Labor & Employment

Working on Overtime: The U.S. Department of Labor's Proposal to Revise the Overtime Exemption Regulations

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Note from the Editor:

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• *FACT SHEET: Middle Class Economics Rewarding Hard Work by Restoring Overtime Pay*, White House Press Release (June 30, 2015), *available at* https://www.whitehouse.gov/the-press-office/2015/06/30/fact-sheet-middle-class-economics-rewarding-hard-work-restoring-overtime.

• *Comments on Department of Labor Expanded Overtime Rules*, The Leadership Conference on Civil and Human Rights (September 4, 2015), *available at* http://www.civilrights.org/advocacy/letters/2015/comments-on-department-of.html.

• Yuki Noguchi, *Giving More Workers Overtime Could Have Downsides, Employers Say*, NPR (September 15, 2015), *available at* http://www.npr.org/2015/09/15/440569766/giving-more-workers-overtime-could-have-downsides-employers-say.

In March 2014, President Obama ordered the U.S. Department of Labor ("DOL") to revise the Fair Labor Standards Act ("FLSA" or the "Act") regulations governing when white collar employees can be classified as "exempt" from the FLSA minimum wage and overtime requirements. Declaring that "Americans have spent too long working more and getting less in return," the President ordered the revision of the overtime regulations with a goal of making millions more workers eligible for overtime pay. In a May 5, 2015 blog post, Secretary of Labor Thomas Perez stated, "The rules governing who is eligible for overtime have eroded over the years. As a result, millions of salaried workers have been left without the guarantee of time and a half pay for the extra hours they spend on the job and away from their families."

The message from the Administration was clear: Using the power of the pen, and without Congressional approval, the DOL intends to revise overtime regulations to require employers to pay overtime to millions of additional employees. The only question is how many millions of employees.

Now we know—well, sort of. In its Notice of Proposed Rulemaking ("NPRM"), published in the Federal Register on July 6, 2015, the DOL proposed to increase the minimum salary level required for exemption to $970 per week ($50,440 annually), more than double the current level of $455 per week. Thus, if adopted as proposed, every employee in the country earning less than $50,440 per year will be entitled to overtime pay. That rule is nice and clear, even if the salary level is unjustifiably high.

However, even employees earning over $50,440 a year will be entitled to overtime pay under the revised rules unless they perform the job duties set forth in the regulations. In the NPRM, the DOL requested comments from the public on possible changes to the duties tests in general, but did not propose any specific changes to the regulatory text; thus, it leaves the public to guess whether and how extensively DOL will revise the duties tests. DOL has opined that its request for comments is sufficient to allow sweeping changes to the duties tests under the Administrative Procedures Acts, stating:

> [W]hile no specific changes are proposed for the duties tests, the NPRM contains a detailed discussion of concerns with the current duties tests and seeks comments on specific questions regarding possible changes. The Administrative Procedure Act does not require agencies to include proposed regulatory text and permits a discussion of issues instead.[1]

Only time, and legal challenges to any duties test changes, will tell whether DOL has this right.

I. A Brief History of the FLSA Overtime Regulations

The FLSA requires employers to pay their employees at least the federal minimum wage (currently $7.25 per hour) for all hours worked, along with overtime pay of one and a half times an employee's regular rate of pay for all hours worked over 40 in a work week.

Although courts expansively interpret the FLSA in order to effectuate its broad remedial purposes, the Act also includes

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over 50 partial or complete exemptions from the minimum wage and overtime requirements. The broadest of these exemptions, included in the FLSA when the Act was passed by Congress in 1938, are the "white collar exemptions" found in section 13(a)(1) of the Act.[2] Section 13(a)(1) provides a complete exemption from both the minimum wage and overtime requirements for "any employee employed in a bona fide executive, administrative, or professional capacity . . . or in the capacity of outside salesman." The FLSA itself does not include any definitions of these key terms – "executive," "administrative," "professional," or "outside sales." Rather, Congress granted the Secretary of Labor authority to "define and delimit" these terms "from time to time by regulations."[3]

The DOL first issued such regulations to define the white collar exemptions on October 20, 1938, at 29 C.F.R. Part 541. The original regulations, only two columns in the Federal Register, set a minimum salary level for exemption at $30 per week and established the job duties employees must perform to qualify for the exemptions.

