Employer Update

Weil

March 2019

Round Two of the Department of Labor's Revised Overtime Threshold Requirements

By Gary D. Friedman, Celine J. Chan, and Lauren E. Richards

In This Issue

On March 7, 2019, the U.S. Department of Labor (DOL) released its long-awaited proposed rule to amend the overtime exemption regulations under the Fair Labor Standards Act (FLSA) for bona fide executive, administrative, professional, and highly compensated employees, also known as the FLSA "white collar" exemptions (the 2019 Proposed Rule). The DOL's highly anticipated 2019 Proposed Rule seeks to revise and update the 15-year-old overtime regulations, and has raised the specter of a potential round two of legal challenges reminiscent of the battles over the proposed overtime rules issued by the Obama administration in 2016 (the 2016 Rule). We previously wrote about the 2016 Rule and offered strategies for complying with it during the legal purgatory period. *See* Weil *Employer Update* articles dated January 2017 and May 2018.[1] While the 2019 Proposed Rule raises the overtime salary thresholds more modestly than the 2016 Rule (approximately to the midpoint between the current threshold and the 2016 Rule threshold), the 2019 Proposed Rule is not immune to challenge from both sides of the employment aisle. Indeed, worker-side advocates may be incentivized to raise challenges merely to delay implementation, in the hope that a new administration will be ushered in the wake of the 2020 presidential election and revive the 2016 Rule. In this article, we discuss the status of the DOL's 2019 Proposed Rule, the significant differences between the two administrations' efforts, what may lie ahead, and the strategies for employers to consider during this "limbo" phase.

The Current Status of the DOL's 2019 Proposed Rule (and Differences from the 2016 Rule)

Under the 2019 Proposed Rule, the minimum weekly salary required for exempt status would increase to $679 per week (the equivalent of $35,308 annually for a full-year worker), an increase of approximately 50% from the currently enforced level of $455 per week (the equivalent of $23,660 annually), which was established in 2004 during the George W. Bush administration. The 2004 salary threshold was set at approximately the 20th percentile of earnings of full-time salaried workers in the lowest-wage census region (then, and now, the South) and in the retail sector. The 2019 Proposed Rule employs the same methodology, undoubtedly with an eye toward minimizing legal challenges to this aspect of the rule.[2] The 2016 Rule, in contrast, would have increased the salary threshold to $913 per week (or $47,476 annually), based on the *40th percentile* of earnings of full-time salaried workers in the lowest-wage census region and in the retail sector,

and would have *automatically* increased this threshold every three years – a feature of the 2016 Rule that was declared "unlawful" by the district court.[3]

Under the 2019 Proposed Rule, while recognizing the need to update the earnings threshold on a regular basis,[4] future updates would be proposed only through notice-and-comment rulemaking every four years, and would allow the DOL to forestall proposing updates if economic or other factors so dictate. The DOL specifically declined to vary the threshold based on regional or other cost of living differences around the country. The DOL has estimated that in 2020, 1.1 million currently exempt employees who earn at least $455 per week but less than the threshold under the 2019 Proposed Rule would become overtime-eligible without some other intervening action by their employers. This is a significant reduction from the estimated 4.2 million exempt employees who were expected to be impacted by (and benefit from) the 2016 Rule (with even more expected to be excluded in the ensuing years, since the 2019 Proposed Rule dropped the automatic salary threshold updating aspect of the 2016 Rule). Indeed, in developing the 2019 Proposed Rule, the DOL stated specifically that it considered the district court's conclusion that the salary level set in the 2016 Rule "exclud[ed] so many employees who perform exempt duties" that it effectively made "salary rather than an employee's duties determinative" of the exemptions.[5]

