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Strategy & Insights

Seyfarth Shaw LLP's FLSA Update

Changes to the FLSA's White Collar Exemptions: Where are we now? What should we be doing?

By Brett Bartlett, Alex Meier, and Kevin Young

Over the past few months, Seyfarth Shaw's lawyers met with business leaders from coast to coast—representing industries and interests from every facet of the American economy—to discuss the Department of Labor's proposed changes to the federal regulations that define who is exempt from the Fair Labor Standards Act's minimum wage and overtime requirements. Those with whom we spoke expressed an understandable and firmly held conviction that the DOL's proposed changes would cause significant disruptions to, and likely require sweeping changes across, their businesses. Some expressed concern that the changes would threaten their survival.

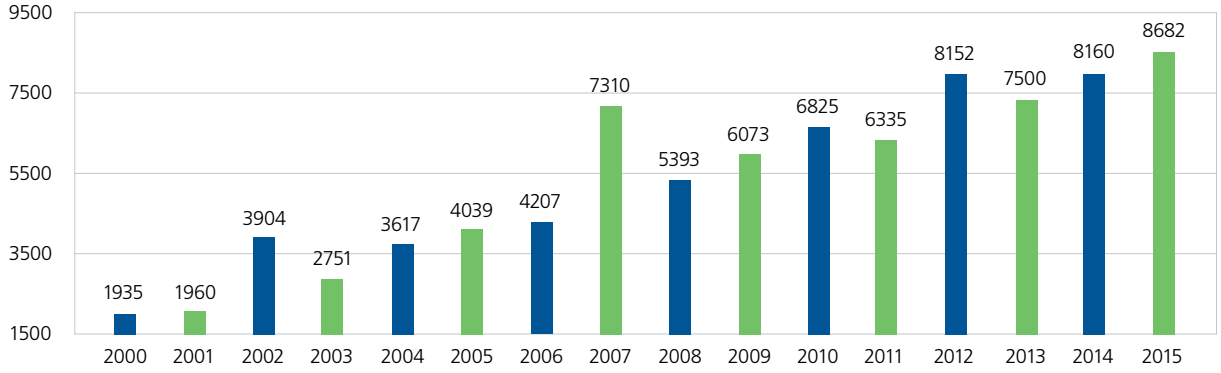
We listened carefully to the businesses' concerns. We carefully considered them. We agreed with nearly all of them.

Seyfarth submitted comments to the DOL on September 4, 2015, as part of the rulemaking process initiated by the agency on June 30, 2015. Our comments, which were informed by the concerns that we heard from so many business leaders, identified the myriad substantive and procedural issues presented by the Department's proposed changes. Our full comments are available *here*.

The comments matter. Agencies have an obligation to consider and address challenges to the legitimacy and feasibility of proposed regulations. We hope that our comments, which detail why businesses across the country are so concerned by the proposed rules, will help to convince the DOL that it has not done the work necessary to justify implementing the rules. Our comments explain why the proposed changes would cause more harm than good.

If enacted, the proposals would certainly do one thing: increase FLSA claims. In the past, overhauls to established regulations have created a spike in litigation; businesses scramble to become compliant and plaintiffs' attorneys set their sights on both slow-adopters and untested regulatory language. The last major revisions to the FLSA occurred in 2003, and the next year saw the number of wage and hour claims filed in federal courts soar. Of course, as the chart below demonstrates, federal overtime and minimum wage lawsuits filed across the country have increased steadily during the past two decades. A spike similar to that seen in 2003 would, of course, be disruptive to businesses regardless of their industry and could push the total number of lawsuits filed under the FLSA to record highs.

FLSA Cases 12 months ending September 30th



The federal court system releases Federal Judicial Caseload statistics. We used those reports for past years and based the 2015 filing total on Public Access to Court Electronic Records ("PACER") categorization for filings from April 1, 2015 to September 30, 2015. The filing totals do not include state law wage-and-hour claims.

All signs suggest that another spike is imminent. The DOL forecasts a sharp increase this year In anticipation, the Department has hired roughly 300 new investigators to investigate and pursue potential FLSA violations. The federal fiscal year ended on September 30, and the most recent data available shows that 522 more FLSA lawsuits were filed between October 1, 2014, and September 30, 2015, than in the prior 12-month period.

