TIME FOR THE FACTS

BACKGROUND

Currently under the Fair Labor Standards Act (FLSA), an individual must satisfy three criteria to qualify as a white collar employee exempt from federal overtime pay requirements: first, they must be paid on a salary basis (the salary basis test); second, that salary must be more than $455/week ($23,660 annually) (the minimum salary requirement or salary threshold); and third, their "primary duties" must be consistent with executive, professional or administrative positions as defined by the US Department of Labor (DOL) (the primary duties test). Employees who do not meet these three requirements or fail to qualify for another exemption must be treated as “hourly” or “nonexempt” employees and be paid for each hour worked and at a rate of one and a half times their normal hourly rate for all hours worked over 40 in a given work week. The latter is known as overtime pay. To ensure employees are paid for all hours worked and at the proper rate for overtime, employers must carefully track the hours nonexempt employees work.

President Barack Obama issued a memorandum on March 13, 2014, directing DOL to “modernize” the FLSA overtime regulations governing eligibility for the white collar exemption. On July 6, 2015, DOL published proposed changes to the regulations. In the proposal, which is known as a Notice of Proposed Rulemaking (NPRM) or proposed rule, DOL asked the public for input on several suggested changes.

The first change being considered by DOL is a massive and unprecedented increase to the salary threshold. DOL proposes increasing the current threshold of $455 per week ($23,660 annually) by 113% to $970 per week (or $50,440 per year), which the agency estimates will be the 40 percentile of earnings for all full time salaried workers in 2016. This proposed salary threshold is higher than minimums set under any state laws—nearly $10,000 higher than that of California and nearly $15,000 higher than that of New York, two of the states with the highest cost of living. Moreover, at no point in history has the salary threshold created an absolute bar to exempt status for such a high percentage of executive, professional and administrative employees. Historically, the agency’s position has been that the threshold is simply intended for “screening out the obviously nonexempt employees,” and it has relied on the duties test to evaluate whether employees making more than the minimum salary fit within the exemption. DOL’s proposal is inconsistent
with this time-tested model and if the agency implements a minimum salary threshold at or near what it has proposed, millions of executive, professional and administrative employees that would have fit within the white collar exemption as it has been defined for the last 80 years will be reclassified as hourly employees.

DOL also proposes automatic annual increases to the salary threshold based on the Consumer Price Index for All Urban Consumers or by pegging the salary threshold to the 40th percentile for weekly earnings of all full time salaried employees. DOL proposes publishing the annual increase only 60 days before the new threshold becomes effective. This also would also be an unprecedented change. From 1938 to 1975, DOL regularly updated the salary level every 5-9 years. While there was no update between 1975 and 2004, complications in applying some outdated provisions in what was known as the “long” duties test” to the modern white collar employees may explain this delay. In 2004, DOL modernized and streamlined the duties test and updated the salary level, so application of the long test to the modern economy should no longer impose an impediment to regular updates to the salary threshold. Presumably, the current administration did not update the salary level within the historic 3-9 year time frame because of the great recession and the associated prolonged and difficult recovery. This was a wise course of action and argues against any “automatic” updates, in that they can exacerbate difficulties in the economy.

Finally, DOL has asked for public input on the current primary duties test. While DOL did not propose any specific regulatory changes, it said in the NPRM that it is considering changes to the duties test, including bringing back aspects of the archaic “long test.” The agency asked several questions about limiting the amount of time exempt employees could perform nonexempt work and/or eliminating the provision in the current regulations on concurrent duties (i.e. the provision in the regulations that allows exempt employees to concurrently perform exempt and non-exempt work such as a manager who supervises employees and serves customers at the same time). So substantial changes could be included in the final rule.

The comment period for the proposed rule is 60 days and is currently set to end on September 4. This is a remarkably short comment period for such a complex and lengthy NPRM—particularly given the unprecedented nature of many of the proposals.

**IMPACT ON EMPLOYEES**
According to DOL, over 10 million workers across the country could be impacted by these proposed changes. In the proposal, DOL lauds the advantages of overtime eligibility. While hourly pay and nonexempt status is appropriate for certain jobs, it is not appropriate for all jobs; otherwise there would be no exemptions to the overtime pay requirements. The general public understands this, and in a recent survey conducted by the polling company, inc./WomanTrend, a 65%-majority of adults would increase the salary limit by no more than 50%, or to $35,490 per year. Only 15% thought the threshold should be increased by over 100%, as DOL is considering.

