

# EVALUATING EMPLOYEE EXEMPT STATUS ACCORDING TO REVISED FLSA EXEMPTION CRITERIA



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## Abstract

In March 2016, the US Department of Labor submitted revised Fair Labor Standards Act (FLSA) regulations to the White House for final approval. The revised regulations define which employees are “exempt” from FLSA protections such as overtime and which employees are non-exempt and thus overtime eligible. We expect that the revisions will be released in the next few months and will greatly reduce the number of employees who qualify for an exemption. Due to the pending revisions, we anticipate that many employers will choose to audit current exemption classification to minimize legal risks associated with misclassification. In this article, we discuss the anticipated FLSA revisions and describe the steps needed to determine which employees in an organization qualify as exempt. Over the years, we have developed and refined methodologies to thoroughly evaluate employee exempt status, and we provide case studies as illustrative examples.

## Introduction

In March 2016, the US Department of Labor (DOL) submitted revisions to the Fair Labor Standards Act (FLSA) regulations to the White House for final approval. The result of the revisions will likely impact the exempt status of millions of US workers and leave many employers uncertain whether their employees qualify for an exemption under the new regulations.

The goal of this paper is to describe several scientifically based methodologies that can be used to determine whether employees qualify as exempt under the FLSA, both currently and after changes are implemented. Our methodologies are particularly well suited to address the expected revisions to the FLSA regulations, because they focus on describing what work employees perform, the amount of time they spend performing that work, and the context in which that work is performed. Over many years, we have developed and refined job analysis methodologies to specifically address key issues when assessing an employee's exempt status, and we have extensive experience conducting these studies across a wide range of industries and job titles—both in response to litigation and proactively to minimize legal risk. In addition, we provide several of these studies as illustrative examples.

## FLSA Overview

The FLSA, enacted in 1938, grants numerous wage and hour protections to all US employees unless they meet the criteria for an exemption and have been classified by their employer as “exempt.” The most notable FLSA protection entitles workers to overtime pay at 1.5 times their regular rate for all hours worked in excess of 40 in a week. Employees who qualify for an exemption may legally be classified as “exempt” and thus are not entitled to any FLSA protections, including overtime pay. Exempt employees are paid a fixed salary regardless of the number of hours they work (i.e., “salaried”).

An employee can qualify for several exemptions, which are described in regulations promulgated by the DOL (see 29 CFR §541 et seq.). The three most common are the Executive, Administrative, and Professional exemptions, commonly known as the “White Collar” exemptions. Although the specific criteria for each exemption differ, exemptions are based on two employee factors: salary (“Salary Test”) and job duties (“Duties Test”). The specific white collar exemption criteria are summarized in Table 1.

**TABLE 1: SUMMARY OF EXISTING FLSA EXEMPTION CRITERIA FOR WHITE COLLAR EXEMPTIONS**

<p><b>Executive Exemption</b></p> <ul style="list-style-type: none"> <li>(1) Paid a salary of \$455 or more per week; and</li> <li>(2) Primary duty is management of the enterprise, department, or subdivision; and</li> <li>(3) Manages two more employees; and</li> <li>(4) Has the authority to hire or fire others (or whose recommendations are given particular weight).</li> </ul>
<p><b>Administrative Exemption</b></p> <ul style="list-style-type: none"> <li>(1) Paid a salary of \$455 or more per week; and</li> <li>(2) Primary duty is 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</li> <li>(3) Primary duty includes the exercise of discretion and independent judgment with respect to matters of significance.</li> </ul>
<p><b>Professional Exemption</b></p> <ul style="list-style-type: none"> <li>(1) Paid a salary of \$455 or more per week; and</li> <li>(2) Primary duty is work requiring one of the following: <ul style="list-style-type: none"> <li>a. Advanced knowledge (i.e., "Learned Professional"); or</li> <li>b. Invention, imagination, originality, or talent in an artistic or creative field (i.e., "Creative Professional").</li> </ul> </li> </ul>

This list is a summary of the criteria contained in the Code of Federal Regulations. The actual regulations (see 29 CFR §541 et seq.) provide additional explanation and guidance.

