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Update in Overtime Compensation Law Deserves to Stand

Executive Summary

- On August 23, 2004, the U.S. Department of Labor's final regulations updating the Fair Labor Standards Act's overtime requirements took effect. The update was long overdue: the job-duties requirements in the old regulations had been unchanged since 1949, and the minimum salary level required for exemption had been unchanged since 1975. The need for reform was evident: the old regulations created confusion for workers and employers alike, generated wasteful class-action litigation, and failed to effectively protect workers' pay rights.

- This update brings stronger overtime protections for millions of workers, including 6.7 million low-wage workers who previously were not eligible for overtime pay or whose rights were uncertain. These low-wage workers joined the ranks of those protected by the law as a result of the Bush Administration's change in the salary threshold for automatic overtime protection. Now, workers earning up to $23,660 a year — up from the previous level of $8,060 — *are guaranteed* overtime pay for overtime work.

- Despite the increased protection for workers, Democrats, in alliance with labor unions and trial attorneys, have devoted themselves to thwarting this reform. In May, Senator Tom Harkin offered an amendment to revoke any part of the final regulations that might have changed the overtime-eligibility status of any worker. The amendment passed as part of S. 1637, the JOBS Act, which subsequently has been sent to a House-Senate conference.

- The Harkin amendment should not become law. As law, it would further complicate compliance and enforcement by creating a two-tiered system for determining eligibility. Further, the Harkin amendment would jeopardize the protections provided to millions of "white collar" salaried employees earning between $23,660 and $100,000. There is no similar House-passed amendment. It is appropriate for the conferees to strike this detrimental and non-relevant amendment from the JOBS Act.

Introduction

The final regulations by the Bush Administration governing overtime pay for millions of American workers became effective on August 23, 2004. The Administration's goal was to publish clear, understandable regulations to update overtime-pay rules that had seen minimal changes since the 1950s. The clarity of the final regulations will benefit employers and employees alike and, in so doing, will reduce the risk of legal confusion and costly litigation.

Every administration – both Republican and Democrat – since the Carter Administration has acknowledged the need to reform these regulations; yet, because of persistent opposition to reform by organized labor and trial attorneys, this regulatory update was not accomplished until now. Organized labor, trial attorneys, and their allies charge that the new regulations will deny overtime pay to millions of workers. Yet the Labor Department's economic analysis reveals that a mere handful of workers (all of whom are highly paid and have managerial duties) could lose their overtime pay — while 6.7 million will gain greater security to their right to overtime pay.[1] A key change in the regulations was to increase the salary threshold for automatic overtime protection. Now, workers earning up to $23,660 a year—up from the previous level of $8,060 – are guaranteed overtime pay. Most workers earning more than $23,660 will see no change to their overtime-eligibility status. This paper will detail the updated regulations, particularly with respect to the duties tests.

Background

The Bush Administration's reform updates the Fair Labor Standards Act of 1938 (FLSA), a 66-year-old labor law that governs wages for most American workers. Specifically, the labor law provides a minimum wage and a standard workweek for American workers. Unless they are exempt by the law, employees who work more than 40 hours a week must be paid overtime pay (at a rate of time-and-a-half). The law exempts from the guaranteed-overtime requirement those deemed "white collar" employees, that is, those employed "in a bona fide executive, administrative or professional capacity."[2] (Additionally, the law provides exemptions for other categories of workers, such as outside sales and certain computer employees, provisions which are also updated by these regulations.) Rather than define the "white collar" exemptions, the FLSA gave the authority to the Secretary of Labor to "define and delimit" these terms "from time to time" by regulations.[3]

The foundation of the FLSA is that covered workers are required to be paid a minimum wage and overtime pay for hours worked in excess of 40 hours a week. In order to be considered for the white-collar exemption, an employee must meet each of the following tests: 1) *a salary basis test*, which requires that the employee be paid a salary, as opposed to an hourly wage, 2) *a salary level test*, which requires that the employee's pay exceed a specified minimum for a given workweek, and 3) *a duties test*, which requires that the employee's job includes the performance

[1] *Federal Register*, preamble to "Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees; Final Rule," April 23, 2004, pg. 22123.
[2] 29 U.S.C. 213(a)(1).
[3] 29 U.S.C. 213(a)(1).

of specific, defined executive, administrative, or professional job duties. It is these defined and delimited job duties that are at the heart of the controversy over who, under the new regulations, will be harmed and who will not.

