough deductions for public employees.

Background.

Under both the Washington Minimum Wage Act (MWA) and the federal Fair Labor Standards Act (FLSA), exempt executive, administrative and professional employees must be paid on a “salary basis.” To be exempt, such employees must receive the same salary each pay period without regard to the quality or quantity of work performed during that pay period. Failure to pay exempt employees on this salary basis will result in a loss of the exemption. Where the exemption is lost, the employer must ensure that the employee’s pay meets or exceeds state minimum wage requirements, and must pay the employee overtime pay for all hours worked over 40 hours in a workweek.

The federal FLSA has long defined “salary basis” in regulations adopted by the U.S. Department of Labor.

See 29 C.F.R. § 541.118. However, prior to L&I’s adoption of the new state “salary basis” regulation this month, the Washington MWA did not define “salary basis.” Instead, employers were left to rely on recent Washington Supreme Court cases (the *Drinkwitz* and *Webster* cases) for guidance in applying the “salary basis” requirement under Washington law. As discussed below, the Washington Supreme Court decided both the *Drinkwitz* and *Webster* cases in the absence of any express definition of “salary basis” under state law.

In *Drinkwitz*, a group of salaried employees who were classified as exempt challenged, among other things, their employer’s practice of making deductions from pay and earned vacation time when the employees failed to meet a mandatory weekly work quota of 40-45 hours. The Washington Supreme Court held that deductions from pay and accrued vacation banks in such circumstances were “inconsistent” with the requirement that exempt employees be paid on a

salary basis. After the ruling in *Drinkwitz*, employers were left with many open questions, including whether any leave bank deductions of less than a full day or weekly increment would be permitted under state law.

In January 2003, the Washington Supreme Court decided the case of *Webster vs. Public School Employees of Washington, Inc.*, ___ Wn.2d ___, 60 P.3d 1183 (2003). In *Webster*, the state Supreme Court expanded on its holding in the *Drinkwitz* case and held that, although partial-day deductions from accrued leave banks are not a per se violation of the salary basis requirements for exempt executive, administrative and professional employees, a single partial-day deduction may be considered “as a factor” in determining whether an employee truly is exempt and paid on a salary basis. By leaving the door open, and holding that partial-day deductions could negate an employer’s attempt to classify employees as “exempt” (including an entire class of employees with a particular job title), partial-day deductions for exempt employees appeared to be very risky for employers after the Webster decision.

The New Regulation.

L&I adopted the new state salary basis regulation after the *Drinkwitz* and *Webster* decisions. The new regulation became effective on February 21, 2003, and provides specific guidance on the “salary basis” requirements for exempt “white collar” employees under state law. In contrast to *Drinkwitz* and *Webster*, the new regulation specifically permits private employers to make partial-day deductions from employee leave banks under the following circumstances:

(a) Deductions may be made from compensatory time in any increment.

(b) Deductions may be made from bona fide leave banks in partial or full day increments. However, partial day deductions may be made only on the express or implied request of the employee for time off from work. Leave bank deductions may not be made for less than one hour.

A “bona fide leave bank” is a benefit provided to employees in the case of absence from work due to sickness or personal time off, including vacation. It must be in writing and contained in contract or agreement, or in a written policy that is distributed to employees. A leave bank policy, or a leave bank provision in a contract or agreement, is not “bona fide” if it is used as a subterfuge to circumvent or evade the requirements of this regulation.

(c) When leave banks are exhausted, deductions from salary may not be made, except as permitted in subsection (3) of this section.

WAC 296-128-532(6) (emphasis added). The new regulation also permits deductions from salary under the following circumstances:

(a) If the employee performs no work in a particular week, regardless of the circumstances, the employer may deduct for the entire week.

(b) When the employee takes at least a whole day off for personal reasons other than sickness or accident, the employer may deduct in full day increments.

(c) Deductions for absences due to sickness or disability may be made in full day increments if the deduction is made according to the employer's bona fide plan, policy or practice of providing paid sick and disability leave (other than industrial accidents or disability).

(i) Deductions are permitted when either leave is exhausted or the employee has not yet qualified under the plan.

(ii) Deductions are permitted even if an employee receives compensation under that plan or under workers' compensation laws.

(d) When an employee is eligible for the federal Family and Medical Leave Act 29 U.S.C. Sec. 2611 et seq., deductions may be made for partial day absences due to leave taken according to that law and the applicable provisions in chapter 49.78 RCW.

(e) In the first and final week of employment, an employee's salary may be prorated for the actual days worked.

(f) Deductions are allowed for disciplinary absences that are imposed for violations of safety rules of major significance. This includes only those relating to the prevention of serious danger to the plant, the public, or other employees, such as rules prohibiting smoking in explosive plants or around hazardous or other flammable materials.

(g) Deductions are allowed when authorized under RCW 49.48.010, 49.52.060, or WAC 296-126-025.

WAC 296-128-532(3). In contrast, the regulation specifically prohibits the following deductions from salary:

(a) Deductions are not permitted for partial days of work, except as permitted by subsection (3)(d) of this section or by WAC 296-128-533.

(b) Deductions are not permitted for lack of work for any amount of time less than a full week.

(c) Deductions are not permitted when the employee participates in jury duty, attendance as a witness, or temporary military leave if the employee performs any work during that week. The employer may, however, offset any amounts received by an employee as jury or witness fees or military pay.

(d) Deductions are not permitted for absences due to sickness or disability if the employer does not have a bona fide plan, policy or practice in place for sick or disability leave.

(e) Any other deductions not allowed under subsection (3) of this section.

WAC 296-128-532(4).

In addition to specifying what deductions from pay and leave banks are permitted under the salary basis test, the regulation also includes a new provision that grants public and private employers a limited right to correct mistaken deductions without losing the employee's exempt status:

A limited window of correction will be permitted when an improper deduction is shown to be infrequent and inadvertent and the employer immediately begins taking corrective steps to promptly resolve the improper deduction when brought to the attention of the supervisor or other appropriate representative of the employer. Such corrections will be allowed only to the extent that the deduction is not due to lack of work or part of a pattern of the same or substantially similar deductions.

WAC 296-128-532(5).

The new regulation also contains specific provisions that address partial-day salary, leave bank and furlough deductions for public employees. *See* WAC 296-128-533(1)-(2).

Washington courts have long recognized that L&I has the power and authority to "define and delimit" through regulations the requirements for determining whether an employee works in an exempt executive, administrative or professional capacity. Accordingly, L&I's new salary basis regulation should be given controlling weight, notwithstanding the fact that it differs in certain respects from the pre-regulation decisions of the Washington Supreme Court in the *Drinkwitz* and *Webster* cases. Subsequent court decisions will undoubtedly be required to apply and interpret the new regulation. Such cases will confront a number of novel and unanswered questions that have been raised by the new salary basis regulation, including what constitutes an "implied request" for time off work, or a "bona fide" leave bank.

What This Means for Employers.

Employers may make deductions from salary or leave banks of exempt salaried employees under the specific circumstances permitted under L&I's new regulation. Apart from these limited categories of approved deductions, employers should be wary of using other forms of salary or leave bank deductions, or of using any sort of deduction as a means of disciplining salaried employees. Such deductions may be prohibited under the Washington Supreme Court's holdings in the *Drinkwitz* and *Webster* cases, and may risk forfeiture of the employees' exempt status.

Because of the changing nature of this area of the law and the importance of individual facts, this information is not meant to provide legal opinions and is not a substitute for the advice of legal counsel.

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