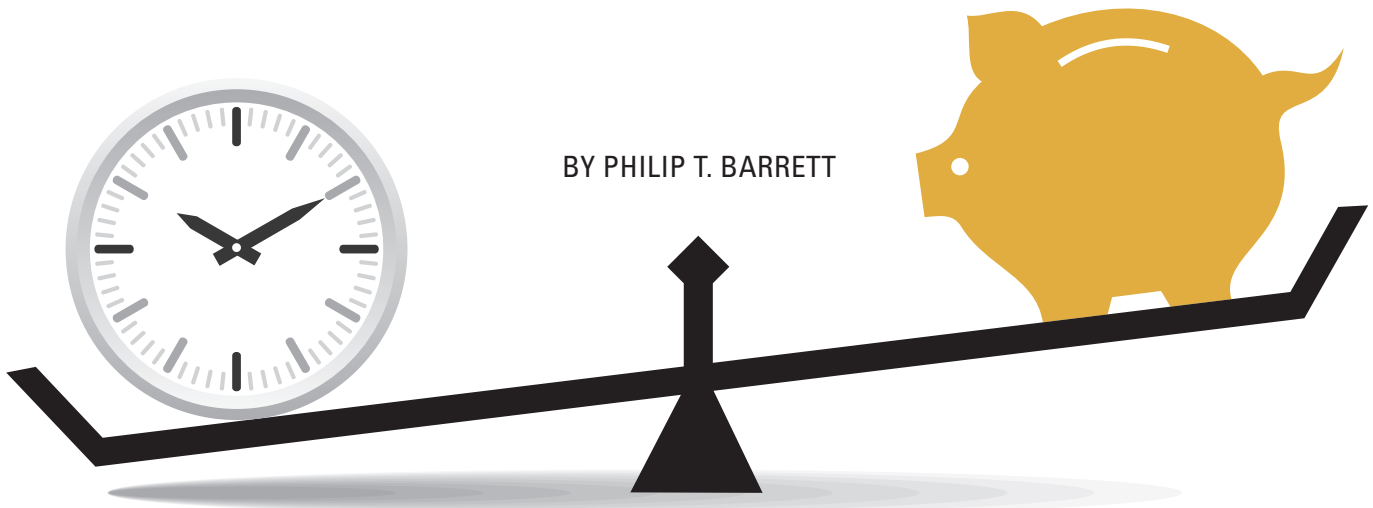


A new federal wage regulation proposed by the Department of Labor raises salary thresholds in a way that significantly expands the number of employees who must be paid time and a half for overtime. Here's an employer's-eye look at the proposed rule.

# FLSA Rule Proposal Could Make Millions Eligible for Overtime

BY PHILIP T. BARRETT

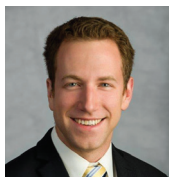


**WHILE CITIES ACROSS THE COUNTRY HAVE VOTED TO RAISE THE LOCAL MINIMUM WAGE**, federal wage requirements remain unchanged. But the Obama administration is now taking a different approach to adjusting wage requirements.

The Department of Labor ("DOL") has issued proposed regulations for the Fair Labor Standards Act ("FLSA") that would replace current managerial-level-employee exemptions for overtime compensation. These regulations have not been changed since 2004, when the DOL under President George W. Bush raised the salary requirement. While the final rule will likely be issued in 2016, the exact date is unknown. (See the sidebar for more on the federal rulemaking process.)

## Raising the threshold for white collar exemption

Section 207 of the FLSA requires employers to pay time and a half to employees who work



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more than 40 hours a week.<sup>1</sup> But the FLSA exempts specified “bona fide executive, administrative, or professional” (“white collar”) employees from the overtime and minimum wage requirements.<sup>2</sup> Under the current FLSA regulations governing these employees, the minimum salary to qualify for the exception is \$455 per week, or \$23,660 per year.<sup>3</sup> Administrative and professional exempt employees may also be paid on per-job basis if it meets the same level as the salary requirement.<sup>4</sup> In general, white collar employees must also primarily perform certain exempt duties, as will be explained below.

