



## **DEPARTMENT OF LABOR**

### **Wage and Hour Division**

#### **29 CFR Part 541**

#### **RIN 1235-AA20**

### **Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees**

**AGENCY:** Wage and Hour Division, Department of Labor.

**ACTION:** Proposed rule and request for comments.

**SUMMARY:** Using a longstanding and commonsense methodology and based on broad-based input, the Department of Labor (Department) proposes to update and revise the regulations issued under the Fair Labor Standards Act (FLSA or Act) implementing the exemption from minimum wage and overtime pay requirements for executive, administrative, professional, outside sales, and computer employees.

**DATES:** Submit written comments on or before [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

**ADDRESSES:** You may submit comments, identified by Regulatory Information Number (RIN) 1235-AA20, by either of the following methods: Electronic Comments: Submit comments through the Federal eRulemaking Portal <http://www.regulations.gov>. Follow the instructions for submitting comments. Mail: Address written submissions to Melissa Smith, Director of the Division of Regulations, Legislation, and Interpretation, Wage and Hour Division, U.S. Department of Labor, Room S-3502, 200 Constitution Avenue, N.W., Washington, D.C. 20210.

Instructions: Please submit only one copy of your comments by only one method. All submissions must include the agency name and RIN, identified above, for this rulemaking. Please be advised that comments received will become a matter of public record and will be

posted without change to <http://www.regulations.gov>, including any personal information provided. All comments must be received by 11:59 p.m. on the date indicated for consideration in this rulemaking. Commenters should transmit comments early to ensure timely receipt prior to the close of the comment period as the Department continues to experience delays in the receipt of mail in our area. For additional information on submitting comments and the rulemaking process, see the “Public Participation” heading of the supplementary information section of this document. For questions concerning the interpretation and enforcement of labor standards related to the FLSA, individuals may contact the Wage and Hour Division (WHD) local district offices (see contact information below). Docket: For access to the docket to read background documents or comments, go to the Federal eRulemaking Portal at <http://www.regulations.gov>.

**FOR FURTHER INFORMATION CONTACT:** Robert Waterman, Division of Regulations, Legislation, and Interpretation, Wage and Hour Division, U.S. Department of Labor, Room S-3502, 200 Constitution Avenue, NW, Washington, DC 20210; telephone: (202) 693-0406 (this is not a toll-free number). Copies of this proposed rule may be obtained in alternative formats (Large Print, Braille, Audio Tape or Disc), upon request, by calling (202) 693-0675 (this is not a toll-free number). TTY/TDD callers may dial toll-free 1-877-889-5627 to obtain information or request materials in alternative formats.

Questions of interpretation and/or enforcement of the agency’s regulations may be directed to the nearest WHD district office. Locate the nearest office by calling WHD’s toll-free help line at (866) 4US-WAGE ((866) 487-9243) between 8 a.m. and 5 p.m. in your local time zone, or log onto WHD’s website for a nationwide listing of WHD district and area offices at <http://www.dol.gov/whd/america2.htm>.

Electronic Access and Filing Comments

Public Participation: This proposed rule is available through the Federal Register and the <http://www.regulations.gov> website. You may also access this document via WHD's website at <http://www.dol.gov/whd/>. To comment electronically on Federal rulemakings, go to the Federal eRulemaking Portal at <http://www.regulations.gov>, which will allow you to find, review, and submit comments on Federal documents that are open for comment and published in the Federal Register. You must identify all comments submitted by including "RIN 1235-AA20" in your submission. Commenters should transmit comments early to ensure timely receipt prior to the close of the comment period (11:59 p.m. on the date identified above in the DATES section); comments received after the comment period closes will not be considered. Submit only one copy of your comments by only one method. Please be advised that all comments received will be posted without change to <http://www.regulations.gov>, including any personal information provided.

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**I. Executive Summary**

The Fair Labor Standards Act (FLSA or Act) requires covered employers to pay employees a minimum wage and, for employees who work more than 40 hours in a week, overtime premium pay at least 1.5-times their regular rate of pay. The FLSA provides a number of exemptions to these two requirements.

Section 13(a)(1) of the FLSA, commonly referred to as the “white collar” or “EAP” exemption, exempts “bona fide” executive, administrative, professional, outside sales, and computer employees from the minimum wage and overtime requirements of the FLSA. The statute delegates to the Secretary of Labor (the Secretary) the authority to define and delimit the terms of this white collar exemption. Since 1940, the regulations implementing the exemption generally have required three things: (1) the employee must be paid a predetermined and fixed salary that is not subject to reduction because of variations in the quality or quantity of work performed (the “salary basis test”); (2) the amount of salary paid must meet a minimum specified amount (the “salary level test”); and (3) the employee’s job duties must primarily involve executive, administrative, or professional duties as defined by the regulations (the “duties test”).

The Department has long used the salary level test as a tool to help define the white collar exemption on the basis that employees paid less than the salary level are unlikely to be bona fide executives, administrators, or professionals, and, conversely, that nearly all bona fide executives, administrators, and professionals are paid at least that much. The salary level test provides

certainty for employers and employees, as well as efficiency for government enforcement agencies. The salary level test's usefulness, however, diminishes as the wages of employees entitled to overtime increase and the real value of the salary threshold falls.

The Department increased the weekly salary level from \$455 (\$23,660 per year) to \$913 (\$47,476 per year) in a final rule published May 23, 2016 ("2016 final rule"). That rulemaking was challenged in court, and on November 22, 2016, the U.S. District Court for the Eastern District of Texas enjoined the Department from implementing and enforcing the rule. On August 31, 2017, the court granted summary judgment against the Department, invalidating the 2016 final rule. An appeal of that decision to the United States Court of Appeals for the Fifth Circuit, based on the salary threshold, is being held in abeyance. Currently, the Department is enforcing the regulations in effect on November 30, 2016, including the \$455 per week standard salary level, which is the same level set in place during the 2004 final rule.

The Department has reconsidered the \$913 per week standard salary level set in the 2016 final rule in light of the district court's decisions, public comments received in response to a July 26, 2017 Request for Information (RFI), and feedback received at public listening sessions the Department held around the country to receive additional public input on issues related to the salary level test.<sup>1</sup> The Department agrees with the vast majority of RFI commenters that the standard salary level needs to exceed \$455 per week to more effectively serve its purpose. But the Department now also believes that increasing the standard salary level to \$913 per week was inappropriate. The increase excluded from exemption 4.2 million employees whose duties would have otherwise qualified them for exemption, a result in significant tension with the text of section 13(a)(1). As the district court noted in its decision invalidating the 2016 final rule, the

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<sup>1</sup> Timely comments and listening session records may be reviewed at [www.regulations.gov](http://www.regulations.gov), docket ID: WHD-2017-0002.

increase also untethered the salary level test from its historical justification: setting a dividing line between nonexempt and potentially exempt employees by screening out from exemption a swath of employees who are unlikely to be bona fide executives, administrators, or professionals because of their compensation level.

To address the district court's and the Department's concerns with the 2016 final rule and set a more appropriate salary level, the Department proposes to rescind formally the 2016 final rule and simply to update the 2004 standard salary level by applying the same methodology to current data. The 2004 final rule set the standard salary level at approximately the 20th percentile of earnings of full-time salaried workers in the lowest-wage census region (then and now the South) and in the retail sector. This proposed rule would do the same. When this method is applied to 2017 data, and projected forward to January 2020 (the approximate date this rule is anticipated to be effective), it results in a proposed standard salary level of \$679 per week (\$35,308 per year). The Department anticipates using 2018 data in development of the final rule. The Department estimates that in 2020, 1.1 million currently exempt employees who earn at least \$455 per week but less than the proposed standard salary level of \$679 per week would, without some intervening action by their employers<sup>2</sup>, gain overtime eligibility.<sup>3</sup> In an attempt to align the regulations better with modern pay practices, the Department also proposes to allow employers to count nondiscretionary bonuses and incentive payments (including commissions) to satisfy up

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<sup>2</sup> Employers may opt to raise salary levels, reorganize workloads, adjust work schedules, or spread work hours in order to avoid payment of overtime pay.

<sup>3</sup> The Department also estimates that an additional 2.0 million white collar workers who are currently nonexempt because they do not satisfy the EAP duties tests and currently earn at least \$455 per week but less than \$679 per week would have their overtime-eligible status strengthened in 2020 because these employees would now fail both the salary level and duties tests.

to 10 percent of the standard salary level test, provided such bonuses are paid annually or more frequently. The Department is not proposing any changes to the standard duties test.

The Department believes that the proposed update to the standard salary level will maintain the traditional purposes of the salary level test, and will help employers more readily identify exempt employees. In proposing a new salary level, the Department considered the district court's conclusion that the salary level set in the 2016 final rule exceeded the Department's authority by "exclud[ing] so many employees who perform exempt duties" thereby making "salary rather than an employee's duties determinative" of the applicability of the EAP exemption.<sup>4</sup> The Department has also considered the comments received in response to the RFI and those presented by interested parties at the nationwide listening sessions.

The Department considered other methods for setting the standard salary level, as described in sections IV.A.v and VI.C. The Department seeks comments on these or other methods that would update the standard salary level to reflect wage growth, are consistent with the salary level's purposes, and are reasonable considering the interests of employers and employees.

In the 2004 final rule, the Department for the first time incorporated a Highly Compensated Employee (HCE) test, which paired a reduced duties requirement with a higher compensation level (\$100,000). To update the HCE total annual compensation level (set to \$100,000 in the 2004 final rule and increased to \$134,004 in the 2016 final rule), the Department is adopting the same methodology used in the 2016 final rule. The Department proposes to set the level equivalent to the 90th percentile of full-time salaried workers nationally, similarly projected forward to 2020, which results in an increase in the annual compensation level to

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<sup>4</sup> *Nevada v. U.S. Dep't of Labor*, 275 F. Supp. 3d 795, 807 (E.D. Tex. 2017).

\$147,414 per year. Without intervening action by their employers, an estimated 201,100 currently exempt workers who earn at least \$100,000 per year but less than the proposed HCE annual compensation level of \$147,414 per year, and who meet the HCE duties test but not the standard duties test, would also gain overtime eligibility.

Additionally, the Department is proposing special salary levels for certain U.S. territories and an updated base rate for employees in the motion picture producing industry. Furthermore, to prevent the earnings threshold levels from becoming significantly outdated in the future and to provide predictability and certainty for the benefit of workers and employers, the Department intends to propose updates to these levels every four years through notice-and-comment rulemaking, and solicits comment from the public regarding that intention.

This proposed rule is expected to be an Executive Order 13771 deregulatory action. When the Department uses a perpetual time horizon to allow for cost comparisons under Executive Order 13771, and using the 2016 rule as the baseline, the annualized cost savings of this proposed rule is \$224.0 million with 7 percent discounting. The net present value of the cost savings is \$3.2 billion using a perpetual time horizon and a 7 percent discount rate.

Because the Department is currently enforcing the 2004 salary level, the economic analysis uses the 2004 rule as the baseline for calculating costs and transfers. The economic analysis quantifies three direct costs resulting from the proposal: (1) regulatory familiarization costs; (2) adjustment costs; and (3) managerial costs. The Department estimates that annualized direct employer costs in the first 10 years following the rule's effective date will be \$120.5 million, including \$464.2 million in Year 1 and \$67.8 million in Year 10. This proposed rulemaking will also give employees higher earnings in the form of transfers of income from employers to employees. Annualized transfers are estimated to be \$429.4 million over the first

ten years, including \$526.9 million in Year 1. Details on the estimated reduced burdens and cost savings of this proposed rule are in the rule’s economic analysis.

## II. Background

### A. The FLSA

On June 25, 1938, the FLSA was signed into law. The FLSA generally requires covered employers to pay their employees at least the federal minimum wage (currently \$7.25 an hour) for all hours worked, and overtime premium pay of at least 1.5-times the regular rate of pay for all hours worked over 40 in a workweek.<sup>5</sup>

The FLSA exempts certain employees from its minimum wage and overtime requirements. Section 13(a)(1) exempts EAP employees from the minimum wage provisions of section 206<sup>6</sup> and the overtime pay provisions of section 207, and delegates to the Secretary the authority to define and delimit the terms of the exemption in regulations<sup>7</sup>

Pursuant to Congress’ grant of rulemaking authority, in 1938 the Department issued the first regulations at 29 CFR part 541, defining the scope of the section 13(a)(1) exemptions. Since 1940, the implementing regulations have generally imposed three requirements for the exemption to apply: (1) an employee must be paid a predetermined and fixed salary that is not subject to reduction because of variations in the quality or quantity of work performed (the “salary basis test”); (2) the amount of salary paid must meet a minimum specified amount (the “salary level test”); and (3) the employee’s job duties must primarily involve executive, administrative, or professional duties as defined by the regulations (the “duties test”).

### B. Regulatory History

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<sup>5</sup> 29 U.S.C. 201, *et seq.*

<sup>6</sup> “[E]xcept subsection (d) in the case of paragraph (1) of this subsection . . . .” 29 U.S.C. 213(a).

<sup>7</sup> *Id.*

The first version of part 541, establishing the criteria for exempt status under section 13(a)(1), was promulgated in October 1938.<sup>8</sup> The Department revised its regulations in 1940,<sup>9</sup> 1949,<sup>10</sup> 1954, 1958,<sup>11</sup> 1961, 1963, 1967, 1970, 1973, and 1975.<sup>12</sup> A final rule increasing the salary levels was published on January 13, 1981, but was stayed indefinitely on February 12, 1981.<sup>13</sup> In 1985, the Department published an Advance Notice of Proposed Rulemaking that was never finalized.<sup>14</sup> In 1992, the Department twice revised the part 541 regulations. First, the Department created a limited exception from the salary basis test for public employees.<sup>15</sup> The Department then implemented the 1990 law exempting employees in certain computer-related occupations.<sup>16</sup>

From 1949 until 2004, the part 541 regulations contained two different tests for exemption—a “long” test that paired a more rigorous duties test with a lower salary level, and a

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<sup>8</sup> 3 FR 2518 (Oct. 20, 1938).

<sup>9</sup> 5 FR 4077 (Oct. 15, 1940). The 1940 regulations were informed by what has come to be known as the Stein Report. *See* Executive, Administrative, Professional . . . Outside Salesman Redefined, Wage and Hour Division, U.S. Department of Labor, Report and Recommendations of the Presiding Officer [Harold Stein] at Hearings Preliminary to Redefinition (Oct. 10, 1940) (“Stein Report”).

<sup>10</sup> 14 FR 7705 (Dec. 24, 1949); 14 FR 7730 (Dec. 28, 1949). The 1949 regulations were informed by what has come to be known as the Weiss Report. *See* Report and Recommendations on Proposed Revisions of Regulations, Part 541, by Harry Weiss, Presiding Officer, Wage and Hour and Public Contracts Divisions, U.S. Department of Labor (June 30, 1949) (“Weiss Report”).

<sup>11</sup> 23 FR 8962 (Nov. 18, 1958). The 1958 regulations were informed by what has come to be known as the Kantor Report. *See* Report and Recommendations on Proposed Revision of Regulations, Part 541, Under the Fair Labor Standards Act, by Harry S. Kantor, Assistant Administrator, Office of Regulations and Research, Wage and Hour and Public Contracts Divisions, U.S. Department of Labor (Mar. 3, 1958) (“Kantor Report”).

<sup>12</sup> *See* 19 FR 4405 (July 17, 1954); 26 FR 8635 (Sept. 15, 1961); 28 FR 9505 (Aug. 30, 1963); 32 FR 7823 (May 30, 1967); 35 FR 883 (Jan. 22, 1970); 38 FR 11390 (May 7, 1973); 40 FR 7091 (Feb. 19, 1975).

<sup>13</sup> 46 FR 11972 (Feb. 12, 1981).

<sup>14</sup> 50 FR 47696 (Nov. 19, 1985).

<sup>15</sup> 57 FR 37677 (Aug. 19, 1992).

<sup>16</sup> 57 FR 46742 (Oct. 9, 1992); *see* Sec. 2, Pub. L. 101-583, 104 Stat. 2871 (Nov. 15, 1990), *codified at* 29 U.S.C. 213 Note.

“short” test that paired a more flexible duties test with a higher salary level. On April 23, 2004, the Department issued a final rule (2004 final rule), which replaced the “long” and “short” test system for determining exemption status with a single “standard” salary level paired with a “standard” duties test. The Department set the standard salary level at \$455 per week.<sup>17</sup>

On May 23, 2016, the Department issued another final rule (2016 final rule), which raised the standard salary level to \$913 per week and instituted a mechanism to automatically update the salary level every three years.<sup>18</sup> The 2016 final rule also permitted employers, for the first time, to satisfy up to 10 percent of the standard salary requirement with nondiscretionary bonuses and incentive payments (including commissions), provided that those forms of compensation were paid at least quarterly. The rule set an effective date of December 1, 2016.

On November 22, 2016, the United States District Court for the Eastern District of Texas issued a preliminary injunction, enjoining the Department from implementing and enforcing the 2016 final rule, pending further review.<sup>19</sup> On August 31, 2017, the district court granted summary judgment against the Department of Labor.<sup>20</sup> The court held that the 2016 final rule’s salary level exceeded the Department’s authority and that the entire final rule was therefore invalid. The court determined that a salary level that excludes from exemption an unusually high number of employees who pass the duties test stands in tension with Congress’s command to exempt bona fide EAP employees.

On July 26, 2017, the Department published a Request for Information (RFI) asking for public input on what changes the Department should propose in a new NPRM on the EAP

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<sup>17</sup> 69 FR 22122 (Apr. 23, 2004).

<sup>18</sup> 81 FR 32391 (May 23, 2016).

<sup>19</sup> See *Nevada v. U.S. Dep’t of Labor*, 218 F. Supp. 3d 520 (E.D. Tex. 2016).

<sup>20</sup> See *Nevada v. U.S. Dep’t of Labor*, 275 F. Supp. 3d 795 (E.D. Tex. 2017).

exemption.<sup>21</sup> The Department received over 200,000 comments on the RFI, which are discussed below. On October 30, 2017, the Government appealed the district court's summary judgment decision to the United States Court of Appeals for the Fifth Circuit. On November 6, 2017, the Fifth Circuit granted the Government's motion to hold that appeal in abeyance while the Department undertook further rulemaking to redetermine the salary level. Further, between September 7 and October 17, 2018, the Department held listening sessions in all five Wage and Hour regions throughout the country to supplement feedback received as part of the RFI.<sup>22</sup>

### C. Overview of Existing Regulatory Requirements

The regulations in part 541 contain specific criteria that define each category of exemption provided by section 13(a)(1) for bona fide executive, administrative, professional, and outside sales employees, as well as teachers and academic administrative personnel. The regulations also define those computer employees who are exempt under section 13(a)(1) and section 13(a)(17). The employer bears the burden of establishing the applicability of any exemption from the FLSA's pay requirements.<sup>23</sup> Job titles, job descriptions, or the payment of salary instead of an hourly rate are insufficient, standing alone, to confer exempt status on an employee.

To qualify for the EAP exemption, employees must meet certain tests regarding their job duties<sup>24</sup> and generally must be paid on a salary basis at least the amount specified in the

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<sup>21</sup> 82 FR 34616 (July 26, 2017).

<sup>22</sup> Listening Session transcripts may be viewed at [www.regulations.gov](http://www.regulations.gov), docket ID WHD-2017-0002.

<sup>23</sup> See, e.g., *Idaho Sheet Metal Works, Inc. v. Wirtz*, 383 U.S. 190, 209 (1966); *Walling v. Gen. Indus. Co.*, 330 U.S. 545, 547–48 (1947).

<sup>24</sup> See §§ 541.100 (executive employees); 541.200 (administrative employees); 541.300, 541.303–.304 (teachers and professional employees); 541.400 (computer employees); 541.500 (outside sales employees).

regulations.<sup>25</sup> Some employees, such as doctors, lawyers, teachers, and outside sales employees, are not subject to salary tests.<sup>26</sup> Others, such as academic administrative personnel and computer employees, are subject to special, contingent earning thresholds.<sup>27</sup> In 2004, the standard salary level for EAP employees was set at \$455 per week (equivalent to \$23,660 per year for a full-time worker), and the total annual compensation level for highly compensated employees was set at \$100,000.<sup>28</sup> In light of the district court’s decision invalidating the 2016 final rule, these are the salary levels currently enforced by the Department.<sup>29</sup>

The 2004 final rule created the “highly compensated employee” (HCE) test for exemption. Under the HCE test, employees who receive at least a specified total annual compensation (which must include at least the standard salary amount per week paid on a salary or fee basis) are exempt from the FLSA’s overtime requirements if they customarily and regularly perform at least one of the exempt duties or responsibilities of an executive, administrative, or professional employee identified in the standard tests for exemption.<sup>30</sup> The HCE test applies only to employees whose primary duty includes performing office or non-

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<sup>25</sup> Alternatively, administrative and professional employees may be paid on a “fee basis” for a single job regardless of the time required for its completion as long as the hourly rate for work performed (*i.e.*, the fee payment divided by the number of hours worked) would total at least the weekly amount specified in the regulation if the employee worked 40 hours. *See* § 541.605.

<sup>26</sup> *See* §§ 541.303(d); 541.304(d); 541.500(c); 541.600(e). Such employees are also not subject to a fee-basis test.

<sup>27</sup> *See* § 541.600(c)–(d).

<sup>28</sup> 69 FR 22123.

<sup>29</sup> The current text of the Code of Federal Regulations (CFR) reflects the updates made in the 2016 final rule. Therefore, unless otherwise indicated, citations to part 541 refer to the current CFR, and the proposed amendments to the regulatory text reflect the current CFR’s inclusion of the 2016 updates. However, because the Department is currently enforcing the 2004 standard salary and total annual compensation levels, the NPRM references the 2004 standard salary and total annual compensation levels.

<sup>30</sup> § 541.601.

manual work.<sup>31</sup> Non-management production line workers and employees who perform work involving repetitive operations with their hands, physical skill, and energy are not exempt under this section.<sup>32</sup>

Finally, the FLSA does not preempt stricter state standards. If a State establishes a stricter standard to qualify for exemption from state overtime standards than the corresponding FLSA standard (*e.g.*, higher earnings thresholds or more rigorous duties tests), the stricter standard continues to apply for state law purposes.<sup>33</sup>

### III. Need for Rulemaking

The primary goal of this rulemaking is to update the weekly salary amounts used by the Department to help define and delimit the EAP exemption, as required by the Act. In light of the district court's decision ruling that the 2016 final rule was invalid, the Department is currently enforcing the \$455 per week standard salary level from the 2004 final rule. The Department recognizes that the \$455 per week standard salary level, which the Department has enforced for nearly a decade and a half, should be updated to reflect current wages.

Therefore, the Department's proposed approach for this rulemaking is simple. It proposes to apply the same method used to calculate the salary threshold in 2004 to current data. The Department expects that this method will keep the standard salary level aligned with the intervening years' growth in wages. This approach has withstood the test of time, is familiar to employees and employers, and can be used without causing significant hardship or disruption to employers or the economy, while ensuring overtime-eligible workers continue to receive the protections intended by Congress.

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<sup>31</sup> § 541.601(d).

<sup>32</sup> *Id.*

<sup>33</sup> *See* 29 U.S.C. 218.

The Department's proposed approach would also address concerns with the 2016 final rule identified by the district court. The salary level test has historically served as a dividing line between nonexempt and potentially exempt employees, excluding from exemption a large swath of employees on the reasoning that employees compensated below the salary level are very unlikely to be employed "in a bona fide executive, administrative, or professional capacity."<sup>34</sup> Given these purposes, the salary level cannot be set too high, or it would unduly deny exemption to bona fide executive, administrative, and professional employees who, Congress has instructed, "shall not" be subject to the FLSA's overtime and minimum wage requirements.<sup>35</sup> The 2016 final rule went beyond the limited traditional purpose of setting a salary "floor" to identify certain obviously nonexempt employees, and instead excluded from exemption many employees who had previously been, and should have continued to be, exempt by reference to their duties. The Department's proposed approach in this rulemaking would address that concern.

The proposed rule includes several additional updates. The Department proposes updating the HCE total annual compensation threshold to an amount of \$147,414. The Department also proposes to allow the inclusion of nondiscretionary bonuses and incentive payments (including commissions) paid on an annual or more-frequent basis to satisfy up to 10 percent of the standard salary level, and to revise the special salary levels provided under part 541. The Department intends to propose an update to the part 541 earnings thresholds every four years to prevent the levels from becoming outdated. More regular updates would promote greater stability, avoiding the disruptive salary level increases that can result from lengthy gaps between updates, and provide appropriate wage protection for those under the threshold.

#### Summary of Comments on the Request for Information and at the Listening Sessions

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<sup>34</sup> 29 U.S.C. 213(a)(1).

<sup>35</sup> 29 U.S.C. 213(a).

On July 26, 2017, WHD published an RFI to solicit public input to inform the Department's work in developing a proposal to revise the part 541 regulations. The RFI solicited feedback on questions related to the salary level test, the duties test, the possibility of multiple salary levels, the inclusion of nondiscretionary bonuses and incentive payments to satisfy a portion of the salary level, the annual compensation test for highly compensated employees, and the automatic updating of the standard salary and HCE annual compensation level tests. The RFI was published in the Federal Register with a 60-day public comment period.<sup>36</sup>

Over 200,000 comments were received from a broad array of stakeholders, including small business owners, large companies, employer and employee associations, state and local governments, unions, higher education institutions, non-profit organizations, law firms, workers, and other interested members of the public.

In the RFI, the Department asked several questions about the standard salary level, seeking input on the appropriate level to fulfill the salary level's historical role in determining exemption status. In particular, the Department asked whether updating the 2004 salary level for inflation or applying the 2004 methodology to current salary data would be appropriate, whether differing standard salary levels should be set for different regions or employer sizes, and whether the Department should set different standard salary levels for the executive, administrative, and professional exemptions. The Department also sought information about the actions taken by employers in anticipation of the 2016 final rule, as well as the effect of increased salary levels on particular occupations.

Commenters expressed diverse views about the standard salary level, but mostly favored increasing the salary level above \$455 per week, with only a small minority requesting that the

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<sup>36</sup> 82 FR 34616.

salary level be eliminated or kept at its current amount. Nearly all commenters representing employers opposed the standard salary level of \$913 per week set in the 2016 final rule. Many expressed the view that this level conflicted with the salary level's longstanding role of screening out obviously nonexempt employees, and would improperly deny exemption for millions of employees who passed the duties test. Several employers expressed concern that raising the standard salary level as high as \$913 per week could lead to significant costs for employers. Many of these commenters also expressed concern that the salary level should account for salaries paid in lower-wage regions and industries. Commenters representing employers offered varied methodologies for setting the salary level, including adjusting the \$455-per-week threshold to account for inflation since 2004 and applying the 2004 final rule's salary-setting methodology to contemporary earnings data. In contrast, most commenters who were employees or represented employees urged the Department to implement the \$913 per week level adopted in the 2016 final rule, although some commenters urged an even higher threshold. For example, some commenters representing employee interests favored applying the pre-2004 short test methodology, or setting the salary level at the 50th percentile of earnings among full-time salaried workers nationwide.

Most commenters supported the continuation of a single nationwide salary level, and expressed concern that introducing multiple standard salary levels—whether differing by region, industry, employer size, or between the executive, administrative, and professional categories—would complicate the regulations. Some commenters representing employers supported region-specific salary levels, and some stated that regional salary levels would be appropriate if the alternative is a single salary level that is too high in low-wage regions or industries. Relatedly, the Department sought views on whether there should be multiple annual compensation levels

(by region or by size of employer) for the HCE exemption. The Department received few comments on this subject, but those that addressed it generally favored a single HCE annual compensation level given its simplicity, and some stated that adding additional levels would increase litigation costs.

The Department also inquired whether it should periodically update the standard salary level and the HCE total annual compensation levels. Most commenters representing employers opposed automatic updating. Commenters in favor of periodic automatic updates, including most commenters representing employees, asserted that updating is needed to preserve a “meaningful” standard salary level. Commenters that opined on the frequency of potential periodic updates generally offered a range of 3 to 5 years for the updates, although some suggested more frequent updates.

In addition to questions regarding the salary level, the Department asked whether it should, as it did with the 2016 final rule, permit nondiscretionary bonuses and incentive payments (including commissions) to satisfy up to 10 percent of an employee’s salary for purposes of the salary level test, and whether this was an appropriate limit. Many commenters supported including at least a portion of nondiscretionary bonuses and incentive payments in the standard salary threshold calculation, but there was some disagreement among commenters about the amount of such payments that should be included and the frequency of the relevant bonus payments. Many commenters representing employees supported a 10-percent cap on inclusion of nondiscretionary bonuses (the same cap was part of the 2016 final rule), or alternatively, not counting bonuses toward the salary level at all. Conversely, many commenters representing employers advocated that a higher percentage of nondiscretionary bonuses, or all types of bonuses and incentive payments, should be counted, in part because they asserted that such a cap

disadvantages industries that rely on incentive compensation. But not all employers agreed. In particular, some public sector employers and smaller non-profits, whose funding restrictions may preclude them from awarding nondiscretionary bonuses and incentive payments, expressed their view that permitting nondiscretionary bonuses to count toward an employee's salary creates a competitive disadvantage for them.

Finally, the Department inquired whether a test for exemption based solely on employee duties is preferable to the current standard test. Most commenters opposed instituting a duties-only test for the section 13(a)(1) exemptions or returning to the long and short duties test combination that existed before the 2004 final rule. Some of these commenters worried that a duties-only test would result in a more rigid test that includes quantitative limits on the performance of nonexempt work, which they felt would unduly burden business operations and increase litigation costs.

As follow-up to the RFI, between September 7 and October 17, 2018, the Department broadened its outreach and conducted listening sessions in diverse locations around the country.<sup>37</sup> A wide range of stakeholders attended the listening sessions, including higher education, employees, employers, business associations, non-profit organizations, small businesses, employee advocates, unions, state and local government representatives, and members of Congress. At the listening sessions, the Department requested input on the following issues:

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<sup>37</sup> The Department conducted listening sessions in a representative city from each of WHD's five regions to get diverse input from stakeholders across the country and assess the impact to each region.

1. What is the appropriate salary level (or range of salary levels) above which the overtime exemptions for bona fide executive, administrative, or professional employees may apply? Why?
2. What benefits and costs to employees and employers might accompany an increased salary level? How would an increased salary level affect real wages (e.g., increasing overtime pay for employees whose current salaries are below a new level but above the current threshold)? Could an increased salary level reduce litigation costs by reducing the number of employees whose exemption status is unclear? Could this additional certainty produce other benefits for employees and employers?
3. What is the best methodology to determine an updated salary level? Should the update derive from wage growth, cost-of-living increases, actual wages paid to employees, or some other measure?
4. Should the Department more regularly update the standard salary level and the total-annual-compensation level for highly compensated employees? If so, how should these updates be made? How frequently should updates occur? What benefits, if any, could result from more frequent updates?<sup>38</sup>

For the most part, feedback provided at the listening sessions was consistent with and reinforced the comments received in response to the RFI. Stakeholders expressed a wide variety of views on the appropriate salary level and salary level methodology, timing for implementing changes, review of the duties tests, and potential impacts of the Department's rulemaking.

Stakeholders overwhelmingly supported increasing the salary level. Many commenters expressed

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<sup>38</sup> 83 FR 49869 (Oct. 3, 2018); 83 FR 43825 (Aug. 28, 2018).

concerns about the size of the increase in the 2016 final rule, while others supported the level set in that rule. While the HCE exemption was not a primary focus of any of the listening sessions, a number of business stakeholders supported retaining the \$100,000 total annual compensation requirement set in the 2004 final rule.

The Department appreciates and has considered the views of all those who submitted comments in response to the RFI and participated in the listening sessions, and welcomes further input from the public in response to this NPRM. The comments to the RFI and the input from the listening sessions have informed the development of this NPRM and the Department's understanding of the effect of the part 541 regulations in the workplace.

#### IV. Proposed Regulatory Revisions

The Department proposes to rescind formally the 2016 final rule, replacing it with a new rule that updates the standard salary and HCE annual compensation levels under part 541 by setting the standard salary level using the 2004 methodology applied to current data and setting the HCE annual compensation level using the 2016 methodology applied to current data, and projecting both levels to January 2020. In addition, the Department proposes to apply a special salary level to Puerto Rico, the Virgin Islands, Guam, and the Commonwealth of the Northern Mariana Islands, a separate special salary level to American Samoa, and an updated special weekly "base rate" to the motion picture producing industry. The Department also proposes that nondiscretionary bonuses and incentive payments (including commissions) paid on an annual or more frequent basis may be used to satisfy up to 10 percent of the standard salary level. Finally, moving forward, the Department intends to propose updates to the salary and compensation levels every four years to ensure that these levels continue to provide useful tests for exemption.

The Department believes that this proposal addresses the legal concerns that led to the invalidation of the 2016 final rule, and appropriately updates the part 541 regulations.

Given the recent history of litigation in this area, the Department here explains for the benefit of commenters the operative effects of the proposed rule. If finalized, the proposed rule would replace the 2016 final rule functionally by revising the part 541 regulatory text in the Code of Federal Regulations. But a final rule based on this proposal would also formally rescind the 2016 final rule. That rescission would operate independently of the new content in the final rule, as the Department intends it to be severable from the substantive proposal for revising part 541. As explained more fully below, the Department believes that rescission of the 2016 final rule is appropriate, regardless of the new content proposed for its replacement. Thus, even if the substantive provisions of a new final rule revising part 541 were invalidated, enjoined, or otherwise not put into effect, the Department would intend the 2004 final rule to remain operative, not the enjoined 2016 final rule that it now proposes to rescind.