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The Need for Regulatory Reform

The Bush Administration was hardly the first to recognize these labor regulations needed to be updated. Every administration since that of President Carter has placed these regulations on their regulatory agenda.[4] Furthermore, the record of public debate on the need to update these regulations includes: a 1985 Advanced Notice of Proposed Rulemaking; two oversight hearings by subcommittees of the House Education and the Workforce Committee in 1995 and again in 2000; and a General Accounting Office report issued in 1999.

The salary level for the white-collar exemption was last adjusted in 1975. No one today is arguing that the 1975 salary level of $155 a week for executive and administrative employees and $170 a week for professionals in today's modern workplace is an appropriate threshold. By comparison, today's minimum-wage worker, with an annual wage of $10,712, could earn more than an executive under the old salary level of $8,060.

The duties tests were last revised in 1949. Under the old regulations, a more stringent "long duties test" was to apply to those earning between $155 and $250 a week, and a less stringent "short duties test" applied to those earning at the higher threshold level of $250 a week. Over the years, inflation rendered the long duties test obsolete. The old regulations used job titles as examples to provide guidance to employers on the applicability of these rules. These job titles, such as "legman" and "straw boss," reflected the age of the regulations, but, in the modern workplace, provided no useful guidance. The new regulations include 21st century job titles.

The outdated nature of the old regulations made it difficult for even the most diligent employers to know with certainty the overtime eligibility status of some employees. These vague and outdated regulations, combined with the possibility of large class-action settlements, have brought a litigation explosion. According to the Administrative Office of the U.S. Courts, the number of FLSA-related, class-action lawsuits has tripled from 31 in 1997 to 102 in 2003.[5] These large lawsuits are not beneficial for employees, even if they prevail. Clearer regulations in years past would have allowed such employees to have received their overtime pay without the delay of a lawsuit, and without paying as much as one third of their award in attorney fees.[6]

Despite such need for reform, the successful accomplishment of modernizing these outdated regulations proved elusive for years. Finally, in 2002, the Department of Labor under the Bush Administration initiated the process by meeting with more than 40 stakeholders, including the AFL-CIO and various business associations, and then publishing a Notice of Proposed Rulemaking on March 31, 2003. After reviewing more than 75,000 public comments

[4] Testimony of Wage and Hour Administrator Tammy McCutchen before the Senate Appropriations Committee's Labor-HHS Subcommittee, May 4, 2004.
[5] Administrative Office of the U.S. Courts, http://www.uscourts.gov/judbususc/judbus.html, August 18, 2004.
[6] Paul Kersey, "Modernizing Overtime Regulations to Benefit Employers and Employees," The Heritage Foundation, August 16, 2004, pg. 4.

(and, in the process, adopting many suggestions to improve the proposed regulations), the Administration issued the final regulations on April 23, 2004.

Recent Senate Action

Organized labor, trial attorneys, and their allies in Congress have continually opposed the Administration's updated regulations. They falsely contend that millions of workers will lose their overtime pay. In September 2003, before the final regulations were issued, Senator Tom Harkin (D-IA) offered an amendment to the FY 2004 Labor-HHS-Education appropriations bill designed to thwart the final regulations. The amendment passed, 54 to 45, but it was later dropped in conference.

In May of this year, Senator Harkin again offered an amendment to obstruct the regulation — this time denying implementation of any portion of the final regulations that changed the overtime eligibility of any worker. The amendment passed, 52 to 47, as part of S. 1637, the JOBS bill. Prior to the vote on the Harkin amendment, the Senate passed an amendment offered by Senator Judd Gregg that lists 55 occupations whose overtime status will not change under the new regulations. The Gregg amendment was intended to showcase the fact that blue-collar and hourly occupations will not lose their overtime-protection status — despite Democrats' contention to the contrary. In fact, now that the new regulations have gone into effect, there is no evidence of wholesale reclassifications of workers as a way to exempt them from overtime pay.

