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The U.S. Department of Labor updates the definitions of overtime-exempt, white-collar employees in an evolutionary rather than revolutionary manner, leaving continuing challenges regarding the appropriate classification of employees as overtime exempt or non-exempt.

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## The Department of Labor's Revised White-Collar Regulations — A New Focus in an Uncertain Arena

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### UPDATE: May 28, 2004

The U.S. House of Representatives twice this month voted to table a non-binding resolution instructing House conferees to adopt an approach similar to the Senate's restrictions on the Department of Labor's white collar regulations. If the Republican leadership in the House maintains control of such procedures, Democratic attempts to restrict the regulations may never reach the White House for the President's signature or veto.

The United States Department of Labor has issued final regulations which make across-the-board changes in the definition of overtime-exempt, white-collar employees. These are the first such changes to be made since 1949 in the definition of overtime-exempt employees under the Fair Labor Standards Act. The changes, which are slated to take effect August 23, 2004, are substantially reduced in scope from those first proposed on March 23, 2003. The reduction in scope, which may (or may not) cool Congressional attempts to limit changes and diminish prospects for any successful court challenge, makes the changes much more a matter of degree than of kind.

### Changes from the Proposed Regulations to the Final Regulations

Principal changes from the proposed regulations to the final regulations include:

- Increasing the salary or fee necessary to be an overtime-exempt executive, administrative or professional employee from \$425 to \$455 per week (\$23,660 per year),
- Increasing the amount of compensation necessary to be exempt as a highly-compensated employee from \$65,000 per year to \$100,000 per year,

- Eliminating the special exemption for executive employees who are in sole charge of an establishment,
- Eliminating the "position of responsibility" and related requirements for exempt administrative employees,
- Restoring the use of "independent judgment and discretion" as a requirement to be an exempt administrative or professional employee,
- Restoring the requirement that exempt administrative work be "directly" related to management policies or general business operations, and
- Re-imposing the requirement that the jobs of exempt professional employees require, essentially, four years of college education.

### The Final Regulations

The final definitions of exempt employees and their relationship to the former definitions are discussed below. In reviewing and applying the exemptions, it is important to bear in mind that all employees are presumed to be entitled to overtime. It is an employer's burden to prove that an employee is overtime exempt.

### Executive Employees

The basic requirements to be an overtime-exempt executive employee are little changed in substance but are somewhat changed in emphasis. An overtime-exempt executive employee must:

- Have as his or her primary duty management of the enterprise or of a customarily recognized department or subdivision of that enterprise,
- Customarily and regularly supervise two full time employees or their equivalent,

- Have the ability to hire or fire employees or be able to make recommendations which are given particular weight regarding hiring or firing or material changes in employees' status, and
- Be paid a salary of at least \$455 per week.

An individual who is a bona fide 20% owner of an enterprise and who is actively engaged in management of the business also qualifies as an overtime-exempt executive employee.

Although the basic requirements of the executive exemption are little changed, the explanatory regulations emphasize that the executive exemption is to extend to individuals who may perform a good deal of non-exempt work. An employee's "primary duty" is now defined for all the exemptions as an employee's "main, major or most important duty" in consideration of the job as a whole. A new provision clarifies the impact of the "concurrent" performance of exempt and non-exempt duties. The regulations emphasize that employees need not spend more than half of their time in work of an exempt nature in order to be overtime exempt. For example, assistant managers of retail stores may be overtime exempt if management is their primary duty, even if they spend more than half of their time in routine cashiering, stocking and customer service tasks.

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### Administrative Employees

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The new regulations leave the administrative exemption largely unchanged and the difficulties in applying the exemption largely unresolved. To be an exempt administrative employee, the employee must:

- Have as a primary duty the performance of office or nonmanual work directly related to the management or general business operations of the employer or the employer's customers,
- Exercise independent judgment and discretion with respect to matters of significance, and
- Be paid a salary or on a fee basis at a rate of \$455 per week or more.

