



The Honorable R. Alexander Acosta
Secretary of Labor
c/o Ms. Melissa Smith, Director
Division of Regulations, Legislation, and Interpretation
Wage and Hour Division
U.S. Department of Labor
200 Constitution Avenue NW, Room S-3502
Washington, DC 20210
Docket ID: WHD-2017-0002

Dear Mr. Secretary:

Comments submitted by Trey Kovacs, Policy Analyst, Competitive Enterprise Institute, in Response to “Request for Information; Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees,” RIN 1235-AA20, 82 Fed. Reg. 34616 (July 26, 2017)

The Competitive Enterprise Institute (CEI) is pleased to submit these comments in response to the Department of Labor’s (DOL) Request for Information (RFI) regarding potential changes to the overtime regulations, located at 29 CFR part 541, which define and delimit exemptions for certain executive, administrative, professional, outside sales and computer employees (EAP) from the Fair Labor Standards Act’s (FLSA) minimum wage and overtime requirements.

CEI is a nonprofit public interest organization dedicated to the principles of limited constitutional government and free enterprise. For the past six years, I have researched the adverse effects of labor and employment law and regulation on job creation and individual prosperity.

History of FLSA Overtime Requirements. In gathering information to make changes to the overtime regulations it is instructive to revisit the intent of Congress in enacting the FLSA and the experience with past regulations governing overtime pay eligibility.

Historically, Congress’ intent behind the FLSA was never to set the wages and hours for all workers. Primarily, it was to ensure an adequate standard of living for the most disadvantaged workers.¹ As stated, in a 1945 Supreme Court case, “the prime purpose of the

¹ Report of the Minimum Wage Study Commission 5 (1981), <http://rsickles.rice.edu/files/2015/11/Minimum-Wage-Study-1983-Carter-Administration-1hkd1cv.pdf>

legislation was to aid the unprotected, unorganized and lowest paid of the nation's working population."² The reference to disadvantaged workers was to factory floor employees. The purpose of the FLSA was not to set wages and hours for executive, administrative, professional employees, who were exempted from minimum wage and overtime requirements because they enjoy better pay, benefits, workplace flexibility, and stronger bargaining power than low-wage workers.

The FLSA's text makes clear that it is not intended to cover all workers. The statute contains numerous exemptions, many of which pertain to overtime requirements. There are nearly 50 full or partial exemptions from the FLSA's overtime requirements.³

Salary Threshold Cannot Supplant Duties Test. When seeking to make changes to overtime requirements, it is crucial to not set a salary threshold too high, because the plain language of the FLSA exempts employees who perform EAP duties without regard to their level of pay.

From 1938 to 1949, the Department of Labor developed a three-pronged test to determine whether an employee is exempt from overtime requirements. Its three components are:

1. **The "salary basis" test:** an employee is paid a predetermined salary;
2. **The "salary threshold" test:** the predetermined pay is above a certain amount; and
3. **The "duties" test:** exempt employees perform executive, administrative, or professional activities as defined by the Department of Labor.

A decision on August 31, 2017, by the Eastern Texas District Court put limitations on the Labor Department's ability to deploy the salary threshold test. The court affirmed that the EAP exemption from overtime requirements in the FLSA is based on what duties an individual performs, not on his or her compensation level. The State of Nevada sued the U.S. Labor Department over the overtime rule, because it would deplete state budgets by forcing states to pay overtime to public employees who perform executive, administrative and professional duties.

During the Obama administration, the DOL set the salary threshold for overtime eligibility so high that it supplanted what duties an employee performs. By making the salary level the predominant factor in determining exemption status, the court found that "because the Final Rule would exclude so many employees who perform exempt duties, the Department fails to carry out Congress's unambiguous intent."⁴

² *Brooklyn Savings Bank v. O'Neil*, 324 U.S. 697 (1945), <https://supreme.justia.com/cases/federal/us/324/697/case.html>.

³ Randel Johnson and Marc Freedman, "Proposed Rule, Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees, 80 FR 38516," RIN 1235-AA11, July 16, 2015, https://www.uschamber.com/sites/default/files/documents/files/u_s_chamber_-_comments_-_part_541_nprm.pdf.

