

## **NEW FEDERAL REGULATIONS REDEFINE “EXEMPT” EMPLOYEE STATUS**

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### **Introduction**

On April 23, 2004, the U.S. Department of Labor published in the Federal Register its long overdue update of overtime regulations under the Fair Labor Standards Act. 69 Fed. Reg. 22122. The new rules become effective August 23, 2004. Employers who have not already done so should take this opportunity to review their workforces to be certain that employees considered “exempt” under the old rules still are, and to make provisions for overtime pay to those employees joining the ranks of the non-exempt.

Under the Fair Labor Standards Act (FLSA), employers must pay a minimum hourly wage with time-and-a-half for overtime work, generally work performed in excess of 40 hours in a given week. Certain “white collar” employees are considered “exempt” from the overtime requirements. Under the FLSA, employees (other than those performing outside sales duties) cannot be classified as “exempt” unless they receive a guaranteed minimum weekly salary and perform certain executive, administrative or professional duties. The Department of Labor is authorized to issue regulations defining “exempt” employee status.

Unfortunately, the regulations defining job duties that employees must perform in order to be considered “exempt” have not been updated since 1949, before most members of the present day workforce were even born, and long before the advent of today’s high technology occupations. Likewise, the minimum salary requirements have not been updated since 1975, almost 30 years ago. Under the old regulations, the minimum salary necessary to be considered an exempt “executive” was a mere \$155.00 per week, just \$8,060.00 a year. The Department of Labor itself acknowledged that the regulations were badly in need of overhaul, both to protect employees from unscrupulous employers and to remove traps for the unwary but well-intentioned employer.

### **New Salary Tests**

The new regulations roughly triple, to \$455.00 per week, the minimum salary required for exempt employee status. Thus, employees earning less than \$23,660.00 per year will be considered non-exempt, regardless of their job duties. The increase in minimum salary may well impact some of the lower echelons of management, especially in the retail and food service industries. Obviously, the first step employers should take is to make sure that each employee classified as exempt is receiving the minimum salary necessary to meet the new standard.

The regulations also create a new category of “highly compensated” employees, those earning \$100,000.00 or more per year. These employees are considered exempt so long as their primary duties involve office or non-manual work and they customarily and regularly perform at least one of the exempt duties defined in the rules. The obvious purpose of this provision is to make it easier for employers to prove an exemption for higher paid members of the workforce.

As was the case under the old regulations, the guaranteed salary must be paid in any week in which the employee performs any work, but need not be paid during a week in which the employee performs no work. There are also exceptions for bona fide leave plans. For example, an exempt employee need not be paid for time not worked after the employee has exhausted his or her sick leave.

### **Changes in the Duties Tests**

Section 541.1 of the regulations makes clear that an employee's job title alone is insufficient to prove exempt status. The exempt or non-exempt status of an employee must be determined based on the duties the employee is required to perform on a day-to-day basis. Thus, employers cannot simply classify employees as exempt based on a job description.

Section 541.3 of the regulations also makes clear that the exemptions do not apply to manual laborers or other "blue collar" workers. Accordingly, non-management employees such as carpenters, electricians, plumbers and other workers who primarily use their hands, physical skill and energy are subject to the minimum wage and overtime pay provisions of the FLSA no matter how highly paid these individuals may be.

The regulations also address a frequently litigated area involving police officers, firefighters, paramedics and other law enforcement and emergency personnel. Employees who directly perform such activities will be considered non-exempt regardless of their rank or pay level.

### **Executives**

In order to qualify as an exempt "executive" employee, the employee must, in addition to meeting the minimum salary test, have primary duties involving the management of at least a customarily recognized department or subdivision of the enterprise, and must regularly direct the work of two or more employees. The new regulations also impose a requirement that the employee either have the authority to hire or fire other employees, or, if he or she does not have ultimate authority, his or her suggestions regarding hiring, firing, advancement or other changes in employee status must be given "particular weight."

An exempt employee does not lose that status simply because he or she may concurrently perform other non-exempt work. For example, an assistant manager of a retail operation whose primary duty is management does not become a non-exempt employee simply because he or she may also cook food or wait on customers. Conversely, an employee who occasionally performs management duties cannot be considered an exempt employee if his or her primary duty is the performance of non-exempt work. Once again, job titles and job descriptions may be evidence of exempt status, but are not dispositive.

### **Administrative Employees**

Administrative employees are those whose primary duties involve non-manual work directly related to the management or general business operations of the employer or the employer's

customers and whose primary duty includes “the exercise of discretion and independent judgment with respect to matters of significance.” The emphasis on matters “of significance” is likely to narrow the scope of administrative employees who can be properly classified as exempt. For example, personnel managers who formulate, interpret or implement employment policies and procedures generally would be considered exempt employees. However, personnel clerks who merely “screen” applicants to determine if they meet minimum requirements for employment generally do not meet the requirement for exercising independent judgment on matters of significance.