#### A. Standard Salary Level

##### i. History of the Standard Salary Level

The first version of part 541, issued in October 1938, set a salary level of \$30 per week for executive and administrative employees.<sup>39</sup> The Department updated the salary levels in 1940, maintaining the salary level for executive employees, increasing the salary level for administrative employees, and establishing a salary level for professional employees. In setting those rates, the Department considered surveys of private industry by federal and state government agencies, experience gained under the National Industrial Recovery Act, and Federal Government salaries to identify a salary level that reflected a reasonable “dividing line” between

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<sup>39</sup> 3 FR 2518 (Oct. 20, 1938).

employees performing exempt and nonexempt work.<sup>40</sup> The Department set the salary level for each exemption slightly below the average salary dividing exempt from nonexempt employees, taking into account salaries paid in numerous industries and the percentage of employees earning below these amounts.

In 1949, the Department evaluated salary data from state and federal agencies, including the Bureau of Labor Statistics (BLS). The Department considered wages in small towns and low-wage industries, wages of federal employees, average weekly earnings for exempt employees, starting salaries for college graduates, and salary ranges for different occupations such as bookkeepers, accountants, chemists, and mining engineers.<sup>41</sup> The Department also looked at data showing increases in exempt employee salaries since 1940, and supplemented it with nonexempt employee earnings data to approximate the “prevailing minimum salaries of exempt employees.”<sup>42</sup> Recognizing that the “increase in wage rates and salary levels” since 1940 had “gradually weakened the effectiveness of the present salary tests as a dividing line between exempt and nonexempt employees,” the Department considered the increase in weekly earnings from 1940 to 1949 for various industries, and then adopted new salary levels at “figure slightly lower than might be indicated by the data” to protect small businesses.<sup>43</sup> Also in 1949, the Department established a second, less-stringent duties test for each exemption, which applied to employees paid at or above a higher “short test” salary level. The original, more-rigorous duties test became known as the “long test.” Apart from the differing salary requirements, the most significant difference between the short test and the long test was that the long test limited the

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<sup>40</sup> Stein Report at 9, 20–21, 31–32.

<sup>41</sup> Weiss Report at 10, 14–17, 19–20.

<sup>42</sup> *Id.* at 12.

<sup>43</sup> *Id.* at 8, 14–20. The Department also justified its modest increases by noting evidence of slow wage growth for executive employees “in some areas and some industries.” *Id.* at 14.

amount of time an exempt employee could spend on nonexempt duties.<sup>44</sup> The short duties tests did not include a specific limit on nonexempt work.

In 1958, the Department set the long test salary levels using data collected by WHD on salaries paid to employees who met the applicable salary and duties tests, grouped by geographic region, broad industry groups, number of employees, and city size, and supplemented with BLS and Census data to reflect income increases for white collar and manufacturing employees during the period not covered by the Department's investigations.<sup>45</sup> The Department then set the long test salary levels for exempt employees "at about the levels at which no more than about 10 percent of those in the lowest-wage region, or in the smallest size establishment group, or in the smallest-sized city group, or in the lowest-wage industry of each of the categories would fail to meet the tests."<sup>46</sup> Thus, the Department set the long test salary levels so that about 10 percent of workers performing EAP duties in the lowest-wage regions and industries would not meet the salary level test and would therefore be nonexempt based on their salary level alone.

The Department followed a similar methodology when determining the salary level increase in 1963. The Department examined data on salaries paid to exempt workers collected in a 1961 WHD survey.<sup>47</sup> The salary level for executive and administrative employees was increased to \$100 per week, for example, when the 1961 survey data showed that 13 percent of establishments paid one or more exempt executives less than \$100 per week, and 4 percent of

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<sup>44</sup> The Department instituted a 20 percent cap on nonexempt work as part of the long duties test for executive and professional employees in 1940, and for administrative employees in 1949. By statute, beginning in 1961, retail employees could spend up to 40 percent of their hours worked performing nonexempt work and still be found to meet the duties tests for the EAP exemption. *See* 29 U.S.C. 213(a)(1).

<sup>45</sup> Kantor Report at 6.

<sup>46</sup> *Id.* at 6–7.

<sup>47</sup> 28 FR 7002 (July 9, 1963).

establishments paid one or more exempt administrative employees less than \$100 per week.<sup>48</sup>

The professional salary level was increased to \$115 per week when the 1961 survey data showed that 12 percent of establishments surveyed paid one or more professional employees less than \$115 per week.<sup>49</sup> The Department noted that these salary levels approximated the same percentages used to update the salary level in 1958.<sup>50</sup>

The Department applied a similar methodology when adopting salary level increases in 1970. After examining data from WHD investigations, BLS wage data, and information provided in a report issued by the Department in 1969 that included salary data for executive, administrative, and professional employees, the Department increased the long test salary level for executive employees to \$125 per week when the salary level data showed that 20 percent of executive employees from all regions and 12 percent of executive employees in the West earned less than \$130 a week.<sup>51</sup> The Department also increased the long test salary levels for administrative and professional employees to \$125 and \$140 per week, respectively.

In 1975, rather than follow the prior approaches, the Department updated the 1970 salary levels based on increases in the Consumer Price Index, but adjusted downward “to eliminate any inflationary impact.”<sup>52</sup> This resulted in a long test salary level for the executive and administrative exemptions of \$155 per week, and \$170 per week for the professional exemption. The short test salary level increased to \$250 per week in 1975.<sup>53</sup> The salary levels adopted were intended as interim levels “pending the completion and analysis of a study by [BLS] covering a

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<sup>48</sup> *Id.* at 7004.

<sup>49</sup> *Id.*

<sup>50</sup> *See id.*

<sup>51</sup> 35 FR 884–85.

<sup>52</sup> 40 FR 7091.

<sup>53</sup> Each time the short test was increased between 1949 and 1975, it was set significantly higher than the long test salary levels.

six-month period in 1975.”<sup>54</sup> Although the Department intended to increase the salary levels based on that study of actual salaries paid to employees, the process was never completed, and the “interim” salary levels remained in effect for the next 29 years.

In 2004, the Department replaced the separate long and short tests with a single “standard” salary level test of \$455 per week, which was paired with a “standard” duties test for executive, administrative, and professional employees, respectively. The Department noted, in accord with numerous comments received during that rulemaking, that as a result of the outdated salary level, “the ‘long’ duties tests [had], as a practical matter, become effectively dormant” because relatively few salaried employees earned below the short test salary level.<sup>55</sup> The Department estimated that 1.3 million workers earning between \$155 and \$455 per week would become nonexempt under the new standard salary level.<sup>56</sup>

In setting the new standard salary level in 2004, the Department used Current Population Survey (CPS) Merged Outgoing Rotation Group (MORG) data collected by BLS that encompassed most salaried employees, including nonexempt salaried employees. The Department selected a standard salary level roughly equivalent to earnings at the 20th percentile of two subpopulations: (1) salaried employees in the South and (2) salaried employees in the retail industry nationwide. Although prior salary levels had been based on salaries of approximately the lowest 10 percent of exempt salaried employees in low-wage regions and industries, the Department explained that the change in methodology was warranted in part to account for the elimination of the short and long tests, and because the data sample included

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<sup>54</sup> *Id.*

<sup>55</sup> 69 FR 22126.

<sup>56</sup> *Id.* at 22123.

nonexempt salaried employees, as opposed to only exempt salaried employees.<sup>57</sup> As in the past, the Department used lower-salary data sets to accommodate businesses for which salaries were generally lower due to geographic- or industry-specific reasons.

The Department published a final rule updating the salary level twelve years later, in 2016.<sup>58</sup> The Department set the standard salary level at an amount that would exclude from exemption the bottom 40 percent of full-time salaried workers (exempt and nonexempt) in the lowest-wage Census Region (the South).<sup>59</sup> The Department estimated that increasing the standard salary level from \$455 per week to \$913 per week would make 4.2 million workers earning between those levels newly nonexempt, absent other changes by their employers.<sup>60</sup> The Department made no changes to the standard duties test. As previously discussed, on August 31, 2017, the U.S. District Court for Eastern District of Texas declared the 2016 final rule invalid, and the Department's appeal of that decision has been held in abeyance. Until the Department issues a new final rule, it is enforcing the part 541 regulations in effect on November 30, 2016, including the \$455 per week standard salary level.

## ii. Purpose of the Salary Level Requirement

The FLSA states that its minimum wage and overtime requirements “shall not apply with respect to . . . any employee employed in a bona fide executive, administrative, or professional capacity . . . (as such terms are defined and delimited from time to time by regulations of the Secretary . . . ).”<sup>61</sup> The Department has long used a salary level test as part of its method for defining and delimiting that exemption.

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<sup>57</sup> *Id.* at 22167.

<sup>58</sup> 81 FR 32391.

<sup>59</sup> *Id.* at 32408.

<sup>60</sup> *Id.* at 32393.

<sup>61</sup> 29 U.S.C. 213(a)–(a)(1).

In 1949, the Department summarized the role of the salary level tests over the preceding decade. The Department explained:

In this long experience, the salary tests, even though too low in the later years to serve their purpose fully, have amply proved their effectiveness in preventing the misclassification by employers of obviously nonexempt employees, thus tending to reduce litigation. They have simplified enforcement by providing a ready method of screening out the obviously nonexempt employees, making an analysis of duties in such cases unnecessary. The salary requirements also have furnished a practical guide to the inspector as well as to employers and employees in borderline cases. In an overwhelming majority of cases, it has been found by careful inspection that personnel who did not meet the salary requirements would also not qualify under other sections of the regulations as the Divisions and the courts have interpreted them.<sup>62</sup>

The Department again referenced these principles in the Kantor Report, reiterating, for example, that the salary level tests “provide[] a ready method of screening out the obviously nonexempt employees,” and that employees “who do not meet the salary test are generally also found not to meet the other requirements of the regulations.”<sup>63</sup> The Department’s 2004 final rule likewise referenced these principles.<sup>64</sup> The Department now proposes to update the standard salary level in light of increased employee earnings, so that it maintains its usefulness in “screening out the obviously nonexempt employees.”

For over 75 years the Department has used a salary level test as a criterion for identifying bona fide executive, administrative, and professional employees. Some statements in the Department’s regulatory history have at times, however, suggested a greater role for the salary level test. The statements include, for instance, from the 1940 Stein Report, that salary is “the best single test of the employer’s good faith in characterizing the employment as of a

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<sup>62</sup> Weiss Report at 8.

<sup>63</sup> Kantor Report at 2–3; *see also* U.S. Dep’t of Labor, *28th Annual Report of the Secretary of Labor for the Fiscal Year Ended June 30, 1940* (1940), at 236 (“the power to define is the power to exclude”).

<sup>64</sup> *See* 69 FR 22165; 2003 NPRM, 68 FR 15560, 15570 (Mar. 31, 2003).

professional nature.”<sup>65</sup> The Stein Report even went so far as to state that “if an employer states that a particular employee is of sufficient importance . . . to be classified as an ‘executive’ employee and thereby exempt from the protection of the [A]ct, the best single test of the employer’s good faith in attributing importance to the employee’s services is the amount he pays for them.”<sup>66</sup>

The district court’s invalidation of the 2016 final rule has prompted the Department to clarify these and similar statements in light of the salary level test’s purposes and regulatory history. The concept of a “dividing line” should not be misconstrued to suggest that the Department views the salary level test as an effort to divide all exempt white collar employees from all nonexempt employees. A salary level is helpful to determine who is not an exempt executive, administrative or professional employee—the employees who fall beneath it. But the salary level has significantly less probative value for the employees above it. They may be exempt or nonexempt. Above the threshold, the Department evaluates an employee’s status as exempt or nonexempt based on an assessment of the duties that employee performs. An approach that emphasizes salary alone, irrespective of employee duties, would stand in significant tension with the Act. Section 13(a)(1) directs the Department to define and delimit employees based on the “capacity” in which they are employed. Salary is a helpful indicator of the capacity in which

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<sup>65</sup> 81 FR 32413 (quoting Stein Report at 42); *see also* 69 FR 22165 (quoting Stein Report at 42).

<sup>66</sup> Stein Report at 19; *see also id.* at 5 (“the good faith specifically required by the [A]ct is best shown by the salary paid”); *id.* at 19 (salary provides “a valuable and easily applied index to the ‘bona fide’ character of the employment for which exemption is claimed”); *cf.* Weiss Report at 9 (“salary is the best single indicator of the degree of importance involved in a particular employee’s job”); Kantor Report at 2 (“[Salary] is an index of the status that sets off the bona fide executive from the working squad-leader, and distinguishes the clerk or sub-professional from one who is performing administrative or professional work.”). The Department “is not bound by the [Stein, Weiss, and Kantor] reports,” though they have been carefully considered. 69 FR 22124.

an employee is employed, especially among lower-paid employees. But it is not “capacity” in and of itself.

The district court’s summary judgment decision endorsed the Department’s historical approach to setting the salary level and held the 2016 final rule unlawful because it departed from it. The district court approvingly cited the Weiss Report and explained that setting “the minimum salary level as a floor to ‘screen[] out the obviously nonexempt employees’” is “consistent with Congress’s intent.”<sup>67</sup> Further endorsing the Department’s earlier rulemakings, the district court stated that prior to the 2016 final rule, “the Department ha[d] used a permissible minimum salary level as a test for *identifying* categories of employees Congress intended to exempt.”<sup>68</sup> The court then explained that in contrast to these acceptable past practices, the 2016 standard salary level of \$913 per week was unlawful because it would exclude from exemption “so many employees who perform exempt duties.”<sup>69</sup> In support, the court cited the Department’s estimate that, without some intervening action by their employers, the new salary level would result in 4.2 million workers becoming nonexempt.<sup>70</sup> The court also emphasized the magnitude of the salary level increase, stating that the 2016 final rule “more than double[d] the previous minimum salary level” and that “[b]y raising the salary level in this manner, the Department effectively eliminate[d] a consideration of whether an employee performs ‘bona fide executive, administrative, or professional capacity duties.’”<sup>71</sup> The district court declared the final rule invalid because the Department had unlawfully excluded from exemption “entire categories of

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<sup>67</sup> 275 F. Supp. 3d at 806 (quoting Weiss Report at 7–8); *see also id.* at 807 at n.6 (supporting salary level that operates “as more of a floor”) (internal quotation marks and citation omitted).

<sup>68</sup> *Id.* at 806 (emphasis in opinion).

<sup>69</sup> *Id.* at 807.

<sup>70</sup> *Id.* at 806.

<sup>71</sup> *Id.* at 807 (quoting 29 U.S.C. 213(a)(1)).

previously exempt employees who perform ‘bona fide executive, administrative, or professional capacity’ duties.”<sup>72</sup>

The Department has reexamined the 2016 final rule in light of the district court’s decision. That rule contained language suggesting that the salary level test had a greater role to play than its modest historical function. For example, the Department stated that in light of the new, single standard duties test, “the salary threshold must play a greater role in protecting overtime-eligible employees,” and specifically that “it is necessary to set the salary level higher . . . because the salary level must perform more of the screening function previously performed by the long duties test.”<sup>73</sup> Such language is inconsistent with the salary level’s historical purpose of setting a floor for exemption.

The 2016 final rule’s approach—under which salary alone would determine exempt status in many more instances—also led to a result in tension with the Act. As the district court recognized, the 2016 final rule removed the EAP exemption from 4.2 million workers who would have otherwise been exempt because they passed the salary basis and duties tests established under the 2004 final rule. In contrast, had the Department simply applied the 2004 methodology to set the standard salary level, the 2016 final rule would have resulted in approximately 683,000 workers who satisfied the duties test becoming nonexempt.<sup>74</sup> The Department has long recognized that the salary level test is “a dividing line [that] cannot be drawn with great precision but can at best be only approximate,”<sup>75</sup> and so any salary level set by the Department will exclude from exemption some employees who pass the duties test. But a salary level that exempts an unusually high number of those employees—as occurred with the

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<sup>72</sup> *Id.* at 806 (quoting 29 U.S.C. 213(a)(1)).

<sup>73</sup> 81 FR 32412, 32465–66.

<sup>74</sup> *See* 81 FR 32504 (Table 32).

<sup>75</sup> Weiss Report at 11.

2016 final rule<sup>76</sup>—stands in tension with Congress’s command to exempt bona fide EAP employees. A salary level set that high does not further the purpose of the Act, and is inconsistent with the salary level test’s useful, but limited, role in defining the EAP exemption.

The Department justified the change in the 2016 final rule in part by explaining that when the salary level increases, “it is inevitable that ‘some employees who have been classified as exempt under the present salary tests will no longer be within the exemption under any new tests adopted.’”<sup>77</sup> However, this consequence (which follows any salary level increase) does not itself inform what salary level the Department should set. The Department also stated in 2016 that the new salary level would narrow the gap between the number of workers who are nonexempt because they fail only the salary level test and those who are nonexempt because they fail only the duties test.<sup>78</sup> But the Department has never compared the number of employees who are nonexempt based exclusively on the salary or duties tests, respectively, to determine the effectiveness of the salary level. To the contrary, parity between these groups would create tension with the salary level’s historical purpose of “screening out the obviously nonexempt employees.”

The Department also justified the 2016 final rule’s salary level by stating that it was correcting a “mismatch” between the 2004 final rule’s salary level and the standard duties test.

The Department stated that while it historically had paired a more rigorous duties test (the long

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<sup>76</sup> The Department explained that (at the time of the analysis) 12.2 million salaried white collar workers earned more than \$455 per week but were overtime eligible because they failed the duties test, while 838,000 salaried white collar workers were overtime eligible because even though they passed the standard duties test they earned below \$455 per week. The Department then estimated that a \$913-per-week salary level would result in 6.5 million salaried white collar workers who failed only the duties test, and increase to 5.0 million the number of salaried white collar workers who passed the duties test but would be overtime eligible because they failed the salary level test. *See* 81 FR 32464–65; *see also id.* at 32413.

<sup>77</sup> *Id.* at 32413 (quoting Kantor Report at 5).

<sup>78</sup> *See supra* n.76 (citing 81 FR 32464–65; 81 FR 32413).

test) with a lower salary level and a less rigorous duties test (the short test) with a higher salary level, the 2004 final rule paired a less rigorous duties test with a lower salary level:

Because the long duties test included a limit on the amount of nonexempt work that could be performed, it could be paired with a low salary that excluded few employees performing EAP duties. In the absence of such a limitation in the duties test, it is necessary to set the salary level higher (resulting in the exclusion of more employees performing EAP duties) because the salary level must perform more of the screening function previously performed by the long duties test. Accordingly the salary level set in this Final Rule corrects for the mismatch in the 2004 Final Rule between a low salary threshold and a less rigorous duties test.<sup>79</sup>

The Department's solution to the purported mismatch, however, introduced a new issue. The 2016 final rule's salary level, which was "at the low end of the historical salary range of short test salary levels,"<sup>80</sup> failed to account for the absence of a long test that employers could use to claim the exemption for lower-paid white collar workers who were traditionally exempt. The Department's analysis did not sufficiently account for this change, and as a result, the \$913 per week standard salary level deviated from the Department's longstanding policy of setting a salary level that does not "disqualify[] any substantial number of" bona fide executive, administrative, and professional employees from exemption.<sup>81</sup>

More fundamentally, except at the relatively low levels of compensation where EAP employees are unlikely to be found, the salary level is not a substitute for an analysis of an employee's duties. It is, at most, an indicator of those duties. For most white collar, salaried employees, the exemption should turn on an analysis of their actual functions, not their salaries, as Congress commanded. The salary level test's primary and modest purpose is to identify potentially exempt employees by screening out obviously nonexempt employees.

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<sup>79</sup> 81 FR 32409.

<sup>80</sup> *Id.* at 32414.

<sup>81</sup> Kantor Report at 5.

The mismatch rationale also failed to account fully for the Department's part 541 exemption history. The standard duties test was introduced by the 2004 final rule and has been in effect for 15 years. The short duties test, which it is similar to, was functionally the predominant test in use for the preceding 13 years, since the 1975 long test salary levels were equaled or surpassed by the FLSA minimum wage in 1991.<sup>82</sup> Altogether, most employers and employees have effectively been covered by this one-test system for over 25 years. This practice is highly relevant to any update by the Department's approach.

In light of the considerations above, the Department concludes that, while an increase in the standard salary level from \$455 per week was warranted, the increase to \$913 per week was inappropriate. As the district court stated, that increase departed from the salary level's purpose as a floor to "screen[] out the obviously nonexempt employees."<sup>83</sup> The Department is engaging in this rulemaking to realign the salary level with its appropriate limited purpose, to address the concerns about the 2016 final rule identified by the district court, and to update the salary level in light of increased employee earnings.

### iii. Salary Level Methodology

The Department, nearly all RFI commenters, and almost all those who spoke during the Department's listening sessions agree that the salary level must exceed \$455 per week to achieve its intended purpose. Most commenters to the RFI and in the listening sessions favored the simplicity of a single nationwide salary level over varying region-specific levels, and urged the Department not to return to its past practice of setting different salary levels for executive,

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<sup>82</sup> In 1975, the Department set a long test salary level of \$155 per week for executive and administrative employees, and of \$170 per week for professional employees. *See* 40 FR 7092. On April 1, 1991, the federal minimum wage increased to \$4.25 per hour, which equals \$170 for a 40-hour workweek. *See* Sec. 2, Pub. L. 101-157, 103 Stat. 938 (Nov. 17, 1989).

<sup>83</sup> *Nevada v. U.S. Dep't of Labor*, 275 F. Supp. 3d at 806 (quoting Weiss Report at 7-8).

administrative, and professional employees. However, some commenters representing employers supported establishing multiple salary levels based on region, industry, or employer size. Nearly all commenters opposed reinstating separate long and short tests with corresponding salary levels and duties tests.

After considering the issues at length, reviewing public comments responding to the RFI, and considering comments provided in the listening sessions, the Department is proposing simply to update the standard salary level set in 2004 using current data. The Department believes that adherence to the 2004 final rule's methodology is reasonable and appropriate. The Department has enforced the 2004 final rule's salary level for nearly 15 years—the second-longest period (after the salary levels set in 1975) for any part 541 salary level. The Department paired that level with the standard duties test when it was enacted, and revisions to the standard duties test are not proposed as part of this rulemaking. After so many years, workers and employers are familiar with a single standard weekly salary level and a single standard duties test. Notably, the 2004 final rule has never been challenged in court. Using the 2004 salary level methodology as the basis for determining an updated salary level thus promotes familiarity and stability for the workplace, ensures workers the important wage protections contained in the Act, and minimizes the uncertainty and potential legal vulnerabilities that could accompany a novel and untested approach.

There are other reasons for this simple approach. The method proposed here is straightforward and avoids new regulatory burdens. It is consistent with the Department's established belief that adopting different salary levels for different areas of the country would create significant administrative difficulties "because of the large number of different salary

levels this would require,<sup>84</sup> and would create undue regulatory complexity. Furthermore, as discussed below, the Department believes that the proposed salary level accounts for nationwide differences in employee earnings and would work appropriately with the standard duties test. The proposed standard salary level also addresses the concerns raised in the district court's summary judgment decision. The \$913 per week standard salary level set in the 2016 final rule more than doubled the 2004 final rule's salary level of \$455 per week, which the district court concluded resulted in "entire categories of previously exempt employees" being disqualified from exemption "based on salary alone."<sup>85</sup> The Department proposes to address this problem by setting a salary level that would more appropriately identify obviously nonexempt employees, without including too great a proportion of employees who would otherwise be exempt. This is consistent with the Department's understanding that salary may be used to identify a category of employees who are not bona fide executive, administrative, and professional employees without unduly excluding employees from the exemption. The proposed \$679 per week standard salary level would preserve the 2004 methodology—which was based on salaries in the South and in the low-wage retail industry—while updating that salary level to reflect the growth of nominal wages and salaries.

The appropriateness of the proposed salary level is further supported by the number of workers it would affect—*i.e.*, the number of employees who currently pass the standard duties test and earn between \$455 and \$679 per week, and thus would become nonexempt absent some intervening action by their employers. The district court's decision raised concerns regarding the large number of exempt workers—4.2 million—who earned between \$455 and \$913 per week

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<sup>84</sup> 69 FR 22171.

<sup>85</sup> 275 F. Supp. 3d at 806. Moreover, the Department estimated in the 2016 final rule that the salary level would rise to \$984 per week in January 2020. 81 FR 32393.

and thus would “automatically become eligible” for overtime under the \$913 per week standard salary level.<sup>86</sup> The district court noted that this relatively high number indicated that the salary level was displacing the role of the duties test in determining exemption status. The Department acknowledges these concerns and, additionally, in this proposal seeks to update the standard salary level in a manner that does not unduly disrupt employers’ operations; dramatically shift employee salaries, hours, or morale; or result in adverse economic effects.

As for the details of the methodology, the Department has followed the methodology it used in 2004. In 2004, the Department set the standard salary level at approximately the 20th percentile of earnings for full-time salaried workers in the lowest-wage Census region (the South) and in the retail sector. The Department set the salary level using the 2002 CPS MORG dataset (the most recent CPS dataset practically available), after excluding from the dataset certain classes of workers that are exempt from the FLSA or its salary-level test.<sup>87</sup>

In this proposed rulemaking, the Department used pooled CPS MORG data for 2015–2017, adjusted to reflect 2017 (hereafter referred to as pooled CPS MORG data; *see* Section VI.B.ii for full description). This is the most recently available data. If this approach is adopted in the final rule, the Department anticipates using 2018 CPS data. The Department believes the CPS dataset would be the most appropriate dataset to use to ascertain worker earnings because of its size (approximately 60,000 households monthly; 15,000 in the MORG dataset) and its breadth of detail (e.g., occupation classifications, salary, hours worked, and industry). Consistent with its proposal to update the salary levels for workers subject to them, the Department analyzed a subset of this CPS MORG data, composed of employed workers age 16 years and older who are

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<sup>86</sup> 275 F. Supp. 3d at 806–07.

<sup>87</sup> *See* 69 FR 22168.

covered by the FLSA; subject to the part 541 salary tests; not in “named occupations”;<sup>88</sup> and not exempt from the FLSA due to the agricultural or transportation exemptions. Thus, the subset excluded 27.9 million workers.

Using this subset of the CPS MORG data, the Department proposes to set the standard salary level at approximately the 20th percentile of earnings for full-time salaried workers in the lowest-wage Census region, again the South in this case, and/or in the retail sector.<sup>89</sup> Normally, this would result in a weekly salary level of \$641 per week (\$33,332 annually), which is also approximately the 20th percentile of both: (1) earnings for full-time salaried workers in the South, and (2) earnings for full-time salaried workers in the retail sector. However, the Department proposes to inflate this figure to reflect anticipated wage growth through January 2020. This results in the standard salary level proposed in this NPRM, which is \$679 per week (\$35,308 annually).

The Department proposes this small adjustment to better reflect employees’ anticipated compensation at the time the rule becomes effective. In the 2004 final rule, the Department set the salary level using earning percentiles as they were two years earlier (2002) than the rule’s effective date (2004), since the 2002 data was the most recent practically available data. In contrast, this proposed rule would set its salary level with a projection to January 2020, the

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<sup>88</sup> This includes teachers, physicians, lawyers, judges, and outside sales workers who pass the standard duties test.

<sup>89</sup> In the 2004 final rule the Department selected a standard salary level roughly equivalent to earnings at the 20th percentile of two subpopulations: (1) full-time salaried employees in the South and (2) full-time salaried employees in the retail industry nationwide. In this rulemaking, the Department is setting the standard salary level at the 20th percentile of the combined subpopulations of full-time salaried employees in the South and full-time salaried employees in the retail industry nationwide. This is a change from how the Department modeled the 2004 methodology in the 2016 final rule, when it used combined subpopulations of full-time salaried employees in the South and full-time salaried employees in leisure and hospitality, other services, and public administration. 81 FR 32462.

approximate date this proposed rule is expected to become effective. The projection would ensure that the standard salary level reflects the 20th percentile of salaried workers in the South and/or in retail when the rule becomes effective, rather than the 20th percentile as of a year or two earlier. The Department acknowledges that the projected number may differ slightly from the results of comprehensive salary data when that data becomes available, but the Department believes that a modest projection is preferable to relying on data that could be a year or two old by the time the final rule becomes effective.

The Department has inflated the salary level by estimating the compound annual growth rate from the standard salary level set in 2004 (\$455) to the standard salary level as it would be using the same methodology in 2017 (\$641), then used that growth rate to project the standard salary level forward to January 2020. The Department considered alternative indices for inflation. The reasons for not using them are described below.

#### v. Alternatives Considered

In determining a proposed salary level, the Department considered the methodologies applied in past rulemakings and other alternatives such as using an index to inflate the 2004 salary level to 2017 and to project it forward to 2020.

The Department considered using price indices such as the Personal Consumption Expenditures Price Index (PCEPI), the Consumer Price Index for All Urban Consumers (CPI-U), and the Chained CPI-U; as well as a wage-based measure such as the Employment Cost Index (ECI). The PCEPI measures the change in the nominal prices of goods and services (1) purchased directly by U.S. households and by nonprofit institutions serving U.S. households and (2) purchased by firms and governments on behalf of U.S. households (*e.g.*, medical expenditures paid by Medicare, Medicaid, or private insurance plans). The Consumer Price

Index for All Urban Consumers (CPI-U) measures the change in nominal prices for a constant-quality market basket of goods and services purchased by urban consumers, who represent 93 percent of the U.S. population.<sup>90</sup> The Bureau of Labor Statistics also developed the Chained CPI-U in 2002 as an alternative to the CPI-U that would provide a better approximation of cost-of-living for all urban consumers by accounting for a substitution effect.<sup>91</sup>

The Department considered the Employment Cost Index (ECI) for wages and salaries of either all civilian workers or just for private sector workers.<sup>92</sup> The ECI is calculated on a quarterly basis by the BLS using the results of the National Compensation Survey (NCS), a survey of non-Federal employers that gathers comprehensive data on employee salaries, wages, and benefits.<sup>93</sup> The ECI measures changes over time in wages and salaries across the overall non-Federal civilian workforce generally and among different subgroups.

The Department has decided against proposing these alternatives for three reasons. The paramount reason is that none is as straightforward, consistent, or accurate as using current salary data. Each is a projection of what current costs are likely to be; however, such costs can be more readily ascertained simply by measuring them. Second, each is a cost index, (albeit to measure wages) rather than a measure of actual salaries. Third, each of the alternatives (and this would hold for any other alternative as well) would be a significant departure from the methodology that served well in 2004—the methodology the Department is proposing to employ

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<sup>90</sup> See the Bureau of Labor Statistics Handbook of Methods, updated February 14, 2018, p. 2, at <https://www.bls.gov/opub/hom/pdf/homch17.pdf> (“A unifying framework for dealing with practical questions that arise in the construction of the CPI is provided by the concept of the cost-of-living index (COLI).”).

<sup>91</sup> See Cage et al., *Introducing the Chained Consumer Price Index*.  
<https://www.bls.gov/cpi/additional-resources/chained-cpi-introduction.pdf>.

<sup>92</sup> See generally Bureau of Labor Statistics, *Employment Cost Trends, How to Use the Employment Cost Index for Escalation*, <https://www.bls.gov/ncs/ect/escalator.htm>.

<sup>93</sup> See Bureau of Labor Statistics, *National Compensation Survey*, <https://www.bls.gov/ncs/>.

again here with minor adjustments and improvements. For the reasons stated earlier—including familiarity, stability, and the standard duties test that accompanied the standard salary level set in 2004—the Department believes an approach that simply updates the 2004 level with current data is preferable to an entirely new methodology.

The Department also considered these same indices for inflating a 2017 salary level (set using the 2004 final rule’s methodology and current data) to January 2020. So used, PCEPI would result in a salary level of \$671 per week, the C-CPI-U would result in \$671 per week, the CPI-U would result in \$675 per week, the ECI for civilian workers would result in \$678 per week, and the ECI for private sector workers would result in \$679 per week.

The Department did not choose to propose any of these alternatives for two reasons. First, the approach being proposed is the most straightforward and consistent using current salary data. It measures the actual wage growth between the 2004 final rule salary level and the 2017 salary level and applies that growth rate to current data; essentially assuming that wage growth will continue at the same pace. Second, there are disadvantages to some of the other indices described above. The PCEPI, CPI-U, and Chained CPI-U, for example, measure the nominal prices of goods and services to consumers, whereas the standard salary level is meant to demarcate worker salaries. It seems more sensible to use data that measures worker compensation than consumers’ cost of living to set such a level. Additionally, the Department notes that use of the ECI for all private sector workers comes to the same result as the methodology chosen.

The salary level increase proposed here would, as discussed in detail in the economic analysis, section VI, result in approximately 1.1 million affected workers losing exempt status (absent other action from their employers). The Department recognizes that any increase to the standard salary level would increase the number of workers who pass the duties test but are paid

below the standard salary level; however, the \$679-per-week salary level, while necessarily imprecise, would identify a large number of obviously nonexempt employees “without disqualifying any substantial number of” bona fide executive, administrative, and professional employees from exemption.<sup>94</sup> Additionally, the 1.1 million workers likely to be affected by this rule’s proposed increase to the standard salary level is close to the 1.3 million workers who were affected by the 2004 final rule’s salary level increase.<sup>95</sup> The Department also anticipates that 3.6 million employees paid between \$455 and \$679 per week who fail the standard duties test (*i.e.*, that are and will remain nonexempt)—2.0 million salaried white collar workers and 1.6 million salaried blue collar workers—will have their nonexempt status made clearer because their salary will fall below the proposed threshold.

