

To Be Exempt or Not Exempt; That Is the Question

Expert analysis of the criteria for determining an employee's exempt classification under state law. Failure to properly classify an employee can be a costly oversight for employers.

By Steven L. Fox

When hiring, many employers do not give proper consideration to whether newly hired employees should be classified as “exempt” employees who by law are not entitled to overtime pay for hours worked in excess of 40 hours in any workweek, or “nonexempt” employees who are entitled to overtime pay. A failure to properly apply the legal criteria for employee classification can be a costly oversight for employers.

The federal Fair Labor Standards Act (FLSA) mandates that employees be paid on an hourly basis of at least the federal minimum wage, currently \$7.25. States and municipalities are free to enact higher minimum wage rates. New Jersey recently passed legislation that will progressively increase the current \$8.85 per hour minimum wage to \$15.00.

The FLSA further mandates that employees be paid at an overtime rate of not less than 1.5 times the employee's regular rate for each hour of work time in excess of 40 hours in any one workweek, *unless* the employee qualifies for one of the exemptions from these overtime requirements set forth in the statute. So how does an employer determine the proper classification of an employee as either nonexempt or exempt? Unfortunately, there are



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no bright-line rules an employer can rely upon in making these determinations, and the employee's job responsibilities and the employer's control over the employee largely dictate the proper classification under the FLSA.

However, the statute specifies the criteria that must be met if the employer intends to avail itself of one of the three principal exemptions set forth in the statute: i) the executive exemption; ii) the administrative exemption; and iii) the learned professional exemption. These requirements will be discussed below, as well as certain other exemption classifications that are available under the FLSA.

Thankfully, New Jersey has adopted the same general criteria for determining an employee's exempt classification under state law.

The Executive Exemption

Executive employees are those “employed in a bona fide executive capacity” who: i) are compensated on a salary base of not less than \$455 per week; ii) whose primary duty is management of the business (or a customarily recognized department or subdivision); iii) customarily and regularly directs the work of two or more other full-time employees; and iv) has the authority to hire and fire other employees, or whose opinions and recommendations to do so are given weight.

Mere supervision is not sufficient to qualify for the exemption. Management responsibilities must be the primary duties of the position, in addition to managing the required number of employees. There is no bright-line test, but a fair general rule is that the employee should be “in charge” of a department or subdivision of the enterprise. Examples of management duties include interviewing, selecting and training employees; planning the work; allocating work among employees; and determining work techniques.

The Administrative Exemption

The administrative exemption is most commonly relied upon by employers to claim exempt status. The FLSA defines administrative employees as those “employed in a bona fide administrative capacity” who i) are compensated on a salary base of not less than \$455 per week; ii) whose primary duties are office or non-manual work; iii) which is related directly to the management of the employer’s general business operations or the employer’s customers; iv) whose primary job duties include exercising discretion and independent judgment; v) on significant issues to the business. The job duties must go well beyond clerical, secretarial or data entry functions.

To satisfy the “exercise of discretion and independent judgment regarding matters of significance” test, the employee must routinely be called upon to independently compare and evaluate possible courses of conduct and consider various possibilities before making a decision. The administrative exemption will not be lost merely because the employee’s decisions

are reviewable and at times are revised or reversed. However, the use of discretion and independent judgment must be more than merely implementing a skill in applying a well-established technique or procedure. The discretion and independent judgment must be real.

“Matters of significance” refers to how important the issue or decision is to the business and must be related to the exercise of discretion and independent judgment. The mere fact that the business will experience financial losses if the employee fails to perform the job properly is not alone considered “matters of significance.”

The Professional Exemption

Professional employees are individuals “employed in a bona fide professional capacity” who i) are compensated at a rate of not less than \$455 per week; ii) whose primary duties of work require advanced knowledge predominately intellectual in character; iii) requiring consistent exercise of discretion and judgment; iv) in a field of science or learning; v) customarily acquired by a prolonged course of specialized intellectual instruction.

