Department of Labor Proposes New Overtime Regulations

DOL Proposes Substantially Raising Salary Thresholds Used in Determining Who Is Exempt from Overtime Pay and Requests Comments on Potential Changes to the Current Regulations Defining the Duties Required to Qualify for Exemption

SUMMARY

Yesterday, the Department of Labor proposed long-awaited revisions to its overtime regulations. The new proposed rules were issued in response to President Obama’s directive to the Secretary of Labor in March 2014 to revise existing overtime regulations, with the express purpose of increasing the number of workers who qualify for overtime payments.

The proposed rules seek to increase the number of employees who are eligible for overtime by significantly increasing the salary thresholds for exemption. Currently, the rules exempt certain categories of employees who earn more than $455 per week ($23,660 per year) and perform certain “primary duties.” The proposed rules increase the basic salary threshold to the 40th percentile of earnings for full-time salaried workers ($951 per week, or $49,452 per year, as of the first quarter of 2015). In a similar vein, the proposed rules increase the highly compensated exemption threshold (above which the standards for determining exemption are more easily achieved) to the 90th percentile of earnings for full-time salaried workers ($122,148 annually). Finally, the proposed rules seek to index the compensation thresholds for inflation, either by maintaining the levels at a fixed percentile of earnings or by updating the level based on changes in the Consumer Price Index. Although the proposed rules do not contain changes to the detailed duties tests that are applied to employees whose compensation is above the threshold levels, the notice requests comment on whether modifications to the duties tests
should be adopted and the Department of Labor seems to be claiming the right to adopt changes to the tests in its final rule, without having sought or received comments on the specifics of what they adopt.

The net effect of the proposed rules is to expand considerably the number of employees who are subject to the overtime requirements of the Fair Labor Standards Act. The Department of Labor estimates that, if the proposed rules are adopted, more than 4.6 million additional workers would become entitled to overtime compensation.

The Department of Labor is seeking public comment on its proposals. The due date for comments will be set upon publication of the notice in the Federal Register, which is imminent. The comment period will likely be 60 days, and thus the comments could well be due soon after September 1. Details on the deadline and the methods for filing will be available at the Department’s web site, http://www.dol.gov/whd/overtime/NPRM2015. Comments can be filed at www.regulations.gov. After the close of the comment period, the Department of Labor will review and respond to comments before publishing the final regulations. Thereafter, Congress may choose to disapprove the rules, subject to the President’s veto power. All told, any rules are unlikely to be final until 2016.

BACKGROUND

The federal overtime provisions are contained in the Fair Labor Standards Act. Employees covered by the Act must receive time-and-a-half pay for all hours worked in excess of 40 in any work week. The Act exempts from overtime eligibility five categories of employees: executive, administrative, professional, computer, and outside sales employees, and also has some other occupationally specific exemptions. To be exempt from overtime requirements, an employee must be paid above a salary threshold and must perform certain of his or her “primary duties” consistent with one of the exemption categories. Employers must classify each of their employees as exempt or non-exempt and treat them accordingly.

THE PROPOSED CHANGES

A. INCREASE IN SALARY-BASIS TEST FOR EXECUTIVE, ADMINISTRATIVE, AND PROFESSIONAL EMPLOYEES

Under current law, to be exempt as an executive, administrative, or professional employee, an employee must be paid on a “salary basis” and earn more than $455 per week ($23,660 per year). An employee is considered to be paid on a salary basis if the employee regularly receives a predetermined amount constituting all or part of the employee’s compensation, and the amount is not subject to reduction because of variations in the quality or quantity of the work performed. All employees earning less than the threshold amount must receive overtime pay regardless of their duties.

The proposed rules retain the salary-basis test but increase the salary threshold to the 40th percentile of earnings for full-time salaried workers, or $951 per week ($49,452 per year) as of the first quarter of 2015. Moreover, the proposed rules seek to index the salary level for inflation annually using one of two
methods, and the Department of Labor has requested comments on which methodology it should use. One proposed method is to update the salary level each year to reflect the 40th percentile of earnings for full-time salaried workers. Alternatively, the salary level could be adjusted based on the Consumer Price Index for all urban consumers.

B. HIGHLY COMPENSATED EMPLOYEES

The overtime regulations contain a category of “highly compensated employees” as to which the overtime exemption standards are more easily met. An employee is exempt from overtime requirements as highly compensated if the employee earns total annual compensation of $100,000 or more (which must include at least $455 per week paid on a salary or fee basis), the employee’s primary duty includes performing office or non-manual work, and the employee regularly meets any one of the standards set forth in the regulations for an executive, administrative, or professional employee. Thus, for example, an employee may qualify as an exempt highly compensated executive if the employee regularly performs one but not all of the exempt duties of an executive.

The proposed rules increase the threshold compensation for highly compensated employees to the 90th percentile of earnings for full-time salaried employees ($122,148 annually), and also seek to update the threshold by either annually adjusting the salary level to remain at the 90th percentile or indexing it to the Consumer Price Index for all urban consumers. The Department of Labor estimates that 36,000 workers would be newly eligible for overtime as a result of this change.

