

CLIENT ALERT

SPRING 2004

FEDERAL FAIR LABOR STANDARDS ACT

Revised Regulations Take Effect August 23rd

The federal Department of Labor (“DOL”) recently issued revised regulations interpreting the Fair Labor Standards Act (“FLSA”). Under the FLSA, employees cannot be classified as exempt from minimum wage and overtime requirements unless they are guaranteed a minimum weekly salary and perform certain required job duties. These so-called “white collar” or “exempt employee” rules apply to executive, administrative, professional, computer and outside sales employees.

The DOL modified its prior regulations regarding these exempt employees with the stated goal of making them less confusing, complex and outdated. While some changes are technical, there are a number of major substantive changes. This Alert will briefly outline these major changes. We urge you to contact members of our Labor and Employment Law Department with any questions you may have.

It is important to keep in mind that state labor departments, such as Connecticut’s, also regulate wage and hour issues, including the status of exempt employees. Connecticut’s DOL has not yet issued any guidance on the potential impact of the new federal regulations.¹ Employers should bear in mind that, absent further guidance, they are required to apply the most protective provision of law, whether federal or state. In other words, whichever exempt employee regulations provide greater rights to an employee will apply, state or federal.

NOTE: These regulations will take effect on August 23, 2004.

I. Executive Exemption

To qualify for the federal executive employee exemption, all the following tests must be met:

1. The employee must be compensated on a salary basis² at a rate of not less than \$455 per week;
2. The employee’s primary duty must be managing the enterprise, or managing a customarily recognized department or subdivision of the enterprise;

3. The employee must customarily and regularly direct the work of at least two or more other full-time employees or their equivalent; and
4. 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 weight³.

The new regulations remove the prior limitation that an employee who devotes more than 20% (40% for employees in retail or service establishments) of his time to activities which are not directly and closely related to the performance of the above duties is not exempt from overtime pay. They also remove the prior “sole charge” rule.⁴ The new regulations include a special exemption for business owners: an employee who owns at least a bona fide 20% equity interest in the enterprise in which employed, regardless of the type of business organization, and who is actively engaged in its management, is considered an exempt executive.

II. Administrative Exemption

To qualify for the federal administrative employee exemption, all the following tests must be met:

1. The employee must be compensated on a salary or fee basis at a rate of not less than \$455 per week;
2. 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
3. The employee’s primary duty includes the exercise of discretion and independent judgment with respect to matters of significance⁵.

This test removes the prior provision that an employee who devotes more than 20% (40% for employees in retail or service establishments) of his time to activities which are not directly and closely related to the performance of the above duties is not exempt from overtime pay.

There are also updated examples of duties that fall under “work directly related to the management or general business operations.” Types of work that potentially qualify for exemption include, but are not limited to, tax; finance; accounting; budgeting; auditing; insurance; quality control; purchasing; procurement; advertising; marketing; research; safety and health; personnel management; human resources; employee benefits; labor relations; public relations; government relations; computer network, internet and database administration; legal and regulatory compliance; and similar activities. Additionally, the new regulations specifically provide exemption for most insurance claims adjusters.

The new regulations state that certain team leaders meet the administrative exemption test. The regulations exempt employees who lead a team of other employees assigned to complete major projects for the employer. Examples of these major projects include purchasing, selling or closing all or part of the business, negotiating a real estate transaction or a collective bargaining agreement, or designing and implementing productivity improvements. This new provision modifies the old regulations’ provision that applied the overtime exemption to “a wide variety of persons” who “carry out major assignments.”

III. Professional Exemption

To qualify for the federal professional employee exemption, all the following tests must be met:

A. Learned Professionals

1. The employee must be compensated on a salary or fee basis at a rate not less than \$455 per week;
2. 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;
3. The advanced knowledge must be in a field of science or learning; and
4. The advanced knowledge must be customarily acquired by a prolonged course of specialized intellectual instruction.

The new regulations give several examples of employees that fall under the learned professionals exemption (if they meet certification or academic requirements for their professions): medical technologists, registered nurses, dental hygienists, physician assistants, accountants, chefs, athletic trainers and funeral directors or embalmers.

B. Creative Professional Exemption

1. The employee must be compensated on a salary or fee basis at a rate of not less than \$455 per week;

2. 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.

One new provision for the creative professional exemption states that journalists may satisfy the duties requirements if their primary duty is work requiring invention, imagination, originality or talent, in contrast to merely collecting, organizing and recording information that is routine or already public, or if they do not contribute a unique interpretation or analysis to a news product.

C. Teachers

Teachers are exempt if their primary duty is teaching, tutoring, instructing or lecturing in the activity of imparting knowledge, and if they are employed and engaged in this activity as a teacher in an educational establishment. The salary and salary basis requirements of the regulations do not apply to teachers.

