

April 2019



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DOL's Overtime Rules: What to Expect for High- Paid Workers

On March 7, 2019 the Department of Labor (DOL) published a long-awaited proposal for revisions to the “white collar” or executive, administrative, and professional (EAP) exemptions from the overtime provisions of the Fair Labor Standards Act (FLSA). The Notice of Proposed Rulemaking (NPRM) sets two new salary thresholds, an EAP threshold and a highly compensated employee (HCE) exemption. Much of the discussion about the proposed revisions has centered around the EAP salary threshold.¹ The focus of this article, however, is the proposed increase in the HCE salary threshold from \$100,000 to \$147,414, which is approximately the 90th percentile of the earnings distribution of full-time non-hourly workers in the entire US.

Workers who earn more than the HCE threshold are subject to a “minimal” duties test in order to be exempt from FLSA overtime requirements, while white collar employees earning less than the HCE threshold are subject to the full EAP duties test. In particular, a highly compensated employee is exempt from the FLSA if they customarily and regularly perform just one of the duties of an exempt executive, administrative, or professional employee specified in the full EAP duties test.²

¹ For example, the *Law360* article that announced the NPRM included the new EAP salary threshold in the headline (<https://www.law360.com/articles/1136567/dol-s-new-ot-rule-sets-flsa-exemption-threshold-at-35k->) and another recent *Law360* article (<https://www.law360.com/articles/1145092/assessing-employee-exemption-under-dol-overtime-regs>) calls the new higher EAP threshold “the most significant change to the federal regulations.”

² Employees paid less than the HCE threshold must satisfy all of the requirements of the EAP duties test. For example, to be exempt from the FLSA an administrative employee’s primary duty must be the performance of office or non-manual work directly related to the management or general business operations of the employer or the employer’s customers; and must include the exercise of discretion and independent judgment with respect to matters of significance. See https://www.dol.gov/whd/overtime/fs17a_overview.htm.

With the new regulation, employees earning between \$100,000 and \$147,414 will no longer be considered highly compensated and will therefore need to pass all of the components of the duties test (instead of just one) to qualify for exempt status beginning in 2020. The proposed rule also makes clear that the DOL will seek increases to the HCE salary threshold every four years and suggests that future HCE thresholds will be linked to the 90th percentile of the earnings distribution.

Which salaried employees are affected by the new HCE threshold?

We examined Current Population Survey (CPS) data³ from 2018 and estimate that there are approximately 6 million “white collar”⁴ employees whose earnings exceed the existing \$100,000 HCE threshold, but who do not earn enough to exceed the proposed HCE threshold of \$147,414. About 70 percent of these employees are either in occupations that are exempt from overtime for other reasons (such as educators⁵) or that the DOL assumes will have at least a 90 percent chance of passing the full EAP duties test (such as chief executives, doctors, and lawyers). The following 15 occupations account for more than half of the remaining 1.8 million employees who will no longer be considered highly compensated, are about to become subject to a more stringent EAP duties test, and are employed in positions that the DOL assumes are associated with duties that may no longer qualify for an FLSA exemption:

- First-Line Supervisors
- Sales Representatives (Retail, Wholesale, Manufacturing, and Services)
- Management Analysts
- Computer Programmers
- Human Resources Workers
- Compliance Officers
- Real Estate Brokers and Sales Agents
- Personal Financial Advisors
- Customer Service Representatives
- Credit Counselors and Loan Officers
- Food Service Managers
- Financial Analysts
- Market Research Analysts and Marketing Specialists
- Insurance Sales Agents
- Claims Adjusters, Appraisers, Examiners, and Investigators

³ We examined the Current Population Survey (CPS) Merged Outgoing Rotation Group (MORG) data from 2018. The NPRM is based on MORG data from 2017.

⁴ We consider “white collar” employees to be not self-employed full-time workers in the occupations that the DOL identifies as having a positive chance of passing the EAP duties test. We also follow the DOL and assume that employees who indicate they are not paid hourly are classified as being exempt from overtime.

⁵ Teachers are exempt from the FLSA under the Creative Professional Exemption https://www.dol.gov/whd/overtime/fs17d_professional.pdf. However, according to the DOL, almost all educators have a 90%+ chance of passing the EAP duties test, so most would qualify for the EAP exemption as well.

