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Before the
United States House of Representatives
Committee on Education and the Workforce

Hearing on
"The Administration's Overtime Rule and Its Consequences for Workers, Students, Nonprofits, and Small Businesses"

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Chairman Kline, Ranking Member Scott, and Members of the Committee:

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

Currently, I am a partner in the Washington, DC office of Seyfarth Shaw LLP, where my practice focuses on helping employers comply with the Fair Labor Standards Act (FLSA), the Service Contract Act, the Davis-Bacon and Related Acts, and state laws related to the payment of minimum or prevailing wages and overtime. The majority of my practice is providing advice and counsel to employers on independent contractor status, overtime exemptions, and other pay practices. I represent employers during wage-hour investigations by the Department and state enforcement agencies.

I have been working on wage and hour issues since entering private practice in the Fall of 1997. In 2005, I left private practice and joined the leadership team of the U.S. Department of Labor's Wage & Hour Division (WHD). In 2006, I was appointed Deputy Administrator of WHD and, in 2007, I became the Acting Administrator. President George W. Bush nominated me to serve as the Administrator in March 2008. I left WHD in 2009 and returned to private practice.

In my testimony today, I will be discussing some of the compliance difficulties likely to face employers—whether they be large, multi-state employers, small businesses, educational employers, or non-profits—under the Department's newly-issued regulations regarding the most-frequently-used exemptions from the FLSA's minimum wage and overtime requirements. In particular, my testimony will focus on the challenges that these employers have been and will continue to face as a result of the Department's decision to double the minimum salary required for exemption and to increase automatically that salary level every three years.

Despite my involvement with a number of associations, including the Partnership to Protect Workplace Opportunity, and my representation of many employers attempting to come into compliance with the new standards, my testimony today is solely my own.

In the short period of time since the revisions were published, it has become clear that it will be incredibly difficult for many employers to implement. Although a few employers may find that all they need to do is "flip a switch," for the vast majority the revisions require a thorough and thoughtful analysis of the costs and benefits associated with each of the potential options for formerly exempt employees currently earning an annual salary between $23,660 and $47,476.

Ultimately, employers are weighing the increased costs of increasing salaries (both for the impacted employees as well as "upstream" employees) against the impacts of converting employees to non-exempt status. As discussed in more detail below, those impacts include:

- harming the ability of employers to provide, and employees to take advantage of, flexible scheduling options;
- treating employees in the same job classification (for the same employer) differently based on regional cost-of-living differences;
- limiting career advancement opportunities for employees;
- decreasing morale for those employees who are demoted to non-exempt status, particularly where peers in other locations remain exempt;
- reducing employee access to a variety of additional benefits, including incentive pay;
- deterring employers from providing newly-reclassified employees with mobile devices and remote electronic access, further limiting employee flexibility;
- increasing FLSA litigation based on off-the-clock and regular rate of pay claims; and
- introducing other legal and operational issues, such as increased administrative costs.

Complicating the analysis is the fact that the Department's revisions would require employers to revisit these issues every three years, deciding whether continued classification of an employee as exempt is worth the new threshold salary increase.

Many of the issues facing employers are due to the significant and abrupt change to the minimum salary required by the revisions. The new salary level is higher than the exempt salary levels set under any state law (*e.g.*, California and New York). Notwithstanding the Department's minimal reduction of the level from the proposal, the level remains too high to achieve the historical purpose of the salary level, will force employers to make classification decisions that ignore regional economic differences, and will cause significant disruption in the workplace. The wage costs, administrative expenses, and intangible consequences of the Department's revisions will be significant.

Unfortunately, the Department's revisions do little to promote the President's directive to "modernize" the regulations. Rather, they will place large numbers of employees under a regulatory scheme that was last updated in the 1960s and is fraught with uncertainty. Indeed, the Department itself is so uncertain of how this regulatory framework applies to the modern workplace that it plans to issue a Request for Information on some of the critical issues. Of course, employers do not have the luxury of waiting for the Department to modernize the regulatory scheme; they must address these issues before the December 1, 2016, effective date.

As a result, the Department's revisions will return us to a 1940s mentality of clock-punching for all but the most highly paid employees. This result is bad for employees and employers alike.

Factors Considered by Employers in Increasing Salary

One of the issues facing employers is the fact that the new salary level often cuts directly through a classification — some employees have salaries in excess of the new level; others fall below. This can be due to a wide variety of reasons, including seniority and experience. Often, it is a result of regional cost-of-living variations. There are substantial pay differences based on geographical region and pay differences between larger and smaller cities that are simply not related to differences in job duties. Because the cost of living varies greatly throughout the country, employers often have different salaries for the same job position depending on where the employee works, similar to how the federal government operates. The job duties are precisely the same. The only thing that differs is location.

