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## *Department of Labor Proposes New Salary Thresholds for Overtime Exemptions and Seeks Comments on Duties Tests*

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### **I. INTRODUCTION**

On June 30, 2015, the U.S. Department of Labor issued a proposed rule to modify the minimum salary level required for the executive, administrative, and professional exemptions, and the minimum total annual compensation required for the highly compensated employee exemption, under the Fair Labor Standards Act ("FLSA"). The proposed rule, according to the DOL's accompanying FAQs, will "simplify the identification of overtime-eligible employees, thus making the white-collar exemptions easier for employers and workers to understand." See FAQ No. 13, at <http://www.dol.gov/whd/overtime/NPRM2015/faq.htm>. The DOL's action arises from President Obama's proclamation on March 13, 2014, in a one-page memorandum to Secretary of Labor Thomas Perez, that the FLSA regulations creating the white collar exemptions from overtime and minimum wage laws are "outdated."

The DOL is encouraging public comment within a 60-day period after publication of the proposed regulations in the Federal Register, which is expected in the next few days. Employers, trade groups, unions and other interested parties may submit comments individually or in a concerted manner.<sup>1</sup> After the public comment period, the DOL will draft a final regulation for review by the Office of Management and Budget's Office of Information and Regulatory Affairs ("OIRA"). The OIRA may take up to 90 days to review the draft regulations, with the possibility of a single, 30-day extension. Once the OIRA conducts a final review and approves the text of the regulations, they will be published in the Federal Register and take effect, unless blocked by Congress.

Although the specific proposed rule addresses only salary thresholds, the DOL also seeks comments on the existing duties requirements. If the final regulations include changes to the duties requirements without first publishing the proposed rule changes in the Federal Register, those regulations may be subject to a procedural legal challenge under the Administrative Procedures Act.

### **II. KEY SALARY THRESHOLD CHANGES IN THE PROPOSED RULE**

Although the FLSA's "white collar" exemption regulations were significantly updated in 2004, President Obama stated in his March 13, 2014 memorandum to Secretary Perez that the overtime regulations "have not kept up with our modern economy," and that "millions of Americans lack the protections of



overtime and even the right to minimum wage.” The President instructed Secretary Perez that, in the course of proposing changes,

[the Labor Department] 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.

The DOL’s proposed rule represents major changes in two key areas.

### ***Minimum Salary Level for White-Collar Exemptions***

At present, to qualify for the FLSA’s white-collar exemptions, an employee must be paid a guaranteed salary or fee of at least \$455 per week. The DOL proposes that the standard minimum salary level be increased to an amount set at the 40th percentile of weekly earnings for full-time salaried workers. The DOL also proposes a mechanism for automatically and annually updating the salary level going forward “to ensure that they remain meaningful tests for distinguishing between bona fide executive, administrative, and professional workers who are not entitled to overtime and overtime-protected white collar workers.” See FAQ No. 5. The DOL projects that there initially will be 4.6 million currently exempt workers who would become entitled to minimum wage and overtime protection with this change.

The DOL plans to rely on data from the Current Population Survey (CPS), a monthly survey of 60,000 households conducted by the U.S. Census Bureau, to set and annually update the 40th percentile of weekly earnings for full-time salaried workers. If the final rule adopts this approach, the DOL expects to rely on CPS data from the first quarter of 2016. The latest data currently available are for the first quarter of 2015, in which the 40th percentile of weekly earnings is \$951, which translates into \$49,452 annually for a full-time worker. **The DOL projects that the 40th percentile weekly wage in the final rule would likely be \$970, or \$50,440 annually for a full-time worker.** Yet to be decided is whether an employer can include nondiscretionary bonuses to satisfy a portion of the standard salary requirement. The DOL is seeking comment on this issue.

The proposed rule considers two mechanisms to annually update the salary level. The DOL invites comments on which methodology would best maintain the effectiveness of the salary basis test. The first method would maintain the standard salary level at the 40th percentile of weekly wages of all full-time salaried workers. The second method would update the salary level based on changes in the Consumer Price Index for urban consumers released by the Bureau of Labor Statistics, an index commonly used to measure inflation.

### ***Minimum Annual Compensation Level for Highly Compensated Employees***

The highly compensated employee (“HCE”) exemption was introduced in the DOL’s 2004 amendments to the exemption regulations. Under the current HCE exemption, employees who earn total annual compensation – which may include salary, commissions and nondiscretionary bonuses – of at least \$100,000, and whose base salary is at least the minimum for other exempt employees, are exempt if they customarily and regularly perform at least one of the duties or responsibilities enumerated in the “white collar” exemptions tests. The minimum annual compensation level for the HCE exemption has remained at \$100,000 since 2004. The DOL found that since the HCE exemption was introduced in 2004, the percentage of employees who earn at least \$100,000 in total annual compensation has increased to 17%.



The DOL proposes that the new annual compensation level for highly compensated employees be increased to the 90th percentile of annual wages of all full-time salaried workers. **The DOL projects that the 90th percentile annual compensation level in the final rule will be \$122,148.** According to the DOL, an estimated 36,000 currently exempt workers who earn at least \$100,000 but less than the 90th percentile of earnings of full-time salaried workers, and who otherwise meet the highly compensated employee duties test, may become eligible for minimum wage and overtime protection with this change.

In order to prevent the salary level from becoming outdated, the DOL has proposed the same two mechanisms for annually updating the salary level as described above.

### **III. THE DUTIES REQUIREMENTS FOR EXEMPTION WOULD REMAIN UNCHANGED – MAYBE**

To qualify for exempt status, employees must meet certain requirements as to their job duties. It is incumbent on employers to establish that the employee's "primary duty" is the performance of exempt work in order for an exemption to apply.

