

# The Fluctuating Workweek Method of Pay: An Employer-Friendly Pay Practice Hits a Snag

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In recent years, the U.S. Department of Labor (DOL) has spent a considerable amount of time on compensation for salaried, nonexempt employees. The attention is derived from the fact that these employees are covered by the overtime provisions of the Fair Labor Standards Act (FLSA). In most cases, employees feel good about this coverage because of the overtime pay protection it provides. One notable exception is salaried, nonexempt employees who work a fluctuating work schedule. They have the dubious distinction of being one of the few groups of employees covered by a statutory pay practice that favors the employer over the employee.

According to a longstanding DOL interpretation of FLSA, when salaried, nonexempt employees work a fluctuating or irregular work schedule, their overtime pay rate declines with each additional hour of overtime they work in a week. This unexpected scenario occurs because their overtime rate is not fixed at 1.5 times their base hourly rate, as it is for most employees covered by the FLSA. Instead, their overtime rate varies weekly based on how many hours they work in a given week. The rate is determined by dividing their salary by the total number of hours they work in a week and multiplying the result by 1.5. The arrangement's primary advantage to employees is that they receive their full base salary for weeks in which they work less than 40 hours. Over the years, employers have sought to strengthen and expand the use of this method of determining overtime pay, while unions and other liberal groups have tried to

weaken the practice and limit its use. It is a controversial quirk in the law that is not immune from political influence.

Computer service technicians and insurance claims adjusters are examples of salaried, nonexempt employees who are likely to be paid in this way. They often work irregular work schedules due to variable demands on their time from business clients.

For the past three years, DOL has been considering whether salaried, nonexempt employees should be eligible to receive premiums and bonuses, in addition to overtime pay, when they work a fluctuating work schedule. In April of 2011, DOL released a final rule saying they cannot be eligible for these programs. This reversed the DOL's 2008 position that they are eligible and, in fact, should be included in these programs. This move adds to the unique status of these employees. Not only do they have to live with a declining overtime rate, they also cannot receive premiums and bonuses like other employees. The change is bound to disrupt pay practices and affect reward planning in many firms. Compensation professionals should become familiar with it, review relevant pay practices, consider alternatives, and seek legal counsel when in doubt.

This article describes and discusses:

- How salaried, nonexempt employees are paid for overtime work and are charged for absences
- The rationale for how they are paid, based on the intent of the law, and how it affects their overtime earnings
- A recent proposed change from the DOL regarding premium and bonus payments
- Positions of groups that tried to influence the adoption of the proposed change
- Alternatives for compensating them that considers a recent change in the position of the DOL.

## **COMPENSATION OF SALARIED, NONEXEMPT EMPLOYEES**

Salaried, nonexempt employees present challenges for compensation professionals because by law and regulation, they are treated in two very different ways for overtime pay and absence purposes, depending on how they are scheduled to work.

### **OVERTIME PAY**

One type of salaried, nonexempt employee is paid a salary for working a fixed number of hours each week, such as 37.5 or 40 hours. The second type receives a salary for however many hours they work in a week, be it 35, 40, 45 or 50 hours. Both receive overtime pay for work over 40 hours at a 1.5 rate, but the calculations of overtime payments are substantially different. For those on a fixed-workweek schedule, the overtime rate is determined by dividing their salary by the number of fixed hours in their schedule, so the overtime rate (1.5 times the quotient) is the same for all weeks of work.

For those working on a fluctuating workweek (FWW) schedule, the overtime rate is determined by dividing their salary by the number of hours worked in a given week and multiplying the quotient by 1.5. Thus, their overtime rate varies weekly and decreases the longer they work.

Because of the decreasing overtime rate feature, the FWW schedule is an unfavorable deal for employees unless they work an offsetting number of weeks of less than 40 hours for which they must receive their full salary. California prohibits the use of the FWW schedule for these employees, perhaps recognizing that many may not be in the best position to negotiate a better deal from their employer. Some compensation professionals and laypersons would expect the half-time, overtime rate to be based on 40 hours of work and to remain fixed for all weeks, in line with how hourly employees are paid.

A third method of paying FWW employees is permitted under the FLSA. In simple terms, employees may enter into a formal individual agreement with their employer that allows the employer to pay the same total compensation each week in the form of a salary, that includes pay for straight time and overtime hours, regardless of how many are actually worked, up to a specified maximum. The agreement provides employees with the security of a regular, weekly income and gives employers the means to predict and control some of their labor costs. There are many restrictions in the FLSA on its use, and California prohibits these contracts. Because it is not commonly used, it will not be discussed in this article. However, further information can be found in the DOL regulations under the heading, “Guaranteed Compensation Which Includes Overtime Pay,” in Sections 778.402 through 778.414. This type of agreement is sometimes referred to as “Belo contract,” after the 1942 Supreme Court ruling, *Walling v. Belo Corp.*, which authorized its use.

