

June 18, 2004

EMPLOYMENT ALERT

NEW DEPARTMENT OF LABOR REGULATIONS FOR EXEMPT EMPLOYEES UNDER THE FAIR LABOR STANDARDS ACT

INTRODUCTION

For the first time in more than 50 years, the United States Department of Labor (DOL) has issued new regulations updating and clarifying who may be exempt as Administrative, Executive, and Professional employees under the Fair Labor Standards Act (FLSA). These regulations will take effect on August 23, 2004.

Oregon employers must comply with both state and federal law. When state and federal law diverge, employers must apply the most generous of the two provisions. Because Oregon state law has, in the past, provided more stringent requirements for exempt status than federal law, the new federal rules will not have as dramatic an effect in Oregon as elsewhere. However, the changes in the federal regulations will nonetheless affect Oregon employers. This Employment Law Alert provides a detailed description of their impact.

The FLSA requires that employees, unless exempt, be paid minimum wage and time and a half for all hours worked over 40 in a workweek. There are more than a dozen exemptions under the FLSA, but the most frequently applied exemptions are the white-collar exemptions for Administrative, Executive, and Professional employees. To be exempt under one of these exemptions, an employee must: (1) be paid a certain compensation level; (2) be paid on a salary basis; and (3) perform certain exempt duties.

CHANGE TO THE REQUIRED SALARY LEVEL

Effective August 23, 2004, the minimum salary an exempt employee must be paid is \$455 per week, or \$23,660 per year. The new salary level is significantly higher than that required under the old regulations, which was \$155 per week under the “long test” and \$250 per week under the “short test.”

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The new salary level is also significantly higher than current Oregon state law, which requires a minimum salary level of \$282 per week (or \$14,664 per year) to be eligible for exempt status.

After August 23, 2004, an employee who makes \$455 or more per week may be eligible to qualify as an exempt employee, so long as the employee is also paid on a salary basis and performs certain exempt duties.

CHANGE TO THE SALARY BASIS TEST

Generally, to qualify for exempt status as Administrative, Executive, or Professional, an employee must be paid on a salary basis. The salary basis test requires that an employee regularly receive a predetermined amount constituting all or part of the employee's salary, which is not subject to deduction based on the quantity or the quality of the work performed. In short, an exempt employee must be paid his or her full salary for every workweek in which *any* work is performed, unless a reduction of salary is authorized by law.

Under the old rule, an employer could reduce an exempt employee's salary under the following circumstances:

- The employee performed *no* work in a workweek;
- The employee was absent for one or more full days for personal reasons, other than sickness or disability;
- The employee was absent from work for one or more full days due to sickness or disability and the deduction in salary was made under a plan, policy, or practice of providing wage replacement benefits for these types of absences;
- To offset any amounts received as payment for jury fees, witness fees, or military pay;
- In first and last weeks of employment, a proportionate part of an employee's full salary may be paid for time actually worked;
- An exempt employee's salary may be reduced for unpaid leave taken pursuant to FMLA; and

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- To punish an employee for violating a “safety rule” of “major significance.”

These deductions from salary are allowed under the new federal regulations. The new federal regulations also add another type of permissible deduction.

Under the old rules, an employer could not subject an exempt employee to an unpaid suspension except in one-week increments (except for violations of safety rules of major significance – a deduction of almost no utility for white-collar workers). Under the new rules, an employer may deduct an exempt employee’s salary “for unpaid disciplinary suspensions of one or more full days imposed in good faith for infractions of workplace conduct rules. Such suspensions must be imposed pursuant to a written policy applicable to all employees.” For example, an employer may suspend an exempt employee without pay for two days for violating a written, generally applicable sexual harassment policy, or for violating a generally applicable written policy prohibiting workplace violence.

According to DOL commentary, this exception to the salary basis test should be construed narrowly and applied only to serious workplace misconduct, not performance or attendance issues. As to the requirement that the unpaid suspension be imposed pursuant to a generally applicable written policy, this refers to a written policy containing significant conduct rules. The policy need not exhaustively list every specific violation that could result in a suspension, but should list illustrative examples of violations and specifically mention that violations of the policy could result in discipline, including an unpaid disciplinary suspension or termination.

