

# Don't Get Clocked

## WITH OVERTIME CLAIMS

Whether or not the **PROPOSED AMENDED REGULATIONS** are finalized, employers need to understand this murky issue that can result in **SIGNIFICANT LIABILITY.**

BY JEFFREY M. SCHLOSSBERG

**W**hat has four words and can cause employers significant liability? Wage and Hour Law. Fair Labor Standards Act. Take your choice. When it comes to understanding the nuances of how to pay employees overtime properly, the old adage of “an ounce of prevention is worth a pound of cure” has never been more appropriate.

And, if the legal landscape was not rough enough, on March 31, 2003, the U.S. States Department of Labor (DOL) issued proposed regulations that stand to change dramatically the standards for determining which employees are exempt from the payment of overtime under the federal Fair Labor Standards Act (FLSA).

However, on Sept. 10, the U.S. Senate voted to block the DOL from finalizing the proposed regulations (earlier this summer, the House voted by a narrow margin to approve them). Business

groups have vowed to carry on the fight to preserve the proposed overtime regulations through a House-Senate Conference bill, which is where things stood at the time this issue went to press.

In the meantime, while the politicians continue their battle, there is no time like the present for employers to focus on the issue of proper payment of overtime and how to classify (or avoid misclassifying) their workforces.

It is no secret that wage and hour litigation does not regularly garner front-page media attention. However, an employer's exposure for failure to comply with the FLSA and accompanying DOL regulations is significant. An aggrieved employee is entitled to unpaid overtime for up to three years, plus double damages and attorney's fees. Complaints can be initiated by a disgruntled employee or former employee, or without complaint by the

DOL on its own through random audit.<sup>1</sup> Moreover, the FLSA permits “class action”-type cases to be brought, thereby entitling an employee and all those similarly situated to seek relief in the context of one lawsuit.

Many experts and business owners alike have questioned whether there is any value in familiarizing themselves with regulations that ultimately may not be implemented in their proposed form. The answer is unequivocally “Yes.” As an initial matter, the regulations in their current form are, in many instances, decades old and out of date. Thus, it is still possible that significant changes to the existing regulations will take place in several fundamental areas. Later in this article, tips will be offered on how to anticipate issues raised by the new regulations (whether implemented in their proposed form or with changes following public comment).

### The Significant Changes

A detailed review of all of the changes is beyond the scope of this article. However, focus is given to the most noteworthy proposals.

#### MINIMUM SALARY LEVEL INCREASED.

For the first time since 1975, the proposed regulations increase the minimum salary for an exempt employee from \$155 per week to \$425 per week. This increase is the largest since Congress passed the FLSA in 1938. According to the DOL, the change would guarantee overtime to employees such as: a restaurant manager earning \$15,600 per year; a department store manager earning \$18,000 per year; and a machine shop supervisor earning \$17,000 per year.

#### 'DUTIES TEST' FOR DETERMINING EXEMPTIONS REPLACED.

The proposal replaces the outdated and complex “duties test” for determining exempt status. The new regulations create a new “primary duty” test for the three major

exempt classifications (executive, administrative and professional).