⁴ *State of Nevada v. Department of Labor*, No. 4:16-CV-731. Eastern Texas District Court, August 31, 2017, <http://www.txed.uscourts.gov/sites/default/files/notable/Memorandum%20Opinion%20and%20Order%20%20Dated%208-31-2017.pdf>.

American employers need a different approach from that of the Obama administration's overtime rule, which raised the overtime salary threshold so high as to increase overtime eligibility for as many employees as possible. It did so with no concern whether these employees previously would be exempt from overtime pay requirements because they performed EAP duties. In the DOL's Final Rule, the agency estimated that 4.2 million employees, previously classified as exempt, would change from exempt to nonexempt status without employers taking any action.⁵

Since the 1940s, the Department of Labor has understood that "it is very difficult to say... where a worker leaves off and a professional or executive begins."⁶ Further, establishing the difference between an exempt and non-exempt employee was once described by a court as a "twilight zone of uncertainty."⁷ That uncertainty is why setting the salary threshold at the proper level is so important.

Raising the salary threshold so high that millions of employees lose exempt status regardless of their workplace duties conflicts with the FLSA's text. The basis for overtime eligibility in the FLSA does not mention anything about how much employees earn or whether they are paid an hourly wage or salary. Rather, the exemption focuses on the duties an employee performs. Section 213(a)(1) of the FLSA states:

[A]ny employee employed in a bona fide executive, administrative, or professional capacity (including any employee employed in the capacity of academic administrative personnel or teacher in elementary or secondary schools), or in the capacity of outside salesman (as such terms are defined and delimited from time to time by regulations of the Secretary.)⁸

Historical Purpose of Salary Threshold and Why It is Set at a Low Level. In considering how to best implement a new overtime rule with a focus on the proper salary threshold, it is key to observe how it has been set in the past. A concern expressed in the DOL's Request for Information is at "what salary level does the duties test no longer fulfill its historical role in determining exempt status?" However, that question carries little relevance in practice. In the past, the salary threshold has been set at a low level so that, generally, an employee who does not meet the salary threshold also does not perform EAP exempt duties.

⁵ Final Rule, Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees, 81 FR 32393, May 23, 2016, <https://www.federalregister.gov/documents/2016/05/23/2016-11754/defining-and-delimiting-the-exemptions-for-executive-administrative-professional-outside-sales-and-computer-employees>.

⁶ William G. Whittaker, "The Fair Labor Standards Act: A Historical Sketch of the Overtime Pay Requirements of Section 13(a)(1)," May 2005, http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1240&context=key_workplace.

⁷ *Ralph Knight, Inc. v. Mantel*, 135 F.2d 514, 517 (8th Cir. 1943), <https://casetext.com/case/ralph-knight-v-mantel>.

⁸ The Fair Labor Standards Act of 1938, as amended 29 U.S.C. 201, <https://www.dol.gov/whd/regs/statutes/FairLaborStandAct.pdf>.

The Department of Labor has acknowledged that one of the best determinants of who may be classified as an EAP employee and exempt from overtime requirements is the salary threshold test. But this does not mean that the salary threshold was meant to be raised so high as to engulf workers who perform legitimate EAP duties.

Though not required by the statute, the salary threshold was implemented to simplify enforcement by screening out clearly nonexempt employees. Historically, that has been the case because “the Department has looked to salaries of exempt employees in the lowest-wage region, the smallest size establishment group, the smallest-sized city group, and the lowest-wage industry.”⁹ DOL does this to help preserve exempt status from its overtime requirements for millions of employees who perform EAP job duties, as intended by Congress when it enacted the FLSA. A low salary threshold is only meant to be used as a guide to simplify enforcement and help DOL investigators and employers distinguish between exempt and non-exempt workers.

Since 1949, the overtime rule’s salary threshold has never been increased by more than 10 percent at any one time.¹⁰ The Obama administration overtime rule increased the salary threshold by 100 percent. Historically, when looking at what percentile of exempt employees’ salaries to set the threshold, the DOL has, used the 10th, 15th and 20th percentile of overtime exempt employee salaries.¹¹ The Obama administration’s rule doubled the historical rate of increase, setting the salary threshold to the 40th percentile of all non-hourly employees.