Here, we have summarized the proposed regulations and our comments. We also included recommendations on how to prepare. Even if the final regulations are less ambitious than the DOL's proposal, businesses will need to take a hard look at who actually performs exempt duties, how those employees are paid, and what should be done to minimize the regulations' impact on their bottom line. Advance planning will go a long way to maintaining productivity levels and ensuring that employees understand and, to the extent possible, buy into whatever changes must be made.

The Proposed Regulations

The DOL's proposed changes are a mixture of concrete revisions and potential modifications.

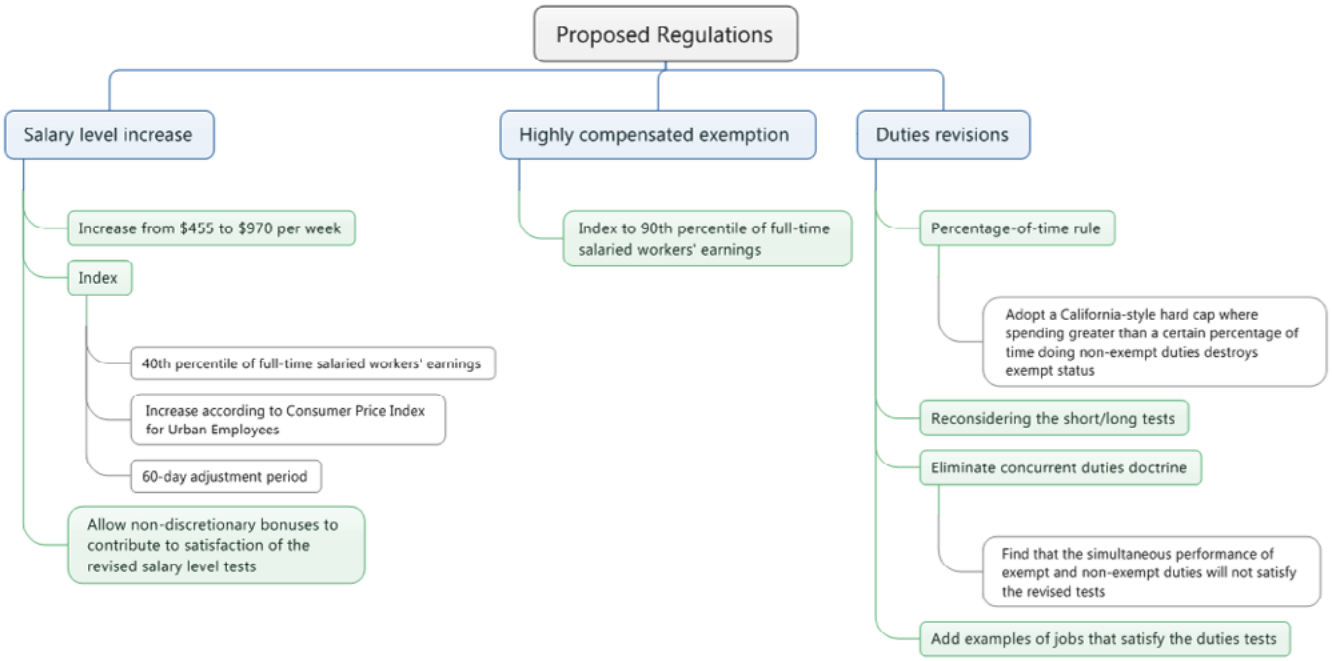
Most concretely, the revisions would alter the minimum salary level for exempt status from $455 per week ($23,660 yearly) to $970 per week ($50,440 yearly). The DOL also proposes increasing the salary level requirement on a year-to-year basis. The metric for making those adjustment remains unsettled. It may be tied to the Consumer Price Index for All Urban Consumers (CPI-U) or the 40th percentile of the weekly earnings for all full-time, non-hourly employees nationwide. Another exemption, the highly compensated exemption, would also be subject to annual revisions to match the 90th percentile of weekly earnings. For future adjustments, businesses would have 60 days after the revision date to ensure compliance.

