Testimony of

Tammy D. McCutchen, Esq.

Before the

United States Senate
Committee on Small Business & Entrepreneurship

Hearing on

"An Examination of the Administration's Overtime Rule and the Rising Costs of Doing Business"

May 11, 2016

Mr. Chairman and members of the Subcommittee:

Thank you for the opportunity to speak with you today regarding the U.S. Department of Labor's (the "Department") proposed revisions to the "white collar" overtime exemption regulations at 29 CFR Part 541.

Currently, I am a principal in the Washington D.C. office of Littler Mendelson, P.C., where my practice focuses on helping employers comply with the Fair Labor Standards Act ("FLSA"), including conducting internal audits on independent contractor status, overtime exemptions, and other pay practices. I also represent employers during wage-hour investigations by the Department and have served as an expert witness in wage-hour collective and class actions. I also serve as VP & Managing Director, Strategic Solutions for ComplianceHR, which develops compliance applications that guide employers through key employment decisions including whether to classify employees as exempt from overtime requirements.

Perhaps of most relevance to the topic of this hearing, I served as Administrator of the Department's Wage and Hour Division from 2001 to 2004. During that time, I oversaw the Department's 2004 revisions to the overtime regulations, the first major changes to the regulations in 55 years. My official biography is attached as Exhibit A.

I am appearing today on my own behalf only. However, I assisted in drafting the U.S. Chamber of Commerce's comments on the Department's Notice of Proposed Rulemaking ("NPRM") on the Part 541 regulations. I am also a member of the Small Business Legal Advisory Board of the National Federation of Independent Business, the nation's leading small business advocacy association. The Chamber's comments to the Department's NPRM are attached as Exhibit B, and the NFIB's comments are attached as Exhibit C.

Mr. Chairman, I request that the entirety of my written testimony and its attachments be entered into the record of this hearing.

I. INTRODUCTION

When Congress passed the FLSA in 1938, establishing the minimum wage and overtime requirements, it excluded executive, administrative, professional and outside sales employees from those protections. Congress believed then that in exchange for not being eligible for overtime, such employees earned salaries well above the minimum wage, were provided above-average benefits and had better opportunities for advancement, setting them apart from the nonexempt workers entitled to overtime pay. This is still true today.

Exempt white collar employees also enjoy more generous paid leave benefits. They earn bonuses, commissions, profit-sharing, stock options and other incentive pay at greater rates than non-exempt employees. Moving from a non-exempt position to an exempt position is the first rung on the promotional ladder.

Perhaps most important, exempt employees enjoy the stability and certainty of a guaranteed salary. Exempt white collar employees must be paid on a salary basis – that is, they must receive a "predetermined" salary that "is not subject to reduction because of variations in the quality or quantity of the work performed."[1] Thus, while exempt employees do not receive overtime for working over 40 hours in a week, they also are not paid less if they work less than 40 hours in a week. If an exempt employee works as little as one hour in the week, and then takes the rest of the week off because of a family emergency, that employee will still be paid her entire weekly salary. A non-exempt employee need be paid only for the one hour she actually worked. A non-exempt employee who takes an afternoon off to attend a parent-teacher conference will not be paid for that time, but an exempt employee will be paid her full guaranteed salary.[2]

This difference provides a level of workplace flexibility that distinguishes exempt from non-exempt employees. Secretary Perez has often discussed the importance of such flexibility in his own professional life:

> Involvement in my kids' sports teams is something I have made time for over the years. I've also been able to coach all three of them in baseball and basketball, something that has strengthened our bonds and given me indescribable joy. I wouldn't trade it for anything. I lost my own father when I was 12, and I am the same age today that he was when he died suddenly of a heart attack. So when it comes to family time, I have a strong sense of the fierce urgency of now.
>
> But I'm lucky. I've had jobs that allow me the flexibility to achieve work-life balance, to be there when one of the kids sinks a jump shot or for the parent-teacher meetings.[3]

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[1] 29 C.F.R. § 541.602(a).
[2] Subject to employer paid leave policies.
[3] *See, e.g.,* Secretary of Labor Thomas E. Perez, *The Most Important Family Value*, Huffington Post (May 27, 2014), *available at* http://www.huffingtonpost.com/thomas-e-perez/the-most-important-family_b_5397442.html.

The Department's proposal to increase the minimum salary level for exemption to the 40th percentile of all "non-hourly" workers – $50,440, an increase of 113% – will eliminate the workplace flexibility that Secretary Perez so values for millions of employees who currently perform exempt executive, administrative, professional, computer, and outside sales job duties. These millions will be reclassified to non-exempt status and will be required to start punching a time clock. They will be paid only for hours they actually work, but that is no guarantee of overtime pay – as many employers will limit their work hours to fewer than 40 in a week. Being eligible for overtime is not the same as earning overtime, even if the employee may currently be working more than 40 hours a week as an exempt employee.

