

# FAIR LABOR STANDARDS ACT UPDATE:

## *The Fair Pay Rules*

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### **I. THE FAIR LABOR STANDARDS ACT**

The United States Congress passed the Fair Labor Standards Act, 29 U.S.C. § 210, *et seq.* (“FLSA” or the “Act”), in 1938 as Depression-era legislation designed to provide equitable wages for the nation’s largely industrial workforce. The Act generally requires employers to pay minimum wage and overtime compensation to employees. While most “blue-collar” employees are covered by the FLSA, *bona fide* executive, administrative, and professional employees are exempt from the Act’s minimum wage and overtime provisions.<sup>1</sup> See 29 U.S.C. § 213(a)(1).

Because the FLSA is remedial legislation, it is narrowly interpreted against the employer. See *Arnold v. Ben Kanowski, Inc.*, 361 U.S. 388, 392 (1960). It is the defendant-employer, not the plaintiff-employee, who bears the burden of establishing exempt status should litigation ensue. Consequently, great care should be taken when making any decision concerning overtime and/or wage payments. In some circumstances, employers should consider seeking legal advice before making a final business decision relating to wage and overtime issues.

### **II. COMMON FLSA PITFALLS**

In many ways, the FLSA has not kept pace with our constantly changing economy. Simply put, the language of the Act no longer adequately parallels the realities of the modern business climate. These incongruities have created subtle traps for the unwary employer. Below is a short list of recommendations to assist employers in avoiding some of the most common FLSA pitfalls.

- **Beware of stock answers and/or boilerplate recommendations.**  
Recommendations that do not take into consideration the facts

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<sup>1</sup> The Act includes other lesser-known and specialized exempt job classifications (*i.e.*, seamen, amusement park workers, and certain retail sales representatives). The Department of Labor has promulgated regulations concerning all of these specialty exemptions, and a fairly complex body of case law has developed over the years. The FLSA also covers limitations on child labor. Due to the limited applicability over these issues, however, no further discussion of these topics will follow. Please do not hesitate to contact Honigman’s Labor and Employment Department for additional consultation concerning these or any other issues particular to your business.

surrounding the specific position at issue can lead to inadvertent misclassifications.

- **Always complete a fact-specific analysis for every job title/position.**
- **Never take a salary deduction without completing a thorough review of facts in advance.** Improper salary deductions can lead to the loss of exempt status for an entire class of employees.
- **Always pay attention to your pay cycle.** While the Act does not require employers to make wage payments every week, the Department of Labor (“DOL”) reviews every pay period independently, and will pursue overtime and minimum wage claims for any failure to make the appropriate minimum wage and/or overtime payments within the employer’s set pay period, even where the employer has met all of its wage obligations in subsequent or previous pay periods.
- **Be careful when making bonus payments to non-exempt employees.** Certain bonus payments (*i.e.*, production, commission, and non-discretionary bonuses) are considered wages under the Act and must be included as part of an employee’s “regular rate of pay” for overtime purposes.
- **Be careful when making commission payments.** As stated above, most commission payments are considered wages for overtime purposes. Also, not all salespeople are exempt under the Act. The use of a pure commission compensation system may lead to loss of exempt status and/or exposure to seemingly inexplicable minimum wage and overtime claims.
- **Legal counsel may be necessary to navigate the FLSA’s subtle and often unknown requirements.**

### **III. THE FAIR PAY RULES**

On April 20, 2004, the DOL introduced new regulations which it titled, “The Fair Pay Rules.” These regulations became effective on August 23, 2004. In the short time since the release of these new regulations, there has been an abundance of media coverage extolling both their vices and their virtues. The Fair Pay Rules include significant changes concerning permissible salary deductions, which an employer now may take without losing exempt status. In addition, the new regulations appreciably modify the requirements for the most common FLSA exemptions (*i.e.* executive, administrative, and professional employees). While, as a whole, the Fair Pay Rules appear to be a net plus for the business community, it is advisable to take a wait-and-see attitude. First, the debate in Congress over these changes is still ongoing. Although the new regulations represent the current state of federal law concerning minimum wage and overtime issues, there is a possibility that Congress will repeal these changes. For its

part, the DOL has vigorously increased FLSA enforcement, and has placed a premium on securing large back-pay awards from employers. With this in mind, a summary of the changes contained in the Fair Pay Rules is provided below.

