Department of Labor Proposes Changes to FLSA White Collar Exemption Rules

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Employment

On July 6, the Department of Labor ("DOL") published in the *Federal Register* a long-awaited notice of proposed rulemaking updating the Fair Labor Standards Act's ("FLSA") overtime exemptions. The proposed rules would significantly increase the minimum salary threshold required to qualify for the FLSA's so-called "white collar" exemptions for executive, administrative, and professional employees. The proposed rules do not contain any changes to the "duties" test, which determines whether salaried workers earning more than the threshold are exempt from the overtime requirements of the FLSA, but DOL has requested and will consider comments on these tests. If adopted, the revised rules would, according to DOL projections, bring nearly 4.7 million currently exempt employees within the scope of overtime protection.

Background

In April 2015, President Obama directed Secretary of Labor Thomas Perez and DOL to reform the current white collar exemptions to increase the number of persons entitled to overtime under the FLSA, which sets minimum wages and requires the payment of overtime to employees who work more than 40 hours in a workweek unless the position held by the employee satisfies an exemption. In order to qualify for a white collar exemption, an employee must be paid a minimum salary (the "salary level" requirement) and principally perform certain specified executive, administrative, or professional duties (the "duties" test). The Act specifically empowers the Secretary of Labor to define the scope of the white collar exemptions, which means that the Secretary's regulations on this issue have the force and effect of statutory law. The most recent revision of the white collar exemption regulations went into effect in 2004.

Major Changes — Increased Minimum Salaries for Exempt Employees

DOL's proposed regulations address concerns that, if left unchanged, the salary level requirement's effectiveness "as a means of determining exempt status diminishes as the wages of employees entitled to overtime increase and the real value of the salary threshold falls." Thus, the agency is proposing the following reform measures:

- Standard Salary Level Update: The current salary threshold, set in 2004, is $455 per week ($23,660 per year). DOL proposes increasing the standard salary level requirement to an amount equal to the 40th percentile of earnings for full-time salaried workers, which is projected to be $970 per week or $50,440 per year in 2016, more than double the current threshold. This revision is motivated, in part, by the agency's view that the 2004 threshold failed to adequately account for a relaxing of the "duties" test. DOL seeks comments on its proposed salary level and on any alternative salary level amounts or methodologies.

- Inclusion of Incentive Payments: DOL is considering, and seeks comment on, allowing nondiscretionary bonuses, incentive payments, and commissions to partially satisfy the standard weekly salary level requirement. The DOL is not considering including in the salary requirement discretionary bonuses, board or lodging, medical or life insurance payments, retirement plan contributions, or other fringe benefits.
- Highly Compensated Employees Update: DOL maintains a special exemption—involving a less rigorous duties test—for highly compensated employees ("HCE"). DOL proposes increasing the salary level requirement for this exemption from the current threshold salary of $100,000 per year to an amount equal to the 90th percentile of earnings for full-time salaried workers. In 2013, this figure corresponded to a $122,148 annual salary.
- Automatic Updates: DOL proposes incorporating automatic annual updates to the salary level test to ensure that salary levels change consistently and gradually (rather than requiring new regulations be issued in order to update the salary requirement). DOL seeks comments on two update methods under consideration: (1) a "fixed percentile" approach tied to the 40th percentile of earnings for full-time salaried workers (and tied to the 90th percentile of such earnings for HCE compensation), or (2) an alternative approach based on changes to the Consumer Price Index.

No Proposed Change to Duties Test, but Comments Requested

In declining to propose changes to the existing duties test, DOL stated that "[a] regularly updated salary level will assist in screening out employees who spend significant amounts of time on nonexempt duties and for whom exempt work is not their primary duty." Nonetheless, DOL seeks comments on potential changes to the duties test; on requiring exempt employees to engage in exempt duties for a minimum amount of time; and on additional examples of nonexempt and exempt occupations that could prove useful as guidance for employers.

Reactions and Next Steps

The Obama administration welcomed DOL's changes, hailing them as measures designed to ensure that employees receive fair pay and that employers are not undercut by low-wage competitors. However, critics warn that an increased overtime threshold would result in increased business costs and a rise in the use of part-time, entry-level workers. The critics further caution that many reclassified employees might lose benefits, flexibility, status and opportunities for advancement.

Employers can take part in shaping DOL's proposed reform by providing comments on the proposed rules; the comment period is open until September 4. In addition, because DOL is acting through agency rulemaking, its proposed changes may be blocked by legislative action such as an amendment to the FLSA or by a withholding of appropriations funding. In the meantime, however, employers should review their current employee classifications and consider increasing the salaries of exempt workers who earn under $50,400 per year, or reclassifying such employees to nonexempt—though any reclassifications should be undertaken with caution. DOL plans to rely on 2016 first quarter data to implement changes; the finalized rules are expected to take effect in 2016.

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