

# The Legal Intelligencer

THE OLDEST LAW JOURNAL IN THE UNITED STATES 1843-2015

JULY 6, 2015

An **ALM** Publication

## W A G E A N D H O U R

### New Salary Thresholds Proposed for Workers Subject to 'White-Collar' Exemptions

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On June 30, the U.S. Department of Labor released its long-awaited Notice of Proposed Rulemaking (NPRM), which contains a new minimum salary threshold for workers to qualify for “white-collar” exemptions to the Fair Labor Standards Act (FLSA) overtime requirements. Most significantly, the DOL’s proposed new minimum salary threshold for the “executive,” “administrative” and “professional” exemptions from overtime pay, which are pegged to the earnings percentiles for full-time salaried workers, would more than double the current salary basis of \$23,660 per year (\$455 per week). The DOL also proposed raising the salary floor for the “highly compensated employee” (HCE) exemption.

The proposed changes, should they be contained in the DOL’s Final Rule, will have a wide-ranging impact on workers and businesses. Consequently, employers should begin preparing today for the likelihood that a significant number of additional employees will be overtime-eligible under the FLSA. In fact, DOL Secretary Thomas E. Perez has stated that “on an annual basis, workers will get roughly \$1.2 to \$1.3 billion in additional wages as a result of this rule.”

#### Background

Since 1940, DOL regulations have generally required each of three tests to be met for one of the FLSA’s white-collar exemptions to apply: (1) the employee must be paid a predetermined and fixed salary that is not subject to reduction because of variations in the quality or quantity of work performed; (2) the employee’s job



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duties must primarily involve executive, administrative, or professional duties as defined by the regulations; and (3) the amount of salary paid must meet a minimum specified amount, which is currently \$23,660 per year. The current minimum weekly salary amount is not inflation-adjusted, and therefore has eroded in terms of real dollar value over time (notwithstanding a modest increase in 2004 under the Bush administration—the first since 1975).

Additionally, HCEs are exempt from overtime pay requirements if their total annual compensation amounts to at least \$100,000 (which must include at least \$455 per week paid on a salary or fee basis) and they customarily and regularly

perform at least one of the exempt duties or responsibilities of an executive, administrative, or professional employee identified in the standard tests for exemption.

The DOL’s 2004 Final Rule discarded the old “long test” for employees paid a lower salary, and “short test” for employees paid a higher salary, and replaced the short-test/long-test structure with a single “standard” duties test. The “standard” duties test does not strictly limit the amount of nonexempt work that may be performed by exempt employees (as did the old long duties test), but does require that exempt employees primarily perform work of an exempt character in order to satisfy the exemption criteria (e.g., overtime-exempt “executive” employees must primarily perform management duties, customarily and regularly direct the work of two or more workers, and possess the authority to hire or fire employees or make recommendations on hiring and firing).

The DOL’s NPRM follows a March 13, 2014, presidential memorandum from President Obama directing the secretary of Labor to propose revisions to the FLSA’s overtime regulations—specifically, the minimum salary requirements for the “executive,” “administrative” or “professional” exemptions from overtime pay obligations.

#### Key Provisions of the Proposed Rule

The DOL’s NPRM focuses primarily on updating the salary and compensation levels required for the white-collar exemptions, based on 2013 data regarding weekly earnings for full-time salaried workers. Specifically, the DOL proposes to:

- Set the standard salary level at the 40th percentile of weekly earnings for full-time

salaried workers, which in 2013 was \$921 per week (\$47,892 annually), and which is projected in 2016 to be \$970 per week (\$50,440 annually).

- Increase the total annual compensation requirement needed to exempt HCEs to the annualized value of the 90th percentile of weekly earnings of full-time salaried workers, which in 2013 was \$2,349 per week (\$122,148 annually).

- Establish a mechanism for automatically updating the salary and compensation levels going forward “to ensure that they will continue to provide a useful and effective test for exemption.”

