



## **Summary of New DOL Regulations on Overtime Exemptions**

**OVERVIEW:** On August 23, 2004, new rules take effect under 29 CFR Part 541 governing “white collar” exemptions to overtime and minimum wage requirements under the Fair Labor Standards Act (FLSA). This document is intended only to provide ACEC members with general information on the key elements of the new regulations, with particular emphasis on those portions of the new rules that may impact the engineering industry. This not intended to constitute legal advice. Firms should consult with their own legal counsel to review the specific circumstances of positions in question and whether they should appropriately be classified as exempt or non-exempt, or with regard to any other questions of a legal nature.

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### **Key Elements:**

- The new rules eliminate the previous “long” and “short” tests for each of the three primary categories of exemption – executive, administrative and professional – and establish a single standard test for each category, applying to employees earning between \$23,660 and \$99,999 per year.
- Engineering employees earning less than \$455 per week (or \$23,660 per year), will be non-exempt, regardless of duties.
- Engineering employees earning \$100,000 in salary, non-discretionary bonuses and commissions will be considered exempt if they perform office or non-manual work and if they customarily and regularly perform at least one of the duties under the new executive, administrative or professional tests.
- Engineering firms will benefit from significant changes under the new rule to the so-called “salary basis” test. Most significantly, the new rule scales back the “subject to” test that has been used in significant legal actions against engineering firms and other businesses. The new regulations specify that exempt status would only be affected in situations where an employer engages in an “actual practice” of improper deductions, and only for employees in the same job classification working for the manager responsible for the improper deduction. A new “safe harbor” will also be created for employers who adopt a policy prohibiting improper salary deductions.

## **Executive Exemption**

The new test will continue the requirement that engineering executives will have management of the firm or a recognized department or subdivision as their “primary duty” (principal, main, major or most important duty) and “customarily and regularly” (regarded as normally and recurrently performed every work week – not isolated or one time tasks) directs the work of two or more employees. In addition, the new test specifies that exempt executives must have the authority to hire and fire employees, or to make recommendations regarding hiring, firing, advancement, promotion or other changes in employment status that have particular weight. For example, project managers in engineering firms may have this authority. If they do, firms need to recognize this fact and ensure that it is documented (training, job descriptions, self and downward evaluations, process forms). See the definition of management under 541.102.

An exempt executive may perform exempt and non-exempt duties concurrently.

## **Administrative Exemption**

The new test for administrative employees will be very similar to the old test. To qualify as exempt under the new administrative test, engineering administrators must have as their primary duty the performance of office or non-manual work directly related to the management or general business operations (541.201) of the firm or the firm’s clients, and that the primary duty includes the exercise of “discretion and independent judgment” with respect to “matters of significance” (see 541.202 for a fuller definition of these terms). The new regulations provide guidance on specific examples of administrative functions that may be exempt, including financial service employees, team leaders on projects for either the firm or a client, the executive or administrative assistant to the firm owner or senior executive, and HR managers, as well as examples that would generally be considered non-exempt. See 541.201 and 541.203 for additional guidance, which will be helpful to firms to better define administrative employees.

While the regulations specify that the exercise of discretion and independent judgment “must be more than the use of applying well-established techniques, procedures or specific standards described in manuals, the new test clarifies for the first time that “the use of manuals, guidelines or other established procedures containing or relating to highly technical, scientific, legal, financial or other similarly complex matters that can be understood or interpreted only by those with advanced or specialized knowledge or skills does not preclude exemption” under these regulations.

## **Professional Exemption**

Similar to the current test, the new test requires that an exempt professional’s primary duty be the performance of work requiring advanced knowledge in a field of science or learning (including engineering and architecture, as well as physical/chemical/biological sciences; see 541.301) customarily acquired by a prolonged course of specialized intellectual instruction (regarded as above the high school level), and includes work requiring the consistent exercise of discretion and judgment. The new rule does recognize that exempt professionals may not possess an academic degree, provided that

they have acquired equivalent knowledge through work experience and other instruction and perform substantially the same work as their peers with degrees, and that learning in the field is customarily acquired by a prolonged course of specialized instruction (see 541.301 for additional information). As such, a non-degreed engineering/architectural professional with equivalent knowledge and duties as degreed peers may qualify for exemption.

