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## LABOR & EMPLOYMENT ADVISORY

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### New Amendments to Overtime Rules Take Effect August 23, 2004

#### I. Introduction

The Fair Labor Standards Act (“FLSA”) requires that employers pay certain workers overtime pay at time and one half the regular rate for all hours worked over 40 hours in a workweek. However, the FLSA specifically exempts from overtime pay those employees who are employed as bona fide executive, administrative, professional, and outside sales employees. Certain computer employees are exempted as well. In order to qualify for one of the exemptions, employees must satisfy certain tests regarding salary thresholds and job duties.

After months of heated debate, the Department of Labor’s amendments to the overtime regulations of the Fair Labor Standards Act (“FLSA”) go into effect today, August 23, 2004. The amendments aim to increase overtime pay to millions of “white collar” workers previously exempt from such pay by guaranteeing overtime protection to all workers earning less than \$455 per week (or \$23,660 per year). In addition, while keeping the aforementioned “exemptions” in place, the amendments seek to streamline the often confusing requirements one must meet to be deemed exempt. As employers scramble to be compliant by the effective date of the amendments, the overriding question now facing employers is whether, in light of the amendments, the status of any of their employees has changed. The following summarizes the amendments and outlines the updated tests used to determine exempt status.

#### II. Overview of the Amendments

The amended Fair Labor Standards Act’s regulations on overtime exemptions are subdivided into Subparts A through Subpart F. 29 C.F.R. § 541 (2004). Subpart A consists of “general regulations,” which consist almost entirely of consolidated,

but substantively unaltered, introductory materials that were formerly scattered throughout various sections of the previous regulations.<sup>1</sup>

Subparts B, C, D, E, and F contain streamlined tests and definitions for the enumerated classes of exempt employees. Previously, many of the exemptions utilized a “long” test based on one salary threshold or a “short” test based on a higher salary threshold. All of the new tests abandon the “long” versus “short” debate, instead opting for one single test per category.

Subpart G consolidates the sections regarding salary requirements for all exempt classes, and clarifies the rules on salary basis, which cover potential loss of exempt status where the employer makes improper salary deductions. §§ 541.602-541.603. It also includes a new section on “highly compensated employees.” § 541.601.

Finally, Subpart H consolidates and defines terms or phrases used throughout the employee exemption categories. §§ 541.700-541.707. It also provides three miscellaneous provisions: the combination exemption, motion picture producing industry provision, and the employees of public agencies provision. §§ 541.708-710.

### **III. Subpart B—Executive Employees**

Under the new regulations, an employee is exempt under the executive exemption when:

- (1) the employee’s salary is not less than \$455 per week;
- (2) the employee’s primary duty is management of the enterprise, or a customarily recognized department or subdivision of the enterprise;
- (3) the employee customarily and regularly directs the work of at least two or more other full-time employees or their equivalent; and
- (4) the employee has 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 are given particular weight. § 541.100(a)(1)-(4).

The new regulations eliminate the special rules for exemptions applicable to “sole charge” executives under §§ 541.1(e) and 541.113 (2003) of the old regulations, while they add the requirement that employees who own at least a bona fide 20-percent equity interest in an enterprise are exempt only if they are “actively engaged in its management.” § 541.101.

To determine whether an employee’s suggestions and recommendations are given “particular weight” under § 541.100(a)(4), factors to be considered include:

- whether it is part of the employee’s job duties to make such suggestions and recommendations,
- the frequency with which such suggestions and recommendations are made; and
- the frequency with which the employee’s suggestions and recommendations are relied upon.

Generally, an executive's suggestions and recommendations must pertain to employees customarily and regularly directed by the executive. It does not include an occasional suggestion with regard to the change in status of a co-worker. An employee's "recommendations may still be deemed to have 'particular weight' 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." § 541.105.

Finally, under the new regulations, the performance of non-exempt work will not disqualify an exempt executive so long as the standard test is otherwise met. § 541.106.

#### **IV. Subpart C—Administrative Employees**

Under new regulations, an employee is exempt under the administrative exemption when:

- (1) the employee is compensated on a salary or fee basis at a rate of not less than \$455 per week;
- (2) the employee's primary duty is 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 significance. § 541.200(a)(1)-(3).

The new regulations provide a detailed definition of the "discretion and independent judgment" requirement, which generally "involves the comparison and the evaluation of possible courses of conduct, and acting or making a decision after the various possibilities have been considered." § 541.202(a). Whether one exercises such discretion and independent judgment depends on "all the facts involved," and it implies that one has the "authority to make an independent choice, free from immediate direction or supervision...even if their decisions or recommendations are reviewed at a higher level." § 541.202(b)-(c).