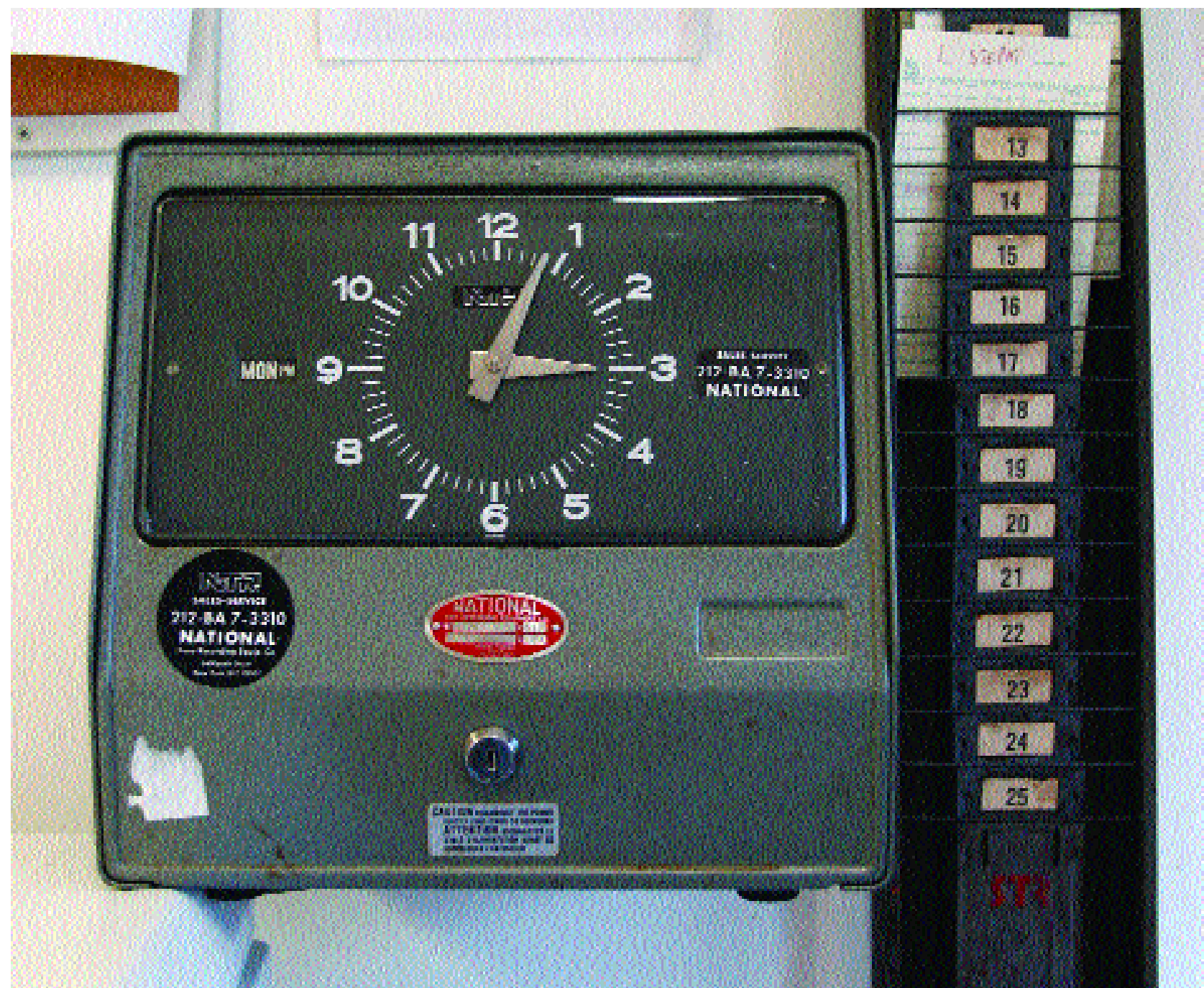
According to the DOL, the changes revise job duties required to qualify for the exemption in order to better correspond to 21st Century workplace realities. The old regulations, written in 1949, mention job classifications that no longer exist, such as key punch operators, straw bosses, leg men and gang leaders. In addition, the proposal eliminates the restriction on exempt employees devoting more than 20 percent of time in a workweek to performing non-exempt duties.

**Executive Duties:** Under the proposed regulations, there are four requirements to meet the “executive” exemption: (1) compensation on a salary basis of not less than \$425 per week; (2) primary duty of managing the enterprise or a customarily recognized department or subdivision; (3) customarily and regularly directing the work of two or more employees; and (4) having authority to hire or fire. The criterion of requiring hiring and firing authority is part of the current short test (the one almost always utilized) for determining the executive exemption. The impact of this particular change may be that employees previously considered exempt “executives” may no longer qualify if they do not have the ability to hire and/or fire (or at least make recommendations that are given great weight).

**Administrative Duties:** The proposal replaces the “discretion and independent judgment” test that had been the subject of substantial confusion. The new test states that to qualify as “exempt,” an employee must hold a “position of responsibility” in the performance of office or non-manual work “related to the management or general business operations of the employer.” A “position of responsibility” is defined in the proposed regulations as including “work of substantial importance” or requiring a “high level of skill or training.”

• **“Related to the Management or General Business Operations”:** This prong of the Administrative exempt classification is a carryover from the current regulations. It means work related to assisting with the running or servicing of the business, as distinguished from working on a manufacturing production line or selling a product. Examples include work in tax, finance, accounting, quality control, purchasing, advertising, marketing, and human resources.

• **“Work of Substantial Importance”:** The regulations addressing the mean-



ing of this term are extensive and complicated. In sum, the focus is on “work that, by its nature or consequence, affects the employer’s general business operations or finances to a significant degree.” For example, formulating policies, analyzing changes to operating procedures, planning business objectives, analyzing data, drawing conclusions and recommending changes are all considered work of substantial importance. Work of substantial importance does not include clerical tasks or routine assignments, such as a personnel clerk screening applicants.

• **“High Level of Skill or Training”:** This term is defined to include work requiring specialized knowledge or abilities, or advanced training. One very significant change to the administrative exemption is that an employee may now be considered exempt where he or she relies upon a reference manual where the use of such manual requires a high level of skill or training because it contains technical, scientific, financial, or other similarly complex information. However, this factor cannot be met if the employer simply requires the employee to look up infor-

mation to determine the correct response to an inquiry. Under the current regulations, reference to such a manual generally precludes a finding of exempt status.