Prior to 2004, the FLSA's regulations contained two different duties tests for executive, administrative, and professional employees depending on the employee's salary level – a "long test" for employees paid a lower salary, and a "short test" for employees paid at a higher salary level. The long duties test included a 20 percent limit on the time spent on nonexempt tasks (40 percent for employees in the retail or service industries). In the 2004 Final Rule, the DOL replaced the differing short and long duties tests with a single standard test for executive, administrative, and professional employees that did not place a limit on the amount of nonexempt work that the employee could perform.

In the proposed regulations, the DOL states that it is "concerned that employees in lower-level management positions may be classified as exempt and thus ineligible for overtime pay even though they are spending a significant amount of their work time performing nonexempt work." The DOL notes "that the removal of the more protective long duties test in 2004 has exacerbated these concerns and led to [] inappropriate classification[s]."

The DOL also questions the appropriateness of maintaining the "concurrent duties doctrine," which recognizes that exempt executives often perform exempt duties concurrently with nonexempt duties. The DOL views this doctrine as "difficult to apply" and believes it leads to inconsistent results. The DOL specifically notes that "California has addressed this issue by requiring that exempt [executive, administrative and professional] employees spend at least 50 percent of their time performing their primary duty, and not counting time during which nonexempt work is performed concurrently."

In light of its concerns, the DOL is considering revisions to the duties tests. While the DOL does not propose specific regulatory changes to the duties tests in the proposed rule just issued, the DOL is seeking additional information on the duties tests. Specifically, the DOL seeks comments on the following issues, among others:

- 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 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?
- Does the single standard duties test for each exemption category appropriately distinguish between exempt and nonexempt employees?
- 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?

Once it receives the requested information and comments, the DOL will need to determine what, if any, additional action to take. If the DOL concludes that the significant increase in the salary level that the agency is proposing, along with the proposed automatic increases in salary each year, is sufficient to alleviate the DOL’s concerns regarding low-level managers performing a disproportionate amount of non-exempt work, there likely would be no change to the duties tests. In that event, the DOL would issue a Final Rule resetting the salary and compensation levels after the comment period closes.

On the other hand, if the DOL concludes the duties tests should be modified, the agency might take one of three courses of action. First, the DOL might issue a Final Rule changing the salary and compensation levels and also release a new Notice of Proposed Rulemaking, announcing proposed changes to the FLSA’s duties tests, which would be subject to a separate review and comment period.

Alternatively, the DOL might withdraw the current proposed rule and issue a new proposed rule. This new proposed rule would include both the changes to the salary and compensation levels, and changes the duties tests, which would start the notice and comment clock again. We view this second alternative as unlikely because the DOL will want the change in salary and compensation levels to take effect as promptly as possible and in any event before the President leaves office.

Finally, the DOL might issue a Final Rule that includes changes to the duties tests *without* first publishing the proposed rule changes in the Federal Register. The DOL specifically stated in the preamble to the proposed rule that “the Department is seeking additional information on the duties tests *for consideration in the Final Rule.*” (Emphasis added.) Depending upon the nature of those changes, this latter option could be subject to challenge under the Administrative Procedures Act, because no changes to the duties tests have been included in the proposed rule that is under consideration.

#### **IV. PROPOSED CHANGES TO RULES REGARDING COMPENSABLE TIME FOR EMPLOYEES WHO CARRY ELECTRONIC DEVICES**

In its FAQs (FAQ #18), the DOL also reveals that it plans to issue a Request for Information in August seeking comments from stakeholders on the use of electronic devices by overtime-protected employees outside of scheduled work hours. The request arises because the increase in the salary minimum will cause many workers who are currently covered by a white collar exemption to become newly entitled to overtime as a result of the planned rulemaking. This is a significant issue, because, presumably, many employers will allow those who are currently exempt to continue to use electronic devices outside of scheduled work hours in the future as they have in the past. Furthermore, the standards that the DOL adopts for the compensability of such time could have implications for the



interpretation of the standards currently found in Part 785 of the Code of Federal Regulations regarding the meaning of “hours worked.”

## **V. STEPS EMPLOYERS SHOULD TAKE**

- Identify the salary levels of employees in your workforce currently classified as exempt under the executive, administrative, or professional exemptions to determine whether they meet the DOL’s proposed \$50,440 annual minimum threshold. Be mindful of job-sharing or other part-time exempt arrangements in which a currently exempt employee may be earning less than \$50,440, because the proposed rule does not contemplate proration.
- Determine whether to adjust the salaries of or reclassify as non-exempt employees who fall below the proposed minimum salary threshold.
- If employees are reclassified from exempt to non-exempt, determine an appropriate hourly rate. Employers are not required to establish an hourly rate by simply dividing an employee’s weekly salary by 40 hours and paying for all additional hours at the overtime rate. Such an approach could dramatically increase compensation costs. Instead, an employer could estimate the number of overtime hours an employee is expected to work and calculate an hourly rate that will match the employee’s current compensation level. Assuming the estimate of overtime hours is accurate, this would not impact compensation costs. It may, however, impact employee morale if employees are expecting the new regulations to afford them a raise and find instead that the regulations only result in trading the certainty of a salary for the uncertainties and other inconveniences of variable hourly compensation. In certain states, employers also have the option to pay employees using the fluctuating workweek method, which can considerably reduce the amount of overtime pay an employee receives.
- Develop an action plan to be ready to implement any changes when the final regulations take effect, including appropriate communications to reclassified employees about timekeeping and meal and rest break requirements.
- Consider aligning with chambers of commerce, organizational associations and trade groups, and legal counsel to submit any comments, concerns, and criticisms to the DOL during the 60-day public comment period.

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<sup>1</sup> The DOL provides information, including an instructional video, about how to submit a public comment here: <http://www.dol.gov/regulations/participate.htm>.

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