EXEMPT EMPLOYEES
COMPLYING WITH THE NEW FLSA RULES

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On August 23, 2004, new federal regulations published by the U. S. Department of Labor (DOL) went into effect for the "white collar" overtime pay exemptions under Sections 13(a)(1) and (a)(17) of the Fair Labor Standards Act of 1938 (FLSA) for executive, administrative, professional, outside sales, and computer employees. The regulations, which are set forth at 29 CFR Part 541 (the "Final Part 541 Regulations"), remain under political and other attack, but currently remain effective. This paper reviews the background of and changes made by the Final Part 541 Regulations.

I. Background on the Final Regulations Regarding Overtime Exemptions

Under the FLSA, employees are entitled to payment of the federal minimum wage established by Congress (currently $5.15 per hour) for all hours worked, and overtime premium pay of time and one-half the employees' "regular rate of pay" (not the same as the minimum wage) for all hours worked in excess of 40 hours per week. However, Section 13(a)(1) of the FLSA provides an exemption from both the minimum wage and overtime protections of the FLSA for bona fide, salaried employees in an executive, administrative, professional and outside sales capacity. In addition, certain computer professional employees may be exempt under Section 13(a)(1) or 13(a)(17) of the FLSA. The Final Part 541 Regulations do not change the statutory "white collar" exemptions, but significantly revise the federal regulations defining and delineating those exemptions.

To be considered exempt from the FLSA's minimum wage and overtime pay requirements, "white collar" employees must: (1) be compensated above a specified minimum salary level; (2) be paid on a "salary basis" (that is not subject to reduction based on the quality or quantity of work performed); and (3) perform certain primary job duties involving managerial, administrative, or professional skills.

Employers have long had difficulty interpreting the regulations. On March 31, 2003, the DOL issued a proposed rule and request for public comments on major revisions to the federal Part 541 regulations for so-called "white collar" overtime pay exemptions under Sections 13(a)(1) and (a)(17) of the FLSA for executive, administrative, professional, outside sales, and computer employees (the "Proposed Regulations.") During a 90-day comment period, the DOL received 75,280 comments from a myriad of employees, employers, trade and professional associations, small business owners, labor unions, government entities, law firms, and others.

In addition, the proposed regulations were actively opposed by organized labor and many members of Congress. On September 10, 2003, the Senate approved an amendment sponsored by Senator Tom Harkin (D-Iowa) to withhold funding from the Department of Labor to finalize parts of the proposed regulations. Facing the threat of a Presidential veto, congressional committees eventually worked out a compromise that allowed the process to move forward. Subsequent congressional attempts to prevent the DOL from issuing the Final Part 541 Regulations also failed, largely by forcing the Senate Leadership to withdraw "must-pass" non-germane legislation to which the DOL funding prohibition had been attached from consideration on the Senate floor. However, the much publicized opposition to the proposed regulations, as well as the numerous

public comments received by the DOL, resulted in a final rule that differs in several significant respects from the proposed regulations.

The Final Part 541 Regulations include, in part, the following new sections which are designed to address specifically and authoritatively the claims and criticisms of the regulations' opponents. These new sections rebut the claimed adverse effect of the proposed regulations, especially as to the loss of overtime protections for certain workers and job classifications, such as "blue collar" workers, first responders, veterans, licensed practical nurses (LPNs), and workers under union contracts.

Overtime exemptions under the Final Part 541 Regulations do not apply to manual laborers or other "blue collar" workers who perform work involving repetitive operations with their hands, physical skill and energy. The Final Part 541 Regulations also do not exempt from overtime police officers, fire fighters, paramedics, emergency medical technicians and similar public safety employees.[1]

New Section 541.301(d) of the Final Part 541 Regulations makes clear that veterans of military service do not lose eligibility for overtime pay as a result of their military training. The final regulations delete references to training in the armed forces and attending a technical school or community college as fulfilling, in part with job experience, the long-standing educational requirements for the "learned professional" exemption.

New Section 541.301(e)(2) provides that licensed practical nurses (LPNs) are not exempt from overtime. While registered nurses (RNs) continue to be exempt as "learned professionals," the Final Part 541 Regulations do not change the customary practice whereby RNs who are paid on an hourly basis are thus eligible for overtime pay, since they do not meet the "salary basis" requirement for exemption.