## **ABSENCES AND PAY DOCKING**

The DOL considers those in the fixed, overtime rate group as little more than hourly employees, not only because of how they are paid overtime, but also because their pay can be docked for absences like hourly employees. For example, their salary can be reduced when they miss work for being sick and have exhausted their annual sick-time allotment.

The DOL and the courts require a different treatment of absences for employees working on a FWW schedule. They have ruled that the docking of pay is permitted only for disciplinary absences, thereby giving meaning to the idea of being paid on a salary for this group. The apparent message here is that if employers consider these employees as salaried and want to enjoy the advantages of paying them a decreasing overtime rate based on a fixed salary, they will have to treat their salary as a true, fixed amount, immune from reduction in “short workweeks.”

To summarize, salaried, nonexempt employees on a fixed work schedule generally are treated much like hourly employees, as they have their overtime pay set at a fixed rate equal to 1.5 times their base hourly rate, which is the quotient of their

salary divided by the number of hours in their fixed schedule. When on a 40-hour schedule, their base hourly rate and overtime rate would be the same as an hourly employee's rate. They can be docked for absences, much like hourly employees.

Salaried, nonexempt employees on a FWW schedule have a variable, hourly, overtime rate that is equal to 1.5 times the quotient of their salary divided by the number of hours they work in a given week. Regarding absences, they are treated much like exempt, salaried employees, as their salary remains intact for all absences, except for disciplinary actions.

### **FWW APPLICATION REQUIREMENTS**

According to DOL regulations, all of the following conditions must be present for the FWW schedule to be used:

- The employee's hours of work fluctuate from week to week.
- The employee receives a fixed salary that does not vary based on the number of 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.
- The employee receives additional compensation (in addition to salary) for all overtime hours worked at a rate of at least one-half the employee's regular rate of pay.
- There is a "clear mutual understanding" between the employer and employee that the fixed salary is compensation for all hours worked each week. Employees who are not unionized do not have to agree to the practice, only understand how it operates.

### **FWW LEGISLATIVE HISTORY**

Now that we understand how salaried, nonexempt employees are compensated, we can turn our attention to how FWW pay practices came about and see how they affect wages.

#### **Fair Labor Standards Act**

In 1938, FLSA established the general rule that certain employees must be compensated at 1.5 times their regular rate of pay for each hour worked in excess of 40 hours per week. Although FLSA did not prohibit overtime work, it sought to create a financial disincentive for using it. Its primary purposes are to spread employment and to protect workers from excessive hours of work.

#### **FWW: Statutory Basis**

The FLSA statute does not explicitly permit the fluctuating workweek method of pay. Authority for its use has been traced to a 1938 DOL interpretation of the law that has been accepted by the courts. However, a rationale for the interpretation could not be located in the letter. One possible source for its interpretation is that, according to the 1941 Supreme Court, there was uncertainty as to what the FLSA

lawmakers meant by the phrase “the regular rate” of pay, which determines an employee’s overtime pay rate. Is it the quotient of an employee’s salary divided by 40, or divided by the actual hours worked?

### Contrary to Congressional Intent

Contrary to one of the purposes of the FLSA, the fluctuating workweek method creates a financial incentive for employers to require overtime work rather than hire new employees. The more overtime hours employees work, the less expensive labor becomes. After 60 hours of work, an employee’s hourly rate of pay is less than the regular hourly rate of another employee working 40 hours a week. For example, an employee who has a salary of \$1,000 per week and works 61 hours makes \$24.60 per overtime hour (\$1,000 divided by 61 hours for a regular rate of approximately \$16.40, plus an \$8.20 per hour overtime premium). If the employer were to hire an additional employee who worked 40 hours per week, that employee’s effective hourly rate would be \$25 (\$1,000 divided by 40 hours). Once more than 60 hours are worked, employers actually have a disincentive to limit overtime or to hire new employees. The disincentive happens at a lower threshold if the costs of recruiting, training and providing employee benefits to a new employee are considered.

