

## Class Actions, Enforcement, and New Regulations

# Emerging FLSA TRENDS

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**THE FAIR LABOR STANDARDS ACT (FLSA),<sup>1</sup> enacted in 1938, establishes minimum wage, overtime pay, recordkeeping, and child labor standards affecting full-time and part-time workers in the private sector and in federal, state, and local governments. The FLSA is enforced by the United States Department of Labor (DOL) Employment Standards Administration's Wage and Hour Division.**

Exploding class action litigation and enforcement activity, as well as new regulations defining the classes of white collar employees who are exempt from the FLSA's overtime pay requirements, make the FLSA one of labor and employment law's current hotbeds of legal activity.

### **Increase in Class Action Litigation**

There were over 150 collective action cases filed or decided in the last three years un-

der the FLSA. Employers such as Wal-Mart (seven times in the last five years); Bed, Bath & Beyond; Nortel Networks; the City of Louisville; Safeco Insurance Companies (twice); Pep Boys; Electronic Arts, Inc.; Minolta Business Solutions; Countrywide Credit Industries; Consec Finance Corp.; NBC; Ameriquest Mortgage Co. (three times); First Union Corp.; Perdue Farms; and the Chicago Transit Authority have been sued for alleged FLSA violations. The majority of these claims focused on whether the

employees were properly classified as exempt from the overtime provisions of the FLSA.

### **Record-Breaking Enforcement Activity**

In the U.S. Government's FY2001, the DOL collected over \$110 million in back wages in FLSA enforcement actions covering nearly 200,000 workers. In FY2002 and FY2003, DOL collected \$143 million and \$182 million in back wages, jumps of 29 and 27 percent, respectively. The number of employees receiving back wages as a result of the DOL's efforts has similarly increased—to 240,000 in FY2002 and nearly 315,000 in FY2003, 24 and 30 percent increases, respectively.<sup>2</sup>

At the same time, the number of complaints, cases concluded, and enforcement hours spent on associated activity have all decreased.<sup>3</sup> Since a DOL investigation is

typically triggered by a single complaint, these statistics indicate that the Department is using individual complaints to do wall-to-wall investigations; thus employers and their legal counsel must pay closer attention to the FLSA and its requirements.

## Revised “White Collar” Exemptions

On April 23, 2004, the DOL issued final regulations regarding what are commonly called the “white collar” exemptions for executive, administrative, professional, outside sales, and computer employees under the FLSA.<sup>4</sup> Employees who do not fit into these exemptions, and who are thus entitled to “time-and-a-half” overtime pay under the FLSA for all hours worked over 40 hours in a work week, are frequently referred to as “non-exempt.”

The new regulations went into effect on August 23, 2004.<sup>5</sup>

The new regulations are significant for a number of reasons. First, these regulations represent the most significant changes in the white collar exemption requirements in over 50 years. Second, large numbers of employees are potentially affected. The DOL estimates that as many as 6.7 million low-paid employees around the country (those earning between \$8,060–\$23,660 annually, or \$155–\$455 weekly) will either gain the right to overtime or have their existing right to overtime clarified or strengthened.<sup>6</sup> Third, given the significant changes to the existing exemptions, the time and cost of coming into compliance could be significant. It is not an overstatement, therefore, to say that these new regulations could be the most significant change in wage and hour laws in the last half-century.

### Summary of the White Collar Exemptions

The job title alone is insufficient to establish the exempt status of an employee.<sup>7</sup> The critical question is whether the employee’s salary and actual duties meet the requirements of the regulations. As under the “old” white collar rules, there is still a “duties” test and a “salary” test to determine whether an exemption applies under the new regulations, although those tests have been modified.

For the “salary” test, the minimum amount that must be paid as a salary to an exempt employee has been raised from \$155 per week (\$8,060 annually) to \$455 per week (\$23,660 annually).<sup>8</sup> The new amount can be paid bi-weekly, semi-monthly, or monthly in the amounts of \$910, \$985.84, or \$1,971.67, respectively. Unless an employee is paid the minimum salary amount, he or she cannot qualify for the professional, administrative, or executive exemptions.<sup>9</sup> Those employees who are paid at least \$455 weekly, but less than \$100,000 annually (see below) must meet what the Department has termed a “standard duties test.”

