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U.S. Department of Labor Issues New Rules Regarding White-Collar Overtime Exemptions

On April 20, 2004, the United States Department of Labor ("DOL") finalized long-awaited revisions to its decades-old regulations construing overtime exemptions under the Fair Labor Standards Act ("FLSA"). The new regulations, which will become effective on August 18, introduce several key changes to the way the DOL will construe the FLSA overtime provisions. This bulletin summarizes six (6) key aspects of those changes, and how they may (or may not) affect California employers.

I. Minimum Salary Requirement

The old regulations provided a minimum exempt status salary of $155 per week ($8,060 annually). This salary standard had not been changed in nearly thirty years, and was clearly outdated. For example, it was less than the pay that a non-exempt hourly employee would receive for full-time employment at the minimum wage (approximately $10,500 per year.) The new regulations update the minimum exempt salary, providing that employees may not be considered exempt unless they earn at least $455 per week ($23,660 annually), and satisfy the applicable duties component of the overtime exemption to which they belong.

Impact on California Employers: California law (which controls to the extent it provides greater protections to employees than federal law), imposes a higher minimum salary requirement ($2,340 per month or $28,080 annually). Therefore, the new salary threshold will not have an impact in California. However, California employers should take note of the new threshold to the extent they employ workers in other states where FLSA regulations may control.

II. Salary Deductions

Two aspects of the new regulations regarding deductions from exempt employees' salaries are important. First, with respect to unpaid disciplinary suspensions, federal law previously permitted deductions only when the employee was suspended for an entire workweek, or for a partial workweek because of a *major safety rule* violation. However, the new regulations permit deductions for unpaid disciplinary suspensions of one or more full days imposed in good faith for infractions of "workplace conduct rules" (for example, violation of a sexual harassment policy), a much broader category of discipline. Importantly, the regulations provide that the employer may only impose the suspensions pursuant to a written policy applicable to *all* employees. Otherwise, such deductions will be deemed inconsistent with a salary basis of payment. All employers should consider adopting written policies that specifically provide for the possibility of full-day unpaid disciplinary suspensions.

Second, the regulations establish a "safe harbor" employers may use to reduce the risk of liability arising from improper deductions. Currently, if an employer improperly deducts from an exempt employee's salary (for example, for a partial day absence), the employee may be deemed non-exempt during the pay period in which the deduction

occurred. However, the new regulations provide that if an employer has a clearly communicated policy that: (i) prohibits improper pay deductions; (ii) articulates a mechanism by which employees can complain about deductions; (iii) reimburses employees for improper deductions; and (iv) reflects a good faith commitment by the employer to avoid future improper deductions, the exemptions will not be jeopardized unless the employer willfully violates the policy. All employers should ensure that they have adopted such written policies.

Impact on California Employers: Although California law does not currently state whether California courts and the California Labor Commissioner will observe these rules regarding salary deductions, we believe that more likely than not California will observe these rules. California does not currently have any regulations that are inconsistent with these rules, and generally California has followed federal rules on salary deductions. The existence of a Republican, pro-business administration in California makes it even more likely that California will observe these rules. Moreover, California employers should strongly consider (in consultation with legal counsel) adopting both forms of written policies identified above (*i.e.*, regarding unpaid disciplinary suspensions, and correcting improper deductions) so that they may benefit from these new rules (assuming California does in fact choose to follow them).

III. Consolidation of "Long" and "Short" Duties Tests

The old federal regulations established a "long" and "short" duties test for the executive, professional, and administrative exemptions. The "long" test applied to administrative and executive employees earning $155-$250 per week, and to professional employees earning $170-$250 per week. The "short test" provided a more lenient duties standard that applied to administrative, executive, and professional employees earning $250 or more per week. Because the salary standards had become so outdated, employers could use the "short test" to evaluate the exempt status of virtually every position. However, the new regulations unify the "long" and "short" tests into a single duties test all employees earning between $23,660 and $100,000 annually.

The new duties regulations are in some respects more lenient and in some respects more strict than before. Most significantly, the duties test is more strict as to the *executive exemption* in that the employee must have authority to hire or fire, or strong recommendation authority as to hiring, firing, advancement, promotion, or other change in status (Note: this is in addition to the other pre-existing requirements for the executive exemption, including supervision of two full-time employees, management responsibility for a recognized department/ subdivision, etc.). The duties standards for these exemptions are more lenient in that they eliminate the requirement of the former long test that the employee generally must not devote more than 20 percent of his or her time to non-exempt work.

Impact on California Employers: California's duties tests are more strict than the new federal regulations, and as a result these changes should not impact California employees. The elimination of the short test is irrelevant in California because California did not recognize any form of "short test." Further, California already required executive employees to have hiring or firing authority. California did not have any rule providing that an exempt employee may not devote more than 20 percent of his or her time to non-exempt work. Rather, California law requires that an employee spend more than 50 percent of his or her time on exempt work. By contrast, federal law requires that the employee's primary (or most important) duty be exempt, which does not necessarily require that the employee spend more than 50 percent of his or her time on exempt work. The new federal regulations do not significantly change the "primary duty" test.

IV. Highly Compensated Employees

The new regulations make it easier to satisfy the administrative, executive and professional duties requirements for "highly compensated employees" (*i.e.*, an employee with total annual compensation of at least $100,000, including nondiscretionary bonuses). Although the regulations do not refer to it as a "short test," the highly compensated category may be viewed as a new kind of short test for the most well paid employees. A "highly compensated employee" is exempt if the employee: (i) performs office or non-manual work; and (ii) "customarily and regularly" (*i.e.* frequently but not constantly) performs any one or more of the exempt duties or responsibilities of an employee in one of the three main exempt categories. For example, an employee who earns in excess of $100,000, performs office work, and supervises two or more employees will fall within the "highly compensated' executive exemption, even if the employee does not have authority to hire and fire.

Impact on California Employers: The "highly compensated" category will not help California employers. Under California law, employers must satisfy the same extensive duties test for exempt employees earning well in excess of $100,000 salary as those who earn well below $100,000.

V. Exempt Employee Reliance on Manuals vs. Exercise of Discretion

The new regulations clarify the duties test in three important respects. First, under both the old regulations and established case law, employees who relied heavily on manuals and other instruction-filled documents that imposed very prescribed limits on how they carry out duties did not possess the requisite "discretion and independent judgment" for the duties test. However, the new regulations clarify that reliance on manuals will not automatically prohibit an exempt classification, if the manuals serve primarily as guidelines (rather than strict instruction manuals) and relate to complex issues that can only be interpreted by those with specialized knowledge or skills. The regulations seem to curtail, to some extent, case law finding employees non-exempt based upon their reliance on manuals to carry out duties.

Impact on California Employers: California does not currently have any regulations that are inconsistent with the new regulations regarding manuals. There is a good chance that they will be followed in California.

VI. Level of Education and the Professional Exemption

The new regulations clarify the meaning of the requirement that a professionally exempt position must involve advanced knowledge that is "customarily acquired by a prolonged coursed of specialized intellectual instruction." The old regulations were vague as to whether a four-year degree in a certain profession would suffice, or whether a more advanced degree (or a four-year degree with some work experience) was required, and court cases seemed to do more to confuse the issue than to clarify it. The new regulations strongly suggest (without expressly stating) that a profession normally requiring a four-year degree should suffice, assuming the other requirements of the professional exemption are met. The regulations emphasize, however, that the 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. Further, the learned professional exemption will not apply to employees who acquire skills through experience rather than advanced specialized intellectual instruction.

Impact on California Employers: California regulations do not conflict with this new provision, and there is a good chance they will be observed in California.