In 2014, President Obama issued a directive to the US Secretary of Labor to "modernize and streamline" the regulations that define the white collar exemptions (Executive Office of the President, 2014). The directive was intended to address the concern that current regulations have "failed to keep up with inflation, only being updated twice in the last 40 years and leaving millions of low-paid, salaried workers without these basic [FLSA] protections" (Office of the Press Secretary, 2014). In response to the directive, the DOL released its Notice of Proposed Rulemaking (NPRM) in July 2015, which described the proposed changes to the regulations. After a period of public comment, the DOL sent the final revisions to the White House for approval on March 14, 2016. We anticipate that the revisions will be released in the next few months (summer 2016).

Based on the proposed revisions in the NPRM, we expect that the majority of employers will be impacted to some degree, with potentially millions of employees subject to reclassification. As a result, many employers will be looking for clarity on whether their current classifications comply with the revised regulations. In response to this need, we provide three strategies that have been effectively used to provide that clarity by helping determine whether employees qualify as exempt.



## Defining Primary Duty

To satisfy the Salary Test under existing regulations, the employee must be paid a minimum of \$455 per week. To satisfy the Duties Test under existing regulations, the employee's "primary duty" must be exempt work. The term "primary duty" is the phrase in the regulations where disputes commonly arise. An evaluation of "primary duties" requires an understanding of what work employees actually perform, the context in which it is performed, the nature of the work, and the time spent on that work. Different methods, such as job analyses, are often required to collect this evidence (Hanvey & Banks, 2015; Banks & Aubry, 2005; Banks & Cohen, 2005; Ko & Kliener, 2005; Honorée, Wyld, & Juban, 2005).

In federal courts, "primary duty" has been interpreted qualitatively, meaning that there is no defined threshold for the percent of time that an employee needs to spend performing exempt duties. Other factors, such as importance of the work performed, may be considered in addition to the percent of time spent when determining an employee's primary duty. As a result, an employee may be considered exempt, even if they spend less than half of their time performing exempt work.

In contrast, California's state labor laws (a jurisdiction where exemption litigation is frequent) are more restrictive, requiring that exempt employees spend more than 50 percent of their time performing exempt work. Employers operating in California must comply with the more restrictive state standard.

## New FLSA Exemption Criteria

The DOL stated its proposed revision to the FLSA regulations in the NPRM. The proposal addressed both the Salary Test and the Duties Test. First, the DOL proposed raising the minimum salary to qualify as exempt. Second, the DOL discussed some possible changes to the Duties Test. Each is discussed below.

### Salary Test

The DOL proposed a significant increase to the minimum salary required to qualify for an exemption, from just under \$24,000 per year (\$455 per week) to the 40th percentile of earnings for full-time salaried workers, which is projected to be around \$50,000 per year (DOL, 2015). This would mean that all exempt employees who previously qualified under one of the white collar exemptions and earn less than \$50,000 per year will no longer meet the Salary Test and will not to qualify for the exemption. This regulatory revision alone will impact millions of employees, according to DOL estimates (DOL, 2015), likely resulting in most of these employees being reclassified to non-exempt hourly employees.

### Duties Test

The DOL also addressed the Duties Test in the NPRM. Prior to the release of the NPRM, many had speculated that the DOL would revise the definition of "primary duty," potentially by following California's lead and setting a minimum percent of time that employees must spend performing exempt tasks. However, the NPRM did not include a specific proposal to change the Duties Test. Instead, the DOL requested feedback on whether—and how—the definition of primary duties should change. The DOL specifically requested feedback on whether a quantitative threshold should be used, referencing the 50 percent "primarily engaged" threshold used in California. It is unknown what changes may be made to the Duties Test, but FLSA regulations may be revised to mirror the 50 percent quantitative threshold used in California.

Any changes to the primary Duties Test would require a significant shift in the way FLSA exemptions are evaluated and further reduce the number of exempt employees. If a quantitative (e.g., 50 percent) threshold is adopted, exemption evaluations would need to focus on precise measurement of the amount of time that employees spend performing exempt and non-exempt work. Data such as the importance of work performed would no longer be relevant. Much of our experience has come from conducting exemption audits in California, and therefore we have developed and implemented methodologies to measure the amount of time employees spend performing exempt work for many organizations and job titles. The three most commonly used methodologies are described in the following section.

