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## Nixon Peabody's Summary of Final "White Collar" Overtime Regulations Now Available

At the end of April, the Department of Labor (DOL) published final regulations redefining the "white collar" exemptions under the Fair Labor Standards Act (FLSA). For the first time in over fifty years, the DOL has modernized the standards for determining whether executive, administrative, professional, outside sales, or computer employees are exempt from the FLSA's minimum wage and overtime requirements. These changes will require employers to reevaluate the FLSA status of their employees under a new set of rules before the regulations go into effect on August 23, 2004.

The regulations have sparked significant controversy in Congress, and the Senate has already passed a bill that would prevent certain of their provisions from going into effect. Nixon Peabody's Wage-Hour team has been monitoring these developments closely, and despite the Senate's best efforts, it now appears likely that the regulations will go into effect as scheduled on August 23.

Nixon Peabody's Wage-Hour team has prepared a summary for our clients detailing the changes in the new "white collar" regulations. Some highlights of the changes include an increase in the "salary level test" to \$455 per week and the creation of a new test for "highly compensated employees" earning at least \$100,000 in total annual compensation. The final rule has streamlined the existing "long" and "short" "duties tests" found in the current regulations into a single "standard" duties test for each exemption. The final rule has also updated the "salary basis test" to allow employers to make deductions from exempt employees' pay for unpaid disciplinary suspensions, to decrease the penalties for those employers who make impermissible deductions, and to create a new "safe harbor" for those employers who promulgate a policy prohibiting impermissible pay deductions.

Our summary outlines these changes and more. It also covers the status of the pending political debate and provides practical advice regarding what employers should start doing now to prepare for the August implementation.

## Background and Overview of the Regulations

The Fair Labor Standards Act (FLSA) exempts from both minimum wage and overtime requirements “any employee employed in a bona fide executive, administrative or professional capacity...or in the capacity of outside salesman.” The Fair Labor Standards Act does not define the terms “executive,” “administrative,” “professional,” or “outside salesman,” but has delegated the authority to define those terms to the DOL through its implementing regulations.

On April 23, 2004, the DOL officially released its long-awaited final regulations defining the executive, administrative, professional, outside sales, and computer employee exemptions. The new regulations are intended to modernize and update the “white collar” exemptions under the FLSA, and do not address any other provision of that statute. The regulations are scheduled to go into effect on August 23, 2004.

Under both the existing and the final regulations, employees must satisfy three separate tests for the exemption to apply: (1) the amount of the employee’s salary must meet minimum specified amounts (the “salary level test”); (2) the employee’s job duties must primarily involve executive, administrative, professional, computer, or outside sales duties as defined by the regulations (the “duties tests”); and (3) the employee must be paid a predetermined and fixed salary that is not subject to deductions because of variations in the quantity or quality of work performed (the “salary basis test”). The DOL last updated the duties tests in 1949 and the salary levels in 1975. The DOL’s new final regulations revise and update all three tests.

Some highlights of these changes include an increase in the “salary level test” to \$455 per week, (\$300 more per week than the current minimum salary level for exemption), and the creation of a new test for “highly compensated employees” earning at least \$100,000 in total annual compensation. The regulations have streamlined the existing “long” and “short” “duties tests” found in the current regulations into a single “standard” duties test for each exemption. The regulations have also updated the “salary basis test” to allow employers to make deductions from exempt employees’ pay for unpaid disciplinary suspensions, and to decrease the penalties for those employers who make impermissible deductions. In addition, the regulations provide a new “safe harbor” for those employers who promulgate a policy prohibiting impermissible pay deductions.

The DOL has also made structural and definitional changes throughout the regulations, with the goal of streamlining regulatory text, reducing unnecessary duplication, and making the regulations easier to understand and apply to particular factual situations. The DOL has eliminated the distinction between the “exemptions” in Subpart A and the “interpretations” in Subpart B of the current regulations, has replaced outdated and uninformative examples with modern interpretations, has updated the definitions of key terms and phrases, and has consolidated provisions relevant to more than one exemption into common sections to eliminate unnecessary repetition.

The DOL published its proposed rule and request for comments on March 31, 2003. The DOL received 75,280 comments during the official comment period, over ninety percent of which were from organizations affiliated with the AFL-CIO expressing general opposition to the proposal.

In the final rule, the DOL dedicates a substantial portion of the preamble as well as several new substantive sections to responding to misleading attacks by union opponents. The new regulations now explicitly state that “blue collar workers” and “first responders” must be paid overtime compensation, no matter how highly paid they might be. The regulations further clarify that FLSA protections cannot be waived or reduced in collective bargaining agreements, and that nothing in the FLSA or the regulations relieves employers from their contractual obligations under such agreements.

Only approximately six hundred of the comments the DOL received included any substantive analysis of the proposed revisions, but it appears that the DOL gave serious consideration to those comments and has responded with some significant changes from the proposed rule. The DOL retreated from some of its more innovative proposals, such as its plan to replace the oft-litigated “discretion and independent judgment” prong of the administrative duties test with a requirement that the employee hold a “position of responsibility.” Likewise, the DOL severely curtailed its new exemption for “highly compensated employees” by raising the level of total annual compensation required for this exemption from \$65,000 to \$100,000. Under pressure from veterans’ advocates, the DOL also deleted language from the professional exemption clarifying that it is available to employees working in learned professions who have substantially the same knowledge as degreed employees, but who attained such knowledge through a combination of work experience, training in the armed forces, attending a technical school or community college, or other intellectual instruction.

While they did not turn out to be the panacea that employers had hoped for, the final regulations do move in the direction of clarifying the requirements for exempt status and providing employers with tools to protect themselves from costly litigation. A detailed analysis of the changes follows.

