



## Separating Media Hype from Regulatory Fact In DOL's FLSA Overtime Upheaval

By Shlomo D. Katz



The federal government proposes new regulations about *something* nearly every working day of the year. Rarely, though, do proposed regulations get top billing on popular news programs. The U.S. Department of Labor's pending proposal to significantly change who is entitled to overtime pay is one of those rare items that has captured the media's attention — probably because of administration claims that the proposal, if enacted, will mean higher pay for nearly five million workers. This article will explain what DOL's proposed rules would change, what other changes may be coming, and what you may have heard on the 10 o'clock news that is more hype than fact.

### Background

The Fair Labor Standards Act (29 U.S.C. §201 *et seq.*) is the basic federal law that requires covered employers to pay covered employees a minimum wage — currently \$7.25 — for every hour worked, plus overtime pay at one-and-one-half the employee's regular rate for each hour worked in excess of 40 hours in a workweek. The FLSA exempts roughly 30 categories of employees from the minimum wage, overtime pay or both — most notably, the "EAP" (acronym of "executive, administrative, professional") or "white collar" exemptions. These are what people usually refer to when they say someone is "exempt." Major revisions to these three tests last occurred in 2004, and before that, in 1975.

On March 13, 2014, President Obama directed the Secretary of Labor:

to propose revisions to modernize and streamline the existing overtime regulations. In doing so, [the President wrote,] you shall consider how the regulations could be revised to update existing protections consistent with the intent of the Act; address the changing nature of the workplace; and simplify the regulations to make them easier for both workers and businesses to understand and apply.

In public remarks in the White House East Room on the previous day, the president made clear that his plan included changing the minimum salary level for exemption. The president said:

Unfortunately, today, millions of Americans aren't getting the extra pay they deserve. That's because an exception that was originally meant for high-paid, white-collar employees now covers workers earning as little as \$23,660 a year. So if you're making \$23,000, typically, you're not high in management. If your salary is even a dollar above the current threshold, you may not be guaranteed overtime. It doesn't matter if what you do is mostly physical work like stocking shelves, it doesn't matter if you're working 50 or 60 or 70 hours a week — your employer doesn't have to pay you a single extra dime.

But, amending regulations, such as the exemption rules in 29 C.F.R. Part 541, is a complicated process. For the last year, DOL has been talking to stakeholders about what should or should not be changed. Then, a sneak preview of the proposed regulations was posted on DOL's website on June 30, 2015, prompting the media coverage mentioned above. On July 6, 2015, the DOL Secretary took the first *official* step in the process of amending the regulations by publishing the proposal in the government's daily journal known as the *Federal Register*.

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It must be emphasized that these are *not* new regulations that will take effect immediately. Contrary to the impression you may have gotten from the news, there is *nothing* employers must change right now; provided, of course, that they are already in compliance with the current rules, which should not to be taken for granted. Rather, the public now has until Sept. 4, 2015 to submit comments on the proposed regulations, and then DOL must consider the comments before issuing final regulations, after which a phase-in period will follow. In other words, it will be January 2016 at the earliest before any changes take effect.

The last time there was a major revision to “Part 541”; that is, the exemption rules, DOL published its proposed changes on March 31, 2003, and the final regulations were not issued until April 23, 2004 — more than a year later. In part, the long interval was due to the fact that DOL received 75,280 public comments on its proposed rules, all of which had to be considered. (That still stands as the record for the most comments on a proposed regulation.) Then again, the changes being proposed now are not as elaborate as those proposed in 2003, so maybe there will be fewer comments to review. Also, the current DOL is working against an artificial deadline: the end of the Obama administration. Thus, the timeline may be shorter. But if the process drags on past the presidential elections, the new rules may never take effect.

### **What Would This Proposal Change?**

One of the common refrains in media reports that this writer has heard is that the proposed changes would “guarantee” overtime pay to managers who perform the same work as their subordinates, but who currently do not receive overtime pay. These types of reports stem, in part, from the common misconception that salary alone determines who is or is not entitled to overtime.

In fact, an employee must currently satisfy three tests to be an exempt executive, administrative or professional employee:

1. the employee must be paid on a salary basis,
2. the employee’s salary must be at least \$455 per week, and
3. the employee must meet a duties test.

