



# White Collar Exemption Changes May Increase Labor Costs

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Very soon, game-changing rules regarding who qualifies for the so-called white collar exemptions from the overtime pay requirements of the Fair Labor Standards Act will be issued for public review and comment by the U.S. Department of Labor's Wage & Hour Division. Once finalized, these changes will affect virtually every employer in the U.S.

Some observers project that as many as 5 million to 10 million employees who are currently classified as exempt from the right to receive overtime pay will be converted as a matter of law to nonexempt status. If so, their employers will be required to pay them "time and one-half" their regular rate (usually expressed as an hourly pay rate) as overtime pay for all hours worked in excess of 40 in any workweek. Whether they are currently paid on a salary basis or not will remain irrelevant to their right to receive overtime pay. If unprepared, employers may experience more than sticker shock when these rules are implemented.

It is anticipated that the new rules will undoubtedly result in greater expense or operational change for many employers as they struggle to deal with a shrinking population of those who are exempt from the overtime pay requirements of the FLSA. When released, it is a virtual certainty that the proposed rules will impose a substantially higher minimum salary for valid application of the FLSA's administrative, executive and professional exemptions. New requirements may also involve more stringent or detailed duty tests.

This month, the Economic Policy Institute recommended to the DOL that the 2015 salary exemption be raised \$970 per week, which annualizes at \$50,440. The current exemption only requires a salary that annualizes at \$23,660 (\$455 per week). For a salary to meet the FLSA's exemption requirements, it must generally be a fixed and unvarying amount that is paid each workweek and not subject to reduction based upon content or quality of work (subject to a few authorized deductions that are specified in applicable regulations). The suggested new minimum salary would represent a 53 percent increase from the current threshold.

The EPI maintains that the last salary adjustment, implemented in 2004, did not take inflation into account, and postulates that if the 1975 minimum salary requirement (\$255) had been adjusted for inflation on an ongoing basis, that requirement today would be worth around \$970 per week. This rationale may be viewed as compelling by many.

## **Current White Collar Exemption Requirements**

In order to qualify for white collar exemption status, employees must meet both the salary test and a primary duties test. While the salary requirement for the three most widely applied white collar exemptions remain constant (currently \$455 per week), the duties and related tests for each differ significantly. A quick recap of current requirements is worth noting here.

Valid application of the administrative exemption requires that affected employees:

1. perform work that primarily involves office/nonmanual tasks directly related to management or general business operations of the employer or employer's customers;
2. perform work that includes discretion and independent judgment in matters of significance; and
3. are paid at least \$455 per week on an approved salary basis.

Valid application of the executive exemption requires that affected employees:

1. perform tasks primarily involving management of the organization or of a recognized unit or subdivision;
2. supervise at least two full-time employees (or their equivalent);
3. are involved in the hiring/firing process or other status changes (such as disciplinary authority over others) that carry weight within the organization; and
4. are paid at least \$455 per week on an approved salary basis.

Valid application of the professional exemption, as it pertains to the learned professions, generally requires that affected employees:

1. perform work primarily requiring advanced knowledge in a recognized field of science or learning, usually gained through prolonged instruction and study;
2. perform work that is principally intellectual in nature and includes consistent exercise of judgment and discretion; and
3. are paid at least \$455 per week on a salary basis.

Valid application of the professional exemption, as it pertains to the creative professions, requires that affected employees:

1. perform work primarily requiring invention, imagination, originality or talent;
2. are in a recognized artistic or creative field; and
3. are paid at least \$455 per week on a salary basis.

Regardless of specifics in the new rules when published in February for review and comment, an important objective of the DOL's rulemaking is to reduce the number of employees who qualify for

important objective of the DOL's rulemaking is to reduce the number of employees who qualify for white collar overtime pay exemptions. Many employers are expectedly concerned about the effects of these changes, given that many employees who were once exempt will at some point soon begin accruing overtime pay when working more than 40 hours in a workweek. The extent to which this may impact our economy as a whole will not be known until the DOL's final rules are implemented and the effects of massive employee reclassifications (by choice or law) work their way through the system. For many employers, these changes could affect their very ability to remain in business.

Let's consider the following example as but one of a myriad of practical problems that could arise from the single act of more than doubling the required minimum salary for the administrative exemption under the FLSA. As background, we should remember that historically many employees classified as administrative do not in reality qualify for exemption (according to the DOL), because they do not regularly and primarily exercise discretion and independent judgment in matters of significance. Under current DOL rules, the matters of significance test is typified by administrative employees performing tasks such as: formulating, interpreting or implementing management or operational policies; committing the employer in matters having significant financial impact (e.g., binding the employer in contract); waiving or deviating from established employer policies and procedures without need for higher-level approval; involvement in long-range business planning; investigation and resolution of workplace matters of significance; and/or handling employee complaints, arbitrating workplace grievances or resolving workplace disputes. Simply exercising skill in applying an employer's well-established techniques, procedures or standards will not currently qualify any employee for administrative exemption.

As you might expect, the interpretation of these requirements has led to many disputes between employers and the DOL regarding the question of whether (and which) employees should be considered administratively exempt under current rules. Usually, however, salary has not been at the core of those disputes, because the current threshold amount is relatively low.

Now, add to the mix the fact that today's bona fide, administratively exempt employee may in the future become nonexempt simply because he or she does not earn at least \$970 per week in salary (we assume here that the employee otherwise meets the primary duty tests discussed above). The employer's conundrum in this calculus is simple yet profound. The employer could increase its direct labor cost by giving all affected administrative employees a sufficient pay raise (not likely unless they are already being paid a salary close to the new minimum). Or, it could reduce the number of administrative employees to contain costs while ensuring the payment of compliant salaries to those administrative employees that it retains and hires in the future.

But what if the employer needs to retain all of its current administrative employees, but simply can't afford them under the new salary requirement? It could assess the cost of overtime pay against the cost of increased guaranteed salaries and decide which is less expensive if that provides an economically viable path. Or the employer could consider raising the price of its goods and services to offset increased direct labor costs. But what if its customers won't pay those prices because they can procure needed goods and services from someone else at a better price?

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While the above hypotheticals are overly simplistic, they illustrate fundamental problems that will ripple throughout our economy as these new rules are implemented. There are innumerable other conceivable scenarios, but effective answers may be more difficult to discern. So significant a change in the minimum salary requirement at a single point in time will undoubtedly cause some employers to experience massive heartburn, while others may have no choice but to go out of business or substantially reorganize themselves in order to remain operationally viable and compliant with the law.

In all probability, the new requirements will not be fully implemented until the summer of 2015 — and perhaps even later. Though changes to the white collar exemptions will not take effect right away, their effects will be long-term and profound. Employers and their legal counsel should begin planning for change now by auditing current practices and projecting the cost of change and FLSA compliance under the anticipated new framework. This includes evaluating the possibility and effects of significantly higher operating costs. When the DOL rules are released in February, employers will be wise to have laid out their options for compliant pay programs that reward their employees appropriately without disrupting the employer's business plans and goals.

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