### Revised Salary Level Test

The final regulations increase the minimum salary level test, below which all workers are entitled to overtime, from \$155 per week (\$8,060 per year) to \$455 per week (\$23,660 per year). Under the final rule, employees who earn a salary of less than \$455 per week are nonexempt and guaranteed overtime, regardless of their job duties. The DOL’s accompanying comments clarify that this amount is not prorated for employees who work on a part-time basis.

### New Highly Compensated Employee Exemption

The regulations also create a new exemption for those employees who are considered “highly compensated.” Employees who receive total annual compensation of at least \$100,000, including commissions and nondiscretionary bonuses but excluding employer contributions toward insurance or retirement benefits, may be eligible for the exemption. To qualify, such employees must also be paid at least \$455 per week on a salary or fee basis, perform office or nonmanual work, and must “customarily and regularly perform at least one of the duties from the executive, administrative, or professional duties tests.”

The \$100,000 amount may be prorated if an employee is employed for only part of a calendar year, but cannot be prorated if the employee takes leave without pay (such as family and medical leave). The final regulations also provide employers the ability to pay employees a “catch-up payment” within one month of the end of year, or within one month of when the employee terminates employment, to bring the employee’s total annual compensation up to \$100,000.

### Revised Duties Tests

The final regulations have replaced the existing “long” and “short” duties tests with a single “standard” duties test for each exemption. Currently, the long duties test applies if an employee’s earnings are above \$155 per week (\$170 per week for professional and computer employees) but less than \$250 per week. However, due to the outdated salary level requirements (which have not been increased since 1975), the “long” duties tests have, as a practical matter, become dormant for some time. Today, a full-time minimum wage worker earns \$206 per week, which well exceeds the existing long duties test level, and which is approaching the existing short duties test level. As a result, most employees today are tested for exemption under the short duties test.

In some cases, the DOL's new standard duties tests have combined elements from the existing long and short tests, making the regulations more protective of employees than in the recent past. In other cases, the standard duties tests reflect only nuanced modifications to the current short test, and may actually result in more employees becoming exempt. The changes to each exemption contained in the final rule are detailed below.

## Executive Exemption

The final rule will make it somewhat more difficult for employees to qualify as exempt executives. In creating a standard duties test, the DOL retained the requirement from the former long test that the executive must have authority to hire or fire other employees or that the executive's recommendations as to hiring, firing, promotion, or other change of status of other employees are given particular weight. Because the long test has for all intents and purposes been defunct for a number of years, this decision effectively adds a new requirement for employees to achieve exempt executive status.

The resulting duties test for the executive exemption may be summarized as follows:

- The employee must be compensated on a "salary basis" at a rate not less than \$455 per week.
- The employee must have a "primary duty" of managing the enterprise or 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 the equivalent).
- *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 final regulations discuss factors to be considered in determining whether an employee's recommendations regarding hiring, firing, advancement, promotion, or any other change of status are given "particular weight." Among the factors cited are whether it is part of the employee's job duties to make such recommendations, the frequency with which such recommendations are made or requested, and the frequency with which they are relied upon. Generally, the recommendations must pertain to employees whom the executive customarily and regularly directs. Even if a higher level manager's recommendation has more importance and even if the employee does not have authority to make the ultimate decision as to the employee's change in status, an employee's recommendations may still be deemed to have "particular weight."

While the final rule does not define "change of status," the DOL's accompanying comments indicate that this term has the same meaning as "tangible employment action" in the context of Title VII liability. In *Burlington Industries, Inc. v. Ellertb*, 524 US. 742 (1998), the Supreme Court defined that term to mean "a significant change in employment status, such as hiring, firing, failing to promote, reassignment with significantly different responsibilities, or a decision causing a significant change in benefits."

The final rule also expands the list of duties considered "managerial," adding to the list such duties as planning and controlling the budget and monitoring or implementing legal compliance measures.

The regulations also address situations in which supervisory employees concurrently perform exempt and nonexempt work, and provide that concurrent performance will not disqualify an employee from the exemption if the employee otherwise satisfies the salary and duties tests. The DOL distinguishes exempt from nonexempt employees in these circumstances by indicating that "exempt executives make the decision regarding when to perform nonexempt duties and remain responsible for the success or failure of business operations under their management while performing nonexempt work," whereas nonexempt employees are typically "directed by a

supervisor to perform the exempt work or [perform] the exempt work for defined time periods.” By way of example, the regulations distinguish assistant managers in a retail establishment, who may serve customers, cook food, or stock shelves while supervising employees at the same time, from relief supervisors, who occasionally have responsibility for directing the work of other employees when the supervisor is unavailable.

Other changes to the rule include the elimination of the special rules for exemption of “sole charge executives,” and the addition of the requirement that an employee who owns a twenty percent equity interest in the employing enterprise is considered an exempt executive only if the ownership interest is “bona fide” and only if the employee is “actively engaged” in the management of the enterprise.

## Administrative Exemption

Although the proposed regulations indicated the DOL was eliminating the confusing “discretion and independent judgment test” from the administrative exemption and replacing it with a test for whether the employee holds a “position of responsibility,” the DOL changed course in the final regulations and heeded comments essentially warning that it is better to deal with the proverbial devil you know than the one you don’t. In creating a new standard test for exemption, the DOL kept the discretion and independent judgment prong of the administrative duties test in place but adopted the less stringent version contained in the short test. This version requires only that the employee’s primary duty “include” the exercise of discretion and independent judgment, in contrast to the long test’s requirement that the employee “customarily and regularly” exercise discretion and independent judgment. The DOL also added language to clarify that discretion and independent judgment must be exercised “with respect to matters of significance,” a requirement that has long been part of the DOL’s interpretation of the exemption.

The resulting duties test for the administrative exemption may be summarized as follows:

- 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 nonmanual work directly related to the management or general business operations of the employer or the employer’s customers.
- The employee’s primary duty *includes* the exercise of discretion and independent judgment *with respect to matters of significance*.