The FWW method has a substantial effect on workers’ overtime wages, when compared to those of an hourly employee. For example, at 50 hours of work, the hourly overtime rate under the FWW method is 80 percent of the overtime rate of an hourly employee. The percent declines to 67 percent at 60 hours and to 50 percent at 80 hours. As previously mentioned, the primary advantage to employees of this system is that they must receive their full base salary for weeks in which they work less than 40 hours.

DOL regulations seem to have a provision to prevent the use of the FWW beyond 60 hours. It states that “Where all the facts indicate that an employee is being paid for his overtime hours at a rate no greater than that which he receives for non-overtime hours, compliance with the act cannot be rested on any application of the fluctuating workweek overtime formula.” Despite this rule, no cases or articles could be found showing that this provision was actually used to challenge use of the FWW method. For example, employees’ counsel in a 2010 district court case did not support their case for invalidating use of the FWW by showing that employees worked 92 hours in some weeks.

With this information about how and why salaried, nonexempt employees working a fluctuating schedule are paid, our attention is directed to a recent significant event at DOL that has created issues for compensation professionals who administer their pay.

### The Proposed DOL Rule Change

In 2008, DOL proposed a change to its regulations on the FWW method of computing overtime compensation for salaried, nonexempt employees. The change

would have permitted the payment of non-overtime bonuses and premiums to employees on the FWW method of pay without invalidating the guaranteed salary required for the half-time, overtime pay computation. The belief at this time was that these employees may only receive a salary and overtime pay.

In justifying the proposed change, DOL stated that employers and the courts had been challenged in applying the current regulations to the payment of bonus supplements and premiums. The proposed regulation provided that such payments would not invalidate the fluctuating workweek method of compensation and eligibility for overtime pay. It included an example to illustrate these principles for an employer that pays a nightshift differential in addition to a fixed salary and overtime pay. DOL stated that its proposal would eliminate any disincentive for employers to pay additional bona fide bonus or premium payments.

### CONDITIONS IN 2008

At the time of the proposal, the FLSA regulations and opinion letters seemed to contain language to permit such payments, and many employers may have been following this guidance in paying their employees. DOL regulations state that “Where all the legal prerequisites for use of the ‘fluctuating workweek’ method of overtime payment are present, the FLSA, in requiring that ‘not less than’ the prescribed premium of 50 percent for overtime hours worked be paid, does not prohibit paying more.”

DOL opinion letters also supported paying more. In 2009, “DOL Opinion Letter FLSA 2009-24” was published approving the payment to these employees of a double premium for Sunday and holiday work. In 2009, the letter was issued on Jan. 16 before President Obama took office on Jan. 20, and was withdrawn in March. During the Bush administration’s final two weeks in office, DOL issued 36 opinion letters, half of which were withdrawn by March 2009. By contrast, only 19 opinions were issued in all of 2008.

The following two letters, which were referenced in the 2009 letter in support for paying more, also have been withdrawn:

- A DOL opinion letter dated May 10, 1999, stated that an employer can make additional payments to an FWW employee for a holiday occurring in a given week.
- A DOL opinion letter dated Oct. 31, 2002, stated that an employer may also pay employees more than the minimum calculated rate under the FWW method for overtime.

### COMMENTS ON THE PROPOSED CHANGE

In 2011, the DOL noted that the solicited comments on the proposed change were sharply divided. In general, commenters representing employers favored the revisions while commenters representing employees strongly opposed the revisions.

## Supporters

The Society for Human Resource Management (SHRM) supported the change, and noted that it is common practice to pay nonexempt, salaried employees a bonus or premium as an incentive for various reasons, such as working less desirable hours. It claimed that such premiums support a business need to attract and retain qualified and dedicated employees. It stated that under various pay methods, such as hourly, piece rates, day rates and job rates, employees may receive a bonus or other premium payments in addition to normal pay and asserted that it was logical and consistent to permit such payments under the fluctuating workweek method of compensation.

The Chamber of Commerce strongly supported the revisions, because they were “beneficial to employers and employees,” as well as being consistent with current guidance. It pointed out that DOL regulations state that the FWW method “in requiring that ‘not less than’ the prescribed premium of 50 percent for overtime hours worked be paid, [the FLSA] does not prohibit paying more.” Other supporters, mostly law firms, did not give specific rationale for their position and, at times, sought somewhat unrelated revisions to the regulations, such as the extension of the FWW pay method to employees working a regular schedule of overtime hours.

## Dissenters

In general, strong opposition was received from the National Employment Law Project, Service Employees International Union, National Employment Lawyers Association, AFL–CIO, 12 Democratic and Independent members of the U.S. Congress (including Barack Obama), and the North Carolina Justice Center.