Although the Department views being reclassified as non-exempt as an advantage, in fact, as stated by many commenters on the proposed regulations with experience managing businesses, limiting an employee's work hours also limits opportunities for advancement. Exempt employees know this too, and will view the reclassification to non-exempt status necessitated by the Department's proposal as a demotion. Employee morale will suffer when their work hours are closely monitored; they fall out of the more generous employee benefit plans; are no longer eligible for incentive pay; and must carefully consider whether they can afford to leave work to attend a child's baseball game.

Among those who will be most impacted by the change in the minimum salary level for exemption will be small businesses. Current salary levels for small business employees who clearly perform exempt job duties fall below the proposed $50,440 threshold. Small businesses cannot afford to increase salaries necessary to maintain the exemption, but also cannot afford to pay overtime – especially when this new regulatory burden is piled on top of Affordable Care Act obligations, state minimum wage increases, and state paid leave requirements. The options for small businesses are few – cut employees, cut work hours – as they do not have excess profits to cover the increased costs.

II. A Brief Regulatory History

The Fair Labor Standards Act requires covered employers to pay employees at least the minimum wage for all hours worked and overtime at one and one-half times the employee's regular rate of pay for hours worked over 40 in a workweek. However, the FLSA also contains about 50 separate partial or complete exemptions from the minimum wage and/or overtime requirements. The hearing today focuses on the exemptions for executive, administrative, professional and outside sales employees, codified at 29 U.S.C. § 213(a)(1).

These exemptions, sometimes called the "white collar" exemptions, were included in the FLSA when the Act was passed by Congress in 1938. The FLSA itself includes no definitions of the terms executive, administrative, professional or outside sales. Rather, the Act provides that these terms are to be "defined and delimited from time to time by regulations of the Secretary."

The Secretary of Labor first issued such regulations to define the white collar exemptions on October 20, 1938, at 29 C.F.R. Part 541. The original regulations, only two columns in the Federal Register, set a minimum salary level for exemption at $30 per week and established the job duties employees must perform to qualify for the exemptions.

The duties tests were significantly revised in 1949, including the addition of "special proviso[s] for high salaried" executive, administrative and professional employees – known as the "short tests." Except for revisions adopted in 1992 at the direction of Congress to allow certain computer employees to qualify for exempt status,[4] the duties tests in the Part 541 regulations remained virtually unchanged for 55 years, from 1949 until the Department significantly revised the regulations in 2004.

From 1940 to 1975, the Department raised the minimum salary level for exempt status every 5 to 10 years. The 1975 salary levels set forth below remained in effect until 2004:

- $155 per week for executive/ administrative
- $170 for professionals
- $250 for the short test

In 2004, the Department eliminated the "long" and "short" test, instead adopting one standard test with a minimum salary of $455 and a test for highly compensated employees with total annual compensation of at least $100,000.

In its Notice of Proposed Rulemaking, published in the Federal Register on July 6, 2015, the Department proposed to increase the minimum salary level for exempt status. The Department has also requested comments on possible changes to the duties tests.

III. MINIMUM SALARY LEVEL FOR EXEMPTION

The Department proposes to set the minimum salary required for exemption from the FLSA overtime requirements at the 40th percentile for all non-hourly paid employees, using data from the Bureau of Labor Statistics (BLS).[5] When the NPRM was published in July 2015, this methodology resulted in a minimum salary level of $921 per week or $47,892 annually. When a final rule is published in 2016, the Department expects that the minimum salary level based on the 40th percentile will increase to $970 per week or $50,440 annually – an increase of 113% over the current minimum salary level for exemption.

The Department's methodology and the amount of the increase are unprecedented in the FLSA's 77-year history. In my opinion, the Department cannot justify increasing the minimum salary level for exemption above $35,000.

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[4] In 1992, at the direction of Congress, the Department revised the duties tests to allow computer employees to qualify as exempt professionals. In 1996, Congress enacted a separate exemption for some computer employees in 29 U.S.C. § 213(a)(17), incorporating some, but not all, of the Department's regulations in the Act itself. Unlike the Section 13(a)(1) exemptions, however, Congress did not give the Department the authority to issue regulations on Section 13(a)(17).

[5] "Non-hourly-paid" employees include employees paid on a salary basis, but also include employees paid on a fee basis, by commission and any other arrangement that is not hourly pay.

In the past, the Department has used information regarding employee salaries to set the minimum salary levels for exemption, but has never used a salary level even close to the 40th percentile. In the 1958 rulemaking, for example, the Department used data on actual salary levels of employees that wage and hour investigators found to be exempt during investigations conducted over an eight-month period. Based on this data, the Department set the minimum salary required for exemption at a level that would exclude the lowest 10th percentile of employees in the lowest wage region, the lowest wage industries, the smallest businesses and the smallest cities. If the 1958 methodology were applied today, the resulting minimum salary level would be $657 per week or $34,167 annually (NPRM at Table 12). Similarly, in 2004, using BLS data, the Department set the minimum salary level to exclude the lowest 20th percentile of employees in the lowest wage region (South) and industry (Retail). The Department doubled the percentile used, from 10% to 20%, to account for changes to the duties test made in the 2004 final rule. According to the NPRM, if the 2004 methodology were applied today, the resulting minimum salary level would be $577 per week or $30,004 annually (NPRM at Table 12).