The regulations also provide an updated explanation of what it means to have a primary duty “directly related to the management or general business operations of the employer.” To satisfy the requirement, employees must perform work directly related to assisting with the running or servicing of the business, as distinguished, for example, from working on a manufacturing production line or selling a product in a retail or service establishment. The DOL’s new examples of such work include a number of functional areas such as tax, finance, accounting, budgeting, auditing, insurance, quality control, purchasing, procurement, advertising, marketing, research, safety and health, human resources, public relations, government relations, computer network, Internet and database administration, and legal and regulatory compliance. The official comments indicate that the DOL plans to deemphasize the “administration versus production” dichotomy that has traditionally been applied in determining whether work relates to management or general business operations, although it is still unclear to what extent it will be deemphasized or what the practical effect will be.

The final regulations also emphasize that an employee may qualify for the administrative exemption if the employee’s primary duty is the performance of work directly related to the management or general business operations of the employer’s *customers*. Thus, employees acting as advisors or consultants to their employer’s clients or customers—such as tax experts or financial consultants—may qualify for the exemption.

The regulations also contain a definition and list of factors to consider when determining whether an employee satisfies the test for “discretion and independent judgment with respect to matters of significance.” In general, the exercise of “discretion and independent judgment” involves the comparison and the evaluation of possible courses of conduct and acting or making a decision after the various possibilities have been considered. The term implies that the employee has authority to make an independent choice, free from immediate direction or supervision, but the fact that an employee’s decisions are revised or reversed after review does not mean that the employee is not exercising discretion and independent judgment. The term “matters of significance” refers to the level of importance or consequence of the work performed. An employee does not exercise discretion and independent judgment with respect to matters of significance merely because the employer will experience financial losses if the employee fails to perform the job properly.

Among the factors listed for determining whether an employee satisfies this test are: (1) whether the employee has authority to formulate, affect, interpret, or implement management policies or operating practices; (2) whether the employee carries out major assignments in conducting the operations of the business; (3) whether the employee performs work that affects business operations to a substantial degree (even if the employee’s assignments relate to the operations of a particular segment of the business); (4) whether the employee has authority to commit the employer in matters that have significant financial impact; (5) whether the employee has authority to waive or deviate from established policies and procedures without prior approval; (6) whether the employee has authority to negotiate and bind the company on significant matters; (7) whether the employee provides consultation or expert advice to management; (8) whether the employee is involved in planning long- or short-term business objectives; (9) whether the employee investigates and resolves matters of significance on behalf of management; and (10) whether the employee represents the company in handling complaints, arbitrating disputes, or resolving grievances. In the preamble to the final regulations, the DOL explained that employees who meet at least two or three of these factors generally exercise discretion and independent judgment.

The regulations also clarify that employees who use manuals, guidelines, or established procedures may be exempt if the manuals contain “highly technical, scientific, legal, financial, or similarly complex matters that can be understood or interpreted only by those with advanced or specialized knowledge or skills.” In contrast, employees who use manuals to apply well-established techniques or to identify specific directions for use in routine circumstances will generally be nonexempt.

The final rule also contains a number of updated examples describing how the administrative exemption is to be applied. The examples specifically address occupations including insurance claims adjusters, financial services employees, team leaders, executive assistants, human resources managers, purchasing agents, inspectors, and administrators in an educational institution.

## Learned Professional Exemption

The changes to the definition of the learned professional exemption are subtle and nuanced. The more significant changes to this exemption can be found in the discussion of how the exemption will be applied to specific occupations.

To qualify for the learned professional employee exemption under the final rule, the following tests 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 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.
- The advanced knowledge must be customarily acquired by a prolonged course of specialized intellectual instruction.

In the preamble, the DOL notes that the “consistent exercise of discretion and judgment” standard under this exemption is less stringent than the “includes work requiring the exercise of discretion and *independent* judgment” standard under the administrative exemption.

In the proposed rule, the DOL had used language clarifying that employees may sometimes acquire the advanced knowledge required for this exemption through means other than a formal degree, such as through an equivalent combination of intellectual instruction and work experience through training in the armed forces, attending a technical school, attending a community college, or other intellectual instruction. The wording of the proposed regulations set off a firestorm response from veterans’ groups, who feared that the new language would cause them to lose their right to overtime.

As a result, the DOL removed the controversial language from the final rule, but its comments suggest that the original intent remains unchanged. The regulations do indicate that employees working in a “field of science or learning” without a formal degree in that field may still qualify as an exempt professional. The rule clarifies that the occupation must be in a field of science or learning where specialized academic training is a standard prerequisite for entrance into the profession, and that employees within such a learned profession only qualify for the exemption if they either possess the advanced degree or “have substantially the same knowledge level and perform substantially the same work as the degreed employees, but...attained the advanced knowledge through a combination of work experience and intellectual instruction.” Thus, the exemption is available to the occasional lawyer who did not go to law school, or the occasional engineer who completed some coursework but does not possess a degree in engineering. This clarification does not expand the exemption to quasi professional fields.

This provision recognizes that some employees, occasional though they may be, have the same knowledge level and perform the same work as degreed professionals but obtained that knowledge through a nontraditional path. The regulations ensure that employees performing the same work and who meet other requirements for exemption are treated equally. This concept is not altogether new, but it is now clearer than in the existing regulations.

Even more significant than the definitional changes are the changes contained in the examples applying this exemption. The final rule outlines specific criteria for exempting employees including medical technologists, registered nurses, dental hygienists, physician assistants, accountants, chefs, paralegals, athletic trainers, funeral directors and embalmers, and teachers. While some of the examples are designed to reflect the existing DOL interpretations and case law, other examples, such as those discussing athletic trainers, represent a complete turnaround in the DOL’s position on the exempt status of the profession.

## Creative Professional Exemption

The language defining the creative professional exemption has been modified slightly, but the DOL’s comments indicate that no changes from the existing regulations are intended.