Being paid a salary alone does *not* make someone exempt; thus, employers were not necessarily denying overtime pay to managers just because they were salaried, and merely changing that salary will not guarantee

overtime pay to managers. For now, though, that is all DOL is proposing to change — the minimum salary level currently set at \$455 per week (\$23,660 per year) would be raised to an amount that will be announced when the final regulations are published, but roughly \$970 per week (\$50,440 per year). Also, the new salary would be indexed so that it increases annually without the need for formal rulemaking.

Where do these figures come from? When DOL chose the \$455 back in 2004 as the minimum salary necessary to qualify for exemption, DOL estimated that it would thereby extend overtime protection to 6.7 million additional workers, who no longer could be exempt regardless of their duties (69 Fed. Reg. 22,164 (Apr. 23, 2004)). At the time, according to DOL, \$455 represented the lowest 20 percent of salaried employees in the retail industry; the lowest 20.2 percent of salaried employees in the South; and the lowest 16.8 percent of all salaried employees (69 Fed. Reg. 22,171).

DOL now says that the \$455 level allows too many workers to be exempt, particularly those managers and supervisors in the retail and food industry who (according to DOL) spend most of their time performing traditionally nonexempt work such as waiting on customers and stocking shelves. Since the current regulations do not require an exempt employee to spend the majority of his time performing his “primary duty”, it is possible for an exempt executive to spend most of her time performing nonexempt work, but to earn no overtime pay. It must be emphasized that, notwithstanding the president’s and the media’s talk about “fair pay,” an employer is 100 percent in compliance with the law if exempt managers devote most of their time to nonexempt duties without receiving overtime pay. On the other hand, when employers label some workers as “managers” and deny them overtime pay even though they perform *exactly* the same work as other employees, the employer is violating the law, a problem that can be solved by DOL investigations and employee lawsuits, but not by changing the rules.

In any event, DOL is proposing to increase the minimum salary for exemption to equal to the 40th percentile of earnings for full-time salaried workers. DOL has not said exactly what the new amount would be, but it estimates that it will be \$970 per week (\$50,440 per year for a full-year worker) by the time the final regulations are published in early 2016. DOL estimates that in the first year after this change, 4.6 million workers would be affected by the increase in the standard salary level test.

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**See *Overtime Upheaval*, p. 3**

## **Overtime Upheaval** (continued from p. 2)

That number, according to DOL, consists of currently EAP-exempt workers who earn at least \$455 per week but less than the 40th percentile of all full-time salaried workers. As mentioned, DOL is proposing to establish a mechanism for automatically updating the minimum salary level for exemption. DOL is seeking comments on the best way to accomplish that, which could include using the Consumer Price Index (that is, the inflation rate) or continuing to use the 40th percentile of all full-time salaried workers as a cutoff.

### **Highly Compensated Workers**

Similarly, DOL is proposing to increase the threshold for the Highly Compensated Employee test from \$100,000 to the 90th percentile of annualized weekly earnings for full-time salaried workers, which translates to \$122,148 annually. This figure too would be indexed if DOL has its way. Remember, no matter the pay the employee is receiving, being salaried or “highly compensated” does not, by itself, make an employee exempt. Only by satisfying the salary *and* duties tests can an employer avoid paying overtime for work in excess of 40 hours in a week. This is one of the most misunderstood facts about the FLSA.

### **What Else Could Change?**

While DOL is not proposing specific changes in the duties tests at this time, it is seeking comments on several issues. These include:

- What, if any, changes should be made to the duties tests?
- Should employees be required to spend a minimum amount of time performing work that is their primary duty in order to qualify for exemption? If so, what should that minimum amount be?
- Should DOL look to the State of California’s law (requiring that 50 percent of an employee’s time be spent exclusively on work that is the employee’s primary duty) as a model? Is some other threshold that is less than 50 percent of an employee’s time worked a better indicator of the realities of the workplace today?
- Does the single standard duties test for each exemption category appropriately distinguish between exempt and nonexempt employees? Should DOL reconsider its decision in 2004 to eliminate the long/short duties tests 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 exempt lower-level executive employees performing nonexempt work?