The final regulations restore the requirement that an exempt employee's duties be "directly" related to management policies or general business operations. The elimination of the term "directly" in the proposed regulations would have diminished the distinction between exempt employees who "service" the business of the employer and those non-exempt employees who "produce" the products or services of the employer. Beginning in 1990, courts had found increasing numbers of employees who held responsible positions to

be non-exempt "production" employees. The new regulations do include "running" a business as exempt work and change the requirement that exempt work relate to management policies to a requirement that exempt work relate to management operations. But, the new regulations do not clarify how this may apply to employees such as production coordinators who have substantial responsibility for day to day operations. Drawing an appropriate distinction between "service" and "production" employees will continue to challenge employees, employers and the courts in the future.

The final regulations also restore the requirement, which was deleted in the proposed regulations, that an exempt administrative employee use "independent judgment and discretion." The proposed regulations had deleted the requirement as too imprecise and difficult to administer. In an attempt to clarify the continued use of this phrase, the final regulations provide a somewhat expanded description of the types of decisions which will entail the exercise of independent judgment and discretion. The duties which demonstrate the exercise of independent judgment and discretion include:

- The authority to formulate, affect, interpret, or implement management policies or operating practices,
- Carrying out major assignments in conducting operations,
- The authority to commit the employer in matters that have significant financial impact,
- The ability to waive or deviate from established policies and procedures without prior approval,
- The provision of expert advice,
- The investigation and resolution of matters of significance,
- And similar tasks.

Recognizing that the definition of exempt administrative tasks is still not clear, the regulations offer an illustrative list of "generally" exempt administrative positions. The list includes insurance claims adjusters, financial services employees, and human resources professionals, employees performing work in tax, auditing, marketing, quality control, and other specialty areas, and individuals who lead teams to complete major projects for the employer.

Academic administration employees are also overtime exempt if their primary duty is performing the administrative functions directly related to academic instruction or training

in educational establishments. Such exempt employees must now be paid on the same basis as other exempt administrative employees.

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### Professional Employees

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The exemption for learned professional employees, which was greatly broadened in the proposed regulations, has been returned to something approximating its previous scope. The exemption for artistic professional employees has been expanded slightly by the rearrangement of its terms. To be an exempt professional employee, an employee must:

- Have a primary duty which is the performance of work that:
- Requires knowledge of an advanced type in a field of science or learning customarily acquired through a prolonged course of intellectual instruction and study, or
- Requires invention, imagination, originality or talent in a recognized field of artistic or creative endeavor, and
- Be paid on a salary or a fee basis at a rate of \$455 per week or more.

Work "requiring advanced knowledge" means work that is predominantly intellectual in character and which requires the "consistent" exercise of independent judgment and discretion. Fields of "science and learning" are those areas of professional endeavor such as accounting, law, medicine, engineering and the like. These requirements were also found in the previous regulations.

Although many commentators urged the DOL to relax the requirement that professional employees have a particular academic degree, this recommendation was not adopted in the final rule. The hallmark of a learned professional's job is that the job cannot be performed without a directly related, four-year college degree. If the job can be performed without the requisite academic degree, the job will not be considered to be overtime exempt. Only the "occasional" exception is permitted for an employee with no degree who has attained the same knowledge and who performs the substantially the same work as degreed employees.

Under the new regulations, certified physician assistants, chefs, funeral directors, and certified athletic trainers who have attained specialized four-year degrees and registered nurses will be exempt if the other requirements of the learned professional exemption are met. For example, a degreed chef may be an exempt learned professional if the chef regularly creates unique dishes.

Paralegals are generally considered to be non-exempt employees under the new regulations.

Teachers in school systems and educational establishments continue to be overtime exempt learned professionals.

There is no minimum compensation requirement for overtime-exempt teachers, doctors and attorneys.