To qualify for the creative professional employee exemption under the final rule, all of the following tests 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, as opposed to work that can be produced by a person with general manual or intellectual ability and training.

This exemption distinguishes the creative professions from work that primarily depends on intelligence, diligence, and accuracy. Exemption depends on the extent of the invention, imagination, originality, or talent exercised by the employee, and is determined on a case-by-case basis. Just as in the existing regulations, the requirements of this exemption are generally met by actors, musicians, composers, soloists, certain painters, writers, cartoonists, essayists, and novelists.

The final regulations contain an updated discussion of the application of this exemption to journalists, which is intended to reflect the current state of the case law. The discussion indicates that journalists are not exempt if they only collect, organize, and record information that is routine or already public, or if they do not contribute a unique interpretation or analysis to a news product. Journalists generally satisfy the exemption, however, if their primary duty is performing on the air in radio, television, or other electronic media, conducting investigative interviews, analyzing or interpreting public events, writing editorials, opinion columns, or commentary, or acting as a narrator or commentator.

## Computer Employee Exemption

In the final rule, the computer employee exemption has been streamlined and simplified.

Due to its unusual legislative history, the computer employee exemption is currently defined by two separate duties tests, with two different earnings requirements. The first test originated in 1990 when Congress directed the DOL to issue regulations permitting computer systems analysts, computer programmers, software engineers, and other similarly skilled professional workers to be exempt employees under Section 13(a)(1) of the FLSA. In response, the DOL drafted regulations describing a duties test for computer employees to qualify for the professional exemption. In 1996, however, Congress enacted separate legislation defining a special computer employee exemption. Codified as FLSA Section 13(a)(17), the legislation adopted most—but not all—of the DOL’s regulatory language defining the computer employee exemption, and adopted an earnings requirement of \$27.63 per hour. The 1996 statute did not include a delegation of rulemaking authority to the DOL to further interpret the exemption, nor did it repeal the 1990 statute.

In the final regulations, the DOL has concluded that it is inappropriate, confusing, and unwieldy to continue the two separate definitions for computer employees. As a result, the DOL has adopted the Section 13(a)(17) duties test as the standard duties test for computer employees. This change makes the 13(a)(17) test applicable not only to those computer employees who earn \$27.63 on an hourly basis (\$57,470 per year for a full-time employee) but also to those who earn \$455 per week on a salary basis (\$23,660 per year).

The most significant effect of this change is that employees will no longer have to satisfy the requirement that they “consistently exercise discretion and judgment” in order to qualify for the computer employee exemption. Currently, only those computer employees earning at least \$27.63 per hour are excused from this requirement.

Thus, to qualify for the computer employee exemption under the final rule, the following tests 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
  1. the application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software or system functional specifications;
  2. 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;
  3. the design, documentation, testing, creation or modification of computer programs related to machine operating systems; or
  4. a combination of the aforementioned duties, the performance of which requires the same level of skills.

Furthermore, the final regulations clarify that many highly skilled employees working in the computer and information technology fields may also qualify for exempt status under the administrative exemption. The final regulations explicitly acknowledge that employees who work in functional areas such as computer network, Internet, and database administration are exempt administrators, so long as their primary duty includes the exercise of discretion and independent judgment with respect to matters of significance. As a result, network, LAN, and database analysts and developers, Internet and network administrators, and other employees with similar duties are likely to satisfy criteria under the administrative exemption.

The regulations also note that the use of manuals by these employees containing highly technical, scientific, or complex information will not necessarily defeat exempt status.

## Outside Sales Exemption

The outside sales exemption has also been simplified, and the changes may result in more employees qualifying for the exemption. The sole modification is the elimination of the requirement that outside sales employees do not devote more than twenty percent of the hours worked by nonexempt employees to activities that are not incidental to and in conjunction with their own outside sales or solicitations. As recognized by the DOL in the preamble, the twenty percent test was both confusing and difficult for employers to apply, because it required employers to track the hours worked by both nonexempt employees and outside sales employees in order to determine how many hours constituted twenty percent of the time worked by nonexempt employees and whether outside sales employees spent more than that amount of time on nonexempt work.

Thus, the new duties test for outside sales employees may be summarized as follows:

- The employee’s primary duty must be making sales 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.
- The employee must be customarily and regularly engaged away from the employer’s place or places of business.
- There are no salary requirements.

Consistent with the existing regulations, “engaged away from the employer’s place or places of business” means that an outside sales employee makes sales at the customer’s place of business or, if selling door-to-door, at the customer’s home. The final regulations clarify that outside sales do not include sales made by mail, telephone, or the Internet, unless such contact is used merely as an adjunct to personal calls. Any fixed site, whether home or office, used by a salesperson as a headquarters or for telephonic solicitation of sales is considered one of the employer’s places of business, even though the employer is not in any formal sense the owner or tenant of the

property. The final rule defining “away from the employer’s place of business” includes a new exception for trade shows of short duration.

The final regulations also clarify circumstances under which promotional work is considered exempt outside sales work. Promotional work that is actually performed incidental to and in conjunction with an employee’s own outside sales or solicitations is exempt work, whereas promotional work that is incidental to sales made (or to be made) by someone else is not.

The regulations also address the classification of drivers who both deliver and sell products, and indicate that such individuals qualify as exempt outside sales employees only if the employee has a primary duty of making sales. The regulations list several factors to consider in determining whether a driver has such a primary duty. Among others, these factors include: (1) a comparison of the driver’s duties with those of other employees engaged as drivers and as salespersons; (2) whether or not the driver has a selling or solicitor’s license when required by law; (3) the presence or absence of customary or contractual arrangements concerning amounts of products to be delivered; (4) the description of the employee’s occupation in collective bargaining agreements; and (5) the proportion of earnings directly attributable to sales.