There also are also many advantages to exempt status. Employers must closely track nonexempt employees hours to ensure compliance with overtime pay and other requirements. As a result, nonexempt employees often have less workplace autonomy and fewer opportunities for flexible work arrangements, career training and advancement than their exempt counterparts. In addition, the FLSA’s rigid rules with respect to overtime pay also make it complicated for employers to provide hourly employees with certain incentive pay and bonuses. Thus, in many cases employees, who are reclassified or classified as hourly due to this proposal, may lose important benefits and opportunities.

For example, if the proposal becomes law, many executive, professional and administrative employees will be classified or reclassified as hourly nonexempt employees and lose the opportunity to work from home or remotely, as it can be difficult for employers to track employees’ hours in those situations. Employers are also more reluctant to provide nonexempt employees with mobile devices or may place restrictions on their use, as employers need to account for any time employees spend on such devices.

Similarly, by setting the minimum salary threshold so high, the proposal would make it difficult for many employers to provide part-time exempt positions. Under the current salary requirement, a part time salary is often sufficient to establish the exemption (it simply must exceed $455 per week ($23,660 annually)). The proposed salary threshold of over $50,000 would make such an arrangement far more difficult, effectively eliminating some flexible workplace arrangements.

For example, currently a full time salaried employee making $60,000 could have the opportunity to reduce his or her position to half time to allow more family time and still be exempt at $30,000. If the salary threshold is increased above $30,000, however, this employee would no longer be exempt. In that case, the employer would need to meticulously record the employee’s working hours, even if he or she never approaches 40 hours, because the FLSA’s “hours worked” record keeping obligations apply to all
nonexempt employees. If the position is an executive, professional and administrative position, it may not lend itself to hourly tracking, and the employer may be reluctant to allow employees to work part time in the position if it means they must be reclassified to nonexempt. The employer would also be subject to variations in weekly costs, because the employees’ hours and pay might differ from week to week. These changes will make providing such part time positions more difficult.

The general public understands this is problematic; nearly 50% of adults that participated in the polling company, inc./WomanTrend survey said they would be less likely to support DOL’s proposal if it resulted in less flexibility for employees.

In addition, nonexempt status can lead to fewer opportunities for career advancement. Again, changing to nonexempt status requires employers—and employees—to watch the clock. For example, employees who have reached or are near 40 hours of work in a week may need to skip additional training or other career-enhancing opportunities, because the employer is not able to pay overtime rates for that time.

Finally, when employees are converted to nonexempt status, they often find that they have lost their ability to earn certain incentive pay (e.g., bonuses). Under the existing rules, employers that provide incentive payments to hourly employees must include those payments in the employees’ “regular pay rate” for purposes of calculating overtime pay rates, even if the bonus is provided months after the overtime takes place. Faced with the difficult recalculation of overtime rates—sometimes for every pay period in a year, employers often simply forgo these incentive payments to nonexempt employees rather than attempt to perform the required calculations.

It’s also important to note that in most cases those reclassified to nonexempt status as a result of the new rule will not receive a pay increase and in some cases, may see a decrease in pay. Just because an employee is eligible for overtime pay does not necessarily mean the employee will earn overtime pay. Hourly employees are not guaranteed any fixed weekly pay—like salaried employees—or guaranteed any specific hours. Employers must carefully manage labor costs to remain in business and frequently limit employees’ hours to prevent paying overtime. There is no reason to believe employers will stop doing so after DOL implements this rule. The American public understands this. In the polling company, inc./WomanTrend survey nearly six in 10 (58%) adults said the DOL proposal would not necessarily lead to additional pay for workers.
There are other negative consequences that can accompany reclassification of executive, professional and administrative employees to hourly nonexempt status. When employees have been reclassified from exempt to nonexempt, there is very often a decline in employee morale, as this change is generally seen as a loss of “workplace status.” Employees often believe they are being punished or demoted, and some even lose trust that their employer sees them as a professional. Forty five percent of retail and restaurant managers surveyed by the National Retail Federation (NRF) believe a change in employment status from salaried to hourly would make them feel they’re working a job rather than pursuing a career; 86% believe their perceptions of themselves as managers would deteriorate in some way. In the survey by the polling company, inc./WomanTrend, 43% of adults said they would not support the changes that would result in workers being moved from salaried to hourly status.

