

# Client Alert

A report  
for clients  
and friends  
of the firm     April 2004

## DOL's Fair Pay Overtime Rules Alter The White Collar Exemption Regulations

On April 23, 2004, the United States Department of Labor ("DOL") published long-awaited final regulations defining the executive, administrative, professional, outside sales, and computer professional exemptions under the Fair Labor Standards Act ("FLSA"). These final regulations will become effective on August 23, 2004, unless Congress votes to disapprove the regulations or amends the FLSA. The new regulations are designed to modernize and update the "white collar" exemptions.

A thorough review of the new regulations and the DOL's explanatory Preamble reveals a host of nuanced and subtle modifications that have been made to clarify the many ambiguities residing in the current regulatory framework for defining exempt employees. Since these rule changes affect virtually all employers, Proskauer will be holding seminars in May 2004 to explain the impact these new regulations will have on your workplace and what you need to do about them. In the meantime, this Client Alert highlights the key changes made by the new regulations.

### Overview

As discussed more fully below, some of the more significant changes in the new regulations include:

- Raising the minimum salary level test below which all workers are entitled to overtime from \$155 per week to \$455 per week (\$23,660 annually);
- Creating a new exemption for highly compensated employees who earn at least \$100,000 annually;
- Replacing the long and short "duties" tests with a standard duties test;
- Specifying that employees in certain occupations—public safety and health officials, licensed practical nurses, paralegals—generally, must be paid overtime compensation;
- Requiring that executive employees have effective authority to hire, fire, promote, or change employee status;
- Altering the "primary duty" requirement for exempt status to make clear that the emphasis is placed on the principal character of the employee's job and not on the percentage of time spent performing the primary duty;
- Recognizing that computer network, Internet, and database engineers and administrators; insurance claims adjusters, and numerous workers in the financial services industry occupy positions directly related to management or general business operations of the employer, thereby making it likely that such employees are administratively exempt *provided* they exercise discretion and independent judgment;
- Satisfying three of the listed factors to determine whether an employee is exercising discretion and independent judgment may be sufficient to meet that test, although a case-by-case analysis is required;
- Expanding the professional exemption to cover "learned" professionals, such as chefs and athletic trainers, among others; and broadening the "artistic" exemption to include "creative" professionals such as actors and certain types of journalists;
- Creating a new exception to the salary basis test for infractions of workplace conduct rules, as well as a new "safe harbor" rule to mitigate improper deductions from pay.

## New Salary Levels and the “Standard Duties” Test — No More “Short” and “Long” Tests

The final rules raise the minimum salary level for exemption from \$155 per week (\$8,060 annually) to \$455 per week (\$23,660 annually). Employees earning less than \$455 per week, who were previously tested for exemption under either the “long” or “short” duties tests, will now be guaranteed overtime protection, *regardless* of their job duties. In addition, the final rules create a new test for “highly compensated” employees earning at least \$100,000 annually. Any employee who performs office or non-manual work, and whose total *non-discretionary* compensation (including commissions) is at least \$100,000 (and includes at least \$455 per week paid on a salary or fee basis) will be exempt, *provided* that he or she “customarily and regularly performs” at least one of the functions that appear in the tests for executive, administrative, or professional employees.

The chart below summarizes these changes.

Earnings	Existing Regulations	Final Regulations
Less than \$155/week	Guaranteed Overtime	Guaranteed Overtime
\$155 to \$249.99/week	Long Duties Test	Guaranteed Overtime
\$250 to \$454.99/week	Short Duties Test	Guaranteed Overtime
\$455/week to \$100,000/year	Short Duties Test	Standard Duties Test
\$100,000/year or more	Short Duties Test	Highly Compensated Test

\* This chart uses information from Table 2-1 in the DOL’s Economic Regulatory Impact Analysis (“Economic Report”).

## New Definition of “Primary Duty”

The new regulations define “*primary duty*” as the principal or most important duty that the employee performs. Factors to consider when determining the *primary duty* of an employee include: (1) the relative importance of the exempt duties as compared with other types of duties; (2) the amount of time spent performing exempt work; (3) the employee’s relative freedom from direct supervision; and (4) the relationship between the employee’s salary and the wages paid to other employees for the same kind of non-exempt work.