C. REQUEST FOR COMMENTS AS TO DUTIES TESTS AND POTENTIAL ADOPTION OF NEW RULE WITHOUT AFFORDING OPPORTUNITY FOR SPECIFIC COMMENT ON IT

The executive, administrative, and professional exemptions currently provide that an employee will be exempt from overtime so long as his or her “primary duties” fall within the exemption. Thus, for example, a bank branch manager may still be exempt under the administrative exemption even if she does some non-managerial work, so long as her “primary duty” is managerial. In its notice, the Department of Labor stated that it recognized the view of employers that in workplace settings it is necessary for exempt employees from time to time to “pitch in” and do non-exempt work. Nevertheless, the Department also recognized the position of those seeking expansion of overtime eligibility that the “primary duties” tests could be overinclusive.

Although the Department did not propose changes to the duties tests in its notice, it requested comments on whether it should do so. It listed a number of specific issues as to which it solicited comments, including:

- What, if any, changes should be made to the duties tests?
- Should employees be required to spend a minimum amount of time performing work that is their primary duty in order to qualify for exemption? If so, what should that minimum amount be?
Should the Department look to the State of California’s law (requiring that 50 percent of an employee’s time be spent exclusively on work that is the employee’s primary duty) as a model? Is some other threshold that is less than 50 percent of an employee’s time worked a better indicator of the realities of the workplace today?

Does the single-standard duties test for each exemption category appropriately distinguish between exempt and nonexempt employees? Should the Department reconsider its decision to eliminate the long/short duties tests structure (a structure that it used prior to 2004, whereby a more stringent “long test” applied to employees paid at a lower salary level, and a less stringent “short test” applied to employees paid at a higher salary level)?

Is the concurrent duties regulation for executive employees (allowing the performance of both exempt and nonexempt duties concurrently) working appropriately or does it need to be modified to avoid sweeping nonexempt employees into the exemption? Alternatively, should there be a limitation on the amount of nonexempt work? To what extent are exempt lower-level executive employees performing nonexempt work?

Should the Department add to the regulations examples of additional occupations to provide guidance in administering the executive, administrative, and professional exemptions?

The Department appears to be reserving the right to adopt final rule changes in the duties tests for those items as to which it specifically solicited comments, such as adopting California’s 50 percent rule for all duties tests or changing the concurrent duties rule for executive employees. In an email released June 30, the Department stated that, “while no specific changes are proposed for the duties tests, the NPRM [Notice of Proposed Rule-Making] contains a detailed discussion of concerns with the current duties tests and seeks comments on specific questions regarding possible changes. The Administrative Procedure Act does not require agencies to include proposed regulatory text and permits a discussion of issues instead.”

If the Department were to adopt final rules that it never published for comment, it would undoubtedly be criticized for having engaged in ambush tactics and court challenges likely would follow. Although the Department is taking an aggressive position about its ability to adopt final rules without previewing their text for comment, even it appears to acknowledge that for matters beyond those specifically discussed in its notice, it would have to provide new notice and opportunity for comment.

**IMPLICATIONS**

If the proposed regulations are adopted in their present form, employers as to whom the change in the salary threshold could affect the number of overtime eligible employees have several options. Employers could, for example, raise salaries of employees who meet the other exemption tests to the new threshold. Alternatively, employers could hire more employees and distribute hours among them to minimize the number of employees who work more than 40 hours a week. Employers also could consider studying the number of hours worked by employees who are currently exempt but are paid below the new threshold and adjust the basic hourly pay rate such that the basic pay plus overtime pay for hours worked above 40 each week would be roughly equivalent to the former salary.
Employers should particularly consider commenting on the questions concerning the duties tests raised by the Department, given the Department’s apparent position that it can adopt final rules on the tests without further comment. Employers also should consider communicating with industry groups to prepare collective comments. The comment period gives employers a chance to explain to the Department of Labor the challenges they face and the concerns specific to their businesses.
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CONTACTS

<table>
<thead>
<tr>
<th>New York</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Theodore O. Rogers, Jr.</td>
<td>+1-212-558-3467</td>
<td><a href="mailto:rogersto@sullcrom.com">rogersto@sullcrom.com</a></td>
</tr>
<tr>
<td>Robin D. Fessel</td>
<td>+1-212-558-3832</td>
<td><a href="mailto:fessler@sullcrom.com">fessler@sullcrom.com</a></td>
</tr>
<tr>
<td>Tracy Richelle High</td>
<td>+1-212-558-4728</td>
<td><a href="mailto:hight@sullcrom.com">hight@sullcrom.com</a></td>
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<table>
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<tr>
<th>Washington, D.C.</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Jeffrey B. Wall</td>
<td>+1-202-956-7660</td>
<td><a href="mailto:wallj@sullcrom.com">wallj@sullcrom.com</a></td>
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