Factors to consider in determining whether an employee exercises discretion and independent judgment include, but are not limited to:

- whether the employee has authority to formulate, affect, interpret, or implement management policies or operating practices;
- whether the employee carries out major assignments in conducting the operations of the business;
- whether the employee 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;
- whether the employee has authority to waive or deviate from established policies and procedures without prior approval.... § 541.202(b).

The amendments to the regulations make clear that one does not exercise discretion and independent judgment if he/she performs "clerical or secretarial work, recording or tabulating data, or

performing other mechanical, repetitive, recurrent or routine work.” § 541.202(e). Finally, the term “matters of significance” (§ 541.200(a)(3)) refers to the “level of importance or consequence of the work performed.” § 541.202(a).

The new regulations also set forth a new section which includes illustrations of the application of the administrative duties test to particular occupations, such as insurance claims adjusters, financial services employees, human resource professionals, employees working in tax, auditing, marketing, quality control, and other fields. § 541.203.

In addition, the new regulations address the “management or general business operations” component of the test (§ 541.200(a)(2)), specifically clarifying that the requirement pertains to the type of work performed by an employee and listing illustrative examples of work areas that qualify (i.e. tax, finance, accounting, etc.). § 541.201. They specify that exempt administrative employees “must perform work 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,” thus clarifying the “production versus staff” dichotomy that was emphasized in the former regulations. *Id.* The new regulations focus on an employee’s “primary duty” instead of the percentage restrictions on nonexempt work found in the previous regulations. *Compare id. with* §541.209 (2003).

Finally, Subpart C gives employees of educational establishments their own section, but otherwise maintain the existing rules as defined under the old regulations. *Compare* § 541.204 *with* §§ 541.2(a)(2) and 541.214 (2003). An employee qualifies as an exempt academic administrative employee when:

- (1) the employee is compensated on a salary or fee basis at a rate of not less than \$455 per week or on a salary which is at least equal to the entrance salary for teachers in the educational establishment by which employed; and
- (2) the employee’s primary duty is performing administrative functions directly related to academic instruction or training in an educational establishment or department or subdivision thereof.

The new section defines the terms used in the test, gives examples of employees who are engaged in academic administrative functions, and adds “academic counselors” as one of the examples of academic administrative employees. § 541.204(b)-(c).

## **V. Subpart D—Professional Employees**

Subpart D now only covers learned professionals, creative professionals, teachers, and employees engaged in the “practice of law or medicine.” It streamlines the tests for learned and creative professionals by instituting a standard duties test, but it does not change the current tests for teachers and employees practicing law or medicine.<sup>2</sup>

Under the new regulations, an employee is exempt as a learned professional when:

- (1) the employee’s salary is not less than \$455 per week, and

- (2) whose primary duty is the performance of work requiring knowledge of an advanced type in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction. § 541.300(a)(1), (2)(i).

Section 541.301 restates the duties test for learned professionals and provides definitions and examples to help further clarify the exemption requirements. It defines “work requiring advanced knowledge” as “work which is predominantly intellectual in character, and which includes work requiring the consistent exercise of discretion and judgment....” § 541.301(b). The new regulation also contains specific examples illustrating how the learned professional duties test applies to specific occupations, including paralegals and accountants, among other positions. § 541.301(e).

Under the new regulations, an employees is exempt as a creative professional is when:

- (1) the employee’s salary is not less than \$455 per week, and
- (2) whose primary duty is the performance of work requiring invention, imagination, originality or talent in a recognized field or artistic or creative endeavor. § 541.300(a)(1), (2)(ii).

Section 541.302 provides definitions to help further clarify the exemption requirements. No significant changes have been made to the existing regulation’s definitions for the creative professional test.

## **VI. Subpart E—Computer Employees**

The new regulations cover computer employees in their own section (separate from the “professional” employee section it had been included under), but otherwise maintain the existing rules as defined under the old regulations. §§ 541.400-541.402.

A computer employee will qualify for exempt status where:

- (1) the employee is compensated on a salary or fee basis at a rate of not less than \$455 per week or on an hourly basis of not less than \$27.63 an hour;
- (2) 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; and
- (3) the employee’s primary duty consists of: (i) the application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software or system functional specifications; (ii) 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; (iii) the design, documentation, testing, creation or modification of computer programs related to machine operating systems; or (iv) a combination of the aforementioned duties, the performance of which requires the same level of skills.