They noted that the proposal would permit employers to reduce employees’ fixed, weekly salaries and shift the bulk of the employees’ wages to bonus and premium pay. They argued that this would harm employees because it would lead to significant variations in weekly wages based on the hours worked. Such variations in pay are inconsistent, they said, with the purpose of the fluctuating workweek, which is to guarantee a salary regardless of how many hours are worked.

They further objected to the proposal because it would expand the use of the fluctuating workweek method to industries, such as health care, in which bonus and premium payments are common. Comments submitted by members of Congress urged that instead of modifying the regulation to expand its use, DOL should consider narrowing its scope to prevent employers from abusing this method to lower workers’ pay.

One dissenter noted that in justifying the proposed change, DOL stated that such additional payments had presented challenges to the courts in applying the current regulations, without citing cases to support the claim.

## Final Rule

In 2011, DOL rejected its own proposed change. It continued to believe that although bonus and premium payments can be beneficial for employees in many other contexts, they are incompatible with the FWW method of computing overtime, unless such payments are overtime premiums, which are the only forms of additional pay sanctioned by DOL regulations.

It agreed with several comments that noted the proposed regulation could have the unintended effect of permitting employers to pay a greatly reduced fixed salary and shift a large portion of employees' compensation into bonus and premium payments, potentially resulting in wide disparities in employees' weekly pay depending on the particular hours worked. It stated that it is just this type of wide disparity in weekly pay that the FWW method was intended to avoid by requiring the payment of a fixed amount as straight time pay for all hours in the workweek, whether few or many.

Although the example in the proposed rule change of adding nightshift premiums resulted in a "relatively modest change" in the employee's pay, DOL believed that the proposed regulation would have been inconsistent with the requirement of a fixed salary payment as set forth by the Supreme Court.

On closer examination and contrary to its 2008 assertion, DOL also noted that the courts have not been greatly challenged in applying the current regulation to additional bonus and premium payments.

Finally, it acknowledged that the proper use of the fluctuating workweek method of pay results in an employee being paid time and a half of the employee's regular rate for overtime hours that decreases as the workweek increases, which may create an incentive to require employees to work long hours. DOL stated that it does not believe that it would be appropriate to expand use of this method of computing overtime pay beyond the scope of the current regulation.

## Analysis of the Process

The process of finalizing the rule's merits warrants an analysis. First, only one organization, SHRM, provided a substantial rationale to support the change— basically, that bonuses and premiums are commonly used incentives to get employees to do undesirable work that are available to employees in other pay systems. The point that SHRM did not make is that if incentives and bonuses are disallowed for FWW salaried, nonexempt employees, they would be treated differently than fixed schedule, nonexempt and exempt, salaried employees who receive them. In some firms, such a division in the workforce would be undesirable from an employee relations standpoint and counter efforts to build a cohesive organizational culture. This is a possible reason why some people believe that DOL's decision is intended to discourage employers from using the FWW.

Another point that was unclear in the comments is that the FWW decreasing overtime rates seem to take advantage of affected employees, which provides

a good rationale for supplementing them with additional payments, to help in attracting, motivating and retaining employees.

Second, many organizations opposed the change and provided several arguments to give the impression that the change benefitted employers more than employees.

Third, the change was proposed when the DOL was under the control of a Republican administration, which may have raised the concerns of unions and “pro-employee” organizations that were influential in having the new rule rejected under a Democratic administration. The fact that, on its face, the change would have increased the compensation of employees might have raised suspicions from these groups about ulterior motives for proposing the change. One possible concern was that the inclusion of bonuses would make the employer-friendly FWW method more amenable to application in other industries such as health care, where such premiums are common.

Fourth, the final rule seemed to contradict the language of the regulations and opinion letters to give support for the role of politics in the decision-making process. Fifth, some employers are granting premiums and bonuses (e.g., attendance or safety bonuses and shift pay) that could potentially invalidate use of the FWW method of pay. The national law firm of Nixon Peabody believes that some employers will need to revise their bonuses and premium pay practices to avoid such troubles.

## **EMPLOYER OPTIONS**

In recent years, employers have sought to enhance and expand use of the FWW method because of its cost advantages, while unions and “pro-employee” organizations have tried to limit its use primarily because of its negative effects on employee earnings. Because of its controversial nature, DOL rules for using it can change significantly when the political affiliation of the White House changes. Today, paying a bonus or premium to FWW employees is illegal.

