Statement of the U.S. Chamber of Commerce

ON: **Restoring the Value of Work: Evaluating DOL's Efforts to Undermine Strong Overtime Protections**

TO: **U.S. House of Representatives Committee on Education and Labor**

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More than 96% of Chamber member companies have fewer than 100 employees, and many of the nation's largest companies are also active members. We are therefore cognizant not only of the challenges facing smaller businesses, but also those facing the business community at large.

Besides representing a cross-section of the American business community with respect to the number of employees, major classifications of American business—e.g., manufacturing, retailing, services, construction, wholesalers, and finance—are represented. The Chamber has membership in all 50 states.

The Chamber's international reach is substantial as well. We believe that global interdependence provides opportunities, not threats. In addition to the American Chambers of Commerce abroad, an increasing number of our members engage in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Testimony of

Tammy D. McCutchen, Esq.

Before the

United States House of Representatives
Committee on Education & Labor
Subcommittee on Workforce Protections

Hearing on

"Restoring the Value of Work: Evaluating DOL's Efforts to Undermine Strong Overtime Protections"

June 12, 2018

Madame Chair and members of the Subcommittee:

Thank you for the opportunity to speak with you about the U.S. Department of Labor's proposed revisions to 29 C.F.R. part 541, commonly known as the "white collar" overtime-exemption regulations.

Let me begin with a brief overview of my background. I am currently a principal in the Washington, D.C. office of Littler Mendelson, P.C., where I help employers comply with the Fair Labor Standards Act. Among other things, I help employers with internal audits on such issues as independent-contractor status, overtime exemptions, and other pay practices. I also represent employers in wage-and-hour investigations by the Department of Labor and serve as an expert witness in wage-and-hour class actions. For example, I served as an expert witness for the Department of Justice in *Nigg v. U.S. Postal Service*, where the plaintiffs alleged that the Postal Service misclassified postal inspectors as exempt from overtime. The courts ultimately found that the employees were properly classified.

In addition to my law practice, I also serve as Vice President and Managing Director, Strategic Solutions for ComplianceHR, which develops compliance applications to guide employers through key employment decisions, such as whether to classify an employee as exempt from overtime requirements.

Perhaps most relevant to our topic today, from 2001 to 2004, I served as the Administrator of the Department of Labor's Wage and Hour Division. During my tenure, I oversaw the 2004 revisions to the overtime regulations. Those revisions were the Department's first major overhaul of the regulations in 55 years.

Today, I am appearing on behalf of the U.S. Chamber of Commerce.

Madame Chair, I ask that my entire written testimony be entered into the record.

I. A Brief Regulatory History

Let me begin with a brief overview of the history of the white-collar exemptions. The Fair Labor Standards Act generally requires covered employers to pay each employee at least the minimum wage for all hours worked. It also requires employers to pay overtime at a rate of one-and-one-half times the employee's regular rate for all hours over 40 in a single workweek. Those general requirements, however, are subject to 51 partial or complete exemptions. The most well known of these exemptions—and the topic of today's discussion—are the exemptions for executive, administrative, and professional employees. These are the "white collar" exemptions.

The white-collar exemptions have been part of the FLSA since Congress first adopted the law in 1938. Congress did not, however, define "executive," "administrative," or "professional." Instead, it delegated authority to define those terms to the Secretary of Labor. Specifically, it wrote that the Secretary could "define and delimit" those terms "from time to time."

The Secretary first exercised that authority on October 20, 1938, when the Department adopted the regulations now at title 29, part 541 of the Code of Federal Regulations. Much as they do today, those original regulations defined the exemptions by two criteria: duties and salary. These two criteria worked together. To qualify for one of the white-collar exemptions, an employee had to satisfy both criteria—he or she had to both earn at least the minimum salary and perform primarily exempt duties.

The Department revisited the minimum salary level in 1940, and again in 1949. Its analysis from those revisions shows that it intended the salary level as a screening mechanism. Through its compliance investigations, it had learned that employees earning below a certain threshold almost invariably failed to satisfy the duties tests, and so failed to qualify for the exemptions. To save employers and investigators time and resources, it therefore adopted the salary test to screen out—in the Department's words—"obviously nonexempt" employees.

Also in 1949, the Department split the duties test in two. Instead of a single test, it provided a "long" test for most employees and a "short" test for "high salaried" employees. It reasoned that employees who earned large salaries were more likely to perform exempt duties, and so it made sense to apply a truncated duties test to those employees.