The new rule references a 1998 opinion letter which indicates that degreed/licensed, non-degreed licensed, and degreed/non-licensed architects would be exempt; non-degreed/non-licensed architects would be non-exempt. The rule also cites with approval recent court decisions that held that an unlicensed design engineer with an associate's degree satisfied the duties test for exemption, as did an engineering specialist with 3 years of college instruction and 30 years of work experience. While these cases, like all decisions, can be limited to their peculiar facts, they provide some indication of the DOL's thinking that is positive from the engineering industry's perspective.

In addition, like in the administrative test described earlier, the use of sophisticated manuals does not preclude satisfaction of the discretion and judgment requirement.

The new test for the creative professional exemption is very similar to the old "short" test, covering employees whose primary duty is the performance of work requiring invention, imagination, originality or talent in a recognized field of artistic or creative endeavor (see 541.302 for additional information). The new rule codifies a 1998 opinion letter that says that a designer who modifies an engineer's design does not perform original or creative work.

### **Computer Employees**

The new rule continues to exempt certain computer professionals where the primary duty consists of the application of systems analysis techniques and procedures to determine hardware, software or system functional specifications; 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; design, documentation, testing, creation or modification of computer programs related to machine operating systems; or a combination of the duties mentioned above. Of note, the computer exemption no longer requires discretion and judgment (see 541.400 for additional information). The new rules also recognize that computer employees may also have executive and administrative duties which qualify for exemption, and use as an example systems analysts and programmers whose primary duties include work such as planning, scheduling, and coordinating activities required to develop systems to solve complex business, scientific or engineering problems of the firm or client. In addition, senior or lead computer programmers who manage the work of two or more other programmers and meet the other duties tests under the executive category generally meet the requirements for exemption (541.402)

### **Highly Compensated Employees**

The new rules create a new bright line test for exemption that applies to “highly compensated” employees, defined as those who perform office or non-manual work and whose total annual non-discretionary compensation is at least \$100,000. Employees could receive a minimum of \$23,660 in salary and fees, while the remaining compensation in the form of bonuses and commissions need not comply with salary or fee basis rules. In addition to compensation requirements, highly compensated employees must customarily and regularly perform any one or more of the exempt duties or responsibilities of an executive, administrative or professional employee.

### **Salary Basis Test**

The new rules make notable changes to the so-called “salary basis” requirements that have been used frequently in high profile lawsuits against engineering firms and other businesses. The FLSA has long required that exempt employees be paid on a salary basis and not subject to pay reductions, except under specified circumstances (such as personal or sick leave under a company plan and offsets for jury duty pay, among others). Businesses that made an improper deduction to an exempt employee’s salary, or had a policy that could *subject* a group of employees to improper deductions -- whether or not deductions ever took place -- opened themselves to significant financial and legal liability, as all affected employees could be reclassified as *non-exempt* and due back overtime pay.

The new rules retain the salary basis requirement, but limit the loss of exempt status only if there is an “actual practice” of making improper deductions. Back pay would be limited to the actual period the deductions in question took place, and limited only to affected employees and those in the same job classification working for the manager responsible for the deductions. In addition, no loss of exempt status would take place for isolated or inadvertent deductions if reimbursed.

The new rules also include a safe harbor for employers that have a clearly communicated policy prohibiting improper deductions, a complaint mechanism, and reimbursement for improper deductions. The Department of Labor is expected to come out with guidance soon on the safe harbor mechanism.

### **State Laws**

Many states have their own overtime laws, some of which impose more stringent requirements than federal law (e.g. California primary duty test) and which may define exemptions more narrowly. Only those states with laws that incorporate the federal definitions by reference will automatically change to the new exemption definitions. Others may retain their current definitions or some other limits on overtime/exempt status.

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