## How to Audit Employees' Exempt Status

The first step toward adapting to the potential new regulations is to determine which exempt employees are at risk or of no longer qualify for an exemption. Our focus in this paper is how to evaluate compliance with the Duties Test. An evaluation of whether employees meet the new Salary Test will involve analyzing payroll data to determine which employees reach the minimum salary threshold. This analysis does not necessarily require expertise in work measurement. In contrast, determining whether different jobs in an organization meet the Duties Test requires detailed measurement of work behaviors, which is where our expertise is most relevant. The following section describes three methodologies that can be used to conduct an exemption audit.

As stated earlier, an employee can qualify for multiple exemptions, and a single employee could meet the criteria for multiple exemptions. The specific method of data collection should be selected and customized based on the specifics of the job and the exemption(s) being evaluated. Having executed more than 100 exemption studies for different positions across a variety of industries, we offer the following general framework for the evaluation process, as well as some specific case examples for illustration purposes.

The common theme across all of the following methods is primary data collection. Reviewing documents that provide high-level descriptions of the work that employees in a certain position are supposed to do (e.g., job descriptions) provides some value in the process, but alone is insufficient to evaluate classification. An effective evaluation requires data that reveal what employees actually do on the job. The most appropriate methods for collecting valid and reliable data are observing and documenting how employees perform their work, or collecting verbal/written self-reports from employees about the work they perform. Each method is based on scientifically-sound job analysis techniques that have been used for nearly a century to collect information about the work employees perform. The appropriate method for a given organization or job is dependent on several factors, such as type of work performed, language ability of employees, geographic disparity of employees, and even practical considerations such as cost and time. Most important, the appropriate method must be capable of generating valid and reliable data.

## *Time and Motion Observations*

Time and motion observation studies result in a robust data set that many readers find particularly compelling. Observations involve a trained job analyst directly observing and documenting a continuous record of all tasks an employee performs throughout the day, along with the duration of each task performed. One advantage of this method is that data are collected from an objective professional who directly observes and documents the tasks performed in a given work environment. This ensures that data are free from self-report biases or memory decay that may lead to inaccurate self-reports.

Once collected, the individually recorded tasks can be grouped into exempt and non-exempt categories and analyzed to provide an overall percentage of time spent on different exempt activities. Other factors relevant to a classification evaluation (e.g., independent judgment and decision making, role in hiring and firing) may be difficult to observe directly because they are non-visible mental processes and may occur infrequently. To address these areas, the observation data can be supplemented with self-report data from incumbents or managers.

Conducting full-shift observations from employees can be time consuming and expensive. Therefore, it is typically necessary to collect data from a sample of employees.

An important consideration when conducting an observation study is the type of job being evaluated. Some tasks (e.g., mental tasks) do not lend themselves to an observation methodology. Jobs comprised primarily of these types of tasks are more challenging to observe, whereas jobs comprised primarily of visible tasks are more easily studied using observational techniques. Below, we share an example of an observation study we conducted for an internet service provider to determine the percent of time managers spent performing exempt work.

## CASE STUDY 1: OBSERVATION STUDY OF CABLE INSTALLATION MANAGERS

A client was facing litigation in California in which plaintiffs claimed that cable installer managers (managers) were misclassified as exempt. The organization believed that the managers met the criteria for the Executive Exemption. To collect relevant data, we designed a study that included conducting 30 full-shift observations and 10 structured interviews with managers.

We started the study by reviewing documents (e.g., job descriptions, training materials), interviewing different district level managers (i.e., supervisors of the managers), and visiting multiple incumbent managers outside of California to observe them performing their work firsthand. Observing out-of-state managers gave us the opportunity to ask incumbent managers questions without tapping into the same group of managers in California that we would ultimately be studying.

Through these visits, we learned important details about the work environment. This information was incorporated into a Task List, a list of individual activities that any manager may perform on the job. This list was used to ensure that observers were able to recognize, accurately record, and categorize the tasks they observed. For example, we learned about the variety of services technicians provided to customers, the names of the different programs and reports, and what terminology (including slang and acronyms) employees used to communicate with others about the work being performed. This list was grouped by topic into “Task Areas,” which were then classified as “exempt” or “non-exempt.” This structure was used to analyze the data collected and determine how time was spent.

