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Employment Law Update

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May 2004

MUDDY WATERS — THE NEW FLSA REGULATIONS

The U.S. Senate Passed Two Amendments on May 4th — Further Muddying the Waters . . .

Over one year ago, the U.S. Department of Labor (DOL) issued proposed Fair Labor Standards Act (FLSA) regulations, which were available for public comment. The proposed regulations included significant changes to the rules for determining the "white-collar" exemptions.

As most readers are aware, the DOL issued the long-awaited final FLSA regulations on April 20, 2004. They were published in the Federal Register on April 23, 2004.

Based on the new rules, employers must be in compliance with the revised FLSA regulations within 120 days of publication, or no later than August 23, 2004. However, due to the highly politicized and publicized process, uncertainty remains as to whether Congress will move to block funding or otherwise stall implementation of these regulations.

Controversy over Regulations

The goal of the proposed regulations was to simplify the rules for applying the FLSA's "white-collar" exemptions (i.e., executive, administrative, professional, outside sales). Disagreement arose as a result of the DOL's proposed rules. The employer community generally supported the changes with the hope that various changes would decrease litigation and enable employers to more easily determine which employees should be exempt. Union representatives and other employee spokespeople, on the other hand, expressed dissatisfaction based on the fear that the new regulations would expand the "white-collar" exemptions to an additional eight million employees.

In response to the proposed rules, certain states even considered legislation to avoid the effect of the proposed regulations. In fact, Illinois passed legislation based on the proposed regulations. This state legislation will likely perpetuate the ambiguity involving exempt classifications under the former rules. Further, while the revised FLSA regulations address various concerns that were raised, employers will be left with continued uncertainty interpreting various portions of the new regulations.

The Salary Basis Test

The "white-collar" exemptions have always required employees to be "paid on a salary basis" and meet "long" or "short" tests involving various factors. Two significant changes are in the final regulations. First, a single test replaces the old "short" and "long" tests. Second, the minimum salary necessary to apply the test increases to $455 per week, or $23,660 per year. The final regulations significantly increase the $155 per week standard in the former FLSA regulations, and even increase the $425 standard in the proposed regulations. For the first time in decades, salary is a salient element of "white-collar" exempt status.

Exempt Status for Highly Compensated Employees

For the first time, FLSA regulations provide an additional exemption for "highly compensated" employees. In order to qualify for exempt status under this new test, an

employee must: (1) perform "office or non-manual work"; (2) receive total compensation of $100,000 or more, which must at least include $455 per week paid on a salary or fee basis; and (3) customarily and regularly perform at least one of the exempt duties or responsibilities of an exempt executive, administrative or professional employee. Total annual compensation also may include commissions, nondiscretionary bonuses and other non-discretionary compensation during a 52-week period. Further, within one month of the end of the year, an employer can make an additional payment to achieve the minimum required salary. Employees working less than a full year also may qualify on a pro rata basis.

The proposed rules only required $65,000 under this test, which led critics to argue that the exemption would encompass too many employees. While the new rules addressed this concern, they are still vague about how frequently the "exempt duty" must be performed.

The Duties Test

For employees to be covered under the "white-collar" exemptions, an employee's "primary duties" must involve exempt work, which the new regulations define as "the principal, main, major, or most important duty that the employee performs." In addition, they drop the "long" test, which prohibited "white-collar" workers from spending not more than 20 percent of their time on nonexempt work. Now employees who spend more than 50 percent of their time performing exempt duties generally will satisfy this requirement. The new regulations also permit exempt status for employees whose primary duty is an exempt duty, even if they spend less than 50 percent of their time at that duty.

Executives

In looking at the specific categories of "white-collar" employees, the new regulations initially address "executives" and maintain the general requirement that the employee's primary duty must involve "management of the enterprise" or a "customarily recognized department thereof." The executive employee also must "customarily and regularly" direct the work of two or more employees or their equivalent. The new rules additionally require that the employee possess the power to hire and fire other employees or, at minimum, have some influence "as to hiring, firing, advancement, promotion, or other change of status." With this additional requirement, certain executive employees may lose exempt status.

Professionals

This exemption maintains and clarifies the two categories: (1) "Learned Professional," whose primary duty requires advanced knowledge in a field of science or learning "customarily acquired by a prolonged course of specialized instruction," and (2) "Creative Professional," whose primary duty requires invention or talent in an artistic or creative endeavor. The major change expands the definition of advanced education. The DOL modified that definition so that an employee also may qualify for exempt status based on acquiring advanced knowledge "through a combination of work experience and intellectual instruction." But the DOL did not provide a method for determining "an equivalent combination."