From 1940 to 1975, the DOL raised the minimum salary level for exemption every 5 to 10 years; after 1975, making those increases became politically difficult. Thus, the 1975 weekly salary requirements—$155 for executive and administrative employees, $170 for professionals, and $250 for "high salaried" employees—remained in effect until 2004.

The duties tests were significantly revised in 1949, including the addition of "special proviso[s] for high salaried" executive, administrative, and professional employees (known as the "short tests"). Except for revisions in 1961 implementing the FLSA amendments eliminating the exemption for employees employed in a "local retailing capacity," and in 1992, made at the direction of Congress to allow certain computer employees to qualify for exemption,[4] the duties tests in the Part 541 regulations were unchanged for 55 years—from 1949 until 2004.

In 2004, the DOL eliminated the "long" and "short" tests, instead adopting one standard test with a minimum salary of $455 and a test for highly compensated employees with total annual compensation of at least $100,000.

II. Proposed Increases to the Salary Levels

In the NPRM, the DOL proposes to increase both the minimum salary level for the white collar exemptions and the salary level for highly compensated employees. Additionally, the DOL proposes to adopt a mechanism for automatic annual increases to the salary levels.

A. Minimum Salary Level

The DOL proposes to set the minimum salary threshold, using data from the Bureau of Labor Statistics (BLS), at the 40th percentile for all non-hourly paid employees. Currently, according to the DOL, this methodology would result in a minimum salary level of $921 per week or $47,892 annually. When a Final Rule is published in 2016, the DOL expects that the minimum salary level based on the 40th percentile will increase to $970 per week or $50,440 annually—more than doubling the current requirement of $455 per week or $23,660 per year. *The DOL's methodology and the amount of the increase are unprecedented in the FLSA's 77 year history.*

In the past, the DOL has used information regarding employee salaries to set the minimum salary levels for exemption, but never used a salary level even close to the 40th percentile. In the 1958 rulemaking, for example, the DOL used data on actual salary levels of employees which wage and hour investigators found to be exempt during investigations conducted over an eight-month period. Based on this data, the DOL set the minimum salary required for exemption at a level that would exclude the lowest 10th percentile of employees in the lowest wage region, the lowest wage industries, the smallest businesses and the smallest size city. If the 1958 methodology were applied today, the resulting minimum salary level would be $657 per week or $34,167 annually.[5] Similarly, in 2004, using BLS data, the DOL set the minimum salary level to exclude the lowest 20th percentile of employees in the lowest wage region (South) and industry (Retail). The DOL doubled the percentile used, from 10 percent to 20 percent, to account for changes to the duties test made in the 2004 Final Rule. According to the NPRM, if the 2004 methodology were applied today, the resulting minimum salary level would be $577 per week or $30,004 annually.[6]

Thus, DOL's proposed methodology of setting the minimum salary level at the 40th percentile of all non-hourly-paid employees[7] results in a minimum salary for exemption which is $20,000 higher than the salary level that would be reached through the 2004 methodology, and $15,000 higher than that reached through the 1958 methodology. The DOL justifies the jump from the 20% of lower wage regions and industries used in 2004 to its proposed 40% of all non-hourly-paid employees by asserting it made a "mistake" in 2004 in not accounting for changes in the duties tests. But the DOL did account for those changes in 2004 by increasing the percentile from 10% to 20%. Further, the DOL has not explained its failure to use salary levels in the lowest wage regions, the lowest wage industries, the smallest businesses and the smallest cities—or its inclusion of earnings data from lawyers, doctors, and sales employees who are not subject to the Part 541 salary requirements. The DOL's data set also includes salaries of federal workers, who generally earn wages higher than employees working in the private sector.

The $50,440 wage level is also unsupported by any other reasonable methodology.