For the next three decades, the Department continued to revisit the salary levels every five to ten years. It originally set the minimum salary at $30 per week, but by 1975, it had raised the levels to $155 per week for executive and administrative employees, $170 per week for professionals, and $250 per week for employees subject to the short test.

Those levels remained unchanged until 2004, when the Department undertook its first major revision in decades. This revision sought to address two related problems. First, the duties tests were unnecessarily complicated. Employers and employees alike complained that using two different tests was confusing. Employers also complained that the short test was too rigid: it put a hard cap on nonexempt tasks, which required minute-by-minute tracking. Second, the salary levels had eroded in value. The long-test salary had fallen below the federal minimum wage, and the short test was only $1.10 above it. The levels had therefore stopped serving any meaningful screening function.

To address these problems, the Department made a number of changes, three of which are particularly relevant here:

- First, it combined the short and long tests into a single duties test. This test borrowed aspects from both tests, but abandoned the long test's cap on nonexempt work.

- Second, it adopted a new methodology for setting the minimum salary levels. This methodology used salary data collected by the Bureau of Labor Statistics as its baseline. It then focused on the lowest-wage Census region and the lowest-wage industry group. Within those groups, it set the salary level at the 20th percentile. That methodology produced a salary level of $455 per week, or $23,660 per year.

- Third, it adopted an exemption for "highly compensated" employees. This exemption provided a streamlined duties test with an elevated salary level. The Department initially set the salary level at $65,000 a year, but in response to public feedback, raised it to $100,000.

The Department left these standards in place until 2016, when it again proposed to raise the salary levels. But instead of applying the 2004 methodology, it adopted a dramatically different formula. It still looked at BLS data in lower-wage regions and industries, but departed significantly from the previous methodology in two key ways: expanding the geography covered to include the higher income jurisdictions of Maryland, Virginia, and the District of Columbia, and doubling the relevant percentile from 20 to 40. These changes caused the salary level to balloon from $23,660 to $47,476. The Department estimated that this new formula would cause more than four million workers to lose their exempt status based on their salaries alone. It decided, however, that such a result was justified by changes in the workforce and the potential for misclassification.

That approach proved legally fatal. In November 2016, the U.S. District Court for the Eastern District of Texas preliminarily enjoined the regulations from taking effect.[1] And the following August, the court struck them down, leaving the 2004 salary level as the current salary test.[2] Referring to the statutory text, the court reasoned that Congress gave the Department authority to define the exemptions by reference to employees' duties, not by reference to their salaries. The salary test was therefore lawful only when it served as a proxy for duties. For most of its history, the Department had used the test in just that way, always making sure to set the level at the lower end of the salary range. But in the final rule issued in 2016, the Department explicitly set out to reclassify whole swaths of the workforce on salary alone. The Department had therefore exceeded its authority. The court then added that if the Department had simply updated the salary levels using the 2004 methodology, its action would almost certainly have been lawful.[3]

II. Salary Levels

This past April, the Department again proposed to update the salary levels—by reverting to the 2004 methodology. That approach follows historical practice and falls comfortably within the Department's delegated authority.

a. The Department correctly returned to the 2004 methodology.

Much of the commentary around the Department's proposal has focused on the salary level—$35,308 per year. But more important than the final number is the method the Department used to reach it. The Department used, more or less, the same methodology it used in 2004. That methodology was the best choice for two reasons: (1) it is consistent with historical practice; and (2) it is the approach that best identifies a salary level that can be a floor to serve as a proxy for identifying exempt and nonexempt duties.

Again, the Department has always used salary levels for a limited purpose. Reports and analyses going back to 1940 emphasize this point again and again. For example, in 1958, the Department wrote that the salary levels "furnish a practical guide to the investigator as well as to employers and employees in borderline cases, and simplify enforcement by providing a ready method of screening out the obviously nonexempt employees."[4] If the salary level becomes too

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[1] *Nevada v. U.S. Dep't of Labor*, 218 F. Supp. 3d 520, 533 (E.D. Tex. 2016).

[2] *Nevada v. U.S. Dep't of Labor*, 275 F. Supp. 3d 795, 806–808 (E.D. Tex. 2017).

[3] *Id.* at 807 n.6 ("[I]f [the salary level] had been just adjusted for inflation, the 2004 figure, we wouldn't be here today . . . because [the salary level] would still be operating more the way it has . . . as more of a floor." (quoting court's statements during oral argument)).