## **VII. Subpart F—Outside Sales Employees**

The new regulations eliminate the 20 percent test, which had employers comparing the work and time of outside sales persons to that of the employer’s non-exempt employees, and replace it with the “primary duty” test as used in the other employee exemption tests and as defined at § 541.700. The

new regulations also do not exempt inside sales employees, but otherwise remain the same as the old regulations.<sup>3</sup>

### **VIII. Subpart G—Compensation Requirements**

Amended Subpart G synthesizes the sections regarding the salaries of all executive, administrative, professional, and computer employees. The amended regulations streamline the salary requirements for exemption, creating a “standard test” that sets the salary basis for all exempt employees at a rate of not less than \$455 per week, exclusive of board, lodging or other facilities. § 541.600(a).

This amended Subpart also includes a new “highly compensated employee” section. Under this section, an employee need not satisfy all the requirements of their corresponding duties test to be exempt, but instead qualifies for exempt status simply by having total compensation of at least \$100,000 per year and in addition he/she: (1) receives total annual compensation of \$455 per week on a salary basis, (2) performs “office or non-manual work” and (3) customarily and regularly performs any one of the exempt duties of an executive, administrative, or professional employee on a regular or recurring basis. § 541.601.

This amended Subpart also revises the salary basis test to clarify what type of deductions will convert an exempt worker into an overtime-eligible worker. § 541.602(a). Generally, an employee’s exempt status will be defeated if an employer makes improper deductions for that employee’s predetermined salary because work is not available, but the employee was willing and able to work. The rule lists seven circumstances in which an employer may take a deduction from the exempt employee’s salary without compromising his or her status. § 541.602(b)(1)-(7).

Deductions from pay are permissible for these purposes:

1. when the employee is absent from work for one or more full days for personal reasons other than sickness or disability;
2. when the employee is absent from work for 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. to offset amounts employees receive as jury or witness fees, or for military pay;
4. for penalties imposed in good faith for infractions of safety rules of major significance;
5. for unpaid disciplinary suspensions of one or more full days imposed in good faith for workplace conduct rule infractions.
6. because employer is not required to pay the full salary in the initial or terminal week of employment,
7. because employer is not required to pay for weeks in which an exempt employee takes unpaid leave under the Family and Medical Leave Act.

The final rule also replaces the “window of correction” provision with a “safe harbor” provision that an employer may apply in order to maintain an employee’s exempt status even when improper deductions have been made. Under this provision an employee’s exempt status will not be defeated if the employer

(1) has a clearly communicated policy prohibiting improper deductions, including a complaint mechanism; (b) reimburses the employee for any improper deductions; and (c) makes a good faith commitment for future compliance. This provision, however, is not available where the employer continues to *willfully* violate the policy after having received multiple complaints. § 541.603(d).

## **IX. Penalties**

The misclassification of a non-exempt employee as exempt may result in significant penalties, including back pay, liquidated damages, fines of \$10,000 and additional fines for additional violations, potential imprisonment for willful violations, and injunctions to further restrain an employer from withholding overtime pay. FLSA § 16.<sup>4</sup>

## **X. Conclusion**

Previously, when it came to compliance under the FLSA, employers tended to make sweeping generalizations as to the exempt status of its employees, without engaging in the careful case-by-case analysis. As a result of the publicity surrounding the new amendments, enforcement by the Department of Labor will likely be a priority. Employers should ensure that someone who has a detailed understanding of the new regulations and their applicability reviews the jobs of their employees to ensure that they are classified correctly.

**XI. Addendum: Side-By-Side Comparison Chart for Exemption Categories**

The following chart compares the old requirements for exemption (both for the old long and short duties tests) for executive, administrative, and professional employees with the new requirements that go into effect on August 23, 2004:

**Executive Exemption**

<b>Test</b>	<b>Old Long Test</b>	<b>Old Short Test</b>	<b>Amended Current Standard Test</b>
<b>Salary</b>	\$155 per week / \$8,060 per year	\$250 per week / \$13,000 per year	\$455 per week / \$23,660 per year
<b>Duties</b>	<p>Primary duty of the management of the enterprise or a recognized department or subdivision.</p> <p>Customarily and regularly directs the work of two or more other employees.</p> <p>Has authority to hire or fire other employees (or recommendations as to hiring, firing, promotion or other change of status of other employees are given particular weight).</p> <p>Customarily and regularly exercises discretionary powers.</p> <p>Does not devote more than 20 percent (40 percent in retail or service establishments) of time to activities that are not directly and closely related to exempt work.</p>	<p>Primary duty of the management of the enterprise or a recognized department or subdivision.</p> <p>Customarily and regularly directs the work of two or more other employees.</p>	<p>Whose primary duty is management of the enterprise in which the employee is employed or of a customarily recognized department or subdivision thereof;</p> <p>Who customarily and regularly directs the work of two or more other employees; and</p> <p>Who has the authority to hire or fire other employees or whose suggestions and recommendations as to the hiring, firing, advancement, promotion or any other change of status of other employees will be given particular weight.</p>