Regulatory Change: Greater Protection for Workers and Employers

The new regulations are designed to ensure three critical outcomes: that employees can understand their rights to overtime pay; that employers can easily determine their legal obligations and comply with the law; and that the Department of Labor can more vigorously enforce the law. The Bush Administration is confident the reforms will achieve these objectives.[7] The framework of the overtime exemptions remain: once a worker has passed the tests of earning a salary (versus an hourly wage) and that the salary exceeds the threshold (now $455 a workweek, which amounts to $23,660 annually), then an assessment of his or her job duties needs to be conducted. Changes to the duties tests are outlined below.

Higher Salary Level – Updating the salary level from $8,060 to $23,660 a year results in stronger overtime protections for 6.7 million salaried workers who earn below the new salary threshold.[8] The stronger protections hold regardless of the worker's duties. Among the 6.7 million salaried workers, 1.3 million are salaried white-collar workers who were exempt under the old salary level but will now see an increase in their take-home pay under the new regulations for overtime work; another 2.6 million were previously nonexempt salaried workers, but were at risk of being incorrectly exempted; and 2.8 million are blue-collar workers who previously were subject to a job-duties test.[9]

[7] McCutchen.
[8] *Federal Register*, preamble to "Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees, Final Rule," April 23, 2004, pg. 22123.
[9] *Federal Register*, pg. 22123.

Stronger Executive Test – The duties test for executives is now more rigorous, making it harder for employees to lose their overtime eligibility. The new test retains the old "short test" requirements that 1) the employee's primary duty must be managing the enterprise, or managing a customarily recognized department of the enterprise, and 2) the employee must customarily and regularly direct the work of at least two other full-time employees. On top of these requirements, there is *an additional requirement* that the employee must have the authority to hire or fire other employees, or the employee's suggestions and recommendations as to the hiring, firing, advancement, promotion, or any other change of status of other employees must be given particular weight.[10]

Critics contend that the Bush Administration weakened overtime protections, causing low-level supervisors to qualify for the exemption despite having no real executive duties. This charge is unfounded because, with the additional duties requirement, the protections for workers are stronger. Lower-level supervisors are now guaranteed to receive overtime pay unless they meet the test for exemption — a test that now is more protective of employees than it was under the old law.

Tightening of Administrative Test – The test for the administrative exemption remains largely unchanged. The old and new regulations both require 1) the employee's primary duty to be the performance of office or non-manual work related to the management or general business operations of the employer or the employer's customers, and 2) the employee's work must include exercising discretion and independent judgment. The new regulations tightened the second element of the test in that an employee's *primary duty* must include exercise of discretion and independent judgment *with respect to matters of significance*.[11]

Critics maintain that this qualification will cause millions of workers to lose their overtime pay. However, the Administration does not expect workers to become exempt due to this change.[12] In fact, the National Retail Federation was recently quoted as saying companies are moving more people than originally anticipated from exempt to non-exempt status, *making more workers eligible* for overtime pay.[13]

Professional Exemption Largely Unchanged – While the professional exemption requirements were reorganized, the job-duties tests remain unchanged. To be exempt from overtime as a professional, an employee's primary duty must include 1) work requiring advanced knowledge in a field of science or learning "customarily acquired by a prolonged course of specialized intellectual instruction" or 2) work requiring invention, imagination, originality, or talent as part of an artistic endeavor.[14] For example, the "learned professional" exemption generally applies to workers in the legal, medical, and architectural professions, among others.[15] The "creative professional" exemption generally applies to those working in artistic fields such