[4] U.S. Dept. of Labor, Wage & Hour & Pub. Contracts Div., Report and Recommendations on Proposed Revision of Regulations, Part 541 under the Fair Labor Standards Act Defining the Terms "Executive, Administrative," "Professional," "Local Retailing Capacity," "Outside Salesman" 2−3 (1958).

high, however, it stops serving this function. It instead becomes determinative for large numbers of otherwise exempt workers. Rather than being a proxy for the duties test, it becomes the whole test.

The 2004 methodology recognizes that issue and so sets the levels at a reasonable point. It screens out fewer exempt workers and allows the duties test to take center stage. In that respect, it is consistent with the Department's longstanding practice.

Perhaps more importantly, it presents the only truly viable option. In proposing new levels, the Department had three choices. First, it could have used the method it used before 2004—sometimes called the "Kantor" method. That method, however, assumes that there will be two salary levels. After the Department consolidated the two duties tests into one, that method no longer made sense. Second, it could have returned to the 2016 method. But that method was declared invalid before the 2016 regulations ever went into effect. The Department could not have responsibly used it again. Third, the Department could simply update the salary levels using the methodology already in place—the 2004 methodology. That methodology had been in effect for nearly 15 years and was familiar to the regulated community. Its results had been applied in countless court decisions across the county. So given the 2016−17 litigation and the Department's historical practice, the 2004 methodology was its only reasonable choice.

b. Critics of the 2004 methodology have misrepresented and oversimplified the Department's approach.

The 2004 methodology is not, of course, without its detractors. It has drawn its share of criticism, mostly from groups who advocated for a significantly different kind of rule with much higher salary thresholds. These groups often argue that the 2004 methodology created a "mismatch" between the short and long tests. They assert that it did nothing more than match the short test's duties with the long test's salary. This, they claim, caused fewer people to be eligible for overtime.

That criticism is unwarranted. In 2004, the Department did more than simply paste the long salary level onto the short duties test; it incorporated elements from both tests. For example, it eliminated the hard cap on nonexempt work, which had proved difficult to track and enforce. In that respect, the new test resembled the short test. But it also incorporated requirements from the long test, such as the requirement that executive employees have the authority to hire and fire, or to make recommendations about hiring, firing, advancement, or other changes in status. The result was a brand new duties test mixing elements of both former tests.

The salary level was new as well. While the long test set its salary level using the 10th percentile of relevant salaries, the 2004 methodology doubled that threshold to the 20th percentile.

It did so in part to compensate for eliminating the long test's cap on nonexempt work. Again, the result was something entirely new—a formula that modernized the salary levels while remaining faithful to the salary test's original purpose.

Another common criticism is that the 2004 methodology increased misclassification—that too many employees have been classified as exempt who should be nonexempt. This argument stems from the Department's belief during the 2016 rulemaking that many workers had been misclassified under the 2004 regulations. Seizing on this statement, critics argue that by returning to the 2004 methodology, the Department is effectively suborning misclassification.

This argument puts the cart before the horse. By definition, misclassification is a misapplication of the rules. The rules therefore "cause" misclassification only when they are too complicated or abstruse to apply correctly. The 2004 regulations had the opposite effect: they streamlined the regulations and simplified compliance. So what the critics really mean when they say the regulations "caused" misclassification is that it allowed employers to classify employees as exempt who the critics believe should not be exempt. But by definition, these employees satisfied the duties tests; otherwise, they could not have been classified as exempt. The critics' real argument, then, is that employees who perform exempt duties should nevertheless receive overtime when they earn less than what the critics consider an adequate salary. But that argument clashes with the statutory text, amplified by the federal judge, which again defines the exemptions only by reference to duties.

Some employees, of course, were misclassified under the 2004 regulations. That is an inescapable reality. But it is also a reality that misclassification occurred long before the 2004 regulations, and will surely continue to occur into the foreseeable future. There will always be close cases where an employee's duties may be considered exempt or nonexempt depending on who is reviewing them. No amount of tinkering with the rules will change that. Misclassification can certainly be reduced, but the Department cannot do that it simply by raising the salary levels higher and higher. As the 2016 regulations proved, salary levels can rise only so high before they usurp the duties test. The answer, then, is to simplify the regulations, increase education, and improve enforcement.

Finally, some critics point to the fact that the 2004 methodology automatically classifies fewer employees as nonexempt than the 2016 methodology would have. That is, however, precisely the point. The salary levels have never been more than a sorting mechanism: they help employers and investigators identify employees who are unlikely to satisfy the duties tests. The 2016 regulations ignored that principle. Instead, they sought to use salaries to reclassify millions of otherwise exempt workers in a single stroke. In doing so, they exceeded the authority Congress delegated and, as a result, were struck down.