The “advanced knowledge” requirement is not satisfied by a high school degree. Rather, it is predominately obtained from upper intellectual education requiring consistent exercise of discretion and judgment to analyze, interpret or make deductions. Generally, the professional exemption will be met if an advanced specialized academic degree is a standard prerequisite for the entry into the profession. For example, the FLSA provides that while a registered nurse qualifies as an exempt professional, a licensed practical nurse and similar health

care employees generally will not qualify because possession of a specialized advanced academic degree is not a standard prerequisite for entry into those occupations. By way of another example, paralegals generally do not qualify as exempt professional employees because most paralegal programs are a two-year associates degree from community colleges or equivalent institutions. However, if a paralegal possesses advanced specialized degrees in other professional fields and applies advanced knowledge in that field in the performance of his/her paralegal duties—such as an engineer hired as a paralegal to provide expert advice on a product liability case—the employee would qualify as an exempt professional.

A creative professional employee is one who i) is compensated at a rate of not less than \$455 per week; and ii) whose primary duties involve “invention, imagination, originality or talent in a recognized field of artistic or creative endeavor.” Exempt status as a “creative professional” is likewise subject to a case-by-case basis. For example, a journalist may qualify as an exempt creative professional if the primary duty requires “invention, imagination, originality or talent.” A newspaper employee who only collects, organizes, records and reports information that is “routine or already public, or does not contribute to the interpretation or analysis to a news product” does not qualify as a creative professional. Other examples of “creative professionals” include artists, entertainers and authors.

The professional exemption also extends to “any employee with a primary duty of teaching, tutoring, instructing or lecturing in the

activity of imparting knowledge,” and who is “employed and engaged in the activity as a teacher in an educational establishment by which that employee is employed.”

The Computer Employee Exemption

Although many high-level IT employees will qualify for the professional employee exemption, the FLSA also provides for a computer employee exemption available for those employees who i) are compensated “on a salary or fee basis at a rate of not less than \$455 per week ... or compensate[ed] on an hourly basis at a rate not less than \$27.63 an hour”; and ii) whose primary duties consist of generally system analysis, design, techniques and similar programming involving hardware and software. Employees engaged only in computer manufacturing and repairs generally do not fall within the exemption.

The Highly Compensated Employee Exemption

The highly compensated employee exemption applies to employees i) whose annual compensation is at least \$100,000, which must include at least \$455 per week paid on a salary or fee basis and may include commissions, nondiscretionary bonuses and other nondiscretionary compensation; ii) who customarily and regularly performs any (one or more) of the exempt duties or responsibilities of an executive, administrative or professional employee; and iii) whose primary duties involve office and non-manual work. The employer may elect any 52-week period, i.e., calendar,

fiscal or anniversary of hire year. If the employer does not so elect, it will be considered a calendar year.

The Outside Sales Exemption

Employees engaged in outside sales are exempt employees. Generally, the regulations refer to those employees whose primary duty is making sales or obtaining orders for customers and who is “customarily and regularly engaged away from the employer’s place or places of business in performing such primary duty.” Individuals who regularly conduct sales from the employer’s facility or a remote office do not qualify for this exemption.

Blue Collar Workers – Nonexempt

Generally, job titles and salaries alone are not determinative of the exempt or nonexempt status. Manual laborers and “blue collar” workers who gain skills through apprenticeships and on-the-job-training for routine performance of manual and physical work are nonexempt employees entitled to receive overtime pay. Examples are carpenters, electricians, construction workers, police officers, parole or probation officers, fire fighters and EMT personnel.

Consequences for Improper Status

Employers who misclassify and fail to pay nonexempt employees overtime face liability for the amount of overtime pay due. If an employee files a claim before the federal or state Department of Labor (DOL), employers may be assessed “liquidated” or double damages and civil penalties of up to \$1,100

per violation. Repeated or willful offenders are exposed to even higher penalties, including criminal prosecution. If the employee elects to prosecute a claim before the courts, liquidated damages and attorney fees are available.

Finally, employers are subject to random audits by the federal or state Department of Labor, who will conduct an inspection of all wage and hour records for three years back, and interview employees in search of additional violations.

Conclusion

The consequences for misclassification go far beyond the payment of any unpaid overtime. Proper classification decisions are critical and should be done with the assistance of employment counsel or human resources professionals trained to make these difficult assessments. Employers who are unsure about whether the employee should be exempt or nonexempt must be mindful that while there is no penalty for paying an exempt employee as a nonexempt employee, there are significant penalties for not paying overtime to a nonexempt employee misclassified as an exempt employee. The phrase “when in doubt, hourly out” of the exempt classification comes to mind.

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