In addition to seeking comments on the duties tests, DOL is also considering whether to add to the regulations examples of additional occupations to provide guidance in administering the EAP exemptions. DOL reports that employer stakeholders have indicated that examples of how the exemptions may apply to specific jobs, such as those provided in the current regulations are useful in determining exempt status and should be expanded. DOL states that it agrees that examples of how the general executive, administrative, and professional exemption criteria may apply to specific occupations are useful to the regulated community, and DOL seeks comments on what specific additional examples of nonexempt and exempt occupations would be most helpful to include. In particular, DOL is considering the suggestions of employer stakeholders from the computer and information technology sectors to include additional examples of the application of the EAP exemptions to occupational categories in computer-related fields.

### **Conclusion**

These proposed changes are significant, but employers should remember that they are only proposals. Employers are not required to change any worker’s pay now. What employers should do is take advantage of their right to comment on the proposed regulations, especially if there is something they don’t like or have strong opinions about. In particular, DOL has telegraphed that it may change the “primary duty” test, so employers that care about this had better speak up now.

Also, employers can start to think about how their operations and budgets will be affected if their currently exempt employees earning more than \$455, but less than \$970, per week become nonexempt. Will employers reduce hours to avoid paying overtime premiums? If so, will they hire more workers to fill any gaps? Or, will they reduce equivalent-hourly pay so that a worker’s hourly wages plus overtime premiums equal their current salaries? These are some of the many things we don’t know about the effect these proposed regulations will have. The proposed regulations were published at

**See Overtime Upheaval, p. 5**

# Department of Labor's Overtime Proposal Would More Than Double FLSA Salary Threshold

*Almost 5 Million Additional Workers Could Be Eligible for Overtime in 2016*

LAS VEGAS — The long-awaited proposed rules to update the Fair Labor Standards Act overtime exemptions, issued June 30 by the U.S. Department of Labor, would extend overtime protections to an additional 5 million workers in 2016. The proposed changes would extend overtime coverage to certain workers making up to approximately \$50,400 per year. The proposal, released just under the wire of DOL's previously stated timeline, would increase the number of employees eligible for overtime at all employers by nearly doubling the existing compensation level required as part of the tests for whether an employee is exempt from the act's overtime requirements. The current threshold to be exempt from overtime is \$455 per week or \$23,660 annually.

President Obama, in a *Huffington Post* editorial announcing the overtime changes, said too many U.S. workers are not rewarded for their hard work.

"Right now, too many Americans are working long days for less pay than they deserve," Obama wrote. "That's partly because we've failed to update overtime regulations for years — and an exemption meant for highly paid, white collar employees now leaves out workers making as little as \$23,660 a year — no matter how many hours they work."

## DOL's Proposal

The DOL proposal laid out three major changes to existing FLSA overtime rules:

- The salary threshold for exemption from overtime would more than double, to \$970 per week, or \$50,440 annually, possibly as soon as 2016. The salary bar would be raised to this level to equal the 40th percentile of earnings for full-time salaried workers, according to the notice of proposed rulemaking. DOL said it used existing data to project what the salary threshold would be in the first quarter of 2016.
- The proposal would also increase the highly compensated employee annual salary level to \$122,148, or the 90th percentile of earnings.
- Finally, the proposal would include a mechanism in the regulations to automatically update the salary and compensation thresholds annually. That could be either based on a fixed percentage of wages or tied to the Consumer Price Index.

The proposal is also notable for what it did not do, which was to propose a specific change to the duties tests that are a key part of the overtime exemptions. DOL was widely expected to propose a quantitative standard threshold for the amount of time a worker could spend in nonexempt work if they were considered exempt from overtime. Instead, the DOL proposed rule solicits input from employers and stakeholders on possible changes to the duties tests that could be implemented in final regulations. It is possible that the duties test could still be targeted for changes when the final rules are released.

In the NPRM, DOL explained the purpose of the proposed rule changes:

The Department seeks to update the salary level to ensure that the FLSA's intended overtime protections are fully implemented, and to simplify the identification of nonexempt employees, thus making the EAP exemption easier for employers and workers to understand. The Department also proposes automatically updating the salary level to prevent the level from becoming outdated with the often lengthy passage of time between rulemakings. Lastly, the Department is considering whether revisions to the duties tests are necessary in order to ensure that these tests fully reflect the purpose of the exemption.