### Revised Salary Basis Test

The final regulations also update and clarify the “salary basis test.” Generally, to qualify for exemption, employees must be paid at not less than \$455 per week on a “salary basis.” (Under the final rule, these salary requirements do not apply to outside sales employees, teachers, licensed employees practicing law or medicine, medical interns and residents, or exempt computer employees paid on an hourly basis at a rate not less than \$27.63 an hour. Administrative, professional, and computer employees may also be paid on a “fee basis.”)

Being paid on a “salary basis” means an employee regularly receives a predetermined amount of compensation each pay period on a weekly or less frequent basis. Subject to a few explicit exceptions, an exempt employee must receive the full salary for any week in which the employee performs any work, regardless of the number of days or hours worked. Employers are not permitted to reduce this predetermined amount due to variations in the quality or quantity of the employee’s work, due to the operating requirements of the business, or if the employee is ready, willing, and able to work when work is not available. Exempt employees do not, however, need to be paid for any workweek in which they perform no work.

### Permissible Deductions from Salary

Under both the current and the final regulations, there are several circumstances in which deductions from pay are permissible when an exempt employee is absent from work. Those circumstances include deductions: (1) for absences of one or more full days for personal reasons other than sickness or disability; (2) for absences of one or more full days due to sickness or disability if the deduction is made in accordance with a bona fide plan, policy, or practice of providing compensation for salary lost due to illness; (3) for absences in which an exempt employee takes unpaid leave under the Family and Medical Leave Act; (4) to offset amounts employees receive as jury or witness fees or for military pay; or (5) for penalties imposed in good faith for infractions of safety rules of major significance. Also, employers are not required to pay the full salary in the initial or terminal week of employment.

The final rules add a new and significant exception permitting unpaid disciplinary suspensions of one or more full days imposed in good faith for workplace conduct rule infractions. The commenters note that this new exception will permit employers to apply the same progressive disciplinary rules to both exempt and nonexempt employees, and is needed in light of federal and state laws requiring employers to take appropriate remedial action to address employee misconduct.

The DOL's comments indicate that "workplace conduct" is to be narrowly construed and that it refers to serious misconduct like sexual harassment, violence, drug or alcohol infractions, or violations of state or federal laws. It does not refer to performance or attendance issues. Furthermore, the exception applies only if the suspension is pursuant to a written policy that is generally applicable to all employees, and which places employees on notice that particular types of misconduct could result in an unpaid disciplinary suspension. The policy need not include an exhaustive list of specific violations that could result in a suspension, but it should be sufficient to put employees on notice that they could be subject to an unpaid disciplinary suspension.

The DOL's comments also clarify that under certain circumstances employers may recover leave and salary advances from employees' final paychecks. They indicate that employers may recover leave advances only for reasons listed in the exceptions. Recovery of partial-day leave advances is essentially a deduction for partial-day personal absences and is impermissible.

### Effect of Improper Deductions from Salary

The regulations also modify the consequences when an employer makes improper deductions from exempt employees' pay. Under the final rule, the central inquiry in determining whether the employer will lose the exemption is whether "the facts demonstrate that the employer did not intend to pay employees on a salary basis." The rule further provides that an "actual practice" of making improper deductions demonstrates the employer did not intend to pay employees on a salary basis.

Previously, the DOL's position was that employers can lose the exemption if there is either an actual practice of making such deductions or an employment policy that creates a "significant likelihood" of such deductions. A "significant likelihood" exists, for example, when employees are covered by an employment policy that communicates deductions will be made in impermissible circumstances.

The final rule describes several factors to be considered in evaluating whether an employer has an "actual practice" of making improper deductions. Factors to consider include, but are not limited to (1) the number of improper deductions, particularly as compared to the number of employee infractions warranting 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.

Under the final rule, if an employer has an "actual practice" of making deductions, the exemption is only lost during the time period of the deductions, and only for employees in the same job classification working for the same managers responsible for the improper deductions. Employees working for different managers or in different classifications do not lose the exemption. Currently, the exemption is lost with respect to all employees in the same job classification.

### Opportunity for Correction

The final rule provides that isolated or inadvertent improper deductions will not result in loss of the exemption if the employer reimburses the employee for the improper deductions. "Inadvertent" deductions are those taken unintentionally, such as those resulting from a clerical or time-keeping error. Whether deductions are "isolated" is determined by weighing the factors described above. Reimbursement does not have to be made immediately upon the discovery that an improper deduction was made.

The final rule is somewhat different from the DOL's current rule, whereby employers making improper deductions from an exempt employee's salary are given a "window of correction" to remedy the error. Under that rule, the exemption will not be lost if it was inadvertent or made for reasons other than a lack of work, and if the

employer reimburses employees for the deductions and promises to comply in the future. This provision has been widely litigated and circuit courts have interpreted it differently. The preamble to the new regulations indicates the DOL hopes the new safe harbor, described below, will replace the window of correction.

## New Safe Harbor

The final rule provides a new safe harbor for employers with respect to impermissible deductions. If an employer (1) has a clearly communicated policy, with a complaint mechanism, which prohibits improper deductions, (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.

If an employer fails to reimburse employees for improper deductions or continues to make improper deductions after receiving employee complaints, the exemption will be lost. While the DOL does not require that the policy be in writing, it has indicated that the best evidence of a “clearly communicated” policy is a written policy that was distributed to employees prior to the improper pay deductions, such as by providing a copy of the policy to employees at the time of hire or publishing the policy in an employee handbook or on the employer’s intranet.

## Other Changes

The final rule makes several other minor clarifications and changes. The rule provides, for example, that an exempt employee’s earnings may be computed on an *hourly*, a daily, or a shift basis, without losing the exemption or violating the salary basis requirement, if the employment arrangement also includes a guarantee of at least the minimum weekly required amount paid on a salary basis (regardless of the number of hours, days, or shifts worked), and if a reasonable relationship exists between the guaranteed amount and the amount employees actually earn. This provision is consistent with the DOL’s prior interpretation of the salary basis requirement, set forth in the DOL’s Field Operation Handbook and opinion letters.