All of these possible consequences of being classified as hourly will fall disproportionately on executive, professional and administrative workers in cities and states with lower costs of living, including college graduates in those areas who will start their professional careers with less flexibility and fewer opportunities for advancement. For example, white collar workers in Indiana, Nebraska, Iowa and Kentucky may be classified as hourly even though they do the same work as employees classified as exempt in New York and California because of regional differences in pay, which are reflective of regional differences in cost of living. This is the case even where the employees in Indiana, Nebraska, Iowa and Kentucky have relatively more purchasing power than their counterparts in New York and California.

In short, while there are some advantages of overtime eligibility, there are also advantages to exempt status, and while hourly pay and nonexempt status is appropriate for certain jobs, it is not appropriate for all jobs; otherwise there would be no exemptions to the overtime pay requirements.

**IMPACT ON JOB CREATORS**

Employers are concerned that the dramatic changes proposed by DOL will reduce opportunity and flexibility for millions of executive, professional and administrative employees who would have historically qualified as exempt salaried workers but would not under DOL’s proposal. As noted above, at no point in history has the salary threshold created an *absolute* bar to exempt status for such a high percentage of executive, professional and administrative employees, and exempt employees often enjoy greater flexibility and opportunity than their nonexempt counterparts.
Small and large businesses, nonprofits, municipalities and schools across the county are also concerned about the administrative and labor cost associated with the proposal. An economic study conducted by the National Retail Federation (NRF) estimates the cost of the proposal at $8.4 billion per year.

These costs will disproportionately fall on those businesses, nonprofits, municipalities and schools in cities and states with lower cost of living. A salary level set for New York City, San Francisco, and Washington, DC, will not work for Birmingham, Boise, Cincinnati, Detroit, Indianapolis or St. Louis, let alone the rural and small towns spread out across the country. In a survey by the polling company, inc./WomanTrend, 63% of adults agree a “one-size-fits-all” approach to overtime rules is inappropriate for the different industries and various regions of the country. Yet, DOL’s proposed salary threshold is higher than minimums set under any state laws, nearly $10,000 higher than that of California and nearly $15,000 higher than New York, two of the states with the highest cost of living.

Indexing the minimum salary threshold could also result in instability in labor and administrative costs for job creators across the country year after year. Each year DOL would issue a new salary threshold, and employers would have 60 days to implement the changes. That means every year businesses would be forced to reconsider the classifications given to its employees and reassess potential raises, bonuses, or promotions for those employees. Employers will need to constantly review the impact the automatic increases have on salary compression, merit increases and budgets. This annual reconsideration of positions costs money.

Finally, by choosing not to propose specific changes to the primary duties test in its proposed rulemaking, DOL is effectively sidestepping the American people and public oversight. If DOL chooses to implement substantial changes to the duties test in its final rule without first undergoing a notice-and-comment period on the specific details of the proposal and providing related cost and economic analysis, employers and the public in general will not have the opportunity to comment on the specific changes made. This will leave public with no opportunity to voice their concerns about the potential impact the proposal could have on employers, workers, or the economy as a whole.

Yet, the impact of changes to the duties test could be very significant. Such changes could require salaried employees to spend a specific percentage of their time performing or not performing certain duties. This means a manager who is responsible for store operations, and thus by virtue of the position is “managing,” would often be prohibited from
performing tasks such as attending to customers’ needs, training employees in nonexempt tasks, and managing inventory. The manager would also be required to track his or her activities, undermining the discretion and flexibility that comes with being exempt.

Such a change could also hurt the business’ reputation. Over 8 in 10 managers (81%) surveyed by the NRF believe their customers will be adversely affected if managers were banned from partaking in non-managerial tasks due to changes to the primary duties test.

California already applies this “quantification requirement;” to be exempt under California state law, an employee must spend more than 50% of his or her time performing primary duties. As a result, exemptions from overtime are very difficult to implement, resulting in many managers being denied the opportunities and flexibility that come with exempt status. There has also been a marked increase in litigation.

Over the last decade, employers have spent tens of millions of dollars defending against expensive litigation related to manager positions under the FLSA. Just as the litigation wave has started to settle down and employers have obtained some legal clarity on these classification issues, new regulations will restart the process, resulting in additional litigation.