The 2019 Proposed Rule would also increase the total annual compensation requirement to qualify as exempt under the highly compensated exemption[6] to $147,414, a substantial increase from the current $100,000 level. The 2016 Rule would have only increased this threshold to $134,000. However, both the 2019 Proposed Rule and the 2016 Rule adopted a similar methodology, setting the level equivalent to the 90th percentile of full-time salaried workers nationally, also projected to 2020 (with the 2019 Proposed Rule threshold accounting for updated data since the fourth quarter of 2015). While it may seem surprising that the current administration's DOL would raise the salary threshold for the highly compensated exemption higher than its predecessor did with the 2016 Rule, the DOL explained that it continues to believe that this exemption must "keep[] pace with growth in nominal wages and salaries" and "appl[y] only to those employees for whom it was originally intended, namely, those 'at the very top of [the] economic ladder.'" The DOL also stated that setting the highly compensated exemption threshold "appropriately high" would ensure that employers continue to apply the standard duties test to employees whose exemption status is truly "less clear." Without intervening action by employers, the DOL estimates that 201,100 currently exempt employees who meet the highly compensated duties test, but not the standard duties test, would become overtime eligible under the 2019 Proposed Rule.

Like the 2016 Rule, the 2019 Proposed Rule would allow employers to use non-discretionary bonuses and incentive payments (including commissions) to satisfy up to 10% of the standard salary level for exempt executive, administrative, or professional employees. Under the 2019 Proposed Rule, employers would need to make these payments on an *annual* or more frequent basis (as compared to quarterly under the 2016 Rule). Employers would also be permitted to make a final "catch-up" payment within one pay period following the end of each 52-week period to bring an employee's compensation up to the required level (up to 10% of the proposed increased threshold salary level, $3,530.80). Any such "catch-up" payment would count *only* toward the prior year's salary amount and not toward the salary amount in the year in which it was paid.

Significantly, the 2019 Proposed Rule, like the 2016 Rule, makes no changes to the standard duties test, which still must be satisfied in order for any of the applicable exemptions to apply. Notably, during its rulemaking process, the DOL did inquire whether a test for exemption based *solely* on employee duties would be preferable to the current test. However, according to the DOL, most commenters opposed a duties-only test, worried that such a test would result in a more rigid test with quantitative limits on non-exempt work, which would unduly burden business operations.

What Lies Ahead

The 2019 Proposed Rule was published in the Federal Register on March 22, 2019, approximately two weeks after the DOL otherwise made the NPRM public. The public now has 60 days from the date of publication (*i.e.*, until 11:59 p.m. on May 21, 2019) to comment on the proposed rule,[7] which, according to the NPRM, uses "a longstanding and commonsense methodology" "based on broad-based input" to revise the FLSA "white collar" exemptions.[8] A significant number of comments are expected, which will become a matter of public record. As part of the request-for-information process in 2017 and 2018 (which sought initial feedback on the rule),[9] the DOL received more than 214,000 comments revealing sharp divisions between both sides.

The 2019 Proposed Rule, if finalized, would formally rescind the 2016 Rule, such that even if substantive provisions of the 2019 Proposed Rule were enjoined or did not become effective, the DOL would continue to enforce the 2004 regulations, not the 2016 Rule. According to the DOL, the current estimated effective date of the 2019 Proposed Rule is January 1, 2020, with several commentators opining that there may be a push to finalize in 2019 to ensure that last-minute regulations are not held up as part of the election process.

In anticipation of the 60-day comment period, the DOL has specifically solicited comments on the following issues, among others:

- The proposed salary level and any alternative salary level or methodology to set the salary level, including whether to use difference indices;
- The proposal to permit nondiscretionary bonuses and incentive payments, and whether the proposed 10% cap is appropriate; and
- The proposal for updating (and increasing) the salary threshold level every four years through notice-and-comment rulemaking.

