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Labor & Employment A Practice Focus

Executive Exemption

FLSA revisions will clarify when white collar workers get overtime pay.

By Thomas S. Williamson Jr. and Reenah L. Kim

The U.S. Department of Labor recently proposed a long overdue regulatory initiative that will substantially assist employers and employees in understanding which white collar employees are entitled to receive overtime pay.

The proposal concerns implementation of the Fair Labor Standards Act, which was intended to help those in the nation's working population who most need protection. The law was originally enacted in 1938, as a response to the Great Depression. Regulations issued by the Department of Labor implementing the "white collar" exemptions have remained largely unchanged since 1954 (i.e., nearly 50 years). During that lengthy tenure, the current regulations have proven to be confusing and irrational in their application. The Labor Department's recently issued proposed revisions to its regulations offer a promising first step in updating the rules. Yet room for improvement still remains.

Among other things, the FLSA provides to certain employees guarantees of a minimum wage and overtime compensation (at one-and-a-half the regular pay rate for all hours worked over 40 in a week). The FLSA also grants to the secretary of labor the authority to define the terms of "white collar" exemptions from the law's minimum wage and overtime requirements. The principal categories of employees who may be exempted from these requirements are defined in the regulations as "executive," "administrative," "professional," "computer," and "outside sales" employees. The proposed revisions would work needed changes in how the Labor Department implements the FLSA's mandates.

Highlights of Changes

The existing regulations set out two principal categories of tests by which employers may determine white collar exemptions. The "salary tests" examine the method and amount of the employee's compensation; the "duties tests" focus on the employee's job functions and responsibilities. For an employee to be exempt, both tests must be satisfied.

Under the department's proposal, the most substantial revisions to the regulations concern the exemptions for executive, administrative, and professional employees. These changes are summarized below.

Salary Tests: Regarding salary levels, the department's proposal eliminates the two different salary levels which trigger separate "long" or "short" duties tests. The existing salary levels for the "long" (i.e., more detailed and exacting) duties test are $155 per week for executive and administrative employees and $170 per week for professional employees, and the existing salary level for the "short" duties test is $250 per week. As revised, the regulations would instead adopt a single, "standard" duties test for each type of exemption and increase the minimum salary level to $425 per week. This change would automatically guarantee eligibility for overtime compensation for any employee making less than $22,100 per year.

Regarding salary basis, the regulations require that, to be exempt, an employee must regularly receive a predetermined amount of salary "not subject to reduction because of variations in the quality or quantity of the work performed." The department's proposal allows employers greater flexibility in "docking" or reducing the pay of exempt employees for disciplinary reasons. By clarifying the "window of correction" and proposing new "safe harbor" provisions, the revised regulations would also ensure that employers do not lose exemptions for entire classes of employees because of isolated, improper pay deductions.

Duties Tests: The DOL proposes replacing the separate long and short duties tests with "standard" tests which focus on the employee's "primary duty." In the revised regulations, the main elements of the duties tests would be as follows:

- Executive: An exempt executive employee has the primary duty of "managing the enterprise" or a recognized subdivision; "customarily and regularly direct[s] the work of two or more other employees"; and either has the "authority to hire or fire other employees," or makes recommendations that

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carry "particular weight" regarding any change in the status of other employees.

- Administrative: An exempt administrative employee has the primary duty of performing "office or nonmanual work related to the management or general business operations of the employer or the employer's customers" and holds a "position of responsibility."
- Professional: An exempt professional employee has the primary duty of performing "office or nonmanual work requiring knowledge of an advanced type in a field of science or learning" or "requiring invention, imagination, originality or talent in a recognized field of artistic or creative endeavor."

Special Rule: In addition to restructuring and redefining the duties tests, the department's proposal includes a special rule for highly compensated employees which would exempt employees who make at least $65,000 per year, perform nonmanual work, and have any one of the executive, administrative, or professional functions described in the standard duties tests. In other words, a highly compensated employee would not have to meet all the elements of these duties tests to qualify for an exemption.

A Positive First Step

In many respects, the department's proposed rules would be a welcome change from the current scheme, which is antiquated and somewhat haphazard in its effectiveness. Revisions to the regulations for white collar exemptions should have occurred decades ago, but there has previously been political timidity or unwillingness to risk upsetting the long-standing status quo.

For example, the Labor Department has not updated the salary level tests since 1975. Under current rules, an employee earning more than $8,840 per year who satisfies the long duties test may be exempt from overtime. Everyone who works 40 hours a week at minimum wage, however, makes more than $10,700 per year, thus rendering the long duties tests irrelevant as a practical matter. Moreover, current regulations are based, in part, on certain assumptions about the workplace that are now out of date. The regulations do not, for example, reflect the effects of technology on the nature of production. The regulations specifically mention job classifications like "key punch operators," "straw bosses," "legmen," and "gang leaders," which no longer exist today or exist only in small segments of the work force.

In addition, years of litigation over the white collar exemptions have demonstrated the difficulty of applying the regulations consistently. At times, the ambiguous terms of the regulations have led to apparently illogical results. For instance, in one case a court found that an airline pilot was an exempt professional because he had the ability to decide whether a plane was airworthy and to determine when weather conditions made take-off impossible. Yet, in another case, a court held that instructors who provided sophisticated training to NASA's space shuttle ground control personnel did not qualify for a professional exemption because they did not exercise sufficient discretion, in that they followed simulation scripts and guidance from supervisors. Despite the divergent outcomes, the two positions obviously have much in common.