By visiting managers, we learned that many of them started their day by leading a team meeting at one of the many facilities throughout the state. Then, managers would perform tasks such as attending to other issues in the office or driving out into the field themselves to handle difficult customers and problematic service issues, and generally check on their installers’ performance. This meant that some observers had to ride along with the managers in their vehicles and accompany them into customer homes.

To standardize the observation data collection and ensure that observers were prepared to appropriately respond to potential customer interactions, we prepared a detailed observation protocol. The protocol provided guidance to observers on how to track unique tasks and scripted language to use in various scenarios.

Through our preliminary research, we learned that managers sometimes performed additional work from home before and after their formal “work day.” To ensure that we captured information about the entire range of tasks performed, we determined that the best approach to collect valid and reliable data would be an observation study with an additional structured interview component to collect self-report information about unobservable tasks.

After the observations were completed, we followed up with a group of managers by phone and asked them to self-report additional information on topics such as work performed from home and possible changes in their jobs over time.

The observation and interview data provided a comprehensive picture of the manager job and enabled us to provide information to the client relevant to evaluating its classification. The client used this data to address the pending litigation.



## *Job Analysis Questionnaires*

A second method for evaluating exemption classifications is a self-report Job Analysis Questionnaire. This method involves collecting self-report responses from employees and/or their managers to a series of written questions. Based on existing science and best practices in the field, the job analysis questionnaire is a carefully designed instrument specifically designed to accurately measure employee behaviors in the workplace. One of the advantages of a self-report questionnaire is that it can be administered to a large number of employees relatively inexpensively. In addition, data can be collected retrospectively and questions can be asked about issues that may be difficult to observe, such as decision-making authority or the purpose of tasks performed. Self-report data collection can be used independently or in conjunction with other methods.

To address factors relevant to the exemptions, a job analysis questionnaire must be thorough, detailed, and comprehensive. For example, our job analysis questionnaires often include five or more subsections, each covering a different element of the job. Given the questionnaire's length, participation can be time consuming for employees; however, this is necessary to collect sufficient data to draw meaningful conclusions.

Topics addressed in a self-report tool can include tasks performed, time spent, decision making, level of autonomy, reasons for performing different tasks, task importance, role in different operational areas, and other special duties or responsibilities. In addition, using this approach can provide insight into the reasons behind employees performing various tasks. If, for example, a manager at a retail store is spending the majority of her time ringing in customers on the register, a self-report tool could reveal that the reason for this behavior is to ensure that a recently repaired register is functioning properly. This type of information can be critical in determining whether certain behaviors are an individualized issue or a structural problem throughout the organization.

Different mediums can be used to administer a job analysis questionnaire. Two that we use for clients are a hard-copy "paper and pencil" questionnaire and an online, Web-based questionnaire. One consideration when choosing a medium for administration is that the administration of a hard-copy questionnaire requires more time and effort to manage, including coordinating and overseeing in-person administration sessions. In contrast, an online questionnaire requires less time to administer, but is only feasible when employees have reliable access to and general familiarity with computers and the internet.

If a hard-copy questionnaire is used, employees' responses must be entered into an electronic form before they can be analyzed. If an online questionnaire is used, no data entry is required, and the responses can be easily downloaded and analyzed to determine how employees responded. Below is an example of an online job questionnaire we administer biannually for a national retailer.

## CASE STUDY 2: ONLINE JOB ANALYSIS QUESTIONNAIRE FOR NATIONAL RETAILER

In-house counsel for a national retail company asked us to develop a program to proactively assess whether its Store Managers were performing their jobs in a way that met the criteria for the executive exemption. They also asked us to design a coaching program to modify the behavior of employees who were not performing the Store Manager job the way it was intended (i.e., majority of time spent on exempt tasks). To accomplish this, we developed an online job analysis questionnaire with an accompanying feedback and coaching component.