The foregoing list certainly does not preclude individuals and businesses from commenting on other aspects of the rule, as the notice-and-comment process enables anyone to submit a comment on any aspect of the proposed rule. At the end of the process, the agency must base its reasoning and conclusions on the entire rulemaking record, consisting of the comments, data, expert opinions, and facts accumulated during the pre-rule and proposed rule stages. If the record contains new data or persuasive arguments, or poses significant difficult questions or issues, the agency may (i) terminate the rulemaking entirely, or (ii) continue the rulemaking process but change aspects of the rule, which, if significant, could lead to publication of a supplemental proposed rule.[10]

In addition to comments during the notice-and-comment period, the 2019 Proposed Rule may also be subject to legal challenges from both employer and employee constituencies, though likely not until after the notice-and-comment period concludes, and the DOL announces its final rule, which is precisely when states and business groups filed lawsuits challenging the 2016 Rule. Upon challenge, a reviewing court can then consider whether a rule (i) is unconstitutional; (ii) exceeds the agency's legal authority; (iii) was made without following the process required by the Administrative Procedure Act or other law; and/or (iv) was arbitrary, capricious, or an abuse of discretion. If a court vacates all or part of a rule, the agency may re-open the comment period, publish a new statement of basis and purpose in the Federal Register to explain and justify its decisions, or re-start the rulemaking process by issuing a new rule.[11]

Regarding the 2019 Proposed Rule, employees may challenge it for not increasing the salary threshold high enough, for failing to account for decades of past inflation that has eroded the overtime standard, for falling far below the threshold set in the 2016 Rule, and for effectively excluding millions of workers who would have become overtime eligible under the 2016 Rule. On the employer side, while the executive, professional, and administrative exemption salary level is apparently in the ballpark of expectation (and uses the same methodology used to calculate the 2004 salary threshold), employers may challenge the spike in salary level for highly compensated employees, which represents a nearly $50,000 jump from the 2004 rule, and a $13,000 increase from the

2016 Rule. Some smaller or local businesses may still challenge the new salary threshold as requiring them to cut jobs in order to make payroll.[12] Employers may also challenge the 2019 Proposed Rule for not updating the 15-year-old duties test to reduce classification uncertainty.

We may also see reaction from a legislative perspective. For example, in November 2017, a Democrat-sponsored bill, titled the Restoring Overtime Pay Act of 2017, was introduced in the 115th Congress, but never enacted. This bill sought "[t]o amend the Fair Labor Standards Act of 1938 to establish a minimum salary threshold for bona fide executive, administrative, and professional employees exempt from Federal overtime compensation requirements, and automatically update such threshold every 3 years."[13] Some expect that Democrats may seek to re-introduce similar legislation to restore the 2016 Rule.

Strategies to Consider Pending a Final Rule

While many employers scrambled in 2016 to re-classify certain portions of their exempt population and implement other compensation changes after the 2016 Rule was announced, given the litigation history surrounding this overtime rulemaking process, employers may want to exercise some caution before implementing any drastic changes. However, during the notice-and-comment period, and the period immediately before the rule becomes effective, employers should consider their options for compliance, analyze the potential impact of classification and compensation changes, and prepare to make any necessary changes.

- At a minimum, employers should identify the salary levels of employees in their workforce currently classified as exempt, whose compensation would not meet the $35,308 minimum threshold (or $147,414 for highly compensated employees) to assess whether to adjust salary levels (if feasible) and other aspects of compensation to potentially offset salary increases, or to re-classify individuals as non-exempt. For highly compensated employees who may not meet the salary threshold under the 2019 Proposed Rule, employers should determine whether they could otherwise satisfy the standard duties test under the executive, administrative, or professional exemptions.
- As part of the re-classification assessment and identifying a potentially equivalent regular hourly rate of pay based on current annual salaries, employers should consider the extent to which individuals work overtime hours. More specifically, any overtime hours would now require additional compensation at an overtime rate, and could result in total annual compensation *higher* than what certain individuals earned while salaried.
- In considering salary adjustments in response to the proposed new threshold, employers should also analyze any impact on exempt individuals who would not appear on their face to be impacted by the 2019 Proposed Rule (*i.e.*, those who already earn at least the proposed salary threshold of $35,308 annually). For example, in the retail industry, if a company's Assistant Managers are currently classified as exempt under the 2004 regulations, but earn less than the 2019 Proposed Rule threshold, their salaries would need to be increased to at least the new threshold to preserve their exempt status. However, that might not be the only change needed. Assume further that the company's Store Managers (to whom Assistant Managers report) are also classified as exempt but earn either at or just above the 2019 Proposed Rule threshold, such that on their face, their salaries would not need to be increased. If the Assistant Managers' salaries are bumped up to or just above the 2019 Proposed threshold to maintain their exemption (and Store Manager salaries are not correspondingly increased), Assistant Managers could effectively be earning approximately the same salaries as their supervising Store Managers, which could create additional classification problems in addition to operational and morale issues.
- Employers should consider using this time to evaluate their nondiscretionary bonus and incentive payment programs and whether they can take advantage of the provision of the 2019