**More than doubling the qualifying amount.** On July 6, 2015, the DOL published proposed regulations to raise the minimum salary requirement for white collar exemptions by more than double the current level.<sup>5</sup> According to the DOL, the current minimum salary threshold is below the poverty level for a family of four.

Under the proposed rules, white collar employees would have to be paid at least \$921 per week, or \$47,892 per year, to qualify for the exemption. The DOL, however, added a wrinkle in the proposed rules, basing its minimum salary requirement not on a specific dollar amount but on being in the 40th percentile of earnings for full-time salaried employees according to Bureau of Labor Statistics (“BLS”) data. This data set defines “full-time” as at least 35 hours of work per week.

Based on the assumption of salary growth by the time the final rules are published, the DOL estimates that the minimum salary requirement will equal \$970 per week, or \$50,440 per year. The proposed rule will also increase the minimum salary requirement every year.

**Highly compensated employees.** The DOL has also sought to increase the level at which workers qualify for the “highly-compensated employee” exemption from minimum wage and overtime requirements. The threshold earning amount is now \$100,000 per annum. The proposed rules increase the minimum salary requirement to the 90th percentile of full-time salaried employees to qualify as “highly-compensated employees.”<sup>6</sup> The 90th percentile is currently at \$122,148 annually.

**Two possible salary measurements.** Other than the minimum salary requirement and the annual increase, the DOL has settled on little in its proposed rule. For instance, although it has proposed to increase the minimum salary level annually, the DOL leaves open the option to measure the minimum in either of two ways: (1) the 40th percentile of full-time salaried employees according to BLS data, or (2) the consumer price index (“CPI-U”) calculation, which measures inflation by the average change in the price paid for a set basket of consumer goods and services.<sup>7</sup>

Thus, the minimum would raise (presumably) every year to either the 40th percentile of full-time salaried employees or be multiplied by the rate of inflation according to the CPI-U calculation.

## Impact on employers

So what does the proposed rule mean for employers? Here’s a look at the proposal’s potential impact.

**Adjustment costs.** The DOL estimates that 4.2 million professional and business service employees will be affected, which is the largest single group. Moreover, the DOL estimates that direct costs to all employers, including regulatory familiarizations costs, adjustment costs, and managerial costs will total \$592.7 million in the first year.

**Shift from exempt to non-exempt.** According to the DOL’s own formula, approximately 21.4 million currently exempt employees could be affected.<sup>8</sup> In the first year (2016), the DOL estimates that 4.6 million employees will go from exempt to non-exempt under the executive, administrative, and professional provisions. By the tenth year, an additional 5 to 5.6 million employees may have changed from exempt to non-exempt status.

Additionally, the number of non-exempt highly compensated employees will increase by 36,000 employees and by another 42,000

## TAKEAWAYS >>

- If an employee works longer than forty hours in a workweek, the Fair Labor Standards Act (FLSA) requires an employer to compensate the employee at a rate of one and one-half times the regular rate. However, the FLSA exempts employees in a “bona fide executive, administrative, or professional” capacity from its overtime compensation and minimum wage requirements.

- In order to qualify as exempt, an executive, administrative, or professional employee must earn above a compensation threshold. The U.S Department of Labor has recently proposed to increase this compensation threshold from \$23,360 per year to roughly \$47,892 per year. The rule actually proposes to tie the threshold to the fortieth percentile of earnings for full-time salaried employees in the U.S., and adjust annually.

- Although the final rule has not yet been issued and its impact is not clear, it is obvious that employers could see increased costs. Employers may need to reassess their employee’s duties and compensation structure. The proposed rule will have a significant impact on the employment landscape, and careful employer monitoring and compliance will be crucial in managing the costs that flow from these regulations.

1. 29 U.S.C. § 207(a)(1).

2. *Id.* at § 213(a)(1). The regulations also updated the salary level requirements for outside salespersons and employees in the motion picture industry, but the focus of this article will concern the executive, administrative, and professional employees.

3. 29 C.F.R. § 541.100 (2015).

4. *Id.* at §§ 541.200(a)(1), 541.300(a)(1), 541.605.

5. 80 Fed. Reg. 38,517 (July 6, 2015).

6. *Id.* at 38,537.

7. *Id.* at 38,540.

8. *Id.* at 38,518.