On several occasions, courts have expressly signaled in written opinions their dissatisfaction and frustration with the lack of clear guidance from the Labor Department. These courts have pointedly noted that deference is not owed to the department's extensive interpretive regulations relating to the white collar exemptions. Also, the unpredictability of the exemption rules likely has generated increased litigation. According to the American Bar Association, the number of federal "collective-action" lawsuits seeking overtime pay from employers actually exceeded the number of class-action employment discrimination suits in 2001.

The department's proposal seeks to respond to these problems by updating the regulations to make them simpler and more in tune with the nation's 21st century economy. As revised, the salary basis tests would include increased salary levels. The debate continues as to the fairness of the department's methods for setting these levels (which, instead of simply adjusting to account for inflation, are based on data for actual salaries currently being paid in the economy). But the proposed salary levels are clearly more appropriate for today's work force.

The revised regulations would also enhance employers' flexibility with respect to pay docking and the salary basis test. Specifically, the department's proposal includes an exception to the no-pay-docking rule for pay deductions associated with full-day disciplinary suspensions. The proposal thereby allows employers to impose various disciplinary measures as appropriate in response to employee misconduct, such as sexual harassment or workplace violence, without sacrificing exemptions.

Furthermore, the revised regulations would mitigate the draconian consequences of employers' improper pay deductions. Currently, an employer that makes improper pay deductions risks losing the exemption for an entire class of employees. The revised regulations would create a safe harbor provision and clarify what is known as the "window of correction" provision, so that employers forfeit the exemption only for a particular pattern and practice of improper deductions.

Room to Improve

Although the Labor Department deserves credit for taking this important first step, improving the white collar exemption rules continues to be a work in progress. In some areas, the department's proposal still falls short of the mark, particularly in achieving greater clarity and predictability. For instance, rules defining the administrative exemption are perhaps the most obscure and difficult to apply. The regulations currently use a duties test which purportedly distinguishes work "related to the administrative operations of the business" from "production" work (the "production versus staff dichotomy"), a distinction that is often difficult to apply. In addition, the Labor Department requires that exempt administrative employees exercise "discretion and independent judgment." These are inherently nebulous concepts in many work situations.

Instead of eliminating these ambiguities, the department's proposal substitutes one subjective definition for another, replacing the "discretion and independent judgment" requirement with "position of responsibility." According to the proposed regulations, this new term means that an exempt administrative employee either "customarily and regularly perform[s] work of substantial importance or perform[s] work

requiring a high level of skill or training." Both elements of the new qualification will be susceptible to multiple interpretations and require further clarification because the old, like the new, definitions rely on highly subjective concepts.

The department's proposal also has not sufficiently diminished the potential for seemingly inconsistent results. Litigation over the status of newspaper and broadcast journalists as "creative" professionals has resulted in uncertain distinctions, with at least one court suggesting that the size of the news organization's market, rather than the nature of the journalist's duties, may be determinative of whether journalists are exempt. The department's proposal establishes a duties test for creative professionals which substantially replicates the current short duties test and therefore does not appear to make much of a difference in resolving these issues.

In another example, the element of the revised duties test for professionals that requires exempt employees to have a "primary duty of performing office or nonmanual work" seems incongruous with the actual tasks of certain professionals, such as scientists who do extensive fieldwork. Moreover, the examples given in the department's proposal occasionally appear to be somewhat arbitrary. The proposal states, for instance, that chefs would satisfy the primary duty test for the "learned" professional exemption, but electricians would not.

Potential for Significant Changes

The proposed regulations have already generated political sparks between advocates for workers and management. This is predictable and inevitable because of the uncertain impact the proposed regulations would have on the aggregate numbers of white collar workers eligible for overtime. The Labor Department tries to suggest that there would be overall offsetting impacts, but labor representatives are concerned that the net effect would be to shrink significantly the numbers of overtime-eligible employees.

The full extent of this impact remains to be seen. According to the Labor Department, its proposed regulations would secure overtime pay for 1.3 million additional workers because of the increased salary levels. For example, assistant managers at fast food restaurants who are currently exempt would presumably become eligible for overtime pay despite their management status, as long as they earn less than $22,100 per year. The Labor Department also concedes that its proposal would cause about 640,000 workers who now qualify for overtime to lose this protection because they would become exempt. Critics contend that this figure would actually be higher because the new regulations would make exemptions easier to establish. For instance, the revised duties test for learned professionals likely would increase the number of exempt employees due to the reduced emphasis on the academic credentials requirement.

Whether the department's revised regulations would help or hurt workers depends on one's perspective. Contending that required overtime pay is often the only measure preventing employers from demanding excessive work hours, union officials, on the one hand, argue that the department's proposal may weaken the traditional 40-hour workweek, forcing higher-income workers to work much longer hours for less pay. The Labor Department, on the other hand, claims that the revised regulations would recognize the professional status of skilled employees, providing them with guaranteed salary and flexible hours.

In addressing these issues, the department has invited comments on whether it should eliminate the duties tests for highly compensated employees (i.e., a salary-only test) or remove the salary-level tests entirely, so that white collar exemptions would be granted solely on the basis of employee duties. Such alternatives would possibly enhance simplicity, but would not likely comport with the purposes of the FLSA and fairness to various categories of workers who should not be swept into the white collar exemption.

The Labor Department has made a positive start on needed reforms; and the comment period will allow the department further opportunities to improve on its proposal before the regulations are published in final form.

Thomas S. Williamson Jr. is a partner at Covington & Burling in Washington, D.C., and head of the firm's employment practice group. From 1993 to 1996, he served as the solicitor of labor for the U.S. Department of Labor. Reenah L. Kim is an associate at Covington & Burling.