



A COMPLIANCE GUIDE FOR THE NEW DOL OVERTIME REGULATIONS

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On April 20, 2004, the U.S. Department of Labor issued new final regulations that revise some of the longstanding rules governing overtime and minimum wage exemptions under the Fair Labor Standards Act ("FLSA"). The new regulations, which the DOL has dubbed the "Fair Pay Rules", will become effective on August 23, 2004, unless their implementation is blocked by Congress or in court. The DOL has posted the full text of the regulations along with some helpful "fact sheets" on their website at www.dol.gov. This article highlights the most important changes for employers.

Duties Tests for White Collar Exemptions

The FLSA contains numerous minimum wage and overtime exemptions, the most important of which are known as the "white collar exemptions." These exemptions apply to executive, administrative, professional, computer and outside sales employees whose work responsibilities satisfy certain "duties tests" set forth in the regulations. Historically, the regulations contained a "long test" and a "short test" for each white collar exemption; if a position satisfied the criteria in either test it could be considered exempt from the FLSA's minimum wage and overtime requirements. The new Fair Pay rules merge the long and shorts tests into one test for each of these exemptions. In addition, the new regulations increase the minimum weekly salary that must be paid to exempt executive, administrative and professional employees to \$455 per week (\$23,660 per year). The new duties tests for each white collar exemption are set forth below.

Executive Exemption

To qualify for the executive employee exemption under the Fair Pay rules, all of the following criteria must be met:

- ✓ The employee must be compensated on a salary basis at a rate not less than \$455 per week;
- ✓ The employee's primary duty must be managing the enterprise, or managing a customarily recognized department or subdivision of the enterprise;
- ✓ The employee must customarily and regularly direct the work of at least two or more other full-time employees or their equivalent; and
- ✓ The employee must have the authority to hire or fire other employees, or the employee's suggestions and recommendations as to the hiring, firing, advancement, promotion or any other change of status of other employees must be given particular weight.

The regulations provide the following examples of “management” functions that may be performed by an exempt executive employee: interviewing, selecting and training employees; setting and adjusting rates of pay and hours of work; directing the work of employees; maintaining production and sales records for use in supervision; evaluating employee performance; handling employee complaints; disciplining employees; planning the work; assigning work; determining techniques, materials and equipment to be used or merchandise to be bought or sold; planning and controlling the budget and monitoring legal compliance.

Administrative Exemption

To qualify for the administrative employee exemption, all of the following criteria must be met:

- ✓ The employee must be compensated on a salary or fee basis at a rate not less than \$455 per week;
- ✓ The employee’s primary duty must be the performance of office or non-manual work directly related to the management or general business operations of the employer or the employer’s customers; and
- ✓ The employee’s primary duty must include the exercise of discretion and independent judgment with respect to matters of significance.

Some examples of work “directly related to management or general business operations” are listed in the regulations as work in functional areas such as tax, finance, accounting, budgeting, auditing, insurance, quality control, purchasing, procurement, advertising, marketing, research, safety and health, human resources, employee benefits, labor relations, public relations, government relations, computer network, internet and database administration, legal and regulatory compliance. However, employees working in these areas must exercise discretion and independent judgment with respect to matters of significance in order to be exempt.

The Fair Pay Rules list the following positions as examples of jobs that may fall under the administrative employee exemption: insurance claims adjusters, financial service analysts, team leader on a major project, executive assistant or administrative assistant to a business owner or senior executive of a large business, human resources managers and purchasing agent.

Professional Exemption

The regulations recognize three general types of exempt professional employees – the learned professional and the creative professional. To qualify for the **learned professional** employee exemption, all of the following criteria must be met:

- ✓ The employee must be compensated on a salary or fee basis at a rate not less than \$455 per week (Note: This requirement does not apply to lawyers, physicians and teachers);
- ✓ The employee’s primary duty must be the performance of work requiring advanced knowledge, defined as work which is predominantly intellectual in character and which includes work requiring the consistent exercise of discretion and judgment;

- ✓ The advanced knowledge must be in a field of science or learning; and
- ✓ The advanced knowledge must be customarily acquired by a prolonged course of specialized intellectual instruction.

The phrase “field of science or learning” is defined in the new regulations to include law, medicine, theology, accounting, actuarial computation, engineering, architecture, teaching, physical, chemical and biological sciences, pharmacy and similar occupations.

The regulations give the following examples of occupations that may qualify for the exemption: registered or certified medical technologists, registered nurses, dental hygienists, physician assistants, accountants, chefs, athletic trainers, funeral directors and embalmers.

To qualify for the **creative professional** employee exemption, all of the following criteria must be met:

- ✓ The employee must be compensated on a salary or fee basis at a rate not less than \$455 per week;
- ✓ The employee’s primary duty must be the performance of work requiring invention, imagination, originality or talent in a recognized field of artistic or creative endeavor.

The regulations give the following examples of creative professional occupations that may qualify for the exemption: actors, musicians, composers, conductors, essayists, screen play writers and journalists.

Computer Employee Exemption

To qualify for the computer employee exemption, the following criteria must be met:

- ✓ The employee must be compensated **either** on a salary or fee basis at a rate not less than \$455 per week **or**, if compensated on an hourly basis, at a rate not less than \$27.63 an hour;
- ✓ The employee must be employed as a computer systems analyst, computer programmer, software engineer or other similarly skilled worker in the computer field performing the duties described below;

The employee’s primary duty must consist of:

- ✓ The application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software or system functional specifications;

- ✓ 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 aforementioned duties, the performance of which requires the same level of skills.

The Fair Pay regulations point out that this exemption is not intended to apply to employees engaged in the manufacture or repair of computer hardware and related equipment.