To develop this customized questionnaire we conducted a thorough review of the Store Manager position. First, we reviewed existing documents, including training and operations documents and job descriptions of various positions in the store. Next, we visited a variety of stores around the country to interview and observe Store Managers to learn firsthand about store operations and the Store Manager job responsibilities. We also held multiple subject-matter expert group meetings with District Managers representing different geographies around the country to gather information about the differences between stores and how that may impact the way a Store Manager spends his/her time.

Based on this background information, we developed a comprehensive list of all tasks Store Managers may perform on the job. This task list was then reviewed by multiple groups of District Managers for accuracy and completeness and modifications were made based on their input.

The task list was used as the basis of the questionnaire. Participants were asked to report the relative time spent on each task. Next, tasks were grouped into Task Areas (i.e., tasks that serve a common function), and participants reported the percent of time they spent performing work in each Task Area. Task Areas were pre-classified as exempt or non-exempt by an external legal expert, allowing calculation of total time spent on exempt work. Finally, we asked Store Managers to report the reasons they performed non-exempt tasks. This was used to help customize the follow-up coaching process. The entire questionnaire was then reviewed by a groups of District Managers for clarity, and revisions were incorporated based on their feedback.

The online questionnaire was then pilot tested with a random sample of Store Managers to ensure that the instructions were clear and that the content was appropriate and accurately reflected the scope of the Store Manager job. After making minor revisions based on this feedback, we administered the questionnaire to more than 1,200 Store Managers nationwide.

Analysis revealed that most of the Store Managers were spending the majority of their time on exempt work.

The Store Managers who were spending a large percentage of their time on non-exempt activities were identified, and the reasons these Store Managers reported performing non-exempt activities were reviewed. Based on this information, a customized coaching program was developed for each of these Store Managers. District Managers were given coaching points that were customized for each Store Manager depending on his/her specific reasons for performing specific tasks. District Managers used the coaching guide to work with each Store Manager to identify goals and strategies for reallocation of time to drive compliance.

After the success of the first administration, the company asked us to revalidate (i.e., update) the questionnaire content periodically and readminister the questionnaire to ensure continued Store Manager compliance with company expectations.

## Structured Interviews

The structured interview is another self-report tool that can be used for evaluating exemption compliance. The same foundations of job analysis practice are used to form the basis of the interview questions. However, unlike the job analysis questionnaire, which typically contains mostly closed-ended (i.e., fixed-scale) questions, the structured interview contains mostly open-ended questions. Open-ended questions allow employees to elaborate and provide significant detail in their responses. These types of interviews can result in interesting and illustrative examples of different scenarios and circumstances. In addition, follow-up questions can be built in to capture the drivers that lead to different employee behaviors. Some interviews incorporate both open- and closed-ended questions, which can expedite the interview and provide numeric data to analyze.

The structured interview approach can be useful when studying complex and highly technical jobs that do not lend themselves to a prestructured questionnaire with defined measurement scales. Given the large number and detailed nature of questions, structured interviews can take a significant amount of time to execute. Depending on the environment, this time requirement can limit the number of employees who can be interviewed.

Employee responses to structured interviews can be lengthy, thus requiring a content-analysis approach to summarize. However, responses typically contain much more detail than other self-report instruments. The case study below describes how we designed and implemented a structured interview tool to a group of employees involved in various stages of the design and creation of integrated circuit chips at a semiconductor company.

### CASE STUDY 3: JOB ANALYSIS OF ENGINEERS AT A SEMICONDUCTOR COMPANY

A semiconductor manufacturing company was facing litigation in which plaintiffs alleged that their “engineers” were misclassified as exempt. The class action had already been certified. We were asked to determine how employees in this position were performing their jobs in relation to several different exemptions. The job class of engineer included the following six job categories: Chip Design/Hardware, Software, Chip Layout, Product Applications, Manufacturing/Operations, and Customer Relations. The group of employees included in our study held many different job titles. The organization considered them all exempt, but different employees were considered exempt under different exemptions, including the professional, administrative, computer professional, and executive exemptions. In addition, because the class of engineers had already been certified, our data collection was limited to those who “opted out” of the litigation. Given the diversity of the jobs included within this study and the technical nature of the positions, we determined that a structured interview method would be the best option to gather reliable data that addressed the key issues relevant to the various exemptions.