The new regulations clarify that a number of payroll practices do not affect an exempt employee’s status. These include: taking deductions from accrued leave accounts, requiring exempt employees to track and record hours worked, requiring exempt employees to work a specified schedule, and implementing across-the-board changes in schedule.

**NEW SAFE HARBOR PROVISION ALLOWING EMPLOYERS
TO CORRECT UNLAWFUL DEDUCTIONS**

Under the old rules, the consequences for violating the salary basis test were particularly harsh: a single unlawful deduction could result in an organization-wide loss of exempt status, and there were limited opportunities for the employer to correct improper deductions. Also, even if an employer did not have an “actual practice” of making improper deductions, exempt status could be lost when the employer maintained policies that created a “significant likelihood” of an improper deduction.

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Like the old rule, the new rule punishes employers who have an actual practice of making improper deductions. "Actual practice" is determined by looking at a number of factors, such as the number of unlawful deductions, the time period, the number and geographic location of employees whose salary was unlawfully reduced, the number of managers responsible for taking the improper deductions, and whether the employer had a clearly communicated policy permitting or prohibiting improper deductions. When an employer maintains an actual practice of making unlawful deductions, the exemption is lost during the time period in which the deductions were made. Unlike the former rule, however, the loss of exempt status extends only to employees in the same job classification working for the same managers responsible for the actual improper deductions. For example, if managers have an actual practice of improperly docking the pay of a professionally exempt physician's assistant in a hospital's internal medicine department, then all the physicians' assistants whose pay could have been docked by the managers who made the improper deduction would lose the exemption and they would be entitled to minimum wage and overtime for the time period in which the improper deductions were made. However, nurses managed by the same managers and physicians' assistants managed by other managers would not lose their exempt status.

The new rule creates a broad safe harbor for employers that allows employers to avoid a classification-wide loss of exempt status. When an employer has a clearly communicated policy that prohibits improper pay deductions, includes a complaint mechanism, reimburses employees for any improper deductions, and makes a good faith commitment to comply in the future, then the employer will not lose the exemption for any employees unless the employer willfully violates its policy by continuing to make improper deductions after receiving employee complaints. If an employer fails to reimburse employees for any improper deductions or fails to correct its practice after receiving employee complaints, the exemption will be lost during the entire time period in which the improper deductions were made as to employees in the same job classification working for the same managers responsible for the actual improper deductions. The best evidence of a clearly communicated policy is a written policy that was distributed to employees prior to the improper pay deductions, for example, the inclusion of a written policy in an employee handbook or publication of it on the employer's intranet. Because the policy must include a complaint mechanism, it is similar to now-standard policies on workplace harassment. When a proper policy is in place, the burden of reporting the violation shifts to the employee, thereby giving the employer an opportunity to correct the violation before a lawsuit is filed.

Finally, the new rule also provides that improper deductions that are inadvertent or isolated will not result in the loss of exemption for any employees who may have been subject to such improper

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deductions, so long as the employer reimburses the employee. This provision makes it clear that a one-time, inadvertent deduction will not result in the loss of exempt status.

CHANGES TO THE DUTIES TEST FOR ADMINISTRATIVE EMPLOYEES

To qualify as an exempt administrative employee, the employee must perform administrative duties as defined in state and federal law. For several years, Oregon has provided a more restrictive definition of exempt administrative duties than federal law. The new federal regulations concerning the duties of administrative employees are updated and more clear, but for the most part set forth requirements that Oregon employers have already been complying with under stricter state standards. Oregon employers should take this opportunity to review the legal standards applicable to exempt administrative employees and ensure compliance with those standards.