The new regulations explicitly state that the term *primary duty* does *not* require that an employee spend over 50% of his/her time performing exempt work, so long as the major duty that the employee performs is exempt work. Thus, the DOL explained, assistant managers in a retail establishment who perform executive work such as directing the work of others,

ordering merchandise, and authorizing bill payment may have management as their *primary duty* even if the assistant manager spends more than 50% of the time running the cash register. Employees who spend more than 50% of the time performing exempt work will be presumed to have a primary duty of performing exempt work.

## Executive Employees Duties Test

	Current Short Test	New Standard Test
Salary Level	\$250 per week	\$455 per week
Duties	<p>Primary duty consists of the management of the enterprise in which s/he is employed or of a customarily recognized department or subdivision thereof; and</p> <p>Who customarily and regularly directs the work of two or more other employees.</p>	<p>Primary duty is management of the enterprise in which the employee is employed or of a customarily recognized department or subdivision thereof;</p> <p>Who customarily and regularly directs the work of two or more other employees; and</p> <p>Who has the authority to hire or fire other employees or whose suggestions and recommendations as to the hiring, firing, advancement, promotion or any other change of status of other employees are given particular weight.</p>

\* This chart uses information from Table 2-2 in the DOL’s Economic Report.

Therefore, in order to satisfy the test as an exempt executive, an employee must be compensated on a salary basis at a rate of not less than \$455 per week and perform the duties set forth in the right column of the above chart.

## Authority to Hire and Fire or have “Particular Weight” Given to Recommendations

Significantly, the new regulations add the requirement that an executive employee have the authority to hire or fire other employees or have “particular weight” given to recommendations which affect a change in employee status. In determining whether “particular weight” has been given to such decisions, factors include: (1) whether it is part of the employee’s job duties to make such suggestions and recommendations; (2) the frequency with which such suggestions and recommendations are made or requested;

and (3) the frequency with which the employee's suggestions and recommendations are relied upon.

### Retail Supervisors May Concurrently Perform Exempt and Non-exempt Work

Concurrent performance of exempt and non-exempt work will not disqualify an employee from the executive exemption if the employee otherwise meets the salary and duties requirements. The new regulations distinguish assistant managers in a retail establishment from "relief" or "working" supervisors on the production line in a manufacturing plant. Working supervisors in non-retail settings (e.g., manufacturing) do not qualify for exemption simply because they occasionally direct the work of non-exempt employees. Conversely, supervisors, such as assistant managers in retail establishments, may qualify for the executive exemption, even while serving customers, stocking shelves, or cooking food, as long as their primary duty is still management (i.e., supervising employees, directing the work of other employees, scheduling employees).

Finally, the new rules provide an executive exemption for any employee who owns at least a bona fide 20% equity interest in the enterprise in which the employee is employed, regardless of whether the business is a corporate or other type of organization, provided that the employee is "actively engaged in its management."

### Administrative Employees Duties Test

	Current Short Test	New Standard Test
<b>Salary Level</b>	\$250 per week	\$455 per week
<b>Duties</b>	Primary duty consists of the performance of office or non-manual work directly related to management policies or general business operations of the employer or the employer's customers; and  Which includes work requiring the exercise of discretion and independent judgment.	Primary duty consists of the performance of office or non-manual work directly related to management or general business operations of the employer or the employer's customers; and  Whose primary duty includes the exercise of discretion and independent judgment with respect to matters of significance.

\* This chart uses information from Table 2-3 in the DOL's Economic Report.

The new standard duties test for the administrative exemption maintains the terminology of the current test with seemingly minor variations. Significantly, however, while the

*terms of art* found in the current regulations are retained, other regulatory provisions clarify their meaning by incorporating interpretations found in federal court rulings. In addition, the new regulations identify occupations presumed to qualify for the administrative exemption as long as the discretion/independent judgment standard is met. Such occupations include insurance claims adjusters; computer network, Internet, and database administrators; and numerous workers in the financial services industry.