We started the job analysis by collecting background information about the parts of the business in which engineers worked. Through this effort, we learned that engineers worked in almost every phase of the product development cycle and that we needed to obtain significant background information about the different procedures and technologies involved in this process to adequately understand what employees in this group of jobs were actually doing. We relied on both internal and external resources, including interviews with external technology experts and industry readings.

Next, we conducted and recorded interviews with more than 40 managers of the different engineering positions. Because of the technical language used during the interviews, the recordings enabled us to listen multiple times in order to accurately transcribe content.

Using the information gained from the background research and manager interviews, we developed a structured interview that asked questions about the nature of the engineer relationship with customers and other employees, the frequency and nature of supervision by their managers, the degree and nature of problem solving required in performing tasks, the technical knowledge and expertise required to perform tasks, the degree and nature of physical and routine work performed, the extent to which engineers supervised others, and the types of decisions made and degree of autonomy in making those decisions, among other things.

The more than 30 hours of interview data we collected resulted in a database with extremely detailed information about the work that engineers in each of the groups performed and specifically how it fit into the areas relevant to the exemption. We prepared a summary report detailing our findings and the significant range in job duties we found across the organization. The client relied on our report to address class certification and merits issues in the case.

## Summary

Pending changes to FLSA regulations will have a significant impact on the exempt status of many employees. We expect these changes will cause many businesses to revisit the classifications of employees. To assist in the process, we provided several job analysis methods we have developed and applied over the years to properly evaluate the exempt status of employees. All research methods have strengths and weakness, so the most appropriate method depends on the specifics of an organization and the position(s) being studied. In addition, we provided several case studies that describe how these methods have actually been implemented in organizations.

Disclaimer: Each method presented above describes data-collection options that can be used to inform job classification decisions. However, we recommend seeking legal counsel before making any decisions related to classification.

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Chester Hanvey, Ph.D. provides consulting services on labor and employment issues in both litigation and non-litigation contexts. Dr. Hanvey has worked with more than 100 organizations across a range of industries including public and private sectors. He specializes in designing and conducting job analyses and conducting statistical analyses to evaluate wage and hour compliance, appropriateness of class certification, allegations of discrimination, and damages.

Dr. Hanvey's wage and hour experience includes the evaluation of overtime exemptions (misclassification), meal- and rest-break compliance, employee vs. contractor status and off-the-clock work. His experience with employment discrimination claims includes the measurement of adverse impact and test validation in the contexts of hiring, promotion, layoffs and compensation to evaluate alleged discrimination on the basis of protected class membership and disability.

Dr. Hanvey holds a Ph.D. in Industrial/Organizational (I/O) psychology with a minor in quantitative methods (statistics). He has authored chapters and journal articles and regularly presents at professional conferences on the topics of wage and hour litigation, class certification, and statistical analyses. He is the co-editor and a contributor to *HR Practitioner's Guide to Legal Issues in Organizations*, a book that offers practical guidance on evaluating a variety of employment legal issues. He has also taught undergraduate courses in psychology and graduate courses in statistics and research design.

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Elizabeth Arnold has 15 years of experience advising clients on issues related to wage and hour compliance. She consults with leading law firms and companies nationwide on state and federal class action wage and hour litigation cases across industries ranging from retail and beverage delivery to meat processing and gaming.

Ms. Arnold consults with clients to develop and implement research methodologies that address complex legal compliance issues, including misclassification (i.e., exempt vs. non-exempt employees, independent contractor), donning and doffing, off-the-clock work, missed meal and rest breaks, and tip pooling. She utilizes research methodologies that include the use of statistical sampling and large-scale data collection using interview, questionnaire, and observation techniques.

Ms. Arnold has advised clients on more than 150 cases in the wage and hour area of employment law. Her engagements often include national projects to determine the tasks and responsibilities of employees and to assess whether the work they perform is sufficiently similar to determine their appropriate status on a group basis under the executive, administrative, professional, and/or outside sales exemptions. Clients have used results from her studies at multiple stages of litigation, including mediation, class certification, and merit evaluation.

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