New Section 541.4 clarifies that nothing in the Final Part 541 Regulations relieve employers of their obligations under collective bargaining agreements. Thus, while the minimum wage and overtime pay standards of the FLSA cannot be waived or reduced, the Final Part 541 Regulations do not disturb union contracts that provide wages or overtime pay eligibility greater than that required under the FLSA or the regulations.

In addition to these sections clarifying the intent and meaning of the Final Part 541 Regulations, and responding to the criticisms of opponents, the final regulations also make significant changes from the Proposed Regulations. For example:

- The minimum weekly salary level for exempt workers in the Final Part 541 Regulations is $455 instead of $425 in the Proposed Regulations.
- The "highly compensated" test rose from $65,000 in the Proposed Regulations to $100,000 in the Final Part 541 Regulations, and adds the requirement that exempt highly compensated employees "customarily and regularly" perform exempt duties.
- The Final Part 541 Regulations delete the special rules for exemption applicable to "sole charge" executives, and adds the requirement that employees who own at least a bona fide 20 percent equity interest in an enterprise are exempt only if they are "actively engaged in its management."
- The Final Part 541 Regulations retain the "long" duties test requirement that an exempt executive must have authority to "hire or fire" other employees or must make recommendations as to the "hiring, firing, advancement, promotion or any other change of status" which are "given particular weight," but provide a new definition of "particular weight."

- The Final Part 541 Regulations eliminate the proposed "position of responsibility" test and the proposed "high level of skill or training" standard under the administrative exemption.
- The Final Part 541 Regulations retain the existing requirement (deleted in the initially proposed regulations) that exempt administrative employees must exercise "discretion and independent judgment."
- The Final Part 541 Regulations state that licensed practical nurses and other similar health care employees do not qualify as exempt professionals. The Final Part 541 Regulations retain the provisions of the existing regulations regarding registered nurses.
- The Final Part 541 Regulations have been modified to make clear that the DOL never intended to allow the professional exemption for any employee based on veteran status. The references to training in the armed forces, attending a technical school, and attending a community college have been removed.
- The Final Part 541 Regulations define "work requiring advanced knowledge," one of the three essential elements of the professional primary duties test, as "work which is predominantly intellectual in character, and which includes work requiring the consistent exercise of discretion and judgment."

II. "Salary Level" Test

A. Minimum Salary Level

The DOL's Final Part 541 Regulations increase the minimum salary level for the "white collar" overtime exemption to $455 a week for all employee classifications. For employees with pay periods greater than one week, the equivalent pay levels are $910 for biweekly pay periods, $985.83 for semi monthly pay periods, $1,971.66 for monthly pay periods, and $23,660 for yearly pay periods. Any employee paid less than that amount will automatically be eligible for overtime pay without regard to job duties. This higher, single salary level replaces the multiple salary level tests under the previous Part 541 regulations.

Previously, two different salary levels existed for each of the exemptions for executive, administrative, and professional employees. For "executive" or "administrative" employees, the salary level under the "long test" of job duties was $155 per week; for "professional" employees, the "long test" salary was $170 per week. For all three exemptions, the "short" salary test (requiring fewer duties to be satisfied) was $250 per week.

The increased $455 per week salary level under the "standard test" for all three employee classifications replaces the "short test"/"long test" dichotomy. By raising the annual salary threshold from $8,060 to $23,660, the DOL estimates overtime protection will be strengthened for more than 6.7 million salaried workers. The 6.7 million salaried workers include:

- 1.3 million currently exempt workers who will now be eligible for overtime pay;
- 2.6 million nonexempt salaried workers who are at particular risk for being misclassified; and
- 2.8 million nonexempt workers in blue-collar occupations whose overtime protection will be automatic under the final rules regardless of their job duties.

B. Highly-Compensated Employees

The Final Part 541 Regulations provide, for the first time, a special, streamlined overtime exemption for "highly-compensated" employees. Under the Final Regulations, employees with "total compensation" of

at least $100,000 per year will be considered exempt if they:

- Make at least $455 per week ($23,660 per year) paid on a salary or fee basis;
- Perform office or non-manual work; and
- Customarily and regularly perform one or more of the exempt job duties that are required for an executive, administrative, or professional exemption.