The impact of this change will be to give overtime rights to any current “white collar” employee (with certain limited exceptions) who is paid more than the existing minimum of \$155 per week, but less than \$455 per week (\$23,660 annually). The DOL estimates that 6.7 million employees fall into this category nationwide.<sup>10</sup>

Highly compensated employees—those who earn at least \$100,000 annually (and at

least \$455 per week)—will qualify as exempt as long as they customarily and regularly perform one or more of the exempt duties of an executive, administrative, or professional employee as provided in the “standard duties test.”<sup>11</sup> However, the Department made it clear that none of the white collar exemptions apply to traditional “blue collar,” non-management employees who do manual or production-oriented work, no matter how much money they make.

There is no minimum salary requirement for the “outside sales” exemption classification, or for teachers, lawyers, and doctors.<sup>12</sup>

### Executive Exemption<sup>13</sup>

Under the new regulations, a person is employed in an executive capacity where he (1) is compensated on a salary basis at a rate of not less than \$455 per week (exclusive of board, lodging, or other facilities); (2) has as his or her primary duty the management of an enterprise in which the employee is employed or of a customarily recognized department or subdivision thereof; (3) customarily and regularly directs the work of two or more full-time employees; and (4) has the authority to hire or fire other employees or whose recommendations as to the hiring, firing, advancement, promotion, or any other change of status of other employees are given particular weight. The new rule on executive employees also 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 performance of exempt and nonexempt duties work does not disqualify an employee from the executive exemption, if he or she otherwise meets the executive criteria and, in particular, where the management of the enterprise/subdivision continues to be their primary duty. “Generally, exempt executives make the decision regarding when to perform nonexempt duties and remain responsible for the success or failure of business operations under their management while performing the nonexempt work.”

### Administrative Exemption<sup>14</sup>

A person is employed in an administrative capacity where the employee (1) is compensated on a salary or fee basis of not less than

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an exempt  
employee’s salary.

\$455 per week (exclusive of board, lodging, or other facilities); (2) has 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; and (3) exercises discretion and independent judgment with regard to matters of significance when carrying out his or her primary duty.

The new regulations define "directly related to management or general business operations" as work that is directly related to assisting in the running or servicing of the business as opposed to working on a manufacturing production line or selling a product in a retail or service establishment. Employees exercise "discretion and independent judgment" when they are involved in comparing and evaluating possible courses of conduct, and acting or making a decision after the various possibilities have been considered. The employee must also have the authority to make an independent choice, free from immediate direction or supervision. Such decisions can include recommendations for action, rather than the actual taking of action.

#### Professional Exemption<sup>15</sup>

A person is employed in a professional capacity where he or she (1) is compensated on a salary basis at a rate not less than \$455 per week (exclusive of board, lodging, or other facilities); and (2) has as his or her primary duty the performance of work either (a) requiring knowledge of an advanced type in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction (learned professionals), or (b) requiring invention, imagination, originality, or talent in a recognized field of artistic or creative endeavor (creative professionals).

For learned professionals, the primary duty has three elements: (1) the employee must perform work requiring advanced knowledge; (2) that advanced knowledge must be in a field of science or learning, and (3) that advanced knowledge must customarily be acquired by a prolonged course of specialized intellectual instruction. In order for the work to be considered as requiring "advanced knowledge," it must be predominantly intellectual in character and include the consistent exercise of discretion and judgment. Creative

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professionals, on the other hand, must perform work pertaining to such fields as music, writing, acting, and the graphic arts, as opposed to work that merely requires intelligence, diligence, and accuracy. The creative professional exemption does not apply to work that can be produced by a person with general manual or intellectual ability and training.

#### Outside Sales Exemption<sup>16</sup>

The new rule clarifies that a sales person is only exempt if he or she has the primary duty of making sales and is regularly engaged away from the employer's place of business when making sales (or performing incidental or promotional work to further the sales effort). The sales must be made at the customer's home or place of business; sales made by mail, telephone, or the internet do not qualify. Any sales work performed at a fixed location, whether home or office, does not qualify because it is considered to be sales work at the employer's place of business. There is no salary requirement applicable to the outside sales exemption.

Drivers who deliver products but also engage in making sales qualify as exempt as long as their primary duty is making sales. Further, there is no longer a 20-percent limitation on non-exempt duties for the outside sales exemption as long as making outside sales is the employee's primary duty.