**A. Permissible and Non Permissible Salary Deductions**

The new regulations define payment on a “salary basis” as regular wage payments received each pay period on a weekly, or less frequent, basis of a predetermined amount constituting all or part of the employee’s compensation which is not subject to reduction because of variations in the quality or quantity of work. 29 C.F.R. § 541.602(a). The new regulations further state that an employee generally is **not** paid a salary where deductions are taken from the employee’s predetermined compensation for absences occasioned by the employer or by the operating requirements of the business. *Id.* This general prohibition against salary deductions, however, is subject to certain exceptions. Employers may make salary deductions without losing exempt status where:

1. An employee is absent from work for one or more **full** days to handle **personal affairs**, other than sickness or disability (*i.e.*, where an employee is absent two full days for personal reasons, the employer may deduct two full days worth of pay, but where the employee is only absent 1.5 days, the employer may only deduct compensation for the one full day’s absence);
2. An employee is absent for one or more full days occasioned by **sickness** or **injury** and the deduction is made in accordance with a *bona fide* plan, policy, or practice of providing compensation for loss of salary occasioned by sickness or injury;
3. An employee receives **jury fees, witness fees, or military pay** while absent from work. The allowable deduction in this circumstance is limited to the amount of jury fees, witness fees or military pay the employee received;
4. An employee is assessed **penalties for infractions of safety rules** of major significance. Such safety rules would include those relating to the prevention of serious danger in the workplace or to other employees (*i.e.*, smoking in an explosives factory, oil refinery or coal mine);
5. An employee is placed on an **unpaid disciplinary suspension** for one or more full days for infractions of workplace conduct rules. Such a deduction may be taken only when the unpaid suspension is imposed pursuant to a written policy applicable to all employees.

**Example 1:** An employer may suspend an exempt employee without pay for three days for violating a generally applicable written policy prohibiting sexual harassment; and

**Example 2:** An employer may suspend an exempt employee without pay for twelve days for violating a generally applicable policy prohibiting workplace violence;

6. An employee did not work a full week in the initial or terminal week of employment. In such a case, an employer may pay a proportionate part of the employee's full salary for the time actually worked in the first or last week of employment; or
7. An employee takes unpaid leave under the Family and Medical Leave Act.

[See 29 C.F.R. § 541.602(b)].

Be very careful when making any salary deductions. Salary deductions in increments of less than one full day's worth of pay are almost always impermissible and may cause the loss of exempt status. While the new regulations permit employers more latitude in this area, an inadvertent deduction could expose the company to substantial monetary risk.

## **B. Changes to FLSA Exemptions**

For the most part, the new regulations incorporate the body of case law which developed under the old regulations. Therefore, the changes include more precise language, more definitions, and more examples to assist employers. For instance, the new regulations expressly state that blue collar workers (*i.e.*, those who perform work involving repetitive operations with their hands, physical skill and energy) are non-exempt employees. In addition, "first responders" (*e.g.*, police, firemen, etc.) also are defined as non-exempt employees.

### ***1. Executive, Administrative, and Professional Exemptions***

Much of the media coverage has centered around changes to the executive, administrative and professional exemptions, as they are the most common. Significantly, the new regulations replace the percentage-of-work test previously used for all of these exemptions, with the "primary duty" test, and raise the minimum salary requirement to \$455 per week (\$23,660 per year). In most other respects, the tests for these exemptions remain the same. In addition, the new regulations define primary duty as the "principal, main, major or most important duty that the employee performs." This is determined by the totality of the circumstances. (Please refer to the Appendix below for a quick reference guide concerning the most common FLSA exemptions).

### ***2. Highly-Compensated Employees***

The new regulations create a shortcut exemption for employees earning over \$100,000 annually. These employees are exempt if they customarily and regularly perform one or more of the duties identified for the administrative, executive, or professional exemptions (see Appendix). In determining salary for this section, the employer can count commissions and non-discretionary bonuses.