For example, an employee in New York City will have a higher cost of living than an employee working in Knoxville, Tennessee. Accordingly, the employer may provide the employee in New York with a higher salary than the employee with the same job title and job responsibilities in Knoxville. With the Department's increase to the minimum salary level, that employer may now need to decide whether the economics of the Knoxville location justify an increase to the new salary level or whether the Knoxville position will need to be reclassified as non-exempt.

Of course, the "economics" of the Knoxville location may also require the employer to increase the salary of the employee in New York to address the cost of living difference. And employers may find that increasing the salary for one employee or group of employees may result in still further costs. Where employees below the proposed salary minimum have their salaries raised to meet the new minimum, employees above the new minimum will likewise need to have their salaries raised to account for the relative value of the work being performed.

Higher levels of education, skill, experience, responsibility, and seniority should (and currently do) correspond to increased compensation. Employers thus attempt to avoid actual or perceived disparity between job titles and comparative compensation. Employees with higher positions, more job responsibility, and better qualifications than others expect to be paid accordingly. If an employer fails to do so, the salary compression will negatively impact employee morale in the workplace.

For example, assume that a group of currently-exempt employees earn $700 per week and their supervisors earn $1,000 per week. The decision to raise the employees' salary to $913 per week to continue their exempt classification does not simply impact those employees. Their supervisors—although not legally required to be paid more to be treated as exempt—nevertheless will need to be paid more to maintain morale and avoid salary compression.

These increased costs have a direct and complicated impact on the determination on whether to reclassify a position to non-exempt as a result of the increased minimum salary level. There are real administrative expenses associated with these decisions. The decision on classification cannot be made in a vacuum; it must consider the impact on other positions from a salary compression standpoint.

Against these very real costs associated with increasing salary levels—for affected employees, for regional cost-of-living differences, and to address salary compression—employers must weigh the consequences of reclassifying affected employees to non-exempt status.

Factors Considered by Employers in Converting to Non-Exempt Status

Converting an employee to non-exempt status means that the employer must treat the employee as non-exempt for all purposes. This means accurately tracking time, ensuring compliance with the minimum wage and overtime provisions, and properly computing the regular rate of pay for overtime.

With respect to tracking time, converting employees to non-exempt status means throwing them into a regulatory scheme developed for the workplace of a different century. Taking them from the 2004 white-collar exemption regulations and placing them under regulations that use as examples messengers working the crossword puzzle, firemen playing checkers, and telephone operators with switchboards in their homes. Most of the cases cited in these regulations are from the 1940s and 1950s.

To say that the workplace has changed significantly since that time is an understatement. The population of workers most likely subject to the Department's revisions—*e.g.*, knowledge workers, entry-level managers—are precisely the types of workers that demonstrate just how significant that change has been.

Although the hours of work regulations provide fairly relevant guidance in determining what parts of a "normal" workday are compensable, they are woefully inadequate in addressing the modern workplace. For example, an employee who gets in her car, travels to the office, answers e-mail all day on a computer, plays solitaire during the downtime, takes an hour for lunch, and returns home is likely on the clock from when she arrives at the office until she leaves the office, less the hour taken for lunch. In an "ordinary" workplace, the downtime and the waiting time between e-mail and response are compensable time; the travel time and the meal period is not.

On the other hand, take an employee who spends an hour responding to e-mail at home, drives to the office, leaves to run an errand and get lunch, which he eats in the car on the way to a coffee shop near his kids' school where he works for a couple of hours before picking them up. He then brings them home, preps dinner, and takes them to their softball practices. All the while, he is responding to e-mail on his mobile device and even takes a call or two. He returns home, feeds the kids dinner, puts them to bed, then responds to e-mail for 20 minutes before watching the latest episode of Game of Thrones on the very same device. At the conclusion of the show, he responds to an e-mail he had been waiting for, then goes to bed.

The old understandings of waiting time, travel time, work time, and even workplace are pushed beyond the point of breaking in this example. How does an employer determine what time is paid and what time is not? Where do the principles of "continuous workday" begin and end? The answers are not clear. The regulations, guidance, and cases provide arguments on virtually every side of the issues. And, every day, employers are sued over the seemingly minor bits of time that have not been included in an employee's hours of work.