An employee employed in a "bona fide administrative capacity" must: (1) be compensated on a salary or fee basis at a rate of not less than \$455 per week; (2) the employee's primary duty must be 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 (3) the primary duty must include the exercise of discretion and independent judgment with respect to matters of significance.

### Specific Examples of Work that Is Directly Related to the Management or General Business Operations of an Employer

The new regulations identify functional areas subsumed within the phrase "management or general business operations," including tax; finance; accounting; budgeting; auditing; insurance; quality control; purchasing; procurement; advertising; marketing; research; safety and health; personnel management; human resources; employee benefits; labor relations; public relations; government relations; computer, network, Internet and database administration; and legal and regulatory compliance.

### Clarifying the Exercise of Discretion and Independent Judgment

The new regulations retain "the exercise of discretion and independent judgment" standard and specify factors to be considered in applying the standard, including whether the employee: (1) has authority to formulate, affect, interpret, or implement management policies or operating practices; (2) carries out major assignments in conducting the operations of the business; (3) 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; (4) has authority to commit the employer in matters that have significant financial impact; (5) has authority to waive or deviate from established policies and procedures without prior approval; (6) has authority to negotiate and bind the company on significant matters; (7) provides consultation or expert advice to management; (8) is involved in planning long- or short-term business objectives; (9) investigates and resolves matters of significance on behalf of management; and (10) represents the company in handling complaints, arbitrating disputes, or resolving grievances.

Noteworthy, in the Preamble to these final regulations, the DOL explained that employees who satisfy at least two or three of these factors generally exercise discretion and independent judgment, although a case-by-case analysis is required.

### Using Manuals Containing Highly Technical, Scientific, or Complex Matters Will No Longer Preclude Exempt Status

The final regulations contain a new provision that allows employees to use manuals, guidelines, or other established procedures—without forfeiting exempt status—so long as the manuals contain “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.” Concomitantly, if employees regularly use manuals to apply well-established techniques or to identify specific directions for use in routine circumstances, exempt status will likely be defeated.

### Specific Examples of Generally Exempt and Non-Exempt Positions

The new regulations identify positions that typically satisfy the duties requirement for the administrative exemption:

- (1) **Insurance claims adjusters** are exempt so long as they interview insureds, witnesses, and physicians; inspect property damage; prepare damage estimates; evaluate and make recommendations regarding claims coverage; determine liability and the value of a claim; negotiate settlements; and make recommendations regarding litigation;
- (2) **Financial services employees** who collect and analyze income, asset, investment and/or debt information; determine which financial products are appropriate given a customer’s financial situation and needs; advise customers regarding selection of different financial products; and who market, service, and promote the employer’s financial products would be exempt;
- (3) **Executive or administrative assistants** to a business owner or senior executive are exempt if granted authority over significant matters. In addition, human resources managers are exempt as long as they formulate, interpret, or implement employment policies;
- (4) **Management consultants** who study the operations of a business and propose changes in organization are exempt employees, as are **purchasing agents** with authority to bind the company on significant purchases;
- (5) **Comparison shoppers** who evaluate competitor prices to set the employer’s prices and an employee who leads a team of other employees assigned to complete major projects would also likely be exempt positions.

Conversely, the new regulations provide several examples of non-exempt employees, including: (1) employees who primarily sell financial products; (2) personnel clerks who screen applicants for minimum qualifications, but do not set the minimum standards or interview applicants; (3) inspectors who rely on standard techniques and procedures and who have little (if any) discretion; (4) employees who examine or grade product quality; (5) comparison shoppers who merely report competitor’s prices; and (6) public sector inspectors or investigators who apply prescribed procedures and whose work does not directly relate to management or general business operations.

### Professional Employees Duties Test — “Learned Professionals”

	Current Short Test	New Standard Test
<b>Salary Level</b>	\$250 per week	\$455 per week
<b>Duties</b>	Primary duty consists of the performance of 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; and  Which includes work requiring the consistent exercise of discretion and judgment.	Primary duty is the performance of work requiring knowledge of an advanced type (defined as work which is predominantly intellectual in character, and which includes work requiring the consistent exercise of discretion and judgment) in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction.