The DOL has also suggested that it might revise its stance on excluding nondiscretionary payments from salary level determinations. Certain nondiscretionary payments, like bonuses tied to meeting specified performance metrics, could count toward satisfying the salary level requirement. The DOL's proposed revision, however, would cap the nondiscretionary amount includable in the salary level at 10% of the payment and require payments to be made on a monthly or less frequent basis. And while the DOL has not proposed specific alterations to the duties tests, some changes might be in the works. The DOL's notice of proposed rulemaking poses several questions to the public, each of which drives at whether the tests should be altered in some significant way. For example, the Department asks whether it should add a California-style-percentage-of-time rule to the duties tests. If enacted, such a rule could have major consequences in several major industries, including retail, restaurant, and hospitality.

Based on the DOL's line of questioning, the concurrent performance of exempt and non-exempt duties may also jeopardize exempt status under the incoming regulations. Under current law, concurrently performing exempt and non-exempt duties, like an assistant manager stocking shelves while overseeing her subordinates, does not convert an employee from exempt to non-exempt. An employee's simultaneous performance of both exempt and non-exempt duties may, however, be subject to a percentage-of-time requirement or some yet-undisclosed modification.

And the DOL has asked whether it should add examples of the types of duties that employees in various, unidentified job positions might perform that likely would or would not qualify for exempt status. As an example of the potential examples, the DOL compares "a help desk operator whose responses to routine computer inquiries . . . are largely scripted or dictated by a manual that sets forth well-established techniques or procedures," and "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." (While the former is clearly not exempt and the latter clearly is, the reality is that most computer-centric jobs fall somewhere in between.)

This chart summarizes the changes:



We found the following proposals were among those causing industry leaders the greatest concern.

Salary Level Revisions Without Locality And Industry Adjustments

The DOL's heightened salary level proposal is based on nationwide data and does not account for regional or industry variations. It appears that, in the DOL's mind, there is no difference between wages paid to an exempt employee in Philadelphia, Pennsylvania and another in Philadelphia, Mississippi. The business leaders with whom we spoke are gravely concerned by this shortsightedness; it is not unusual for an employer with operations in multiple locations to see drastic swings in the wages that it pays employees depending on where they live and work. Even the federal government makes locality adjustments. A federal government General Schedule employee in the "locality" of "San Jose-San Francisco-Oakland," California, receives locality pay of 35.15% of the applicable base salary grade. This means that a Grade 9, Step 1 employee in the San Francisco area earns an annual salary of $57,302. In contrast, a Grade 9, Step 1 employee in Puerto Rico receives locality pay of 14.16% of the applicable base salary grade, which yields an annual salary of $48,403. Erasing geographic cost-of-living considerations for salary determinations is at odds with how the government compensates its employees. Other employers should be entitled to the same level of flexibility.

Further, the DOL's proposal fails to account for differences in pay across industries. High volume, low margin industries would be especially hard-hit. Businesses in these industries, like retail, expressed particular concern. For example, the annual mean wage for First-Line Supervisors of Retail Sales Workers nationally is $42,190. Meanwhile, the mean wage for all other First-Line Supervisor is $84,010—approximately 175% of the proposed salary level.

A salary level adjustment of this magnitude would ripple across these businesses' compensation structures. If the salaries of First-Line Supervisors were raised by as much as $26,780 in 2016 (i.e., from $23,660 or more to at least $50,440 annually), many employers would find it necessary to raise the salary level of those employees' managers and supervisors as well. Otherwise, entry-level managers would suddenly earn almost as much as their immediate supervisors. Depending on the differentials that employers currently maintain in the pay rates of their employees at successive levels of the organizational hierarchy, the salaries of the supervisors' supervisors could have to be raised as well.

To offset the dramatic increase in labor costs, the retail employer might have no choice but to make operational changes. These could include: reducing the number of regional managers and increasing their workload by requiring them to supervise a greater number of stores across a broader geographic area; closing less-profitable locations where the salary increases could not be absorbed, and laying off both exempt and non-exempt store employees or requiring them to relocate to other stores; demoting or firing the store managers whose work performance did not justify a salary level of $970 or more per week; hiring more non-exempt, part-time employees to share the workload of the displaced store managers and regional managers while avoiding the incursion of expensive overtime hours; and focusing even more resources toward growth of online business.