In calculating the total annual compensation of highly-compensated employees, base salary, commissions, non-discretionary bonuses, and other non-discretionary compensation may be considered in determining whether an employee is paid $100,000 or more per year. An employee's total annual compensation does not include credit for board, lodging or other facilities, payments for medical or life insurance, or contributions to retirement plans or fringe benefits.

The DOL estimates that by adding the new highly compensated employee test, approximately 107,000 workers may no longer qualify for overtime.

III. "Salary Basis" Test

The DOL's Final Part 541 Regulations retain the current "salary basis" test which requires that employees receive their full salary, on a weekly or less frequent basis. Their salary may not be reduced because of variations in the quality or quantity of work performed, for any week in which they perform any work (without regard to the number of days or hours worked). The Final Part 541 Regulations also retain the controversial prohibition on deductions from pay for "partial day absences."

Under the Final Part 541 Regulations, certain deductions continue to defeat the salary basis test:

- An employee is not paid on a salary basis if deductions from the predetermined salary are made for absences occasioned by the employer or by the operating requirements of the businesses.
- If the employee is ready, willing and able to work, deductions may not be made for time when work is not available.

The Final Part 541 Regulations do, however, make important changes permitting deductions for full-day disciplinary absences (*i.e.*, a one-day unpaid suspension). The previous regulations permitted one-day deductions only for violations of major safety rules; otherwise, unpaid disciplinary suspensions had to be for a full workweek.

Under the Final Part 541 Regulations, there are seven exceptions to the "no pay-docking" rule:

- Absence from work for one or more full days for personal reasons, other than sickness or disability.
- Absence from work for one or more full days due to sickness or disability if deductions are made under a bona tide plan, policy or practice of providing wage replacement benefits for these types of absences.
- To offset any amounts received as payment for jury tees, witness fees, or military pay.
- Penalties imposed in good faith for violating safety rules of "major significance."
- Unpaid disciplinary suspension of one or more full days imposed in good faith for violations of workplace conduct rules (*e.g.*, violations of company sexual harassment or workplace violence policies).

- Proportionate part of an employee's full salary may be paid for time actually worked in the first and last weeks of employment.
- Unpaid leave taken pursuant to the Family and Medical Leave Act.

However, the deductions allowed are for certain types of full day absences. Deductions for partial-day absences violate the salary basis rule unless they occur in the first or final week of an employee's employment or for unpaid leave taken pursuant to the FLSA. In the regulations, the DOL has provided some specific example of improper deductions, including:

- Deduction for a partial-day absence to attend a parent-teacher conference.
- Deduction of a day of pay because the employer was closed due to inclement weather or a company holiday.
- Deduction of three days pay because the employee was absent from work for jury duty, rather than merely offsetting any amount received as payment for the jury duty.
- Deduction for a two-day absence due to a minor illness when the employer does not provide wage replacement benefits for such absences.

The Final Part 541 Regulations provide a broader "safe harbor" to prevent an employer's loss of overtime exemptions for an entire class of employees due to "isolated" or "inadvertent" improper deductions from pay. Under the Final Part 541 Regulations, the overtime exemption would be lost only if there is an "actual practice" of making improper deductions, and then only (i) during the time period in which improper deductions were made, (ii) for employees in the same job classification, and (iii) for employees working for the same manager who is responsible for the improper pay-docking decision or policy. Thus, the loss of exempt status would not extend to employees company-wide, thereby reducing the incentive for trial lawyers to threaten or file multi-plaintiff collective actions.

Factors suggesting the employer has an "actual practice" of improper salary deductions include, but are not limited to: (i) the number of improper deductions, (ii) the time period during which the employer made improper deductions, (iii) the number and geographic location of both the employees whose salaries were improperly reduced and the managers responsible for making the improper deductions, and (iv) whether the employer has a clearly communicated policy permitting or prohibiting improper deductions.