An exempt administrative employee must have as his or her primary duty 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 or the academic administration of a school. While federal law requires that the primary duty "include" the exercise of discretion and independent judgment, Oregon state law requires that the employee "*customarily and regularly* exercise discretion and independent judgment." Both state and federal law require that the discretion and independent judgment that is exercised be on matters of significance.

Additionally, Oregon law requires that the discretion and independent judgment be exercised in the course of: (a) regularly and directly assisting a proprietor, an executive or an administrative employee; (b) performing highly specialized or technical work under only general supervision; or (c) executing special assignments and tasks under only general supervision.

PRIMARY DUTY IS DIRECTLY RELATED TO MANAGEMENT

Work related to management refers to work related to the running or servicing of the business, as distinguished from production work that the enterprise exists to perform. For example, selling products in a retail establishment is not work directly related to management or general business operations. Work that directly relates to management or general business operations includes, but is not limited to, work in such areas as tax, finance, accounting, budgeting, marketing, human resources, public relations, legal compliance, labor relations, government relations, internet and database and computer network administration, research, quality control, safety and health, and similar activities.

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DISCRETION AND INDEPENDENT JUDGMENT

Under Oregon law, an exempt administrative employee must also customarily and regularly exercise discretion and independent judgment with respect to matters of significance. “Customarily and regularly” means a frequency that is greater than occasional, but which may be less than constant. It includes work that is normally and recurrently performed every workweek.

The exercise of discretion and independent judgment involves the comparison and evaluation of possible courses of conduct. It implies that the employee has authority to make an independent choice, free from immediate supervision, though the fact that an employee’s decision or recommendation is subject to review does not mean that the employee is not exercising discretion and independent judgment.

Factors to consider in determining whether an employee exercises discretion and independent judgment with respect to matters of significance include: 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 business; whether the employee has authority to negotiate and bind the employer on significant matters; whether the employee performs work that affects business operations to a significant degree; and whether the employee represents the employer in handling complaints, resolving grievances and the like. Independent judgment does not include applying well-established techniques, or work that is clerical, secretarial, mechanical, or routine in nature.

EXAMPLES

The regulations provide updated examples of exempt administrative activities and positions. For example, an employee in the financial services industry may be exempt if he or she collects and analyzes information about customer assets, determines which products are best, and advises customers about the relative advantages and disadvantages. However, an employee whose primary financial duty is selling financial products does not qualify as an administrative employee. An employee who leads a team of other employees to complete major projects (such as purchasing or closing a business) is exempt. Other examples of exempt administrative employees include human resource managers who formulate, interpret or implement employment policies; management consultants who study the operations of a business; and executive assistants to a business owner who have been delegated authority regarding matters of significance.

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CHANGES TO DUTIES TEST FOR EXECUTIVE EMPLOYEES

To qualify as an exempt executive employee, the employee must perform executive duties as defined by state and federal law. As the case for administrative duties, federal law concerning exempt executive duties now tracks more closely Oregon state requirements that Oregon employers have had to comply with for years. A review of those requirements follows.

To qualify as an exempt executive employee under state and federal law, the employee must have: (1) a primary duty of management; (2) must customarily and regularly direct the work of two or more full-time employees (or the equivalent); and (3) must have authority to hire or fire others, or whose recommendations as to hiring, firing, advancement, promotion or other significant change in employment status be given particular weight. In addition, Oregon law requires that (4) the employee must customarily and regularly exercise discretionary powers.

PRIMARY DUTY IS MANAGEMENT

Management includes activities such as interviewing, selecting and training employees, setting and adjusting rates of pay and hours, directing work, maintaining production or sales records for use in supervision, appraising productivity for the purpose of recommending changes in employee status, handling employee complaints, disciplining employees, planning and assigning work, determining the materials to be bought and sold, providing for safety and security, planning and controlling the budget, and monitoring or implementing legal compliance measures. The management that must be exercised is over the entire business or a subpart that has a permanent status and continuing function.

CUSTOMARILY AND REGULARLY DIRECTS TWO OR MORE FULL TIME EMPLOYEES

Another duty requirement for executives is that they customarily and regularly direct the work of two or more employees. What is required is the supervision of two full-time, 40 hours per week employees, or the equivalent.