\* This chart uses information from Table 2-4 in the DOL’s Economic Report.

To qualify for the learned professional exemption, an employee’s primary duty must: (1) involve the performance of work requiring advanced knowledge; (2) the advanced knowledge must be in a field of science or learning; and (3) the advanced knowledge must be customarily acquired by a prolonged course of specialized intellectual instruction. Work requiring “advanced knowledge” means work which is predominantly intellectual in character, and which includes work requiring the *consistent exercise of discretion and judgment*. Advanced knowledge cannot be attained at the high school level.

Under the final rules, advanced knowledge may, in limited circumstances, be acquired by an equivalent combination of intellectual instruction and work experience. This exception is restricted to “professions where specialized academic training is a standard prerequisite for entrance into the

profession,” and may not be applied to occupations that customarily may be performed with only general knowledge acquired by an academic degree in any field, acquired through an apprenticeship, or with training in the performance of routine tasks. Thus, the self-taught apprentice lawyer who has not gone to law school, or the occasional chemist who does not possess a degree in chemistry, would be subsumed in this category. Accordingly, the new rules open the door for certain employees to fall within the learned professional exemption without specialized academic training, but rather based on extensive work experience. While the express reference to military experience contained in the proposal was removed, it is still possible that some employees with extensive experience obtained while in the military service might fall within this exception. However, this exception is not expected to be widely used.

### Specific Examples of Exempt and Non-exempt “Learned” Professional Occupations

The regulations provide numerous examples of exempt occupations. For example:

- (1) **Registered or Certified Medical Technologists** are exempt if they have completed three years of study at an accredited university and one year of course work in an approved medical technology school;
- (2) **Registered Nurses** are typically exempt, as are **Dental Hygienists** with four years of professional study at an accredited university;
- (3) **Physician Assistants** who have completed four years of professional study and who are certified by the National Commission on Certification of Physician Assistants qualify as exempt professional employees;
- (4) **Certified Public Accountants** and **accountants who perform similar duties** satisfy the learned professional exemption; and
- (5) **Chefs** who hold a four-year degree from a culinary arts program will generally be exempt, as will **Athletic Trainers** who have successfully completed four years of professional study in an accredited curriculum and who are certified by the Board of Certification of the National Athletic Trainers Association.

In contrast, Licensed Practical Nurses and similar health care employees who lack a specialized advanced academic degree will *not* be exempt. Accounting clerks and bookkeepers who primarily perform routine work are not learned professionals, nor are cooks who perform primarily routine mental, manual, mechanical, or physical work. In addition, paralegals and legal assistants who possess a general four-year degree will not qualify for the professional exemption – only paralegals with advanced specialized degrees in other professional fields who apply that knowledge in the

performance of their duties (such as an engineer who works as a paralegal on patent matters) will be exempt.

### Professional Employees Duties Test — “Creative Professionals”

	Current Short Test	New Standard Test
<b>Salary Level</b>	\$250 per week	\$455 per week
<b>Duties</b>	Primary duty consists of the performance of work requiring invention, imagination, or talent in a recognized field of artistic endeavor.	Primary duty is the performance of work requiring invention, imagination, originality or talent in a recognized field of artistic or creative endeavor.

\* This chart uses information from Table 2-4 in the DOL’s Economic Report.

The final regulations have broadened what used to be considered the “artistic” professional exemption to include “creative” professionals as well. This includes fields such as music, writing, acting, and the graphic arts. The requirement of “invention, imagination, originality or talent” distinguishes the creative professions from work that primarily depends on intelligence, diligence, and accuracy. Examples of “creative” professionals include: actors, musicians, composers, conductors, and soloists; painters and cartoonists who must rely on their own creative ability to express a concept; essayists, novelists, short-story writers, and screenwriters; and persons holding the more responsible writing positions in advertising agencies.