The DOL also modified several of its definitions applicable to multiple exemptions, the most notable of which may be the definition of an employee’s “primary duty.” The regulations modify the definition of this term to clarify that emphasis should be placed on the principal character of the employee’s job, and not on the particular percentage of time spent performing the primary duty. The final rule specifies that “primary duty” does not require that an employee spend more than fifty percent of his or her time performing exempt work, as long as the major duty performed by the employee is exempt work. For example, assistant managers in a retail establishment who perform executive duties, such as directing the work of others, ordering merchandise, and managing the budget, have a primary duty of management even if the assistant manager spends more than fifty percent of the time running the cash register. Employees who spend more than fifty percent of the time performing exempt work, however, will be presumed to have a primary duty of performing exempt work.

The regulations also list factors to consider when determining an employee’s “primary duty.” These factors include (1) the relative importance of the exempt duties 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 relationship between the employee’s salary and the wages paid to other employees for the same kind of nonexempt work.

## Status of the Final Regulations

While the final regulations are scheduled to go into effect on August 23, 2004, there is still some question whether they will be implemented in their entirety.

The Senate has displayed vigorous opposition to the final regulations. So far, it has passed two amendments to an import tax bill (S. 1367) that would effectively eradicate any benefits the regulations may have held for employers. The first amendment, sponsored by Sen. Tom Harkin (D-IA), would retain the increased salary threshold under which more workers would qualify for overtime pay, but would nullify any provision of the new regulations that would exempt from overtime pay any employee who would not otherwise be exempt if the existing regulations remained in effect. This amendment, which essentially requires employers to apply both the current and final regulations and comply with the stricter of the two, passed by a vote of 52 to 47. The second amendment, sponsored by Sen. Judd Gregg (R-NH), would have essentially the same effect as the Harkin amendment, but only with respect to fifty-five enumerated occupations. Many of the fifty-five occupations, however, are those whose exempt status the DOL sought to clarify with the final rule. The Gregg amendment passed with a vote of 99 to 0. The Senate approved the final version of S. 1367 on May 11 by a vote of 92 to 5.

It does not appear, however, that the House of Representatives shares the Senate's fervor. On May 12, the House voted 222 to 205 to table a motion by Rep. George Miller (D-CA) to instruct House members of the conference committee on the 2004 Labor, Health and Human Services and Education Appropriations bill to report out an amendment blocking any portion of the final overtime regulations that diminishes the rights of workers who qualify for overtime under the current rules. The Miller motion would have had largely the same effect as the Harkin amendment in the Senate. By tabling the motion, the House prevented debate and a vote on the issue itself. House GOP leaders have promised to delay any similar votes until after the regulations go into effect.

Even if the Harkin, Gregg, or a similar amendment were to pass in the House of Representatives, the Bush administration has indicated the president will veto any legislation that includes a measure to block the new regulations. While the vote on the Gregg amendment indicates there is enough opposition to the regulations in the Senate to override a veto, it does not appear there would be enough support in the House.

At this point, there is no indication that Congress plans to repeal the regulations in total. At the very least, therefore, employers must be prepared to implement those provisions of the new regulations that are more protective of employee rights than the current regulations. But given the current political state, it appears the regulations will go into effect, in their entirety, as planned on August 23.

## What Should Employers Start Doing Now?

Employers should begin preparing now for an August 23 implementation of the new regulations, at least with respect to those provisions that are more protective of employee rights than the current regulations. Where the regulations have created a higher threshold for exempt status, employers need to start evaluating jobs that are currently classified as exempt to determine whether they will remain exempt following the effective date of the regulations.

The most obvious place to start is by identifying any exempt employees who currently earns a salary of less than \$455 per week, and to decide whether to reclassify these employees as nonexempt or to raise their salary to the new minimum level.

Employers should also reevaluate positions currently satisfying an exempt duties test to ensure they meet any additional requirements imposed by the final regulations. For example, employers need to evaluate whether their executives have authority to hire or fire other employees, or whether their suggestions and recommendations as to the change of status of other employees are given "particular weight." Where appropriate, job descriptions should be revised to reflect this additional authority. Where employees would not satisfy the new duties test, employers need to decide whether to give them additional responsibility satisfying the duties test requirement or whether to reclassify them as nonexempt.

For those employers who compute exempt employees' earnings on an hourly, daily, or shift basis, employers need to ensure that the employment arrangement also includes a guarantee of at \$455 per week paid on a salary basis regardless of the number of hours, days, or shifts worked, and that a "reasonable relationship" exists between the guaranteed amount and the amount actually earned.

Given the likelihood that the regulations will go into effect in their entirety on August 23, employers should also prepare to utilize the provisions of the final rule that inure to their benefit. Employers should, for example, draft a "safe harbor" policy prohibiting improper pay deductions from the salary of exempt employees. Such a policy should provide that deductions from an exempt employee's salary are generally prohibited and should describe the lawful exceptions. The accompanying complaint procedure should instruct employees that improper deductions are a serious violation of company policy and should direct employees to report such violations to human resources. Employers should also ensure they have written disciplinary policies, generally applicable to all employees, placing employees on notice that particular types of misconduct could result in an unpaid disciplinary suspension. These policies should be distributed to all employees, placed in employee handbooks, and posted on the employer's intranet.

The changes to the duties tests also create the possibility that some employees who are currently nonexempt will become exempt. New provisions in the administrative exemption, for example, clarify that employees acting as advisors or consultants to their employer's clients or customers may be exempt. The regulations also clarify that team leaders assigned to complete major projects for the employer generally satisfy the administrative exemption, even if the employees do not have direct supervisory authority over other employees on the team. The final regulations addressing the professional exemption contain new requirements for employees working in certain occupations, such as medical professionals, chefs, athletic trainers, and funeral directors, to qualify for exemption, and further clarify that non-degree-bearing individuals performing the same duties as bona fide professionals may also qualify. Furthermore, the elimination of the limitation on nonexempt work for outside sales employees and of the "discretion and judgment" requirement for computer employees also creates the possibility that additional employees will fall within the scope of these exemptions.