The work of artistic professionals is distinguished by the need to use the prescribed “invention, imagination, originality or talent” in a field of artistic endeavor. If a job can be performed by an individual with skill and general manual training, the job is non-exempt. Exempt employees are generally given no more than the general subject matter of their undertaking and must use their creative ability to produce the final result. The determination of whether an individual exercises sufficient “invention, imagination, originality or talent” must be made on a case-by-case basis. For example, journalists who merely record community events will not be exempt; journalists who analyze public events or who provide editorial comment may be exempt. The new definition of an artistic professional is, arguably, somewhat broader than the previous definition, which required the work of an artistic professional to be both “original and creative.”

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### Computer Professionals

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The exemption for computer professionals has been streamlined. In order to be exempt, computer professionals must:

- Have as a primary duty:
  - The application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software or system functions,
  - 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,
  - The design, documentation, testing, creation or modification of computer programs related to machine operating systems, or
  - A combination of the above, which requires the same level or skill, and
- Be paid a salary of \$455 per week or more or be paid at a rate of \$27.63 per hour or more.

The exemption includes only employees who perform fairly high level systems analysis and programming work. The final regulation does eliminate some qualifications to the previous exemption, such as the previous requirement

that exempt employees have a “practical and theoretical” knowledge of computer systems and perform work that requires the “consistent exercise of independent judgment and discretion.” Employees who use computers to perform work, who work closely with programs but who do no programming, or who manufacture or repair computers are not overtime exempt. The revised exemption does little to alter recent DOL advice letters that had concluded some systems administrators were not exempt computer professionals.

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### The Outside Sales Exemption

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The outside sales exemption has been amended to eliminate the previous requirement that an exempt employee spend not more than 20% of a workweek in work unrelated to the employee’s own outside sales. In order to be an exempt outside salesperson, an employee now must:

- Have a primary duty of making sales or obtaining orders for services or the use of facilities for which consideration will be paid, and
- Customarily and regularly be engaged in such work away from the employer’s premises.

The distinction between an employee’s exempt sales work and an employee’s non-exempt promotion of others’ sales is continued by the new regulations. The distinction between exempt and non-exempt driver salespersons has been clarified.

Although urged in the comments to the proposed regulations, the final rule does not add an exemption for inside sales employees. Only inside sales employees in traditional retail and service establishments which meet the day to day needs of the general public can be classified as exempt, and then only if they meet particularized compensation requirements.

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### Highly Compensated Employees

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Under this new test, white-collar employees earning \$100,000 a year or more in “total compensation” will be exempt if they:

- Are paid a salary of at least \$455 per week,
- Are paid at least \$100,000 per year, including salary, commissions, non-discretionary bonuses and other non-discretionary income, but excluding benefits,
- Perform office or non-manual work, and
- Customarily and regularly perform one or more of the duties required of an exempt executive, administrative, or professional employee.

Employees who are engaged in computer and

outside sales occupations cannot qualify for the highly-compensated-employee exemption.

The increase in the minimum amount of compensation needed to be an exempt, highly compensated employee from \$65,000 to \$100,000 will limit the impact of this new provision. The \$100,000 annual can be prorated for incomplete initial and final years of employment, but cannot be prorated for leaves of absence. Employers may make a one-time make-up payment within a month after the end of a year or the end of the employment if the employee did not earn income that was expected to exceed \$100,000 for the year.

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### Changes to the Salary Basis Requirement

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The salary basis test has been updated to provide much-needed guidance regarding permissible deductions from salaries and the effect of making impermissible deductions. An employee must be paid his or her salary for any week in which the employee does any work, subject to the following exceptions:

- Docking is permitted for absences of one or more full days for personal reasons, other than sickness or disability.
- Docking is permitted for absences of one or more full days due to sickness, if there is a plan for providing compensation for such absences in place. If such a plan is in place, docking may occur before an employee is eligible for plan benefits or after plan benefits are exhausted.
- Deductions of any type may be made for violations of major safety rules.
- Docking is permitted for suspensions of one or more full days for the violation of written workplace conduct policies that are applied to all employees, such as rules against sexual harassment and workplace violence.
- Docking is not permitted for partial-week absences due to military, jury or witness duty, but the fees for such service in a given week may be offset against the salary due for the absence in that week.
- Docking is not permitted for partial-week absences due to the operating requirements of the employer, such as a lack of work.
- Docking is permitted in order to pro-rate a salary in proportion to the time actually worked during the first and last weeks of employment.
- Docking is permitted to pro-rate a salary in proportion to full day or partial-day unpaid leave taken pursuant to the Family and

Medical Leave Act.