D. Practice of Law or Medicine

An employee holding a valid license or certificate permitting the practice of law or medicine is exempt if the employee is actually engaged in such a practice. The salary and salary basis requirements of the regulations do not apply to practitioners of law or medicine.

IV. Computer Employee Exemption

The salary requirement for computer employees continues to be slightly different than for other employees. To qualify, 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. Otherwise, the test for computer employee exemption remains unchanged from the previous law.

1. 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;
2. The employee’s primary duty must consist of:
 - a. The application of systems analysis technique and procedures, including consulting with users, to determine hardware, software or system functional specifications;
 - b. 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;
 - c. The design, documentation, testing, creation or modification of computer programs related to machine operating systems; or
 - d. A combination of the aforementioned duties, the performance of which requires the same level of skills.

V. Outside Sales Exemption

The salary requirements of the regulations do not apply to the outside sales exemption. To qualify for the outside sales employee exemption, the following test must be met:

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

The new regulation removes the prior restriction that outside sales employees who perform work unrelated to outside sales for more than 20% of the time worked by nonexempt employees of the employer are not exempt.

VI. Highly Compensated Employees

The regulations create a new exemption category for so-called "highly compensated" employees. To qualify for the highly compensated employee exemption the following test must be met;

1. The employee must receive total annual compensation of \$100,000 or more (which must include at least \$455 per week on a salary or fee basis);
2. The employee must perform office or non-manual work, and customarily and regularly perform at least one of the duties of an exempt executive, administrative or professional employee (as set out in the standard tests for those exemptions, see above).

VII. Deductions From Salary

Deductions from salary for absence from work generally remain improper except in limited circumstances. These are unchanged from the prior regulations, except for a new regulation allowing deduction for unpaid disciplinary suspensions of one or more full days imposed in good faith for workplace conduct rule infractions, a much broader rule than the prior one⁶.

The employer will lose the exemption if it has an "actual practice" of making improper deductions from salary. Factors to consider whether a deduction is improper include:

1. The number of improper deductions;
2. The time period during which the employer made improper deductions;
3. The number and geographic location of both the employees whose salary was improperly reduced and the managers responsible; and
4. Whether the employer has a clearly communicated policy permitting or prohibiting improper deductions.

The new regulations provide a "Safe Harbor" for an employer who has made an improper deduction. If an employer (1) has a clearly communicated policy⁷ prohibiting improper deductions and including a complaint mechanism, (2) reimburses employees for any improper deductions, and (3) makes a good faith commitment to comply in the future, the employer will not lose the exemption for any employees unless the employer willfully violates the policy by continuing the improper deductions after receiving employee complaints.

VIII. Blue-Collar Workers

Finally, the new regulations make clear that the exemptions above do not apply to manual laborers or other "blue-collar" workers who perform work involving repetitive operations with their hands, physical skill and energy. Examples set out in the new regulations include carpenters, electricians, mechanics, plumbers, iron workers, craftsmen, operating engineers, longshoremen, construction workers and laborers. Additionally, police officers, fire fighters and other first responders are not exempt under the FLSA.

¹In some states the law is expected to change automatically, since they do not have their own generally applicable overtime laws or those laws automatically incorporate the federal approach to exempt employee status. Other states are likely to proceed with combinations of state/federal requirements or will not automatically change. We urge you to contact counsel to discuss concerns regarding the laws in specific states.

²The new federal regulations have retained the fundamental salary basis requirements, and therefore an exempt employee must receive "each pay period on a weekly, or less frequent basis, a predetermined amount constituting all or part of the employee's compensation, which amount is not subject to reduction because of variations in the quality or quantity of the work performed."

³The new regulations say that "factors to be considered" in determining whether or not the executive's suggestions and recommendations are given particular weight include (but are not limited to) the following: whether it is part of the executive's job to make such suggestions/recommendations, the frequency with which such suggestions/recommendations are made or requested, and the frequency with which the executive's suggestions/recommendations are relied upon.

⁴Under the sole charge rule, an employee was not subject to the 20/40 percent limitations if he or she was "in sole charge of an independent establishment or a physically separate branch establishment."

⁵The new regulations state that "matters of significance" refers to "the level of importance or consequence of the work performed." Factors will include whether the employee has authority to formulate, affect, interpret or implement management policies or operating policies, carries out major assignments in conducting operations of the business, performs work that affects business operations to a substantial degree, whether the employee has authority to commit the employer in matters that have significant financial impact and, whether the employee has authority to waive or deviate from established policies and procedures without prior approval.

⁶The prior regulation referred to violations of a safety rule of major significance.

⁷The new regulations state that the "best evidence" of a clearly communicated policy is a "written policy" the employer distributed before any improper deductions, for example by providing it at time of hire, or in an employee handbook, or posting it on the employer's Intranet.