Historically, with only a few exceptions, the DOL has increased the salary levels at a rate of between 2.8 percent and 5.5 percent per year. Applying the median annual increase of 4.25% would result in a new salary level of $35,727. The DOL's proposed increase to $50,440 represents an increase of 9.43% per year. Over the last decade, however, according to the BLS Employment Cost Index (ECI), earnings for private sector workers in management, professional and related occupations increased an average of only 2.6% annually. Applying the ECI would result in a new salary level of $32,194.

Since 1949, and in the 2015 NPRM, the DOL has consistently stated that the purpose of setting a minimum salary threshold is to provide a "ready method of screening out the *obviously* nonexempt employees." After all, in Section 13(a)(1), Congress exempted white collar employees from both the minimum wage and overtime requirements of the FLSA. Thus, to implement Congress' intent, the DOL should not set the

minimum salary threshold at a level that excludes many employees who *obviously meet* the duties tests for exemption. Or, put another way, DOL should not set the level so high that it expands the number of employees eligible for overtime beyond what Congress envisioned when it created the exemptions. Yet, this is exactly what the DOL proposes in this rulemaking. Particularly in the retail, restaurant, hospitality, and health care industries—and in the non-profit and public sectors—where many employees earning below $50,440 have been found exempt under the duties tests both in DOL investigations and by the federal courts.

Perhaps most tellingly, the DOL's proposed minimum salary level of $970 per week, $50,440 annually, is higher than the current minimum salary levels for exemption under California and New York law. As with the minimum wage, states may set higher standards for exemptions from state overtime requirements; federal law is a floor. In New York, the minimum salary level for exemption is $34,124—$16,320 *lower* than what the DOL has proposed on a national level. In California, the minimum salary level is currently $37,440 annually—$13,000 *lower* than the DOL's proposal. Although California's minimum salary level will increase to $41,600 in 2016, this will still leave California's minimum almost $9,000 lower than the proposed federal level. If the DOL's proposed salary level is $9,000 to $16,000 higher than the salary level required for exemption under the laws of two states with some of the highest incomes and costs of living, how can it possibly reflect the local economies in the rural South and Midwest?

The DOL is also seeking comments on the possibility of allowing nondiscretionary bonuses provided to exempt employees to satisfy up to 10% of the standard salary level. Although this proposal would provide some relief, the DOL's intention to limit the credit to bonuses paid monthly or more frequently negates most of this relief. Most bonuses earned by exempt employees are only paid quarterly or annually.

B. Automatic Annual Increases to the Salary Levels

The DOL has also proposed to establish a mechanism for automatically increasing the salary levels annually based either on the percentile methodology or on inflation (CPI-U). Such annual automatic increases appear inconsistent with Congressional intent and would be unprecedented in the 77 year history of the FLSA.

In Section 13(a)(1), Congress directed the DOL to revise its overtime regulations "from time to time by regulations of the Secretary subject to the provisions of [the Administrative Procedure Act." Putting the minimum salary levels, a central part of the regulations for 77 years, on automatic pilot seems to contradict this directive. In addition, although Congress has provided indexing under other statutes, it has never done so under the FLSA. Congress has never provided for automatic increases of the minimum wage, although state minimum wages are sometimes indexed. Nor has Congress indexed the minimum hourly wage for exempt computer employees under section 13(a)(17) of the Act, the tip credit wage under section 3(m) or any of the subminimum wages available in the Act. Thus, it seems unlikely that Congress intended the DOL to impose automatic annual increases for the salary-based exemption from the FLSA's minimum wage and overtime requirements.