Thus, the Department's proposed methodology of setting the minimum salary level at the 40th percentile of all non-hourly-paid employees nationwide results in a minimum salary for exemption that is $20,000 higher than the salary level that would result if the Department applied the 2004 methodology, and $15,000 higher than the salary level that would result if the Department applied the 1958 methodology. The Department justifies the jump from the 20% of lower wage regions and industries used in 2004 to its proposed 40% of all non-hourly-paid employees nationwide by asserting it made a "mistake" in 2004 in not accounting for changes in the duties tests. But, the Department did account for those changes in 2004 by increasing the percentile from 10% to 20%. Further, even applying the 40th percentile, the Department has not explained its failure to use salary levels in the lowest wage regions, the lowest wage industries, the smallest businesses and the smallest cities – or its inclusion of earnings data for lawyers, doctors and sales employees who are not subject to the Part 541 salary requirements. The Department's data set also includes salaries of federal workers, who generally earn wages higher than employees working in the private sector.

The graphic below, from an August 2015 study by Oxford Economics (attached to the Chamber's comments on the NPRM), illustrates the significant disproportionate economic impact the Department's reliance on national salary levels will have in lower wage regions. In Massachusetts, for example, a minimum salary level of $50,440 will exclude the lowest 27.3% of salaried employees. However, in Louisiana, over 50% of salaried employees will be ineligible for the exemption. In Washington State, only 28.7% of salaried employees earn below $50,440, but in Florida, 50.3% of salaried employees are below the Department's proposed new salary threshold.

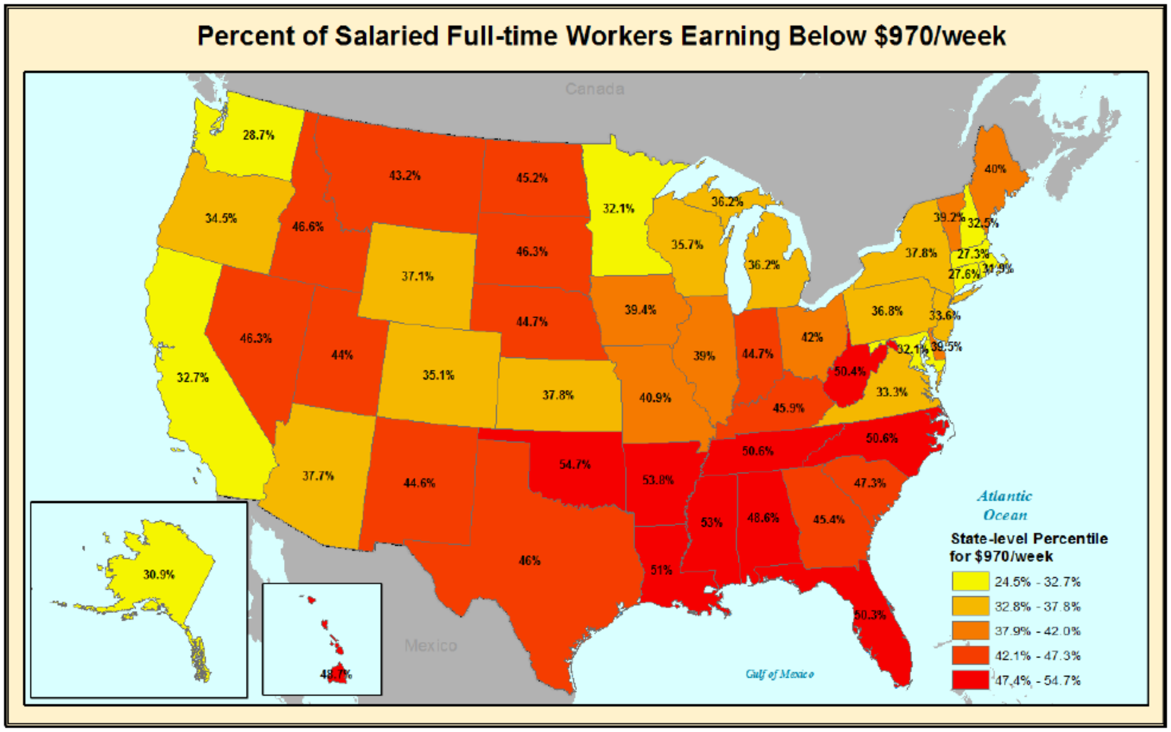

Figure 4. Percentile of salaried full-time state wage distribution that national 40th percentile wage ($970) represents.