#### vi. Summary of Standard Salary Level Proposal

For the reasons discussed above, the Department proposes to set the standard salary level to qualify for exemption from the FLSA’s minimum wage and overtime requirements as an executive, administrative, or professional employee at \$679 per week. The Department believes that the proposed standard salary level would help employers identify a large group of employees who perform nonexempt duties, would aid in identifying bona fide EAP employees, and would address the legal concerns that led to the invalidation of the salary level set in the 2016 final rule. The Department invites comments on this proposed salary level and on any alternative salary level or methodology, including but not limited to whether the use of the indices described above, would be more appropriate.

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<sup>94</sup> Kantor Report at 5.

<sup>95</sup> 69 FR 22213. The 2004 rule estimated that 1,297,855 workers would, without some intervening action by their employers, lose exempt status as a result of the \$455 standard salary level set at that time. *See* 69 FR 22213, 22253.

## B. Special Salary Tests

### i. Puerto Rico, Virgin Islands, Guam, and the Commonwealth of the Northern Mariana Islands<sup>96</sup>

Since 2004, the Department has applied the standard salary level to Puerto Rico.<sup>97</sup> After the Department published the 2016 final rule, Congress passed the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA).<sup>98</sup> Section 404 of PROMESA states that “any final regulations issued related to” the Department’s 2015 overtime rule NPRM—*i.e.*, the 2016 final rule—“shall have no force or effect” in Puerto Rico until the Comptroller General of the United States completes and transmits a report to Congress assessing the impact of applying the final regulations to Puerto Rico, and the Secretary of Labor, “taking into account the assessment and report of the Comptroller General, provides a written determination to Congress that applying such rule to Puerto Rico would not have a negative impact on the economy of Puerto Rico.”<sup>99</sup>

The Department believes that PROMESA does not apply to this NPRM because it is a new rulemaking and thus is not “related to” the 2015 overtime rule NPRM within the meaning of PROMESA. Nonetheless, section 404 reflects Congress’ concern with increasing the salary level in Puerto Rico, and Puerto Rico’s current economic climate reinforces the importance of the Department exercising caution on this issue. Accordingly, the Department proposes to set a special salary level in Puerto Rico of \$455 per week—the level that currently applies under PROMESA. The Department seeks comments on this proposal.

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<sup>96</sup> Under the proposal, the special salary tests would not apply to employees of the Federal government employed in Puerto Rico, the U.S. Virgin Islands, Guam, the Commonwealth of the Northern Mariana Islands, and American Samoa.

<sup>97</sup> See 69 FR 22172.

<sup>98</sup> See Pub. L. 114-187, 130 Stat. 549 (June 30, 2016).

<sup>99</sup> See 48 U.S.C. 2193(a)-(b). The Comptroller General’s report was published on June 29, 2018 and is available at: <https://www.gao.gov/products/GAO-18-483>.

The Department currently applies the standard salary level to the Virgin Islands, Guam, and the Commonwealth of the Northern Mariana Islands (CNMI).<sup>100</sup> The Department understands that U.S. territories face their own economic challenges and that an increase in the salary level affects them differently than the States. In recognition of these challenges and to promote special salary level consistency across U.S. territories, the Department is proposing to also set a special salary level of \$455 per week for the Virgin Islands, Guam, and the CNMI. The Department seeks comment on whether this special salary level is appropriate, or whether instead the Department should continue applying the standard salary level to these U.S. territories.

ii. American Samoa

The Department has historically applied a special salary level test to employees in American Samoa because minimum wage rates there have remained lower than the federal minimum wage.<sup>101</sup> The Fair Minimum Wage Act of 2007, as amended, provides that industry-specific minimum wages rates in American Samoa will increase every three years until each equals the federal minimum wage.<sup>102</sup> The disparity with the federal minimum wage is expected to remain for the foreseeable future. Accordingly, the Department proposes to maintain a special salary level for employees in American Samoa.

The special salary level test for employees in American Samoa has historically equaled approximately 84 percent of the standard salary level.<sup>103</sup> The Department proposes to maintain this percentage and considered whether to set the special salary level in American Samoa equal to 84 percent of the proposed standard salary level (\$679 per week)—resulting in a special salary

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<sup>100</sup> In Guam and the CNMI, the Department has applied the salary level test(s) applicable to the States. In the Virgin Islands, the Department applied a special salary level test prior to 2004, but applied the standard salary level beginning in 2004.

<sup>101</sup> See 69 FR 22172.

<sup>102</sup> See Sec. 1, Pub. L. 114-61, 129 Stat. 545 (Oct. 7, 2015).

<sup>103</sup> See, e.g., 69 FR 22172.

level of \$570 per week—or to set it equal to approximately 84 percent of the proposed special salary level applicable to the other U.S. territories (\$455 per week)—resulting in a special salary level of \$380 per week. The Department is proposing to set a special salary level of \$380 per week in American Samoa. This approach not only maintains the special salary level that the Department is currently enforcing in American Samoa, but also ensures that American Samoa, which has a lower minimum wage than the other U.S. territories, does not have a higher special salary level. The Department seeks comments on this proposal.

### iii. Motion Picture Producing Industry

The Department has permitted employers to classify as exempt employees in the motion picture producing industry who are paid a specified base rate per week (or a proportionate amount based on the number of days worked), so long as they meet the duties tests for the EAP exemption.<sup>104</sup> This exception from the “salary basis” requirement was created in 1953 to address the “peculiar employment conditions existing in the [motion picture producing] industry,” and applies, for example, when a motion picture producing industry employee works less than a full workweek and is paid a daily base rate that would yield the weekly base rate if 6 days were worked.<sup>105</sup> Consistent with its practice since the 2004 final rule, the Department proposes to increase the required base rate proportionally to the proposed increase in the standard salary level test, resulting in a proposed base rate of \$1,036 per week (or a proportionate amount based on the number of days worked).<sup>106</sup> The Department seeks comments on this proposal.

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<sup>104</sup> See § 541.709.

<sup>105</sup> 18 FR 2881 (May 19, 1953).

<sup>106</sup> The Department calculated this figure by dividing the proposed weekly salary level (\$679) by \$455, and then multiplying this result (rounded to the nearest hundredth) by the base rate set in the 2004 final rule (\$695 per week). This produces a new base rate of \$1,036 (per week), when rounded to the nearest whole dollar.

### C. Inclusion of Nondiscretionary Bonuses, Incentive Payments, and Commissions in the Salary Level Requirement

Since 1940, the part 541 regulations have required that exempt EAP employees be paid on a salary basis. Historically, the Department assessed compliance with the salary level test by looking only at the salary or fee payments made to employees and, with the exception of the total annual compensation requirement of the highly compensated employee (HCE) test introduced in 2004, did not include bonus payments of any kind in this calculation. The Department's longstanding position has been to allow employers to pay additional compensation in the form of bonuses, but those payments did not count toward the payment of the required minimum salary.

During public listening sessions held by the Department prior to issuing the 2015 proposal, stakeholders encouraged the Department to consider including nondiscretionary bonuses in determining whether the salary level is met.<sup>107</sup> The stakeholders noted that such bonuses can be a significant part of exempt employees' compensation, and therefore supported the inclusion of bonuses in determining whether the salary level is met.<sup>108</sup> In the 2016 final rule, the Department for the first time allowed employers to use nondiscretionary bonuses and incentive payments that were paid quarterly or more frequently to satisfy up to 10 percent of the standard salary level.<sup>109</sup> Although the 2016 final rule was invalidated,<sup>110</sup> the Department believes that there are benefits to this approach because such bonuses and incentives are an important part of many employers' compensation systems.

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<sup>107</sup> 80 FR 38516, 38521 (July 6, 2015).

<sup>108</sup> *Id.*

<sup>109</sup> 81 FR 32423–27.

<sup>110</sup> *See* 275 F. Supp. 3d at 808. The nondiscretionary bonuses provision was not discussed in the decision.

In the 2017 RFI and the listening sessions, many commenters reiterated the view that nondiscretionary bonuses and incentive payments should count toward the salary threshold to some degree, although commenters disagreed about the percentage allowance, and some opposed counting such payments toward the salary level at all. Some RFI commenters also expressed concern about the 2016 final rule's requirement that such bonuses be paid at least quarterly to count toward the salary level. These commenters explained that annual bonuses can be substantial, and employers would be penalized if those bonuses were only creditable in the quarter in which they were paid. Having considered these comments, and consistent with its goal of modernizing the part 541 regulations, the Department proposes to permit nondiscretionary bonuses and incentive payments (including commissions) to satisfy up to 10 percent of the standard salary level test for the executive, administrative, and professional exemptions, provided that such bonuses or payments are paid annually or more frequently.<sup>111</sup> Such payments may include, for example, nondiscretionary incentive bonuses tied to productivity and profitability.<sup>112</sup>

The Department believes this approach is appropriate because such payments have become associated with EAP duties, such as the exercise of independent judgment and management skills. However, the Department received information during the 2016 rulemaking

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<sup>111</sup> The employer may use any 52-week period, such as a calendar year, a fiscal year, or an anniversary of the hire year. The Department recognizes that some businesses pay significantly larger bonuses. Where larger bonuses are paid, the amount attributable toward the EAP standard salary level requirement would be capped at 10 percent of the salary level.

<sup>112</sup> The Department notes that nonexempt employees may also receive such bonuses. Where nondiscretionary bonuses or incentive payments are made to nonexempt employees, the payments must be included in the regular rate when calculating overtime pay. The Department's regulations at §§ 778.208—.210 explain how to include nondiscretionary bonuses in the regular rate calculation. One way to calculate and pay such bonuses is as a percentage of the employee's total earnings. Under this method, the payment of the bonus includes the simultaneous payment of overtime due on the bonus payment. *See* § 778.210.

from State and local governments and nonprofits stating that they do not traditionally use such pay methods and might be at a competitive disadvantage if the overtime rule allowed a significant portion of the salary level to be met through such bonus payments. The Department accordingly determined that limiting the amount of the salary requirement that may be satisfied through such payments to 10 percent would help maintain parity between industries that use such pay methods and those that traditionally have not done so, such as nonprofit organizations, and ensure that exempt employees are paid regularly, as required by regulation. The Department did receive comments in the 2016 rulemaking that bonuses are an important part of compensation for some exempt employees. But the standard salary level test is meant to identify a class of nonexempt employees. The Department believes that employees with wages below the proposed standard salary level, who would be nonexempt by definition, also do not typically receive a substantial portion of their wages through bonuses. While the Department proposes to allow employers up to one year to apply nondiscretionary bonus or incentive payments to satisfy 10 percent of the standard salary level, the remaining 90 percent must be paid on a salary or fee basis in accordance with the regulations.

Finally, the Department proposes to permit employers to make a final “catch-up” payment within one pay period after the end of each 52-week period to bring an employee’s compensation up to the required level. Under the proposal, each pay period an employer must pay the exempt executive, administrative, or professional employee 90 percent of the standard salary level (\$611.10 per week), and if at the end of the 52-week period the salary paid plus the nondiscretionary bonuses and incentive payments (including commissions) paid does not equal the standard salary level for 52 weeks (\$35,308), the employer would have one pay period to make up for the shortfall (up to 10 percent of the standard salary level, \$3,530.80). Any such

catch-up payment would count only toward the prior year's salary amount and not toward the salary amount in the year in which it was paid.<sup>113</sup>

The Department seeks comments on its proposal to permit nondiscretionary bonuses and incentive payments (including commissions) to satisfy part of the standard salary level. The Department further requests comment on whether the proposed 10 percent cap is appropriate, or if a higher or lower cap is preferable.<sup>114</sup>

#### D. Highly Compensated Employees

The 2004 final rule created a new test under the EAP exemption, known as the highly compensated employee (HCE) test. The HCE test is based on the rationale that it is unnecessary to apply the standard duties test to employees who earn at least a certain amount annually—an amount substantially higher than the annual equivalent of the weekly standard salary level—because such employees “have almost invariably been found to meet all the other requirements of the regulations for exemption.”<sup>115</sup> Thus, the HCE test combines a high compensation requirement with a less-stringent, more-flexible duties test.

To be exempt under the HCE test, an employee must earn at least the amount specified in the regulations in total annual compensation and must customarily and regularly perform any one or more of the exempt duties or responsibilities of an executive, administrative, or professional

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<sup>113</sup> Because employers may use nondiscretionary bonuses to satisfy the vast majority of the total annual compensation paid to HCEs, such bonuses will not be permitted to satisfy the standard salary level portion of their compensation.

<sup>114</sup> The Department is not considering changing the exclusion of board, lodging, or other facilities from the salary calculation, a position that it has held consistently since the salary requirement was first adopted. *See* § 541.600. Similarly, the Department also declines to consider including in the salary requirement payments for medical, disability, or life insurance, or contributions to retirement plans or other fringe benefits. *See* § 541.601(b)(1).

<sup>115</sup> 69 FR 22174 (quoting Weiss Report at 22); *see* § 541.601(c) (“A high level of compensation is a strong indicator of an employee’s exempt status, thus eliminating the need for a detailed analysis of the employee’s job duties.”).

employee.<sup>116</sup> The HCE test applies “only to employees whose primary duty includes performing office or non-manual work.”<sup>117</sup> Additionally, such an employee must receive at least the standard salary level per week on a salary or fee basis, while the remainder of the employee’s total annual compensation may include commissions, nondiscretionary bonuses, and other nondiscretionary compensation.<sup>118</sup> Total annual compensation does not include board, lodging, and other facilities, and does not include payments for medical insurance, life insurance, retirement plans, or other fringe benefits.<sup>119</sup> An employer is permitted to make a final “catch-up” payment “during the last pay period or within one month after the end of the 52-week period” to bring an employee’s compensation up to the required level.<sup>120</sup> If an employee works for less than a full year, the employee may still qualify for exemption under the HCE test if the employee receives a pro rata portion of the required annual compensation, based upon the number of weeks of employment.<sup>121</sup>

The 2004 final rule set the HCE total annual compensation amount at \$100,000. In the 2016 final rule, the Department reaffirmed the appropriateness of the HCE test, and increased the total annual compensation requirement to reflect increases in salaries.<sup>122</sup> The Department explained that like the standard salary level, the 2004 HCE total annual compensation value had “eroded over time” and that the share of full-time salaried workers with salaries exceeding \$100,000 in fiscal year 2017 was predicted to be about three times the share who earned that

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<sup>116</sup> § 541.601(a).

<sup>117</sup> § 541.601(d).

<sup>118</sup> § 541.601(b)(1).

<sup>119</sup> *Id.*

<sup>120</sup> § 541.601(b)(2).

<sup>121</sup> § 541.601(b)(3). Similar to employees who work for a full year, one final “catch-up” payment may be made “within one month after the end of employment.” *Id.*

<sup>122</sup> 81 FR 32428–29.

amount in 2004.<sup>123</sup> In response, the Department increased the total annual compensation requirement for the HCE test to the annualized weekly earnings of the 90th percentile of full-time salaried workers nationally, which was \$134,004 based on the fourth quarter of 2015.<sup>124</sup> As a result of the district court's decision invalidating the 2016 final rule, the Department is currently enforcing the 2004 final rule, including its \$100,000 total annual compensation level and the requirement that \$455 per week must be paid on a salary or fee basis.<sup>125</sup>

The Department continues to believe that the HCE test is a useful alternative to the standard salary level and duties tests for highly compensated employees. The Department also believes that the HCE compensation level set in 2004, \$100,000 per year, was an appropriate level at the time, given that only roughly 10 percent of likely exempt employees who were subject to the salary tests earned at least that amount annually.<sup>126</sup> However, as with the standard salary level, the HCE total annual compensation level must be updated to ensure that it remains a meaningful and appropriate standard when paired with the more-flexible HCE duties test. In 2004, the Department concluded that the HCE compensation level was appropriate because “white collar” employees who earn such high salaries would nearly always satisfy any duties test, and “in the rare instances when these employees do not meet all other requirements of the regulations, a determination that such employees are exempt would not defeat the objectives of section 13(a)(1) of the Act.”<sup>127</sup> Accordingly, it is important to ensure that the HCE total annual

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<sup>123</sup> *Id.* at 32429. Whereas approximately 6.3 percent of full-time salaried workers had salaries exceeding \$100,000 in 2004, *see* 69 FR 22169, this number was predicted to be approximately 20 percent by fiscal year 2017, *see* 81 FR 32429. By January 2021, this number is expected to be approximately 26 percent.

<sup>124</sup> 81 FR 32429.

<sup>125</sup> The district court's decision did not specifically discuss the HCE test; however, the decision invalidated the entire 2016 final rule.

<sup>126</sup> 69 FR 22174.

<sup>127</sup> *Id.* (quoting Weiss Report at 22–23).

compensation level keeps pace with growth in nominal wages and salaries so that it applies only to those employees for whom it was originally intended, namely, those “at the very top of [the] economic ladder.”<sup>128</sup> Additionally, setting an appropriately high total annual compensation level for highly compensated employees ensures that employers continue to apply the standard duties test to employees whose exemption status is less clear.

The Department proposes to update the HCE test by setting it at the 90th percentile of all full-time salaried workers nationally using 2017 CPS data, then inflated to January 2020. This is similar to the method used in the 2016 final rule, which likewise set the HCE threshold at the 90th percentile of all full-time salaried workers. The inflation to January 2020 is proposed for the same reason as inflating the standard salary level: to more accurately reflect the salaries of employees at the time the rule becomes effective, rather than at the time data was collected. This results in a proposed HCE total annual compensation level of \$147,414, of which \$679 must be paid weekly on a salary or fee basis.<sup>129</sup> Notably, this proposed HCE threshold is slightly lower in relative terms than when the HCE threshold was initially adopted in 2004, when it covered 93.7 percent of all full-time salaried workers.<sup>130</sup> But the Department continues to believe that this simpler approach—*i.e.*, pegging the HCE threshold to the 90th percentile of all full-time salaried

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<sup>128</sup> *Id.*

<sup>129</sup> Although the Department is proposing that employers may use nondiscretionary bonuses to satisfy up to 10 percent of the weekly standard salary level when applying the standard salary and duties tests, the Department’s proposal does not permit employers to use nondiscretionary bonuses to satisfy the weekly standard salary level requirement for HCE workers. Employers may use commissions, nondiscretionary bonuses, and other nondiscretionary compensation to satisfy the remaining portion of the HCE total annual compensation amount. Because employers may use nondiscretionary bonuses to satisfy the vast majority of the total annual compensation paid to HCE employees, it is not necessary to permit the use of such bonuses to satisfy the standard salary level portion of their compensation.

<sup>130</sup> The \$100,000 annual compensation level set in 2004 corresponded to approximately 89.8 percent of likely exempt employees and 93.7 percent of full-time salaried workers. *See* 69 FR 22169-70 (Tables 3 and 4).

earnings nationwide—would result in a threshold high enough to “ensure that virtually every salaried white collar employee [above it] would satisfy any duties test.”<sup>131</sup>

Additionally, as with the standard salary level, to ensure that the Department regularly reviews the appropriateness of the HCE total annual compensation amount, the Department intends to propose an update to the level every four years, as discussed further in section IV.E below. The Department estimates that 201,100 workers—those who earn between \$100,000 and the proposed HCE total annual compensation level and pass the HCE duties test, but not the standard duties test—would, without some intervening action by their employers, be affected by the increase in the HCE compensation level.

#### E. Future Updates to the Earnings Thresholds

Congress has instructed the Department to define and delimit the overtime and minimum wage exemptions “from time to time.”<sup>132</sup> The rationale for updating the standard salary and HCE total compensation levels is straightforward: as employees’ earnings rise over time, they begin surpassing the earnings thresholds set in the past; the earnings thresholds thus become a less useful measure of employees’ relative earnings, and a less useful method for identifying exempt employees. As the Department noted in 2004, outdated regulations “allow unscrupulous employers to avoid their overtime obligations and can serve as a trap for the unwary but well-intentioned employer”; they can also lead increasing numbers of nonexempt employees to “resort to lengthy court battles to receive their overtime pay.”<sup>133</sup> Moreover, lengthy delays between updates to the earnings thresholds may necessitate disruptively large increases when the thresholds are updated.

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<sup>131</sup> 81 FR 32429.

<sup>132</sup> 29 U.S.C. 213(a)(1); *see also* FLSA Amendments of 1961, Pub. L. 87-30; 75 Stat. 65 (May 5, 1961).

<sup>133</sup> 69 FR 22122.

While the need to update the part 541 earnings thresholds on a regular basis is clear, the method and frequency of doing so has been contested. The Department has historically used notice-and-comment rulemaking to update the salary level tests, but various stakeholders throughout the years have submitted comments asking the Department to establish a mechanism to update the thresholds automatically. In the 1970 final rule, the Department remarked that one commenter’s suggestion to implement automatic annual updates to the salary tests based on BLS earnings data “appear[ed] to have some merit” given the delays between some of the Department’s earlier updates, but ultimately concluded that “such a proposal [would] require further study.”<sup>134</sup> In the 2004 final rule, the Department declined commenter requests to create an automatic updating mechanism. Instead, the Department expressed its intent “in the future to update the salary levels on a more regular basis.”<sup>135</sup>

When the Department next revisited the part 541 regulations in 2016, however, it adopted a mechanism to automatically update the earnings thresholds every three years, applying the same methodology used to initially set each threshold in that rulemaking.<sup>136</sup> The stated purpose of the 2016 final rule’s updating mechanism was to “ensure that the salary test level is based on the best available data (and thus remains a meaningful, bright-line test), produce more predictable and incremental changes in the salary required for the EAP exemption, and therefore provide certainty to employers, and promote government efficiency.”<sup>137</sup> The district court’s summary judgment decision invalidating the 2016 final rule stated that because the standard

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<sup>134</sup> 35 FR 884.

<sup>135</sup> 69 FR 22171–72.

<sup>136</sup> Specifically, the mechanism provided for using the 40th percentile of non-hourly earnings in the lowest-wage Census Region to automatically update the standard salary level, the 90th percentile of non-hourly earnings nationwide to automatically update the HCE total annual compensation threshold, and making proportionate increases to the special salary levels provided elsewhere in part 541.

<sup>137</sup> 81 FR 32430.

salary level established by the 2016 final rule was unlawful, the mechanism to automatically update that standard salary level was “similarly . . . unlawful.”<sup>138</sup>

In light of the district court’s decision and the concerns about lengthy delays between updates to the part 541 earnings thresholds, the Department asked for feedback in the 2017 RFI on how the salary and compensation levels should be updated going forward.<sup>139</sup> Responses to this question were mixed. Proponents of an automatic updating mechanism cited lengthy delays between earlier salary level updates, disruptively large increases necessitated by such delays, and the desire for added certainty. Other stakeholders, however, argued that the Department lacked the authority to update the salary level automatically, that an automatic updating mechanism might not be sufficiently flexible to account for unique economic circumstances, and that affected members of the public would not have any influence over the magnitude or timing of future salary level updates. Commenters generally agreed that the earning thresholds should be updated more frequently than to date, but some commenters were concerned that frequent updating would be unduly disruptive.

After considering the feedback provided in response to the RFI and at the listening sessions, the Department is committing to evaluate more frequently the part 541 earnings thresholds going forward. Specifically, the Department believes that the standard salary level and the HCE total annual compensation threshold should be proposed to be updated on a quadrennial basis (*i.e.*, once every four years) through an NPRM published in the Federal Register, followed by notice-and-comment rulemaking. The Department intends to propose such updates using the same methodology as the most recent final rule, meaning, in the first instance, the methodology employed by the final rule for which this NPRM is providing notice and opportunity to

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<sup>138</sup> 275 F. Supp. 3d at 808.

<sup>139</sup> 82 FR 34619.

comment. In these future rulemakings, the Department also intends to seek comment on whether to update the special salary levels that apply to the U.S. territories. Proposed quadrennial updates would ensure public input on how earning thresholds could continue to be up-to-date, while giving businesses sufficient time to adjust to these more frequent (and thus smaller) increases. The Secretary, however, may forestall proposing updates if economic or other factors so indicate. Accordingly, the Department proposes to delete the current (though not enforced) § 541.607, while affirming its intention to propose increasing the earnings thresholds every four years.<sup>140</sup> The Department seeks comment from the public regarding this proposal.

#### V. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (PRA), 44 U.S.C. 3501 *et seq.*, and its attendant regulations, 5 CFR part 1320, require the Department to consider the agency's need for its information collections, their practical utility, as well as the impact of paperwork and other information collection burdens imposed on the public, and how to minimize those burdens. The PRA typically requires an agency to provide notice and seek public comments on any proposed collection of information contained in a proposed rule. *See* 44 U.S.C. 3506(c)(2)(B); 5 CFR 1320.8. Persons are not required to respond to the information collection requirements until the Office of Management and Budget (OMB) approves them under the PRA. This NPRM would

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<sup>140</sup> Were the Department to codify this commitment in the final rule, the codified provision could have the following two features. First, it could provide that the Department publish a Notice of Proposed Rulemaking in the Federal Register in January 2023, and every four years thereafter, proposing an update to the standard salary level and highly compensated employee threshold in accord with the same methodology in the Department's most recent final rule establishing that salary level and threshold (the Notice would propose to retain the most recent levels set for the special salary levels applicable to U.S. territories, while inviting comment on whether to change them). And second, it could provide that the Secretary may, in his or her sole discretion, decline to publish the Notice of Proposed Rulemaking due to economic or other factors, with an accompanying notice published in the Federal Register giving the reason or reasons for declining.

revise the existing information collection requirement previously approved under OMB control number 1235-0018 (Records to be Kept by Employers – Fair Labor Standards Act) and OMB control number 1235-0021 (Employment Information Form) in that employers would need to maintain records of hours worked for more employees and more employees may file complaints to recover back wages under the overtime pay provision. As required by the PRA, the Department has submitted the information collection revisions to OMB for review to reflect changes that would result from this proposed rule were it to be adopted.

Summary: FLSA section 11(c) requires all employers covered by the FLSA to make, keep, and preserve records of employees and of wages, hours, and other conditions of employment. An FLSA-covered employer must maintain the records for such period of time and make such reports as prescribed by regulations issued by the Secretary of Labor. The Department has promulgated regulations at 29 CFR part 516 to establish the basic FLSA recordkeeping requirements. This NPRM, if adopted, would not impose any new information collection requirements; rather, using the currently enforced 2004 salary level as the baseline, burdens under existing requirements are expected to increase as more employees receive minimum wage and overtime protections. More specifically, the proposed changes in this NPRM may cause an increase in burden on employers because they will have additional employees to whom certain long-established recordkeeping requirements apply (*e.g.*, maintaining daily records of hours worked by employees who are not exempt from the both minimum wage and overtime provisions). Additionally, the proposed changes in this NPRM may cause an increase in burden if more employees file a complaint with WHD to collect back wages under the overtime pay requirements. The Department anticipates that this increased burden will wane over time as employers adjust to the new rule.

**Purpose and Use:** WHD and employees use employer records to determine whether covered employers have complied with various FLSA requirements. Employers use the records to document compliance with the FLSA, including showing qualification for various FLSA exemptions. Additionally, WHD uses the Employment Information form to document allegations of non-compliance with labor standards the agency administers.

**Technology:** The regulations prescribe no particular order or form of records, and employers may preserve records in forms of their choosing provided that facilities are available for inspection and transcription of the records.

**Minimizing Small Entity Burden:** Although the FLSA recordkeeping requirements do involve small businesses, including small state and local government agencies, the Department minimizes respondent burden by requiring no specific order or form of records in responding to this information collection. Burden is reduced on complainants by providing a template to guide answers.

**Public Comments:** As part of its continuing effort to reduce paperwork and respondent burden, the Department conducts a preclearance consultation program to provide the general public and Federal agencies with an opportunity to comment on proposed and continuing collections of information in accordance with the PRA. This program helps to ensure that requested data can be provided in the desired format, reporting burden (time and financial resources) is minimized, collection instruments are clearly understood, and the impact of collection requirements on respondents can be properly assessed. The Department seeks public comments regarding the burdens imposed by the information collections associated with this NPRM. Commenters may send their views about this information collection to the Department in the same manner as all other comments (*e.g.*, through the [regulations.gov](https://www.regulations.gov) website). All

comments received will be made a matter of public record and posted without change to <http://www.regulations.gov>, including any personal information provided.

As previously noted, an agency may not conduct an information collection unless it has a currently valid OMB approval, and the Department has submitted information collection requests under OMB control numbers 1235-0018 and 1235-0021 in order to update them to reflect this rulemaking and provide interested parties a specific opportunity to comment under the PRA. *See* 44 U.S.C. 3507(d); 5 CFR 1320.11. Interested parties may receive a copy of the full supporting statements by sending a written request to the mailing address shown in the ADDRESSES section at the beginning of this preamble. In addition to having an opportunity to file comments with the Department, comments about the paperwork implications may be addressed to OMB. Comments to OMB should be directed to: Office of Information and Regulatory Affairs, Attention OMB Desk Officer for the Wage and Hour Division, Office of Management and Budget, Room 10235, 725 17<sup>th</sup> Street N.W., Washington, D.C. 20503; Telephone: 202-395-5806 (this is not a toll-free number). OMB will consider all written comments that the agency receives within 30 days of publication of this proposed rule. Commenters are encouraged, but not required, to send the Department a courtesy copy of any comments sent to OMB. The courtesy copy may be sent via the same channels as comments on the rule.

OMB and the Department are particularly interested in comments that:

- Evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;
- Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used;

- Enhance the quality, utility, and clarity of the information to be collected; and
- Minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology, *e.g.*, permitting electronic submission of responses.

Total annual burden estimates, which reflect both the existing and new responses for the recordkeeping and complaint process information collections, are summarized as follows:

*Type of Review:* Revisions to currently approved information collections.

*Agency:* Wage and Hour Division, Department of Labor.

*Title:* Records to be Kept by Employers -- Fair Labor Standards Act.

*OMB Control Number:* 1235-0018.

*Affected Public:* Private sector businesses or other for-profits, farms, not-for-profit institutions, state, local and tribal governments, and individuals or households.

*Estimated Number of Respondents:* 5,588,627 (unaffected by this rulemaking)

*Estimated Number of Responses:* 48,101,522 (2,583,333 added by this rulemaking)

*Estimated Burden Hours:* 3,631,819 hours (2,583,333 added by this rulemaking)

*Estimated Time per Response:* Various (unaffected by this rulemaking)

*Frequency:* Various (unaffected by this rulemaking)

*Other Burden Cost* 0

*Title:* Employment Information Form.

*OMB Control Number:* 1235-0021.

*Affected Public:* Businesses or other for-profit, farms, not-for-profit institutions, state, local and tribal governments, and individuals or households.

*Total Respondents:* 35,819 (242 added by this rulemaking)

*Estimated Number of Responses:* 35,819 (242 added by this rulemaking)

*Estimated Burden Hours:* 11,940 (81 hours added by this rulemaking)

*Estimated Time per Response:* 20 minutes (unaffected by this rulemaking)

*Frequency:* once

*Other Burden Cost:* 0

VI. Analysis Conducted In Accordance with Executive Order 12866, Regulatory Planning and Review, and Executive Order 13563, Improving Regulation and Regulatory Review

Executive Orders 12866 and 13563 direct agencies to assess the costs and benefits of a regulation and to adopt a regulation only upon a reasoned determination that the regulation's net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity) justify its costs. Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility.

Under Executive Order 12866, the Office of Management and Budget (OMB) must determine whether a regulatory action is a "significant regulatory action," which includes an action that has an annual effect of \$100 million or more on the economy. Significant regulatory actions are subject to review by OMB. As described below, this proposed rule is economically significant. Therefore, the Department has prepared a Preliminary Regulatory Impact Analysis

(RIA)<sup>141</sup> in connection with this NPRM as required under section 6(a)(3) of Executive Order 12866, and OMB has reviewed the rule.

When the Department uses a perpetual time horizon to allow for cost comparisons under Executive Order 13771,<sup>142</sup> the annualized cost savings of the proposed rule is \$224.0 million with 7 percent discounting. This proposed rule is accordingly expected to be an Executive Order 13771 deregulatory action.

## A. Introduction

### i. Background

The FLSA requires covered employers to: (1) pay employees who are covered and not exempt from the Act's requirements not less than the federal minimum wage for all hours worked and overtime premium pay at a rate of not less than one and one-half times the employee's regular rate of pay for all hours worked over 40 in a workweek, and (2) make, keep, and preserve records of their employees and of the wages, hours, and other conditions and practices of employment. It is widely recognized that the general requirement that employers pay a premium rate of pay for all hours worked over 40 in a workweek is a cornerstone of the Act, grounded in two policy objectives. The first policy objective is to reduce overwork and its detrimental effect on the health and well-being of workers. The second is to spread employment (or, in other words, reduce involuntary unemployment) by incentivizing employers to hire more employees rather than requiring existing employees to work longer hours.

The FLSA provides a number of exemptions from the Act's minimum wage and overtime pay provisions, including one for bona fide executive, administrative, and professional (EAP)

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<sup>141</sup> The terms "regulatory impact analysis" and "economic impact analysis" are used interchangeably throughout this Proposed Rule.

<sup>142</sup> 82 FR 9339 (Feb. 3, 2017).

employees. Such employees perform work that cannot easily be spread to other workers after 40 hours in a week and that is difficult to standardize to any timeframe. They also typically receive more monetary and non-monetary benefits than most blue collar and lower-level office workers. The exemption applies to employees employed in a bona fide executive, administrative, or professional capacity and to outside sales employees, as those terms are “defined and delimited” by the Department.<sup>143</sup> The Department’s regulations implementing these “white collar” exemptions are codified at 29 CFR part 541.

