Proposed Changes to Overtime Regulations
August 26, 2015

On July 6, 2015, the U.S. Department of Labor (“DOL”) issued proposed new regulations that will significantly change the law governing certain “white collar” workers who are exempt from minimum wage and overtime pay. All employers need to become familiar with these proposed rules, which may, if they become final, greatly impact wages and overtime pay to workers. In addition, for those that want to have their voices heard, there is still time (until September 4, 2015) for the public to make formal comments to the DOL.

Executive Summary

Under the Fair Labor Standards Act (“FLSA”), which is the federal wage and hour law, some employees may be classified as “exempt” from the Act’s minimum wage and overtime pay requirements. The most well-known and commonly used exemptions are the so-called “white collar” exemptions applicable to executive, administrative, and professional employees. The DOL’s proposed rules will change the current regulations to more than double the current minimum salary level for exempt employees, significantly increase the salary level required for employees to be exempt from overtime as highly compensated employees, and automatically adjust that minimum salary level each year to account for the increase in the cost of living. No exception is made for small businesses.

As a practical matter, the proposed regulations will mean that fewer employees will meet the requirements to be exempt from overtime (and thus will be entitled to overtime pay), or that employers must pay higher salaries in order for many employees to remain exempt under the FLSA. Here are the specific changes proposed to the white collar exemptions, which are expected to become final in 2016:

1. Increase (by more than double) the current minimum salary threshold (currently $455 per week, or $23,660 per year) to $921 per week, or $47,892 per year. This amount will be adjusted annually by the DOL through published notice. Assuming these regulations become final in 2016, the minimum salary is estimated to be $970 per week, or $50,440 per year.

2. Increase the minimum compensation for Highly Compensated Employees (“HCE”) from its current level ($100,000 per year) to $122,148 per year.

3. Create an automatic, yearly adjustment mechanism for the minimum salary thresholds for the standard exemption and that for HCE. (The DOL is asking for public comments to guide its determination to use one or the other of two adjustment mechanisms.)
The DOL states that under the proposed regulations, approximately 4.6 million workers would lose their exemption (and thus be eligible for overtime pay), unless employers increase their pay. In terms of economic impact, these changes are significant. The DOL estimates that the “average annualized direct employer costs will total between $239.6 and $255.3 million per year.” In addition, the DOL also states that this “proposed rulemaking will also transfer income from employers to employees in the form of higher earnings. Average annualized transfers are estimated to be between $1.18 and $1.27 billion, depending on which of the two updating methodologies is used.”

After a period of public comment, the DOL will publish the final rules, which will be codified as final and binding federal regulations. It seems all but certain, barring some sort of exceptional set of circumstances, that the proposed rules increasing the salary levels and adding a mechanism for automatic annual increase will become final.

For those who wish to have their voices heard on these proposed regulations, the DOL is accepting public comments until September 4, 2015. Details for submitting comments are included below.

The FLSA: Background

When it comes to wage and hour compliance, no law is more important than the FLSA, 29 U.S.C. § 201 et seq. The FLSA is the principal federal law governing wage and hour requirements for employers and employees. Enacted in 1938, the FLSA has set forth the core wage and hour requirements for workers and businesses for more than 75 years.

The FLSA is very broad in scope and in coverage. The law governs, among other things, minimum wage, overtime pay, recordkeeping requirements, child labor standards, and equal pay in employment. The Act covers any business (including any non-profit business) that is engaged in interstate commerce and has an annual gross income of $500,000 or more, and it also extends to public agencies, hospitals, health care facilities, and schools. 29 U.S.C. § 203(s).

Overview of the “White Collar” and “Highly Compensated Employees” Exemptions and Proposed Changes

As a general proposition, the FLSA places employees into two categories, exempt and non-exempt. “Exempt” employees are workers who are exempt from the FLSA’s overtime and minimum wage requirements. “Non-exempt” employees, on the other hand, are subject to the minimum wage and overtime requirements, and are therefore entitled to be paid minimum wage, and must be paid overtime when they work more than 40 hours in a week.

The largest category of exempt employees are those employed in the so-called “white collar” professions, which include certain executive, professional, administrative, outside sales, and computer positions. (In addition, the proposed rules require salaried computer workers to be paid at the new, higher salary level. The current rules regarding outside sales employees are not changed.)
The text of the FLSA itself contains almost no discussion of the “white collar” exemptions. The Act simply states that the following employees are exempt from the minimum wage and overtime requirements: “[A]ny employee employed in a bona fide executive, administrative, or professional capacity . . . or in the capacity of outside salesman.” 29 U.S.C. § 213(a)(1).