Faced with the uncertainty of anything other than being sued, many employers long ago decided that non-exempt employees would not have remote access or work-related mobile devices. Many employers will make the same decision with respect to newly-reclassified workers. Though there may certainly be some employees who feel relief at being untethered, many others will be disappointed by the lack of flexibility in their workday that loss of remote access affords.

It is the employer's obligation to keep adequate records of employees' time, and the complicated application of the old concepts to the new workforce may force employers to make decisions that they would not otherwise make. It is also the fact that employers are responsible for tracking time that makes the Department's insistence that there is no requirement to "punch a clock" so disappointing. While hyper-technically accurate, any employer that wishes to avoid time-consuming and expensive litigation will require its employees to thoroughly track time, not simply to write down "8" at the end of each workday. Small amounts of time, repeated daily, by hundreds of employees add up quickly and result in massive exposure for employers.

In addition to the hours worked issues, there are significant issues related to regular rate of pay. In creating conditions in which employees must be reclassified to non-exempt status, the Department's salary level will negatively impact many employees' ability to earn incentive compensation. When employees are converted to non-exempt status, they often find that they have lost their ability to earn incentive pay. Under the existing rules for calculating overtime rates for hourly workers, many incentive payments must be included in a non-exempt employee's "regular rate" (*i.e.*, the base rate for overtime) of pay. Faced with the difficult calculation (and recalculation) of these overtime rates—sometimes looking back over every pay period in a year—employers often simply forgo these types of incentive payments to non-exempt employees rather than attempt to perform the required calculations.

In determining whether to convert an employee to non-exempt status, employers must consider the impact on morale. Employees often view reclassifications to non-exempt status as "demotions." Particularly where other employees within the same organization will continue to be exempt (due to regional economic variations or full-time status), it is easy to see why. The non-exempt employee will now need to account for his or her time in a way he or she has not had to previously. In addition, because of the increased attention that must be paid to the hours worked by the non-exempt employee, he or she is likely to be at a competitive disadvantage to the exempt employee in the same role. Many training opportunities will now become compensable time under the FLSA and where those opportunities would put the non-exempt employee into an overtime situation, his or her access to those opportunities may be limited; the same is not so for his or her exempt colleague.

Similarly, the non-exempt employee may be limited in his or her ability to "get it done" now that he or she must record and account for all hours worked. These types of intangibles—being known as someone who "just gets the job done"—are often considered in whether an employee receives a promotion, bonus, or training opportunity. As a result of the Department's dramatically increased minimum salary level, career advancement may become more a function of where an employee sits than what he or she does.

Finally, employers need to consider how to pay employees who are converted to non-exempt: do they convert to hourly? Do they pay salary plus overtime? Do they convert to a fluctuating workweek arrangement (in those states that permit it)? Does the Department's legally inaccurate statement in a 2011 preamble impact the ability to pay incentive pay to employees under fluctuating workweek? Does the employer base the new hourly pay or salary on a 40-hour workweek, resulting in additional compensation (above the existing salary) for every overtime hour? Or is it better to base it on the hours worked by the employee such that the normal hours worked will be the equivalent of the existing salary? How will employees react to the decision? And how does the employer even determine how many hours are typically worked by employees who have not been recording time and who have not been beholden to the hours of work rules established by the Department in the 1960s?

All of these factors are weighed against the cost of increased salaries as employers address the classification decisions forced by the increased minimum salary. These are not easy decisions, and they take a significant amount of time and effort to address. Yet, in many cases, the decisions ultimately will end up being ones of form over function. Employees will work the same, they will earn the same (if not immediately, at least over time as raises are minimized to account for the additional overtime costs), but they will lose flexibility and be required to track their work in a way that they have not done previously.

Additional Specific Issues Raised by the Salary Increase

As expected, the Department's increase to the minimum salary level is negatively impacting the ability of employers to provide part-time exempt positions. Under the current regulations, an employee who performs tasks that clearly meet one or more of the exemption duties tests can be classified as exempt so long as his or her salary exceeds $23,660 per year. Thus, a part-time employee working a 50% schedule can qualify as exempt so long as he or she works in a position that has a full time salary of approximately $48,000 per year. This is true not because the full-time equivalent salary is $48,000, but because the part-time salary of $24,000 is still in excess of the regulatory minimum.