Under the "safe harbor" provision, if an employer (i) has a "clearly communicated" policy which prohibits improper deductions and includes a complaint mechanism, (ii) reimburses employees for any improper deductions, and (iii) 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 the policy by continuing to make improper deductions after receiving employee complaints. According to the DOL, the best evidence of a clearly communicated policy is a written one distributed to employees before the improper pay deductions occur, for example, by providing a copy of the policy to employees when they are hired, publishing it in an employee handbook or distributing it to employees over the employer's lntranet. Based on this new safe harbor, employers should implement and communicate to their employees a policy which meets the requirements of the safe harbor provision contained in Section 541.603 of the regulations. The policy should clearly communicate to the employees that the company prohibits improper payroll deductions and should provide a way for employees to complain if they feel they have been subject to improper deductions.

IV. "Duties" Tests

The DOL's Final Part 541 Regulations attempt to simplify and streamline the "duties" tests for

executive, administrative, and professional employees. The proposed regulations eliminate the current "long test"/"short test" dichotomy and substitute a single "standard duties" test and single salary level of $455 a week for all exempt employee classifications. The regulations also remove entirely the percentage limitations on non-exempt work for all three categories of exempt employees (currently, no more than 20 percent non-exempt work, or up to 40 percent for exempt employees in retail or service establishments). Instead, the Final Part 541 Regulations substitute a "primary duty" test for each "white collar' employee classification.

As the regulations explain, the "primary duty" of performing exempt work does not require that employees spend more than 50 percent of their time on exempt work. However, an employee who spends more than 50 percent of their time performing exempt work will generally satisfy the primary duty requirement. An employee's primary duty is the principal, main, major or most important duty that the employee performs. Factors to consider when determining an employee's primary duty include, but are not limited to:

- Relative importance of the exempt duties;
- Amount of time spent performing exempt work;
- Relative freedom from direct supervision; and
- Relationship between the employee's salary and the wages paid to other employees for the same kind of nonexempt work.

A. Executive Employees

The Final Part 541 Regulations' "duties" test provides that an "executive employee" must: (1) have a "primary duty" of managing the enterprise, or a "customarily recognized department or subdivision"; (2) "customarily and regularly" direct the work of "two or more employees"; and (3) have the authority to hire or fire other employees, or have the authority to suggest or recommend hiring, firing, advancement, promotion, or any other change in job status that are given "particular weight."

The Final Part 541 Regulations eliminate entirely the current requirement of "discretionary powers," and the current restrictions on percentage of nonexempt work that are not directly and closely related to performing exempt managerial work. The Final Part 541 Regulations also recognize as exempt an executive employee who owns at least "20 percent equity interest" in the enterprise and is actively engaged in the management of the enterprise. The salary level and salary basis requirements do not apply to 20 percent equity owners.

In describing "management of the enterprise" duties, the Final Part 541 Regulations include activities such as: interviewing, selecting and training employees; setting and adjusting pay rates and work hours; conducting performance appraisals; handling employee complaints and grievances; disciplining employees; apportioning work among employees; determining merchandise to be bought, stocked and sold; planning and controlling the budget; and monitoring or implementing legal compliance measures.

As set forth above, an exempt employee must also manage the entire business or have management responsibility over a "customarily recognized department or subdivision of the business." A "department or subdivision" must have a permanent status and continuing function. However, the department or subdivision need not be physically within the employer's establishment and may move from place to place. Thus, the fact than an employee works at more than one location does not defeat the exemption. In addition, if an executive supervises employees in a recognized unit, it does not matter if some of the employees are drawn from other recognized units. On the other hand, a mere collection of employees assigned from time to time

to a specific job or series of jobs is not a recognized sub division. Moreover, recognized subdivisions can also be geographically separate offices or branch establishments (*e.g.*, sales managers in charge of each regional or district sales office can be exempt).

Another element for the executive exemption is "customarily and regularly" directing the work of "two or more employees." "Customarily and regularly" is defined as a frequency that must be greater than occasional, but which may be less than constant. It includes work normally and recurrently per formed every workweek and does not include isolated or one-time tasks. Thus, an exempt employee should normally direct the work of other employees at least once a week, but not every day. However, the exemption will not be lost if an occasional week passes during which the executive does not direct a subordinate. The term "two or more employees" means the exempt executive must direct the work of two full-time employees or an equivalent number of hours of worked supervised.