Not only does raising the salary threshold to such extreme levels run counter to congressional intent and historical increases, it is outside of the DOL’s authority, as decided recently by the Eastern Texas District Court.¹²

Despite potential abuses of the salary threshold, a duties-only test would not be preferable to the Labor Department’s current three-prong test. Even though the FLSA gives wide latitude to the Labor Secretary to increase the threshold, the salary threshold test greatly eases compliance and enforcement for all stakeholders.

The DOL’s ability to raise the salary threshold has been somewhat constrained by the recent Eastern Texas Court decision, but the ruling did not specify at what level the salary

⁹ U.S. Department of Labor Wage and Hour Division, Proposed Revision of Regulations, Part 541, under the Fair Labor Standards Act, Report and Recommendations, 1958.

¹⁰ Tammy McCutchen, Testimony to the U.S. House of Representatives Committee on Education and the Workforce Subcommittee on Workforce Protections, “Examining the Costs and Consequences of the Administration’s Overtime Proposal,” July 23, 2015, https://edworkforce.house.gov/uploadedfiles/mccutchen_testimony.pdf.

¹¹ Johnson and Freedman.

¹² *Nevada v. DOL*, Eastern District Texas, No. 4:16-CV-731, August 31, 2017, <http://www.txed.uscourts.gov/sites/default/files/notable/Memorandum%20Opinion%20and%20Order%20Dated%202017-08-31-2017.pdf>.

threshold would supplant the duties test, just that the previous salary level of \$47,476 was too high. As such, the DOL may still raise the salary threshold above historical norms.

It is far easier for regulators and employers to have a straightforward tool like the salary threshold test to screen out employees who are obviously nonexempt. Using a duties-only test would create more uncertainty and is a poor tool alone to adequately differentiate exempt and nonexempt employees.

Single Salary Threshold vs. Regional Salary Thresholds. A salary threshold should be set low enough so there is no need to create differing regional thresholds that take into account varying cost of living and wage disparities across the country, as has been the case in the past. A low national salary threshold is preferable because it is only meant to screen out obviously nonexempt employees, which as a test it does well.

Keeping the national salary threshold at a low level works for high and low wage regions. For example, setting a salary threshold at a level that screens out obviously nonexempt employee in the rural South would do the same in New York City. The opposite is not true; a salary threshold set for New York City would inappropriately screen out employees that perform EAP duties in the rural South.

There are other reasons for setting a national salary level instead of differing regional levels. Former acting Wage and Hour Administrator Alexander Passantino says multiple standard salary levels are “a great idea in principle—somewhat difficult in application.” To explain, he poses a hypothetical situation. “Imagine a company incorporated in Delaware with headquarters in New York, a regional office in Denver, a field supervisor working out of his home in Santa Fe, who services a district covering El Paso, Texas, to Phoenix,” he says. “Then imagine he spends half his time in the Denver office and half his time working out of his home.” Setting multiple salary thresholds based on regional differences would create more challenges for the DOL than the setting a single salary level.¹³

Setting a national salary threshold at a low level also alleviates concerns from employers with locations throughout the country.

Negatively Impacted Entities from High Salary Threshold. The problems associated with a high salary threshold extend beyond the private sector. Local governments, non-profit organizations, and public universities would all be affected by a change in policy. Unlike for-profit businesses, these entities largely work on a business model that exchanges low wages for non-monetary benefits like flexible schedules,

¹³ Allen Smith, “DOL Asks if Multiple Salary Levels for Overtime Exemptions Are a Good Idea,” Society for Human Resource Management, July 26, 2017, <https://www.shrm.org/resourcesandtools/legal-and-compliance/employment-law/pages/ot-rfi-multiple-salary-levels.aspx>.

independence, greater job satisfaction, and telecommuting, and would face severe financial constraints from salary threshold that is set too high.

For example, Nancy Duncan, associate vice president of human resources at the nonprofit Operation Smile, stated in written testimony to the Senate Committee on Small Business and Entrepreneurship, “the [Obama administration overtime] rule will increase the nonprofit’s payroll cost by close to \$1 million a year.”¹⁴ The organization does not have the ability to instantly raise \$1 million in revenue to offset rising labor costs. Ultimately, setting too high a salary threshold means fewer children would receive Operation Smile’s assistance in getting life-altering surgeries to repair cleft lips, cleft palates, and other facial deformities.