### Administrative Exemption

Test	Old Long Test	Old Short Test	Amended Current Standard Test
<b>Salary</b>	\$155 per week / \$8,060 per year	\$250 per week / \$13,000 per year	\$455 per week / \$23,660 per year
<b>Duties</b>	<p>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.</p> <p>Customarily and regularly exercises discretion and independent judgment.</p> <p>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.</p> <p>Does not devote more than 20 percent (40 percent in retail or service establishments) of time to activities that are not directly and closely related to exempt work.</p>	<p>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.</p> <p>Customarily and regularly exercises discretion and independent judgment.</p>	<p>Whose primary duty is 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</p> <p>Whose primary duty includes the exercise of discretion and independent judgment with respect to matters of significance.</p>

## Professional Exemption

### Learned Professional Employees

Test	Old Long Test	Old Short Test	Amended Current Standard Test
<b>Salary</b>	\$170 per week / \$8,840 per year	\$250 per week / \$13,000 per year	\$455 per week / \$23,660 per year
<b>Duties</b>	<p>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.</p> <p>Consistently exercises discretion and judgment.</p> <p>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.</p> <p>Does not devote more than 20 percent of time to activities that are not an essential part of and necessarily incident to exempt work.</p>	<p>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.</p>	<p>Whose primary duty is the performance of work requiring knowledge of an advanced type in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction.</p>

### Creative Professional Employees

Test	Old Long Test	Old Short Test	Amended Current Standard Test
<b>Salary</b>	\$170 per week / \$8,840 per year	\$250 per week / \$13,000 per year	\$455 per week / \$23,660 per year
<b>Duties</b>	<p>Primary duty of performing work that is original and creative in character in a recognized field of artistic endeavor, and the result of which depends primarily on the invention, imagination, or talent of the employee.</p> <p>Consistently exercises discretion and judgment.</p> <p>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.</p> <p>Does not devote more than 20 percent of time to activities that are not directly and closely related to exempt work.</p>	<p>Performs work requiring invention, imagination, or talent in a recognized field of artistic endeavor.</p>	<p>Whose primary duty is the performance of work requiring invention, imagination, originality or talent in a recognized field of artistic or creative endeavor.</p>

**(Footnotes)**

- 1 For example, the amended general regulations now state outright that manual laborers and other “blue collar” workers, such as non-management production line employees and non-management employees in maintenance, construction and similar occupations, are non-exempt. § 541.3. In addition, the new regulations specify that “first responders,” such as police officers and firefighters, are non-exempt. *Id.*
- 2 An employee qualifies as an exempt teacher where the employee’s primary duty is teaching, tutoring, instructing or lecturing in the activity of imparting knowledge and who is employed and engaged in this activity as a teacher in an educational establishment by which the employee is employed. § 541.303(a). The normal salary requirements do not apply to employees covered under this section. § 541.303(d).

The exemption provision for employees who practice law or medicine covers:

- (1) Any employee who is the holder of a valid license or certificate permitting the practice of law or medicine or any of their branches and is actually engaged in the practice thereof; and
- (2) Any employee who is the holder of the requisite academic degree for the general practice of medicine and is engaged in an internship or resident program pursuant to the practice of the profession. § 541.304(a).

The normal salary requirements do not apply to employees covered under this exemption. § 541.304(d).

3. An employee is an exempt as an outside sales employee when:
  - (1) the employee’s primary duty is:
    - i. making sales within the meaning of Section 3(k) of the FLSA, or
    - ii. obtaining orders or contracts for services or for the use of facilities for which a consideration will be paid by the client or customer; and
  - (2) the employee is customarily and regularly engaged away from the employer’s place or places of business in performing such primary duty. §541.500(a).

Section 541.501(b) defines “sales within the meaning of Section 3(k) of the FLSA” to include “the transfer of title to tangible property, and in certain cases, of tangible and valuable evidences of intangible property.” The section also notes that “Section 3(k) of the [FLSA] states that “sale” or “sell” includes any sale, exchange, contract to sell, consignment for sale, shipment for sale, or other disposition.” *Id.*

The normal salary requirements do not apply to employees covered under this exemption. § 541.500(c).

- 4 The FLSA does not penalize employers for misclassifying exempt employees as non-exempt.

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