Before employers implement any changes that are unfavorable to employees, such as changing an employee's status from nonexempt to exempt, they must verify whether applicable state laws permit the change. Approximately one third of states have their own overtime requirements, some of which mirror the existing FLSA regulations and some of which are even more protective of employees' rights. In the absence of new legislation in these states, employers will be required to comply with whichever law (the FLSA or the state wage and hour law) provides employees with greater protection.

Given the recent boom in Fair Labor Standards Act litigation, subjecting even sophisticated employers to enormous liability for improperly classifying or paying employees, now is also an ideal time to conduct a complete audit to determine whether your employees are properly classified and paid. In some cases, employers will find that employees whose jobs are unaffected by any changes in the final regulations were misclassified in the first place. While the final regulations do not change the rules governing the inclusion of certain forms of extra compensation in the calculation of overtime for nonexempt employees, employers frequently violate the FLSA by failing to include shift differentials, on-call payments, nondiscretionary bonuses, commissions, and other forms of incentive earnings in nonexempt employees' overtime pay. This is also an ideal time to review pay practices to ensure nonexempt employees are paid for all hours worked. Employers should ensure that they have (and enforce) a policy requiring that nonexempt employees record all working time, and that all working time must be paid.

The members of Nixon Peabody's Wage-Hour team are available to answer questions, to assist employers in implementing the new regulations, and to conduct partial or complete audits of pay practices. If you would like more information, please contact your Nixon Peabody representative or a member of the Wage-Hour team identified below.

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## Salary Level Tests\*

Earnings**	Current Regulations	Final Regulations
Less than \$155 per week	guaranteed overtime	guaranteed overtime
\$155 to \$169.99 per week	apply long duties tests for executive and administrative exemptions;  all others guaranteed overtime	guaranteed overtime
\$170 to \$249.99 per week	apply long duties tests for all exemptions	guaranteed overtime
\$250 to \$454.99 per week	apply short duties tests	guaranteed overtime
\$455 per week to \$100,000 per year	apply short duties tests	apply new standard duties tests (see charts that follow)
\$100,000 per year or more	apply short duties tests	apply highly compensated employee test

\* Salary level test does not apply to executives owning a bona fide twenty-percent equity interest in the employing enterprise, to learned professionals holding a valid license permitting the practice of law or medicine actually engaged in the practice thereof, to medical interns or residents, to teachers, or to outside sales employees.

\*\* Earnings must generally be paid on a “salary basis.” For the administrative, professional and computer employee exemptions, earnings may also be paid on a “fee basis” as defined in the regulations.

## Executive Employees

	Current Long Test	Current Short Test	Proposed Standard Test	Final Standard Test
Salary	\$155 per week	\$250 per week	\$425 per week	\$455 per week
Duties	Primary duty of the management of the enterprise or a customarily recognized department or subdivision.	Primary duty of the management of the enterprise or a customarily recognized department or subdivision.	Primary duty of the management of the enterprise or a customarily recognized department or subdivision.	Primary duty of the management of the enterprise or customarily recognized department or subdivision.
	Customarily and regularly directs the work of two or more other employees.	Customarily and regularly directs the work of two or more other employees.	Customarily and regularly directs the work of two or more other employees.	Customarily and regularly directs the work of two or more other employees.
	Has authority to hire or fire other employees or the employee's suggestions and recommendations as to the hiring or firing and as to the advancement and promotion or any other change of status of other employees will be given particular weight.		Has 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 will be given particular weight.	Has 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 are given particular weight.
	Customarily and regularly exercises discretionary powers.			
	Does not devote more than twenty percent (forty percent in retail or service establishments) of time to activities that are not directly and closely related to exempt work.			

# Administrative Employees

	Current Long Test*	Current Short Test	Proposed Standard Test	Final Standard Test
Salary	\$155 per week	\$250 per week	\$425 per week	\$455 per week
Duties	Primary duty of performing office or non-manual work directly related to management policies or general business operations of the employer or the employer's customers; <i>or</i> performing functions in the administration of a school system or educational establishment or institution, or of a department or subdivision thereof, in work directly related to the academic instruction or training carried on therein.	Primary duty of performing office or nonmanual work directly related to management policies or general business operations of the employer or the employer's customers; <i>or</i> performing functions in the administration of a school system or educational establishment or institution, or of a department or subdivision thereof, in work directly related to the academic instruction or training carried on therein.	Primary duty of performing office or nonmanual work directly related to the management or general business operations of the employer or the employer's customers.	Primary duty of performing office or nonmanual work directly related to the management or general business operations of the employer or the employer's customers.
	Customarily and regularly exercises discretion and independent judgment.	Primary duty includes exercise of discretion and independent judgment.	Holds a "position of responsibility" with the employer, defined as either (1) performing work of substantial importance or (2) performing work requiring a high level of skill or training	Primary duty includes exercise of discretion and independent judgment with respect to matters of significance.

\* In the case of academic administrative personnel, compensated at \$155 per week or on a salary basis that is at least equal to the entrance salary for teachers in the school system, educational establishment, or institution by which employed.

# Administrative Employees

	Current Long Test	Current Short Test	Proposed Standard Test	Final Standard Test
Duties (cont'd)	Regularly and directly assists a proprietor, or exempt executive or administrative employee; <i>or</i> performs specialized or technical work requiring special knowledge under only general supervision; <i>or</i> executes special assignments under only general supervision.			
	Does not devote more than twenty percent (forty percent in retail or service establishments) of time to activities that are not directly and closely related to exempt work.			