In 2004, the Department determined that two earnings level tests should be used to help employers distinguish nonexempt employees from exempt employees: the standard salary test, which it set at \$455 a week, and the highly compensated employee (HCE) total-compensation test, which it set at \$100,000 per year (see II.C. for further discussion). In 2016, the Department published a final rule setting the standard salary level at \$913 per week and the HCE annual compensation level at \$134,004. As previously discussed, the U.S. District Court for Eastern District of Texas declared the 2016 final rule invalid.

The standard salary level should be an appropriate dividing-line between employees who are nonexempt and employees who may be performing exempt duties. The threshold essentially screens out obviously nonexempt employees whom Congress intended the FLSA’s minimum wage and overtime provisions to protect. Therefore, employers are not burdened with conducting a duties analysis to determine nonexempt status for the employees who fall below the threshold, as those employees are unlikely to pass the duties test for exemption.

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<sup>143</sup> 29 U.S.C. 213(a)(1).

ii. Need for Rulemaking

The Department has updated the salary level test seven times since its implementation in 1938. Table 1 presents the weekly salary levels associated with the EAP exemptions since 1938, organized by exemption and long/short/standard duties tests.<sup>144</sup> The Department has revised the levels once in the 44 years since 1975.<sup>145</sup> In contrast, in the 37 years between 1938 and 1975, the Department increased salary test levels approximately every five to nine years.

Table 1: Historical Salary Levels for the EAP Exemptions

Date Enacted	Long Test			Short Test (All)
	Executive	Administrative	Professional	
1938	\$30	\$30	--	--
1940	\$30	\$50	\$50	--
1949	\$55	\$75	\$75	\$100
1958	\$80	\$95	\$95	\$125
1963	\$100	\$100	\$115	\$150
1970	\$125	\$125	\$140	\$200
1975	\$155	\$155	\$170	\$250
Standard Test				
2004	\$455			

Since the update in 2004, the purchasing power, or real value, of the standard-salary level test has eroded substantially, and as a result, increasingly more workers earn above the salary

<sup>144</sup> From 1949 until 2004 the regulations contained two different tests for exemption—a long test for employees paid a lower salary that included a more rigorous examination of employees’ duties, and a short test for employees paid at a higher salary level that included a more flexible duties test.

<sup>145</sup> The Department revised the EAP salary levels in 2004. In 2016, the Department also issued a final rule revising the EAP salary levels; however, on August 31, 2017, the U.S. District Court for Eastern District of Texas held that the 2016 final rule’s standard salary level exceeded the Department’s authority and was therefore invalid. *See Nevada v. U.S. Dep’t of Labor*, 275 F. Supp. 3d 795 (E.D. Tex. 2017). Until the Department issues a new final rule, it is enforcing the part 541 regulations in effect on November 30, 2016, including the \$455 per week standard salary level set in the 2004 final rule.

threshold. Between 2004 and 2017, the real value of the standard-salary level declined 22.9 percent, calculated using the Consumer Price Index for all urban consumers (CPI-U).<sup>146</sup>

As a result of the erosion of the real value of the standard-salary level, more and more workers earn above the standard salary level. Each year that the salary level is not updated, its utility as a distinguishing mechanism between nonexempt and potentially exempt workers declines. For example, the annualized equivalent of the standard salary level set in 2004 (\$23,660, or \$455 per week for 52 weeks) is now below the 2017 poverty threshold for a family of four (\$24,858).<sup>147</sup> Similarly, in 2017, approximately 23 percent of full-time salaried workers earned at least \$100,000 annually, more than three times the share who earned that amount (6.3 percent) when the HCE test was created in 2004.<sup>148</sup>

In the 2004 rulemaking, the Department stated the intention to “update the salary levels on a more regular basis, as it did prior to 1975,” and added that the “salary levels should be adjusted when wage survey data and other policy concerns support such a change.”<sup>149</sup> In the 2016 final rule, the Department recognized that the salary level had become outdated and that an update was needed. As previously discussed, the U.S. District Court for Eastern District of Texas declared the 2016 final rule invalid because the standard salary level excluded from exemption too many employees who perform exempt duties.

Now, to restore the value of the standard salary level as a line of demarcation between those workers for whom Congress clearly intended to provide minimum wage and overtime protections and other workers who may be bona fide EAPs, and to maintain the salary level’s

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<sup>146</sup> CPI-U data available at: [https://www.bls.gov/data/inflation\\_calculator.htm](https://www.bls.gov/data/inflation_calculator.htm).

<sup>147</sup> This is the 2017 poverty threshold for a family of four with two related people under 18 in the household. Available at: <https://www.census.gov/data/tables/time-series/demo/income-poverty/historical-poverty-thresholds.html>.

<sup>148</sup> Calculated using pooled CPS MORG data.

<sup>149</sup> 69 FR 22171.

continued validity, the Department proposes to update standard salary level using the 2004 methodology with current CPS data. Using pooled 2017 CPS MORG data, a salary level of \$641 (\$33,332 annually) corresponds to the 20th percentile of earnings for full-time salaried workers in the South Census region and/or in the retail industry.<sup>150</sup> To account for expected changes between 2017 and January 2020, and to make it so that the salary level will accurately reflect compensation at the approximate effective date, the salary level was inflated using the compound annual growth rate that increased the standard salary level from \$455 to \$641 over 15 years (2.31 percent =  $((\$641/\$455)^{1/15} - 1)$ ).<sup>151</sup> Applying this growth rate for an additional 2.5 years (assuming 2017 data represents mid-2017 on average) results in a January 2020 salary level of \$679 ( $\$641 \times 1.0231^{2.5}$ ). Similarly, to update the HCE total compensation requirement, the Department used CPS MORG data to ascertain the 90th percentile of all full-time salaried workers in 2017 (\$139,464), calculated the compound annual growth rate from 2002 to 2017 (2.24 percent), then applied that rate over 2.5 years to inflate the 2017 level to \$147,414 for January 2020.

Additionally, as just discussed, in this proposed rule the Department commits to evaluate more frequently the part 541 earnings thresholds going forward. Specifically, the Department intends to update the earnings thresholds once every four years (*see* section IV.E for further discussion). Such proposed quadrennial updates would preserve the effectiveness of the salary level as a dividing line between nonexempt workers and workers who may be exempt, eliminate the volatility associated with previous changes in the thresholds, and increase certainty for employers with respect to future changes.

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<sup>150</sup> Excluding workers who are not subject to FLSA, not subject to the salary level test, or in agriculture or transportation.

<sup>151</sup> The standard salary level of \$455 per week became effective in 2004. However, this level was determined using 2002 CPS MORG data. We therefore calculated the compound annual growth rate over 15 years, from 2002 to 2017.

### iii. Summary of Affected Workers, Costs, Benefits, and Transfers

The Department estimated the number of affected workers and quantified costs and transfer payments associated with this proposed rule, using the currently enforced 2004 salary level as the baseline. To produce these estimates, the Department used data from the pooled CPS MORG data. *See* section VI.B. Most critically, the Department estimates that 1.1 million workers who would otherwise be exempt under the currently enforced standard salary level of \$455 per week would become eligible for overtime, and that 3.6 million employees paid between \$455 and \$679 per week who fail the standard duties test (i.e., that are and will remain nonexempt) would have their overtime eligibility made clearer because their salary would fall below the proposed threshold.

The Department estimated that in Year 1, there would be 46.2 million white collar salaried employees whom a change to the Department's part 541 regulations may affect.<sup>152</sup> Of these workers, the Department estimated that 31.9 million would be exempt from the minimum wage and overtime pay provisions under the part 541 EAP regulations promulgated in 2004 (*i.e.*, in the baseline scenario without the rule taking effect). The other 14.3 million workers would not satisfy the duties tests for EAP exemption and/or earn less than \$455 per week.<sup>153</sup> However, of the 31.9 million workers, 7.6 million were in "named occupations" and thus only needed to pass the duties tests to be subject to the standard EAP exemptions.<sup>154</sup> Therefore, these workers were

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<sup>152</sup> This excludes workers who are exempt under another FLSA exemption and thus would remain exempt from minimum wage and overtime pay protections without qualifying for the EAP exemption.

<sup>153</sup> Here and elsewhere in this analysis, numbers are reported at varying levels of aggregation, and are generally rounded to a single decimal point. However, calculations are performed using exact numbers. Therefore, some numbers may not match the reported total or the calculation shown due to rounding of components.

<sup>154</sup> Workers not subject to the EAP salary level test include teachers, physicians, lawyers, judges, and outside sales workers. Additionally, academic administrative personnel are not subject to the

not considered in the analysis, leaving 24.3 million EAP exempt workers potentially affected by this proposed rule.

In Year 1, an estimated 1.1 million workers would be affected by the proposed increase in the standard salary level test (Table 2). This figure consists of currently exempt workers subject to the salary level test who earn at least \$455 per week but less than \$641 per week (the Department analyzed the economic effects of a standard salary level of \$641 per week using pooled 2017 CPS MORG data as the best representation of the likely economic effects of the proposed standard salary level of \$679 per week taking effect in 2020).<sup>155</sup> Additionally, an estimated 201,100 workers would be affected by the increase in the HCE compensation test from \$100,000 per year to \$139,464 per year (the Department analyzed the economic effects of an HCE compensation level of \$139,464 per year using pooled 2017 CPS MORG data as the best representation of the likely economic effects of the proposed HCE compensation level of \$147,414 per year taking effect in 2020). By Year 10,<sup>156</sup> the Department estimates that 625,000 workers would be affected by the change in the standard salary level test and 426,000 workers would be affected by the change in the HCE total annual compensation test, compared to a

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EAP salary level test if they are paid on a salary basis equivalent to an entry level teacher in their institution.

<sup>155</sup> The Department performed a preliminary check of an analogous three-year gap that indicates that 2014 data would yield a prediction of more potentially affected workers than the 2017 data. This result may be driven by the late 2016 and 2017 data showing the effects of employers adjusting workers' salaries, implicit wages, and hourly/salaried status in anticipation of the 2016 rule taking effect.

<sup>156</sup> Although the Department anticipates proposing to update the standard salary and HCE compensation level requirements periodically, the proposed updates are not required under this rulemaking and therefore are not included in this RIA. Future updates will be proposed and promulgated through notice and comment rulemaking and will be accompanied by their own RIA.

baseline assuming the currently enforced earnings thresholds (*i.e.*, \$455 per week and \$100,000 per year) remain unchanged.<sup>157</sup>

This analysis quantifies three direct costs to employers: (1) regulatory familiarization costs; (2) adjustment costs; and (3) managerial costs (*see* section VI.D.iii for further discussion on costs). The costs presented here are the combined costs for both the change in the standard salary level test and the HCE total compensation level (these will be disaggregated in section VI.D.iii). Total annualized direct employer costs over the first 10 years were estimated to be \$120.5 million, assuming a 7 percent discount rate<sup>158</sup> (Table 2).

In addition to the costs described above, this proposed rule will also transfer income from employers to employees in the form of wages. The Department estimated annualized transfers would be \$429.4 million. The majority of these transfers would be attributable to the FLSA's overtime provision; a smaller share would be attributable to the FLSA's minimum wage requirement. Transfers also include salary increases for some affected EAP workers to preserve their exempt status. Employers may incur additional costs, such as hiring new workers. These other potential costs are discussed in section VI.D.iii. The proposed rulemaking could provide some benefits; however, these benefits could not be quantified due to data limitations, requiring the Department to discuss such benefits qualitatively. *See* VI.D.v.

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<sup>157</sup> In later years, earnings growth will cause some workers to no longer be affected because their earnings will exceed the new salary threshold. Additionally, some workers will become newly affected because their earnings will exceed \$455 per week, and in the absence of this Proposed Rule would have lost their overtime protections. To estimate the total number of affected workers over time, the Department accounts for both of these effects.

<sup>158</sup> Hereafter, unless otherwise specified, annualized values will be presented using the 7 percent real discount rate.

Table 2: Summary of Regulatory Costs and Transfers, Standard and HCE Salary Levels  
(Millions in 2017\$)

Impact	Year 1	Future Years [a]		Annualized Value	
		Year 2	Year 10	3% Real Discount Rate	7% Real Discount Rate
Affected Workers (1,000s)					
Standard	1,070	1,027	625	--	--
HCE	201	215	426	--	--
Total	1,271	1,241	1,051	--	--
Costs and Transfers (Millions in 2017\$) [b]					
Direct employer costs	\$464.2	\$74.2	\$67.8	\$112.6	\$120.5
Transfers [c]	\$526.9	\$421.3	\$447.1	\$428.0	\$429.4

[a] These cost and transfer figures represent a range over the nine-year span.

[b] Costs and transfers for affected workers passing the standard and HCE tests are combined.

[c] This is the net transfer from employers to workers. There may also be transfers of hours and income from some workers to others.

#### iv. Terminology and Abbreviations

The following terminology and abbreviations will be used throughout this RIA.

**Affected EAP workers:** The population of potentially affected EAP workers who either pass the standard duties test and earn at least \$455 but less than the new salary level (for this analysis modeled as \$641 in Year 1), or pass only the HCE duties test and earn at least \$100,000 but less than the new HCE compensation level (for this analysis modeled as \$139,464 in Year 1). This was estimated to be 1.3 million workers.

**Baseline EAP exempt workers:** The projected number of workers who would be EAP exempt if the rulemaking did not take effect.

**BLS:** Bureau of Labor Statistics.

**CPI-U:** Consumer Price Index for all urban consumers.

CPS: Current Population Survey.

Duties test: To be exempt from the FLSA's minimum wage and overtime requirements under section 13(a)(1), the employee's primary job duty must involve bona fide executive, administrative, or professional duties as defined by the regulations. The Department distinguishes among four such tests:

Standard duties test: The duties test used in conjunction with the standard salary level test, as set in 2004 and applied to date, to determine eligibility for the EAP exemptions. It replaced the short and long tests in effect from 1949 to 2004, but its criteria closely follow those of the former short test.

HCE duties test: The duties test used in conjunction with the HCE total annual compensation requirement, as set in 2004 and applied to date, to determine eligibility for the HCE exemption. It is much less stringent than the standard and short duties tests to reflect that very highly paid employees are much more likely to be properly classified as exempt.

Long duties test: One of two duties tests used from 1949 until 2004; this more restrictive duties test had a greater number of requirements, including a limit on the amount of nonexempt work that could be performed, and was used in conjunction with a lower salary level to determine eligibility for the EAP exemptions (*see* Table 1).

Short duties test: One of two duties tests used from 1949 to 2004; this less restrictive duties test had fewer requirements, did not limit the amount of nonexempt work that could be performed, and was used in conjunction with a higher salary level to determine eligibility for the EAP exemptions (*see* Table 1).

EAP: Executive, administrative, and professional.

HCE: Highly compensated employee; a category of EAP exempt employee, established in 2004 and characterized by high earnings and a minimal duties test.

Hourly wage: For the purpose of this PRIA, the amount an employee is paid for an hour of work.

Base hourly wage: The hourly wage excluding any overtime payments. Also used to express the wage rate without accounting for benefits.

Implicit hourly wage: Hourly wage calculated by dividing reported weekly earnings by reported hours worked.

Straight time wage: Another term for the hourly wage excluding any overtime payments.

MORG: Merged Outgoing Rotation Group supplement to the CPS. Conducted on approximately one-fourth of the CPS sample monthly to obtain information on weekly hours worked and earnings.

Named occupations: Workers in named occupations are not subject to the salary level or salary basis tests. These occupations include teachers, academic administrative personnel,<sup>159</sup> physicians,<sup>160</sup> lawyers, judges,<sup>161</sup> and outside sales workers.

Overtime workers: The Department distinguishes between two types of overtime workers in this analysis.

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<sup>159</sup> Academic administrative personnel (including admissions counselors and academic counselors) need to be paid either (1) the salary level or (2) a salary that is at least equal to the entrance salary for teachers in the educational establishment at which they are employed. *See* § 541.204(a)(1). Entrance salaries at the educational establishment of employment cannot be distinguished in the data and so this alternative is not considered (thus these employees were excluded from the analysis, the same as was done in the 2004 final rule).

<sup>160</sup> The term physician includes medical doctors including general practitioners and specialists, osteopathic physicians (doctors of osteopathy), podiatrists, dentists (doctors of dental medicine), and optometrists (doctors of optometry or with a Bachelor of Science in optometry). *See* § 541.304(b).

<sup>161</sup> Judges may not be considered “employees” under the FLSA definition. However, since this distinction cannot be made in the data, all judges are excluded (the same as was done in the 2004 final rule). Including these workers in the model as FLSA employees would not impact the estimate of affected workers.

Occasional overtime workers: The Department uses two steps to identify occasional overtime workers. First, all workers who report they usually work 40 hours or less per week (identified with variable PEHRUSL1 in CPS MORG) but in the survey (or reference) week worked more than 40 hours (variable PEHRACT1 in CPS MORG) are classified as occasional overtime workers. Second, some additional workers who do not report usually working overtime and did not report working overtime in the reference week are randomly selected to be classified as occasional overtime workers so that the proportion of workers who work overtime in our sample matches the proportion of workers, measured using SIPP data, who work overtime at some point in the year.

Regular overtime workers: Workers who report they usually work more than 40 hours per week (identified with variable PEHRUSL1 in CPS MORG).

Pooled 2017 CPS MORG data: CPS MORG data from 2015-2017 with earnings inflated to 2017 dollars and sample observations weighted to reflect employment in 2017. Pooled data were used to increase sample size. The analytic database will be updated to pool CPS MORG data from 2016–2018 for the final rulemaking.

Potentially affected EAP workers: EAP exempt workers who are not in named occupations and are included in the analysis (*i.e.*, white collar, salaried, not eligible for another (non-EAP) overtime pay exemption). This is estimated to be 24.3 million workers.

Price elasticity of demand (with respect to wage): The percentage change in labor hours demanded in response to a one percent change in wages.

Real dollars (2017\$): Dollars adjusted using the CPI-U to estimate the purchasing power they would have in 2017.

Salary basis test: The EAP exemptions' requirement that workers be paid on a salary basis, that is, a pre-determined amount that cannot be reduced because of variations in the quality or quantity of the employee's work.

Salary level test: The salary a worker must earn to be subject to the EAP exemptions. The Department distinguishes among four such tests:

Standard salary level: The weekly salary level associated with the standard duties test that determines eligibility for the EAP exemptions. The standard salary level was set at \$455 per week in the 2004 final rule.

HCE compensation level: Workers who meet the standard salary level requirement but not the standard duties test nevertheless are exempt if they pass a minimal duties test and earn at least the HCE total annual compensation required amount. The HCE required compensation level was set at \$100,000 per year in the 2004 final rule, of which at least \$455 per week must be paid on a salary or fee basis.

Short test salary level: The weekly salary level associated with the short duties test (eliminated in 2004).

Long test salary level: The weekly salary level associated with the long duties test (eliminated in 2004).

SIPP: Survey of Income and Program Participation.

Workers covered by the FLSA and subject to the Department's part 541 regulations: Includes all workers except those excluded from the analysis because they are not covered by the FLSA or subject to the Department's requirements. Excluded workers include: members

of the military, unpaid volunteers, the self-employed, many religious workers, and federal employees (with a few exceptions).<sup>162</sup>

The Department also notes that the terms *employee* and *worker* are used interchangeably throughout this analysis.

## B. Methodology to Determine the Number of Potentially Affected EAP Workers

### i. Overview

This section explains the methodology used to estimate the number of workers who are subject to the part 541 regulations and the number of potentially affected EAP workers. In this proposed rule, as in the 2004 final rule, the Department estimated the number of EAP exempt workers because there is no data source that identifies workers as EAP exempt. Employers are not required to report EAP exempt workers to any central agency or as part of any employee or establishment survey.<sup>163</sup> The methodology described here is largely based on the approach the Department used in the 2004 and 2016 final rules.<sup>164</sup>

### ii. Data

The estimates of EAP exempt workers were based on data drawn from the CPS MORG, which is sponsored jointly by the U.S. Census Bureau and the BLS. The CPS is a large,

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<sup>162</sup> Employees of firms with annual revenue less than \$500,000 who are not engaged in interstate commerce are also not covered by the FLSA. However, these workers are not excluded from this analysis because the Department has no reliable way of estimating the size of this worker population, although the Department believes it composes a small percent of workers. These workers were also not excluded from the 2004 final rule.

<sup>163</sup> In 2015, RAND released results from a survey conducted to estimate EAP exempt workers. However, this survey does not have the variables or sample size necessary for the Department to base the RIA on this analysis. Rohwedder, S. and Wenger, J.B. (2015). The Fair Labor Standards Act: Worker Misclassification and the Hours and Earnings Effects of Expanded Coverage. RAND Labor and Population.

<sup>164</sup> See 69 FR 22196–209; 81 FR 32453–60. Where the proposal follows the methodology used to determine affected workers in both the 2004 and 2016 final rules citations to both rules are not always included.

nationally representative sample of the labor force. Households are surveyed for four months, excluded from the survey for eight months, surveyed for an additional four months, then permanently dropped from the sample. During the last month of each rotation in the sample (month 4 and month 16), employed respondents complete a supplementary questionnaire in addition to the regular survey.<sup>165</sup> This supplement contains the detailed information on earnings necessary to estimate a worker's exemption status. Responses are based on the reference week, which is always the week that includes the 12th day of the month.

Although the CPS MORG is a large scale survey, administered to approximately 15,000 households monthly representing the entire nation, it is still possible to have relatively few observations when looking at subsets of employees, such as exempt workers in a specific occupation employed in a specific industry, or workers in a specific geographic location. To increase the sample size, the Department pooled together three years of CPS MORG data (2015 through 2017). Earnings for each 2015 and 2016 observation were inflated to 2017 dollars using the CPI-U. The Department requests comments on whether there are better options for projecting salary growth than the application of a broad inflation index, and if a broad index is used, whether it should be CPI-U, or whether another inflation measure such as the GDP Deflator or the Personal Consumption Expenditures (PCE) price index would be more appropriate. The weight of each observation was adjusted so that the total number of potentially affected EAP workers in the pooled sample remained the same as the number for the 2017 CPS MORG. Thus, the pooled CPS MORG sample uses roughly three times as many observations to represent the same total number of workers in 2017. The additional observations allow the Department to better characterize certain attributes of the potentially affected labor force. This pooled dataset is

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<sup>165</sup> This is the outgoing rotation group (ORG); however, this analysis uses the data merged over twelve months and thus will be referred to as MORG.

used to estimate all impacts of the proposed rulemaking. For the analyses supporting the final rule, the Department anticipates using pooled CPS-MORG data updated to include 2016 through 2018.

Some assumptions were necessary to use these data as the basis for the analysis. For example, the Department eliminated workers who reported that their weekly hours vary and provided no additional information on hours worked. This was done because the Department cannot estimate effects for these workers since it is unknown whether they work overtime and therefore unknown whether there would be any need to pay for overtime if their status changed from exempt to nonexempt. The Department reweighted the rest of the sample to account for this change (*i.e.*, to keep the same total employment estimates).<sup>166</sup> This adjustment assumes that the distribution of hours worked by workers whose hours do not vary is representative of hours worked by workers whose hours do vary. The Department believes that without more information this is an appropriate assumption.<sup>167</sup>

### iii. Number of Workers Covered by the Department's Part 541 Regulations

To estimate the number of workers covered by the FLSA and subject to the Department's part 541 regulations, the Department excluded workers who are not subject to its regulations or whom the FLSA does not cover. This may happen, for instance, if a worker is not an employee

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<sup>166</sup> The Department also reweighted for workers reporting zero earnings. In addition, the Department eliminated, without reweighting, workers who both reported usually working zero hours and working zero hours in the past week.

<sup>167</sup> This is justifiable because demographic and employment characteristics are similar across these two populations (*e.g.*, age, gender, education, distribution across industries, share paid nonhourly). The share of all workers who stated that their hours vary (but provided no additional information) is 5.2 percent. To the extent these excluded workers are exempt, if they tend to work more overtime than other workers, then transfer payments and costs may be underestimated. Conversely, if they work fewer overtime hours, then transfer payments and costs may be overestimated.

under the FLSA. These workers include military personnel, unpaid volunteers, self-employed individuals, clergy and other religious workers, and federal employees (with a few exceptions described below).

Many of these workers are excluded from the CPS MORG, including members of the military on active duty and unpaid volunteers. Self-employed and unpaid workers are included in the CPS MORG, but have no earnings data reported and thus are excluded from the analysis. The analysis excluded religious workers identified by their occupation codes: ‘clergy’ (Census occupational code 2040), ‘directors, religious activities and education’ (2050), and ‘religious workers, all other’ (2060). Most employees of the federal government are covered by the FLSA but not the Department’s part 541 regulations because the Office of Personnel Management (OPM) regulates their entitlement to minimum wage and overtime pay.<sup>168</sup> Exceptions exist for U.S. Postal Service employees, Tennessee Valley Authority employees, and Library of Congress employees.<sup>169</sup> The analysis identified and included these covered federal workers using occupation and/or industry codes.<sup>170</sup> The FLSA also does not cover employees of firms that have annual revenue of less than \$500,000 and who are not engaged in interstate commerce. The Department does not exclude them from the analysis, however, because it has no reliable way of estimating the size of this worker population, although the Department believes it is a small percentage of workers. The 2004 final rule analysis similarly did not adjust for these workers.

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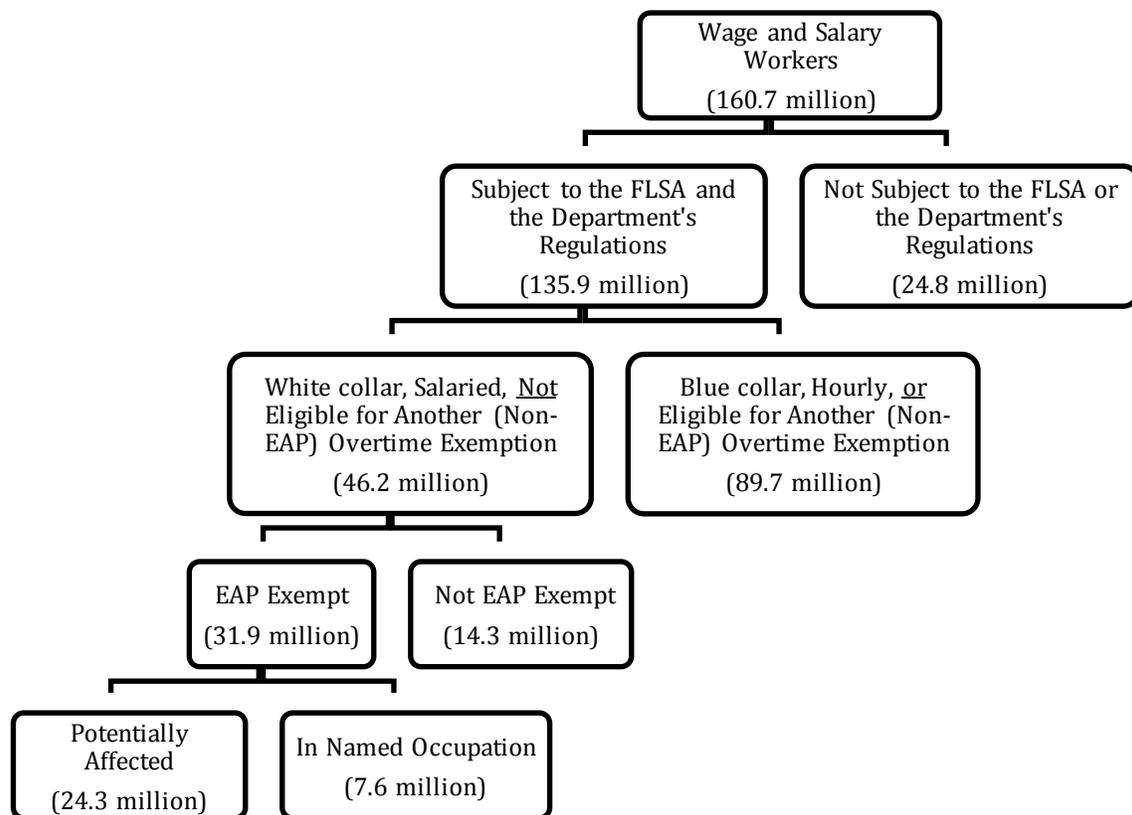
<sup>168</sup> See 29 U.S.C. 204(f). Federal workers are identified in the CPS MORG with the class of worker variable PEIO1COW.

<sup>169</sup> See *id.*

<sup>170</sup> Postal Service employees were identified with the Census industry classification for postal service (6370). Tennessee Valley Authority employees were identified as federal workers employed in the electric power generation, transmission, and distribution industry (570) and in Kentucky, Tennessee, Mississippi, Alabama, Georgia, North Carolina, or Virginia. Library of Congress employees were identified as federal workers under Census industry ‘libraries and archives’ (6770) and residing in Washington D.C.

The Department estimated that in Year 1 there would be 160.7 million wage and salary workers in the United States (Figure 1). Of these, 135.9 million would be covered by the FLSA and subject to the Department's regulations (84.6 percent). The remaining 24.8 million workers would be excluded from FLSA coverage for the reasons described above. Figure 1 illustrates how the Department analyzed the U.S. civilian workforce through successive stages to estimate the number of potentially affected EAP workers.

Figure 1: Flow Chart of FLSA Exemptions and Estimated Number of Potentially Affected Workers



iv. Number of Workers in the Analysis

After limiting the analysis to workers covered by the FLSA and subject to the Department's part 541 regulations, several other groups of workers were identified and excluded

from further analysis since this proposed rule is unlikely to affect them. These include blue collar workers, workers paid on an hourly basis, and workers who are exempt under certain other (non-EAP) exemptions.

The Department excluded a total of 89.7 million workers from the analysis for one or more of these reasons, which often overlapped (*e.g.*, many blue collar workers are also paid hourly). The Department estimated that in 2017 there were 49.0 million blue collar workers. These workers were identified in the CPS MORG data following the methodology from the U.S. Government Accountability Office's (GAO) 1999 white collar exemptions report<sup>171</sup> and the Department's 2004 regulatory impact analysis. *See* 69 FR 22240–44. Supervisors in traditionally blue collar industries were classified as white collar workers because their duties are generally managerial or administrative, and therefore they were not excluded as blue collar workers. Using the CPS variable indicating a respondent's hourly wage status, the Department determined that 79.9 million workers were paid on an hourly basis in 2017.<sup>172</sup>

Also excluded from further analysis were workers who were exempt under certain other (non-EAP) exemptions. Although some of these workers may also be exempt under the EAP exemptions, they would independently remain exempt from the minimum wage and/or overtime pay provisions based on the non-EAP exemptions. The Department excluded an estimated 4.9 million workers, including some agricultural and transportation workers, from further analysis because they would be subject to another (non-EAP) overtime exemption. *See* Appendix A: Methodology for Estimating Exemption Status, contained in the rulemaking docket, for details on how this population was identified.

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<sup>171</sup> GAO/HEHS. (1999). Fair Labor Standards Act: White Collar Exemptions in the Modern Work Place. GAO/HEHS-99-164, 40-41.

<sup>172</sup> CPS MORG variable PEERNHRY.

Agricultural and transportation workers are two of the largest groups of workers excluded from the population of potentially affected EAP workers in the current analysis, and with some exceptions, they were similarly excluded in 2004. The 2004 final rule excluded all workers in agricultural industries from the analysis,<sup>173</sup> while the current analysis, similar to the 2016 analysis, only excludes agricultural workers from specified occupational-industry combinations since not all workers in agricultural industries qualify for the agricultural overtime pay exemptions. The exclusion of transportation workers matched the method for the 2004 final rule. Transportation workers were defined as those who are subject to the following FLSA exemptions: section 13(b)(1), section 13(b)(2), section 13(b)(3), section 13(b)(6), or section 13(b)(10). The Department excluded 1.0 million agricultural workers and 2.1 million transportation workers from the analysis. In addition, the Department excluded another 1.8 million workers who fall within one or more other FLSA minimum wage and overtime exemptions. The criteria for determining exempt status for agricultural and transportation workers are detailed in Appendix A. However, of these 1.8 million workers, all but 23,700 are either blue collar or hourly, and thus the effect of excluding these workers is negligible.

#### v. Number of Potentially Affected EAP Workers

After excluding workers not subject to the Department's FLSA regulations and workers who are unlikely to be affected by this proposed rule (*i.e.*, blue collar workers, workers paid hourly, workers who are subject to another (non-EAP) overtime exemption), the Department estimated there would be 46.2 million salaried white collar workers for whom employers might claim either the standard EAP exemption or the HCE exemption. To be exempt under the standard EAP test, the employee must:

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<sup>173</sup> 69 FR 22197.

- be paid a predetermined and fixed salary that is not subject to reduction because of variations in the quality or quantity of work performed (the salary basis test);<sup>174</sup>
- earn at least a designated salary amount (the 2004 final rule set the salary level at \$455 per week (the standard salary level test)); and
- primarily perform exempt work, as defined by the regulations (the standard duties test).

The 2004 final rule's HCE test allows certain highly-paid employees to qualify for exemption as long as they customarily and regularly perform one or more exempt job duties. The HCE annual compensation level set in the 2004 final rule was \$100,000, including at least \$455 per week paid on a salary or fee basis. The CPS annual earnings variable is topcoded at \$150,000 (*i.e.*, workers earning above \$2,884.61 (\$150,000/52 weeks) per week are reported as earning \$2,884.61 per week). Topcoding helps protect respondent confidentiality. Because the proposed HCE salary level is close to the topcoded value, the Department imputed earnings for topcoded workers in the CPS data to adequately estimate affected workers when the HCE compensation level exceeds \$150,000.<sup>175,176</sup> Earnings were not imputed for previous rulemakings because the HCE salary level was significantly below the topcoded value.