What can we learn from the list of occupations that will not be eligible for the highly compensated employee exemption?

- 1. Many of the affected jobs are found in most (if not all) industries:** Virtually all employers have some version of first-line supervisors, and many also have their own human resource and marketing functions. All jobs with exempt employees in the affected salary range should be reviewed closely. The dollar cost of misclassification is high for high-earners, and the fact that many employers do not track work time for such employees means employers could find themselves with limited defense against associated unpaid overtime claims.
- 2. Many first-line supervisors fall into this group:** The largest group is the first-line supervisors, and it includes a wide range of employees. Supervisors of Sales Workers (both retail and non-retail) are the largest group, and the DOL believes those employees have between a 50 percent and 90 percent chance of passing the EAP duties test. However, the DOL assumes that first-line supervisors of construction trades and extraction workers; housekeeping and janitorial workers; farming, fishing, and forestry workers; and personal service workers have less than a 10 percent chance of passing the EAP duties test. Employers should not assume that all supervisor positions qualify for the EAP exemption.
- 3. Some of the listed jobs are higher risk than others:** According to the DOL, Sales Representatives in Wholesale, Manufacturing, and Services; Compliance Officers; Real Estate Brokers and Sales Agents; Customer Service Representatives; and Food Service Managers have less than a 50 percent chance of passing the EAP duties test. As a result, employees in those positions classified as exempt are likely to be met with more skepticism from regulators and the plaintiffs' bar.
- 4. Professional services may require closer review:** Several of the positions are in professional services where it can be particularly hard to describe and document employees' daily activities. Such positions can also have a wide mix of responsibilities and functions within the same job title. It may take additional effort to confirm these employees pass the EAP duties test and ensure that sufficient documentation is maintained.
- 5. Some industries will be affected more than others:** Industries with a particularly large number of people in the affected positions and salary range include Retail, Finance, Real Estate, Insurance, and Health Care.

This isn't the end—expect the HCE threshold to grow substantially after 2020.

The \$147,414 threshold in the NPRM represents the DOL's projection for the 90th percentile of the earnings distribution in 2020. However, that amount assumes an annual growth rate of 2.24% for the 2.5 years from mid-2017 to January 2020. There are several reasons why the HCE threshold will grow much faster than the DOL has indicated:

- 1. The DOL understated previous growth in the 90th percentile.** The CPS data indicate that the 90th percentile grew between 2002 and 2017 at an annual rate of 2.99% (not 2.24%) because the 90th percentile in 2002

was about \$90,000 (and not \$100,000 as indicated in the NPRM).

2. Growth at the top percentiles of the earnings distribution is accelerating. The CPS data indicates that the 90th percentile grew at an annual rate of 4.22% in the past five years, and the 90th percentile in 2018 was already \$149,968 – higher than the projection for January 2020 in the NPRM.

3. The proposed rules, if enacted, will cause the lowest paid exempt workers to be reclassified as non-exempt. This will “hollow out” the pay distribution of non-hourly employees and further accelerate the growth in the 90th percentile of the non-hourly earnings distribution.

Consequently, employers should prepare for much higher growth rates in the HCE threshold as long as the DOL intends to link the threshold to the 90th percentile of the earnings distribution. In fact, we expect the 90th percentile to grow by at least 4.2% per year and exceed \$188,000 by January 2024.

Conclusions

Businesses with FLSA exempt employees who earn between \$100,000 and \$147,414 should carefully review whether those employees would pass the stricter EAP duties test rather than the minimal HCE duties test and, if so, ensure sufficient documentation is maintained. The magnitude of potential damages from misclassification is unpredictable for employers that have not been recording the weekly hours of white collar employees who earn in excess of \$100,000 per year. The dollar cost of misclassification can be substantial for these employees; with potential hourly regular rates of compensation in excess of \$50, back pay for unpaid overtime can add up quickly. Furthermore, many employees who earn above \$147,414 will not be considered highly compensated when the HCE thresholds are determined for 2024. ■

Originally published in *Law360*, April 2019.



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