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[10] *Federal Register*, pg. 22130. Also refer to 29 C.F.R Section 541.100.
[11] *Federal Register*, pg. 22137. Also refer to 29 C.F.R. Section 541.200.
[12] *Federal Register*, pg. 22123.
[13] Victor Godinez, "Federal Overtime Rules Kick in Next Week," The Dallas Morning News, August 17, 2004. (Details on which employers are giving more employees the right to overtime pay can be found at U.S. Chamber of Commerce, *"How Are Employers Implementing the New FairPay Rules Classifying White Collar Employees?"* September 2004.)
[14] 29 C.F.R. Section 541.300.
[15] 29 C.F.R. Section 541.301(c).

as music, writing, and acting.[16] As under the old regulations, the learned professional must perform work that includes the exercise of discretion and judgment.[17]

Registered nurses are among those who fall within the professional category. A new section was added in the final regulations stating that RNs generally meet the duties requirements, as they did under the old regulations. This section was added to respond to allegations by opponents that nurses will lose their overtime pay. The new regulations provide that licensed practical nurses and other similar health care professionals generally will not meet the exemption test because they lack an advanced academic degree.[18]

Computer Employee Exemption Unchanged – The new regulations simply regrouped the requirements for certain computer professionals. The exemption applies to those employed as a computer systems analyst, computer programmer, software engineer, or other similarly skilled worker in the computer field. To qualify, an employee's primary duty must consist of 1) the application of systems analysis techniques and procedures; 2) the design, development, documentation, analysis, creation, testing, or modification of computer systems or programs; and 3) the design, documentation, testing, creation, or modification of computer programs related to machine operating systems; 4) or a combination of the above mentioned duties. As under the old regulations, the computer employee professional must be compensated at either an hourly rate of at least $27.63 or on a salary basis raised to be not less than $455 a week.

Outside Sales Slightly Modified – This category remained relatively unchanged with the exception of removing the restriction that exempt outside sales employees could not perform unrelated work for more than 20 percent of their hours. "Outside sales" are those employees who routinely work away from the employer's place of business, making sales at a customer's home or place of business. The duties tests require an employee's primary duty to include making sales as defined by the FLSA, or obtaining orders or contracts for services or for the use of facilities; and the employee must be customarily and regularly engaged away from the employer's place or places of business in performance of their primary duty.[19] As under the old regulations, no salary requirement applies to this exemption category.

New Section for Highly Compensated Workers – The Labor Department long has recognized that the salary paid to an employee is the best test for exempt status.[20] Pursuant to this regulatory history, the Administration provided streamlined duties tests for those earning more than $100,000 a year when they also perform at least one of the exempt job duties of the executive, administrative, or professional duties tests. This test applies only to workers performing office or non-manual work; in contrast, carpenters, mechanics, and others who perform manual work will continue to qualify for overtime pay, regardless of their salary level.[21]

[16] 29 C.F.R. Section 541.302(b).
[17] 29 C.F.R. Section 541.301(b).
[18] 29 C.F.R. Section 541.301(e)(2).
[19] 29 C.F.R. Section 541.500.
[20] *Federal Register*, pg. 22165.
[21] 29 C.F.R. 541.601.

The Updated Overtime-Compensation Regulations: Facts and Myths

It is important to set the record straight, correct misinformation, and demonstrate why the Harkin amendment is both unnecessary and harmful.

Millions-Denied-Overtime Myth: The liberal Economic Policy Institute (EPI) asserts that the Bush Administration's final regulations "could strip away the right to overtime pay for over 6 million workers."[22] Senator Harkin points to registered nurses,[23] insurance claims examiners, and nursery school teachers[24] as examples of workers who will lose their overtime pay under the new regulations.