Finally, the exempt executive must have the authority to hire or fire other employees or his or her recommendations as to the hiring, firing, advancement, promotion or other key change of status must be given "particular weight." Factors to consider when determining whether an employee's recommendations are given "particular weight" include, but are not limited to: whether it is part of the employee's job duties to make recommendations; the frequency with which recommendations are made or re quested; and the frequency with which the recommendations are relied upon. A recommendation can be given "particular weight" even if it is reviewed by a higher level of management and the exempt executive need not have the authority to make the ultimate decision. However, making an occasional suggestion regarding a change in status of a co-worker does not meet the "particular weight" standard.

B. Administrative Employees

The administrative exemption is continually one of the most troublesome for employers. Although the Final Part 541 Regulations have streamlined the administrative employee exemption, the final version retains the requirement from the current Part 541 regulations that exempt administrative employees must consistently exercise "discretion and independent judgment." Thus, the job duties requirements for the administrative exemption under the new regulations are essentially the same as the current "short test."

In place of the "long test"/"short test" dichotomy, the new test provides that an employee will meet the duties test for the administrative exemption if (1) the employee's primary duty is the performance of office or non-manual work directly related to the "management or business operations" of the employer or the employer's customers and (2) the employee customarily and regularly exercises "discretion and independent judgment" with respect to matters of significance. "Management or business operations" refers to the type of work performed by the employee. The work performed by an exempt administrative employee must be directly related to assisting the running or servicing of the business, and does not include working on a manufacturing production line or selling a product in a retail or service establishment. The DOL has defined the following jobs as typically administrative in nature (*i.e.*, directly related to the management or general business operations): tax, finance, accounting, budgeting, auditing, insurance, quality control, purchasing, procurement, advertising, marketing, research, safety and health, human resources, public relations, legal and regulatory compliance, employees acting as advisors or consultants to clients or customers, and other similar activities.

An exempt administrative employee's primary duty must include the exercise of "discretion and independent judgment" with respect to "matters of significance." Exercising "discretion and independent judgment" generally involves an employee comparing and evaluating possible courses of conduct, and acting or making a decision after the various possibilities have been considered. The term "matters of significance" refers to the level of importance or consequence of the work performed.

The regulations list a number of factors to consider in determining whether an employee exercises discretion and independent judgment with respect to matters of significance. These factors include, but are not limited to, whether the employee:

- Has authority to formulate, affect, interpret, or implement manage-ment policies or operating practices;
- Carries out major assignments in conducting the operations of the business;
- Performs work that affects business operations to a substantial degree;
- Has authority to commit the employer in matters that have significant financial impact;
- Has authority to waive or deviate from established policies and procedures, without prior approval;
- Has authority to negotiate and bind the company on significant matters;
- Provides consultation or expert advice to management;
- Is involved in planning long- or short-term business objectives;
- Investigates and resolves matters of significance on behalf of manage-ment; and
- Represents the company in handling complaints, arbitrating disputes or resolving grievances.

An exempt employee may exercise discretion and independent judgment even if the employee's decisions are reviewed at a higher level, and occasionally revised or reversed. An employee will not be found to exercise discretion and independent judgment in the following instances:

- Applying well-established techniques, procedures or specific standards described in manuals or other sources;

- Clerical or secretarial work;

- Recording or tabulating data; and

- Performing mechanical, repetitive, recurrent or routine work.

Although exempt status depends on the actual job duties performed by an employee, Section 541.203 of the Final Part 541 Regulations contains a number of examples illustrating when employees typically meet the duties requirements for the administrative exemption. For example, insurance claims adjusters generally meet the duties requirements for the administrative exemption if they perform work such as: (i) interviewing insureds, witnesses and physicians; (ii) inspecting property damage; (iii) reviewing factual information to prepare damage estimates; (iv) evaluating and making recommendations regarding coverage of claims; (v) determining liability and total value of a claim; (vi) negotiating settlements; and (vii) making recommendations regarding litigation.