The regulatory history of Part 541 provides no precedent for indexing. Public commenters have suggested automatic updates to the salary levels in at least two past rulemakings. In 1970, for example, a "union representative recommended an automatic salary review" based on an annual BLS survey.[8] The DOL quickly dismissed the idea as "needing further study," although stating that the suggestion "appear[ed] to have some merit particularly since past practice has indicated that approximately 7 years elapse between amendment of these salary requirements."[9] However, the "further study" came in 2004, after *29 years* had elapsed between salary increases. Nonetheless, in 2004, the DOL rejected indexing as contrary to congressional intent, disproportionately impacting lower-wage geographic regions and industries, and because the Department intended to do its job:

> [S]ome commenters ask the Department to provide for future automatic increases of the salary levels tied to some inflationary measure, the minimum wage or prevailing wages. Other commenters suggest that the Department provide some mechanism for regular review or updates at a fixed interval, such as every five years. Commenters who made these suggestions are concerned that the Department will let another 29 years pass before the salary levels are again increased. The Department intends in the future to update the salary levels on a more regular basis, as it did prior to 1975, and believes that a 29-year delay is unlikely to reoccur. The salary levels should be adjusted when wage survey data and other policy concerns support such a change. Further, the Department finds nothing in the legislative or regulatory history that would support indexing or automatic increases. Although an automatic indexing mechanism has been adopted under some other statutes, Congress has not adopted indexing for the Fair Labor Standards Act. In 1990, Congress modified the FLSA to exempt certain computer employees paid an hourly wage of at least 6.5 times the minimum wage, but this standard lasted only until the next minimum wage increase six years later. In 1996, Congress froze the minimum hourly wage for the computer exemption at $27.63 (6.5 times the 1990 minimum wage of $4.25 an hour). In addition, as noted above, the Department has repeatedly rejected requests to mechanically rely on inflationary measures when setting the salary levels in the past because of concerns regarding the impact on lower wage geographic regions and industries. This reasoning applies equally when considering automatic increases to the salary levels. The Department believes that adopting such approaches in this rulemaking is both contrary to congressional intent and inappropriate.[10]

Now, the DOL seems to be admitting that it is incapable of doing its job:

> This history underscores the difficulty in maintaining an up-to-date and effective salary level test, despite the Department's best intentions. Competing regulatory priorities, overall agency workload, and the time-intensive nature of notice and comment rulemaking have all con-

> tributed to the Department's difficulty in updating the salary level test as frequently as necessary to reflect changes in workers' salaries. These impediments are exacerbated because unlike most regulations, which can remain both unchanged and forceful for many years if not decades, in order for the salary level test to be effective, frequent updates are imperative to keep pace with changing employee salary levels. Confronted with this regulatory landscape, the Department believes automatic updating is the most viable and efficient way to ensure that the standard salary level test and the HCE total annual compensation requirement remain current and can serve their intended function of helping differentiate between white collar workers who are overtime-eligible and those who are not.[11]

The DOL also states that automatic annual increases to the salary will "promote government efficiency by removing the need to continually revisit this issue through resource-intensive notice and comment rulemaking."[12] The DOL seems to be missing the point of the Administrative Procedure Act: Congress *intended* rulemaking to be "resource-intensive."

Further, the DOL's proposed methodology for determining the amount of the annual increase is not well thought out. Particularly troubling is the proposal to reset the salary level every year using a "fixed percentile" (the 40th percentile of full-time, non-hourly paid earnings).[13] The DOL has apparently missed a huge problem with this approach: An index that recalibrates the 40th percentile, each year, based on salaries of non-hourly paid employees will be relying on an ever shrinking pool of such employees, causing a never ending, upward ratcheting effect. In response to the final rule, employers may give a salary increase to some exempt employees already near $50,440. However, employers will need to reclassify millions of other employees to non-exempt status. Although non-exempt employees may be paid on a salary, a significant percentage of reclassified employees will be converted to hourly pay. Consequently, the lowest paid salary employees are likely to leave the pool of "non-hourly paid" employees. As a result, the 40th percentile of employees remaining in the data set will correspond to a higher salary level, which will further reduce the number who meet the salary threshold. The following year that will increase even further the salary corresponding to the 40th percentile, etc. The result will be that tomorrow's 40th percentile and its salary level will be an even poorer proxy for the actual work performed by exempt employees because the measure itself will drive the outcome.

