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What's the Deal With the New Overtime Rules?

BY ADAM BROWN

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Changes in overtime regulation are afoot. Or are they? The Department of Labor (DOL) had issued new overtime regulations that were scheduled to take effect Dec. 1, 2016, and were expected to affect 4.6 million currently exempt employees—making them overtime-eligible. The new rules had significantly increased the salary thresholds, entitling employees under the new threshold to overtime pay. But days before the new overtime rules were to become effective, a Texas federal court issued a nationwide injunction blocking their implementation. And now that we have a new administration in Washington, the fate of these new overtime rules hangs in the balance. So what can we expect next?

The injunction is now on appeal. And during the pendency of the appeal, a new secretary of labor could change the landscape of the issue entirely, either by



ADAM BROWN is an associate in Stradley Ronon Stevens & Young's Philadelphia office where he focuses his practice on employment and labor matters. He has represented companies in a variety of employment-related litigation, and also advises clients regarding hiring, wage payment issues, sexual harassment prevention, internal complaints and investigations, disciplinary and termination matters, human resources policies, social media issues, restrictive covenants, and theft of trade secrets and other proprietary material. Contact him at abrown@stradley.com or 215-564-8729.

withdrawing the appeal or by issuing alternative overtime regulations. In any of these scenarios, it is far from clear what will become of these Obama-era rules.

The modifications to the overtime rules, which implement provisions of the Fair Labor Standards Act (FLSA) known as the “white-collar exemptions,” were long anticipated by employers and generated a flurry of changes to employee status and compensation. Now, employers who made changes must decide whether to roll them

back and risk an employee-relations backlash, or leave them in place even though they may prove to have been unnecessary.

THE EXEMPTIONS

The DOL's overtime regulations are the key to compliance with federal overtime requirements. As employers know, the FLSA generally requires employers to pay one and a half times an employee's regular rate for hours worked in excess of 40 per workweek. But the statute exempts certain employees from the overtime requirement based on their compensation and the duties they perform. The white-collar exemptions cover “executive, administrative, or professional” employees, “outside salesmen,” and “computer employees.” The FLSA does not define these terms, instead delegating that task to the DOL.

The DOL regulations “defining and delimiting” the white-collar exemptions provide that employees qualify as exempt from overtime if they perform certain delineated job duties, are paid on a salaried basis,

and receive a specified minimum salary. An employee generally must meet all three requirements to be exempt from the FLSA's overtime requirements. (There are limited exceptions for teachers, lawyers, physicians and—depending on their compensation

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structure—computer professionals and outside sales employees.)

REVISION OF THE WHITE-COLLAR REGULATIONS

The DOL first issued regulations concerning the white-collar exemptions in 1938. Since then, it has updated the regulations periodically and has increased the minimum salary requirements to bring them in line with contemporary economic and workplace conditions. In 2004, the minimum salary level increased from \$155 per week (\$8,060 annually) to \$455 per week (\$23,660 annually). In addition, the 2004 regulations provided that any employee who makes a total of \$100,000 per year and “regularly and customarily performs” any one of the exempt job duties is a “highly compensated employee” and is not entitled to overtime pay.

In March 2014, President Barack Obama directed the DOL to “modernize and streamline” the white-collar exemptions, noting that the 2004 regulations had not sufficiently kept up with the modern economy. In response, the DOL issued new rules that would increase the minimum salary threshold for exempt employees from \$455 per week to \$913 per week (or from \$23,660 to \$47,476 annually), and would increase the “highly compensated employee” salary level to \$134,004. The new salary levels correspond to the 40th and 90th earnings percentiles, respectively, in the lowest-wage region of the United States according to U.S. Census data. The rules also contain provisions that would automatically update the minimum salary levels every three years to remain tied to those percentiles. The DOL did not change the job-duty requirements for the exemptions.

The stated goal of the new rules was to update and simplify the process of determining which employees are not exempt and therefore must be paid overtime. The changes were scheduled to take effect Dec. 1, 2016.

COMPLIANCE BY EMPLOYERS AND REACTION BY OPPONENTS

In anticipation of these changes, many employers took steps to comply with the new rules. For example, some employers chose to increase salaries to exceed the new minimum, ensuring that otherwise qualifying employees would remain exempt. Some chose instead

to convert salaried employees to hourly pay and reclassify them as nonexempt. Others capped hours for newly nonexempt employees, hired more part-time employees, or reduced hourly wages in anticipation of paying more employees time and a half.