In addition, financial services employees generally meet the duties requirements for the administrative exemption if their duties include: (i) collecting and analyzing information regarding the customer's income, assets, investments or debts; (ii) determining which financial products best meet the customer's needs and financial circumstances; (iii) advising the customer regarding the advantages and disadvantages of different financial products; and (iv) marketing, servicing or promoting the employer's financial products. However, if the employee's primary duty is selling financial products, he or she will not qualify for the administrative exemption.

Another example given in the regulations is that of human resource managers. Human resource managers who formulate, interpret or implement employment policies generally meet the administrative duties requirements. On the other hand, personnel clerks who "screen" applicants to obtain data regarding minimum qualifications and fitness for employment, but make no hiring decisions, generally do not meet the duties requirement for the administrative exemption. In addition to the above, the regulations provide other examples of positions that will and will not be considered exempt under the administrative exemption.

C. Professional Employees

As with the other exemptions, the Final 451 Regulations eliminate the "long test"/"short test" dichotomy and the percentage limitation on non-exempt work. There are two general types of professional exemptions: "learned professionals" and "creative professionals." In addition to the new salary requirements, which generally apply to all the exemptions, the learned professional exemption applies only if the employee's primary duty is the performance of work requiring "advanced knowledge" in a field of science or learning which is customarily acquired by a prolonged course of specialized intellectual instruction.

According to the regulations, work requiring "advanced knowledge" means work that is predominately intellectual in character, and which includes work requiring the consistent exercise of discretion and judgment. An exempt professional employee typically uses this advanced knowledge to analyze, interpret or make deductions from varying facts or circumstances. The work performed by an exempt professional employee cannot be routine mental, manual or physical work, and must be performed in occupations with a recognized professional status (*e.g.*, law, theology, medicine, pharmacy, accounting, teaching, architecture, engineering and sciences). Examples of nonexempt professions include, but are not limited to, accounting clerks and bookkeepers who normally perform a large amount of routine work; cooks who perform predominantly routine work; paralegals and legal assistants; engineering technicians; and licensed practical nurses.

The second major type of professional exemption is the "creative" professional exemption. To qualify, the professional employee's primary duty must be the performance of work requiring invention, imagination, originality, or talent in a recognized field of artistic or creative endeavor. Creative professional work does not include work that primarily depends on intelligence, diligence and accuracy or work that can be produced by a person with general manual ability and training. The recognized fields of artistic or creative endeavor include:

- Music (musicians, composers, conductors, soloists);
- Writing (essayists, novelists, screen play writers who chose their own subjects and hand in finished pieces of work to their employers and per sons holding responsible writing positions in advertising agencies);
- Acting; and
- Graphic arts (painters, photographers, cartoonists).

Employees of newspapers, magazines, television and other media are not exempt if they collect organize and record information that is routine or public; do not contribute a unique interpretation or analysis; or prepare work product under substantial control.

D. Computer Employees

The Final Part 541 Regulations make no substantive changes to the current regulatory provisions covering certain computer-skilled workers, which have been codified into law in Section 13(a)(17) of the FLSA. Any such changes would require legislative amendments.

E. Outside Sales Employees

The outside sales exemption has essentially remained intact. The Final Part 541 Regulations for "outside sales employees" eliminate the 20 percent restriction on non-exempt work but continue to require that the employee's "primary duty" is making sales or obtaining orders or contracts for services. The Final Part 541 Regulations also continue the requirement that exempt outside sales employees be "customarily and regularly engaged away from the employer's place or places of business."

The Final Part 541 Regulations confirm that **"inside sales"** employees are not within the scope of the statutory exemption for "outside sales" employees. Thus, a legislative amendment to the FLSA would be required if "inside sales" employees are to be an exempt classification. Of course, inside sales representatives may qualify under one of the other exempt classifications.