AUTHORITY TO HIRE, FIRE, OR WHOSE DECISIONS ABOUT JOB STATUS ARE GIVEN PARTICULAR WEIGHT

Under the old federal rule, an exempt executive did not have to have the authority to hire and fire employees, or to make recommendations as to employee status changes that were given particular

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weight. Under the new federal rule and Oregon state law, to qualify as an exempt executive employee, the employee must have authority to hire employees, or to make recommendations about status changes that are given particular weight.

The new federal regulations clarify what is meant by the term “particular weight.” While an executive need not have the authority to make the final decision, “particular weight” refers to more than the occasional suggestion about a coworker. To determine if an employee has this level of authority, courts will look at whether it is part of the employee’s job duties to make recommendations, how often they are made, and how often relied upon.

CUSTOMARILY AND REGULARLY EXERCISES DISCRETIONARY POWERS

Under Oregon state law, exempt employees must customarily and regularly exercise discretionary powers. Discretion refers to the selection of a course of action among a number of alternatives after consideration, and implies that one’s decision is made freely, without immediate supervision, and that discretion is exercised with respect to matters of significance.

CHANGES TO THE DUTIES TEST FOR PROFESSIONAL EMPLOYEES

Under the new regulations, the duties of a learned professional include primary work requiring advanced knowledge in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction. New federal regulations provide that this is work that is predominately intellectual in character and requires the “consistent” exercise of discretion and independent judgment.

New federal regulations clarify the requirement that the advanced knowledge be customarily acquired by a prolonged course of specialized intellectual instruction. This phrase restricts the exemption to professions where specialized academic training is a standard prerequisite for entrance into the profession. The best evidence that an employee meets this requirement is possession of the appropriate academic degree. However, the exemption is also available to employees in such professions who have substantially the same knowledge level and perform substantially the same work as the degree employees but who attained the advanced knowledge through a combination of work experience and intellectual instruction. This would permit the exemption to apply to the occasional chemist, for example, who does not hold an advanced degree in chemistry. The exemption is not applicable, however, to occupations in which most employees have acquired their skill by experience rather than by advanced specialized intellectual instruction.

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The new federal regulations list a number of professions that generally meet the requirements for exempt professional status. These include: lawyers, teachers, accountants, pharmacists, engineers, actuaries, doctors, physicians' assistants, registered nurses (but not LPNs), athletic trainers who have successfully completed four academic years of pre-professional and professional study (and who meet other requirements), and executive chefs who have attained a four-year specialized academic degree in a culinary arts program.

THE HIGHLY COMPENSATED EMPLOYEE EXEMPTION

New federal regulations create an exemption for employees whose total annual compensation is at least \$100,000, and who customarily perform one or more of the exempt duties or responsibilities of an exempt Administrative, Executive, or Professional employee. Because Oregon state law contains no such exemption at this point, Oregon employers should not rely on this exemption.

SUMMARY

The new federal regulations provide more generous coverage as to the salary requirement that exempt employees be paid a salary of at least \$455 per week. New federal regulations also provide more opportunity for employers to avoid the harsh consequences for failing to comply with the salary basis test. State and federal laws provide slightly different, but largely overlapping, duties tests, and Oregon employers must comply with the regulations most favorable to employees.

REQUIRED ACTIONS

These final regulations will take effect on August 23, 2004. As a result, employers should now undertake the following actions:

- Review each position that you believe is exempt to determine whether the position is correctly classified as exempt under the new rules. If a position is in the "gray zone," or if you have questions about reclassification, call counsel.
- Adopt a new policy for payment of exempt employees on a salary basis, including a complaint mechanism.

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- Adopt a policy on serious workplace misconduct (or review and revise your existing policy on serious workplace misconduct). Doing so will give you greater latitude in disciplining exempt employees for serious misconduct.

If you have questions, please feel free to call any of our labor and employment lawyers.

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