The $50,440 wage level is also unsupported by looking to historical salary level increases. Table 1 below shows the history of salary level increases in the Part 541 regulations and calculates the percentage of increase from the prior levels. Historically, the Department has increased the salary levels at a rate of between 2.78% and 5.56% per year, with a median of 4.25%. Applying the 4.25% annual median increase for 12 years (2004 to 2016) to the current salary level of $455 per week ($23,660) would result in a salary level of $687 per week ($35,727 annually).

Table 1

Year	Salary Level		Percentage Increase Total	Percentage Increase Per Year
1938	$30	All		
1940	$30	Exec	0.00%	
	$50	Admin, Prof	66.67%	33.33%
1949	$55	Exec	83.33%	9.26%
	$75	Admin, Prof	50.00%	5.56%
	$100	Short Test		
1958	$80	Exec	45.45%	5.05%
	$95	Admin, Prof	26.67%	2.96%
	$125	Short Test	25.00%	2.78%
1963	$100	Exec, Admin	25.00%	5.00%
	$115	Prof	21.05%	4.21%
	$150	Short Test	20.00%	4.00%
1970	$125	Exec, Admin	25.00%	3.57%
	$140	Prof	21.74%	3.11%
	$200	Short Test	33.33%	4.76%
1975	$155	Exec, Admin	24.00%	4.80%
	$170	Prof	21.43%	4.29%
	$250	Short Test	25.00%	5.00%
2004	$455	All	82.00%	2.83%
2016	$970	All	113.19%	9.43%

The Department's proposed increase to $50,440 represents an increase of 9.43% per year. Over the last decade, salaries did not increase on average by 9.43% annually. Employment Cost Index data from BLS shows that for 2004 through 2014, earnings for all wage and salary workers increased 27.1% cumulatively over the period – a 2.7% average annual change (2.2% per year compound rate). For the subset of private sector workers in management, professional and related occupations, the cumulative earnings increase for 2004 through 2014 was 32.5%, equivalent to a 2.6% average yearly change. Applying these average growth rates for each of 12 years (2004 to 2016) to the current salary level of $455 per week ($23,660 annually) would result in an updated salary level of between $590.78 per week ($30,720.30 annually) and $619.13 per week ($32,194.60).

Perhaps most telling, the Department's proposed minimum salary level of $970 per week, $50,440 annually, is higher than the current minimum salary levels for exemption under Alaska, California and New York law. Just like the minimum wage, states may set higher standards for exemptions from state overtime requirements. In Alaska, the minimum salary level for exemption is $40,560. In California, the minimum salary level is currently $41,600 annually. In New York, the minimum salary level is $35,100 annually. Thus, the Department's proposed salary level of $50,440 is:

- $8,840 higher than the salary level required for exemption in California;
- $9,880 higher that the salary level required in Alaska, and
- $15,340 higher than the salary level required in New York –

which are three of the five highest cost-of-living states in the country, and among the highest states for median income.

Finally, the Department's proposed $50,440 salary level is higher even than starting salaries for federal employees with Master's degrees. On its web page, the federal Office of Personnel Management explains:

> The General Schedule has 15 grades – GS-1 (lowest) to GS-15 (highest). Agencies establish (classify) the grade of each job based on the level of difficulty, responsibility, and qualifications required. Individuals with a high school diploma and no additional experience typically qualify for GS-2 positions; those with a Bachelor's degree for GS-5 positions; and those with a Master's degree for GS-9 positions.

Although some employees holding Bachelor's degrees do not perform the duties required for the Part 541 exemptions, federal employees with Master's degrees are unlikely to be classified as non-exempt. Thus, the dividing line between exempt and non-exempt federal employees is most likely at GS-7, the mid-point between GS-5 where some employees may perform exempt duties and GS-9 where most federal employees likely are exempt. As shown in Appendix C, the salary at GS-7, Step 1, is $35,009, and federal employees with Master's degrees start in GS-9, Step 1, at $42,823.

Methodology	Salary Level
2004 Regulations	$30,004
Employment Cost Index	$32,194
1958 Methodology	$34,167
New York State Minimum	$35,100
Historical Percentage Salary Level Increases	$35,727
California State Minimum	$41,600
Federal Employees with Master's Degree, Starting Salary	$42,823

Since 1949, and in the 2015 NPRM, the Department has consistently stated the purpose of setting a minimum salary threshold is to provide a "ready method of screening out the ***obviously*** nonexempt employees." After all, in Section 13(a)(1), Congress exempted white collar employees from both the minimum wage and overtime requirements of the FLSA. Thus, to implement Congress' intent, the Department should not set the minimum salary threshold at a level that excludes many employees who ***obviously meet*** the duties tests for exemption. Or, put another way, Department should not set the level so high that it expands the number of employees eligible for overtime beyond what Congress envisioned when it created the exemptions. Yet, this is exactly what the Department proposes in this rulemaking. Particularly in the retail, restaurant, hospitality and health care industries, for small businesses and in the public sector, there are many, many employees earning below $50,440 annually who have been found exempt under the duties tests both in Department investigations and by the federal courts.