Whether an employee qualifies as exempt under one of these “white collar” professions ultimately turns on the application of three regulatory tests. Over time, these three tests have become known as the “salary basis test,” the “salary level test,” and the “duties test.” In summary:

- **The salary basis test.** The employee must be paid a predetermined and fixed salary that is not subject to deduction because of variations in the quantity or quality of work. (Note: This requirement does not apply to the outside sales classification.)

- **The salary level test.** The employee must earn a certain minimum salary per week. The current minimum salary is $455 per week. **PROPOSED CHANGE: THE PROPOSED REGULATIONS WOULD INCREASE THIS AMOUNT IN 2016 TO $970 PER WEEK, OR $50,440 PER YEAR.** (Note: This requirement does not apply to the outside sales classification.)

- **The duties test.** The employee’s primary duties in his or her job must entail certain specific types of tasks. The employee’s actual job title does not matter.

In addition, an employee may be treated as exempt under the exemption for Highly Compensated Employees (“HCE”) if all of the following criteria are met:

- The employee must earn total annual compensation of at least $100,000. **PROPOSED CHANGE: THE PROPOSED REGULATIONS WOULD INCREASE THIS AMOUNT TO AT LEAST $122,148 PER YEAR.**

- The employee’s total annual compensation must include at least $455 per week paid on a salary or fee basis. **PROPOSED CHANGE: THE PROPOSED REGULATIONS WOULD INCREASE THIS AMOUNT IN 2016 TO $970 PER WEEK.**

- The employee must customarily and regularly perform the exempt duties or responsibilities of an exempt executive, administrative, or professional employee.

- The employee’s primary duty must include performing office or non-manual work (non-management employees in occupations like maintenance and construction are not exempt under this section, regardless of rate of pay).

**Emerging Issues and Reactions**

At the directive of President Obama to “modernize and streamline” the white collar exemptions, the Wage and Hour Division of the DOL on July 6, 2015, published the proposed rules in a formal
Notice of Proposed Rulemaking (“NPRM”) in the Federal Register entitled, “Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees.” In essence, this NPRM presents proposed changes to overtime regulations, as discussed above.

In addition to the changes noted above, the proposed regulations would also automatically update the salary threshold for being an exempt employee and the salary threshold for being a HCE. 80 Fed. Reg. 38537. Until now, the salary level was not adjusted for cost of living, and the current rate ($23,660 per year) has been in effect since the last amendments to the regulations in 2004. The proposed regulations identify two alternatives for updating methodologies. The first proposed method, the “fixed percentile” approach, would annually update the thresholds based on fixed percentiles of earnings for full-time salaried workers. It would maintain the minimum salary threshold at the 40th percentile of the weekly wages of all full-time salaried workers. 80 Fed. Reg. 38540. The second proposed method would update the thresholds based on changes to the Consumer Price Index for All Urban Consumers (“CPI-U”). Id.

Of note, the proposed rules do not address two issues that many observers thought would be addressed. First, the proposed rules make no changes to the duties test for the exemptions, i.e., the primary type of work that must be performed in order to qualify for the executive, professional, and administrative exemptions. Second, the proposed rules do not address whether nondiscretionary bonuses may serve to satisfy a portion of the standard salary requirement. Instead, the DOL stated that it would continue to study these issues, and invited the public to offer comments to help inform the DOL’s consideration.

Reactions to the proposed regulations have been mixed. For example, workers’ rights organizations generally have supported the proposed rules. The AFL-CIO asserts that the proposed regulations will adjust existing protections of the FLSA for inflation, and the Center for American Progress asserts that the proposed regulations will strengthen the middle class, drive economic growth, and help Millennials attain financial stability.¹ On the other hand, many business organizations argue that the proposed regulations will hinder industry and job growth. The United States Chamber of Commerce states that the proposed regulations would “negatively impact small businesses and drastically limit employment opportunities.”² The National Retail Federation likewise opposes the proposed regulations, arguing that they would undermine customer service and harm job creation.³

**Public Comments**

Under federal rulemaking procedures, the public may express its opinions in writing. Any written comments must be submitted to the DOL before midnight on September 4, 2015. Comments may be submitted either electronically or by regular mail. For instructions on how to submit comments, see the DOL’s notice at [http://www.regulations.gov/index.jsp#!docketDetail;D=WHD-2015-0001](http://www.regulations.gov/index.jsp#!docketDetail;D=WHD-2015-0001).

If you have any questions about the proposed changes to overtime regulations, please contact John Pueschel at 336.721.3726 or JPueschel@wcsr.com, or a member of Womble Carlyle’s Labor & Employment Team.
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