Automatic Increases by Index

The DOL has also suggested that its final revisions to the white-collar exemptions will include a salary escalator that, in effect, will increase the exemptions' salary level requirement each year. The Department defends this proposal as a necessary change to prevent gradual erosion because of inflation. In our comments, we explained our belief that the DOL lacks the authority to implement such a rule, and its proposed timeline for implementing adjustments would leave businesses scrambling to ensure that exempt workers with salaries close to the minimum requirement remain exempt. In 2003 and 2004, when it last revised the white collar exemptions, the Department concluded that it lacked the authority to implement automatic increases to salary levels. It was correct then, and it is wrong now.

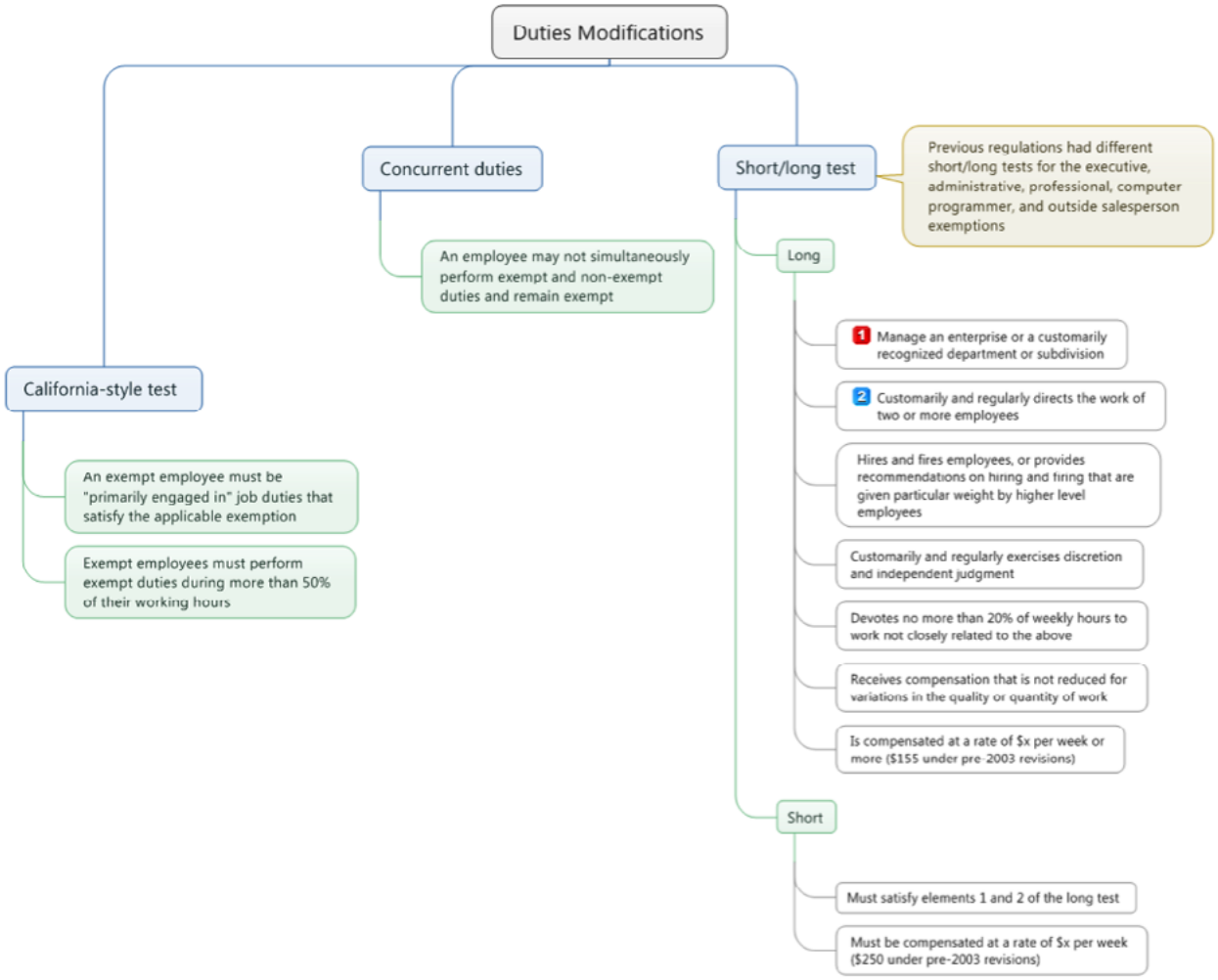
Duties Revisions

Although the DOL did not outline specific proposed revisions to the white-collar exemptions' duties tests, it asked a series of questions apparently intended to evaluate whether it should modify the current tests. As many industry leaders agreed, we explained in our comments that the implementation of revised duties tests without having proposed a single regulatory revision would create confusion at best and chaos at worst.