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<sup>174</sup> Some computer employees may be exempt even if they are not paid on a salary basis. Hourly computer employees who earn at least \$27.63 per hour and perform certain duties are exempt under section 13(a)(17) of the FLSA. These workers are considered part of the EAP exemptions but were excluded from the analysis because they are paid hourly and will not be affected by this Proposed Rule (these workers were similarly excluded in the 2004 analysis). Salaried computer workers are exempt if they meet the salary and duties tests applicable to the EAP exemptions, and are included in the analysis since they will be impacted by this Proposed Rule. Additionally, administrative and professional employees may be paid on a fee basis, as opposed to a salary basis. § 541.605(a). Although, the CPS MORG does not identify workers paid on a fee basis, they are considered nonhourly workers in the CPS and consequently are correctly classified as "salaried" (as was done in the 2004 final rule).

<sup>175</sup> We used the standard Pareto distribution approach to impute earnings above the topcoded value as described in Armour, P. and Burkhauser, R. (2013). Using the Pareto Distribution to Improve Estimates of Topcoded Earnings. Center for Economic Studies (CES).

### Salary Basis

The Department included only nonhourly workers in the analysis based on CPS data.<sup>177</sup> For this rulemaking, the Department considered data representing compensation paid to nonhourly workers to be an appropriate proxy for compensation paid to salaried workers. The Department notes that it made the same assumption regarding nonhourly workers in the 2004 final rule.<sup>178</sup>

The CPS population of “nonhourly” workers includes workers who are paid on a piece-rate, a day-rate, or largely on bonuses or commissions. Data in the CPS are not available to distinguish between salaried workers and these other nonhourly workers. However, the Panel Study of Income Dynamics (PSID) provides additional information on how nonhourly workers are paid. In the PSID, respondents are asked how they are paid on their main job and are also asked for more detail if their response is other than salaried or hourly. Possible responses include piecework, commission, self-employed/farmer/profits, and by the job/day/mile. The Department analyzed the PSID data and found that relatively few nonhourly workers were paid by methods other than salaried. The Department is not aware of any statistically robust source that more closely reflects salary as defined in its regulations.

### Salary Level

Weekly earnings are available in the CPS MORG data, which allowed the Department to estimate how many nonhourly workers pass the salary level tests.<sup>179</sup> However, the CPS earnings variable does not perfectly reflect the Department’s definition of earnings. First, the CPS

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<sup>176</sup> Earnings exceeding the topcoded value only affect the analyses regarding potential updates.

<sup>177</sup> The CPS variable PEERNHRY identifies workers as either hourly or nonhourly.

<sup>178</sup> See 69 FR 22197.

<sup>179</sup> The CPS MORG variable PRERNWA, which measures weekly earnings, is used to identify weekly salary.

includes all nondiscretionary bonuses and commissions, which may be used to satisfy up to 10 percent of the new standard salary level under this proposed rule. This discrepancy between the earnings variable used and the FLSA definition of salary may cause a slight overestimation of the number of workers estimated to meet the standard salary level test. Second, CPS earnings data includes overtime pay, commissions, and tips. The Department notes that employers may factor into an employee's salary a premium for expected overtime hours worked. To the extent they do so, that premium would be reflected in the data. Similarly, the Department believes tips will be an uncommon form of payment for these workers since tips are uncommon for white collar workers. The Department also believes that commissions make up a relatively small share of earnings among nonhourly employees.<sup>180</sup>

#### Duties

The CPS MORG data do not capture information about job duties; therefore, the Department used occupational titles, combined with probability estimates of passing the duties test by occupational title, to estimate the number of workers passing the duties test. This methodology is very similar to the methodology used in the 2004 rulemaking, and the Department believes it is the best available methodology. In 2004, to determine whether a worker met the duties test, the Department used an analysis performed by WHD in 1998 in response to a request from the GAO. Because WHD enforces the FLSA's overtime requirements and regularly assesses workers' exempt status, WHD was uniquely qualified to provide the

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<sup>180</sup> In the PSID, relatively few nonhourly workers were paid by commission. Additionally, according to the BLS ECI, about 5 percent of the private workforce is incentive-paid workers (incentive pay is defined as payment that relates earnings to actual individual or group production). See William J. Wiatrowski, Bureau of Labor Statistics, *The Effect of Incentive Pay on Rates of Change in Wages and Salaries* (November 24, 2009), <http://www.bls.gov/opub/mlr/cwc/the-effect-of-incentive-pay-on-rates-of-change-in-wages-and-salaries.pdf>, at 1.

analysis. The analysis was used in both the GAO's 1999 white collar exemptions report<sup>181</sup> and the Department's 2004 regulatory impact analysis.<sup>182</sup>

WHD examined 499 occupational codes, excluding nine that were not relevant to the analysis for various reasons (one code was assigned to unemployed persons whose last job was in the Armed Forces, some codes were assigned to workers who are not FLSA covered, others had no observations). Of the remaining occupational codes, WHD determined that 251 occupational codes likely included EAP exempt workers and assigned one of four probability codes reflecting the estimated likelihood, expressed as ranges, that a worker in a specific occupation would perform duties required to meet the EAP duties tests. The Department supplemented this analysis in the 2004 final rule regulatory impact analysis when the HCE exemption was introduced. The Department modified the four probability codes for highly paid workers based upon our analysis of the provisions of the highly compensated test relative to the standard duties test (Table 3). To illustrate, WHD assigned exempt probability code 4 to the occupation "first-line supervisors/managers of construction trades and extraction workers" (Census code 6200), which indicates that a worker in this occupation has a 0 to 10 percent likelihood of meeting the standard EAP duties test. However, if that worker earned at least \$100,000 annually, he or she was assigned a 15 percent probability of passing the shorter HCE duties test.

The occupations identified in GAO's 1999 report and used by the Department in the 2004 final rule map to an earlier occupational classification scheme (the 1990 Census occupational codes). For this proposed rule, the Department used occupational crosswalks to map the previous

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<sup>181</sup> Fair Labor Standards Act: White Collar Exemptions in the Modern Work Place, *supra note* 171, at 40-41, <https://www.gao.gov/assets/230/228036.pdf>.

<sup>182</sup> See 69 FR 22198.

occupational codes to the 2002 Census occupational codes and then to the 2010 Census occupational codes, which are used in the CPS MORG 2015 through 2017 data.<sup>183</sup> If a new occupation comprises more than one previous occupation, then the new occupation's probability code is the weighted average of the previous occupations' probability codes, rounded to the closest probability code.

Table 3: Probability Worker in Category Passes the Duties Test

Probability Code	The Standard EAP Test		The HCE Test	
	Lower Bound	Upper Bound	Lower Bound	Upper Bound
0	0%	0%	0%	0%
1	90%	100%	100%	100%
2	50%	90%	94%	96%
3	10%	50%	58.4%	60%
4	0%	10%	15%	15%

These codes provide information on the likelihood that an employee in a category met the duties test but they do not identify the workers in the CPS MORG who actually passed the test. Therefore, the Department designated workers as exempt or nonexempt based on the probabilities. For example, for every ten public relations managers, between five and nine were estimated to pass the standard duties test (based on probability category 2). However, it is unknown which of these ten workers are exempt; therefore, the Department must determine the status for these workers. Exemption status could be randomly assigned with equal probability, but this would ignore the earnings of the worker as a factor in determining the probability of exemption. The probability of qualifying for the exemption increases with earnings because

<sup>183</sup> References to occupational codes in this analysis refer to the 2002 Census occupational codes. Crosswalks and methodology available at: <https://www.census.gov/topics/employment/industry-occupation/guidance/code-lists.html>.

higher paid workers are more likely to perform the required duties, an assumption to which both the Department in the 2004 final rule and the GAO in its 1999 Report adhered.<sup>184</sup>

The Department estimated the probability of exemption for each worker as a function of both earnings and the occupation's exempt probability category using a gamma distribution.<sup>185</sup> Based on these revised probabilities, each worker was assigned exempt or nonexempt status based on a random draw from a binomial distribution using the worker's revised probability as the probability of success. Thus, if this method is applied to ten workers who each have a 60 percent probability of being exempt, six workers would be expected to be designated as exempt.<sup>186</sup> However, which particular workers are designated as exempt may vary with each set of ten random draws. For details see Appendix A, (in the rulemaking docket).

The Department acknowledges that the probability codes used to determine the share of workers in an occupation who are EAP exempt are 21-years old. However, the Department believes the probability codes continue to estimate exemption status accurately given the fact that the standard duties test is not substantively different from the former short duties tests

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<sup>184</sup> For the standard exemption, the relationship between earnings and exemption status is not linear and is better represented with a gamma distribution. For the HCE exemption, the relationship between earnings and exemption can be well represented with a linear function because the relationship is linear at high salary levels (as determined by the Department in the 2004 final rule). Therefore, the gamma model and the linear model would produce similar results. See 69 FR 22204–08, 22215–16.

<sup>185</sup> The gamma distribution was chosen because, during the 2004 revision, this non-linear distribution best fit the data compared to the other non-linear distributions considered (*i.e.*, normal and lognormal). A gamma distribution is a general type of statistical distribution that is based on two parameters that control the scale (alpha) and shape (in this context, called the rate parameter, beta).

<sup>186</sup> A binominal distribution is frequently used for a dichotomous variable where there are two possible outcomes; for example, whether one owns a home (outcome of 1) or does not own a home (outcome of 0). Taking a random draw from a binomial distribution results in either a zero or a one based on a probability of “success” (outcome of 1). This methodology assigns exempt status to the appropriate share of workers without biasing the results with manual assignment.

reflected in the codes. For the 2016 rulemaking, the Department looked at O\*NET<sup>187</sup> to determine the extent to which the 1998 probability codes reflected current occupational duties. The Department's review of O\*NET verified the continued appropriateness of the 1998 probability codes.

#### Potentially Affected Exempt EAP Workers

The Department estimated that of the 46.2 million salaried white collar workers considered in the analysis, 31.9 million qualified for the EAP exemption under the current regulations. Some of these workers were excluded from further analysis because the proposed rule would not affect them. This excluded group contains workers in named occupations who are not required to pass the salary requirements (although they must still pass a duties test) and therefore whose exemption status does not depend on their earnings. These occupations include physicians (identified with Census occupation codes 3010, 3040, 3060, 3120), lawyers (2100), teachers (occupations 2200-2550 and industries 7860 or 7870), academic administrative personnel (school counselors (occupation 2000 and industries 7860 or 7870) and educational administrators (occupation 0230 and industries 7860 or 7870)), and outside sales workers (a subset of occupation 4950). Out of the 31.9 million workers who were EAP exempt, 7.6 million, or 23.9 percent, were expected to be in named occupations in 2017. Thus, changes in the standard salary level and HCE compensation tests would not affect these workers. The 24.3 million EAP exempt workers remaining in the analysis are referred to in this proposed rule as “potentially affected.”

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<sup>187</sup> The O\*NET database contains hundreds of standardized and occupation-specific descriptions. See <http://www.onetcenter.org>.

Based on analysis of the occupational codes and CPS earnings data (described above), the Department has concluded that in Year 1, in the baseline scenario in which the rule does not change, of the 24.3 million potentially affected EAP workers, approximately 15.8 million will pass only the standard EAP test, 8.2 million will pass both the standard and the HCE tests, and approximately 310,000 will pass only the HCE test.

### C. Determining the Revised Salary and Compensation Levels

For the reasons discussed in section IV.A.iii, the Department has decided to update the 2004 standard salary level by reapplying the 2004 methodology. Using pooled 2017 CPS MORG data, the 20th percentile of earnings for full-time salaried workers in the South and/or in the retail industry roughly corresponds to a standard salary level of \$641.<sup>188</sup> The proposed rule then inflates this standard salary level to January 2020 by applying 2.5 years of growth, calculated as the compound annual growth rate between a weekly salary level of \$455 (based on 2002 data) and a weekly salary level of \$641 (based on 2017 data) (2.31 percent).<sup>189</sup> Applying this rate to the \$641 salary level results in a January 2020 salary level of \$679.

For the HCE compensation level, the Department used 2017 CPS MORG data to ascertain the earnings for the 90th percentile of all full-time salaried workers (\$139,464),<sup>190</sup> which, when inflated to January 2020 using the compound annual growth rate between 2002 and

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<sup>188</sup> Excluding workers who are not subject to FLSA, not subject to the salary level test, or in some agriculture or transportation occupations.

<sup>189</sup> The standard salary level of \$641 per week was calculated from 2017 CPS MORG data that included the entire 2017 calendar year. Thus, the value reflects an average over the entire calendar year, and is best characterized as representing the salary level at the midpoint of 2017 (*i.e.*, July 1). Therefore, the Department inflated both the 2017 standard salary and HCE earnings levels 2.5 years to estimate the value for January 1, 2020.

<sup>190</sup> BLS. Available at: [https://www.bls.gov/cps/research\\_nonhourly\\_earnings\\_2017.htm](https://www.bls.gov/cps/research_nonhourly_earnings_2017.htm).

2017 in the HCE compensation level (2.24 percent), results in a proposed HCE annual compensation level of \$147,414.<sup>191</sup>

i. Rationale for the Methodologies Chosen

As explained in greater detail earlier in sections IV.A.iii and IV.D, upon further consideration, the Department believes that the earnings thresholds and methodology established in the 2004 final rule—*i.e.*, the \$455 per week standard salary level and the \$100,000 per year HCE total annual compensation requirement—were appropriate at the time they were adopted. Those thresholds have never been challenged in court, and their use promotes familiarity and stability. The Department accordingly believes that reapplying the 2004 method to update the salary levels set in 2004 to account for earnings growth in the intervening years is also appropriate. The Department proposes to use the same methodology used in 2004 for the standard salary level, setting it at the 20th percentile of full-time salaried workers in the South and/or in the retail sector nationally. The Department proposes to set the HCE total annual compensation requirement using the 2016 final rule methodology, *i.e.*, equivalent to the earnings of the 90th percentile of all full-time salaried workers nationally. The Department proposes to then inflate the salary levels to their anticipated value in January 2020.

As an alternative, the Department also considered setting the standard salary level by adjusting the 2004 earnings threshold levels for inflation, that is, a sustained increase in the general price level of goods and services over time that can undermine the effectiveness of the part 541 earnings thresholds. The Department considered using price indices such as the Personal Consumption Expenditures Price Index (PCEPI), the Consumer Price Index for All Urban

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<sup>191</sup> The Department used 2002 data to determine the 2004 HCE earnings level.

Consumers (CPI-U), and the Chained CPI-U; as well as a wage-based measure such as the Employment Cost Index (ECI).

The Department decided against using an index to adjust the 2004 salary level for inflation, because it is not as straightforward, consistent, or accurate as using current salary data. The Department believes that an approach that simply updates the 2004 methodology with current data is preferable to an entirely new methodology. Table 4 presents possible 2017 standard salary levels as calculated using each alternative approach considered:

- Alternative 0: Maintain the average minimum wage protection in place since 2004.
- Alternative 1: Inflate the 2004 weekly salary level using the PCEPI.
- Alternative 2: Inflate the 2004 weekly salary level using Chained CPI-U.
- Alternative 3: Inflate the 2004 weekly salary level using CPI-U.
- Alternative 4: Inflate the 2004 weekly salary level using the ECI for wages and salaries for civilian workers.
- Alternative 5: Inflate the 2004 weekly salary level using the ECI for wages and salaries for private sector workers.

Table 5 projects the selected 2017 standard salary level of \$641 to January 2020 using each of the inflation indices considered above.

Section VI.D details the transfers, costs, and benefits of the proposed new salary level and the above alternatives.

Table 4: Standard Salary Level and Alternatives in 2017

Alternative	2017 Salary Level (Weekly/Annually)	Total Increase [a]	
		\$	%
Alt. #0: Maintain average minimum wage protection	\$503 / \$26,156	\$48	10.5%

since 2004 [d]			
Alt. #1: Inflate 2004 level using PCEPI [b]	\$597 / \$31,044	\$142	31.2%
Alt. #2: Inflate 2004 level using Chained CPI [b]	\$599 / \$31,148	\$144	31.6%
Alt. #3: Inflate 2004 level using CPI-U [b]	\$620 / \$32,240	\$165	36.3%
Alt. #4: Inflate 2004 level using ECI civilian [b]	\$639 / \$33,228	\$184	40.4%
Proposed rule: 2004 method [c]	\$641 / \$33,332	\$186	40.9%
Alt. #5: Inflate 2004 level using ECI private [b]	\$643 / \$33,436	\$188	41.3%

[a] Change between salary level or alternative and the salary level set in 2004 (\$455 per week).

[b] Inflated using growth in the index from 2002 to 2017.

[c] Calculated using pooled 2015-2017 CPS MORG data.

[d] When the \$455 weekly threshold was established in 2004, the federal minimum wage was \$5.15, so the salary threshold was equivalent to the earnings of an employee working 72.2 hours at the minimum wage (including time-and-a-half for hours beyond the fortieth in a week). That amount fell with increases in the minimum wage and is now 55.2 hours. The weighted average across the 15 years since the overtime threshold was last changed is 59.6 hours, and a threshold that would provide 59.6 hours of \$7.25 minimum wage protection and overtime pay for hours over 40 would be \$503.

Table 5: Alternatives for Projecting the 2017 Earnings Levels to January 2020

Alternative	Standard Salary Level		HCE Level	
	January 2020 Levels	Annual Growth Rate	January 2020 Levels	Annual Growth Rate
Inflate 2017 levels using PCEPI	\$671	1.83%	\$145,919	1.83%
Inflate 2017 levels using Chained CPI-U	\$671	1.86%	\$146,023	1.86%
Inflate 2017 levels using CPI-U	\$675	2.08%	\$146,843	2.08%
Inflate 2017 levels using ECI civilian	\$678	2.29%	\$147,593	2.29%
Proposed rule: Inflate 2017 levels using growth in earnings levels	\$679	2.31%	\$147,414	2.24%
Inflate 2017 levels using ECI private	\$679	2.33%	\$147,742	2.33%

### iii. Methodology for the HCE Total Annual Compensation Level and Alternative Methods

For the reasons described above, the Department proposes to update the HCE compensation level using earnings for the 90th percentile of all full-time salaried workers nationally (\$139,464 in 2017), inflated to January 2020 by applying the average growth in the HCE compensation levels between 2002 and 2017 (2.24 percent annually). The proposed HCE compensation level is \$147,414 in January 2020.

The Department also evaluated the following alternative HCE compensation levels:

- HCE alternative 1: Leave the HCE compensation level unchanged at \$100,000 per year.
- HCE alternative 2: Inflate the 2004 level using the PCEPI.
- HCE alternative 3: Inflate the 2004 level using Chained CPI-U
- HCE alternative 4: Inflate the 2004 level using CPI-U.
- HCE alternative 5: Inflate the 2004 level using the ECI for wages and salaries for civilian workers.
- HCE alternative 6: Inflate the 2004 level using the ECI for wages and salaries for private sector workers.

Table 6 presents possible 2017 HCE levels as calculated using each alternative approach considered.

Table 6: HCE Compensation Levels and Alternatives in 2017

Alternative	Salary Level (Weekly/Annually)	Total Increase [a]	
		\$	%
HCE alt. #1: No change	\$1,923 / \$100,000	\$0	0.0%
HCE alt. #2: Inflate 2004 level using PCEPI [b]	\$2,523 / \$131,189	\$31,189	31.2%
HCE alt. #3: Inflate 2004 level using Chained CPI [b]	\$2,534 / \$131,750	\$31,750	31.8%
HCE alt. #4: Inflate 2004 level using CPI-U [b]	\$2,620 / \$136,253	\$36,253	36.3%
Proposed rule: 90th percentile of full-time salaried workers [c]	\$2,682 / \$139,464	\$39,464	39.5%
HCE alt. #5: Inflate 2004 level using ECI civilian	\$2,702 / \$140,480	\$40,480	40.5%
HCE alt. #6: Inflate 2004 level using ECI private	\$2,718 / \$141,337	\$41,337	41.3%

[a] Change between updated/alternative compensation level and the compensation level set in 2004 (\$100,000 annually).

[b] Inflated using growth in the index from 2002 to 2017.

[c] 2017 salary level available at: [https://www.bls.gov/cps/research\\_nonhourly\\_earnings\\_2017.htm](https://www.bls.gov/cps/research_nonhourly_earnings_2017.htm).

#### D. Effects of Revised Salary and Compensation Levels

##### i. Overview and Summary of Quantified Effects

The economic effects of increasing the EAP salary and compensation levels will depend on how employers respond. Employer response is expected to vary by the characteristics of the

affected EAP workers. Transfers from employers to employees and between employees, and direct employer costs depend on how employers respond to finalization of the proposed rule.

The Department anticipates that the proposed rule, once finalized, will become effective in 2020. Its proposed standard salary level is derived using the 2004 methodology, and the HCE compensation level is derived using the 2016 methodology, in both cases using 2017 CPS data, then projecting these levels to January 2020.

Given that the Department is using 2017 CPS MORG employment and earnings data—the most recent data available at the time of analysis—to estimate the economic effects of the proposed rule taking effect in 2020, and given that such data will change between now and 2020, there are two options to measure the economic effects of the proposed rule upon taking effect. One option would be to use the proposed standard salary and HCE total compensation levels and project the CPS MORG data forward to 2020. However, such a projection would add “noise” to the CPS MORG data, making an analysis using such projections less accurate. A second option would be to measure the economic effects of the proposed rule by using the most recent CPS MORG data to determine the 2017 standard salary and HCE compensation levels as if the rule were to be promulgated in 2017. The potential impacts of the rule are then assessed using 2017 population characteristics. When measuring the number of workers affected, using a 2017 salary level on the 2017 CPS MORG data is a good approximation of a 2020 level on the earnings data of workers in 2020, so the second option better reflects the economic effects of the proposed rule than the first option. Therefore, the Department chose to analyze the economic effects of a standard salary level of \$641 per week and an annual HCE compensation level of \$139,464 using 2017 CPS MORG data as the best representation of likely economic effects of the proposed

standard salary level of \$679 per week and an annual HCE compensation level of \$147,414 taking effect in 2020.

Table 7 presents the estimated number of affected workers, costs, and transfers associated with increasing the salary and compensation levels. The Department estimated that the direct employer costs of this proposed rule would total \$464.2 million in the first year, with 10-year annualized direct costs of \$112.6 million per year using a 3 percent real discount rate and \$120.5 million per year using a 7 percent real rate.

In addition to these direct costs, this proposed rule would transfer income from employers to employees. Year 1 transfers would equal \$526.9 million, with annualized transfers estimated at \$428.0 million and \$429.4 million per year using the 3-percent and 7-percent real discount rates, respectively. Potential employer costs due to reduced profits and additional hiring were not quantified but are discussed in section VI.D.iii.

Table 7: Summary of Affected Workers and Regulatory Costs and Transfers, Standard and HCE Earnings Thresholds

Impact [a]	Year 1	Future Years [b]		Annualized Value	
		Year 2	Year 10	3% Real Discount Rate	7% Real Discount Rate
Affected Workers (1000s)					
Standard	1,070	1,027	625	--	--
HCE	201	215	426	--	--
Total	1,271	1,241	1,051	--	--
Direct Employer Costs (Millions in 2017\$)					
Regulatory familiarization	\$324.9	\$0.0	\$0.0	\$37.0	\$43.2
Adjustment [c]	\$66.6	\$1.5	\$3.6	\$10.0	\$11.2
Managerial	\$72.7	\$72.7	\$64.2	\$65.6	\$66.0
Total direct costs [d]	\$464.2	\$74.2	\$67.8	\$112.6	\$120.5
Transfers from Employers to Workers (Millions in 2017\$) [e]					
Due to minimum wage	\$57.0	\$30.4	\$17.6	\$27.7	\$28.6
Due to overtime pay	\$469.9	\$390.9	\$429.5	\$400.3	\$400.7
Total transfers [d]	\$526.9	\$421.3	\$447.1	\$428.0	\$429.4

[a] Additional costs and benefits of the rule that could not be quantified or monetized are discussed in the text.

[b] These costs/transfers represent a range over the nine-year span.

[c] Adjustment costs occur in all years when there are newly affected workers. Adjustment costs may occur in years without updated earnings thresholds because some workers' projected earnings are estimated using negative earnings growth.

[d] Components may not add to total due to rounding.

[e] This is the net transfer from employers to workers. There may also be transfers between workers.

## ii. Affected EAP Workers

### 1. Overview

The Department estimated there are 24.3 million potentially affected EAP workers—that is, EAP workers who either (1) passed the salary basis test, the standard salary level test, and the standard duties test, or (2) passed the salary basis test, the standard salary level test, the HCE total compensation level test, and the HCE duties test (but not the standard duties test). This number excluded workers in named occupations, who are not subject to the salary tests, or those who qualify for another (non-EAP) exemption.

Using the proposed method described above, the Department estimated that if the rule were promulgated today, the standard salary level would increase from \$455 per week to \$641 per week and would affect 1.1 million exempt workers in Year 1 (Figure 2).<sup>192</sup> Based on currently available data, the Department projects that if the final rule becomes effective in 2020, the standard salary level will be \$679 per week. The Department also estimated that the HCE annual compensation level would increase from \$100,000 to \$139,464 if the rule went into effect today, and 201,100 workers would be affected in Year 1 (the number of workers who earn at least \$100,000 but less than \$139,464 and pass the minimal HCE duties test but not the standard

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<sup>192</sup> This group includes workers who may currently be nonexempt under more protective state EAP laws and regulations, such as some workers in Alaska, California, and New York.

duties test).<sup>193</sup> The Department projects that if the final rule takes effect in 2020, the HCE compensation level will be \$147,414. In total, the Department expects that 1.3 million workers will be affected in Year 1 by the proposed earnings threshold increases, composing about 5.2 percent of the pool of potentially affected EAP workers.

Figure 2: Number of Affected Workers in Year 1

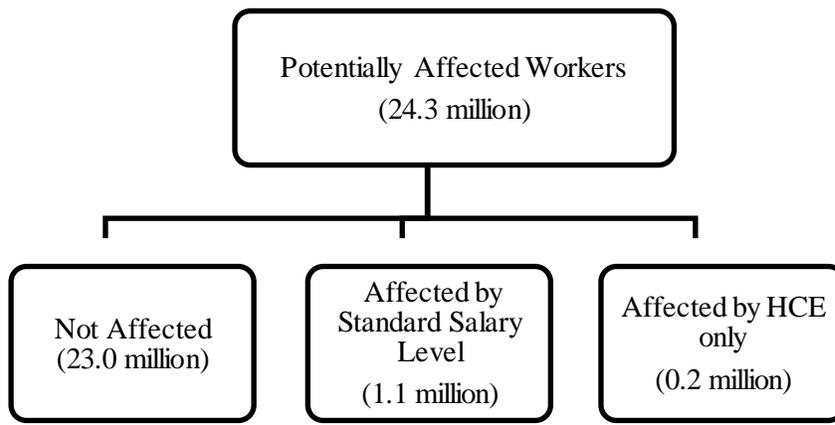


Table 8 presents the number of affected EAP workers, the mean number of overtime hours they work per week, and their average weekly earnings. The 1.1 million workers affected by the increase in the standard salary level work on average 1.6 usual hours of overtime per week and earn on average \$564 per week.<sup>194</sup> However, the majority of these workers (about 86 percent) work zero usual hours of overtime. The 14 percent of affected workers who regularly work overtime average 11.4 hours of overtime per week. The 201,100 EAP workers affected by the change in the HCE compensation level average 4.9 hours of overtime per week and earn an

<sup>193</sup> The 2016 final rule applied joint probabilities to estimate the number of affected HCE workers (*i.e.*, the number of HCE workers who pass the HCE duties test but fail the standard duties test). In order to provide a more accurate estimate, this NPRM applies conditional probabilities to determine the number of affected HCE workers.

<sup>194</sup> CPS defines “usual hours” as hours worked 50 percent or more of the time.

average of \$2,179 per week (\$113,327 per year). About 60 percent of these workers work zero usual hours of overtime while the 40 percent who work usual hours of overtime average 12.4 hours of overtime per week.

Although most affected EAP workers who typically do not work overtime are unlikely to experience significant changes in their daily work routine, those who regularly work overtime may experience significant changes. Moreover, affected EAP workers who routinely work overtime and earn less than the minimum wage are most likely to experience significant changes because of the revised standard salary level.<sup>195</sup> Employers might respond by paying overtime premiums; reducing or eliminating overtime hours; reducing employees' regular wage rates (provided that the reduced rates still exceed the minimum wage); increasing employees' salary to the updated salary level to preserve their exempt status (although this will be less common for affected workers earning below the minimum wage); or using some combination of these responses.

Table 8: Number of Affected EAP Workers, Mean Overtime Hours, and Mean Weekly Earnings, Year 1

Type of Affected EAP Worker	Affected EAP Workers [a]		Mean Overtime Hours	Mean Usual Weekly Earnings
	Number (1,000s)	% of Total		
Standard Salary Level				
All affected EAP workers	1,070	100%	1.6	\$564
Earn less than the minimum wage [b]	15	1.4%	24.1	\$516
Regularly work overtime	152	14.2%	11.4	\$562
CPS occasionally work overtime [c]	41	3.8%	8.2	\$566
HCE Compensation Level				

<sup>195</sup> A small proportion (1.4 percent) of affected EAP workers earn implicit hourly wages that are less than the applicable minimum wage (the higher of the state or federal minimum wage). The implicit hourly wage is calculated as an affected EAP employee's total weekly earnings divided by total weekly hours worked. For example, workers earning the currently enforced \$455 per week standard salary level would earn less than the federal minimum wage if they work 63 or more hours in a week ( $\$455 / 63 \text{ hours} = \$7.22 \text{ per hour}$ ).

All affected EAP workers	201	100%	4.9	\$2,179
Earn less than the minimum wage [b]	--	--	--	--
Regularly work overtime	80	39.8%	12.4	\$2,198
CPS occasionally work overtime [c]	10	4.9%	9.3	\$2,140

Note: Pooled data for 2015-2017 adjusted to reflect 2017.

[a] Estimated number of workers exempt under the EAP exemptions who would be entitled to overtime protection under the updated salary levels (if their weekly earnings do not increase to the new salary levels).

[b] The applicable minimum wage is the higher of the federal minimum wage and the state minimum wage. HCE workers will not be affected by the minimum wage provision. These workers all regularly work overtime and are also included in that row.

[c] Workers who do not usually work overtime but did in the CPS reference week. Mean overtime hours are actual overtime hours in the reference week. Other workers may occasionally work overtime in other weeks. These workers are identified later.

The Department considered two types of overtime workers in this analysis: regular overtime workers and occasional overtime workers.<sup>196</sup> Regular overtime workers typically worked more than 40 hours per week. Occasional overtime workers typically worked 40 hours or less per week, but they worked more than 40 hours in the week they were surveyed. The Department considered these two populations separately in the analysis because labor market responses to overtime pay requirements may differ for these two types of workers.

In a representative week, the increases in the standard salary level and the HCE compensation level affected an estimated 51,000 occasional overtime workers (4.0 percent of all affected EAP workers). They averaged 8.4 hours of overtime in the weeks they worked overtime. This group represents the number of workers with occasional overtime hours in the week the CPS MORG survey was conducted. Because the survey week is a representative week, the Department believes the prevalence of occasional overtime in the survey week, and the

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<sup>196</sup> Regular overtime workers were identified in the CPS MORG with variable PEHRUSL1. Occasional overtime workers were identified with variables PEHRUSL1 and PEHRACT1.

characteristics of these workers, is representative of other weeks (even though a different group of workers would be identified as occasional overtime workers in a different week).

## 2. Characteristics of Affected EAP Workers

In this section, the Department examined the characteristics of EAP workers whom the proposed rule would affect. Table 9 presents the distribution of affected EAP workers by industry and occupation, using Census industry and occupation codes. The industry with the most affected EAP workers would be education and health services (293,000), while the industry with the highest percentage of affected EAP workers would be leisure and hospitality (about 10 percent). The occupation category with the most affected EAP workers would be management, business, and financial (484,000), while the occupation category with the highest percentage of affected EAP workers would be in services (about 14 percent).

Finally, approximately 7 percent of potentially affected workers in private nonprofits would be affected compared with about 5 percent in private for-profit firms. However, as discussed in section VI.B.iii, our estimates of workers subject to the FLSA include workers employed by enterprises that do not meet the enterprise coverage requirements because there is no reliable way of estimating that population. Although failing to exclude workers who work for non-covered enterprises would only affect a small percentage of workers generally, it may have a larger effect (and result in a larger overestimate) for workers in nonprofits because when determining enterprise coverage only revenue derived from business operations, not charitable activities, is included.