V. Collective Actions Under The Fair Labor Standards Act (FLSA)

Wage and hour class actions/collective action cases have resulted in substantial settlements over the last few years. Some recent settlements or verdicts in wage and hour actions are listed below:

A. February 2003: New China Buffet of Chicago and other restaurant owners settle minimum wage and overtime pay action brought by Department of Labor for approximately $700,000.[2]

B. January 2003: Honda Manufacturing agrees to pay $1.2 million not including back pay ($500 per employee) to some 2000 employees in a donning uniforms case.[3]

C. December 2002: A jury found Wal-Mart guilty of "off the clock" violations of the FLSA in the Company's stores in Oregon in a case brought by some 425 employees.[4]

D. October 2002: Perdue Farms settles case by paying $10 million to chicken processing workers who alleged they were not paid for time spent putting on, taking off, and cleaning sanitary and protective equipment.[5] (This lawsuit came a few months after Perdue Farms settled a Department of Labor lawsuit challenging its donning and doffing pay practices.)

E. August 2002: A California court approved an $18 million settlement in a lawsuit against UPS brought by workers who claimed they should not have been classified as exempt managers.[6]

F. July 2002: RadioShack Corp. agreed to pay $29.9 million to approximately 1,300 current and former California store managers to settle a state-law, class-action lawsuit alleging improper overtime exemptions.[7] Managers covered by the settlement received about $40,000 each.

G. April 2002: Starbucks Corp. settles two California class actions for misclassifying managers and assistant managers as exempt employees for approximately $18 million.[8]

H. December 2001: Pacific Bell agreed to pay $35 million to settle claims brought by 1,500 current and former engineers who alleged they were not paid for overtime worked.[9]

I. October 2001: Coca-Cola Bottling Co. of Los Angeles, an independent bottler, settled an overtime wages class action brought by 1,100 sales representatives for $20.2 million.[10]

J. July 2001: A California jury awarded more than $90 million to some 2,400 current and former Farmers Insurance Exchange adjusters on claims they were denied overtime pay.[11]

VII. Reducing the Risks Of Wage & Hour Collective Actions

A. Be Aware Of Litigation Trends in Your Industry

Certain industries are more vulnerable to wage-and-hour actions, for example "cookie cutter" businesses where employees have similar jobs and managers may not be exempt. Consider auditing your company's workplace for possible wage-and-hour violations.

1. Evaluate every job to determine what jobs are actually exempt and nonexempt. Don't assume that just because you're paying an employee $50,000 a year, they are exempt. Maybe, maybe not.

2. Look for "off the clock" work. Are employees' coming to work early, staying late, or waiting for work – without being compensated for the time?

3. Are you properly paying employees for pre-shift and post-shift activities?

4. Are you paying employees for time spent traveling to and from job sites?

5. Are your so called independent contractors entitled to overtime compensation?[12]

6. Do you "dock" the wages of exempt employees for less than full day absences or for improper reasons?

7. Do you give employees "comp time" in lieu of overtime compensation?

8. How are your "on call" employees, who are required to carry beepers, pagers, or cellular telephones, being compensated?

9. Are you recalculating the regular rate of pay to include certain bonuses?

10. Do your records show exactly how many hours employees work?

B. Re-evaluate Your Company's Written and Unwritten Policies and Procedures Regarding Compensation

1. Does your company reward managers for keeping labor costs low, and does this create incentives for managers to violate the FLSA?

2.. Do you have written policies that require minimum wage, overtime compensation, breaks? Do policies prevent "off the clock" work or other violations?

C. Remind Management About The Possibility Of Individual Liability And Even Criminal Liability Under The FLSA

1. If an individual manager had supervisory authority over the complaining worker and was responsible in whole or in part for the alleged violation, or had control over the employer's compliance with the FLSA, the manager can be personally liable as an "employer" under the FLSA.[13] (This same definition applies in actions under the FMLA as well.)

2. Violations of certain provisions of the FLSA (minimum wage, overtime compensation, retaliation, child labor, hot goods, recordkeeping, and homework) can result in criminal liability under certain conditions.[14]

D. Remember the "Window of Corrections" Defense

This defense offers employers a chance to correct certain violations, for example, inadvertently deducting less than one week's pay for reasons other than a lack of work, thereby threatening exempt status.