#### Salary Considerations under the New Regulations

Under the new rules, unpaid disciplinary suspensions of one or more full days may be imposed on a salaried employee who violates written workplace conduct rules that apply to all employees. An example: an employer could suspend an exempt employee without pay for three full days for violating a written workplace sexual harassment policy that ap-

plies to all employees. These suspensions must be imposed pursuant to a written policy applicable to all employees.<sup>17</sup>

There is a "safe harbor" in the new rules for employers who make improper deductions from an exempt employee's salary. An employer will not lose any exemptions if (1) it has a clearly communicated policy that prohibits improper deductions; (2) it has a compliant mechanism that employees can use to report improper deductions; (3) it reimburses any employees for any improper deductions; and (4) it makes a good faith commitment to comply in the future.<sup>18</sup>

Finally, the new rules place limits on the liability an employer can face if it has a practice of making improper deductions from an exempt employee's salary. Employers who are found to have a practice of making improper deductions will lose the overtime exemption for (1) the time period during which improper deductions were made and (2) as to those employees in the same job classification who work for the same manager(s) who was (were) responsible for the improper deductions. Isolated or inadvertent improper deductions will not cause the loss of any overtime exemptions.<sup>19</sup>

The rules also clarify, to some extent, the circumstances under which an exempt employee may receive extra compensation or be paid on an hourly, shift, or daily basis without affecting his exempt status. An employer may provide an exempt employee with additional compensation without losing the exemption or violating the salary basis requirement, if the "employment arrangement" also includes a guarantee of at least the required minimum weekly salary amount. Such additional compensation can include: (1) amounts paid on a commission basis; (2) a percentage of sales or profits; and (3) amounts based on hours worked for work beyond the normal

workweek and “may be paid on any basis (e.g., flat sum, bonus payment, straight-time hourly amount, time and one-half, or any other basis), and may include paid time off.”<sup>20</sup>

### Suggested Steps for Compliance with New Exemption Regulations

The DOL has stated that it will “vigorously enforce” the new regulations starting on their effective date, August 23, 2004. It would be wise, therefore, for all lawyers to advise their clients to take a look at their current pay practices to ensure compliance with the new regulations. Counsel specializing in employment law who are familiar with the new regulations should be contacted in this process. At a minimum, the following steps are suggested:

1. Audit all current jobs that are being treated as exempt to determine if they meet appropriate duties test.
2. Consult with counsel concerning questionable exempt status.
3. Draft and publish company policy prohibiting unlawful deductions.
4. Draft and publish company complaint procedure under which employees can advise the company whenever they believe they have not received their full salary.
5. Develop internal mechanism for handling such complaints: identify the person(s) responsible for receiving and investigating complaints; provide for reimbursement in the event there was an improper

deduction; and allow for recommendation concerning other possible prophylactic measures.

6. Ensure that any policy providing for disciplinary suspensions (1) specifies the particular offenses, (2) provides for suspensions in full day increments only, and (3) pertain to acts of workplace misconduct only.
7. Consider consulting with company payroll department or (if performed by an outside company) vendor regarding how to avoid possible inadvertent deductions as well other prohibited deductions.
8. Consider publishing the following policies, if you have not already done so:
  - A. All nonexempt employees are required to report time worked accurately.
  - B. All nonexempt employees will be paid for all time worked.
  - C. All overtime must be preapproved.
9. Establish an internal process for answering questions regarding FLSA.

### Conclusion

Whether working with employees or employers, practitioners would be well advised to understand the complexities of the FLSA and its implementing regulations. Given the DOL's aggressive enforcement and the proliferation of private FLSA class action lawsuits, the results of failing to take pro-active measures to ensure compliance could be costly. ♦

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### Footnotes

1. 29 USC 206 et seq.
2. See <http://www.dol.gov/esa/whd/statistics/200318.htm> and <http://www.dol.gov/esa/whd/statistics/200212.htm>.
3. See id.
4. Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees, 69 Fed. Reg. 22122, 22260 (April 23, 2004) (to be codified at 29 CFR Part 541).
5. See id., 69 Fed. Reg. at 22122.
6. See <http://www.dol.gov/esa/regs/compliance/whd/fairpay/main.htm>.
7. 29 CFR 541.2.
8. See, e.g., 29 CFR 541.100(a)(1).
9. The computer employee's exemption has an alternative to the payment of the \$455 weekly salary, the option of paying the employee \$27.63 an hour. The outside sales exemption has no salary requirement.
10. See supra, note 6.
11. See 29 CFR 541.601.
12. See 29 CFR 541.303(d), 541.304(d), 541.500(c).
13. See generally 29 CFR 541 Subpart B.
14. See generally 29 CFR 541 Subpart C.
15. See generally 29 CFR 541 Subpart D.
16. See generally 29 CFR 541 Subpart F.
17. 29 CFR 541.602(b)(5).
18. 29 CFR 541.603(d).
19. 29 CFR 541.603(b–c).
20. 29 CFR 541.604.