The Department's current proposal builds on that lesson. It returns to historical practice and comports with Congress's intent. For that reason, it deserves support.

c. The Department correctly abandoned its proposal to automatically update salary levels.

The proposal also deserves support for something it did not do—provide automatic updates.

In 2016, for the first time ever, the Department proposed to update salary levels every three years automatically. Stakeholders in the regulated community protested this change vehemently and warned that it exceeded the Department's authority. The Department disregarded that feedback, citing delays between prior updates through rulemaking. It argued, in effect, that rulemaking had proven too slow and cumbersome to keep up with rising salaries, and, therefore, the goal of keeping the salary level updated could no longer be entrusted to the Secretary as Congress had envisioned.

The Department's current proposal rejects that rationale. Instead, it proposes to revisit the salary levels every four years through notice-and-comment rulemaking. That approach is consistent with the Department's nearly 80-year practice. In the past, every time the Department has updated the salary levels, it has done so through rulemaking—and for good reason. Congress has never given the Department authority to update the salary levels automatically. Instead, it authorized the Department to define and delimit the exemptions "from time to time." That language suggests a deliberative, intentional process, not a formula tied to inflationary measures.

Moreover, automatic updates would have clashed with the Administrative Procedure Act (APA). In the APA, Congress directed agencies to effect major policy changes through formal notice-and-comment rulemaking. It recognized that agencies made better decisions when they drew on the widest possible range of information, including information provided by interested stakeholders. Rulemaking requires the agency to engage with the public and learn more about the issue. By circumventing the rulemaking process, the 2016 regulations would have deprived the Department of that give-and-take. It would have led to less nuanced analysis and, in all likelihood, worse decisions.

Proponents of the 2016 approach have argued that rulemaking is too slow and complex. They point to the gap between the Department's 1975 update and the 2004 regulations, during which the salary levels remained unchanged for nearly 30 years. But this argument ignores the fact that sometimes, slow change is a virtue. Congress designed the rulemaking process to make agencies accountable to the public. When rulemaking becomes difficult, or even impossible, it is sometimes because the public disagrees with the rule. Besides, Congress long ago judged that exchanging speed for accountability and legitimacy was a worthwhile trade. The Department's latest proposal respects that judgment.

III. Criticisms of the Department's Proposal

None of this is to say the Department's current proposal is perfect. It made several mistakes, not least of which was its application of the 2004 methodology.

Again, the 2004 methodology begins by looking at salary data from the lowest-wage Census region in the country. In 2004 and today, that region is the South. The South, however, is hardly uniform. It comprises three divisions: the South Atlantic, the East South Central, and the West South Central. The East and West South Central include largely lower-wage jurisdictions. The South Atlantic, by contrast, includes three of the highest-wage jurisdictions in the county: Maryland, Virginia, and Washington, D.C.

The Department recognized that discrepancy in 2004 and so excluded South Atlantic from its calculations. The Department's current proposal, however, includes all three divisions. The choice to include the South Atlantic skewed the Department's final numbers and resulted in a salary level higher than a strict application of the the 2004 approach would have suggested. This higher level will fall most heavily on small employers in lower-wage jurisdictions—the same employers the Department should be trying hardest to protect.

For much the same reason, the Department's proposal to raise the highly compensated salary level skewed far too high. The Department set the new level at the 90th percentile of nationwide salaries, excluding employees earning below the current minimum salary level ($455 per week). This approach differed from prior efforts—and indeed, from the Department's current approach to the standard salary levels—which had always looked to regional data instead. Unsurprisingly, the new approach inflated the salary level to $147,414. That level represents a nearly 50% increase over the current level—the largest single increase, dollar for dollar, the Department has ever proposed.

The Department offered no reason for such a dramatic change. Salaries have not risen 50% since 2004, and few suggest that the highly compensated exemption captured many otherwise nonexempt employees. Worse, the proposed level is so high that only large employers in major urban centers will be able to use it. It will become a benefit only for the financially powerful, a result the Department could not have intended.

IV. Conclusion

These criticisms aside, the Department's proposal is, on balance, a reasonable and measured approach to addressing real issues. Few can dispute that after 15 years, the 2004 salary levels are due for an update. The Department approached that update in a practical way. It looked to history, precedent, and the law, and chose the safest and most effective method of updating and modernizing the salary levels. That effort deserves our support and should be implemented.

This concludes my statement. I would be pleased to answer any questions.