DOL sees the salary level set in 2004 as "too low to efficiently screen out from the exemption overtime-protected white collar employees when paired with the standard duties test," the department explained.

DOL will accept comments on the proposed rules for 60 days after the NPRM appears in the *Federal Register*, which is scheduled for July 6.

## Implications for Employers

Employer representatives at the Society for Human Resource Management's Annual Conference, which was taking place when the proposed rules were issued, expressed concern about their effect on worker classifications, budgets, workplace flexibility and employee morale. The budgetary implications of increasing the number of employees eligible for overtime, and therefore the amount of overtime some companies would have to pay, was top of mind for many employers with workers just below the proposed new salary threshold, based on a June 30 session at the SHRM conference in Las Vegas.

**See *Salary Threshold*, p. 5**

## **Salary Threshold** (continued from p. 4)

Reclassifying workers presents a significant headache for companies that now must reconsider their pay structures, some employers noted. Plus, many employers with workforces of educated professionals making salaries close to the new threshold feared morale problems and internal communication challenges if such workers must be reclassified as hourly because of the new rules.

The final regulations also could look very different from the proposed rules, SHRM experts cautioned. The duties tests will remain a question mark for the time being while DOL collects comments from interested stakeholders. Changes to the exemptions' duties tests still could be an issue for employers. Just because specific changes to the duty tests weren't outlined in the NPRM does not mean they are off the table, said Tammy McCutchen, an attorney with Littler Mendelson and former Wage and Hour Division Administrator who oversaw the last major FLSA overhaul. DOL could still include changes for the duties tests in the final regulations, but that approach would rob employers of both the chance to comment on any changes and the chance to prepare for changing classification policies.

"It's harder for the employer community to react when there's no language to react to," McCutchen said,

## **Overtime Upheaval** (continued from p. 3)

80 Fed. Reg. 38516 (July 6, 2015). Comments may be submitted at <http://www.regulations.gov/#!documentDetail;D=WHD-2015-0001-0001>.

One more thing: Whenever minimum wages and overtime are in the news, employees take note. Therefore, now is a good time to review your FLSA compliance in general so that you do not become a news headline yourself.

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and it makes it much more difficult for employers to plan ahead.

## **Reactions to the Proposal**

SHRM itself still is analyzing the proposed changes, but "it is clear that this rule will affect nearly every employer in every industry and sector," the group stated. "Specifically, SHRM supports the need to adjust the salary basis level under the regulations. However, more than doubling the salary threshold will significantly impact employers and employees and will disproportionately affect the nonprofit and service sector industries, as well as certain geographic areas of the country." SHRM is concerned that the proposed rules, as written, would "further exacerbate an already complicated set of regulations for employers and employees."

Employee advocates had been pushing for a significantly higher salary bar in the FLSA exemptions, and hailed DOL's announcement as a positive and long overdue step.

"The Obama administration has taken a crucial step toward remedying decades of neglect in maintaining overtime pay protections and reversing decades of wage declines that have hammered America's middle class," said Christine Owens, executive director of the National Employment Law Project. "We applaud the Labor Department's proposal to raise the overtime salary to \$970 per week in 2016, or \$50,440 in full-time earnings. Workers earning less than that would be automatically entitled to overtime pay when they work more than 40 hours per week."

However, NELP expressed concern that the proposal's failure to specifically address the duties test portion of the exemption rules would deny overtime pay to additional workers that should receive it. The organization intends to submit comments urging DOL to clarify this portion of the exemption as well. ❖

### **For additional information about the salary basis test see:**

- ¶320 in the *Employer's Guide to the Fair Labor Standards Act*;
- ¶220 in the *Fair Labor Standards Handbook for States, Local Government and Schools*;
- ¶200 in the *FLSA Employee Exemption Handbook*; and
- ¶200 in the *Public Employer's Guide to Employee Classification*.