Table 9: Estimated Number of Exempt Workers with the Current and Updated Salary Levels, by Industry and Occupation, Year 1

Industry / Occupation / Nonprofit	Workers subject to FLSA (Millions)	Potentially Affected EAP Workers (Millions) [a]	Not-Affected (Millions) [b]	Affected (Millions) [c]	Affected as Share of Potentially Affected
Total	135.92	24.29	23.02	1.27	5.2%
By Industry [d]					
Agriculture, forestry, fishing, & hunting	1.28	0.04	0.04	0.00	5.7%
Mining	0.81	0.21	0.20	0.01	2.7%
Construction	7.92	0.91	0.88	0.04	4.2%
Manufacturing	15.34	3.50	3.39	0.11	3.1%
Wholesale & retail trade	19.18	2.55	2.37	0.18	6.9%
Transportation & utilities	7.30	0.88	0.84	0.05	5.3%
Information	2.73	0.95	0.90	0.05	5.2%
Financial activities	9.46	3.65	3.48	0.17	4.6%
Professional & business services	15.02	5.24	5.05	0.19	3.7%
Education & health services	33.26	3.98	3.69	0.293	7.4%
Leisure & hospitality	12.96	0.86	0.78	0.08	9.5%
Other services	5.44	0.61	0.56	0.05	8.5%
Public administration	5.24	0.90	0.84	0.05	6.1%
By Occupation [d]					
Management, business, & financial	20.29	12.23	11.75	0.48	4.0%
Professional & related Services	31.48	8.34	7.93	0.41	4.9%
Sales and related	23.71	0.20	0.18	0.03	14.5%
Office & administrative support	13.77	2.34	2.13	0.21	9.0%
Office & administrative support	17.72	0.96	0.84	0.12	12.3%
Farming, fishing, & forestry	0.96	0.00	0.00	0.00	0.0%
Construction & extraction	6.41	0.02	0.02	0.00	6.8%
Installation, maintenance, & repair	4.58	0.04	0.04	0.00	7.5%
Production	8.43	0.10	0.09	0.01	8.0%
Transportation & material moving	8.57	0.04	0.03	0.01	13.3%
By Nonprofit and Government Status					
Nonprofit, private	9.46	1.93	1.80	0.13	6.6%
For profit, private	107.97	20.36	19.35	1.01	5.0%
Government (state, local, and	18.49	2.00	1.86	0.13	6.6%

federal)					
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Note: Pooled data for 2015-2017 adjusted to reflect 2017.

[a] Exempt workers who are white collar, salaried, not eligible for another (non-EAP) overtime exemption, and not in a named occupation.

[b] Workers who continue to be exempt after the increases in the salary levels (assuming affected workers' weekly earnings do not increase to the new salary level).

[c] Estimated number of workers exempt under the EAP exemptions who would be entitled to overtime protection under the updated salary levels (if their weekly earnings do not increase to the new salary levels).

[d] Census industry and occupation categories.

Table 10 presents the distribution of affected EAP workers based on Census Regions and divisions, and metropolitan statistical area (MSA) status. The region with the most affected workers would be the South (544,000), but the South's percentage of affected workers is similar to other regions (6.4 percent as compared to 4.4 to 5.0 percent elsewhere). Although 89 percent of affected EAP workers would reside in MSAs (1.14 of 1.27 million), so do a corresponding 88 percent of all workers subject to the FLSA.<sup>197</sup>

Employers in low-wage industries, regions, and non-metropolitan areas may be more affected because they typically pay lower wages and salaries. However, the Department believes the salary level adopted in this proposed rule is appropriate for these lower-wage sectors because the methodology used in 2004, and applied for this rulemaking, used earnings data in the low-wage retail industry and the low-wage Southern region. Effects by region and industry are considered in section VI.D.vi.

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<sup>197</sup> Identified with CPS MORG variable GTMETSTA.

Table 10: Estimated Number of Potentially Affected EAP Workers with the Current and Updated Salary Levels, by Region, Division, and MSA Status, Year 1

Region / Division / Metropolitan Status	Workers subject to FLSA (Millions)	Potentially Affected EAP Workers (Millions) [a]	Not-Affected (Millions) [b]	Affected (Millions) [c]	Affected as Share of Potentially Affected
Total	135.92	24.29	23.02	1.27	5.2%
By Region / Division					
<u>Northeast</u>	<u>24.99</u>	<u>5.09</u>	<u>4.86</u>	<u>0.23</u>	<u>4.4%</u>
New England	6.81	1.46	1.40	0.06	3.9%
Middle Atlantic	18.18	3.63	3.46	0.17	4.7%
<u>Midwest</u>	<u>30.05</u>	<u>5.03</u>	<u>4.78</u>	<u>0.25</u>	<u>5.0%</u>
East North Central	20.38	3.43	3.26	0.17	5.0%
West North Central	9.67	1.60	1.51	0.08	5.0%
<u>South</u>	<u>49.36</u>	<u>8.53</u>	<u>7.99</u>	<u>0.54</u>	<u>6.4%</u>
South Atlantic	25.88	4.80	4.49	0.31	6.4%
East South Central	7.38	0.99	0.92	0.07	7.5%
West South Central	16.10	2.74	2.58	0.16	6.0%
<u>West</u>	<u>31.52</u>	<u>5.64</u>	<u>5.39</u>	<u>0.25</u>	<u>4.5%</u>
Mountain	9.93	1.66	1.57	0.09	5.3%
Pacific	21.59	3.98	3.82	0.16	4.1%
By Metropolitan Status					
Metropolitan	118.99	22.66	21.53	1.14	5.0%
Non-metropolitan	15.94	1.52	1.40	0.13	8.3%
Not identified	0.99	0.10	0.09	0.01	8.9%

Note: Pooled data for 2015-2017 adjusted to reflect 2017.

[a] Exempt workers who are white collar, salaried, not eligible for another (non-EAP) overtime exemption, and not in a named occupation.

[b] Workers who continue to be exempt after the increases in the salary levels (assuming affected workers' weekly earnings do not increase to the new salary level).

[c] Estimated number of workers exempt under the EAP exemptions who would be entitled to overtime protection under the updated salary levels (if their weekly earnings do not increase to the new salary levels).

### iii. Costs

#### 1. Summary

The Department quantified three direct costs to employers in this analysis: (1) regulatory familiarization costs; (2) adjustment costs; and (3) managerial costs. The Department estimated costs for Year 1 assuming that the rule will go into effect in 2020 (Table 11). The Department estimated that in Year 1, regulatory familiarization costs would be \$324.9 million, adjustment costs would be \$66.6 million, and managerial costs would be \$72.7 million. Total direct employer costs in Year 1 would be \$464.2 million.

Table 11: Summary of Year 1 Direct Employer Costs (Millions)

Direct Employer Costs	Standard Salary Level	HCE Compensation Level	Total
Regulatory familiarization [a]	--	--	\$324.9
Adjustment	\$56.1	\$10.5	\$66.6
Managerial	\$55.4	\$17.3	\$72.7
Total direct costs	\$111.4	\$27.9	\$464.2

[a] Regulatory familiarization costs are assessed jointly for the change in the standard salary level and the HCE compensation level.

Adjustment costs and management costs are recurring, so we also projected them for years 2 through 10 in section VI.D.viii. The Department discusses costs that are not quantified in section VI.D.iii.5.

#### 2. Regulatory Familiarization Costs

Changing the standard salary level and the HCE total compensation level will impose direct costs on firms by requiring them to review the regulation. To estimate these “regulatory familiarization costs,” three pieces of information must be estimated: (1) the number of affected establishments; (2) a wage level for the employees reviewing the rule; and (3) the amount of time employees spend reviewing the rule.

It is unclear whether regulatory familiarization costs are a function of the number of establishments or the number of firms. To avoid underestimating these costs, the Department assumed that regulatory familiarization occurs at a decentralized level and used the number of establishments in its cost estimate; this results in a higher estimate than would result from using the number of firms. The most recent data on private sector establishments at the time this NPRM was drafted are from the 2015 Statistics of U.S. Businesses (SUSB), which reports 7.66 million establishments with paid employees.<sup>198</sup> Additionally, there were an estimated 90,106 state and local governments in 2012, the most recent data available.<sup>199</sup> We thus estimated 7.75 million establishments altogether.

The Department believes that all establishments will incur some regulatory familiarization costs, even if they do not employ exempt workers, because all establishments will need to confirm whether this proposed rule includes any provisions that may affect their employees. Firms with more affected EAP workers will likely spend more time reviewing the regulation than firms with fewer or no affected EAP workers (since a careful reading of the regulation will probably follow the initial decision that the firm is affected). However, the Department did not know the distribution of affected EAP workers across firms, so it used an average cost per establishment.

The Department believes one hour per establishment is appropriate because the EAP exemptions have existed in one form or another since 1938. The most significant change proposed by this rulemaking is setting a new standard salary level for exempt workers, and the proposed changed regulatory text is only a few pages. The Department thus believes that one

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<sup>198</sup> Statistics of U.S. Businesses 2015, <https://www.census.gov/programs-surveys/susb.html>.

<sup>199</sup> 2012 Census of Governments: Government Organization Summary Report, [http://www2.census.gov/govs/co/g12\\_org.pdf](http://www2.census.gov/govs/co/g12_org.pdf).

hour is an appropriate average estimate for the time each establishment will spend reviewing the changes made by this rulemaking. Time spent to implement the necessary changes was included in adjustment costs. The Department invites comments and data on the time required for regulatory familiarization.

The Department's analysis assumed that mid-level human resource workers with a median wage of \$25.64 per hour will review the proposed rule.<sup>200</sup> The Department also assumed that benefits are paid at a rate of 46 percent of the base wage<sup>201</sup> and overhead costs are paid at a rate of 17 percent of the base wage,<sup>202</sup> resulting in an hourly rate of \$41.91. The Department thus estimates regulatory familiarization costs in Year 1 would be \$324.9 million ( $\$41.91 \text{ per hour} \times 1 \text{ hour} \times 7.75 \text{ million establishments}$ ).<sup>203</sup>

### 3. Adjustment Costs

Changes in the standard salary level and HCE compensation level would also impose direct costs on firms by requiring them to evaluate the exemption status of employees, update

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<sup>200</sup> The median wage in the pooled 2017 CPS data for workers with the Census 2010 occupations "human resources workers" (0630); "compensation, benefits, and job analysis specialists" (0640); and "training and development specialists" (0650). The Department determined these occupations include most of the workers who would conduct these tasks. *See* Bureau of Labor Statistics, U.S. Department of Labor, Occupational Outlook Handbook.

<sup>201</sup> The benefits-earnings ratio is derived from the BLS's Employer Costs for Employee Compensation data using variables CMU1020000000000D and CMU1030000000000D. This fringe benefit rate includes some fixed costs such as health insurance.

<sup>202</sup> The Department believes that the overhead costs associated with this rule are small because existing systems maintained by employers to track currently hourly employees can be used for newly overtime eligible workers. However, acknowledging that there might be additional overhead costs, we have included an overhead rate of 17 percent. Because the 2016 final rule did not include overhead costs in its cost and transfer estimates, estimated costs and transfers associated with the 2016 final rule have been recalculated for comparison purposes in section VI.D.ix.

<sup>203</sup> As previously noted, the Department used the number of establishments rather than the number of firms, which results in a higher estimate of the regulatory familiarization cost. Using the number of firms, 6.0 million, would result in a reduced regulatory familiarization cost estimate of \$251.1 million in Year 1.

and adapt overtime policies, notify employees of policy changes, and adjust their payroll systems.<sup>204</sup> The Department believes the size of these “adjustment costs” will depend on the number of affected EAP workers and will occur in any year when exemption status is changed for any workers. To estimate adjustment costs, three pieces of information must be estimated: (1) a wage level for the employees making the adjustments; (2) the amount of time spent making the adjustments; and (3) the estimated number of newly affected EAP workers. The Department again estimated that the average wage with benefits and overhead costs for a mid-level human resource worker would be \$41.91 per hour (as explained above).

The Department estimated that it will take establishments an average of 75 minutes per affected worker to make the necessary adjustments. Little applicable data were identified from which to estimate the amount of time required to make these adjustments.<sup>205</sup> Therefore, the Department used the estimate of 1.25 hours from the 2016 final rule after reviewing public comments on the 2015 NPRM. The estimated number of affected EAP workers in Year 1 is 1.3 million (as discussed in section VI.D.ii). Therefore, total Year 1 adjustment costs would be \$66.6 million ( $\$41.91 \times 1.25 \text{ hours} \times 1.3 \text{ million workers}$ ).

A reduction in the cost to employers of determining employees’ exempt status may partially offset adjustment costs. Currently, to determine whether an employee is exempt, employers must apply the duties test to salaried workers who earn at least \$455 per week. If

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<sup>204</sup> While some companies may need to reconfigure information technology systems to include both exempt and overtime-protected workers, the Department notes that most organizations affected by the rule already employ overtime-eligible workers and have in place payroll systems and personnel practices (*e.g.*, requiring advance authorization for overtime hours) so that additional costs associated with the rule should be relatively small in the short run.

<sup>205</sup> Costs from the 2004 final rule were considered, but because that revision included changes to the duties test, the cost estimates are not directly applicable; in addition, the 2004 final rule did not separately account for managerial costs. The 2015 NPRM separately accounted for managerial costs. Some commenters responded with higher time estimates, but these estimates were not substantiated with data or were considered excessive.

finalized as proposed, firms will no longer be required to apply the potentially time-consuming duties test to employees earning less than the proposed standard salary level. This will be a clear cost savings to employers for the approximately 3.6 million salaried employees (2.0 million in white collar occupations and 1.6 million in blue collar occupations) who do not pass the duties test and earn at least \$455 per week but less than the updated salary level. The Department did not estimate the potential size of this cost savings.

#### 4. Managerial Costs

If employers reclassify employees as overtime-eligible due to the changes in the salary levels, then firms may incur ongoing managerial costs because the employer may spend more time developing work schedules and closely monitoring an employee's hours to minimize or avoid overtime. For example, the manager of a reclassified worker may have to assess whether the marginal benefit of scheduling the worker for more than 40 hours exceeds the marginal cost of paying the overtime premium. Additionally, the manager may have to spend more time monitoring the employee's work and productivity since the marginal cost of employing the worker per hour has increased. Unlike regulatory familiarization and adjustment costs, which occur primarily in Year 1, managerial costs are incurred more uniformly every year.

There was little precedent or data to aid in evaluating these costs. With the exception of the 2016 rulemaking, prior part 541 rulemakings did not estimate managerial costs. The Department likewise found no estimates of managerial costs after reviewing the literature. We thus used the same methodology as the 2016 final rule, which the Department adopted after considering comments on the 2015 NPRM.

The Department applied managerial costs to workers who (1) are reclassified as nonexempt, overtime-protected and (2) either regularly work overtime or occasionally work

overtime, but on a predictable basis—an estimated 344,300 workers (see Table 14 and accompanying explanation). The Department estimated these costs assuming that management spends an additional five minutes per week scheduling and monitoring each affected worker expected to be reclassified as nonexempt, overtime-eligible as a result of this rule, and whose hours are adjusted. As discussed in detail below, most affected workers do not currently work overtime, and there is no reason to expect their hours worked to change when their status changes from exempt to nonexempt. For that group of workers, management will have little or no need to increase their monitoring of hours worked; therefore, these workers are not included in the managerial cost calculation. Under these assumptions, the additional managerial hours worked per week would be 28,700 hours ((5 minutes/60 minutes) × 344,300 workers).

The median hourly wage in 2017 for a manager was \$29.81 and benefits were estimated to be paid at a rate of 46 percent of the base wage.<sup>206</sup> Together with the 17 percent overhead costs used for this analysis, this totals \$48.72 per hour. Thus, the Year 1 managerial costs would total \$72.7 million (28,700 hours/week × 52 weeks × \$48.72/hour). Although the exact magnitude would vary with the number of affected EAP workers each year, employers would incur managerial costs annually.

The Department believes that most companies already manage a mix of exempt and nonexempt employees and have policies and recordkeeping systems in place for nonexempt employees. Thus, most companies would be unlikely to purchase systems or hire additional monitoring personnel as a result of this rulemaking. Moreover, this rulemaking would not impose any new recordkeeping requirements.

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<sup>206</sup> Calculated as the projected median wage in the CPS for workers in management occupations (excluding chief executives) in 2015-2017, adjusted to reflect 2017. The adjustment ratio is derived from the BLS' Employer Costs for Employee Compensation data using variables CMU1020000000000D and CMU1030000000000D.

## 5. Other Potential Costs

In addition to the costs discussed above, the proposed rule may impose additional costs that have not been quantified. These costs are discussed qualitatively below, but we note that in some cases (e.g., schedule flexibility, salaried status) these costs may directly affect workers' wages because they face a tradeoff in the labor market between cash wages and the nonpecuniary aspects of jobs.<sup>207</sup>

### Reduced Scheduling Flexibility

Exempt workers may enjoy more scheduling flexibility because their hours are less likely to be monitored than nonexempt workers. If so, the proposed rule could impose costs on newly nonexempt, overtime-eligible workers by, for example, limiting their ability to adjust their schedules to meet personal and family obligations. But the proposed rule does not require employers to reduce scheduling flexibility. Employers can continue to offer flexible schedules and require workers to monitor their own hours and to follow the employers' timekeeping rules. Additionally, some exempt workers already monitor their hours for billing purposes. For these reasons, and because there is little data or literature on these costs, the Department did not quantify potential costs regarding scheduling flexibility.

### Preference for Salaried Status

Some of the workers that become nonexempt as a result of the proposed rule and are changed by their employer from salaried to hourly status may have preferred to remain salaried. Research has shown that salaried workers are more likely than hourly workers to receive benefits

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<sup>207</sup> See, e.g., Ashenfelter, O. & Layard, R. (1986). Handbook of Labor Economics. Volume 1. 641–92. <https://www.sciencedirect.com/science/article/abs/pii/S1573446386010155>.

such as paid vacation time and health insurance,<sup>208</sup> and are more satisfied with their benefits.<sup>209</sup> Additionally, when employer demand for labor decreases, hourly workers tend to see their hours cut before salaried workers, making earnings for hourly workers less predictable.<sup>210</sup> However, this literature generally does not control for differences between salaried and hourly workers such as education, job title, or earnings; therefore, this correlation is not necessarily attributable to hourly status.

If workers are reclassified as hourly, and hourly workers have fewer benefits than salaried workers, this could reduce workers' benefits. But the Department notes that this rule does not require such reclassification. These workers may continue to be paid a salary, as long as that salary is equivalent to a base wage at least equal to the minimum wage rate for every hour worked, and the employee receives a 50 percent premium on that base wage for any overtime hours each week.<sup>211</sup>

### Quality of Services

To the extent that employers respond to this rule by restricting employee work hours, this rulemaking could negatively affect the quality of public services provided by local governments and nonprofits. However, the Department believes the effect of the rule on public services will be small. The Department acknowledges that some employees who work overtime providing

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<sup>208</sup> Lambert, S. J. (2007). Making a Difference for Hourly Employees. In A. Booth, & A. C. Crouter, Work-Life Policies that Make a Real Difference for Individuals, Families, and Communities. Washington, D.C.: Urban Institute Press.

<sup>209</sup> Balkin, D. B., & Griffeth, R. W. (1993). The Determinants of Employee Benefits Satisfaction. Journal of Business and Psychology, 7(3), 323-339.

<sup>210</sup> Lambert, S. J., & Henly, J. R. (2009). Scheduling in Hourly Jobs: Promising Practices for the Twenty-First Century Economy. The Mobility Agenda. Lambert, S. J. (2007). Making a Difference for Hourly Employees. In A. Booth, & A. C. Crouter, Work-Life Policies that Make a Real Difference for Individuals, Families, and Communities. Washington, D.C.: Urban Institute Press.

<sup>211</sup> §§ 778.113–.114.

public services may see a reduction in hours as an effect of the rulemaking. But if the services are in demand, the Department believes additional workers may be hired, as funding availability allows, to make up some of these hours, and productivity increases may offset some reduction in services. In addition, the Department expects many employers will adjust base wages downward to some degree so that even after paying the overtime premium, overall pay and hours of work for many employees will be relatively minimally impacted. Additionally, as noted above, many nonprofits are non-covered enterprises because when determining enterprise coverage only revenue derived from business operations, not charitable activities, are included.

### Increased Prices

Business firms may pass along increased labor costs to consumers through higher prices. The Department anticipates that some firms may offset part of the additional labor costs through charging higher prices for the firms' goods and services. However, because costs and transfers are, on average, small relative to payroll and revenues, the Department does not expect the proposed rule to have a significant effect on prices. The Department estimated that, on average, costs and transfers make up less than 0.02 percent of payroll and less than 0.003 percent of revenues, although for specific industries and firms this percentage may be larger. Therefore, any potential change in prices would be modest. Further, any significant price increases would not represent a separate category of effects from those estimated in this economic analysis; rather, such price increases (where they occur) would be the channel through which consumers, rather than employers or employees, bear rule-induced costs (including transfers).

### Reduced Profits

The increase in workers' earnings resulting from the revised salary level is a transfer of income from firms to workers, not a cost. The Department acknowledges that the increased

employer costs and transfer payments as a result of this proposed rule may reduce the profits of business firms, although (1) some firms may offset some of these costs and transfers by making payroll adjustments, and (2) some firms may mitigate their reduced profits due to these costs and transfers through increased prices.<sup>212</sup> To the extent that the proposed rule would reduce profits at business firms after all these adjustments are made, these firms would have marginally lower after-tax returns on new investments in equipment, structures, and intellectual property and would therefore make fewer such investments going forward. All else equal, less business investment slows economic growth and reduces employment. However, the Department expects that any anti-growth effects of the proposed rule would be minimal.

#### Hiring Costs

To the extent that firms respond to an update to the salary level test by reducing overtime, they may do so by spreading hours to other workers, including current workers employed for less than 40 hours per week by that employer, current workers who retain their exempt status, and newly hired workers. If new workers are hired to absorb these transferred hours, then the associated hiring costs are a cost of this proposed rule.

#### iv. Transfers

##### 1. Overview

Transfer payments occur when income is redistributed from one party to another. The Department has quantified two transfers from employers to employees that would likely result from the proposed rule: (1) transfers to ensure compliance with the FLSA minimum wage provision; and (2) transfers to ensure compliance with the FLSA overtime pay provision.

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<sup>212</sup> Because costs and transfers compose on average less than 0.003 percent of revenues, the Department expects any such price increases to be minor.

Transfers in Year 1 due to the minimum wage provision were estimated to be \$57.0 million. The increase in the HCE compensation level does not affect minimum wage transfers because workers eligible for the HCE exemption earn well above the minimum wage. Transfers due to the overtime pay provision would be \$469.9 million: \$195.5 million from the increased standard salary level and \$274.3 million from the increased HCE compensation level. Total Year 1 transfers would be \$526.9 million (Table 12).

Table 12: Summary of Year 1 Regulatory Transfers (Millions)

Transfer from Employers to Workers	Standard Salary Level	HCE Compensation Level	Total
Due to minimum wage	\$57.0	\$0.0	\$57.0
Due to overtime pay	\$195.5	\$274.3	\$469.9
Total transfers	\$252.5	\$274.3	\$526.9

Because the overtime premium depends on the base wage, the estimates of minimum wage transfers and overtime transfers are linked. This can be considered a two-step approach. The Department first identified affected EAP workers with an implicit regular hourly wage lower than the minimum wage, and then calculated the wage increase necessary to reach the minimum wage.

## 2. Transfers Due to the Minimum Wage Provision

For purposes of this analysis, the hourly rate of pay was calculated as usual weekly earnings divided by usual weekly hours worked. To earn less than the federal or state minimum wage, this set of workers must work many hours per week. For example, a worker paid \$455 per week must work 62.8 hours to earn less than the federal minimum wage of \$7.25 per hour

(\$455/\$7.25 = 62.8).<sup>213</sup> The applicable minimum wage is the higher of the federal minimum wage and the state minimum wage as of January 1, 2017. Most affected EAP workers already receive at least the minimum wage; only an estimated 1.4 percent of them (15,100 in total) earn an implicit hourly rate of pay less than the minimum wage. The Department estimated transfers due to payment of the minimum wage by calculating the change in earnings if wages rose to the minimum wage for workers who become nonexempt.<sup>214</sup>

In response to an increase in the regular rate of pay to the minimum wage, employers may reduce the workers' hours. Since the quantity of labor hours demanded is inversely related to wages, a higher mandated wage will result in fewer hours of labor demanded. The Department estimated the potential disemployment effects (*i.e.*, the estimated reduction in hours) of the transfer attributed to the minimum wage by multiplying the percent change in the regular rate of pay by a labor demand elasticity of -0.2.<sup>215</sup>

At the new standard salary level, the Department estimated that 15,100 affected EAP workers would, on average, see an hourly wage increase of \$1.45, work 3.2 fewer hours per week, and receive an increase in weekly earnings of \$72.68 as a result of coverage by the minimum wage provisions (Table 13). The total change in weekly earnings due to the payment

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<sup>213</sup> Workers in states with minimum wages higher than the federal minimum wage could earn less than the state minimum wage working fewer hours.

<sup>214</sup> Because these workers' hourly wages will be set at the minimum wage after this Proposed Rule, their employers will not be able to adjust their wages downward to offset part of the cost of paying the overtime pay premium (which will be discussed in the following section). Therefore, these workers will generally receive larger transfers attributed to the overtime pay provision than other workers.

<sup>215</sup> This elasticity estimate represents a short run demand elasticity for general labor, and is based on the Department's analysis of Lichter, A., Peichl, A. & Siegloch, A. (2014). The Own-Wage Elasticity of Labor Demand: A Meta-Regression Analysis. IZA DP No. 7958. We selected a general labor demand elasticity because employers will adjust their demand based on the cumulative change in employees' earnings, not on a conceptual differentiation between increases attributable to the minimum wage and the overtime provisions of the FLSA.

of the minimum wage was estimated to be \$1.1 million per week ( $\$72.68 \times 15,100$ ) or \$57.0 million in Year 1.

Table 13: Minimum Wage Only: Mean Hourly Wages, Usual Overtime Hours, and Weekly Earnings for Affected EAP Workers, Year 1

	Hourly Wage [a]	Usual Weekly Hours	Usual Weekly Earnings	Total Weekly Transfer (1,000s)
Before Proposed Rule	\$8.29	64.1	\$515.88	--
After Proposed Rule	\$9.75	61.0	\$588.56	--
Change	\$1.45	-3.2	\$72.68	\$1,097

Note: Pooled data for 2015–2017 adjusted to reflect 2017.

[a] The applicable minimum wage is the higher of the federal minimum wage and the state minimum wage.

### 3. Transfers Due to the Overtime Pay Provision

#### Introduction

The proposed rule will transfer income to affected workers who work in excess of 40 hours per week. Requiring an overtime premium increases the marginal cost of labor, which employers will likely try to offset by adjusting wages and/or hours of affected workers. The size of the transfer will depend largely on how employers respond to the updated salary levels. Employers may respond by: (1) paying overtime premiums to affected workers; (2) reducing overtime hours of affected workers and potentially transferring some of these hours to other workers; (3) reducing the regular rate of pay for affected workers working overtime (provided that the reduced rates still exceed the minimum wage); (4) increasing affected workers' salaries to the updated salary or compensation level to preserve their exempt status; or (5) using some combination of these responses. How employers will respond depends on many factors, including the relative costs of each of these alternatives; in turn, the relative costs of each of these alternatives are a function of workers' earnings and hours worked.

## Literature on Employer Adjustments

Two conceptual models are useful for thinking about how employers may respond to reclassifying certain employees as overtime-eligible: (1) the “fixed-wage” or “labor demand” model, and (2) the “fixed-job” or “employment contract” model.<sup>216</sup> These models make different assumptions about the demand for overtime hours and the structure of the employment agreement, which result in different implications for predicting employer responses.

The fixed-wage model assumes that the standard hourly wage is independent of the statutory overtime premium. Under the fixed-wage model, a reclassification of workers from overtime exempt to overtime non-exempt would cause a reduction in overtime hours for affected workers, an increase in the prevalence of a 40-hour workweek among affected workers, and an increase in the earnings of affected workers who continue to work overtime.

In contrast, the fixed job model assumes that the standard hourly wage is affected by the statutory overtime premium. Thus, employers can neutralize any reclassification of workers from overtime exempt to overtime non-exempt by reducing the standard hourly wage of affected workers so that their weekly earnings and hours worked are unchanged, except when minimum wage laws prevent employers from lowering the standard hourly wage below the minimum wage. Under the fixed-job model, a reclassification of workers from overtime exempt to overtime non-exempt would have differential effects on minimum-wage workers and above-minimum-wage workers. Similar to the fixed-wage model, minimum-wage workers would experience a reduction in overtime hours, an increase in the prevalence of a 40-hour workweek at a given employer (though not necessarily overall), and an increase in earnings for the portion of

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<sup>216</sup> See Trejo, S.J. (1991). The Effects of Overtime Pay Regulation on Worker Compensation. American Economic Review, 81(4), 719–740, and Barkume, A. (2010). The Structure of Labor Costs with Overtime Work in U.S. Jobs. Industrial and Labor Relations Review, 64(1), 128-142.

minimum-wage workers that continue to work overtime for a given employer. Unlike the fixed-wage model, however, above-minimum-wage workers would experience no change.

The Department conducted a literature review to evaluate studies of how labor markets adjust to a change in the requirement to pay overtime. In general, these studies are supportive of the fixed-job model of labor market adjustment, in that wages adjust to offset the requirement to pay an overtime premium as predicted by the fixed-job model, but do not adjust enough to completely offset the overtime premium as predicted by the model.

The Department believes the two most important papers in this literature are the studies by Trejo (1991) and Barkume (2010). Analyzing the economic effects of the overtime pay provisions of the FLSA, Trejo (1991) found “the data analyzed here suggest the wage adjustments occur to mitigate the purely demand-driven effects predicted by the fixed-wage model, but these adjustments are not large enough to neutralize the overtime pay regulations completely.” Trejo noted, “In accordance with the fixed job model, the overtime law appears to have a greater impact on minimum-wage workers.” He also stated, “[T]he finding that overtime pay coverage status systematically influences the hours-of-work distribution for non-minimum wage works is supportive of the fixed-wage model. No significant differences in weekly earnings were discovered between the covered and non-covered sectors, which is consistent with the fixed-job model.” However, “overtime pay compliance is higher for union than for nonunion workers, a result that is more easily reconciled with the fixed wage model.” Trejo’s findings are

supportive of the fixed-wage model whose adjustment is incomplete largely due to the minimum-wage requirement.<sup>217</sup>

A second paper by Trejo (2003) took a different approach to testing the consistency of the fixed-wage adjustment models with overtime coverage and data on hours worked. In this paper, he examined time-series data on employee hours by industry. After controlling for underlying trends in hours worked over 20 years, he found changes in overtime coverage had no impact on the prevalence of overtime hours worked. This result supports the fixed-job model. Unlike the 1991 paper, however, he did not examine impacts of overtime coverage on employees' weekly or hourly earnings, so this finding in support of the fixed-job model only analyzes one implication of the model.<sup>218</sup>

Barkume (2010) built on the analytic method used in Trejo (1991).<sup>219</sup> However, Barkume observed that Trejo did not account for "quasi-fixed" employment costs (e.g., benefits) that do not vary with hours worked, and therefore affect employers' decisions on overtime hours worked. After incorporating these quasi-fixed costs in the model, Barkume found results consistent with those of Trejo (1991): "though wage rates in otherwise similar jobs declined with greater overtime hours, they were not enough to prevent the FLSA overtime provisions from increasing labor costs." Barkume also determined that the 1991 model did not account for evidence that in the absence of regulation some employers may voluntarily pay workers some overtime premium to entice them to work longer hours, to compensate workers for unexpected

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<sup>217</sup> Trejo, S. J. (1991). The Effects of Overtime Pay Regulation on Worker Compensation. American Economic Review, 81(4), 719-740.

<sup>218</sup> Trejo, S. J. (2003). Does the Statutory Overtime Premium Discourage Long Workweeks? Industrial and Labor Relations Review, 56(3), 375-392.

<sup>219</sup> Barkume, A. (2010). The Structure of Labor Costs with Overtime Work in U.S. Jobs. Industrial and Labor Relations Review, 64(1), 128-142.

changes in their schedules, or as a result of collective bargaining.<sup>220</sup> Barkume found that how much wages and hours worked adjusted in response to the overtime pay requirement depended on what overtime pay would be in absence of regulation.

In addition, Bell and Hart (2003) examined the standard hourly wage, average hourly earnings (including overtime), the overtime premium, and overtime hours worked in the United Kingdom. Unlike the United States, the United Kingdom does not have national labor laws regulating overtime compensation. Bell and Hart found that after accounting for overtime, average hourly earnings are generally uniform in a given industry because firms paying below-market level straight-time wages tend to pay above-market overtime premiums and firms paying above-market level straight-time wages tend to pay below-market overtime premiums. Bell and Hart concluded “this is consistent with a model in which workers and firms enter into an implicit contract that specifies total hours at a constant, market-determined, hourly wage rate.<sup>221</sup> Their research is also consistent with studies showing that employers may pay overtime premiums either in the absence of a regulatory mandate (e.g., Britain), or when the mandate exists but the requirements are not met (e.g., United States).<sup>222</sup>

On balance, the Department finds strong support for the fixed-job model as the best approximation for the likely effects of a reclassification of above-minimum-wage workers from overtime exempt to overtime non-exempt and the fixed-wage model as the best approximation of

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<sup>220</sup> Barzel, Y. (1973). The Determination of Daily Hours and Wages. The Quarterly Journal of Economics, 87(2), 220–238 demonstrated that modest fluctuations in labor demand could justify substantial overtime premiums in the employment contract model. Hart, R. A. and Yue, M. (2000). Why Do Firms Pay an Overtime Premium? IZA Discussion Paper No. 163, showed that establishing an overtime premium in an employment contract can reduce inefficiencies.

<sup>221</sup> Bell, D. N. F. and Hart, R. A. (2003). Wages, Hours, and Overtime Premia: Evidence from the British Labor Market, Industrial and Labor Relations Review, 56(3), 470-480.

<sup>222</sup> Hart, R. A. and Yue, M. (2000). Why Do Firms Pay an Overtime Premium? IZA Discussion Paper No. 163

the likely effects of a reclassification of minimum-wage workers from overtime exempt to overtime non-exempt. In addition, the studies suggest that although observed wage adjustment patterns are consistent with the fixed-job model, this evidence also suggests that the actual wage adjustment is less than 100 percent as predicted by the fixed-job model. Thus, the hybrid model used in this analysis may be described as a substantial, but incomplete fixed-job model.