Fact: The EPI estimate of 6 million to lose overtime pay is based on misinformation and misinterpretations. The Bush Administration has stated that the overtime status of nurses (including registered nurses),[25] insurance claims examiners,[26] and nursery school teachers[27] will not change under the final regulations. Registered nurses who in the past have been paid on an hourly basis or under a collective bargaining agreement will remain eligible for overtime pay under the new regulations. However, in general, RNs have been viewed as exempt "learned professionals" since 1971—a position reflected in the old regulations—and so will continue to be eligible for the professional exemption at their employer's discretion. (Recall that even if an employee is legally eligible for overtime exemption, an employer is free to pay that employee time-and-a-half — or even more — and frequently will do so in order to retain that employee. This is a practice often observed with jobs in high demand, such as RNs.)[28]

A federal district court recently corrected the false claims regarding the administrative exemption, and insurance claims examiners in particular. On July 1, 2004, the U.S. District Court for the District of Columbia looked to the new regulations, which were not in effect at the time, for guidance, to determine whether GEICO claims examiners were exempt employees. It found they would in fact be eligible for overtime pay.[29] The Court stated, as the Bush Administration has continually maintained, that the administrative exemption under the new regulations is essentially similar to the requirements under the old regulations.

False claims are also being made regarding nursery school teachers. The truth is that the final regulations make no change to the current *statutory* law regarding the exempt status of nursery school teachers *whose primary function is teaching.* As expressly stated in the new regulations, but ignored by critics, day care center workers *whose primary duty is to provide custodial care of children* will continue to be eligible for overtime pay.[30]

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[22] Ross Eisenbrey, "Briefing Paper: Longer Hours, Less Pay: Labor Department's new rules could strip overtime protection from millions of workers," Economic Policy Institute, July 2004.
[23] *Congressional Record*, May 3, 2004, pg. S4743.
[24] *Congressional Record*, pg. S4744.
[25] Fact Sheet #17N: Nurses and the Part 541 Exemptions Under the Fair Labor Standards Act (FLSA), U.S. Department of Labor, www.dol.gov/fairpay, August 20, 2004.
[26] Fact Sheet #17L: Insurance Claims Examiners and the Part 541 Exemptions Under the Fair Labor Standards Act (FLSA), U.S. Department of Labor, www.dol.gov/fairpay, August 20, 2004.
[27] Fact Sheet: Overtime Security for the 21st Century Workforce, U.S. Department of Labor, July 2004.
[28] Godinez.
[29] *Robinson-Smith v. Government Employees Ins. Co.*, D.D.C., No. 01-1340 PLF, July 1, 2004.
[30] 29 CFR 541.204.

The Administration's economic analysis indicates that 107,000 highly compensated employees could lose their overtime pay.[31] These are employees who are paid an annual salary above $100,000 and perform at least one exempt job duty of an executive, administrative, or professional employee.

Rather than the false claims of organized labor, the net effect of the regulations will be that millions more workers will be protected, millions of employers will better understand the law, and that only the status of few currently covered and highly compensated employees might change.

Large Groups of Workers Reclassified Myth: The AFL-CIO asserts that the regulations fail to protect the interests of working Americans by making large categories of workers ineligible for overtime pay. As an example, the AFL-CIO points to 900,000 workers without college or advanced degrees likely to be reclassified as exempt professionals.

Fact: Similar to organized labor's assessment of insurance claims examiners, nursery school teachers, and nurses, thousands of workers without college degrees will not automatically become exempt professionals. The *final regulations* made no substantive change to the professional exemption. The language regarding the educational requirement of a learned professional was changed in the *proposed regulations* to recognize advanced knowledge that could be acquired through a combination of intellectual instruction *and* work experience.[32] In response to public comments received on the proposed revision, the Administration returned the language to that of the *old regulations*. The final regulations — just like the old — require advanced knowledge that is "customarily acquired by a prolonged course of specialized intellectual instruction."[33] Returning to the old language removes the possibility that large groups of workers will lose their overtime. On the other hand, 6.7 million workers will gain greater overtime protection because the final regulations raised the salary level.

The Blue Collar Myth: During the debate on the JOBS bill, Senator Tom Harkin referred to oil rig workers and other blue-collar workers earning over $100,000 a year among those deserving overtime pay.

Fact: Under the final regulations these workers will continue to earn overtime pay. The new regulations, like the old regulations, have *no impact on blue-collar workers*. The new regulations added a section specifically addressing these categories of workers. New Section 541.3(a) states that "the regulations in this part do not apply to manual laborers or other 'blue collar' workers who perform work involving repetitive operations with their hands, physical skill and energy."[34] Oil rig workers, as manual laborers, will continue to receive overtime pay — regardless of salary level.