Outside Sales Exemption

To qualify for the outside sales employee exemption, all of the following criteria must be met:

- ✓ The employee's primary duty must be making sales (as defined in the FLSA), or obtaining orders or contracts for services or for the use of facilities for which a consideration will be paid by the client or customer; and
- ✓ The employee must be customarily and regularly engaged away from the employer's place or places of business.

There is no minimum salary requirement for the outside sales exemption.

Work that is incidental to making sales is also considered exempt. Such work includes incidental deliveries, collections, writing sales reports, updating sales or display catalogue, planning itineraries and attending sales conferences.

Drivers who deliver products and also sell such products may qualify as exempt under the outside sales exemption if the driver's primary duty is making sales. For example a driver who is the only sales contact between the employer and the customers visited, who calls on customers and takes orders and who is paid on the basis of products sold is likely to be exempt. On the other hand, a route driver whose primary duty is to transport products sold by the employer through vending machines and to keep such machines stocked would likely not qualify for the exemption. The regulations provide additional guidance on the distinction between exempt and non-exempt drivers who engage in sales.

Definition of Primary Duty

All of the exemptions discussed above only apply if an employee's "primary duty" is exempt in nature. This term is defined in the regulations as "the principal, main, major or most important duty that the employee performs." Several factors are considered when determining an employee's primary duty, including: (1) the relative importance of the exempt duties as compared with other types of duties; (2) the amount of time spent performing exempt work; (3) the employee's relative freedom from direct supervision; and (4) the employee's salary relative to wages paid to non-exempt employees who perform the types of non-exempt work that the exempt employee also performs. Employees who spend more than 50% of their time performing exempt duties will generally satisfy this requirement; however, the

regulations point out that an employee may satisfy the requirement even if performance of exempt duties account for less than one-half of the employee's work time.

Highly Compensated Employees and Business Owners

In order to fall under one of the white collar exemptions, an employee's "primary duty" must be exempt in nature. However, the Fair Pay regulations include a new exemption for "highly compensated" employees who "customarily and regularly" perform exempt duties, even though these duties may not constitute the employee's "primary duty." This exemption applies only to employees who earn at least \$100,000 per year, inclusive of salaries, commissions, bonuses, etc. and whose primary duty includes performance of office or non-manual work. To qualify for this exemption, the employee must be paid a fixed base salary of at least \$455 per week and must "customarily and regularly" perform white collar exempt duties. The new regulations define "customarily and regularly" as "normally and recurrently performed every workweek."

The new regulations further provide that the executive employee exemption will apply to any employee who owns at least a bona-fide 20% equity interest in an enterprise in which the employee is employed and who is actively engaged in management of the enterprise. Such individuals are exempt regardless of the amount of their salary.

Permissible Deductions from Salary

As a general rule, an employee must be paid on a salary basis to qualify for any of the white collar exemptions. Under the old regulations, an exempt employee's salary could not be subject to reduction due to variations in the quantity or quality of work performed. However, the old regulations contained several exceptions to this rule (e.g. deductions for full day absences due to personal reasons or for partial day absences covered by FMLA). The Fair Pay regulations retain many of these exceptions and add a new one. Under the new regulations, an employer may deduct an employee's salary for unpaid disciplinary suspensions of one or more full days imposed in good faith for infractions of written work rules that are applicable to all employees.

Safe Harbor for Salary Deductions

Employers who have a practice of making improper deductions from the salaries of exempt employees will generally lose the exemption for all employees subject to this practice during the period in which the improper deductions were made. However, the Fair Pay regulations point out that improper deductions that are either isolated or inadvertent will not result in loss of the exemption if the affected exempt employee is reimbursed for the amount that was improperly deducted. In addition, the new regulations create a "safe harbor" for employers that have a clearly communicated policy that prohibits improper pay deductions, which includes a complaint mechanism and which provides for reimbursement for any improper deductions. Employers with such policies will not lose an exemption based on impermissible deductions unless they willfully violate their policy and continue to make improper deductions after receiving employee complaints.

Additional Compensation for Exempt Employees

The Fair Pay regulations incorporate the DOL's longstanding position that an employer may pay additional compensation to an exempt employee (above his or her normal guaranteed salary) without jeopardizing the employee's exempt status. Such additional compensation may be paid on an hourly basis, as well as in the form of a commission or bonus.

A Compliance Plan for Employers

As noted above, the Fair Pay regulations are not scheduled to go into effect until August 23, 2004 and it is possible that the Department of Labor may be blocked from implementing parts of the regulations by Congress or in court. Nevertheless, prudent employers should begin to analyze how the regulations would affect them and whether revisions to their pay practices and policies are necessary. At a minimum, employers should take the following steps:

- ✓ Determine whether you have any exempt employees who are paid a salary of less than \$455 per week (\$23,660 per year). Once the regulations are in effect, such employees will either need to be treated as non-exempt or, to retain exempt status, be paid on a salary basis of at least \$455 per week.
- ✓ Determine whether you have any non-exempt employees who earn over \$100,000 per year. Review whether you are able to take advantage of the new exemption for highly compensated employees.
- ✓ Review payroll practices to ensure that salaried exempt employees are not subject to impermissible deductions.
- ✓ Develop, communicate and enforce a policy prohibiting impermissible deductions which meets all requirements of the "safe harbor" provision in the new regulations.
- ✓ Determine whether the revisions to the duties tests for the white collar exemptions impact your classification of any employees.
- ✓ Review and revise job descriptions to ensure that all positions which are classified as exempt are properly described as such.

We hope that this overview of the new Fair Pay regulations is helpful to you. Should you have any questions or concerns regarding the regulations, please contact any of the attorneys for additional information.