Labor & Employment ADVISORY ■

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Department of Labor Issues Proposed Rule to Amend Overtime Regulations

Last week, the U.S. Department of Labor (DOL) published a proposed rule that would significantly change the "white collar" exemptions from the minimum wage and overtime pay requirements of the Fair Labor Standards Act (FLSA). The DOL published the long-awaited proposed rule on July 6 and has invited interested parties to submit written comments about it over the next two months. The proposed changes would more than double the minimum salary threshold currently required to satisfy the FLSA's white collar exemptions and provide for automatic salary increases in the future. It is expected that the final rule will be published sometime in 2016.

The FLSA requires most employers to pay their employees at least the minimum wage for each hour they work and to provide employees with overtime pay at a rate of one-and-a-half times their regular rate of pay for any hours worked in excess of 40 per week. Employees who are paid on a salary basis and earn a certain minimum weekly salary, however, are exempt from the FLSA's overtime requirements if they also satisfy the "duties test" of one of the white collar exemptions, which include the executive, administrative, professional, outside sales and computer employee exemptions. There is also a special rule for highly compensated workers, currently employees who are paid $100,000 or more annually.

According to the DOL, the new rule would make an additional 5 million U.S. employees eligible for overtime pay by increasing the minimum salary levels required to be overtime-exempt. It will undoubtedly have a significant effect on employers. But, although complying with the new rule once it is finalized will present certain challenges for employers, it will also provide cover for employers to review and change current FLSA classifications with less risk of the fallout that can sometimes accompany such reclassifications.

Lead-Up to the Proposed Rule

Over a year ago, President Obama issued a memorandum directing the DOL to "modernize and streamline" the regulations that govern the exemptions from the FLSA's minimum wage and overtime pay requirements. The March 2014 memorandum ordered Secretary of Labor Thomas Perez to consider whether revisions to the regulations were appropriate. The President noted that the FLSA's overtime protections are a linchpin of the middle class, and that the failure to continuously update the salary level requirement for the white collar exemptions has left millions of low-paid, salaried workers ineligible for overtime.

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In response to the President's memorandum, the DOL began conducting research on certain issues, such as: (1) the appropriate salary level for exempt status; (2) the types of changes that should be made to the duties tests, if any; and (3) how the regulations can be simplified. On May 5, 2015, the DOL sent a proposed rule to amend the white collar exemptions to the White House Office of Information and Regulatory Affairs, where it was under review until June 30.

DOL's Proposed Overtime Exemption Rule

The current rules defining the white collar exemptions were last updated in 2004 under the George W. Bush Administration. Presently, the salary threshold to qualify the white collar exemptions stands at $455 per week (or $23,660 per year). To be exempted as a highly compensated employee, a worker must earn at least $100,000 a year. The proposed rule would make the following changes to the white collar exemptions:

- Increase the salary level to an amount equal to the 40th percentile of earnings for full-time salaried workers. The DOL projects that by 2016, when the final rule would go into effect, the salary level would be at or near $970 per week or $50,440 per year;
- Increase the salary level for highly compensated employees to the annualized value of the 90th percentile of weekly earnings of full-time salaried workers (approximately $122,000 annually); and
- Establish a mechanism to automatically update the minimum salary threshold for the white collar exemptions on an annual basis by using a fixed percentile of wages or the consumer price index (the DOL is seeking public comment on both options).

According to the DOL, the proposal that the salary level requirements change over time is meant to "prevent the levels from becoming outdated with the often lengthy passage of time between rulemakings." A mechanism that would automatically update the salary levels would account for economic factors such as inflation or statistical data on actual wages paid to salaried employees in a given year.

By setting the standard salary level for the white collar exemptions at 40 percent of all full-time salaried employees, the DOL claims that it is attempting to distinguish between employees who may satisfy the duties tests for the exemptions and those who likely do not, "without necessitating a return to the more detailed long duties test." This stated goal suggests that the final rule will not revive the short and long duties tests included in the regulations from 1949 until 2004. During that time, the regulations provided for a long duties test for exemption for employees paid at a lower salary and a short duties test for exemption for employees paid at a higher salary level. But, the proposed rule does not make clear what, if any, changes to the duties tests will be incorporated into the final regulations.

Unanswered Questions

The proposed rule provides for significant changes to the salary level thresholds of the white collar exemptions. Somewhat surprisingly, however, the rule does not propose specific regulatory changes to the duties tests for such exemptions. Instead, the DOL states that it will "determine whether, in light of [its] salary level proposal, changes to the duties tests are also warranted," and has invited interested parties to comment on the issue. Specifically, the DOL is seeking comments on the following questions:

A) What, if any, changes should be made to the duties tests?

B) 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?

C) Should the [DOL] look to [California] 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 threshold that is less than 50 percent of an employee's time worked a better indicator of the realities of the workplace today?

D) Does the single standard duties test for each exemption category appropriately distinguish between exempt and nonexempt employees? Should the [DOL] reconsider [its] decision to eliminate the long/short duties tests structure?

E) 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?

The DOL also asks whether and how nondiscretionary bonuses might be used to satisfy the salary level threshold. Currently, such bonuses are only included in calculating the total annual compensation under the highly-compensated employee exemption. The DOL is considering changes to this rule, in light of the fact that in certain industries, such as retail and restaurant, large portions of the earnings of salaried employees who might be eligible for a white collar exemption may be in the form of nondiscretionary bonuses. The DOL believes it should limit the amount of the salary requirement that could be satisfied through the payment of nondiscretionary bonuses and incentive pay. Specifically, the DOL is considering whether to limit the amount to 10 percent of the standard weekly salary level. In addition, the DOL is considering whether to require employers who credit bonus compensation toward the salary requirement to make bonus payments more frequently than in one annual lump sum, such as once a month.