Harkin Amendment Myth: Senator Harkin claims his amendment is necessary to prevent the loss of overtime pay for workers as a result of the Bush Administration's final

[31] *Federal Register*, pg. 22123.
[32] Preamble, pg. 22147.
[33] 29 C.F.R. Section 541.300(2)(i).
[34] 29 C.F.R. Section 541.3(a).

regulations. The Harkin amendment is structured to have a "fall back" assessment using the duties tests from the final regulations for workers found ineligible for overtime pay under the old regulations.

Fact: This amendment would essentially create a complex, unworkable, two-tiered system for determining overtime eligibility. Should the Harkin amendment become law, employers and government enforcement officials must look to both the old and the new regulations to determine eligibility for overtime for each employee. This two-tiered system would become a bureaucratic nightmare for employers and employees, and limit the enforcement abilities of Labor Department investigators and the courts. Instead of simplifying compliance and decreasing the opportunities for litigation, the Harkin amendment would result in the reverse. The complications imposed under the Harkin amendment could cause the Administration to rescind its new regulations and reinstate the old ones.[35]

According to the Employment Policy Foundation (EPF), 23.5 million American workers could lose stronger overtime protections if the Administration is forced to rescind its final overtime regulations.[36] Police, firefighters, nurses, and blue collar workers are among those who would lose the greater protection guaranteed by the Administration's revised regulations. Additionally, according to the EPF, returning to the old regulations would cost employers and employees up to $868 million in annual administrative costs by taking away the compliance burden savings that result from the simpler structure and language of the new regulations.[37] Employers also already have incurred substantial costs in connection with the implementation of the new regulations.

Furthermore, the Harkin amendment could limit the ability of employees to advance from their current status. If his amendment were law, it would require employers to continue to consider a worker non-exempt, regardless of her career advancement. For example, a non-exempt secretary in the human resources department who continued her education and worked her way up through promotions to become an exempt director of human resources would still have to be paid overtime pay. This perverse result would discourage employers from promoting employees into more senior positions with higher pay and better benefits.

If enacted into law, the Harkin amendment would most harm career advancement opportunities for women and minorities who are more likely to take an alternative, nontraditional career path to middle- and upper-level corporate management. To further complicate matters, the amendment would allow an employer to treat differently employees performing the same job. For example, a non-exempt bookkeeper who becomes an exempt certified public accountant and stays with the same employer would still have to be paid overtime, while a certified public accountant later hired – and working in the same office – would be treated as a professional and not qualify for overtime pay.

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[35] Fact Sheet: FLSA Reform, Employment Policy Foundation, http://www.epf.org/pubs/factsheets/2004/fs20040518.pdf.

[36] EPF Fact Sheet. (The EPF estimated impact adds to the Administration's estimate of 6.7 million workers estimated to gain greater protections, 14 million hourly workers with a likelihood to perform exempt duties that will lose their greater protections to overtime pay by the final regulations, plus 2.8 million workers who are blue collar, hourly workers with exempt duties who could lose their greater protection to overtime pay should the final regulations be rescinded.)

[37] EPF Fact Sheet.

Conclusion

The Bush Administration got it right. The final regulations governing overtime pay for white-collar workers represent the best compromise and a much-needed update. The new regulations give employers and employees clear rules that allow them greater certainty of their rights and obligations. This critical legal clarity will reduce wasteful litigation, allow for better compliance, and help employers who have been operating in good faith. The new regulations strengthen overtime protection for 6.7 million low-wage workers, including 1.3 million low-salaried workers who were not entitled to overtime earnings under the old regulations.

Congress should oppose the Harkin amendment because it will complicate enforcement and take away the guaranteed right to overtime for millions of workers. Congress should refrain from altering these regulations. The final regulations protect workers, are good for the economy, and deserve to continue to serve as the law of the land, unamended.