In a recent analysis, Edgeworth Economics illustrates how quickly the minimum salary level for exemption will increase: "If just *one quarter* of the full-time nonhourly workers earning less than $49,400 per year ($950 per week) were re-classified as hourly workers, the pay distribution among the remaining nonhourly workers would shift so that the 40th percentile of the 2016 pay distribution would be $54,184 ($1,042 per week), about 9.6 percent higher than it was in 2015." [14] This process would repeat each year as the lowest paid nonhourly workers fail the salary test and are re-classified as non-exempt hourly workers. After five years, even in the absence of inflation, "the new 40th percentile of the nonhourly pay distribution would be $72,436 ($1,393 per week), which is about 46.6 percent more than the minimum salary threshold in 2015.[15]

This upward ratcheting "becomes more pronounced if more nonhourly workers who failed the salary test are reclassified into hourly positions each year."[16] For example, if half of the reclassified employees are paid hourly, the 40th percentile "will increase by 19.9 percent in the first year and by 94 percent over a five year period. This means that a salary threshold of $49,400 ($950 per week) in 2015 would increase to $95,836 ($1,843 per week) by 2020, even in the absence of inflation."[17]

C. Changes to the Duties Tests

For an employer to classify an employee as exempt, in addition to paying more than the minimum salary level on a salary basis, the employee must also meet one of the duties tests for exemption. The Part 541 regulations establish different duties tests for executive, administrative, learned professional, creative professional, computer, and outside sales employees. Many employees earn above the minimum salary level, but cannot be classified as exempt because they do not supervise employees, are not involved with managing the business, or do not hold professional degrees—engineering technicians, who often earn $80,000 or even $100,000 annually depending on the industry, are a good example.

There is much confusion and concern in the business community regarding what changes the DOL intends to make to the duties tests. In the NPRM, the DOL stated that it "is not proposing specific regulatory changes at this time" and that the agency "seeks to determine whether, in light of our salary level proposal, changes to the duties test are also warranted."

Instead, the DOL raises "issues" for discussion that seems to indicate that the agency is considering some very significant and unprecedented changes:

> What, if any changes, should be made to the duties test?
>
> Should employees be required to spend a minimum amount of time performing work that is their primary duty in order to qualify for the exemption? If so, what should that minimum be?
>
> Does the single standard duties test for each exemption category appropriately distinguish between exempt and nonexempt employees? Or, should the Department reconsider our decisions to eliminate the long/short duties test structure?
>
> Is the concurrent duties regulation for executive employees (allowing the performance of both exempt and nonexempt duties concurrently) working appropriately or does it need to be modified to avoid sweeping nonexempt employees into the exemption? Alternatively, should there be a limitation on the amount of nonexempt work? To what extent are lower-level executive employees performing nonexempt work?

The DOL also is requesting comments regarding what additional occupational titles or categories as well as duties should be included as examples in the regulations, especially in the computer industry.

The business community is deeply concerned that the DOL will implement the California over-50% quantitative rule for primary duty. The California example is instructive:

the implementation of the quantitative rule, rather than the federal qualitative standard that has been the test for exemption under the white collar exemptions since 1949, has resulted in considerably higher levels of litigation in California. Plaintiffs' attorneys understand how difficult it is for employers to prove the amount of time that employees spend on exempt versus non-exempt tasks.

Similarly, employers are concerned that the DOL will eliminate the concept of concurrent duties in the final rule. Currently, exempt employees such as store or restaurant managers are permitted to perform duties that are non-exempt in nature while simultaneously acting in a managerial capacity. If this "concurrent duties" provision is eliminated, it could mean the wholesale loss of the exemption for both assistant store managers and store managers, particularly in smaller establishments.

Finally, returning to the "long test"—a test effectively inoperable since the early 1980s because of the low salary level—seems to be a radical change, but cannot be ruled out.

The DOL's failure to provide specific regulatory text for any of these "issues" (or any other changes to the duties tests) is perhaps the most alarming aspect of the NPRM. On the duties tests, the NPRM reads more like a preliminary Request for Information than proposed revisions to a regulation. Never before has the DOL made changes to the duties tests without proposing specific regulatory language. Yet, now, the DOL has publicly stated that the Administrative Procedures Act ("APA") requires no more than "a discussion of issues."