Several options are available to deal with this change, including those described below. Each option has advantages and disadvantages that must be weighed to find a good fit for each organization in terms of its ability to pay, operational requirements, compensation philosophy and practices, organizational culture, employee relations climate and other factors. One confusing point that needs legal review is whether these employees can receive a year-end bonus or similar payment. Past DOL opinion letters and its proposed change, as well as court rulings, have not dealt with this issue, only with premiums for shift, Sunday and holiday work.

The options fall into two categories. The first involves adopting staffing and work-schedule practices commonly found in 24/7 industries, such as steelmaking, as well as in work settings, such as police departments, to reduce or eliminate the need for overtime work, which support the FWW method of pay. The other involves changing the way employees are paid.

## CHANGES IN STAFFING/SCHEDULING PRACTICES

- Stagger work schedules. In weeks in which seven-day coverage is required, stagger the work schedules of employees so that peak days of work are covered by some employees during their first five days of work at their straight time rate of pay. For example, some employees could be scheduled to work Tuesday through Saturday or with split days off to add coverage on peak days. Although such a move could reduce costs, it would be viewed by some employees as undesirable because Saturday and Sunday would not be their regularly scheduled days off.
- Use “fill-in” employees to cover overtime. Depending on how the overtime work occurs, permanent staff could be added to work, at straight-time pay, on the regularly scheduled days off of other employees that require overtime pay. In multiple shift operations, the “fill-in” employees, could, for example, be scheduled to work two, 12-hour shifts each weekend day. One advantage is that work would be done at a lower cost at straight-time pay rather than overtime pay, thereby providing more time off for some employees.
- Use temporary employees for overtime work. Temporary employees could be added to work during periods that require the permanent staff to work excessive amounts of overtime. This is a flexible, cost-effective response to the peaks and valleys in the work requirements that drive the FWW.

## CHANGES IN PAY PRACTICES

- Include premiums and bonuses in base salary. One way of complying with the law that maintains employees’ salaried status is to increase their base salaries by a small amount to compensate for the inability to grant such payments. One potential advantage for employees is that once separate payments are included in base salary, they will benefit from a higher salary for the remainder of their careers and experience a higher level of participation in salary-based employee benefit programs. Such a move runs counter to the current trend toward the increased use of variable pay methods that do not permanently increase base pay.

An employer concern is that if a higher salary were granted to all affected employees, some would be overcompensated if they were not eligible for certain premium payments, such as shift premiums, before the salary roll-in. And it would be impractical to offer such premium work to them after it takes effect. This problem can be overcome by increasing the salaries only of the affected employees. And salaries could conceivably be reduced if the conditions for granting them no longer exist. Since varying salary levels in this way is a somewhat unorthodox move, it should be reviewed by legal counsel to ensure compliance.

It would be unnecessary to vary salaries in the same way for attendance and safety bonuses, as their eligibility is not tied to shift assignments and

particular days of the week employees are scheduled to work, as are shift and Sunday premiums.

- Use fixed schedule pay system and reduce base salary. Another option that preserves their salaried status is to pay them a true 1.5 overtime premium, as under the fixed schedule concept, and reduce their base salaries to compensate for these improvements, to keep their overall pay approximately the same. This change should be reviewed by counsel to ensure that it is consistent with the payment of additional premiums, as employees would continue to work an irregular schedule.

One potential disadvantage for employees is that some would have their salaries reduced even though they never worked overtime. And unless overtime opportunities can be evenly distributed after salaries are reduced, they would be unable to make up for the loss of base salary. In similar circumstances, IBM provided a one-time transition payment to make up for the difference. Additionally, overtime opportunities in general might decline in the future to negatively affect all employees' ability to make up for the loss in base pay.

- Convert employees to hourly status. Where salaried status does not have high value and employee relations are not a concern, an employer could convert these employees to an hourly status and pay them a lower base hourly rate than their salary provides. This action would recognize their eligibility to receive a true 1.5 overtime pay rate for all hours of work over 40, as well as receive additional premiums and bonuses. In evaluating this option, consideration must be given to any loss of prestige, employee benefits, and other rewards that go with hourly employment, as well as the uncertainty of overtime opportunities.

## FINAL THOUGHTS

This change in DOL guidance underscores the importance to compensation professionals of staying abreast of regulatory developments to avoid embarrassing and costly missteps in paying employees. For many compensation professionals, regular communication and consultation with legal counsel will be a prudent step for staying out of hot water, especially when it comes to the controversial FWW method of pay that has a history of being affected by political forces. ■

**Author's Note:** This article was prepared as general information and is not meant to provide legal advice with respect to any specific matter and should not be acted upon without professional counsel.

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