Proposed Rule that permits them to use such payments to satisfy up to 10% of the salary threshold, provided that these payments are paid at least on an annual basis.

- Employers should remain current with overtime thresholds in the specific states in which they operate to ensure compliance, as several states already have overtime thresholds that exceed those to be set in the 2019 Proposed Rule. For example, for New York City employers (with 11 or more employees), the salary threshold is currently $1,125 per week (with other portions of the state cascading down to $832 per week) – significantly higher than the 2019 Proposed Rule. Similarly, in California, for employers with 26 or more employees, the salary threshold is currently $960 per week. The 2019 Proposed Rule would not preempt these (and other states') stricter standards. Indeed, advocates of the 2016 Rule who do not believe any agency or legislative action will satisfactorily address overtime on a federal level may focus their efforts on additional state legislation to make more workers overtime-eligible than under the federal law.
- Employers should also consider submitting comments on any aspect of the 2019 Proposed Rule that either is unclear to them or pertains to their industry so the DOL has an opportunity to address it. Certain business and worker groups are also expected to host discussions regarding the impact of the 2019 Proposed Rule, with the goal of streamlining comments on behalf of their members. For example, the U.S. Small Business Administration, Office of Advocacy is scheduled to host such roundtable discussions next month "to hear directly from small businesses about the impact of the proposed rule."[14]
- Businesses and their counsel, both in-house and external, should also be mindful of the 2019 Proposed Rule when conducting diligence in the context of corporate transactions. More specifically, as part of any classification analysis and assessment of potential risk during the diligence process, one must factor in the prospect of the new salary threshold, including the impact that commissions and bonuses might have in bridging any salary gap.

---

[1] As a quick refresher, on May 23, 2016, the DOL issued the final 2016 Rule increasing the salary threshold, among other changes. It was set to go into effect on December 1, 2016, but was enjoined by the United States District Court for the Eastern District of Texas on November 22, 2016. *See Nevada v. U.S. Dep't of Labor*, 218 F. Supp. 3d 520 (E.D. Tex. 2016) (concluding that the 2016 Rule "exceeds [the DOL's] delegated authority and ignores Congress's intent by raising the minimum salary level such that it supplants the duties test"). On August 31, 2017, the district court granted summary judgment against the DOL, holding that a salary level that excludes from exemption an unusually high number of employees who pass the duties test stands in tension with the statute's intent to exempt bona fide exempt employees. *See Nevada v. U.S. Dep't of Labor*, 275 F. Supp. 3d 795 (E.D. Tex. 2017). The district court's decision was appealed to the United States Court of Appeals for the Fifth Circuit, and has been held in abeyance since November 6, 2017, pending the current administration's rulemaking process. The DOL is currently enforcing the 2004 base salary levels.

[2] According to the Notice of Proposed Rulemaking (NPRM), the DOL used 2017 data (projected to January 2020) to set the salary level of $679 per week, but anticipates using 2018 data to develop its final rule, which may result in a slightly adjusted figure. Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees, 84 Fed. Reg. 56 (proposed Mar. 22, 2019) (to be codified at 29 C.F.R. 541), https://www.govinfo.gov/content/pkg/FR-2019-03-22/pdf/2019-04514.pdf [hereinafter 2019 NPRM].

[3] *See Nevada v. U.S. Dep't of Labor*, 275 F. Supp. 3d 795, 807 (E.D. Tex. 2017) ("Having determined the [2016 Rule] is unlawful under *Chevron*, the Court similarly determines the automatic updating mechanism is unlawful.").

