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Tenth Circuit rules that the fluctuating workweek method of calculating a back pay award for unpaid overtime is appropriate where the parties had a "clear mutual understanding" that the employee would be paid a fixed salary regardless of hours worked.

# Tenth Circuit Endorses "Fluctuating Workweek" Method of Calculating Overtime for Misclassified Salaried Employees

*By Joshua B. Kirkpatrick and Stephanie L. Hankin*

In a decision that could lead to significant litigation cost savings for employers, the United States Court of Appeals for the Tenth Circuit endorsed the "fluctuating workweek" method of calculating back pay awards for misclassified salaried employees in lawsuits arising under the Fair Labor Standards Act (FLSA). In *Clements v. Serco, Inc.*, 2008 U.S. App. LEXIS 13806 (10th Cir. July 1, 2008), the Tenth Circuit held that the district court properly used the fluctuating workweek method to calculate a back pay award for unpaid overtime, rather than the alternative "time-and-a-half" formula, because the parties had a "clear mutual understanding" that the plaintiffs would be paid a fixed salary regardless of the number of hours they worked each workweek. In addition, the court joined the First and Fourth Circuit Courts of Appeals in rejecting the proposition that the fluctuating workweek method applies only where the parties also had a "clear mutual understanding" as to how overtime pay would be calculated.

## Background

Two former civilian military recruiters sued their former employer, Serco, Inc., a military services contractor, for unpaid overtime compensation. While employed by Serco, the plaintiffs were paid on a salary basis and were not paid overtime. On summary judgment at the district court level, Serco argued that the plaintiffs were outside sales employees who were exempt from the FLSA's overtime pay requirements. The district court disagreed, holding that the plaintiffs were nonexempt employees and thus entitled to back pay for unpaid overtime.

In calculating the plaintiffs' back pay award, the district court applied the fluctuating workweek method approved by the Department of Labor's (DOL) regulations, which limited the back pay award to one-half of the plaintiffs' regular rate for all overtime hours worked, rather than the common "time-and-a-half" formula for calculating overtime. Serco appealed the district court's grant of summary judgment on the exemption issue, and the plaintiffs appealed the district court's use of the fluctuating workweek method in calculating their back pay award.

In general, the FLSA mandates that employers pay nonexempt employees one and one-half times their regular rate of pay for all hours worked in excess of 40 in a workweek. However, in certain circumstances, employers may pay overtime at one-half an employee's regular rate, which is referred to as the fluctuating workweek method. Pursuant to DOL regulations, the fluctuating workweek method applies only when the following factors are met:

- The employee's hours fluctuate from week to week;
- The employee receives a fixed salary that does not vary based on the number of hours worked each workweek;
- There is a "clear mutual understanding" between the parties that the fixed salary is compensation for all hours worked each workweek;
- The fixed salary is sufficient to provide compensation to the employee at a rate not less than the applicable minimum wage for all hours worked each workweek; and
- The employee receives additional com-

pensation (in addition to the salary payment), for all overtime hours worked at a rate of at least one-half the employee's regular rate of pay.

29 C.F.R. § 778.114(a).

In such situations, according to the regulations, "the regular rate of the employee will vary from week to week and is determined by dividing the number of hours worked in the workweek into the amount of the salary to obtain the applicable rate for the week." When the fluctuating workweek applies, employees receive overtime compensation at a rate of one-half their regular rate for the week – as opposed to the usual rate of one-and-one-half times the regular rate – "because such hours have already been compensated at the straight time regular rate, under the salary arrangement." Therefore, applying the fluctuating workweek approach typically reduces the amount of overtime compensation to which an employee is entitled.

## The Tenth Circuit's Holding

On appeal, the Tenth Circuit affirmed the district court's holding that the plaintiffs were nonexempt employees under the FLSA and were therefore entitled to overtime compensation. The court then evaluated the district court's calculation of the plaintiffs' back pay award pursuant to the fluctuating workweek method. The plaintiffs argued that they did not have a "clear mutual understanding" that they would receive a fixed salary for all hours worked in a workweek, as required by the DOL regulations. The plaintiffs further contended that the regulations require an additional showing that the parties have a "clear mutual understanding" as to how overtime pay would be calculated.

The Tenth Circuit rejected the plaintiffs' attempt to extend the regulations' "clear mutual understanding" requirement to how overtime premiums would be calculated. The court reasoned that because the parties initially agreed that no overtime would be paid, no such agreement as to the payment of overtime ever existed. Therefore, the court limited its inquiry to whether the parties had a clear and mutual understanding that the plaintiffs would be paid on a salary basis for however many hours they worked, rather than for a fixed number of hours per week. The court found sufficient evidence of such an understanding. Notably, the plaintiffs stated in deposition testimony that they were hired on a salaried basis and that they routinely worked more than 40 hours a week. The plaintiffs were neither docked for working less than 40 hours a week nor paid more for working more than 40 hours a week. Further, in letters to the DOL, the plaintiffs described salary, not hourly, wage arrangements. The court held that such evidence fully supported the conclusion that the fluctuating workweek method applied and therefore affirmed the district court's back pay award.

## Conclusion

The *Clements* decision is welcome news to employers facing overtime misclassification claims. The fluctuating workweek method of calculating overtime typically results in significantly reduced backpay awards—slightly less than one third of the award under a "time-and-a-half" calculation method. It should be noted that while other federal courts of appeals (notably, the First and Fourth Circuits) have taken the same position as the Tenth Circuit did in *Clements*, other federal circuit courts have reached the opposite conclusion, while others still have not reached a definitive holding.

This decision should not have a significant impact on employers voluntarily choosing to use a fluctuating workweek compensation system. Because specific requirements must be met for this method to apply, employers should seek the advice of counsel before utilizing a fluctuating workweek method. Additionally, in order to satisfy the DOL regulations' "clear mutual understanding" criterion—and notwithstanding the *Clements* decision—it remains advisable for employers to memorialize fixed salary plus overtime arrangements in express written agreements with employees. Employers should also be aware that some states, including California, prohibit the use of the fluctuating workweek method.

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