

Summary of U.S. Chamber Comments on Proposed Changes to Overtime Exemption Regulations

History of Statutory Exemptions

The Fair Labor Standards Act, enacted by Congress in 1938 during the Great Depression, generally requires covered employers to pay their employees at least the federal minimum wage (currently, \$7.25 per hour) for all hours worked and overtime pay at one and one-half an employee's regular rate of pay for all hours worked over 40 in a single workweek.¹ In addition to ensuring additional pay for working over 40 hours, Congress intended the Act's overtime pay requirement to encourage employers to spread the available work among a larger number of workers and thereby reduce unemployment.

When Congress passed the FLSA in 1938, establishing the minimum wage and overtime requirements, they excluded executive, administrative, professional and outside sales employees from those protections. Congress believed then that in exchange for not being eligible for overtime, such employees earned salaries well above the minimum wage, were provided above-average benefits and had better opportunities for advancement, setting them apart from the nonexempt workers entitled to overtime pay. This is still true today.

Congress included the white collar exemptions in section 13(a)(1) of the original 1938 act, which exempted from both the minimum wage and overtime requirements "any employee employed in a bona fide executive, administrative, professional, or local retailing capacity, or in the capacity of outside salesman (as such terms are defined and delimited by regulations of the Administrator)."² Congress amended section 13(a)(1) in 1961 to remove the "local retailing capacity" exemption, but also prohibited the Department from denying the exemption to retail or service employees who spend less than 40 percent of hours worked performing non-exempt tasks.³ In 1966, Congress added academic administrative personnel and teachers to the exemption.⁴ Thus, today, section 13(a)(1) of the FLSA provides an exemption from both the minimum wage and overtime requirements for:

[A]ny employee employed in a bona fide executive, administrative, or professional capacity (including any employee employed in the capacity of academic administrative personnel or teacher in elementary or secondary schools), or in the capacity of outside salesman (as such terms are defined and delimited from time to time by regulations of the Secretary, subject to the provisions of [the Administrative Procedure Act], except that an employee of a retail or service establishment shall not be excluded from the definition of employee employed in a bona fide executive or administrative capacity because of the number of hours in his workweek which he devotes to activities not directly

¹ 29 U.S.C. §§ 206 (minimum wage), 207 (overtime).

² 52 Stat. 1060, 1067 (June 25, 1938).

³ P.L. 87-30, 74 Stat. 65 (May 5, 1961).

⁴ P.L. 89-601, 80 Stat. 830 (Sept. 23, 1966).

or closely related to the performance of executive or administrative activities, if less than 40 per centum of his hours worked in the workweek are devoted to such activities).⁵

History of Regulations and Summary of Proposed Changes

Since 1940, the Part 541 regulations implementing the statutory exemptions have included three tests that employees must meet before qualifying for exemption: *First*, employees must be paid at least the minimum salary level for exemption established in the regulations, currently \$455 per week (\$23,660 annually) as set in 2004.⁶ *Second*, employees must be paid on a “salary basis.” An employee is paid on a salary basis “if the employee regularly receives each pay period on a weekly, or less frequent basis, a predetermined amount constituting all or part of the employee’s compensation, which amount is not subject to reduction because of variations in the quality or quantity of the work performed.”⁷ *Third*, the employees must have a primary duty of performing the exempt executive, administrative, professional, computer or outside sales job duties.⁸ Highly compensated employees, currently defined as employees with total annual compensation of at least \$100,000, are exempt if they customarily and regularly perform at least one of the exempt duties of an executive, administrative or professional employee.⁹

On the salary level tests, the Department has proposed to set the minimum salary required for exemption at the 40th percentile of weekly earnings for full-time salaried workers.¹⁰ The Department expects that the 40th percentile will increase to \$970 per week or \$50,440 annually by the time a final rule is issued in 2016.¹¹ The Department seeks comments on whether “to permit nondiscretionary bonuses and incentive payments to count toward partial satisfaction of the salary level test.”¹² The Department also proposes to increase the total annual compensation requirement needed to exempt highly compensated employees (HCEs) to the annualized value of the 90th percentile of weekly earnings of full-time salaried workers, which is estimated at \$122,148 annually.¹³ Finally, the Department proposes to establish a mechanism for automatically updating the salary levels on an annual basis using either the 40th (standard test) and 90th (HCE test) percentiles or based on an inflationary measure (the CPI-U).¹⁴

⁵ 29 U.S.C. § 213(a)(1).

⁶ 29 C.F.R. § 541.600.

⁷ 29 C.F.R. § 541.602. Teacher, doctors, lawyers and outside sales employees are not subject to the salary level and salary basis tests. 29 C.F.R. § 541.303(d) (teachers); 29 C.F.R. § 541.304(d) (doctors and lawyers); 29 C.F.R. § 541.500(c) (outside sales). In addition, exempt computer employees may be paid by the hour. 29 U.S.C. § 213(a)(17); 541.29 C.F.R. § 541.400(b).

⁸ 29 C.F.R. § 541.100 (executives); 29 C.F.R. § 541.200 (administrative employees); 29 C.F.R. § 541.300 (professionals); 29 C.F.R. § 541.400 (computer); 29 C.F.R. § 541.500 (outside sales).

⁹ 29 C.F.R. § 541.601.

¹⁰ 2015 NPRM at 38517.

¹¹ *Id.*, n.1.