Journalists will likely now satisfy this duty requirement so long as their primary duty is performing on the air in radio, television, or other electronic media; conducting investigative interviews; analyzing or interpreting public events; writing editorials, opinion columns, or other commentary; or acting as a narrator or commentator. Similarly, employees of newspapers, magazines, television, and other media may also fall within the creative exemption if their primary duty is work requiring invention, imagination, originality, or talent. However, such employees will not qualify for exemption if their work product is subject to substantial control by the employer; if they only collect, organize, and record information that is routine or already public; or if they do not contribute a unique interpretation or analysis to a news product.

### Computer Employees Duties Test

The duties test for computer employees remains the same. Computer systems analysts, computer programmers, software engineers, or other similarly skilled workers in the computer field are eligible for exemption as computer professionals *if* they are compensated on a salary or fee basis at a rate of at

least \$455/week or \$27.63/hour *and* their primary duty consists of: (1) the application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software, or system functional specifications; (2) the 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; (3) the design, documentation, testing, creation, or modification of computer programs related to machine operating systems; or (4) a combination of the aforementioned duties, the performance of which requires the same level of skills. This exemption does *not* apply to employees engaged in the manufacture or repair of computer hardware and related equipment, or to employees whose work is highly dependent upon or facilitated by the use of computers or software but who are not primarily engaged in systems analysis and programming.

### Many Computer Employees May Now Fall Within the Administrative Exemption

Although the computer professional standard has not changed, many highly skilled employees working in the computer and information technology fields may well now qualify for exempt status under the administrative exemption. Thus, the final regulations explicitly acknowledge that employees who work in functional areas such as computer network, Internet, and database administration are exempt, so long as their primary duty includes the exercise of discretion and independent judgment with respect to matters of significance. Consequently, network, LAN, and database analysts and developers, Internet and network administrators, and other employees with similar duties are likely to satisfy criteria under the administrative exemption. Notably, now their use of manuals containing highly technical, scientific, or complex information will not necessarily defeat exempt status.

Finally, the DOL has also made clear that the “highly compensated” test does *not* apply to computer professionals, as this exemption came into being via Congressional enactment, beyond the DOL’s purview to affect. However, it is quite possible that the “highly compensated” test *would* apply to those employees in computer-related occupations who qualify for exemption under the administrative or executive criterion, rather than the computer professional exemption.

### Outside Sales Employees

	Current Long Test	New Standard Test
<b>Salary Level</b>	None required	None required
<b>Duties</b>	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. Does not devote more than 20 percent of the hours worked by non-exempt employees of the employer to activities that are not incidental to and in conjunction with the employee’s own outside sales or solicitations.	Primary duty is making sales or obtaining orders or contracts for services or for the use of facilities for which a consideration will be paid by the client or customer; and is customarily and regularly engaged away from the employer’s place(s) of business in performing such primary duty.

The new regulations leave the outside sales exemption largely untouched, with the exception that the new standard duties test replaces the 20% time limitation on non-exempt work hours. As the DOL indicated in its Preamble, the 20% test was both confusing and difficult for employers to apply. Under the current regulations, employers are required to track the hours worked by both non-exempt employees and outside sales employees (who spend the majority of their time away from the employers’ places of business). Employers have had to determine how many hours constituted 20% of the time worked by non-exempt employees; if exempt outside sales employees spent more than that amount of time on non-exempt work, the employer lost the exemption. Inside sales employees, including those who make sales by mail, telephone, or the Internet, do not qualify for the exemption.

### Exception for Public Safety Employees

The new regulations explicitly state that the “white collar” exemptions do *not* apply to: police officers, detectives, deputy sheriffs, state troopers, highway patrol officers, investigators, inspectors, correctional officers, parole or probation officers, park rangers, firefighters, paramedics, emergency medical technicians, ambulance personnel, rescue workers, hazardous materials workers, and similar employees, regardless of rank or pay level. All such employees remain overtime-eligible so long as they perform

work: preventing, controlling or extinguishing fires of any type; rescuing fire, crime or accident victims; preventing or detecting crimes; conducting investigations or inspections for violations of law; performing surveillance; pursuing, restraining and apprehending suspects; detaining or supervising suspected and convicted criminals, including those on probation or parole; interviewing witnesses; interrogating and fingerprinting suspects; preparing investigative reports; or other similar work.