[4] Specifically, the current DOL acknowledged in the NPRM that "lengthy delays between updates to the earnings thresholds may necessitate disruptively large increases when the thresholds are updated." 2019 NPRM, at 10914.

[5] 2019 NPRM, at 10901.

[6] The highly compensated exemption combines a higher compensation requirement with a "less-stringent, more flexible duties test," according to the DOL, and requires meeting only one of the exempt duties or responsibilities of an executive, administrative, or professional employee. 2019 NPRM, at 10919.

[7] Having delayed publication in the Federal Register by approximately two weeks from the date the NPRM was made

public, the DOL may decline requests to extend the comment period following the 60-day period, increasing the agency's chances of publishing a final rule that corresponds with its expressed goal of implementing a January 2020 effective date.

[8] 2019 NPRM, at 10900.

[9] Before publishing the 2019 Proposed Rule, the DOL also held six public listening sessions to solicit views and opinions from a broad spectrum of interests, ranging from employee advocates, trade and business associations, private sector employers, public sector employers, educational institutions, professors, charitable and nonprofit entities, think tanks, and small businesses. *See* Arsen et al., *WHD Conducts Final Listening Session on Part 541 Regulations, Announces March 2019 Target Date for NPRM*, THE NATIONAL LAW REVIEW, Oct. 31, 2018, https://www.natlawreview.com/article/whd-conducts-final-listening-session-part-541-regulations-announces-march-2019.

[10] OFFICE OF THE FEDERAL REGISTER, A GUIDE TO THE RULEMAKING PROCESS (2011), https://www.federalregister.gov/uploads/2011/01/the_rulemaking_process.pdf.

[11] *Id.*

[12] Indeed, as of the date of this publication, at least some of the comments received and published in the Federal Register have expressed this very concern about the 2019 Proposed Rule's impact on smaller communities and their inability to handle raises like larger companies in larger cities, further noting that such raises are less essential in areas with a lower cost of living. *See* Amy Noon, Comment on the Proposed Rule: Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees (Mar. 22, 2019), https://www.regulations.gov/document?D=WHD-2019-0001-0011.

[13] Restoring Overtime Pay Act of 2017, S. 2177, 115th Cong. (2017).

[14] U.S. Small Business Association, Office of Advocacy, Advocacy to Hold Three Small Business Roundtables on DOL's New Overtime Rules in Alabama, D.C., & Florida (Mar. 19, 2019), https://content.govdelivery.com/accounts/USSBA/bulletins/237880d.

Employer Update is published by the Employment Litigation and the Executive Compensation & Benefits practice groups of Weil, Gotshal & Manges LLP, 767 Fifth Avenue, New York, NY 10153, +1 212 310 8000, www.weil.com.

If you have questions concerning the contents of this issue, or would like more information about Weil's Employment Litigation and Executive Compensation & Benefits practices, please speak to your regular contact at Weil, or to the practice group members listed below.

Practice Group Members:

Jeffrey S. Klein
Practice Group Leader
New York
+1 212 310 8790
jeffrey.klein@weil.com

Frankfurt
Stephan Grauke
+49 69 21659 651
stephan.grauke@weil.com

London
Ivor Gwilliams
+44 20 7903 1423
ivor.gwilliams@weil.com

Miami
Edward Soto
+1 305 577 3177
edward.soto@weil.com

New York
Sarah Downie
+1 212 310 8030
sarah.downie@weil.com

Gary D. Friedman
+1 212 310 8963
gary.friedman@weil.com

Steven M. Margolis
+1 212 310 8124
steven.margolis@weil.com

Michael Nissan
+1 212 310 8169
michael.nissan@weil.com

Nicholas J. Pappas
+1 212 310 8669
nicholas.pappas@weil.com

Amy M. Rubin
+1 212 310 8691
amy.rubin@weil.com

Paul J. Wessel
+1 212 310 8720
paul.wessel@weil.com

Silicon Valley
David Singh
+1 650 802 3010
david.singh@weil.com