E. If Your Company Is Sued or If You Anticipate Suit, Call Legal Counsel Immediately

1. Approach the lawsuit in light of the results of a thorough preliminary factual investigation.
2. If you are sure you can win and want to maintain an overtime exemption or other practice going forward, contest the suit vigorously.
3. If the situation is tenuous, consider mediation or other options, and consider changing the exempt status of the positions at issue as part of the settlement.
4. If it appears that your company did violate the law, consider settling early in order to defray the increased costs of settlement and attorneys' fees after lengthy litigation.
5. There may be other reasons to vigorously contest the suit, for example, to prevent a second round of collective actions brought by "opt outs."
6. Watch out for the "double bind" of litigating and settling collective or class actions.

    a) When defending wage-and-hour collective actions (or class actions), employers want to limit the size of the "opt in" group (or of the potential class).
    b) But when settling these actions, it is in the best interest of employers to include as many "opt ins" as possible in the settlement (or to have as broad a class for purposes of settlement as possible).
    c) Otherwise, the employer may be subject to the same or similar lawsuit brought by plaintiffs who did not "opt in" (or were not bound because they were not members of the class).

X. The Effect of the New Regulations on Collective Actions

The new provisions and Model Policy are designed to discourage collective action lawsuits. These provisions of the new regulations may be the most significant of all the changes to the part 541 regulations because they provide an affirmative defense to collective action lawsuits for improper deduction from exempt salaries. (Previously such a deduction could cause loss of an exempt status for an entire classification of employees company-wide).

The new regulations limit the loss of the exemption to situations where there is an "actual practice" of making improper deductions (i.e. not isolated or inadvertent deductions), and even then the exemption is lost only during the time period of the deductions, and for only those employees in the same job classification working for the same managers responsible for the improper deductions.

This is especially helpful in the hospitality industry, as it seems unlikely that an actual practice will extend beyond one hotel or restaurant.

Although the new regulations should reduce the number of collective actions filed in the future, they are not retroactive. Due to the two and three year limitations period under the FLSA, employers are still subject to collective action lawsuits. The new regulations apply to collective actions based on events occurring after August 23, 2004.

The new regulations contain a safe-harbor provision which limits employers' liability in the event improper deductions are made from exempt employees. Like the other regulations, these safe-harbor provisions are not retroactive.

The new safe-harbor provision reads as follows:

> "If an employer (1) has a clearly communicated policy prohibiting improper deductions and including a complaint mechanism, (2) reimburses employees for any improper deductions, and (3) makes a good faith commitment to comply in the future, the employer will not lose the exemption for any employee unless the employer willfully violates the policy by continuing the improper deductions after receiving employee complaints."[15]

The Department of Labor provided an example of a policy which should comply with § 541.603(d), addressing the "Effect of improper deductions from salary." A copy of that policy follows this paper

ENDNOTES

[1] Sections 541.3(a) and (b).
[2] Chao v. New China Buffet of Chicago, Inc., Nos. 02 C 6949 to 6955 (N.D. Ill.) (seven cases).
[3] Daily Labor Report at A-8 (Jan. 9, 2003).
[4] Thiebes v. Wal-Mart Stores, Inc., No. 98-00802-KI (D. Or.).
[5] Chao v. Perdue Farms, Inc., No. 2:02-CV-0033 (M.D. Tenn.).
[6] Archie v. United Parcel Service, Inc., GIC-748-8800 (Cal. Super. Ct.).
[7] Belazi et al. v. Tandy Corp et al., No. 00CC03817 (Cal. Super. Ct.).
[8] Shields v. Starbucks Corp., No. 01-06446 FMC (C.D. Cal.).
[9] Kelley v. Pacific Telesis Gp., No. 97-CV-02729 (N.D. Cal.).
[10] Evans v. BCI Coca-Cola Bottling Co., No. BC 220 525 (Cal. Super. Ct.).
[11] Bell v. Farmers' Ins. Exchange, No. 774013-0 (Cal. Super. Ct.).
[12] See Ansoumana v. Gristede's Operating Corp., No. 00Civ.253 (AKH)(S.D.N.Y. Jan 28, 2003).
[13] The FLSA defines "employer" as "any person acting directly or indirectly in the interest of an employer in relation to any employee," and the term "person" under the FLSA includes an "individual." 29 U.S.C. § 203(d), 203(a)
[14] Id § 216(a)
[15] Section 541.603(d)