This carve-out does not mean that *all* police officers or firefighters are overtime-eligible. While federal courts have usually found that positions such as fire captain and police sergeant are *not* exempt, the DOL's preamble recognizes that some high-level police and fire officials may be exempt executives or administrative employees, in limited situations. Notably, such employees must, in addition to satisfying the other pertinent requirements, such as directing the work of two or more employees as required for the executive exemption, have as their primary duty the performance of managerial tasks more in line with administering the affairs of the department or general business operations, as opposed to investigation.

### Salary Basis Test

The new regulations preserve the "salary basis test," a long-standing component for determining exempt status. The regulations also retain the six exceptions, under which an employer may make deductions from pay in less than full-week increments without forfeiting the exemption. Thus, docking remains permissible: for absences from work for a full day for personal reasons, other than sickness or disability; for absences of a full day occasioned by sickness or disability in accordance with a bona fide plan, policy, or practice providing wage replacement benefits; to offset jury or witness fees or military pay received by the employee; for penalties imposed in good faith for infractions of "safety rules of major significance"; for hours not worked in the first or last weeks of employment; or for hours taken as unpaid leave under the Family and Medical Leave Act ("FMLA").

### New Deductions for Infractions of Workplace Conduct

The final regulations add a new exception to the salary basis test, allowing deductions for "unpaid disciplinary suspensions of one or more full days imposed in good faith for infractions of workplace conduct rules." This new exception enables employers to suspend exempt employees (in full-day increments that need not be a full week in duration) for sexual harassment, workplace violence, or other similar misconduct. In its explanatory preamble, the DOL clarified that "workplace conduct" refers to serious workplace misconduct, *not* performance or attendance issues, and it should not be construed expansively.

As a further limitation, the workplace conduct exception only applies if the suspension is pursuant to a policy that is generally applicable to all employees. The policy must be in

writing and place employees on notice that particular types of misconduct could result in an unpaid disciplinary suspension.

### The New Safe Harbor Rule

As in the past, the FLSA exemption is lost where an employer makes improper deductions from salary. The proposed regulations preserve the "window of correction" in the current regulations to provide that isolated or inadvertent deductions will not defeat the exemption, if the employee is reimbursed. Thus, a clerical or time-keeping error will not destroy the FLSA exemption.

Significantly, the new regulations create a new "safe harbor" to mitigate the risk that improper deductions from pay will destroy the FLSA exemption. Under this new provision, the exemption is not lost provided the employer: (1) has a clearly communicated policy (preferably one in writing, distributed to all employees) that prohibits improper pay deductions; (2) reimburses employees for any improper deductions; and (3) makes a good faith commitment toward future compliance. The safe harbor is not available if the employer willfully violates the policy by continuing to make improper deductions after receiving employee complaints. The safe harbor operates in a manner analogous to the *Faragher/Elzerth* defense to sexual harassment claims – if an employer has a clear, widely distributed policy regarding pay deductions that is consistent with the FLSA, the unauthorized, improper conduct of a rogue supervisor or manager with respect to docking employee pay (even if such improper docking is more than an isolated or inadvertent occurrence) will not defeat the FLSA exemption, provided the employer makes the affected employee(s) whole after it learns of the improper docking and takes other corrective steps to prevent a recurrence.

If, on the other hand, an employer has an "actual practice" of making improper deductions, the exemption will be lost during the time period in which the improper deductions were made for employees in the same job classification working for the same manager. Factors to be considered in determining whether an actual practice exists include the: number of improper deductions made, time period over which they occurred, number and geographic location of affected employees, number and geographic location of managers responsible for the improper deductions, and whether the employer has a clearly communicated policy pertaining to such improper deductions.

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### Client Alert

Proskauer's Labor and Employment Department includes over 160 attorneys with significant and diverse labor and employment experience.

For an extensive analysis of the new "white collar" exemption regulations, Proskauer will be holding seminars in May 2004 in New York City, Newark, and Boca Raton. Details will follow shortly. In the meantime, if you have any questions about the impact of the new regulations, please contact one of the Proskauer attorneys listed below:

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