Other examples of employees who generally meet the requirements of this section include insurance claims adjusters, provided they exercise independent judgment in the investigation and payment of claims, or purchasing agents with authority to bind the company on significant purchases. This category also includes employees who perform administrative functions in an educational setting. Such academic administrative functions may include the superintendent or other head of a school, academic counselors or individuals responsible for the administration of a particular school department.

### **Professional Employees**

The new regulations eliminate the “long” and “short” tests for professional employees in favor of a single test. Professional employees are defined as those who perform work requiring knowledge of an advanced type in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction, or requiring invention, imagination, originality or talent in a recognized field of artistic or creative endeavor. The regulations further define the categories of “learned professionals” and “creative professionals,” formerly “artistic” professionals.

The “learned professional” exemption applies to a myriad of professions and occupations such as engineering, accounting, nursing and similar professions requiring specialized training and, often, a license. The term “customarily acquired” in the above-quoted definition is intended to make the exemption available to professionals who have acquired their knowledge through a combination of work experience and intellectual instruction. Other employees considered to be exempt professionals include teachers, doctors and lawyers.

The learned professional exemption is not available for occupations that customarily may be performed with only the general knowledge acquired by an academic degree in any field. Also, the level of knowledge and experience must be “advanced.” For example, registered nurses who must pass an appropriate state examination generally meet the requirements for the learned professional exception. However, licensed practical nurses do not meet these requirements even though, as the name implies, these individuals may be required to be licensed in a particular state.

“Creative professionals” are individuals whose work involves invention, imagination, originality or talent, such as writers, actors, musicians and artists. Because the creative professional is difficult to define with precision, membership in this category must be determined on a case-by-case basis. For instance, a newspaper reporter whose work involves independent investigation

and original writing would ordinarily qualify for the exemption, while reporters who merely rewrite press releases or standard accounts of public information would not.

### **Computer Employees**

The rules create a new exempt category for computer employees. In order to qualify for this exemption, the employee must meet the minimum salary test and have primary duties involving systems analysis, design, development or testing of computer systems or programs or a combination of duties requiring the same relatively high level of skill. Employees involved in the manufacture and repair of computers, but who are not primarily engaged in computer systems analysis, programming or other similarly skilled occupations are considered non-exempt.

Computer professionals may also qualify as exempt under one or more of the other exemptions. For example, a senior or lead computer programmer who manages the work of two or more other programmers, and whose recommendations for hiring, firing, or advancement are given particular weight, would generally meet the requirements for the executive exemption.

### **Outside Sales Employees**

Outside sales employees are those employees whose primary duty is making sales or obtaining orders away from the employer's place of business. Unlike other exempt employees, the salary requirements do not apply to outside sales employees, who may be, and often are, paid strictly on a commission basis.

### **Other new Features**

One of the more interesting features of the new regulations is that an employer may now impose unpaid disciplinary suspensions of one or more full days for infractions of workplace conduct rules. Under the old rules, exempt employees could not be suspended without pay for less than a full week, except for violations of safety rules of major significance. This led to an unusual dilemma for employers. An exempt employee who violated an employer policy could be terminated outright or suspended for a full week, but could not be given a lesser suspension without violating the FLSA.

Under the new rules, an employer may suspend an exempt employee without pay for one or more days for violating a generally applicable written policy, such as a policy prohibiting sexual harassment. Although the new rules allow employers additional flexibility, they should not be overused, and should be applied only to violations of clear workplace rules of general applicability.

The new rules also help to clarify an employer's obligation when an exempt employee takes unpaid leave under the Family and Medical Leave Act. In cases where the employee takes less than a full week of leave, the employer may pay a proportionate share of the full salary for time actually worked. Thus, an exempt employee who normally works 40 hours per week who takes four hours of unpaid medical leave may have his or her salary reduced by 10% for that week.

Generally, an exempt employee's pay cannot be subject to reduction based on the quality or quantity of work performed. Under the regulations, the effect of improper deductions on salary will depend in part on the employer's intent. While it is never desirable to make an improper deduction from an exempt employee's salary, it may be possible to limit the employer's exposure where the employer has a clearly communicated policy that prohibits improper pay deductions and includes a complaint mechanism, reimburses employees for any improper deductions and makes a good faith commitment to comply in the future. On the other hand, employers who routinely subject employees to improper deductions can lose the exemption for all employees in that job category. As before, the burden of proving exempt status under the new regulations is on the employer.

### **Conclusion**

The overtime provisions of the FLSA increasingly have been viewed as fertile ground for litigation. The new regulations may not change that, at least in the short term. There is bound to be a "learning curve" as employers gear up to comply with the new regulations. Since failure to comply with the new regulations for even a single category of employees can cost an employer hundreds of thousands of dollars in overtime pay, it behooves every employer to pay attention to the new regulations and be ready to comply with them by the effective date.