IV. IMPACT ON SMALL BUSINESS AND ORGANIZATIONS

Small businesses and their advocates uniformly agree that the Department's proposed $50,440 salary level will disproportionately and negatively impact small businesses, small non-profit organizations and small government entities. Over a thousand small business filed comments objecting to and opposing the Department's proposed $50,440 salary level. In addition, organizations representing small businesses also filed comments detailing the negative impact of the Department's proposal – including, for example, the Small Business Association Office of Advocacy, the National Federation of Independent Businesses, the National Association of Women Small Business Owners, the National Association of Women in Real Estate and the Louisiana Small Business Council.

The NFIB and the SBA Office of Advocacy, whose comments are attached as Exhibit C and Exhibit D, both raised significant issues regarding the Department's regulatory flexibility analysis. The Department claims that small business will face $750 million in new costs during the first year after the regulations are finalized -- $186.6 million in costs associated with implementing the rule and $561.5 million in additional wages that will now be paid to workers. However, all small business commenters agree that the $186.6 million in costs to implement the rule is a gross underestimate. According to the Department, an affected small establishment is expected to spend only one hour to familiarize themselves with the final rule, one hour per each affected worker in adjustment costs and five minutes each week for scheduling and monitoring each affected worker – leading to a cost per entity of only $100 to $600.

In reality, it will take far more than an hour or two – or even ten – to comply with the final rule. Since leaving the Department in 2004, I have assisted dozens and dozens of employers to reclassify employees from exempt to non-exempt. In my experience, reclassifications can take six months or more to achieve and hundreds of hours spent by business leaders, human resources professionals and outside attorneys.

Deciding who to reclassify is just the first step, but difficult enough. Small businesses will need to identify all employees earning under the new minimum salary level, and then analyze the cost of raising salaries versus the cost of reclassify the employees and paying overtime. This analysis requires the small business to determine the number of work hours currently exempt employees are working – a challenge as employers are not required to, and most employers do not, track the hours worked by exempt employees. Thus, small businesses will need to conduct fact-finding to determine hours worked.

After the small entity determines which employees will receive salary increases and which will be reclassified, implementing the reclassification involves far more than just flipping a switch. First, the employer must redesign the compensation plan for the reclassified employees: Will the employees continue to be paid a salary or be converted to the hourly wage? If the employees will be converted to hourly, what will those hourly wages be? If the employees will continue to be paid a salary, how will the overtime be calculated – by dividing salary by 40 hours, by dividing salary by actual hours worked or by adopting the fluctuating workweek method for calculating overtime? Does the preferred method of calculating overtime comply with the state laws? Will the employer continue to pay bonuses and commissions to reclassified employees or fold such incentive pay into the base pay to off-set additional costs? If the employer decides to continue providing incentive pay, does the employer's payroll system correctly calculate the additional overtime due on bonuses, commissions, prizes, awards and other incentive pay? Are the reclassified employees currently receiving any other employee benefits available only to exempt employees? Will the employer continue to provide such benefits? If so, do the eligibility provisions in the ERISA benefit plans need to be changed?

Small businesses will need to conduct cost analysis and make dozens of decisions just on compensation alone. But, to ensure compliance with the FLSA, employers will also need to:

- Review, change and/or implement new timekeeping systems to ensure the reclassified employees can accurately track and record all hours worked;

- Review, reprogram and/or implement new payroll systems to ensure that the system correctly calculates overtime pay, especially for reclassified employees who will continue to receive bonuses, commissions and other incentive pay;

- Review, revise and or adopt new wage and hour policies – policies on timekeeping, overtime, meal and rest breaks, travel time, meeting and training time, using smart phones and lap tops outside of work hours, for example – to ensure compliance with both the FLSA and state laws regarding when the reclassified emploees must be paid for such time;

- Develop materials to communicate the changes in compensation, timekeeping practices and policies to both the reclassified employees and their managers; and

- Provide training on timekeeping and wage-hour policies to the reclassified employees and their managers who may never before had to know what activities are considered work for which the reclassified employees must track their time.

The Department may believe that compliance with the final regulations will take only a few hours, but responsible small businesses risk significant liability if they do not commit substantial time to compliance. Frankly, I am surprised that the Department would encourage any employer to spend so little time ensuring compliance with the FLSA.

The comments filed by the SBA Office of Advocacy details the significant flaws in the Departments regulatory flexibility analysis, including:

- The Department underestimate the cost of compliance;

- The Department did not analyze the impact of the proposed rule on small non-profits organizations or small government entities;

- The Department analyzed the impact on small businesses only in the aggregate using general industry definitions (using the general 2- or 3- digit North American Industry Classification System) when more specific data are readily available thus obscuring the impact of the proposed rule on an industry-subsector basis;

- The Department applied multiple unsupported assumptions to the Census' Survey of U.S. Businesses (SUSB) data to determine the number of affected businesses and workers; and

- The Department failed to analyze the small business data to determine impact of the proposed rule on a state-by-state or regional basis.