Under the Department's minimum salary level, that employee would no longer qualify for exemption. Instead, the Department's revisions require an employee working a 50% schedule to be working in a position earning more than $95,000 on a full-time basis. This will have a disproportionate impact on women in the workplace, and, in particular, likely will impact mothers who may be seeking to re-enter the workplace as professionals, but not on a full-time basis.

The Department's increase to the minimum salary level will create two classes of employees performing the same work: full-time exempt employees and part-time non-exempt employees. Employers would be unable (for practical purposes) to take a consistent approach to a job because it simply is not feasible to reclassify entire positions as non-exempt due to the issues related to part-time employees. As a result, however, individuals working side-by-side would be subject to different rules and obligations simply because one is a full-time employee and one is a part-time employee. Although fairness, and the nature of their work, should dictate that such colleagues be treated the same, the Department's new salary level all but requires the part-time employee to be treated differently. Teamwork, productivity, and morale will undoubtedly suffer.

We also have been hearing questions for which the Department has not provided adequate guidance. Some of these, such as the precise contours of how the 10% bonus provision will work (*e.g.*, what types of bonuses, how the applicable quarterly period is determined), are a direct result of the Department's rule. Others are more indirect; they are questions that are asked because employers are seeking new and creative ways to address the massively increased salary. These include questions on the application of the teacher and outside sales exemptions to positions that traditionally have not been classified as such (or, for which those exemptions may have been "fallback" positions), the types of positions that qualify for the academic administrative provision, and which "teachers" qualify as the basis for the provision that permits academic administrators to meet the exemption when paid on a "salary basis which is at least equal to the entrance salary for teachers in the educational establishment by which employed."

As is the case with the hours of work rules discussed earlier, the Department's revisions bring these provisions into the spotlight. The current regulatory scheme has not required employers to resort to these provisions. As a result, there is little-to-no guidance on how these provisions should be applied to the employees impacted by the salary increase. This uncertainty is likely to result in additional litigation in the future.

Impact on Small Businesses, Educational Employers, and Not-for-Profits

Regulatory familiarization, adjustment, and managerial costs will be significant for all employers. Perversely, however, these costs may be more significant for those organizations that can least afford it, such as small businesses, educational employers, and not-for-profits. These organizations have the least discretion in their budgets and, in many ways, they will need to be the most creative in developing solutions. As noted, compliance with the Department's revisions may not be as simple as reviewing the salary level and making a decision. Due to the many, varied issues identified, the time and effort associated with complying with the proposed rule will be immense as employers determine which positions will remain exempt, which will be reclassified as non-exempt, and how the employer will implement the conversion to non-exempt status, including adjustments to time and attendance systems and associated administrative issues.

The Department, however, has not done an adequate job of addressing all of the costs associated with the revisions, particularly the costs related to the impact on small businesses, many of whom do not have large human resources and legal departments to walk them through the tangled web of making these decisions. I understand that H.R. 4773, the Protecting Workplace

Advancement and Opportunity Act, would require that the Department address the significant costs associated with its rulemaking, particularly as it relates to small businesses and other entities most impacted by the increase.

The Department's Automatic Increase is Legally Questionable

H.R. 4773 would also prevent the Department from automatically implementing salary increases without notice-and-comment rulemaking. This would confirm that the Department lacks the ability to implement the automatic changes, which already appears to be the case.

In the NPRM, the Department stated that it sought "to 'modernize' the EAP exemptions by establishing a mechanism for automatically updating the standard salary test."[1] The Department suggests that automatic updates would "promote government efficiency by removing the need to continually revisit the issue through resource-intensive notice and comment rulemaking."[2]

The Department, however, cannot avoid its obligations to engage in notice-and-comment rulemaking simply because notice-and-comment rulemaking takes time and resources; a federal agency cannot exceed the limits of its authority or otherwise "exercise its authority 'in a manner that is inconsistent with the administrative structure that Congress enacted into law'" no matter how difficult an issue it seeks to address.[3]

At no point since Congress authorized the Department to issue regulations on the FLSA's section 13(a)(1) exemption has Congress granted the Department the authority to index its salary test. Congress could have provided such authority if it desired the Department to have it; Congress has permitted indexing expressly in other statutes, including the Social Security Act (which preceded the passage of the FLSA and was amended to add indexing in 1975) and the Patient Protection and Affordable Care Act (which was passed subsequent to the most recent revision to the Part 541 regulations). Yet Congress, despite full knowledge of the fact that the Department has increased the salary level required for exemption on an irregular schedule, has never amended the FLSA to permit the Department to index the salary level.[4] Congress's actions in the face of regulatory history demonstrate a clear intent that the salary level be revisited as conditions warrant, allowing the Department, and the regulated community, the opportunity to provide input into the appropriate level.