State and local governments would be negatively affected by a salary threshold that is set too high. The State of Iowa, for example, estimates the overtime rule will increase costs on the state government and public universities by approximately \$19.1 million in just the first year.¹⁵ In Arkansas, about 3,995 employees will no longer be overtime exempt. If the state were to maintain its present level of overtime usage, the cost of overtime would exceed \$1 million.¹⁶ Many of the state employees are nurses and law enforcement officers. As 21 attorneys general, including Arkansas’ Leslie Rutledge, stated in their lawsuit challenging the rule, those positions “are inherently restricted in the ability to shift or limit workloads, and will therefore necessarily suffer increased overtime payouts that could cripple budgets.”¹⁷

Startup firms would also be harmed. At many startups, employees agree to receive low pay during the firm’s early days, but collect equity in the firm as part of their compensation packages. The recently invalidated overtime rules failed to take equity into account when calculating whether an employee meets the salary threshold exemption. The Obama administration’s overtime regulation could impose at least \$317 million in compliance costs on tech startups.¹⁸ But if the salary threshold is set at a low enough level, these costs would be alleviated and would not pose significant negative effects on small business formation.

Business models and pay practices have changed greatly in the past 80 years. Applying regulation designed for the economy of the 1930s—one dominated by large companies that could offer workers career-long employment—is anachronistic and counterproductive in

¹⁴ Nancy Duncan, Testimony to the U.S. Senate Committee on Small Business and Entrepreneurship, “An Examination of the Administration’s Overtime Rule and the Rising Costs of Doing Business,” May 11, 2016, https://www.sbc.senate.gov/public/_cache/files/9/9/998e48e6-bfd4-47d4-b80f-3d92aec23a74/EA7A52B29A53FB15FCC9BCF5C3EDD790.duncan-testimony.pdf.

¹⁵ *State of Nevada v. Department of Labor*, No. 1:16-cv-00407. Eastern District of Texas, September 20, 2016, <http://www.wagehourinsights.com/wp-content/uploads/sites/697/2016/09/DOL-OT-Rule-Complaint-Filed.pdf>.

¹⁶ *Ibid*.

¹⁷ *Ibid*.

¹⁸ Donald J. Boudreaux and Liya Palagashvili, “An Economic Analysis of Overtime Pay Regulations,” Mercatus Center, April 4, 2016, <https://ppe.mercatus.org/system/files/Boudreaux-Overtime-Pay-Regs-v2.pdf>.

today's economy, in which people change careers often.¹⁹ Setting a low salary threshold would allow upstart businesses to thrive and experiment with new business models, by lightening their regulatory burden in their early growth phases. And even as they grow, it would help provide employers the flexibility to offer differing compensation packages that employees value.

Conclusion. The Department of Labor should take great care in making changes to its overtime requirements by weigh how modifications may negatively impact workers and job creators. Setting a salary threshold too high can harm employees who are on a management track who could be reclassified as hourly workers. For low-level managers who are reclassified and have their hours capped, it will greatly restrict their ability to receive flexible schedules, a benefit many professional employees value and have come accustomed to. In addition, employers that seek to control labor costs reclassifying salaried employees as hourly will find savings hard to come by, because of increased record keeping costs.

In addition, the Obama administration's overtime policy interferes with people's ability to determine their own work goals and choices. Ambitious employees will find the overtime rule a roadblock to such career pursuits.

Regulations like the overtime rule impose costs that have to be made up somewhere. Many times those regulatory costs are made up by employers reducing wages or not creating jobs. My organization, the Competitive Enterprise Institute, estimates the total annual burden of regulation on the economy at about \$1.9 trillion. It is important that any new overtime rule only adds minimal costs or reduces this already overwhelming sum. If the regulations were not so costly and burdensome, more resources would be available to support more good paying jobs.²⁰

Respectfully submitted,

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¹⁹ Iain Murray, "Punching the Clock on a Smartphone App? The Changing Nature of Work in America and Regulatory Barriers to Success," *Issue Analysis* 2016 No. 8, Competitive Enterprise Institute, September 7, 2016, <https://cei.org/changingnatureofwork>.

²⁰ Wayne Crews, *Ten Thousand Commandments 2017: An Annual Snapshot of the Federal Regulatory State*, Competitive Enterprise Institute, May 31, 2017, <https://cei.org/10kc2017>.