

# General Counsel Column

## Exempt/Non-Exempt Misclassifications Still Plague Employers

By Kathryn M. Hindman

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The federal and state white-collar exemptions are not new, but employers still struggle to make sense of them. With agencies increasing their audits and enforcing strict compliance, employers should periodically review the exempt and non-exempt classifications of their employees to ensure they are correctly paid pursuant to the federal Fair Labor Standards Act (FLSA) and state wage and hour laws. FLSA misclassification remains a “hot area” in virtually every business, with the threats of class suits looming for large companies, and high penalties for all employers. Conducting periodic audits and reviewing the key factors to determine whether the three main exemptions apply will go a long way toward insuring good faith compliance with these laws.

Before you begin that audit, remember the basics: The FLSA and state laws exempt executive, administrative and professional white-collar employees from overtime and minimum wage requirements, so long as the employees meet the minimum salary amount and the salary basis test, and meet the specific duties test, for each exemption. Your periodic audit should involve a three-step process: (1) Determine whether the employee meets the salary test; (2) make an initial decision using the “key” factors to determine if the employee’s job meets the duties test for one or more of the exemptions; and (3) if s/he does meet the threshold factors, conduct a specific job analysis to determine whether the employee’s actual performance of the duties meets the exemption.

For the first step, determining whether an employee meets the salary test isn’t as difficult as it was a decade ago. Typically, most employers know that exempt employees must be paid a guaranteed salary of at least \$455 a week (or \$23,660 a year), which, as a general rule does not decrease when the employees work less than a full week, or if they are disciplined. This general rule of paying exempt employees their full salary if they work at all in a workweek, has specific exceptions clearly outlined in the FLSA regulations and state rules. For example, reducing the salary by a full day if an employee is sick or gone for personal reasons, reducing paid leave banks, and paying an exempt employee “extra” for attaining specific goals is allowed, and are common deductions that will not defeat the salary test.

For the second step of the audit, determining if an employee’s duties meet one (or more) of the three exemptions, is the biggest hurdle for most employers. Using these threshold key factors should help with step two of our audit; they are not detailed requirements of all the duties tests. Once we meet these key duties, we can move on to step three. Let’s start with the executive exemption.

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**Executive Exemption – Key #1:** The first key to the executive exemption is to determine if the employee’s “primary duty” is really managing the business or a recognized department, and is regularly directing the work of two or more full-time employees (or the equivalent of two or more full-time employees (FTEs)).

- ◆ Directing the work of two employees who work 30 hours or 38 hours is not enough. Directing the work of four employees who each work 20 hours a week is the equivalent of two or more FTE and is enough. In order to count, these employees have to be under the supervision of your “executive,” you cannot credit all the hours to more than one supervisor.
- ◆ “Managing” includes responsibilities for interviewing, hiring, training, setting employee schedules, disciplining and taking care of grievances, planning the work, and controlling the budget and materials. It does not mean manual work.

**“Primary Duty”:** The executive’s “primary duty” has to be “managing.” For an executive, this means that the main, major or most important character of the job has to be managing the department and supervising those two + FTEs. For the administrative and professional exemption, an exempt employee’s specific “primary duty” requires a different analysis, but it must still be the main, major or most important aspect of the job. The determination of whether an employee’s “primary duty” is exempt work can be based on the amount of time (more than 50%) or what the FLSA regulations call “other relevant factors” (for example, the importance of the manager’s duties compared to other types of duties). Beware ... state laws notoriously increase the factors required for an employee’s “primary duty” to be exempt work. Indeed, an analysis of state laws regarding the exemptions is important since most states, including Oregon, have not adopted all of the FLSA exemption regulations.

**Executive Exemption Key # 2:** Once you are convinced that your managers have managing a department and supervising two or more FTEs as their primary duty, the second key to the executive exemption is to make sure that, they also have the authority to hire or fire (or their suggestions on those decisions are given particular weight). To ensure compliance, involve your front-line managers in hiring decisions, or advancement, promotion, discipline or termination decisions. Whether a manager has some authority and meaningful input in hiring or firing employees is frequently an issue in class-suit white-collar worker litigation involving low-level supervisors and store-level managers.

**Administrative Exemption Key #1:** The first key to the administrative exemption is to determine if the employee’s primary duty is non-manual work, directly related to management or general business operations of the employer or the employer’s customers. This means that the employee’s primary job is assisting with the actual running or servicing of the business and not performing the day-to-day tasks of the business (like working on a manufacturing production line, or selling a product in a retail or service establishment). For example, private electrical companies sell electricity. If your job is to make calls and otherwise “sell” that product, you are not servicing the business operations, you are performing the day-to-day work and will not meet the threshold primary duty for the administrative exemption. The administrative exemption typically applies to jobs in human resources, accounting, marketing, auditing, quality control, public relations, employee benefits, and computer network and data base administration.

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## General Counsel Column (cont.)