The Department's own actions in reaching out to the regulated community before publication of the NPRM, as well as soliciting input on the salary level in the NPRM itself, demonstrate the importance of notice-and-comment on the salary level. In 2004, the comment process resulted in increases to both the proposed salary level and the proposed highly compensated employee salary level. The Department is not omniscient on these issues, and automatic increases to the salary level are inconsistent with both the Department's statutory authority and with the Department's long-held understanding of the salary level's purpose. An annual revision to the salary level is inconsistent with the salary level's gatekeeper function. How can it be the case

[1] *See* 80 Fed. Reg. at 38,537.
[2] *Id.*
[3] *See FDA v. Brown & Williamson Tobacco Corp.*, 529 U. S. 120, 125 (2000) (internal citations omitted).
[4] Similarly, when Congress has amended the FLSA to increase the minimum wage, it has not indexed that amount.

that an employee is "clearly exempt" on December 31 and "clearly non-exempt" on January 1 of the following year because of the indexing calculation? A gate need not be moved on an annual basis to ensure that it functions properly; only when it approaches the end of its usefulness does it need to be "fixed."

The Department recognized its lack of authority to index the salary level in its 2004 rulemaking. And it acknowledges as much in the current NPRM, noting that it determined "nothing in the legislative or regulatory history . . . would support indexing or automatic increases."[5] The Department was correct in 2004, and nothing has occurred since that time to justify a different conclusion.

When the Department has increased the salary level in the past, it has done so by stating what the new salary level would be and by leaving adjustments to that level to the Administrative Procedure Act's required notice-and-comment rulemaking process. The current regulatory process also requires the Department to follow the Regulatory Flexibility Act and to undertake a detailed economic and cost analysis. In the revisions, however, the Department plans to announce a new salary level every three years in the Federal Register without notice-and-comment, without a Regulatory Flexibility Act analysis, and without any of the other regulatory requirements established by various Executive Orders. Each of those regulatory requirements is intended to force the agency to consider the consequences of its proposed actions and to ensure that the regulatory actions are carefully crafted and well-supported before being implemented. The rule thus operates as a "super-proposal," deciding once and for all what (in the Department's belief) is best without consideration of its impact now or in the future. In fact, it would not be possible for the Department to accurately estimate the impact of the automatic increases in future years as the workforce and the economy are always changing.

Conclusion

Since at least 1940, the Department has recognized that the purpose of the salary level is to "provid[e] a ready method of screening out the obviously nonexempt employees."[6] That is, the salary level should be set at a level at which the employees below it clearly would not meet any duties test; above the level, employees would still need to meet a duties test in order to qualify for exemption. In setting the proposed level as high as it has, however, the Department has turned this analysis on its head. The Department seems to be setting the salary level at a point at which all employees above the line would be exempt, turning the salary level from its historical role as a screening device into the de facto sole test and a mechanism for greatly limiting the ability of employers to avail themselves of these exemptions. Indeed, built into the Department's (erroneous) assumption that litigation will decrease as a result of this rulemaking is the belief that employees above the line will be more clearly exempt. That has never been the Department's goal in setting the salary level.

Such a dramatic departure from the historical purpose of the salary level will have far-reaching consequences. The Department's new minimum salary level will force employers to reclassify

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[5] *See* 80 Fed. Reg. at 38,537.
[6] *Defining and Delimiting the Exemption for Executive, Administrative, Professional, Outside Sales, and Computer Employees; Final Rule*, 69 Fed. Reg. 22,122, 22,165 (April 23, 2004).

positions that clearly meet the duties test where the nature of the industry (*e.g.*, non- profit) or the regional economy cannot justify a salary increase.

The Department has recognized that "the exemptions were premised on the belief that the exempted workers typically earned salaries well above the minimum wage and were presumed to enjoy other privileges to compensate them for their long hours of work, such as above average fringe benefits, greater job security, and better opportunities for advancement, setting them apart from the nonexempt workers entitled to overtime pay."[7] Yet, because the Department's revisions more than double the salary level, it would have the perverse effect of forcing many employers to take away the benefits, job security, and opportunities for advancement for those employees who will lose exempt status.

[7] *Defining and Delimiting the Exemption for Executive, Administrative, Professional, Outside Sales, and Computer Employees; Proposed Rule*, 80 Fed. Reg. 38,516, 38,517 (July 6, 2015).