To determine the magnitude of the adjustment, the Departments accounted for the following findings. Earlier research had demonstrated that in the absence of regulation some employers may voluntarily pay workers some overtime premium to entice them to work longer hours, to compensate workers for unexpected changes in their schedules, or as a result of collective bargaining.<sup>223</sup> Barkume (2010) found that the measured adjustment of wages and hours to overtime premium requirements depended on what overtime premium might be paid in absence of any requirement to do so. Thus, when Barkume assumed that workers would receive an average voluntary overtime pay premium of 28 percent in the absence of an overtime pay regulation, which is the average overtime premium that Bell and Hart (2003) found British employers paid in the absence of any overtime regulations, the straight time hourly wage adjusted downward by 80 percent of the amount that would occur with the fixed-job model. When Barkume assumed workers would receive no voluntary overtime pay premium in the absence of an overtime pay regulation, the results were more consistent with Trejo's (1991) findings that the adjustment was a smaller percentage. The Department modeled an adjustment process between these two findings. Although it seemed reasonable that some premium was paid

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<sup>223</sup> Barzel, Y. (1973). The Determination of Daily Hours and Wages. The Quarterly Journal of Economics, 87(2), 220–238 demonstrated that modest fluctuations in labor demand could justify substantial overtime premiums in the employment contract model. Hart, R. A. and Yue, M. (2000). Why Do Firms Pay an Overtime Premium? IZA Discussion Paper No. 163, showed that establishing an overtime premium in an employment contract can reduce inefficiencies.

for overtime in the absence of regulation, Barkume’s assumption of a 28 percent initial overtime premium is likely too high for the salaried workers potentially affected by a change in the salary and compensation level requirements for the EAP exemptions because this assumption is based on a study of workers in Britain. British workers were likely paid a larger voluntary overtime premium than American workers because Britain did not have a required overtime pay regulation and so collective bargaining played a larger role in implementing overtime pay.<sup>224</sup>

The Department requests comment on this analysis, and how employers would likely respond to an increase in the salary level.

#### Identifying Types of Affected Workers

The Department identified four types of workers whose work characteristics affect how it modeled employers’ responses to the changes in both the standard and HCE salary levels:

- Type 1: Workers who do not work overtime.
- Type 2: Workers who do not regularly work overtime but occasionally work overtime.
- Type 3: Workers who regularly work overtime and become overtime eligible (nonexempt).
- Type 4: Workers who regularly work overtime and remain exempt, because it is less expensive for the employer to pay the updated salary level than to pay overtime and incur additional managerial costs.<sup>225</sup>

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<sup>224</sup> Bell, D. and Hart, R. (2003). Wages, Hours, and Overtime Premia: Evidence from the British Labor Market. *Industrial and Labor Relations Review*, 56(3), 470–480.

<sup>225</sup> There is some evidence that employers will respond in this manner. In response to the RFI, one employer association reported that when making adjustments in anticipation of the 2016 final rule, more than 40 percent of its members raised the salaries of at least one worker above the 2016 final rule salary level. Similarly, it is possible that employers will increase the salaries paid to some “occasional” overtime workers to maintain the exemption for the worker, but the Department has no way of identifying these workers.

The Department began by identifying the number of workers in each type. After modeling employer adjustments, it estimated transfer payments. Type 3 and 4 workers were identified as those who regularly work overtime (CPS variable PEHRUSL1 greater than 40). Distinguishing Type 3 workers from Type 4 workers involved a four-step process. First, the Department identified all workers who regularly work overtime. Then the Department estimated each worker's weekly earnings if they became nonexempt, to which it added weekly managerial costs for each affected worker of \$4.06 ( $\$48.72 \text{ per hour} \times (5 \text{ minutes}/60 \text{ minutes})$ ).<sup>226</sup> Last, the Department identified as Type 4 those workers whose expected nonexempt earnings plus weekly managerial costs exceeds the updated standard salary level, and, conversely, as Type 3 those whose expected nonexempt earnings plus weekly managerial costs are less than the new standard salary.<sup>227</sup> The Department assumed that firms will include incremental managerial costs in their determination of whether to treat an affected employee as a Type 3 or Type 4 worker because those costs are only incurred if the employee is a Type 3 worker.

Identifying Type 2 workers involved two steps. First, using CPS MORG data, the Department identified those who do not usually work overtime but did work overtime in the survey week (the week referred to in the CPS questionnaire, variable PEHRACT1 greater than 40). Next, the Department supplemented the CPS data with data from the Survey of Income and Program Participation (SIPP) to look at likelihood of working some overtime during the year. Based on 2012 data, the most recent available, the Department found that 39.4 percent of non-hourly workers worked overtime at some point in a year. Therefore, the Department classified a

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<sup>226</sup> See *supra* § VI.D.iii.4 (managerial costs).

<sup>227</sup> When analyzing impacts of increasing the standard salary level, Rohwedder and Wenger conducted a similar analysis; however, they use straight-time pay rather than overtime pay to calculate earnings in the absence of a pay raise to remain exempt. Rohwedder, S. and Wenger, *supra* note 163.

share of workers who reported they do not usually work overtime, and did not work overtime in the reference week (previously identified as Type 1 workers), as Type 2 workers such that a total of approximately 39.4 percent of affected workers were Type 2, 3, or 4.

#### Modeling Changes in Wages and Hours

The substantial, but incomplete fixed-job model (hereafter referred to as the incomplete fixed-job model) predicts that employers will adjust wages of regular overtime workers but not to the full extent indicated by fixed-job model, and thus some employees may receive a small increase in weekly earnings due to overtime pay coverage. Therefore, when modeling employer responses with respect to the adjustment to the regular rate of pay, the Department used the incomplete fixed-job model.

The Department determined that an appropriate estimate of the effect on the implicit hourly rate of pay for regular overtime workers should be determined using the average of two estimates of the incomplete fixed-job model adjustments: Trejo's (1991) estimate that the overtime-induced wage change is 40 percent of the adjustment toward the amount predicted by the fixed-job model, assuming an initial zero overtime pay premium, and Barkume's (2010) estimate that the wage change is 80 percent of the predicted adjustment assuming an initial 28 percent overtime pay premium.<sup>228</sup> This is approximately equivalent to assuming that salaried overtime workers implicitly receive the equivalent of a 14 percent overtime premium in the absence of regulation (the midpoint between 0 and 28 percent).

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<sup>228</sup> Both studies considered a population that included hourly workers. Evidence is not available on how the adjustment towards the employment contract model differs between salaried and hourly workers. The employment contract model may be more likely to hold for salaried workers than for hourly workers since salaried workers directly observe their weekly total earnings, not their implicit equivalent hourly wage. Thus, applying the partial adjustment to the employment contract model as estimated by these studies may overestimate the transfers from employers to salaried workers. We do not attempt to quantify the magnitude of this potential overestimate.

Modeling changes in wages, hours, and earnings for Type 1 and Type 4 workers was relatively straightforward. Type 1 affected EAP workers will become overtime-eligible, but because they do not work overtime, they will see no change in their weekly earnings. Type 4 workers will remain exempt because their earnings will be raised to at least the updated EAP level (either the standard salary level or HCE compensation level). These workers' earnings will increase by the difference between their current earnings and the amount necessary to satisfy the new salary or compensation level. It is possible employers will increase these workers' hours in response to paying them a higher salary, but the Department did not have enough information to model this potential change.<sup>229</sup>

Modeling changes in wages, hours, and earnings for Type 2 and Type 3 workers was more complex. The Department distinguished those who regularly work overtime (Type 3 workers) from those who occasionally work overtime (Type 2 workers) because employer adjustment to the proposed rule may differ accordingly. Employers are more likely to adjust hours worked and wages for regular overtime workers because their hours are predictable. However, in response to a transient, perhaps unpredicted, shift in market demand for the good or service such employers provide, employers are more likely to pay for occasional overtime rather than adjust hours worked and pay.

The Department treated Type 2 affected workers in two ways due to the uncertainty of the nature of these occasional overtime hours. The Department assumed that 50 percent of these occasional overtime workers worked expected overtime hours and the other 50 percent worked unexpected overtime. Workers were randomly assigned to these two groups. Workers with

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<sup>229</sup> Cherry, Monica, "Are Salaried Workers Compensated for Overtime Hours?" Journal of Labor Research 25(3): 485–494, September 2004, found that exempt full-time salaried employees earn more when they work more hours, but her results do not lend themselves to the quantification of the effect on hours of an increase in earnings.

expected occasional overtime hours were treated like Type 3 affected workers (incomplete fixed-job model adjustments). Workers with unexpected occasional overtime hours were assumed to receive a 50 percent pay premium for the overtime hours worked and receive no change in base wage or hours (full overtime premium model).<sup>230</sup> When modeling Type 2 workers' hour and wage adjustments, the Department treated those identified as Type 2 using the CPS data as representative of all Type 2 workers. The Department estimated employer adjustments and transfers assuming that the patterns observed in the CPS reference week are representative of an average week in the year. Thus, the Department assumes total transfers for the year are equal to 52-times the transfers estimated for the single representative week for which the Department has CPS data. However, these transfers are spread over a larger group including those who occasionally work overtime but did not do so in the CPS reference week.<sup>231</sup>

Since employers must now pay more for the same number of labor hours, for Type 2 and Type 3 EAP workers, the quantity of labor hours demanded by employers will decrease. It is the net effect of these two changes that will determine the final weekly earnings for affected EAP workers. The reduction in hours is calculated using the elasticity of labor demand with respect to wages. The Department used a short-term demand elasticity of -0.20 to estimate the percentage decrease in hours worked in Year 1 and a long-term elasticity of -0.4 to estimate the percentage

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<sup>230</sup> We use the term "full overtime premium" to describe the adjustment process as modeled. The full overtime premium model is a special case of the general fixed-wage model in that the Department assumes the demand for labor under these circumstances is completely inelastic. That is, employers make no changes to employees' hours in response to these temporary, unanticipated changes in demand.

<sup>231</sup> If a different week was chosen as the survey week, then likely some of these workers would not have worked overtime. However, because the data are representative of both the population and all twelve months in a year, the Department believes the share of Type 2 workers identified in the CPS data in the given week is representative of an average week in the year.

decrease in hours worked in Years 2-10.<sup>232</sup> The Department acknowledges that the academic literature on elasticity can be interpreted in multiple ways, and invites comment on the appropriate elasticity to use.

For Type 3 affected workers, and the 50 percent of Type 2 affected workers who worked expected overtime, the Department estimated adjusted total hours worked after making wage adjustments using the incomplete fixed-job model. To estimate adjusted hours worked, the Department set the percent change in total hours worked equal to the percent change in average wages multiplied by the wage elasticity of labor demand.<sup>233</sup>

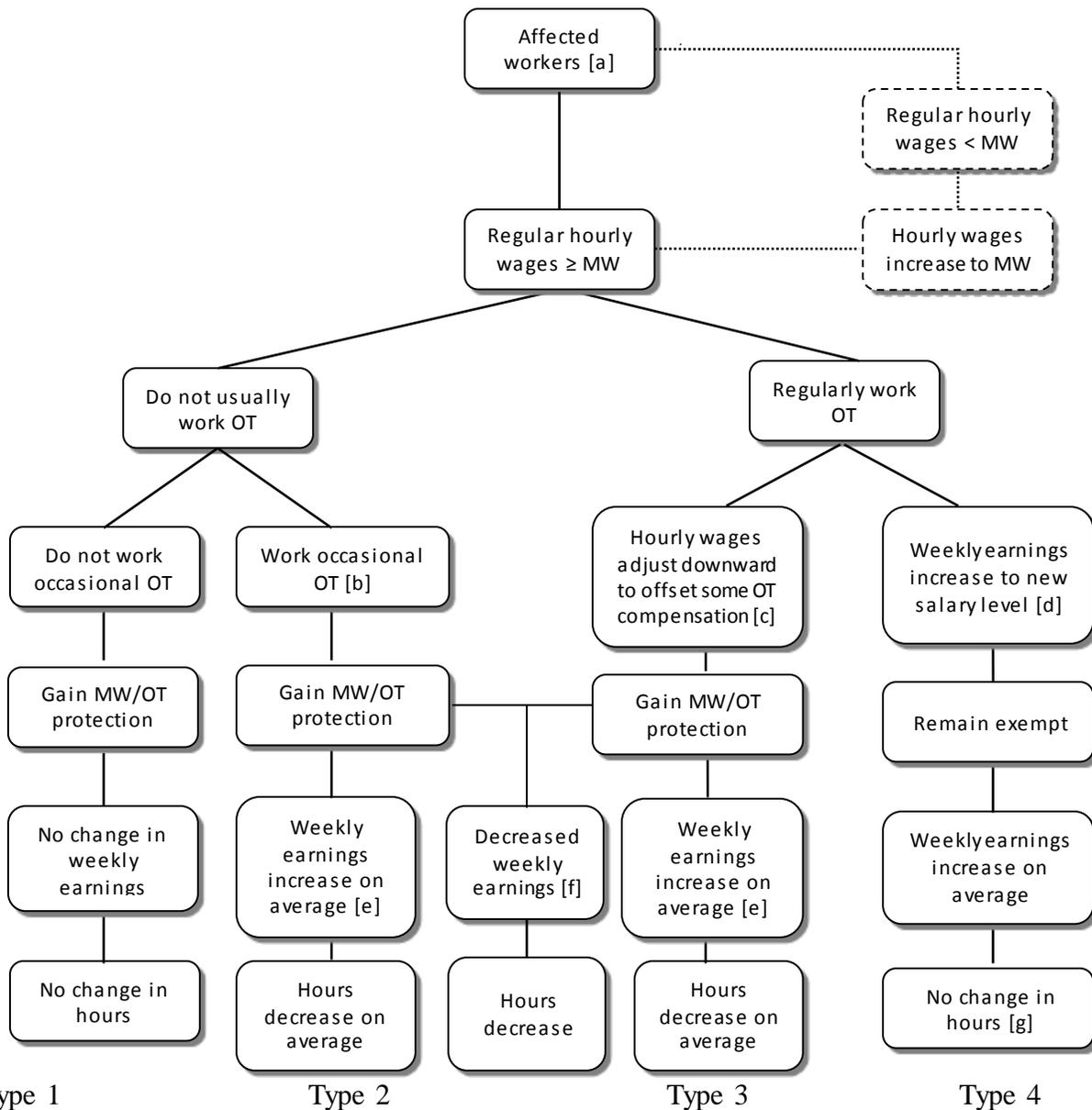
Figure 3 is a flow chart summarizing the four types of affected EAP workers. Also shown are the effects on exempt status, weekly earnings, and hours worked for each type of affected worker.

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<sup>232</sup> This elasticity estimate is based on the Department's analysis of Lichter, A., Peichl, A. & Siegloch, A. (2014). The Own-Wage Elasticity of Labor Demand: A Meta-Regression Analysis. IZA DP No. 7958. Some researchers have estimated larger impacts on the number of overtime hours worked (Hamermesh, D. and S. Trejo. (2000). The Demand for Hours of Labor: Direct Evidence from California. The Review of Economics and Statistics, 82(1), 38–47 concludes the price elasticity of demand for overtime hours is at least -0.5. The Department decided to use a general measure of elasticity applied to the average change in wages since the increase in the overtime wage is somewhat offset by a decrease in the non-overtime wage as indicated in the fixed-job model.

<sup>233</sup> In this equation, the only unknown is adjusted total hours worked. Since adjusted total hours worked is in the denominator of the left side of the equation and is also in the numerator of the right side of the equation, solving for adjusted total hours worked requires solving a quadratic equation.

Figure 3: Flow Chart of Proposed Rule's Effect on Earnings and Hours Worked



[a] Affected EAP workers are those who are exempt under the current EAP exemptions and would gain minimum wage and overtime protection or receive a raise to the increased salary or compensation level.

[b] There are two methods the Department uses to identify occasional overtime workers. The first includes workers who report they usually work 40 hours or less per week (identified with variable PEHRUSL1 in CPS MORG) but in the reference week worked more than 40 hours (variable PEHRACT1 in CPS MORG). The second includes reclassifying some additional workers who usually work 40 hours or less per week, and in the reference week worked 40 hours or less, to match the proportion of workers measured in other data sets who work overtime at any point in the year.

[c] The amount wages are adjusted downwards depends on whether the fixed-job model or the fixed-wage model holds. The Department's preferred method uses a combination of the two.

Employers reduce the regular hourly wage rate somewhat in response to overtime pay requirements, but the wage is not reduced enough to keep total compensation constant.

[d] Based on hourly wage and weekly hours it is more cost efficient for the employer to increase the worker's weekly salary to the updated salary level than to pay overtime pay.

[e] On average, the Department expects employees' overall weekly earnings will increase despite a small decrease in average hours worked.

[f] In some cases, employers might decrease employees' hours enough to cause those employees' weekly earnings to decrease. If so, such employees may seek a second job to offset their lost weekly earnings. In extreme cases, some workers may become unemployed.

[g] The Department assumed hours would not change due to lack of data and relevant literature; however, it is possible employers will increase these workers' hours in response to paying them a higher salary or to avoid paying overtime premiums to newly nonexempt coworkers.

In response to the Department's RFI and at the listening sessions, some commenters provided information concerning their proposed wage and hour adjustments in anticipation of an increase to the standard salary level and HCE total compensation level. Employers indicated they would respond by making a variety of adjustments to wages, hours worked, or both.

Estimated Number of and Effects on Affected EAP Workers

The Department estimated the proposed rule would affect 1.3 million workers (Table 14), of which 760,100 were Type 1 workers (59.8 percent of all affected EAP workers), 279,500 were estimated to be Type 2 workers (22.0 percent of all affected EAP workers), 204,600 were Type 3 workers (16.1 percent of all affected EAP workers), and 27,100 were estimated to be Type 4 workers (2.1 percent of all affected workers). All Type 3 workers and half of Type 2 employees (344,300) are assumed to work predictable overtime.

Table 14: Affected EAP Workers by Type (1,000s), Year 1

	Total	No Overtime (T1)	Occasional Overtime (T2)	Regular Overtime	
				Newly Nonexempt (T3)	Remain Exempt (T4)
Standard salary level	1,070.2	648.9	269.6	127.4	24.3
HCE compensation level	201.1	111.2	9.9	77.2	2.8
Total	1,271.3	760.1	279.5	204.6	27.1

Note: Pooled data for 2015-2017 adjusted to reflect 2017.

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- \*Type 1: Workers without regular OT and without occasional OT and become overtime eligible.
  - \*Type 2: Workers without regular OT but with occasional OT. These workers become overtime eligible.
  - \*Type 3: Workers with regular OT who become overtime eligible.
  - \*Type 4: Workers with regular OT who remain exempt (*i.e.*, earnings increase to the updated salary level).

The proposed rule would affect some affected workers' hourly wages, hours, and weekly earnings. Predicted changes in implicit wage rates are outlined in Table 15, changes in hours in Table 16, and changes in weekly earnings in Table 17. How these would change depends on the type of worker, but on average weekly earnings would be unchanged or increase while hours worked would be unchanged or decrease.

Type 1 workers would have no change in wages, hours, or earnings.<sup>234</sup> Employers were assumed to be unable to adjust the hours or regular rate of pay for the occasional overtime workers whose overtime is irregularly scheduled and unpredictable. The Department used the incomplete fixed-job model to estimate changes in the regular rate of pay for Type 3 workers and the 50 percent of Type 2 workers who regularly work occasional overtime. As a group, Type 2 workers would see a decrease in their average regular hourly wage; however, because workers would now receive a 50 percent premium on their regular hourly wage for each hour worked in excess of 40 hours per week, average weekly earnings for Type 2 workers would increase.<sup>235</sup>

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<sup>234</sup> It is possible that these workers may experience an increase in hours and weekly earnings because of transfers of hours from overtime workers. Due to the high level of uncertainty in employers' responses regarding the transfer of hours, the Department did not have credible evidence to support an estimation of the number of hours transferred to other workers.

<sup>235</sup> Type 2 workers do not see increases in regular earnings to the new salary level (as Type 4 workers do) even if their new earnings in this week exceed that new level. This is because the estimated new earnings only reflect their earnings in that week when overtime is worked; their earnings in typical weeks that they do not work overtime do not exceed the salary level.

Similarly, Type 3 workers would also receive decreases in their regular hourly wage as predicted by the incomplete fixed-job model but an increase in weekly earnings because these workers would now be eligible for the overtime premium. Type 4 workers' implicit hourly rates of pay would increase to meet the updated standard salary level or HCE annual compensation level.

Table 15: Average Regular Rate of Pay by Type of Affected EAP Worker, Year 1

	Total	No Overtime (T1)	Occasional Overtime (T2)	Regular Overtime	
				Newly Nonexempt (T3)	Remain Exempt (T4)
<b>Standard Salary Level</b>					
Before Proposed Rule	\$15.70	\$16.74	\$15.78	\$11.32	\$10.35
After Proposed Rule	\$15.65	\$16.74	\$15.72	\$10.83	\$11.01
Change (\$)	-\$0.06	\$0.00	-\$0.05	-\$0.49	\$0.66
Change (%)	-0.4%	0.0%	-0.3%	-4.3%	6.3%
<b>HCE Compensation Level</b>					
Before Proposed Rule	\$49.71	\$54.41	\$53.51	\$42.66	\$44.21
After Proposed Rule	\$48.58	\$54.41	\$50.70	\$40.04	\$45.08
Change (\$)	-\$1.13	\$0.00	-\$2.81	-\$2.61	\$0.87
Change (%)	-2.3%	0.0%	-5.2%	-6.1%	2.0%

Note: Pooled data for 2015-2017 adjusted to reflect 2017.

\*Type 1: Workers without regular OT and without occasional OT and become overtime-eligible.

\*Type 2: Workers without regular OT but with occasional OT. These workers become overtime-eligible.

\*Type 3: Workers with regular OT who become overtime eligible.

\*Type 4: Workers with regular OT who remain exempt (*i.e.*, earnings increase to the updated salary level).

Hours for Type 1 workers would not change. Similarly, hours would not change for the half of Type 2 workers who work irregular overtime. Half of Type 2 and all Type 3 workers would see a small decrease in their hours of overtime worked. This reduction in hours is relatively small and is due to the effect on labor demand from the increase in the average hourly wage as predicted by the incomplete fixed-job model (Table 16). Type 4 workers' hours may increase, but due to lack of data, the Department assumed hours would not change.

Table 16: Average Weekly Hours for Affected EAP Workers by Type, Year 1

	Total	No Overtime Worked (T1)	Occasional OT (T2)	Regular OT	
				Newly Nonexempt (T3)	Remain Exempt (T4)
Standard Salary Level [a]					
Before Proposed Rule	39.7	37.2	39.2	49.6	60.5
After Proposed Rule	39.6	37.2	39.2	49.1	60.5
Change (hours)	-0.1	0.0	0.0	-0.5	0.0
Change (%)	-0.2%	0.0%	-0.1%	-0.9%	0.0%
HCE Compensation Level [a]					
Before Proposed Rule	45.1	39.5	49.3	52.1	61.3
After Proposed Rule	44.9	39.5	49.0	51.7	61.3
Change (hours)	-0.2	0.0	-0.3	-0.4	0.0
Change (%)	-0.4%	0.0%	-0.6%	-0.7%	0.0%

Note: Pooled data for 2015-2017 adjusted to reflect 2017.

[a] Usual hours for Types 1, 3, and 4 but actual hours for Type 2 workers identified in the CPS MORG.

\*Type 1: Workers without regular OT and without occasional OT and become overtime eligible.

\*Type 2: Workers without regular OT but with occasional OT. These workers become overtime eligible.

\*Type 3: Workers with regular OT who become overtime eligible.

\*Type 4: Workers with regular OT who remain exempt (*i.e.*, earnings increase to the updated salary level).

Because Type 1 workers would not experience a change in their regular rate of pay or hours, they would have no change in earnings due to the proposed rule (Table 17). Although both Type 2 and Type 3 workers would, on average, experience a decrease in both their regular rate of pay and hours worked, their weekly earnings would increase as a result of the overtime premium. Weekly earnings after the standard salary level increased were estimated using the new wage (*i.e.*, the incomplete fixed-job model wage) and the reduced number of overtime hours worked. Type 4 workers' salaries would increase to the new standard salary level or the HCE compensation level.

Table 17: Average Weekly Earnings for Affected EAP Workers by Type, Year 1

	Total	No Overtime (T1)	Occasional Overtime (T2)	Regular Overtime	
				Newly Nonexempt (T3)	Remain Exempt (T4)
Standard Salary Level [a]					
Before Proposed Rule	\$563.76	\$558.32	\$577.87	\$555.45	\$596.04
After Proposed Rule	\$568.30	\$558.32	\$583.34	\$573.43	\$641.00
Change (\$)	\$4.54	\$0.00	\$5.47	\$17.98	\$44.96
Change (%)	0.8%	0.0%	0.9%	3.2%	7.5%
HCE Compensation Level [a]					
Before Proposed Rule	\$2,179.37	\$2,126.62	\$2,623.44	\$2,182.02	\$2,627.16
After Proposed Rule	\$2,205.61	\$2,126.62	\$2,683.14	\$2,240.70	\$2,682.00
Change (\$)	\$26.23	\$0.00	\$59.70	\$58.68	\$54.84
Change (%)	1.2%	0.0%	2.3%	2.7%	2.1%

Note: Pooled data for 2015-2017 adjusted to reflect 2017.

[a] The mean of the hourly wage multiplied by the mean of the hours does not necessarily equal the mean of the weekly earnings because the product of two averages is not necessarily equal to the average of the product.

\*Type 1: Workers without regular OT and without occasional OT and become overtime eligible.

\*Type 2: Workers without regular OT but with occasional OT. These workers become overtime eligible.

\*Type 3: Workers with regular OT who become overtime eligible.

\*Type 4: Workers with regular OT who remain exempt (*i.e.*, earnings increase to the updated salary level).

At the new standard salary level, the average weekly earnings of all affected workers would increase \$4.54 (0.8 percent), from \$563.76 to \$568.30. Multiplying the average change of \$4.54 by the 1.1 million affected standard EAP workers and 52 weeks equals an increase in earnings of \$252.5 million in the first year (Table 18). For workers affected by the change in the HCE compensation level, average weekly earnings would increase by \$26.23. When multiplied by 201,100 affected workers and 52 weeks, the national increase would be \$274.3 million in the first year. Thus, total Year 1 transfer payments attributable to this proposed rule would total \$526.9 million.

Table 18: Total Change in Weekly and Annual Earnings for Affected EAP Workers by Provision, Year 1

Provision	Annual Change in Earnings (1,000s)
Total	\$526,894
Standard salary level	
Total	\$252,546
Minimum wage only	\$57,041
Overtime pay only [a]	\$195,505
HCE compensation level	
Total	\$274,348
Minimum wage only	--
Overtime pay only [a]	\$274,348

[a] Estimated by subtracting the minimum wage transfer from the total transfer.

Rohwedder and Wenger (2015) analyzed the effects of increasing the standard salary level.<sup>236</sup> They compared hourly and salaried workers in the CPS using quantile treatment effects. This methodology estimates the effect of a worker becoming nonexempt by comparing similar workers who are hourly and salaried. They found no statistically significant change in hours or wages on average. However, their point estimates, averaged across all affected workers, show small increases in earnings and decreases in hours, similar to our analysis. For example, using a salary level of \$750, they estimated weekly earnings may increase between \$2 and \$22 and weekly hours may decrease by approximately 0.4 hours. The Department estimated weekly earnings for workers affected by the standard salary level would increase by \$4.54 and hours would decrease by 0.1 hours.

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<sup>236</sup> Rohwedder and Wenger, *supra* note 163.

#### 4. Potential Transfers Not Quantified

There may be additional transfers attributable to this proposed rule; however, the magnitude of these other transfers could not be quantified and therefore are discussed only qualitatively.

##### Reduced Earnings for Some Workers

Holding regular rate of pay and work hours constant, payment of an overtime premium will increase weekly earnings for workers who work overtime. However, as discussed previously, employers may try to mitigate cost increases by reducing the number of overtime hours worked, either by transferring these hours to other workers or monitoring hours more closely. Depending on how hours are adjusted, a specific worker may earn less pay after this proposed rule.

##### Additional Work for Some Workers

Affected workers who remain exempt would see an increase in pay but may also see an increase in workload. The Department estimated the net changes in hours, but due to the data limitations as noted in section VI.D.iv.3, did not estimate changes in hours for affected workers whose salary is increased to the new threshold so they remain overtime exempt.

##### Reduction in Bonuses and Benefits for Some Workers

Employers may offset increased labor costs by reducing bonuses or benefits instead of reducing base wages or hours worked. Due to data limitations, the Department has not modeled this effect separately. The Department observes that any reductions in bonuses or benefits would be likely accompanied by smaller reductions in base wages or hours worked.

#### v. Benefits and Cost Savings

##### Potential Benefits and Effects Not Discussed Elsewhere

The Department has determined that the proposed rulemaking would provide some benefits; however, these benefits could not be quantified due to data limitations, requiring the Department to discuss such benefits only qualitatively.

#### 1. Reduce employee misclassification

The revised salary level reduces the likelihood of workers being misclassified as exempt from overtime pay, providing an additional measure of the effectiveness of the salary level as a bright-line test delineating exempt and nonexempt workers. The Department's analysis of misclassification drew on CPS data and looked at workers who are white collar, salaried, subject to the FLSA and covered by part 541 regulations, earn at least \$455 but less than \$641 per week, and fail the duties test. Because only workers who work overtime may receive overtime pay, when determining the share of workers who are misclassified the sample was limited to those who usually work overtime. Workers were considered misclassified if they did not receive overtime pay.<sup>237</sup> The Department estimated that 9.3 percent of workers in this analysis who usually worked overtime did not receive overtime compensation and are therefore misclassified as exempt. Applying this estimate to the sample of white collar salaried workers who fail the duties test and earn at least \$455 but less than \$641 (the 2017 proposed salary level used for the RIA), the Department estimated that there are approximately 188,100 white collar salaried workers who are overtime-eligible but whose employers do not recognize them as such.<sup>238</sup> These employees' entitlement to overtime pay will now be abundantly evident.

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<sup>237</sup> Overtime pay status was based on worker responses to the CPS MORG question concerning whether they receive overtime pay, tips, or commissions at their job ("PEERNUOT" variable).

<sup>238</sup> The Department applies the misclassification estimate derived here to both the group of workers who usually work more than 40 hours and to those who do not.

RAND has conducted a survey to identify the number of workers who may be misclassified as EAP exempt. The survey, a special module to the American Life Panel, asks respondents: (1) their hours worked, (2) whether they are paid on an hourly or salary basis, (3) their typical earnings, (4) whether they perform certain job responsibilities that are treated as proxies for whether they would justify exempt status, and (5) whether they receive any overtime pay. Using these data, Susann Rohwedder and Jeffrey B. Wenger<sup>239</sup> found “11.5 percent of salaried workers were classified as exempt by their employer although they did not meet the criteria for being so.” Using RAND’s estimate of the rate of misclassification (11.5 percent), the Department estimated that approximately 232,400 salaried workers earning between \$455 and \$641 per week who fail the standard duties test are currently misclassified as exempt.<sup>240</sup> By raising the salary level the proposed rule will increase the likelihood that these workers will be correctly classified as nonexempt.

## 2. Reduced Litigation

One result of enforcing the 2004 standard salary level for 14 years is that the established “dividing line” between EAP workers who are exempt and not exempt has gradually eroded and no longer holds the same relative position in the distribution of nominal wages and salaries. Therefore, as nominal wages and salaries for workers have increased over time, while the standard salary level has remained constant, more workers earn above the “dividing line” and

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<sup>239</sup> Rohwedder and Wenger, *supra* note 163.

<sup>240</sup> The number of misclassified workers estimated based on the RAND research cannot be directly compared to the Department’s estimates because of differences in data, methodology, and assumptions. Although it is impossible to reconcile the two different approaches without further information, by calculating misclassified workers as a percent of all salaried workers in its sample, RAND uses a larger denominator than the Department. If calculated on a more directly comparable basis, the Department expects the RAND estimate of the misclassification rate would still be higher than the Department’s estimate.

have moved from nonexempt to potentially exempt. The Department's enforcement of the 2004 salary levels has burdened employers with performing duties tests to determine overtime exemption status of white collar workers for a larger proportion of workers than in 2004 and has created uncertainty regarding the correct classification of workers as nonexempt or exempt. This may have contributed to an increase in FLSA lawsuits since 2004,<sup>241</sup> much of which has involved cases regarding whether workers who satisfy the salary level test also meet the duties test for exemption.

Updating the standard salary level should restore the relative position of the standard salary level in the overall distribution of nominal wages and salaries as set forth in the 2004 rule. Additionally, proposed regular updates to the standard salary level would maintain its desired position within the distribution of nominal wages and salaries and therefore would keep the standard salary test's effectiveness as a "dividing line" for separating nonexempt and potentially exempt EAP workers. Increasing the standard salary level from \$455 per week to the proposed level of \$679 per week would increase the number of white collar workers for whom the standard salary-level test is determinative of their nonexempt status, and employers would no longer have to perform a duties analysis for these employees. This would reduce the burden on employers and may reduce legal challenges and the overall cost of litigation faced by employers in FLSA overtime lawsuits, specifically litigation that turns on whether workers earning above the current standard salary level (\$455 per week) pass the duties test. The size of the potential social benefit from fewer legal challenges and the corresponding decline in overall litigation

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<sup>241</sup> See [https://www.washingtonpost.com/news/work/wp/2015/11/25/people-are-suing-more-than-ever-over-wages-and-hours/?utm\\_term=.c8dcc2783351](https://www.washingtonpost.com/news/work/wp/2015/11/25/people-are-suing-more-than-ever-over-wages-and-hours/?utm_term=.c8dcc2783351); <https://www.bna.com/uptick-flsa-litigation-n57982064020/>.

costs is difficult to quantify, but a reduction in litigation costs would be beneficial to both employers and workers.