Employers should be prepared for changes to the duties tests for the white collar exemptions, even though the proposed rule does not contain specific amendments in this regard. As stated in the proposed rule, the DOL has long recognized that "the salary level test works in tandem with the duties test," and it is clear that the performance of certain job duties will remain a factor in evaluating the exempt status of employees who may be eligible for the white collar exemptions. Indeed, the DOL emphasizes that it has always required that employers "establish that the employee's 'primary duty' is the performance of exempt work in order for the exemption to apply." The fact that the DOL has raised the duties tests issue, and asked numerous detailed questions about it, suggests that the final rule will include one or a combination of such changes. The questions raised in the proposed rule indicate that the final rule could drastically change the duties tests for overtime exemption eligibility, even without the benefit of public comment on the specific changes.

Anticipated Timeline for the Final Rule

The proposed rule was published in the *Federal Register* on July 6, and the 60-day comment period ends on Friday, September 4. Given the significant changes proposed by the DOL, high participation in the comment period is expected, and it is possible that the comment period may be extended. When the DOL last proposed revisions to the white collar exemptions in 2003, it received 75,280 comments during a 90-day comment period. If similar participation occurs in response to the current proposed rule, it is unlikely that the DOL will be able to issue a final rule this year. Before it can do so, the DOL must first review the comments it receives during the comment period and consider and possibly address any issues the comments raise. In addition, the agency may time its announcement of the final

rule to correspond with the 2016 presidential election. Thus, it is expected that the final rule will not be released until the summer or early fall of 2016.

Challenges and Opportunities for Employers

Assuming the DOL's final rule contains the recently announced revisions and establishes as-of-yet unannounced changes to the duties tests, complying with the rule will present significant challenges for employers. First and most notably, the final rule will almost certainly increase the current salary threshold for the white collar exemptions, and thereby increase labor costs. As proposed, the new salary threshold will more than double the current salary threshold, and employers will be required either to pay overtime to currently exempt employees whose salaries are below the higher threshold or to increase salaries to meet that threshold amount, keep the employees as exempt and so avoid paying overtime. In other words, exempt employees who no longer meet the minimum salary threshold under the new rule will have to be converted to nonexempt status or be paid higher salaries to remain overtime-exempt. Inevitably, this will significantly increase costs for employers and require changes to policies and payroll practices.

In addition to increasing labor costs, the final rule will likely require employers to make the necessary adjustments to account for any changes the final rule might make to the duties tests. The proposed rule does not lay out the specific changes being considered, but it is still very possible that the final rule will incorporate new duties tests or revive old ones. Either way, employers must be prepared for employee reclassifications. For example, an employee whose job duties meet the current test for the administrative exemption under the current duties test may no longer be exempt from the FLSA under another standard, such as the long and short duties tests that existed prior to the 2004 regulatory changes, California's 50 percent test or some other variation of the duties test that the final rule may adopt. In such circumstances, the employer might have to reclassify the employee as nonexempt, and begin paying him overtime, or alter the employee's job duties to meet the new test.

Third, employers may find it challenging to comply with a final rule that establishes a mechanism for automatically updating the salary levels for a white collar exemption based on economic factors. Under the proposed rule, the updated salary rate would be published annually at least 60 days before year-end. Thus, an employer could have only two months' notice of the upcoming year's minimum salary threshold prior to its effective date. This amount of time would pose challenges for employers that need to adjust their budgets to account for salary increases and/or increased overtime costs in response to an updated salary rate. This would be especially challenging for companies that set their budgets more than 60 days prior to the end of the calendar year, which is typical for many businesses. In addition, a proposal that the minimum salary threshold be based on a fixed percentile of actual salaries in a given year or the consumer price index measuring inflation may result in salary levels that are out of sync with the realities of the economy and workplace. This is particularly true because the mechanism for determining the salary increase in the threshold will not take into account differences based on geography, industry or other distinguishing factors.

Despite their challenges, the impending changes provide some opportunities for employers. First, it is an excellent time for employers to take a close look at their FLSA classifications to determine if they comply with current requirements and what we know about the proposed new rule. In the time leading up to the issuance of the final rule, employers should conduct audits to prepare for the upcoming changes. Further, to the extent that an employer's current FLSA classifications are out of line with present standards, or the proposed new standards, the impending rule changes provide an opportunity to explain to employees that any changes are being made to comply with the new rule, which may help to minimize employee questions about prior classification decisions.

Second, because the proposed rule was announced well in advance of its final issuance, employers have time to consider the proposals and options for minimizing their impact on the bottom line. Employers have a variety of options for offsetting the additional costs associated with the impending rule. For example, an employer could consider salary reductions for currently exempt employees such that their overall earnings remain nearly the same when they become overtime eligible and are due overtime wages. In addition, employers can also consider converting salaried workers to hourly workers and setting a lawful hourly rate that would account for any additional overtime payments based on an employee's typical work schedule, assuming the employee's work schedule is consistent from week-to-week. Employers could also restructure shifts by limiting certain workers to a 40-hour workweek and assigning additional work to other employees.

Overall, employers should take the time to prepare for sweeping changes to their FLSA exemption classifications and related increases in labor costs. The final rule will not be employer-friendly, but it may not sound the death knell for the Bush-era regulations. Instead, taking advantage of the time leading up to the final rule may provide employers with opportunities to curtail its detrimental effect.

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