**Administrative Exemption Key # 2:** In addition, an administratively exempt employee's primary duty must include the exercise of discretionary power in the sense that s/he is more than a "figure head," and, is called upon to exercise that discretion and independent judgment on "matters of significance." The Department of Labor believes that although this is case by case analysis, it is generally likely that employees who meet at least two of the three factors listed below will be exercising discretion and independent judgment on matters of significance:

- ◆ The employee has the authority to formulate, affect, interpret, or implement management 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, even if the employee's assignments are related to operation of a particular segment of the business;
- ◆ has the authority to waive or deviate from established policies and procedures without prior approval;
- ◆ has authority to negotiate and bind the employer on significant matters;
- ◆ has the authority to commit the employer in matters that have significant financial impact;
- ◆ 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 management; and/or
- ◆ represents the agency in handling complaints, arbitrating disputes or resolving grievances.

Although an administrative employee does not have to be the ultimate decision maker, his or work must be more than simple clerical or secretarial work, recording or tabulating data, or performing other mechanical, repetitive or routine work.

**Professional Exemption Key #1:** You can meet the professional exemption in three ways: be a professional teacher, a creative "professional," or meet the "learned" professional duties test. For the creative professionals, their primary duty must be in the invention and imagination, in an artistic or creative field. For the learned professional exemption, an employee's initial primary duty must be the performance of work requiring advanced, prolonged knowledge at a college or graduate-level. For the most learned professional, although it is possible to obtain "advanced knowledge" without an advanced degree, many states, including Oregon, require an advanced college degree that is a qualification for the particular job in order to be professionally exempt. Such advanced knowledge under the FLSA (and Oregon) cannot be obtained at the high school level, cannot be routine mental, manual or physical work, and must be in a field of science or learning (for example law, medicine, engineering, chemical and biological science and pharmacy).

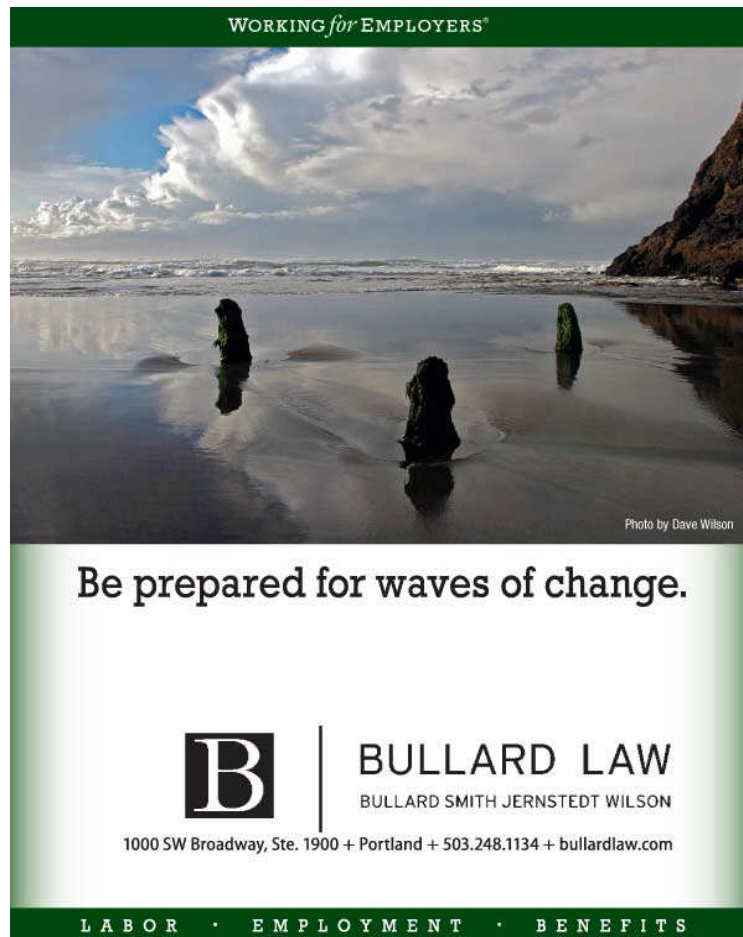
Once you perform steps one and two in your audit, and make your initial determination that the particular employee may be exempt, it is up to you to move on to step three to ensure the individual employee is actually performing exempt work. The executive, administrative and professional exemptions are only three exemptions among several available under federal and state law. In addition to these three main exemptions, white-collar exemptions also include those who are highly-skilled computer professionals, and outside sales people.

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# General Counsel Column (cont.)

Finally, FLSA misclassification is just the tip of the iceberg when it comes to wage and hour compliance. Even if you master the exempt/non-exempt audit, you must also juggle compliance with more employee-protective state and local wage and hour laws, as well as union contracts. Performing periodic audits and using these key factors to weed out obvious non-exempt employees, is the first step to compliance.

Note: Be sure you correct last week's general counsel article that misstated Washington's minimum wage. Washington's 2011 new minimum wage is \$8.67 an hour.



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