# Learned Professional Employees

	Current Long Test	Current Short Test	Proposed Standard Test	Final Standard Test
Salary	\$170 per week*	\$250 per week	\$425 per week	\$455 per week
Duties	Primary duty of performing work requiring knowledge of an advanced type in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction and study.	Primary duty of performing work requiring knowledge of an advanced type in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction and study.	Primary duty of performing office or nonmanual work requiring knowledge of an advanced type in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction, but which also may be acquired by alternative means such as an equivalent combination of intellectual instruction and work experience.	Primary duty of performing work requiring knowledge of an advanced type (defined as work that is predominantly intellectual in character, and which includes work requiring consistent exercise of discretion and judgment) in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction.
	Consistently exercises discretion and judgment.	Consistently exercises discretion and judgment.		
	Performs work that is predominantly intellectual and varied in character and is of such character that the output produced or result accomplished cannot be standardized in relation to a given period of time.			
	Does not devote more than twenty percent of time to activities that are not an essential part of and necessarily incident to exempt work.			

\* Salary level test does not apply to employees holding a valid license permitting the practice of law or medicine or any of their branches and who is actually engaged in the practice thereof, to medical interns or residents, or to teachers.

# Creative Professional Employees

	Current Long Test	Current Short Test	Proposed Standard Test	Final Standard Test
Salary	\$170 per week	\$250 per week	\$425 per week	\$455 per week
Duties	<p>Primary duty of performing work that is original and creative in character in a recognized field of artistic endeavor (as opposed to work that can be produced by a person endowed with general manual or intellectual ability and training), and the result of which depends primarily on the invention, imagination, or talent of the employee.</p>	<p>Primary duty of performing work requiring invention, imagination, or talent in a recognized field of artistic endeavor.</p>	<p>Primary duty of performing office or nonmanual work requiring invention, imagination, originality, or talent in a recognized field of artistic or creative endeavor.</p> <p>The exemption does not apply to work that can be produced by a person with general manual ability and training.</p>	<p>Primary duty of performing work requiring invention, imagination, originality, or talent in a recognized field of artistic or creative endeavor.</p> <p>The exemption does not apply to work that can be produced by a person with general manual or intellectual ability and training.</p>
	Consistently exercises discretion and judgment.			
	Performs work that is predominantly intellectual and varied in character and is of such character that the output produced or result accomplished cannot be standardized in relation to a given period of time.			
	Does not devote more than twenty percent of time to activities that are not directly and closely related to exempt work.			

# Computer Employees

	Current Long Test	Current Short Test	Section 13(a)(17) Test	Proposed Standard Test	Final Standard Test
Salary	\$170 per week	\$250 per week	\$27.63 an hour	\$425 per week or \$27.63 an hour	\$455 per week or \$27.63 an hour
Duties	Primary duty of performing work requiring theoretical and practical application of highly specialized knowledge in computer systems analysis, programming, and software engineering.	Primary duty of performing work requiring theoretical and practical application of highly specialized knowledge in computer systems analysis, programming, and software engineering.	Primary duty of (a) application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software, or system functional applications; <i>or</i> (b) 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; <i>or</i> (c) design, documentation, testing, creation, or modification of computer programs related to machine operating systems; <i>or</i> (d) a combination of duties described in (a), (b), and (c), the performance of which requires the same level of skills.	Position requires high level of skill or expertise in the theoretical and practical application of highly specialized knowledge in computer systems analysis, programming, and software engineering.  Primary duty of (a) application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software, or system functional applications; <i>or</i> (b) 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; <i>or</i> (c) design, documentation, testing, creation, or modification of computer programs related to machine operating systems; <i>or</i> (d) a combination of duties described in (a), (b), and (c), the performance of which requires the same level of skills.	Primary duty of (a) application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software, or system functional applications; <i>or</i> (b) 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; <i>or</i> (c) design, documentation, testing, creation, or modification of computer programs related to machine operating systems; <i>or</i> (d) a combination of duties described in (a), (b), and (c), the performance of which requires the same level of skills.

# Computer Employees

	Current Long Test	Current Short Test	Section 13(a)(17) Test	Proposed Standard Test	Final Standard Test
Duties (cont'd)	Employed as a computer systems analyst, computer programmer, software engineer, or other similarly skilled worker in the computer software field.	Employed as a computer systems analyst, computer programmer, software engineer, or other similarly skilled worker in the computer software field.	Employed as a computer systems analyst, computer programmer, software engineer, or other similarly skilled worker in the computer field.	Employed as a computer systems analyst, computer programmer, software engineer, or other similarly skilled worker in the computer field.	Employed as a computer systems analyst, computer programmer, software engineer, or other similarly skilled worker in the computer field.
	Consistently exercises discretion and judgment.	Consistently exercises discretion and judgment.			
	Performs work that is predominantly intellectual and varied in character and is of such character that the output produced or result accomplished cannot be standardized in relation to a given period of time.				
	Does not devote more than twenty percent of time to activities that are not directly and closely related to exempt work.				

## Outside Sales Employees

	Current Long Test	Current Short Test	Proposed Standard Test	Final Standard Test
Salary	None required.	None required.	None required.	None required.
Duties	Employed for the purpose of and customarily and regularly engaged away from the employer's place of business in making sales; <i>or</i> in obtaining orders or contracts for services or for the use of facilities for which a consideration will be paid by the client or customer.	No separate "short" test.	Primary duty of making sales; or of obtaining orders or contracts for services or for the use of facilities for which a consideration will be paid by the client or customer.  Customarily and regularly engaged away from the employer's place or places of business.	Primary duty of making sales; or of obtaining orders or contracts for services or for the use of facilities for which a consideration will be paid by the client or customer.  Customarily and regularly engaged away from the employer's place or places of business.
Does not devote more than twenty percent of the hours worked by nonexempt employees of the employer to activities that are not incidental to and in conjunction with the employee's own outside sales or solicitations.				