Where an actual practice of making inappropriate deductions exists, employees will lose their exempt status. The proposed regulations specify that an actual practice of making deductions is to be judged by the number of affected employees, their location, the frequency of improper deductions, the existence of a salary pay policy and the like. A failure to pay a salary will, however, only affect the exempt status of employees who work in the business unit which made impermissible deductions.

The new salary pay rule also contains a “safe harbor,” which allows employers to correct some failures to pay the compensation necessary to maintain an employee’s exempt status. Failures to pay the required salary can be remedied if:

- The employer has a written policy stating that exempt employees’ pay will not be docked in violation of the salary pay rules,
- Employees are given notice of this policy, and
- Employees are reimbursed for any inadvertent deductions.

It is important to note that the safe harbor will not be available if an employer continues to make improper deductions or fails to reimburse employees after receiving employee complaints.

**Impact of the New Regulations**

The new regulations will slightly relax the overtime exemptions, some more substantially than others. The increased minimum salary under the new regulations will also result in some employees who are currently treated as exempt becoming entitled to overtime. There is substantial disagreement as to the ultimate effect of the revised regulations.

At a minimum, employers across the nation will need to review the status of the more than 6.7 million salaried workers who earn between the current minimum salary level of \$155 per week (\$8,060 annually) and the new, increased minimum salary of \$455 per week (\$23,660 annually). Although employers may be skeptical, the DOL expects the clarified regulations to ease confusion over compliance obligations and, ultimately, to reduce employers’ litigation costs. Time will tell whether this prediction is borne out. In the short-term, there will likely be a new round of litigation as the validity of the exemptions is challenged and the limits of the new exemptions are tested. Moreover, at time of publication, the U.S. Senate had voted 52 - 47 to preclude any hourly employees from being reclassified as salaried under the new regulations. It remains

to be seen whether the Senate amendment will pass in the House of Representatives, survive a conference committee or face a threatened presidential veto.

The changes in federal law will undoubtedly make the classification of employees more complex because the changes in federal law will create conflicts with the existing overtime exemptions under state law. An employer must comply with both the FLSA and state law. Where a state has an overtime requirement and has more narrowly defined exemptions from the obligation to pay overtime, an employer must make sure that its employees meet the requirements of the state’s exemptions or pay the overtime required by state law. For example, Illinois recently passed legislation to specifically preserve its limited overtime exemptions regardless of the changes in the federal exemptions.

**What Your Company Should Do Now**

The 120-day period prior to the rules’ effective date provides employers with the opportunity to evaluate the impact of the new regulations on their organizations. As part of this review, employers should assess the following fundamentals for an effective compliance program:

- Assess the current salary levels of exempt employees to identify anyone who may lose exempt status under the \$455 per week salary threshold. For employees who do not meet the minimum salary pay requirement, decide whether to increase salaries or reclassify the employees as non-exempt. Make sure that employees whose salaries are increased meet all of the requirements of the new exemptions.
- Assess carefully the job duties of exempt employees who meet the \$455 per week salary threshold. Ensure that such employees are still exempt and adjust their status as necessary. Determine whether it is appropriate to classify any additional employees as exempt, given the somewhat broader scope of the new regulations.
- Implement a policy explaining the salary program for exempt employees. Include a mechanism for employees to raise and remedy salary pay concerns. Designate an individual to be responsible for salary pay administration. Make sure that the individual has the information and authority necessary to maintain compliance with the salary pay requirement.

This article is intended for informational

purposes only, and should not be construed as legal advice. Please contact employment law counsel to discuss the effect of the new FLSA regulations — or any law or regulation — on your particular organization.

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