# A Tipsheet for Coping with Pending Overtime Changes

**The bad news:** New overtime regulations proposed by the Obama administration would increase the salary level an employee must meet to be considered exempt from overtime pay from \$455 per week to \$970 per week in 2016 (based on salary projections). And that number would be increased regularly by a yet undetermined mechanism. Under current Fair Labor Standards Act regulations an employee must satisfy three tests to be considered exempt from the act's overtime requirements: the employee must be paid on a salary basis; the employee's salary must be at least \$455 per week; and the employee must meet a duties test. The new rule would more than double the salary threshold from the current level.

**The good news:** Conscientious employers have time to prepare for the pending changes. There's no better time than right now to clean house, before the regulations are finalized and the U.S. Department of Labor turns its focus to enforcement strategies.

**The unknown:** It's possible that additional changes to the overtime exemption rules still could come. Experts are worried that when finalized, the DOL regulations will include additional, surprise changes to the duties test that is also part of the major overtime exemptions. For now, DOL has asked for input on elements of the duties test, but has yet to propose any specific changes. Knowing the current state of your employee classifications will help you plan for any duty changes and could save you a major headache down the road.

## Why This Is Important

- Your overtime obligation could significantly increase overnight if you have employees who will be impacted by the changing regulations.
- If the regulation is approved as it's currently written, it will make at least 5 million additional workers eligible for time-and-a-half overtime, according to the administration. That figure could rise to 11 million for categories of workers that fall into a "grey area" where their exempt/nonexempt status isn't clear cut.
- As with any new major initiative, DOL is likely to make enforcement of the regulation a top priority once it is implemented: leaving any employer that didn't take the changes seriously open to significant financial liability, not to mention civil lawsuits and associated costs.
- However, if you start planning now you may be able to strategically mitigate your risk. If you have job classifications and descriptions that you worry need updating or that were never done properly in the first place, the new rules provide the perfect opportunity to clean house as you comply with evolving federal laws.

## Tips for Employers

Think about these three important first steps as you evaluate your company's practices in light of the new regulations and plan how to deal with any pending changes.

- ✓ *Operational Strategy* —How your operations and budgets will be affected if you have to reclassify your exempt workers who earn more than \$455 but less than \$970 per week. Consider:
  - Will you reduce hours to avoid overtime premiums?
  - Will you hire more workers to fill in gaps and keep overtime to a minimum?
  - Will you reduce equivalent-hourly pay so workers' hourly wages plus overtime premiums still equals their current salaries?
  - How will this affect employee flexibility?

- ✓ *Manager Buy-in* — Ascertain whether those in control of day-to-day operations (your senior executives and decision makers) are supportive of performing a classification audit or job analysis.
  - Keep in mind that upper-level managers, executives and owners need to be enthusiastic advocates of the process to bring lower-level management on board.
  - Key individuals must be made aware of the range of benefits that will accrue to them and their departments, for example reclassifying workers to keep overtime liability to a minimum and maintaining current budget allocations for individual departments.
- ✓ *Communication Strategy* — The way you communicate with employees about the new regulations will make a difference in how well changes are implemented. Employee morale could suffer if you don't properly communicate what is happening.
  - Impress upon employees that changes to how you calculate their salary for payroll purposes (that is, hourly vs. salaried) do not reflect how important their work is, how valued they are or what they do on a day to day basis.
  - Remember: never make promises, before or during analysis, description or evaluation regarding any compensation-related or promotional/demotional/layoff changes that might result from such a process. Doing so could result in possible legal claims if implied or explicit employment promises were made and not kept by management.
- ✓ *Classification Audits and Job Analysis Initiatives* — Once you have your top level strategy in place consider whether a reclassification of segments of your workforce may be in order. Keep in mind that assessing how you classify and pay employees may be a tremendous opportunity.
  - Don't underestimate the importance of conducting a job analysis or classification audit for your FLSA compliance, and beyond. Job analysis not only will reveal which positions are exempt from the FLSA, but it also will provide useful data in a number of other areas.
  - Job analysis is a critical way for an organization to establish a solid basis for its job descriptions, compensation and performance appraisal systems, assuming valid criteria and methodologies have been used.
  - Job analysis also demonstrates the employer's underlying good faith in making objective employment-related decisions. It also gives an employer evidence that it is making the best decisions possible based on the information it has on hand. ❖



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