With the loosening of the educational requirement, opponents of these changes feared that various employees would lose exempt status. Veterans' groups were successful in lobbying for an exclusion of military training from the alternate education requirement. Thus, a veteran's military experience does not qualify as "advanced instruction and work experience" under this exemption.

Administrative Employees

In the past, the lack of clarity in this category of "exempt" status frustrated many employers. The new FLSA rules alleviate some of the confusion. The final regulations retain the former test, but add modern examples of exempt jobs. Thus, the primary duties remain "performance of office or non-manual work directly related to the management or general business operation of the employer or the employer's customers and . . . includes the exercise of discretion and independent judgment with respect to matters of

significance." The final regulations abandon the proposed substitution of a "position of responsibility" test. They also provide an extensive list of "administrative exemption" examples. Exempt examples include insurance claims adjusters, certain financial services industry employees, team leaders on significant projects, executive assistants, business executives of large companies, and certain human resources managers. Typically nonexempt jobs include inspectors doing "ordinary" inspections, examiners or graders, comparison shoppers, and certain public sector inspectors.

Computer Employees

The new regulations consolidate all the regulatory guidance on the computer occupations exemption into a new regulatory subpart. The language essentially remains unchanged, except that the applicable minimum salary is now $455 per week. If the employee is paid hourly, that rate must be at least $27.63 per hour.

Outside Sales

The new regulations retain the basic requirements for exempt status by requiring sales or obtaining orders "customarily and regularly" away from the employer's place of business. However, the new regulations eliminate any percentage limitation involving incidental nonsales work and merely focus on the "primary duty" of the employee.

Certain Deductions Allowed under Salary Basis Test

The new regulations continue to permit deductions in various circumstances without jeopardizing exempt status. Also, they add flexibility for employees, particularly dealing with employee discipline. Permitted deductions include the following:

- Deductions for absences of a day or more for personal reasons, other than sickness or disability.
- Deductions for absences of a day or more for sickness or disability in accordance with a bona fide plan providing compensation-based sickness or disability (after exhaustion of permitted leave).
- Offsets for a particular week for amounts received as jury fees, witness fees or military pay.
- Deductions from pay as a penalty imposed in good faith for infractions of safety rules of "major significance."
- Deductions from pay for unpaid disciplinary suspensions of one or more days (rather than the former rule requiring an entire week of suspension).
- Deductions for partial weeks in the initial and final weeks of employment.
- Deductions based on unpaid leave under the FMLA.

Generally, these deductions must be taken only in full-day increments.

"Safe Harbor" Provision

Finally, the new rules modify the former window of correction that allowed employers to address improper deductions from salary payments. Now employers with clearly communicated policies, including a complaint procedure, no longer face an automatic loss of exemption for an inadvertent deduction from an exempt employee's salary. But employers who continue improper deductions after an employee's complaint will lose that exemption.

Employers now have an incentive to promulgate plain policies explaining how employees are paid and to enable employees to voice internal complaints if those policies are not followed. Once notified of a

discrepancy, employers can take prompt remedial action, including repayment of the improper salary deduction. This provision encourages greater compliance without increasing employers' exposure to class litigation.

Legislative Response

Although the DOL significantly changed the proposed regulations, the debate continues. Senator Harkin (D-Iowa) continues to lead the charge against the regulations, suggesting blocking DOL funding or using the Congressional Review Act to derail the rules. The Senator also introduced an amendment to his bill, Jumpstart Our Business Strength, designed to curb the new regulations. That bill originally slated for Senate vote on May 3, 2004, passed 52–47. Senator Gregg (R-New Hampshire) also introduced an amendment to the Jobs Act that passed 99–0 and extends the new overtime protection to 55 additional classes of employees. Both amendments were passed on May 4.

The debate, not surprisingly, ranges beyond the Senate. Opponents of the regulations, including Senator Harkin, claim millions could lose overtime protections. The President of the AFL-CIO, John J. Sweeney, wrote to several major newspapers arguing that workers need greater protection. Labor Secretary Chao, however, countered this opposition at a House Oversight Hearing on April 28, 2004, stating the new regulations "strengthen and guarantee overtime pay protection" for millions of additional workers. A simple resolution is not likely because this is a campaign year and the debate is growing more contentious. In fact, the DOL charged Senator Harkin and others of conducting an "orchestrated misinformation campaign . . . with absolutely false assertions."

If you have any questions about these matters, please call Barry A. Hartstein (312/609-7745) or Edward G. Renner (312/609-7831) or any other Vedder Price attorney with whom you have worked.

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