**Professional Duties:** The proposal recognizes as an exempt “learned professional” those employees who acquire advanced knowledge in a field of science or learning through work experience, not just formal schooling. Under the current system, only knowledge gained through formal training can qualify one as an exempt learned “professional.” This change reflects the DOL’s recognition that in today’s workplace, employees can obtain advanced knowledge through a combination of formal education and training as well as on-the-job training.

**SUPER SALARY TEST PROPOSED:** The proposed regulations for the first time establish a bright-line test: an employee performing office or non-manual work that falls under the duties of an executive, administrative or professional and earns a “guaranteed total annual compensation” of at least \$65,000 is automatically “exempt.” Special rules apply to determine whether bonuses and

commissions are included, and how to calculate the test when an employee has not worked the full year.

**PERMISSIBLE SALARY DEDUCTIONS CLARIFIED:** Over the years, one of the largest pitfalls for employers has been making improper deductions from “exempt” employees’ salaries, thereby resulting in the loss of their exemption. The regulations state that in order for an employee to be exempt, he must receive his full salary for any week in which he performs work. Loss of the exemption bears grave consequences — the DOL will treat as non-exempt that employee as well as all those similarly situated, for up to three prior years, resulting in significant back pay in the form of unpaid overtime and double damages.

The proposed regulations include two employer-friendly changes to this rule. The first allows the employer to impose unpaid disciplinary suspensions of one full day or more without risking the loss of the employee’s exempt status. Currently, the imposition of an unpaid disciplinary suspension of less than one week compromises the

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employee's exempt status.

The second change creates a new "safe harbor" provision to protect employers in the event they make improper deductions. The DOL's proposal clarifies that the exemption is lost only if there is a pattern and practice of improper deductions, and then only for employees in the same job classification who work for the manager who made the improper deduction. And, if the employer has a written policy prohibiting improper pay deductions, notifies employees of the policy and reimburses them for improper deductions, the employer will not lose the exemption unless it repeatedly and willfully violates its own policy.

### What's an Employer to Do?

There are several steps an employer can take to prepare for the revised regulations. And, even assuming that they remain unchanged, there are other steps to take now that the DOL has got your attention and your company is focused on the issue of overtime.

Initially, employers should conduct a

general internal review of job classifications and how particular classes of employees are classified (exempt or non-exempt). While it may be premature to engage in a full-scale audit until regulations are finalized, an employer certainly can examine the universe of jobs and check job descriptions and salary payment procedure. In other words, is your clerk (a position clearly entitled to overtime) being paid \$300 per week and then not being paid overtime because he gets a "salary"?

Employers also should take time to consider the impact on the employees of reclassification. Employees reclassified as non-exempt may not mind being paid overtime wages if they work over 40 hours in a week. However, to many employees, being paid hourly comes with a stigma, and they may feel that their status is somehow diminished. In addition, newly designated non-exempt employees will be required to record their exact hours on a daily basis. Employers must prepare in advance to meet these issues head on.

Changing an employee from non-exempt to exempt presents different

problems. An employee who earned extra compensation for working more than 40 hours may resent being paid a flat salary regardless of the number of hours worked. In addition, these employees may take exception to working long hours without a direct reward, i.e. hour-for-hour overtime pay. While increasing such an employee's flat rate of pay to account for the change is not required by law, employers may want to consider adjusting the salary of such a newly designated exempt employee to correlate in some manner to the rate of total compensation, including overtime, which the employee earned as a non-exempt employee.

Development of a written policy to comply with the "safe harbor" provision regarding improper deductions is also highly recommended. The "safe harbor" protects employers from liability for improper deductions from an exempt employee if the employer has a written policy and reimburses employees for any such deductions.

Finally, regardless of the final outcome of the regulations, employers need to focus on the myriad of pitfalls

in the area of wage and hour law other than the exempt vs. non-exempt analysis. Some of these issues include: How much time is required for lunch? (None under FLSA; 30 minutes in New York). Is lunch paid or unpaid? (Depends). Is compensatory time permitted in lieu of overtime? (No, but there may be ways to avoid that problem). Does an employer have to pay employees for time engaged in preparing for work (e.g., changing clothes)? (Depends).

With proper focus and attention on all aspects of the issues presented by wage and hour regulations, the above and other pitfalls can be proactively addressed simply and effectively before a claim is made. •

1. It bears mention that the New York State Department of Labor also enforces New York's overtime payment law and relies upon the standards and regulations issued by the federal agency. However, New York law gives the state Department of Labor and an aggrieved employee up to six years to assert a complaint, thereby significantly increasing an employer's potential exposure.

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