### **3. *Computer Professionals***

This exemption category is largely defined in the statute itself, and the only significant change is that the new regulations eliminate the additional regulatory requirement that the employee exercise discretion and independent judgment. Computer employees qualify for the this exemption if they are paid at least a salary of \$23,660 annually, or \$27.63 per hour, and their primary duty consists of either (1) systems analysis techniques, (2) design, creation, documentation, testing, and modification of computer programs, or (3) a combination of the preceding (see Appendix). The regulations clarify that the exemption does not include employees engaged in the manufacture or repair of computer hardware or equipment.

### **4. *The Outside Salesperson Exemption***

The only significant change to the outside salesperson exemption is the replacement of the non-exempt work percentage test with the primary duty test. An outside sales person is exempt if (1) his or her primary duty involves making sales or obtaining orders, and (2) he or she is customarily and regularly engaged away from the employer's place of business.

# APPENDIX

## Executive Employees

	<b>Prior Long Test</b>	<b>Prior Short Test</b>	<b>Current Standard Test</b>
<b>Salary Requirement</b>	\$155 per week	\$250 per week	\$455 per week
<b>Duties Requirements</b>	<p>Primary duty of the management of the enterprise or a recognized department or subdivision.</p> <p>Customarily and regularly directs the work of two or more other employees.</p> <p>Has authority to hire or fire other employees (or recommendations as to hiring, firing, promoting or other changes of employment status are given particular weight).</p> <p>Customarily and regularly exercises discretionary powers.</p> <p>Does not devote more than 20 percent (40 percent in retail or service establishments) of time to activities that are not directly and closely related to exempt work.</p>	<p>Primary duty of the management of the enterprise or a recognized department or subdivision.</p> <p>Customarily and regularly directs the work of two or more other employees.</p>	<p>Primary duty of the management of the enterprise or a recognized department or subdivision.</p> <p>Customarily and regularly directs the work of two or more other employees.</p> <p>Has authority to hire or fire other employees (or recommendations as to hiring, firing, promoting or other changes of employment are given particular weight).</p> <p><u>See</u> 29 C.F.R. § 541.100.</p>

## Administrative Employees

	<b>Prior Long Test</b>	<b>Prior Short Test</b>	<b>Current Standard Test</b>
<b>Salary/Fee Requirement</b>	\$155 per week	\$250 per week	\$455 per week
<b>Duties Requirement</b>	<p>Primary duty of performing office or non-manual work directly related to management policies or general business operations of the employer or the employer's customers.</p> <p>Customarily and regularly exercises discretion and independent judgment.</p> <p>Regularly and directly assists a proprietor, or exempt executive or administrative employee; or performs specialized or technical work requiring special knowledge under only general supervision; or executes special assignments under only general supervision.</p> <p>Does not devote more than 20 percent (40 percent in retail or service establishments) of time to activities that are not directly and closely related to exempt work.</p>	<p>Primary duty of performing office or non-manual work directly related to management policies or general business operations of the employer or the employer's customers.</p> <p>Customarily and regularly exercises discretion and independent judgment.</p>	<p>Primary duty of performing office or non-manual work directly related to the management or general business operations of the employer or the employer's customers.</p> <p>Primary duty includes the exercise of discretion and independent judgment with respect to matters of significance.</p> <p><u>See</u> 29 C.F.R. § 541.200.</p>



## Learned Professional Employees

	<b>Prior Long Test</b>	<b>Prior Short Test</b>	<b>Current Standard Test</b>
<b>Salary/Fee Requirement</b>	\$170 per week	\$250 per week	\$455 per week
<b>Duties Requirements</b>	<p>Primary duty of performing work requiring knowledge of an advanced type in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction and study.</p> <p>Consistently exercises discretion and judgment.</p> <p>Performs work that is predominantly intellectual and varied in character and is of such character that the output produced or result accomplished cannot be standardized in relation to a given period of time.</p> <p>Does not devote more than 20 percent of time to activities that are not an essential part of and necessarily incident to exempt work.</p>	<p>Primary duty of performing work requiring knowledge of an advanced type in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction and study.</p> <p>Consistently exercises discretion and judgment.</p>	<p>Primary duty of performing office or non-manual work requiring:</p> <p>(1) knowledge of an advanced type;</p> <p>(2) in a field of science or learning;</p> <p>(3) customarily acquired by a prolonged course of specialized intellectual instruction (which also may be acquired by alternative means such as an equivalent combination of intellectual instruction and work experience).</p> <p><u>See</u> 29 C.F.R. § 541.301.</p>

