I. Introduction

On June 30, 2015, the Department of Labor (DOL) Wage and Hour Division published proposed rules outlining revisions to the Fair Labor Standards Act’s (FLSA) overtime exemptions. The proposed rules seek to:

1. Update the minimum salary level needed to qualify for the exemption;
2. Propose a mechanism to automatically update the salary level on an annual basis; and
3. Gather feedback on whether the DOL, in light of the compensation proposals, should revise the duties test used to determine which employees meet the administrative, executive and professional exemptions.

Employees and employers across every industry and sector will be impacted, and it is estimated that overtime benefits would be extended to 5 million people nationwide. Most employers covered by the FLSA will need to analyze employee classifications and make other changes by a likely 2016 effective date, which will be established in the final rule.

II. Background

The FLSA guarantees a minimum wage and overtime pay at a rate of not less than one and one-half times the regular rate for hours worked over 40 in a workweek. While these protections extend to most workers, the FLSA does provide a number of exemptions, known as the “white collar” exemptions. The DOL’s 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 (the “salary basis test”);
2) The amount of salary paid must meet a minimum specified amount (the “salary level test”); and
3) The employee’s job duties must primarily involve executive, administrative, or professional duties as defined by the regulations (the “duties test”).

Additionally, certain highly compensated employees (HCE) are exempt from the overtime pay requirement if they are paid total annual compensation of at least $100,000 (which must include at least $455 per week paid on a salary or fee basis) and if 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.

III. Overview

Through its proposed rule, the DOL seeks to ensure that the FLSA’s intended overtime protections are fully implemented and to simplify the identification of nonexempt employees, thus making the exemption easier for employers and workers to understand. In order to better accomplish this objective, the DOL proposes the following:

A. Increasing the Standard Salary Level

Under the current regulation, for which salary levels were last updated in 2004, a full time salaried worker must be paid at least $455 per week ($23,660 per year) for the exemption to apply. Similarly, an HCE must earn above $100,000 in total annual compensation for the exemption to apply. Per the DOL, if the salary level is left at the same amount over time, the effectiveness of the salary level test 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. In order to maintain the effectiveness of the test, the DOL proposes to set the standard salary level at the 40th percentile of weekly earnings for full time salaried workers ($921 per week or $47,892 per year, in 2013) and 90th percentile of weekly earnings for HCE ($122,148 per year for 2013. As proposed, this would raise the salary threshold from $455 a week (the equivalent of $23,660 a year) to about $970 a week ($50,440 a year) in 2016 for full time salaried workers.

B. Automatic Salary Level Updates

A well-calibrated salary level that is fixed becomes obsolete as wages for nonexempt workers increase over time. Accordingly, DOL has, in addition to increasing the standard salary level, proposed to establish a mechanism for automatically updating the standard salary test annually, as well as the total annual compensation requirement for HCE. The DOL has asked for input on the two alternative methodologies that it is considering for the annual updates. One method would update the thresholds based on a fixed percentile of earnings for full-time salaried workers. The other method would update the thresholds based on changes in the Consumer Price Index for All Urban Consumers (CPI-U), which is a commonly used economic indicator for measuring inflation.

1 Also updated in 2004
C. **Include Nondiscretionary Bonuses in the Salary Level Requirement**

In recognition of the increased role bonuses play in many compensation systems, the DOL is also considering whether to permit nondiscretionary bonuses and incentive payments to count toward a portion of the standard salary level test for the exemption. An example of a nondiscretionary bonus is an incentive bonus tied to productivity and profitability. No changes have been proposed by the DOL, but it is seeking comments on the appropriateness of including commissions as part of nondiscretionary bonuses and other incentive payments that could partially satisfy the standard salary level test.

D. **Revise Duties Requirements for Exemption**

Examination of the duties performed by the employee is an integral part of the determination of exempt status, and employers must establish that the employee’s “primary duty” is the performance of exempt work in order for the exemption to apply. Currently, there is no cap on the amount of nonexempt work that could be performed by an exempt employee. The DOL 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. Per the DOL, a disproportionate amount of time spent on nonexempt duties may call into question whether an employee is, in fact, a bona fide exempt employee. Accordingly, the DOL is seeking comments on changing the duties tests.\(^2\)

E. **Example of Exempt Computer Related Occupations**

The industry provides unique challenges in categorizing the workers that would satisfy the exemption. For example, a help desk operator whose responses to routine computer inquiries (such as requests to reset a user’s password or address a system lock-out) are largely scripted that sets forth well-established techniques or procedures would not possess the discretion and independent judgment necessary for the exemption. On the other hand, an information technology specialist who, without supervision, routinely troubleshoots and repairs significant glitches in his company’s point of sale software for the company’s retail clients might be an example of an exempt employee, as this employee’s work appears to be directly related to the management or business operation of his employer or employer’s customers and requires the use of discretion and independent judgment with respect to matters of significance. The DOL is thus considering the suggestions of employer stakeholders from the computer and information technology sectors to include additional examples of the application of exemptions to the occupational categories.

IV. **Next Steps**

The proposed rule has not yet been published in the Federal Register. Once published, the DOL will be accepting comments on the proposal for 60 days after publication. This can be done

\(^2\) Specifically DOL has asked for input on what changes should be made to the tests. Should the employee spend a minimum amount of time on their primary duty? What should be the threshold?
through the Federal eRulemaking Portal at http://www.regulations.gov or by mailing written submissions to Mary Ziegler, Director of the Division of Regulations, Legislation, and Interpretation, Wage and Hour Division, U.S. Department of Labor, Room S-3502, 200 Constitution Avenue, N.W., Washington, D.C. 20210. Members of the public may comment on anything in the proposed rule, but the DOL has identified some specific issues of particular interest. These include the current duties test and the current requirements. Additionally, the DOL is soliciting suggestions for additional occupation examples and also seeks comment on the possibility of including nondiscretionary bonuses to satisfy a portion of the standard salary requirement.

Employers are not yet required to comply with the proposed rule. The changes as proposed, however, will most likely require employers to examine and reclassify a significant number of employees from exempt to nonexempt status.

Brennan, Manna & Diamond, LLC’s Labor and Employment group advises its clients on various FLSA issues and routinely conducts employee classification analyses for employers. BMD can assist you in developing a plan to audit your employee classifications once the new regulations are in effect. Should you have any questions regarding the proposed regulations, please feel free to contact John Childs, Esq. or Katie Basch, Esq. Mr. Childs and Ms. Basch can be reached at (330) 253-5060 or jnchilds@bmdllc.com and krbasch@bmdllc.com.