First, the DOL has an obligation to present its *proposed* regulations for comments, not present whatever questions may prompt changes to current regulations. Absent concrete proposals, the public cannot offer meaningful feedback on whatever regulations the DOL ultimately decides to implement.

Second, if the DOL were to adopt a percentage-based duties test or resurrect something resembling the pre-2004 short/long test, it would materially hinder the ability of employers to classify employees as exempt, increase the amount of FLSA cases litigated, and prevent determinations on many FLSA exemptions absent going to trial.

The chart below illustrates how the revised duties tests might depart from the current duties tests:



Recommendations

We anticipate that the final rules will be implemented by November 2016, though the exact implementation date will depend on the DOL's response to the comments it received. In the interim, we recommend:

- **Reviewing "borderline" employees**. For employees earning more than $45,000 but less than $50,000, assess whether it would be more effective to raise the employees' salaries, bring in additional, lower-wage employees, or convert most borderline employees to non-exempt status. For borderline employees with discretionary bonuses, take a look at converting part of their bonus to a guaranteed bonus.

- **Going empirical**. The actual economic impact on your business hinges on how many, if any, overtime hours are necessarily worked by the employees you might reclassify. We recently *posted* an article discussing how employers can use proxy data and pilot studies to help estimate how many hours exempt employees work per week and minimize the financial impact of reclassification.
- **Examining duties.** If you have employees who frequently perform the same tasks as the employees they supervise, consider how it would affect your business if they exclusively performed managerial work for at least half their time at work.
- **Revisiting corporate organization**. If the new regulations were implemented, would it be more cost efficient to hire more nonexempt, part-time employees at much lower hourly wage rates to share the workload? If you opt to hire more part-time employees, will that affect your compliance with the Affordable Care Act?
- **Keeping geography in mind**. Many businesses are drawn to low cost-of-living areas because employees will accept lower wages. If you have a "top-heavy" business with many employees who perform exempt duties but fall short of the proposed salary level, consider shifting those functions to a higher cost-of-living area and keeping non-executive functions in the low cost-of-living area.
- **Having the tough talk with H.R. and I.T**. Sit down with your Human Resources and Information Technology officers to determine whether your current infrastructure can handle, or be scaled up to handle, a large increase in employees who need to clock in and out. Discuss how policies concerning email access and work laptops may need to be revised to prevent "off-the-clock" claims for the newly non-exempt. Begin to examine how you will deliver the news to formerly exempt employees without making them feel like they've been "demoted" to hourly positions.
- **Taking the opportunity to ensure compliance**. Make sure that employees classified as exempt are actually performing exempt duties and being paid a sufficient salary on a FLSA-compliant salary basis.
- **Making sure that you thoroughly consider how these regulatory revisions will affect your organization by talking to your Seyfarth wage-and-hour lawyer.** These are the kinds of matters that justify the attorney-client privilege and the attorney work product privilege protections. Wage and hour litigation is rampant. Don't risk harm during a lawsuit for doing the right thing with your review.

We will continue to monitor the regulatory process and issue an update when the DOL publishes the final rules. In the interim, please feel free to contact us if you have any questions about how the proposed changes might affect your business or how your business should begin preparing for the incoming modifications.

Seyfarth Shaw LLP's national Wage & Hour Litigation Practice Group comprises more than 100 lawyers who devote all or a substantial portion of their practices to helping U.S. businesses comply with local, state, and federal minimum wage and overtime requirements, and to helping businesses defend lawsuits and investigations concerning those laws. Its FLSA Overtime Exemption Task Force has mobilized to protect businesses against the dramatic regulatory changes impacting industries across our economy. Contact the authors or your favorite Seyfarth lawyer if we may assist you.

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