Because of these flaws, the SBA Office of Advocacy states, the true impact of the Department's proposed $50,440 salary level cannot be known. The SBA Office of Advocacy thus recommends that the Department publish a supplemental regulatory flexibility analysis prior to publication of the final rule to provide a more accurate estimate of the impact of the proposed salary level on small entities. I urge the Committee to adopt this recommendation.

With a flexibility analysis correcting these flaws, the true impact on small organizations can only be demonstrated anecdotally, but the stories being told my owners and managers of small businesses, small non-profit organizations and small governmental entities. Such as the non-profit organization operating Head Start programs in Louisiana who will need to find an additional $74,000 in funding to cover first year costs to comply with the proposed regulations. Since 80 percent of this entity's operating budget comes from federal programs and cannot be used to pay for management costs like labor, this Louisiana Head Start program may have to cut critical community services. Small grocery stores in Kentucky who attended an SBA Office of Advocacy roundtable reported that their profit margins were under one percent and they could not pass on these extra costs to their customers – leaving the only option to reduce employees or work hours. An owner of a small restaurant in Louisville calculated that the Department's proposed regulations would cost his business $50,000, or 8% of payroll. An owner of five Dairy Queens in and around Austin, Texas with 10 exempt managers earning $30,000 per year with bonuses based on success of the business will have to demote and reclassify the managers to non-exempt – demeaning the managers by forcing them to clock in and out but also controlling their hours to fewer than 40 to avoid overtime costs. These stories and many others told in the comments to the NPRM tell the true story of the impact on small organizations – fewer jobs, more part-time employment, less work hours, fewer benefits – all harming the very employees that the Department seeks to protect.

V. AUTOMATIC ANNUAL INCREASES TO THE SALARY LEVELS

The Department has proposed to establish a mechanism for automatically increasing the salary levels annually based either on the percentile (the 40th percentile for the white collar exemptions, the 90th percentile for highly compensated employees) methodology or inflation (CPI-U).

Such annual automatic increases also would be unprecedented in the 77-year history of the FLSA. There is no evidence that Congress intended that the salary level test for exemption under section 13(a)(1) be indexed. In the 77-year history of the FLSA, Congress has never provided for automatic increases of the minimum wage, although state minimum wages are sometimes indexed. Nor has Congress indexed the minimum hourly wage for exempt computer employees under section 13(a)(17) of the Act, the tip credit wage under section 3(m), or any of the subminimum wages available in the Act. Although Congress has provided indexing under other statutes, it has never done so under the FLSA.

The regulatory history of Part 541 provides no precedent for indexing. Public commenters have suggested automatic updates to the salary levels in at least two past rulemakings. In 1970, for example, a "union representative recommended an automatic salary review" based on an annual BLS survey, the National Survey of Professional, Administrative, Technical, and Clerical Pay.[6] The Department quickly dismissed the idea as "needing further study," although stating that the suggestion "appear[ed] to have some merit particularly since past practice has indicated that approximately 7 years elapse[d] between amendment of these salary requirements."[7] However, the "further study" came in 2004, after *29 years* had elapsed between salary increases. Nonetheless, in 2004, the Department rejected indexing as contrary to congressional intent, disproportionately impacting lower-wage geographic regions and industries, and because the Department intended to do its job:

> [S]ome commenters ask the Department to provide for future automatic increases of the salary levels tied to some inflationary measure, the minimum wage or prevailing wages. Other commenters suggest that the Department provide some mechanism for regular review or updates at a fixed interval, such as every five years. Commenters who made these suggestions are concerned that the Department will let another 29 years pass before the salary levels are again increased. The Department intends in the future to update the salary levels on a more regular basis, as it did prior to 1975, and believes that a 29-year delay is unlikely to reoccur. The salary levels should be adjusted when wage survey data and other policy concerns support such a change. Further, the Department finds nothing in the legislative or regulatory history that would support indexing or

[6] 35 Fed. Reg. 883, 884 (Jan. 22, 1970).
[7] *Id.*

> automatic increases. Although an automatic indexing mechanism has been adopted under some other statutes, Congress has not adopted indexing for the Fair Labor Standards Act. In 1990, Congress modified the FLSA to exempt certain computer employees paid an hourly wage of at least 6.5 times the minimum wage, but this standard lasted only until the next minimum wage increase six years later. In 1996, Congress froze the minimum hourly wage for the computer exemption at $27.63 (6.5 times the 1990 minimum wage of $4.25 an hour). In addition, as noted above, the Department has repeatedly rejected requests to mechanically rely on inflationary measures when setting the salary levels in the past because of concerns regarding the impact on lower wage geographic regions and industries. This reasoning applies equally when considering automatic increases to the salary levels. The Department believes that adopting such approaches in this rulemaking is both contrary to congressional intent and inappropriate.[8]

Now, the Department seems to be admitting that it is incapable of doing its job:

> This history underscores the difficulty in maintaining an up-to-date and effective salary level test, despite the Department's best intentions. Competing regulatory priorities, overall agency workload, and the time-intensive nature of notice and comment rulemaking have all contributed to the Department's difficulty in updating the salary level test as frequently as necessary to reflect changes in workers' salaries. These impediments are exacerbated because unlike most regulations, which can remain both unchanged and forceful for many years if not decades, in order for the salary level test to be effective, frequent updates are imperative to keep pace with changing employee salary levels. Confronted with this regulatory landscape, the Department believes automatic updating is the most viable and efficient way to ensure that the standard salary level test and the HCE total annual compensation requirement remain current and can serve their intended function of helping differentiate between white collar workers who are overtime-eligible and those who are not.[9]

The Department also states that automatic annual increases to the salary level will "promote government efficiency by removing the need to continually revisit this issue through resource-intensive notice and comment rulemaking."[10]

The Department seems to be missing the point of the Administrative Procedure Act ("APA"). Congress *intended* rulemaking to be "resource-intensive," and section 13(a)(1)'s directive to the Department to define and delimit the white collar regulations "from time to time" seems fairly unambiguous; Congress *wants* the Department to "continually revisit" the Part 541 regulations. There is no indication that Congress wanted to put these regulations on autopilot.

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[8] 2004 Final Rule at 22171-72.
[9] 2015 NPRM at 38539.
[10] *Id.* at 38537.

The Department argues that Congress' failure to provide "guidance either supporting or prohibiting automatic updating" indicates it has authority to do so. However, equally plausible is the assumption that Congress felt no need to act because: (1) the Department, in the 77-year history of the FLSA, has never seriously considered indexing the salary level; (2) in 2004, the Department concluded that indexing would violate congressional intent; and (3) Congress' failure to ever index anything under the FLSA is sufficient guidance.

The Department also now states that the 2004 final rule "did not discuss the Department's authority to promulgate such an approach through notice and comment rulemaking."[11] In 2004, the Department concluded that indexing the salary level is "contrary to congressional intent." Once concluding that Congress did not give the Department authority to provide automatic increases to the salary level, the subject was closed; the Department could not then proceed to adopt indexing through the regulatory process. The Department provides no explanation of why its views on congressional intent have changed.

Notice and comment rulemaking has achieved the purpose of the APA by ensuring vigorous public debate about the salary levels, including submission of salary information in public comments. The regulatory history shows that the Department has adjusted its proposals based on public comment. Proposed salary levels have been increased and decreased in the final regulations. For example, in 2004, in response to the public comments, the Department increased its proposed standard salary level from $425 per week to $455 per week, and the annual compensation for the highly compensated test from $65,000 to $100,000. The Department's proposal for automatic salary increases would end this public debate forever.

Similarly, the Department's proposed methodology for determining the amount of the annual increase is not well thought out. Particularly troubling is the proposal to reset the salary level every year using a "fixed percentile" – pulling the flawed CPS data, year after year, to determine the 40th percentile of full-time, non-hourly paid earnings.[12] The Department seems to favor this approach, but has apparently missed a huge problem: An index that recalibrates the 40th percentile each year, based on salaries of non-hourly paid employees, will be relying on an ever shrinking pool of such employees, causing a never-ending, upward ratcheting effect. In response to the final rule, employers may give a salary increase to some exempt employees already near $50,440. However, employers will need to reclassify millions of other employees to non-exempt status. Although non-exempt employees may be paid on a salary, a significant percentage of reclassified employees will be converted to hourly pay. Consequently, the lowest paid salary employees are likely to leave those ranks. As a result, the 40th percentile of employees remaining in the data set will correspond to a higher salary level, which will further reduce the number of employees who meet the salary threshold. This upward shift at the 40th percentile will continue year after year. The result will be that tomorrow's 40th percentile and its salary level will be an even poorer proxy for the actual work performed by exempt employees because the measure itself will drive the outcome.

[11] 2015 NPRM at 38537.
[12] 2015 NPRM at 38540.

An analysis by Edgeworth Economics illustrates how quickly the minimum salary level for exemption will increase: "If just *one quarter* of the full-time nonhourly workers earning less than $49,400 per year ($950 per week) were re-classified as hourly workers, the pay distribution among the remaining nonhourly workers would shift so that the 40th percentile of the 2016 pay distribution would be $54,184 ($1,042 per week), about 9.6% higher than it was in 2015." [13] This process would repeat each year as the lowest-paid nonhourly workers fail the salary test and are re-classified as non-exempt hourly workers. After five years, even in the absence of inflation, "the new 40th percentile of the nonhourly pay distribution would be $72,436 ($1,393 per week), which is about 46.6% more than the minimum salary threshold in 2015."[14]

This upward ratcheting "becomes more pronounced if more nonhourly workers who failed the salary test are re-classified into hourly positions each year."[15] For example, if half of the reclassified employees are paid hourly, the 40th percentile "will increase by 19.9% in the first year and by 94% over a five year period. This means that a salary threshold of $49,400 ($950 per week) in 2015 would increase to $95,836 ($1,843 per week) by 2020, even in the absence of inflation."[16]

In addition to the rulemaking and precedential issues, adopting the consumer price index as the measure for increasing the salary threshold would also be problematic as prices and salaries are related only in the long run. Year-to-year there have been wide differences in their rates of increase and shifts in job duties are more closely correlated with wages than prices.