¹² *Id.* at 38536.

¹³ *Id.* at 38537.

¹⁴ *Id.* at 38524, 38537-42.

Whether the Department is proposing changes to the duties tests is far from clear. In the NPRM, the Department states that it “is not proposing specific regulatory changes at this time.”¹⁵ Rather, the DOL only “seeks to determine whether, in light of our salary level proposal, changes to the duties tests are also warranted” and “invites comments on whether adjustments to the duties tests are necessary, particularly in light of the proposed change in the salary level test.”¹⁶ The Department then requests comments on the following issues:

- 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 Department 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?
- D. Does the single standard duties test for each exemption category appropriately distinguish between exempt and nonexempt employees? Should the Department reconsider our 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?¹⁷

Possible Impacts on Employees and Chamber Objections

Exempt white collar employees often enjoy more generous paid leave benefits. They earn bonuses, commissions, profit-sharing, stock options and other incentive pay at greater rates than non-exempt employees. Moving from a non-exempt to an exempt position is the first rung on the promotional ladder.

Perhaps most importantly, exempt employees enjoy the stability and certainty of a guaranteed salary. Exempt white collar employees must be paid on a salary basis – that is, they must receive a “predetermined” salary that “is not subject to reduction because of variations in

¹⁵ *Id.* at 38543.

¹⁶ *Id.*

¹⁷ *Id.* at 38543.

the quality or quantity of the work performed.”¹⁸ Thus, while exempt employees do not receive overtime for working over 40 hours in a week, they also are not paid less if they work less than 40 hours in a week. If an exempt employee works as little as one hour in the week, and then takes the rest of the week off because of a family emergency, that employee will still be paid her entire weekly salary. A non-exempt employee need be paid only for the one hour he actually worked. A non-exempt employee who takes an afternoon off to attend a parent-teacher conference will not be paid for that time, but an exempt employee will be paid her full guaranteed salary.¹⁹

The Department’s proposal to increase the minimum salary level for exemption to the 40th percentile of all “non-hourly” workers – \$50,440, an increase of 113 percent – will eliminate the workplace flexibility that Secretary Perez so values for millions of employees who currently perform exempt executive, administrative, professional, computer, and outside sales job duties. These millions will be reclassified to non-exempt and be required to start punching a time clock. They will be paid only for hours they actually work, but that is no guarantee of overtime pay – as many employers will limit their work hours to fewer than 40 in a week. Being eligible for overtime is not the same as earning overtime, even if the employee may currently be working more than 40 hours a week as an exempt employee.

Although the Department views being reclassified as non-exempt as an advantage, in fact, Chamber members with vast experience managing private sector businesses know that limiting an employee’s work hours also limits opportunities for advancement. Exempt employees know this too, and will view the reclassification to non-exempt necessitated by the Department’s proposal as a demotion. Employee morale will suffer as their work hours are closely monitored, they fall out of the more generous employee benefit plans, are no longer eligible for incentive pay, and must carefully consider whether they can afford to leave work to attend a child’s baseball game.

In addition, because of the Department’s proposal to automatically increase the salary level every year, more exempt employees will be reclassified every year and lose flexibility, benefits and opportunities for advancement every year.

Among the employers who will be most impacted by the change in the salary threshold will be those in the nonprofit and medical provider sectors. These employers are unable to increase their revenues to cover the increased costs of complying with the higher salary threshold, either because they are charitable organizations that survive on contributions, or their revenue is dictated by insurance rates that they have no opportunity to influence.

¹⁸ 29 C.F.R. § 541.602(a).

¹⁹ Subject to employer paid leave policies.

President Obama directed the Department to “modernize” the white collar regulations,²⁰ but the Department’s proposal will return our workplaces back to the 1950s when all but the most highly paid employees punched a time clock and managers were prevented by union contracts from pitching in and lending a hand to help supervised employees complete the job. Forcing employees back into a time-clock punching, shift work model will not be welcome when 74 percent of workers value “being able to work flexibly and still be on track for promotion,” second only after competitive pay and benefits.²¹

In addition to likely triggering large-scale reclassifications to employee detriment, this proposal has inherent flaws. Procedurally, the Department creates an impression that changes to the duties test will be made based merely on questions posed in the preamble, without proposed regulatory text or any of the accompanying analysis, supporting data, or economic impact studies. Doing so would mean employers and other regulated parties will never have had a chance to review and comment on the specific changes, which would be contrary to the intent and spirit of the Administrative Procedure Act, Executive Orders 12866 and 13563 on proper rulemaking procedures, and President Obama’s own Open Government Initiative.

Also, the economic data relied upon by the Department to support the new salary threshold is flawed and does not provide sufficient detail to support the claims made by the Department. Similarly, the economic impact analysis provided fails to consider many factors and severely underestimates the economic impact of the Department’s proposal, even without taking into consideration transfer payments related to compliance with changing the salary threshold.

As the Chamber’s comments demonstrate, the Department’s proposal should be withdrawn.

²⁰ Shortly thereafter, Secretary Perez conducted “listening sessions” with representatives of the employer community, including the U.S. Chamber. Unfortunately, there is no evidence that these sessions had any impact on the Department’s proposal.

²¹ Ernst & Young Study, *Work-Life Challenges Across Generations* (2015), available at <http://www.ey.com/US/en/About-us/Our-people-and-culture/EY-work-life-challenges-across-generations-global-study>