Most likely, if the DOL makes changes to the duties tests, the agency will rely on the "logical outgrowth" doctrine. The APA requires that an agency's proposed rulemaking include "either the terms or substance of the proposed rule or a description of the subjects and issues involved."[18] This notice requirement is fulfilled if the final rule is a "logical outgrowth" of the proposal.[19] But the DOL's "discussion" of potential changes to the duties test, which runs less than three pages in the federal register,[20] is incredibly vague. Does seeking comments on "what, if any changes should be made to the duties test" give the DOL carte blanche to make every change suggested by the AFL-CIO?

"Outgrowth" implies *something* to grow out of. The public cannot be asked to "divine" the agency's "unspoken thoughts."[21] And words matter. Specific word choices, and even the placement of a comma, can make a significant difference in how a regulation is interpreted and applied by the DOL itself and federal courts. In comments to the DOL's 2003 Notice of Proposed Rulemaking, for example, the AFL-CIO argued that changing the word "whose" to the word "a" resulted in a significant weakening of the duties tests.[22] Yet, apparently, the DOL is signaling that it plans to make significant changes to the specific text of the regulations if the business community objects to the high $50,440 salary level, without giving the public any chance to review and comment on that language.

Regardless of the legal arguments, the DOL's failure to propose specific changes to the regulatory text, as the agency did in 2003, seems contrary to President Obama's commitment to "creating an unprecedented level of openness in Government" by ensuring "transparency, public participation, and collaboration."[23]

Endnotes

1 Ben James, *Final OT Rule May Go Beyond Salary Hike, Lawyers Say,* Law360 (June 30, 2015).

2 29 U.S.C. § 213(a)(1).

3 *Id.*

4 In 1992, at the direction of Congress, DOL revised the duties tests to allow computer employees to qualify as exempt professionals. In 1996, Congress enacted a separate exemption for some computer employees in 29 U.S.C. § 213(a)(17), incorporating some, but not all, of DOL's regulations in the Act itself. Unlike the Section 13(a)(1) exemptions, however, Congress did not give DOL authority to issue regulations on Section 13(a)(17).

5 NPRM at Table 12.

6 *Id.*

7 "Non-hourly-paid employees" include employees paid on a salary basis, but also includes employees paid on a fee basis, by commission, and any other arrangement which is not hourly pay.

8 35 FR 883, 884 (Jan. 22, 1970).

9 *Id.*

10 2004 Final Rule at 22171-72.

11 2015 NPRM at 38539.

12 *Id.* at 38537.

13 2015 NPRM at 38540.

14 *"Indexing the White Collar Salary Test: A Look at the DOL's Proposal,"* Edgeworth Economics (Aug. 27, 2015), *available at* http://www.edgeworth-economics.com/experience-and-news/edgewords-blogs/edgewords-business-analytics-and-regulation/article:08-27-2015-12-00am-indexing-the-white-collar-salary-test-a-look-at-the-dol-s-proposal/.

15 *Id.*

16 *Id.*

17 *Id.*

18 5 U.S.C. § 553(b)(3).

19 *Fertilizer Inst. v. EPA*, 935 F.2d 1303, 1311 (D.C. Cir. 1991) (explaining that an agency may issue rules that "do not exactly coincide with the proposed rule," as long as the final rule is the logical outgrowth of the proposed rule).

20 80 Fed. Reg. 38516, 38542-44 (July 6, 2015).

21 *Arizona Public Serv. Co. v. EPA*, 211 F.3d 1280 (D.C. Cir. 2000) (citation omitted).

22 *See, e.g.,* 69 Fed. Reg. 22122, 22131 (April 23, 2004).

23 President Barack Obama, *Transparency and Open Government*, Memorandum for the Heads of Executive Departments and Agencies (January 21, 2009), *available at* https://www.whitehouse.gov/the_press_office/TransparencyandOpenGovernment.