IN SOME CASES, IT WILL MAKE SENSE TO RAISE SALARIES TO KEEP EMPLOYEES EXEMPT AFTER THE CHANGE TAKES EFFECT.

employees in year 10. For perspective, the DOL estimates that at the proposed salary level, 50 percent fewer employees would be paid at or above the minimum salary requirement to qualify for the exemption.

**'Duty requirement' for exemption unchanged.** Although the DOL raised the minimum salary level, it is not proposing to change the duty requirements for exempt employees. Under current regulations, to qualify for the executive exception, the employee must meet three

requirements: (1) the primary duty must be management; (2) the employee must customarily and regularly direct the work of two or more employees; and (3) the employee's recommendations about hiring, firing, etc., of these workers must be given "particular weight."<sup>9</sup>

For administrative employees, the primary duty must (1) be performing office or non-manual work directly related to the management or general business operations of the employer or its customers and (2) include the exercise of discretion and independent judgment on significant matters.<sup>10</sup> In general, an exempt professional employee must primarily do work (1) requiring advanced knowledge in a field of science or of other high-level learning or (2) in a recognized field of artistic endeavor.<sup>11</sup>

To qualify for the highly compensated employee exemption, an employee must customarily and regularly perform one or more exempt duties of an executive, administrative, or professional nature.<sup>12</sup>

Again, the proposed rule makes no changes in the duty requirements. Employers should note, however, that

the proposed rule left open for comment whether the duty requirements should be changed for these exempt employees. Changing those requirements would make labor costs considerably less predictable.

For example California already requires that an exempt employee not spend more than 50 percent of his or her time performing non-exempt work. Should this requirement be instituted at the federal level, employers will need to track the amount of time an employee spends performing nonexempt tasks, which could be burdensome.

**Little effect unless employee works overtime.** Importantly, the exceptions primarily affect overtime compensation. They will have little if any effect on an employee who does not work more than 40 hours a week. Under the federal minimum wage, an employee would have to work 63 hours per week to have a minimum wage violation under a previously exempt salary of \$455 per week.<sup>13</sup> The total is 55 hours per week under the Illinois minimum wage of \$8.25 per hour.<sup>14</sup>

Under the FLSA, the higher minimum wage between the federal and state wage controls.<sup>15</sup> Thus, at least in Illinois, an employee would still have to work overtime to create an issue, and it follows that there is no reason for employers to attempt to restructure their arrangement with employees who do not regularly work overtime.

## How employers can adjust to the new rule

### Raising salary above the threshold.

Employers should review how they compensate employees with the new exemption levels in mind. In some cases, it will make sense to raise salaries to keep employees exempt. Some examples

## ISBA RESOURCES >>

- Matthew Hector, *Federal Minimum Wage and Overtime Protection Extended to Home Care Workers*, 102 Ill. B.J. 518 (Nov. 2014), <http://www.isba.org/ibj/2014/11/lawpulse/federalminimumwageandvertimeprotec>.
- Glenn R. Gaffney, *Double Whammy – Employers Engaged in Systematic Wage Theft Best Beware*, Labor & Employment (March 2011), <http://www.isba.org/sections/laboremploymentlaw/newsletter/2011/03/doublewhammyemployersengagedinsystematicwag>.
- Richard A. Russo, *A Snowy Day and Exempt Employees' Pay*, Labor & Employment (March 2011), <http://www.isba.org/sections/laboremploymentlaw/newsletter/2011/03/asnowydayandexemptemployeespay>.
- Jon D. McLaughlin, *Disciplining Attorneys and Other FLSA-Exempt Employees for Attendance Problems*, 95 Ill. B.J. 600 (Nov. 2007), <http://www.isba.org/ibj/2007/11/discipliningattorneysandotherflsaex>.
- Bruce C. Beal, *Fair Labor Standards Act: Is Your Supervisor Really Exempt?*, Labor & Employment (Dec. 2000), <http://www.isba.org/sections/laboremploymentlaw/newsletter/2000/12/fairlaborstandardsactisyoursupervis>.

9. 29 C.F.R. § 541.100.

10. *Id.* at § 541.200.

11. *Id.* at § 541.300.

12. *Id.* at § 541.601(a).

13. *Id.* at § 206(a)(1)(C); 80 Fed. Reg. 38,568 (July 6, 2015).