The Department also fails to consider the impact of automatic increases during a future economic downturn. Employers will be denied the option of lowering salaries to quickly respond to decreased revenue experienced in bad economic times. Both of the proposed methodologies for setting the new salary levels will be slow to reflect actual economic conditions. Implementing automatic increases in the salary threshold, by whichever methodology, will guarantee increases at precisely the wrong times for employers and employees. If the Department wishes to cement a legacy of negatively impacting future employers, there could hardly be a better way.

VI. DUTIES TESTS

In addition to earning the minimum salary level paid on a salary basis, an employee does not qualify for an exemption unless he or she also meets one of the duties tests for exemption. The Part 541 regulations establish different duties tests for executive, administrative, learned professional, creative professional, computer and outside sales employees. Many employees

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[13] *"Indexing the White Collar Salary Test: A Look at the DOL's Proposal,"* Edgeworth Economics (Aug. 27, 2015), *available at* http://www.edgewortheconomics.com/experience-and-news/edgewords-blogs/edgewords-business-analytics-and-regulation/article:08-27-2015-12-00am-indexing-the-white-collar-salary-test-a-look-at-the-dol-s-proposal/.
[14] *Id.*
[15] *Id.*
[16] *Id.*

earn above the minimum salary level, but cannot be classified as exempt because they do not supervise employees, are not involved with managing the business or do not hold professional degrees – engineering technicians, who often earn $80,000 or even $100,000 annually depending on the industry, are a good example.

There is much confusion and concern in the business community regarding what changes the Department intends to make to the duties tests. In the NPRM, the Department stated that it "is not proposing specific regulatory changes at this time" and that the agency "seeks to determine whether, in light of our salary level proposal, changes to the duties test are also warranted."

Instead, the Department raises "issues" for discussion, thus indicating that the agency is considering some very significant and unprecedented changes:

- What, if any changes, should be made to the duties test?

- Should employees be required to spend a minimum amount of time performing work that is their primary duty in order to qualify for the exemption? If so, what should that minimum be?

- Does the single standard duties test for each exemption category appropriately distinguish between exempt and non-exempt employees? Or, should the Department reconsider our decisions to eliminate the long/short duties test structure?

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

The Department also is requesting comments regarding what additional occupational titles or categories, as well as duties, should be included as examples in the regulations, especially in the computer industry.

The NPRM contains no proposed changes to the regulatory text describing the duties that employees must perform to qualify for exemption. However, the Department's failure to propose specific changes to the regulatory text does not mean that the Department will not make any changes to the duties test in the final regulations. Traditionally, under the Administrative Procedures Act, the Department would be effectively precluded from making changes because it will not have given the public notice and the opportunity to comment. But, the Department has not foreclosed that possibility. To the contrary, in an email responding to a question from the publication Law360, the Department stated, "while no specific changes are proposed for the duties tests, the NPRM 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."

The Department's failure to provide specific regulatory text for any of these "issues" is perhaps the most alarming aspect of the NPRM. Perhaps the Department plans to rely on the "logical outgrowth" doctrine that allows regulators to issue final regulations that are a "logical outgrowth" of the proposed regulations. But "outgrowth" implies *something* to grow out of. Words matter. Specific word choices, and even the placement of a comma, can make a significant difference in how a regulation is interpreted and applied by the Department itself and by federal courts. Yet, apparently, the Department is signaling that it plans to make changes to the specific text of the regulations, especially if the business community objects to the high $50,440 salary level, without giving the public any chance to review and comment on that language. Even if the Department has a colorable argument that it need not propose specific regulatory text, making significant changes to the Part 541 regulations without first doing so flies in the face of Congress' intent in passing the Administrative Procedure Act to allow the public a meaningful role in rulemaking, and also contradicts the Administration's promise to bring more transparency to the federal government's policy-making process.

Small businesses will be significantly and adversely impacted if the Department adopts changes to the duties tests. Small businesses rarely have access to expert employment attorneys or human resources personnel to guide them in complying with wage and hour laws. Changing the duties tests without providing a sufficient opportunity to comment on the specific changes, and imposing a short effective date, will make it difficult, if not impossible, for small business to comply with the final regulations. This is especially true if the Department's final rule moves toward the California over-50% quantitative rule for determining primary duty, eliminates the concurrent duties test for executives, or returns to the "long test" – a test effectively inoperable since the early 1980s.

This concludes my statement. I would be pleased to respond to any questions.