Meanwhile, several legal and legislative actions sought to stop or delay the new rules. In September 2016, 21 states initiated a lawsuit in the Eastern District of Texas alleging that the new regulations were unlawful and asking the court to enjoin their implementation. The lawsuit (later consolidated with a separate but similar case filed in the same court by business groups) challenged the DOL's statutory and constitutional authority to issue the regulations. At the same time, the House of Representatives passed a bill to delay implementation of the new rules, but the bill stalled in the Senate. An earlier House bill to phase the changes in over several years gained some bipartisan support, but ultimately did not pass.

THE NATIONWIDE INJUNCTION

Then, just as employers were poised to adapt to the new overtime landscape, and shortly before the rules were scheduled to take effect, one of the legal challenges exploded in court. On Nov. 22, 2016, the district court in Texas issued a preliminary injunction stopping the scheduled Dec. 1 implementation of the new rules. The court determined that, by using salary levels as a determinative

criterion for whether an employee meets a white-collar exemption, the DOL had exceeded the authority delegated to it under the FLSA. Examining the text of the FLSA regarding the exemptions, the court reasoned that Congress had intended them to be based on the duties employees perform, not on their salary levels. On that basis, the court found that the DOL had exceeded its statutory authority by “raising the minimum salary level such that it supplants the duties test.” The salary-level test, in the court’s view, had been included in the DOL regulations over the years simply to screen out low-wage employees who were obviously nonexempt, whereas the new rule “creates essentially a de facto salary-only test.”

The DOL appealed the decision to the U.S. Court of Appeals for the Fifth Circuit and requested an expedited schedule, which the court granted. In its briefing on appeal, the DOL has argued that the Fifth Circuit’s decision is foreclosed by one of its own decisions from 1966, in which it upheld the DOL’s authority to use a salary-level test to “define and delimit” the scope of the white-collar exemptions. According to the DOL, that decision, as well as a 1997 U.S. Supreme Court case, recognize a grant of broad authority to the DOL regarding the exemptions, and the salary levels contained in the new rules are consistent with 75 years of similar DOL regulation.

The appeal is now fully briefed and pending oral argument, which

has not yet been scheduled. Nevertheless, the appeal is unlikely to be decided before a new secretary of labor is confirmed.

THE CHANGE OF ADMINISTRATION

That new labor secretary could well decide not to pursue the appeal and to allow the injunction to stand. The pending nominee, Andy Puzder, has indicated publicly that he disagrees with the new overtime rules. In May 2016, for example, Forbes published an op-ed by Puzder in which he sharply criticized the DOL for increasing the salary thresholds, asserting that the changes would result in greater regulatory cost to employers and less opportunity for employees. And, as CEO of CK Restaurants (the parent company of Carl’s Jr. and Hardee’s), Puzder has been an outspoken critic of overtime and minimum wage regulations, claiming they hurt businesses and extend too much protection to employees.

The labor secretary, once confirmed, would have the authority to withdraw the appeal and allow the district court to make the injunction permanent, effectively halting the new rules for good. The newly constituted DOL would then be free either to keep the 2004 salary levels, start a new rulemaking on the issue, or defer to the House and Senate to pass legislation.

WHAT HAPPENS NEXT?

For now, employers must still comply with the existing 2004 salary thresholds. For those

employers who have not made changes to comply with the new rules, most are choosing to keep the status quo until further action is necessary. Those who have made changes, on the other hand, may be tempted to consider reversing them now (despite administrative and employee-relations issues that may arise) or in the future once the fate of the new regulations is known. Some employers may decide that leaving the changes in place is the better course, even though they were prompted by rules that may never take effect. If a Puzder-led DOL decides to chart its own path and start from scratch on revisions to the overtime regulations, the lengthy review and comment process will begin anew, and so will compliance efforts.

Due to the dynamic nature of this issue, it warrants close attention. Developments over the next few weeks and months could have far-reaching implications for companies of all sizes across the country. It is critical that employers and their advisers marshal resources to respond appropriately as the situation continues to evolve. Stay tuned. •