## Creative Professional Employees

	<b>Prior Long Test</b>	<b>Prior Short Test</b>	<b>Current Standard Test</b>
<b>Salary/Fee Basis</b>	\$170 per week	\$250 per week	\$455 per week
<b>Duties</b>	<p>Primary duty of performing work that is original and creative in character in a recognized field of artistic endeavor, and the result of which depends primarily on the invention, imagination, or talent of the employee.</p> <p>Consistently exercises discretion and judgment.</p> <p>Performs work that is predominantly intellectual and varied in character and is of such character that the output produced or result accomplished cannot be standardized in relation to a given period of time.</p> <p>Does not devote more than 20 percent of time to activities that are not directly and closely related to exempt work.</p>	<p>Performs work requiring invention, imagination, or talent in a recognized field of artistic endeavor.</p>	<p>Primary duty of performing work requiring invention, imagination, originality or talent in a recognized field of artistic or creative endeavor. (Does not include work which can be produced by a person with general manual or intellectual ability and training).</p> <p><u>See 29 C.F.R. § 541.302.</u></p>

## Computer Employees

	<b>Prior Long Test</b>	<b>Prior Short Test</b>	<b>Section 13(a)(17) Test</b>	<b>Current Standard Test</b>
<b>Salary/Wage Requirement</b>	\$170 per week	\$250 per week	\$27.63 an hour	\$455 per week or \$27.63 an hour
<b>Duties Requirements</b>	<p>Primary duty of performing work requiring theoretical and practical application of highly-specialized knowledge in computer systems analysis, programming, and software engineering.</p> <p>Employed as a computer systems analyst, computer programmer, software engineer, or other similarly skilled worker in the computer software field.</p> <p>Consistently exercises discretion and judgment.</p> <p>Performs work that is predominantly intellectual and varied in character and is of such character that the output produced or result accomplished cannot be standardized in relation to a given period of time.</p> <p>Does not devote more than 20 percent of time to activities that are not directly and closely related to exempt work.</p>	<p>Primary duty of performing work requiring theoretical and practical application of highly-specialized knowledge in computer systems analysis, programming, and software engineering.</p> <p>Employed as a computer systems analyst, computer programmer, software engineer, or other similarly skilled worker in the computer software field.</p> <p>Consistently exercises discretion and judgment.</p>	<p>Primary duty of (A) application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software or system functional applications; or (B) design, development, documentation, analysis, creation, testing, or modification of computer systems or programs, including prototypes, based on and related to user or system design specifications; or (C) design, documentation, testing, creation or modification of computer programs related to machine operating systems; or (D) a combination of duties described in (A), (B) and (C), the performance of which requires the same level of skills.</p> <p>Employed as a computer systems analyst, computer programmer, software engineer, or other similarly skilled worker in the computer field.</p>	<p>Primary duty of (A) application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software or system functional applications; or (B) design, development, documentation, analysis, creation, testing, or modification of computer systems or programs, including prototypes, based on and related to user or system design specifications; or (C) design, documentation, testing, creation or modification of computer programs related to machine operating systems; or (D) a combination of duties described in (A), (B) and (C), the performance of which requires the same level of skills.</p> <p>Employed as a computer systems analyst, computer programmer, software engineer, or other similarly skilled worker in the computer field. (See 29 C.F.R. § 541.400).</p>

## Outside Sales Employees

	<b>Prior Standard Test</b>	<b>Current Standard Test</b>
<b>Salary</b>	None Required	None Required
<b>Duties</b>	<p>Employed for the purpose of and customarily and regularly engaged away from the employer's place of business in making sales; or in obtaining orders or contracts for services or for the use of facilities for which a consideration will be paid by the client or customer.</p> <p>Does not devote more than 20 percent of the hours worked by nonexempt employees of the employer to activities that are not incidental to and in conjunction with the employee's own outside sales or solicitations.</p>	<p>Primary duty of making sales; or of obtaining orders or contracts for services or for the use of facilities for which a consideration will be paid by the client or customer.</p> <p>Customarily and regularly engaged away from the employer's place or places of business.</p> <p><u>See</u> 29 C.F.R. § 541.500.</p>

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