The DOL concluded that, because the current salary level only screens from exemption approximately 15 percent of overtime-eligible white-collar salaried employees, it is not an effective test for exemption and has failed its intended purpose of simplifying application of the exemption by reducing the number of employees for whom employers must perform a duties analysis. Accordingly, the DOL opined that its proposal to set the standard salary level at the 40th percentile of weekly earnings for full-time salaried workers would “minimize the risk that employees legally entitled to overtime will be subject to misclassification based solely on the salaries they receive, without excluding from exemption an unacceptably high number of employees who meet the duties test.”

The DOL further stated that its proposal to automatically update the standard salary and HCE total annual compensation requirements would 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. The two different methodologies proposed by the DOL would either keep the standard salary and HCE total annual compensation levels pegged to the 40th and 90th percentiles of earnings for full-time salaried workers, respectively, or adjust the standard salary and HCE compensation thresholds based on changes in inflation, as measured by the Consumer Price Index for All Urban Consumers (CPI-U).

## More Coming?

While the DOL did not propose specific regulatory changes on either issue, it did solicit comments on the current standard duties

test as well as the possibility of including nondiscretionary bonuses (including, for example, production or performance bonuses, or other nondiscretionary incentive bonuses tied to productivity and profitability) to satisfy a portion of the salary requirement.

With regard to the current standard duties test, the DOL specifically is seeking comments on whether employees should “be required to spend a minimum amount of time performing work that is their primary duty in order to qualify for exemption” and whether the DOL should “look to the state of California’s law” that requires that 50 percent of an employee’s time be spent exclusively on work that is the employee’s primary duty as a “model” for potential revisions to the regulations. It is unclear whether the DOL intends to issue a new NPRM with regard to these proposed changes or whether it believes its invitation for comment is sufficient to support the issuance of a Final Rule. The latter view, however, would surely invite litigation under the Administrative Procedures Act.

The DOL also recently announced that it will publish a request for information “in the near future” seeking information from stakeholders on the use of electronic devices by overtime-protected (nonexempt) employees outside of scheduled work hours.

## Potential Impact

In the first year, the DOL estimates that 4.6 million workers who are exempt under the current regulations, and who earn at least the current weekly salary level of \$455 but less than the proposed salary level of \$921 would, without some intervening action by their employers, become entitled to overtime protections under the FLSA. Similarly, an estimated 36,000 exempt workers who earn at least \$100,000, but less than \$122,148, and who meet the minimal HCE duties test, but not the standard duties test, may also become eligible for minimum wage and overtime.

The DOL estimates that within 10 years following the proposed increase (and annual increases) in the salary basis, somewhere between 5.1 million and 5.6 million additional workers would be overtime-eligible (again absent intervening action by employers). Perez acknowledged, however, that “employers have a range of options in terms of how to comply.” Contrary to its intended purpose of “giving America a raise,”

for example, employers might simply adjust base pay rates downward such that overall rates of pay and hours worked will remain unchanged, or reduce available hours and spread work around to other employees to avoid paying high hourly rates for overtime work. The latter scenario would be consistent with the goals of the Great Depression-era FLSA, i.e., use the overtime wage premium to encourage employers to hire additional workers and alleviate overall unemployment.

## Preparation

Businesses and individuals impacted by the NPRM have 60 days to provide comment following the publication of the NPRM in the Federal Register, and it likely will be many months before a Final Rule is issued by the DOL. While it is unclear exactly what number the DOL will propose in its Final Rule after it receives comments on the NPRM, it is clear that the salary basis to qualify for the FLSA’s white-collar exemptions will increase substantially (unless the proposal is completely blocked, which is unlikely). Any Final Rule will, in all likelihood, set the salary basis at a level at least double its current level.

Employers should consider proactively assessing their current wage-and-hour practices to determine the operational and financial impact of a significant increase in the salary basis along the lines proposed by the DOL. Employers have multiple options to mitigate against the potential for increased labor costs attendant with a rise in the salary basis, including considering changes to staffing or salary levels, more closely monitoring hours worked, or hiring additional workers such that there is sufficient coverage to avoid overtime costs. Many possible strategies available to employers (and financial forecasting/budgeting to address increased overtime expenses) take time to conceive and implement. Once a Final Rule is issued, organizations may have little time to adjust their practices, and accordingly would be well advised to begin the process of considering the impact of the anticipated final regulations on their businesses now.