14. 820 ILCS 105/4(a)(1).

15. 29 U.S.C. § 206(b); 29 C.F.R. § 531.26.

illustrate this point.

Recall that the minimum exemption requirement under the proposed rule is \$921 per week (and could be \$970 or more by the time the final rule is published). If an employee, such as an assistant manager who formerly fell under the exception, worked a 50-hour workweek at a salary basis of \$770 per week, he would be earn \$1,155 (one and one-half times \$770). Obviously, if this employee regularly works more than 40 hours a week, it is best to raise his salary to at least \$50,440, both to save money and make labor costs more predictable.

Assume, however, another employee makes \$425 per week and worked enough overtime to earn \$637.50 per week, or \$33,150 per annum. There is no need to raise her salary to comply with the proposed rule. The same is true for exempt employees under the current rule who only occasionally work more than 40 hours in a week.

**Splitting duties between employees – but beware Title VII.** Instead of raising the salary of one employee, employers may choose to split the duties between multiple employees who do not work overtime. The DOL explicitly noted in the proposed rule that employers have several options in dealing with newly overtime eligible employees, including (1) paying the required overtime premium, (2) reduction of the regular rate of pay so that total weekly earnings and hours do not change after overtime is paid, (3) eliminating overtime hours, (4) increasing the employee's salary to the proposed minimum salary level, and (5) a combination of the previous four.<sup>16</sup>

Thus, if a manager is working 60 hours per week, an employer may instead choose to hire another manager to split the duties between the two at 30 hours per week each. The FLSA does not prohibit such an arrangement, but employers need to be aware of possible Title VII implications.

The concern: reducing an employee's hours could constitute an "adverse employment action" for the purposes of


a Title VII claim.<sup>17</sup> Denying a raise could have the same effect.<sup>18</sup> The employee, however, would still need some other basis for the claim, such as race, age, or gender discrimination. Also, some courts have held a mere reduction in hours is not a *per se* adverse employment action, and thus the employee would have to show more for a Title VII claim.<sup>19</sup>

Interestingly, the DOL did not adopt but is considering a rule that would include non-discretionary bonuses in salary calculations. It would not, however, allow employers to make a "catch-up" payment at the end of the year – such payments would have to be made monthly or more frequently. The bonuses might also be capped at 10 percent of the standard weekly income, and fringe benefits and discretionary bonuses will not be considered.

### Be ready to comply

Although the full impact of the final rules is not clear, there will be implementation costs for employers. Non-compliance could lead to litigation and other costs. Additionally, if the DOL

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changes course and implements new duty regulations, employers will have to engage in more thorough analysis to comply. 

16. 80 Fed. Reg. 38,562-63 (July 6, 2015).

17. See, e.g., *Hill v. Potter*, 625 F.3d 998, 1001 (7th Cir. 2010).

18. See, e.g., *Fabiyi v. McDonald's Corp.*, No. 11-CV-8085, 2014 U.S. Dist. LEXIS 32876, at \*34 (Mar. 13, 2014).

19. *Id.* at \*36-37.

## How a proposed rule becomes legally enforceable

A federal agency's authority to enact regulations is predicated on an Act of Congress being passed. In the typical situation, Congress passes a statute and directs an agency to promulgate and implement regulations to clarify, carry out, and enforce the statute. The FLSA grants the DOL rulemaking authority on its executive, professional, and administrative exemptions pursuant to the Administrative Procedure Act ("APA").

From a procedural standpoint, the proposed rule on overtime compensation came about in an unusual way. Instead of proposing a rule after Congress amended or passed a statute, President Obama issued a presidential memorandum on March 13, 2014, which directed the DOL to update the white collar employee exemptions. 79 Fed. Reg. 18,737 (April 3, 2014).

Once rulemaking authority is granted, a regulation generally becomes enforceable after an agency issues a proposed rule, the public is given an opportunity to comment, and a final rule is ultimately issued. The public comment period for the DOL's proposed rule on overtime compensation ended on September 4, 2015.

In general, there is no specified period after the public comment window has closed in which a final rule must be published. Still, under the APA, final rules are to be published at least 30 days prior to their effective date. As of press time, it remains unclear when the DOL will issue its final rule for the new overtime compensation regulations.

– Philip Barrett

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