To provide a general estimate of the size of the potential benefits from reducing litigation, the Department used data from the federal courts' Public Access to Court Electronic Records (PACER) system and the CPS to estimate the number and percentage of FLSA cases that concern EAP exemptions and are likely to be affected by the proposed rule. For this step of the analysis, to avoid using data that could reflect changed behavior in anticipation of the 2016 final rule, the Department used the data gathered during the 2016 rulemaking. As explained in that rule, to determine the potential number of cases that would likely be affected by the proposed rule, the Department obtained a list of all FLSA cases closed in 2014 from PACER (8,256 cases).<sup>242</sup> From this list, the Department selected a random sample of 500 cases. The Department identified the cases within this sample that were associated with the EAP exemption. The Department found that 12.0 percent of these FLSA cases (60 of 500) were related to the EAP exemptions. Next the Department determined what share of these cases could potentially be avoided by an increase in the standard salary and HCE compensation levels.

The Department estimated the share of EAP cases that may be avoided due to the proposed rule by using data on the salaried earnings distribution from the 2017 CPS MORG to determine the share of EAP cases in which workers earn at least \$455 but less than \$641 per week or at least \$100,000 but less than \$139,464 annually. From CPS, the Department selected white collar, nonhourly workers as the appropriate reference group for defining the earnings distribution rather than exempt workers because if a worker is litigating his or her exempt status, then we do not know if that worker is exempt or not. Based on this analysis, the Department

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<sup>242</sup> See 81 FR 32501.

determined that 21.3 percent of white collar nonhourly workers had earnings within these ranges. Applying these findings to the 12 percent of cases associated with the EAP exemption yields an estimated 2.6 percent of FLSA cases, or about 211 cases, that may be avoidable. The assumption underlying this method is that workers who claim they are misclassified as EAP exempt have a similar earnings distribution as all white collar nonhourly workers.

After determining the potential number of EAP cases that the proposed rule may avoid, the Department examined a selection of 56 FLSA cases concluded between 2012 and 2015 that contained litigation cost information to estimate the average costs of litigation to assign to the potentially avoided EAP cases.<sup>243</sup> To calculate average litigation costs associated with these cases, the Department looked at records of court filings in the Westlaw Case Evaluator tool and on PACER to ascertain how much plaintiffs in these cases were paid for attorney fees, administrative fees, and/or other costs, apart from any monetary damages attributable to the alleged FLSA violations. (The FLSA provides for successful plaintiffs to be awarded reasonable attorney's fees and costs, so this data is available in some FLSA cases.) After determining the plaintiff's total litigation costs for each case, the Department then doubled the figures to account for litigation costs that the defendant employers incurred.<sup>244</sup> According to this analysis, the

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<sup>243</sup> The 56 cases used for this analysis were retrieved from Westlaw's Case Evaluator database using a keyword search for case summaries between 2012 and 2015 mentioning the terms "FLSA" and "fees." Although the initial search yielded 64 responsive cases, the Department excluded one duplicate case, one case resolving litigation costs through a confidential settlement agreement, and six cases where the defendant employer(s) ultimately prevailed. Because the FLSA only entitles prevailing plaintiffs to litigation cost awards, information about litigation costs was only available for the remaining 56 FLSA cases that ended in settlement agreements or court verdicts favoring the plaintiff employees.

<sup>244</sup> This is likely a conservative approach to estimate the total litigation costs for each FLSA lawsuit, as defendant employers tend to incur greater litigation costs than plaintiff employees because of, among other things, typically higher discovery costs.

average litigation cost for FLSA cases concluded between 2012 and 2015 was \$654,182.<sup>245</sup>

Applying this figure to approximately 211 EAP cases that could be prevented as a consequence of this rulemaking, the Department estimated that avoided litigation costs resulting from the rule may total approximately \$138.2 million per year. The Department believes these totals may underestimate total litigation costs because some FLSA overtime cases are heard in state court and thus were not captured by PACER; some FLSA overtime matters are resolved before litigation or by alternative dispute resolution; and some attorneys representing FLSA overtime plaintiffs may take a contingency fee atop their statutorily awarded fees and costs.

### 3. Benefits of Transparency and Certainty

The proposed rule also affirms the Department's intention to update the part 541 earnings thresholds every four years going forward. This would help maintain the relative position of the standard salary and HCE compensation levels in the overall distribution of nominal wages and salaries over time. Proposing to adjust the standard salary level and HCE compensation test every four years may provide social benefits from increased transparency and certainty for employers.

The Department believes an update to the salary level tests is long overdue. Long periods between adjustments result in large changes in the salary levels to restore the appropriate relative position of the "dividing line" between nonexempt and potentially exempt workers. The size and unpredictability of these changes in the past are challenging and costly to employers, because there are significant familiarization, adjustment, and managerial costs associated with infrequent updates.

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<sup>245</sup> The median cost was \$111,835 per lawsuit.

The Department hopes to increase transparency and certainty by proposing to update the salary levels routinely. Adjustments that are more frequent would be smaller and make compliance easier and less costly to employers, compared to large adjustments, which are more disruptive. Employers would be aware of the timing of proposed updates and would be able to anticipate the increase beforehand. The increased transparency and certainty in regards to future proposed adjustments would help employers make more effective short- and long-term employment decisions, as well as improve their estimates of future costs.

#### vi. Sensitivity Analysis

This section includes estimated costs and transfers using either different assumptions or segments of the population. First, the Department presents bounds on transfer payments estimated using alternative assumptions. Second, the Department considers costs and transfers by region and by industry.

##### 1. Bounds on Transfer Payments

Because the Department cannot predict employers' precise reaction to the proposed rule, the Department calculated bounds on the size of the estimated transfers from employers to workers. These bounds on transfers do not generate bounded estimates for costs.

For a reasonable upper bound on transfer payments, the Department assumed that all occasional overtime workers and half of regular overtime workers would receive the full overtime premium (*i.e.*, such workers would work the same number of hours but be paid 1.5 times their implicit initial hourly wage for all overtime hours) (Table 19). The full overtime premium model is a special case of the fixed-wage model where there is no change in hours. For the other half of regular overtime workers, the Department assumed in the upper-bound method that they would have their implicit hourly wage adjusted as predicted by the incomplete fixed-job

model (wage rates fall and hours are reduced but total earnings continue to increase, as in the preferred method). In the preferred model, the Department assumed that only 50 percent of occasional overtime workers and no regular overtime workers would receive the full overtime premium.

The plausible lower-transfer bound also depends on whether employees work regular overtime or occasional overtime. For those who regularly work overtime hours and half of those who work occasional overtime, the Department assumes the employees' wages will fully adjust as predicted by the fixed-job model.<sup>246</sup> For the other half of employees with occasional overtime hours, the lower bound assumes they will be paid one and one-half times their implicit hourly wage for overtime hours worked (full overtime premium).

Table 19: Summary of the Assumptions Used to Calculate the Lower Estimate, Preferred Estimate, and Upper Estimate of Transfers

Lower Transfer Estimate	Preferred Estimate	Upper Transfer Estimate
Occasional Overtime Workers (Type 2)		
50% fixed-job model	50% incomplete fixed-job model	100% full overtime premium
50% full overtime premium	50% full overtime premium	
Regular Overtime Workers (Type 3)		
100% fixed-job model	100% incomplete fixed-job model	50% incomplete fixed-job model 50% full overtime premium

\* Full overtime premium model: Regular rate of pay equals the implicit hourly wage prior to the regulation (with no adjustments); workers are paid 1.5 times this base wage for the same number of overtime hours worked prior to the regulation.

\* Fixed-job model: Base wages are set at the higher of: (1) a rate such that total earnings and hours remain the same before and after the regulation; thus the base wage falls, and workers are paid 1.5 times the new base wage for overtime hours (the fixed-job model) or (2) the minimum wage.

\* Incomplete fixed-job model: Regular rates of pay are partially adjusted to the wage implied

<sup>246</sup> The straight-time wage adjusts to a level that keeps weekly earnings constant when overtime hours are paid at 1.5 times the straight-time wage. In cases where adjusting the straight-time wage results in a wage less than the minimum wage, the straight-time wage is set to the minimum wage.

by the fixed-job model.

The cost and transfer payment estimates associated with the bounds are presented in Table 20. Regulatory familiarization costs and adjustment costs do not vary across the scenarios. Managerial costs are lower under these alternative employer response assumptions because fewer workers' hours are adjusted by employers and thus managerial costs, which depend in part on the number of workers whose hours change, will be smaller.<sup>247</sup> Depending on how employers adjust the implicit regular hourly wage, estimated transfers may range from \$234.7 million to \$1,053.9 million, with the preferred estimate equal to \$526.9 million.

Table 20: Bounds on Year 1 Cost and Transfer Payment Estimates, Year 1 (Millions)

Cost/Transfer	Lower Transfer Estimate	Preferred Estimate	Upper Transfer Estimate
Direct employer costs	\$394.7	\$464.2	\$409.7
Reg. familiarization	\$324.9	\$324.9	\$324.9
Adjustment costs	\$66.6	\$66.6	\$66.6
Managerial costs	\$3.2	\$72.7	\$18.1
Transfers	\$234.7	\$526.9	\$1,053.9

Note 1: Pooled data for 2015-2017 adjusted to reflect 2017.

## 2. Effects by Regions and Industries

This section presents estimates of the effects of this proposed rule by region and by industry. The Department analyzed effects on low-wage regions by comparing the number of affected workers, costs, and transfers across the four Census Regions. The region with the largest number of affected workers would be the South (544,000). However, as a share of potentially affected workers in the region, the South would not be significantly more affected relative to other regions (6.4 percent are affected compared with 4.4 to 5.0 percent in other regions). As a

<sup>247</sup> In the lower transfer estimate, managerial costs are for employees whose hours change because their hourly rate increased to the minimum wage.

share of all workers in the region, the South would also not be particularly affected relative to other regions (1.1 percent are affected compared with 0.8 to 0.9 percent in other regions).

Table 21: Potentially Affected and Affected Workers, by Region, Year 1

Region	Workers Subject to FLSA (Millions)	Potentially Affected Workers (Millions) [a]	Affected Workers			
			Number (Millions) [b]	Percent of Total Affected	Percent of Potentially Affected Workers in Region	Percent of All Workers in Region
All	135.9	24.3	1.271	100%	5.2%	0.9%
Northeast	25.0	5.1	0.226	17.7%	4.4%	0.9%
Midwest	30.1	5.0	0.251	19.7%	5.0%	0.8%
South	49.4	8.5	0.544	42.8%	6.4%	1.1%
West	31.5	5.6	0.251	19.7%	4.5%	0.8%

Note: Pooled data for 2015-2017 adjusted to reflect 2017.

[a] Potentially affected workers are EAP exempt workers who are white collar, salaried, not eligible for another (non-EAP) overtime exemption, and not in a named occupation.

[b] Estimated number of workers exempt under the EAP exemptions who would be entitled to overtime protection under the updated salary levels (if their weekly earnings do not increase to the new salary levels).

Total transfers in the first year were estimated to be \$526.9 million (Table 22). As expected, the transfers in the South would be the largest portion because the largest number of affected workers would be in the South; however, transfers per affected worker would be the lowest in the South. Annual transfers per worker would be \$336 in the South, but \$437 to \$511 in other regions.

Table 22: Transfers by Region, Year 1

Region	Total Change in Earnings (Millions)	Percent of Total	Per Affected Worker
All	\$526.9	100%	\$414.44
Northeast	\$115.3	21.9%	\$511.25
Midwest	\$109.6	20.8%	\$437.34
South	\$182.7	34.7%	\$335.63

West	\$119.3	22.6%	\$475.47
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Note: Pooled data for 2015-2017 adjusted to reflect 2017.

Direct employer costs are composed of regulatory familiarization costs, adjustment costs, and managerial costs. Total first year direct employer costs would be \$464.2 million (Table 23). Total direct employer costs would be the highest in the South (\$172.2 million) and lowest in the Northeast (\$87.0 million). While the three components of direct employer costs vary as a percent of these total costs by region, the percentage of total direct costs in each region would be fairly consistent with the share of all workers in a region. Direct employer costs in each region as a percentage of the total direct costs would range from 18.7 percent in the Northeast, to 37.1 percent in the South. Once again, these proportions are almost the same as the proportions of the total workforce in each region: 18.4 percent in the Northeast and 36.3 percent in the South.

Table 23: Direct Employer Costs by Region, Year 1

Region	Regulatory Familiarization	Adjustment	Managerial	Total Direct Costs
Costs (Millions)				
All	\$324.9	\$66.6	\$72.7	\$464.2
Northeast	\$62.7	\$11.8	\$12.5	\$87.0
Midwest	\$71.4	\$13.1	\$16.4	\$100.9
South	\$114.2	\$28.5	\$29.5	\$172.2
West	\$76.7	\$13.1	\$14.3	\$104.2
Percent of Total Costs by Region				
All	100.0%	100.0%	100.0%	100.0%
Northeast	19.3%	17.7%	17.2%	18.7%
Midwest	22.0%	19.7%	22.5%	21.7%
South	35.1%	42.8%	40.6%	37.1%
West	23.6%	19.7%	19.7%	22.4%

Note: Pooled data for 2015-2017 adjusted to reflect 2017.

Another way to compare the relative effects of this proposed rule by region is to consider the transfers and costs as a proportion of current payroll and current revenues (Table 24).

Nationally, employer costs and transfers would be approximately 0.013 percent of payroll. By region, direct employer costs and transfers as a percent of payroll would be also approximately the same (between 0.012 and 0.014 percent of payroll). Employer costs and transfers as a percent of revenue would be 0.002 percent nationally and in each region.

Table 24: Annual Transfers and Costs as Percent of Payroll and of Revenue by Region, Year 1

Region	Payroll (Billions)	Revenue (Billions)	Costs and Transfers	
			As Percent of Payroll	As Percent of Revenue
All	\$7,461	\$42,832	0.0133%	0.0023%
Northeast	\$1,646	\$8,614	0.0122%	0.0023%
Midwest	\$1,589	\$9,766	0.0132%	0.0022%
South	\$2,483	\$15,308	0.0143%	0.0023%
West	\$1,743	\$9,145	0.0128%	0.0024%

Notes: Pooled data for 2015-2017 adjusted to reflect 2017. Payroll, revenue, costs, and transfers all exclude the federal government.

Sources: Private sector payroll and revenue data from 2012 SUSB. State and local payroll data from State and Local Government Finances Summary: FY2015.

In order to gauge the effect of the proposed rule on industries, the Department compared estimates of combined direct costs and transfers as a percent of payroll, profit, and revenue for the 13 major industry groups (Table 25).<sup>248</sup> This provides a common method of assessing the relative effects of the rule on different industries, and the magnitude of adjustments the rule may require on the part of enterprises in each industry. The relative costs and transfers expressed as a percentage of payroll are particularly useful measures of the relative size of adjustment faced by organizations in an industry because they benchmark against the cost category directly associated with the labor force. Measured in these terms, costs and transfers as a percent of payroll would

<sup>248</sup> Note that the totals in this table for transfers and direct costs do not match the totals in other sections due to the exclusion of transfers to federal workers and costs to federal entities. Federal costs and transfers are excluded to be consistent with payroll and revenue which exclude the federal government.

be highest in agriculture, forestry, fishing, and hunting; leisure and hospitality; and other services. However, the overall magnitude of the relative shares would be small, representing less than 0.1 percent of overall payroll costs across industries.

The Department also estimated transfers and costs as a percent of profits.<sup>249</sup> Benchmarking against profits is potentially helpful in the sense that it provides a measure of the proposed rule's effect against returns on investment. However, this metric must be interpreted carefully as it does not account for differences across industries in risk-adjusted rates of return, which are not readily available for this analysis. The ratio of costs and transfers to profits also does not reflect differences in the firm-level adjustment to changes in profits reflecting cross-industry variation in market structure.<sup>250</sup> Nonetheless, the overall magnitude of costs and transfers as a percentage of profits would be small, representing in less than 0.3 percent of overall profits in every industry. The range of values of total costs and transfers would vary among industries as a percent of profits ranging from a low of 0.02 percent (financial activities) to a high of 0.28 percent (agriculture, forestry, fishing, and hunting). However, because the share is less than 0.3 percent, even for the industry with the largest impact, we believe this proposed rule would not disproportionately affect any industries.

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<sup>249</sup> Internal Revenue Service. (2013). Corporation Income Tax Returns. Available at: <https://www.irs.gov/statistics/soi-tax-stats-corporation-complete-report>. Table 5 of the IRS report provides information on total receipts, net income, and deficits. The Department calculated the ratio of net income (column (7)) less any deficit (column (8)) to total receipts (column (3)) for all firms by major industry categories. Costs and transfers as a percent of revenues were divided by the profit to receipts ratios to calculate the costs and transfers as a percent of profit.

<sup>250</sup> In particular, a basic model of competitive product markets would predict that highly competitive industries with lower rates of return would adjust to increases in the marginal cost of labor arising from the rule through an overall, industry-level increase in prices and a reduction in quantity demanded based on the relative elasticities of supply and demand. Alternatively, more concentrated markets with higher rates of return would be more likely to adjust through some combination of price increases and profit reductions based on elasticities as well as interfirm pricing responses.

Finally, the Department's estimates of transfers and costs as a percent of revenue by industry also indicated very small effects (Table 25) of less than 0.02 percent of revenues in any industry. The industries with the largest costs and transfers as a percent of revenue would be agriculture, forestry, fishing, and hunting; and leisure and hospitality. However, the difference between the agriculture, forestry, fishing, and hunting industry, the industry with the highest costs and transfers as a percent of revenue, and the industry with the lowest costs and transfers as a percent of revenue (public administration), would be only 0.011 percentage points. Table 25 illustrates that the actual differences in costs relative to revenues would be quite small across industry groupings.

Table 25: Annual Transfers, Total Costs, and Transfers and Costs as Percent of Payroll, Revenue, and Profit by Industry, Year 1

Industry	Transfers (Millions)	Direct Costs (Millions)	Costs and Transfers		
			As Percent of Payroll	As Percent of Revenue	As Percent of Profit [a]
All	\$525.7	\$454.2	0.013%	0.002%	0.04%
Agriculture, forestry, fishing, & hunting	\$3.0	\$1.1	0.066%	0.012%	0.28%
Mining	\$8.5	\$2.1	0.016%	0.002%	0.05%
Construction	\$13.7	\$31.7	0.015%	0.003%	0.09%
Manufacturing	\$75.8	\$25.3	0.016%	0.002%	0.03%
Wholesale & retail trade	\$103.6	\$84.5	0.024%	0.001%	0.05%
Transportation & utilities	\$21.0	\$14.6	0.014%	0.003%	0.10%
Information	\$23.3	\$11.3	0.013%	0.003%	0.03%
Financial activities	\$53.3	\$51.2	0.016%	0.002%	0.02%
Professional & business services	\$71.0	\$75.0	0.011%	0.006%	0.06%
Education & health services	\$67.6	\$68.4	0.014%	0.005%	0.10%
Leisure & hospitality	\$51.6	\$43.7	0.033%	0.010%	0.19%
Other services	\$14.8	\$36.1	0.032%	0.008%	0.20%
Public administration	\$18.58	\$9.1	0.003%	0.001%	[b]

Sources: Private sector payroll and revenue data from 2012 Economic Census. State and local payroll and revenue data from State and Local Government Finances Summary: FY2015 are

used for the Public Administration industry. Profit to revenue ratios calculated from 2012 Internal Revenue Service Corporation Income Tax Returns.

[a] Profit data based on corporations only.

[b] Profit is not applicable for public administration.

Although labor market conditions vary by Census Region and industry, the effects from updating the standard salary level and the HCE compensation level would not unduly affect any of the regions or industries. The proportion of total costs and transfers in each region would be fairly consistent with the proportion of total workers in each region. Additionally, although the shares will be larger for some firms and smaller for others, the average estimated costs and transfers from this proposed rule are very small relative to current payroll or current revenue—generally less than a tenth of a percent of payroll and less than two-hundredths of a percent of revenue in each region and in each industry.

#### vii. Regulatory Alternatives

As mentioned earlier, the Department considered a range of alternatives before selecting the 2004 methodology for updating the standard salary level and the 2016 methodology for updating the HCE compensation level (*see* section VI.C.i). As seen in Table 26, the Department has calculated 2017 salary levels, the number of affected workers, and the associated costs and transfers for the alternative methods that the Department considered. Regulatory familiarization costs were not included because they do not vary over the alternatives. As with the regulatory analysis for the proposed levels, we use 2017 salary levels and 2017 earnings data to estimate the effect of January 2020 salary levels and 2020 earnings.

Table 26: Updated Standard Salary and HCE Compensation Levels and Alternatives, Affected EAP Workers, Costs, and Transfers, Year 1

Alternative	2017 Salary	Affected EAP	Year 1 Effects (Millions)
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	Level [a]	Workers (1,000s)	Adj. & Managerial Costs [b]	Transfers
<b>Standard Salary Level (Weekly)</b>				
Alt. #0: Maintain average minimum wage protection since 2004 [c]	\$503	242	\$21.5	\$35.7
Alt. #1: Inflate 2004 level using PCEPI	\$597	786	\$77.9	\$155.2
Alt. #2: Inflate 2004 level using Chained CPI	\$599	787	\$78.0	\$158.3
Alt. #3: Inflate 2004 level using CPI-U	\$620	924	\$94.1	\$207.5
Alt. #4: Inflate 2004 level using ECI civilian	\$639	1,069	\$110.6	\$250.1
Proposed rule: 2004 method	\$641	1,070	\$111.4	\$252.5
Alt. #5: Inflate 2004 level using ECI private	\$643	1,072	\$111.8	\$255.0
<b>HCE Compensation Level (Annually)</b>				
HCE alt. #1: No change	\$100,000	0	--	--
HCE alt. #2: Inflate 2004 level using PCEPI	\$131,189	186	\$24.4	\$226.4
HCE alt. #3: Inflate 2004 level using Chained CPI	\$131,750	186	\$24.5	\$229.0
HCE alt. #4: Inflate 2004 level using CPI-U	\$136,253	198	\$26.2	\$257.1
Proposed rule: 90th percentile of full-time salaried workers	\$139,464	201	\$27.9	\$274.3
HCE alt. #5: Inflate 2004 level using ECI civilian	\$140,480	204	\$28.1	\$277.8
HCE alt. #6: Inflate 2004 level using ECI private	\$141,337	204	\$28.3	\$280.3

Note: Pooled data for 2015-2017 adjusted to reflect 2017.

[a] These salary levels reflect estimated values for 2017 to approximate Year 1 effects.

[b] Regulatory familiarization costs are excluded because they do not vary based on the selected values of the salary levels.

[c] When the \$455 weekly threshold was established in 2004, the federal minimum wage was \$5.15, so the salary threshold was equivalent to the earnings of an employee working 72.2 hours at the minimum wage (including time-and-a-half for hours beyond the fortieth in a week). That amount fell with increases in the minimum wage and is now 55.2 hours. The weighted average across the 15 years since the overtime threshold was last changed is 59.6 hours, and a threshold that would provide 59.6 hours of \$7.25 minimum wage protection and overtime pay for hours over 40 would be \$503.

## viii. Projections

### 1. Methodology

The Department projected affected workers, costs, and transfers forward for ten years.

This involved several steps.

First, the Department calculated workers' projected earnings in future years. The wage growth rate is calculated as the compound annual growth rate in median wages using the historical CPS MORG data for occupation-industry categories from 2007 to 2016.<sup>251</sup> This is the annual growth rate that when compounded (applied to the first year's wage, then to the resulting second year's wage, etc.) yields the last historical year's wage. In occupation-industry categories where the CPS MORG data had an insufficient number of observations to reliably calculate median wages, the Department used the growth rate in median wages calculated from BLS' Occupational Employment Statistics (OES).<sup>252</sup> Any remaining occupation-industry combinations without estimated median growth rates were assigned the median of the growth rates in median wages from the CPS MORG data for all industries and occupations. For projecting costs, we similarly projected wage rates for the human resource and managerial workers whose time is spent on these tasks.

Second, the Department compared workers' counter-factual earnings (*i.e.*, absent any rulemakings) to the earnings levels. If the counter-factual earnings are below the relevant level (*i.e.*, standard or HCE) then the worker is considered affected. In other words, in each year affected EAP workers were identified as those who would be exempt in Year 1 absent any change to the current regulations but have projected earnings in the future year that are less than the relevant salary level.

Third, sampling weights were adjusted to reflect employment growth. The employment growth rate is the compound annual growth rate based on the ten-year employment projection

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<sup>251</sup> To increase the number of observations, three years of data were pooled for each of the endpoint years. Specifically, data from 2006, 2007, and 2008 (converted to 2007 dollars) were used to calculate the 2007 median wage and data from 2015, 2016, and 2017 (converted to 2016 dollars) were used to calculate the 2016 median wage.

<sup>252</sup> To lessen small sample bias, this rate was only calculated using CPS MORG data when these data contained at least 30 observations in each period.

from BLS' National Employment Matrix (NEM) for 2016 to 2026 within an occupation-industry category.

Adjusted hours for workers affected in Year 1 were re-estimated in Year 2 using a long-run elasticity of labor demand of -0.4.<sup>253</sup> For workers newly affected in Year 2 through Year 10, employers' wage and hour adjustments are estimated in that year, as described in section VI.D.iv, except the long-run elasticity of labor demand of -0.4 is used. Employer adjustments are made in the first year the worker is affected and then applied to all future years in which the worker continues to be affected (unless the worker switches to a Type 4 worker). Workers' earnings in predicted years are earnings post employer adjustments, with overtime pay, and with ongoing wage growth based on historical growth rates (as described above).

## 2. Estimated Projections

The Department estimated that the proposed rule would affect 1.3 million EAP workers in Year 1 and 1.1 million workers in Year 10 (Table 27). The projected number of affected workers includes workers who were not EAP exempt in the base year but would have become exempt in the absence of this proposed rule in Years 2 through 10. For example, a worker who passes the standard duties test may earn less than \$455 in Year 1 but between \$455 and the new salary level in subsequent years; such a worker would be counted as an affected worker.

The Department quantified three types of direct employer costs in the ten-year projections: (1) regulatory familiarization costs; (2) adjustment costs; and (3) managerial costs. Regulatory familiarization costs only occur in Year 1. Although start-up firms must still become familiar with the FLSA following Year 1, the difference between the time necessary for

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<sup>253</sup> This elasticity estimate is based on the Department's analysis of the following paper: Lichter, A., Peichl, A. & Sieglöcher, A. (2014). The Own-Wage Elasticity of Labor Demand: A Meta-Regression Analysis. IZA DP No. 7958.

familiarization with the current part 541 regulations and the regulations as modified by the proposed rule is essentially zero. Therefore, projected regulatory familiarization costs for new entrants over the next nine years would be zero.

Adjustment costs would occur in any year in which workers are newly affected. After Year 1, these costs would be relatively small since the majority of workers would be affected in Year 1. Management costs would recur each year for all affected EAP workers whose hours are adjusted. However, managerial costs generally decrease over time as the number of affected EAP workers decreases. The Department estimated that Year 1 managerial costs would be \$72.7 million; by Year 10 these costs decline to \$64.2 million.

The Department projected two types of transfers from employers to employees associated with workers affected by the regulation. Transfers due to the minimum wage provision would be \$57.0 million in Year 1 and would fall to \$17.6 million in Year 10 as increased earnings over time move workers' implicit rate of pay above the minimum wage.<sup>254</sup> Transfers due to overtime pay decline over time because the number of affected workers decreases. Thus, transfers due to the overtime pay provision would decrease from \$469.9 million in Year 1 to \$429.5 million in Year 10.<sup>255</sup>

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<sup>254</sup> Increases in minimum wages were not projected. If state or federal minimum wages increase during the projected timeframe, as anticipated, then projected minimum wage transfers may be underestimated.

<sup>255</sup> If earnings levels were in fact updated quadrennially as the Department intends, which remains a matter within the Secretary's sole discretion, then the potential projected costs and transfers would be higher in the Department's estimation than those shown here, based on the Department's estimates on future outcomes many years into the future. Because those potential costs and transfers would be the result of any future rulemakings and therefore included in the economic analyses of those rulemakings, they have not been incorporated into this analysis. The Department has estimated these potential costs and transfers, however. With updates in Years 6 and 10, the ten-year annualized costs, based on the Department's estimates and subject to change given that it relies on future projections and the Secretary's discretionary actions, would increase

Projected costs and transfers were deflated to 2017 dollars using the Congressional Budget Office's projections for the CPI-U.<sup>256</sup>

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from \$120.5 million to \$135.9 million. Annualized transfers would increase from \$429.4 million to \$510.0 million.

<sup>256</sup> Congressional Budget Office. 2018. The Budget and Economic Outlook: 2018 To 2028. *See* <https://www.cbo.gov/publication/53651>

Table 27: Projected Costs and Transfers, Standard and HCE Salary Levels

Year (Year #)	Affected EAP Workers (Millions)	Costs				Transfers		
		Reg. Fam.	Adjust- ment [a]	Manag- erial	Total	Due to MW	Due to OT	Total
		(Millions 2017\$)						
Year								
Year 1	1.3	\$324.9	\$66.6	\$72.7	\$464.2	\$57.0	\$469.9	\$526.9
Year 2	1.2	\$0.0	\$1.5	\$72.7	\$74.2	\$30.4	\$390.9	\$421.3
Year 3	1.2	\$0.0	\$1.7	\$68.5	\$70.2	\$28.0	\$374.9	\$402.8
Year 4	1.1	\$0.0	\$2.2	\$66.5	\$68.7	\$25.4	\$378.0	\$403.4
Year 5	1.1	\$0.0	\$2.9	\$63.0	\$65.9	\$25.8	\$380.5	\$406.3
Year 6	1.0	\$0.0	\$3.4	\$62.5	\$65.9	\$25.2	\$375.5	\$400.7
Year 7	1.0	\$0.0	\$3.2	\$60.3	\$63.6	\$21.9	\$387.2	\$409.1
Year 8	1.0	\$0.0	\$3.3	\$60.8	\$64.1	\$19.2	\$401.9	\$421.1
Year 9	1.0	\$0.0	\$3.4	\$61.8	\$65.1	\$18.5	\$413.4	\$431.9
Year 10	1.1	\$0.0	\$3.6	\$64.2	\$67.8	\$17.6	\$429.5	\$447.1
Annualized value								
3% real discount rate	--	\$37.0	\$10.0	\$65.6	\$112.6	\$27.7	\$400.3	\$428.0
7% real discount rate	--	\$43.2	\$11.2	\$66.0	\$120.5	\$28.6	\$400.7	\$429.4

[a] Adjustment costs occur in all years when there are newly affected workers. Adjustment costs may occur in years without updated salary levels because some workers' projected earnings are estimated using negative earnings growth.

Table 27 also summarizes annualized costs and transfers over the ten-year projection period, using 3 percent and 7 percent real discount rates. The Department estimated that total direct employer costs have an annualized value of \$120.5 million per year over ten years when using a 7 percent real discount rate. The annualized value of total transfers was estimated to equal \$429.4 million.

ix. Alternative Regulatory Baseline, Including Calculation of Cost Savings under Executive Order 13771

Other portions of this regulatory impact analysis contain estimates of the impacts of this proposed rule relative to the 2004 final rule, which is the policy that the Department is currently enforcing. However, Circular A-4 states that multiple regulatory baselines may be analytically relevant. In this case, a second informative baseline is the 2016 final rule, which is currently in the Code of Federal Regulations (CFR).<sup>257</sup> Moreover, for purposes of determining whether this proposed rule is deregulatory under E.O. 13771, the economic impacts should be compared to what is currently published in the CFR. As such, most of this section presents an estimate of the cost savings of this proposed rule relative to the 2016 rule, and in addition to estimating annualized cost savings for the proposed rule using a 10-year time horizon, we also estimated annualized costs savings in perpetuity in accordance with E.O. 13771 accounting standards. Later in this section, the Department presents transfer and benefits estimates from the analysis accompanying the 2016 final rule—values that are also relevant to this second regulatory baseline.

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<sup>257</sup> 29 CFR Part 541

To ensure the estimated costs of the 2016 final rule can be directly and appropriately compared with the costs estimated for this proposed rule, the Department started with the analytic model for this proposed rule and replaced the proposed salary and compensation thresholds with the thresholds set in the 2016 final rule. The Department assumed that initial regulatory familiarization costs would be identical under adoption of either the proposed rule or the 2016 final rule, because the same number of employers would be potentially affected in Year 1. In addition, the Department added the updated thresholds from the planned triennial updates in years 4, 7 and 10 from the 2016 final rule. Therefore, the *only* differences in estimated costs presented here between the 2016 final rule and this proposed rule are attributable to the initial difference in earnings thresholds and the effects of the 2016 final rule’s automatic updating mechanism, which updates the thresholds every three years.

Table 28: Weekly Earnings Thresholds Used in Comparison of 2016 Final Rule and 2018 Proposed Rule

Year	2016 Final Rule		2018 Proposed Rule	
	Standard Salary Threshold	HCE Compensation Threshold	Standard Salary Threshold	HCE Compensation Threshold
Year 1	\$913	\$2,577	\$641	\$2,682
Year 4	\$984	\$2,837	\$641	\$2,682
Year 7	\$1,049	\$3,080	\$641	\$2,682
Year 10	\$1,118	\$3,345	\$641	\$2,682

Note: Year 1 impacts are calculated using 2017 pooled CPS MORG data (the most recently available data); therefore, the earnings thresholds in Year 1 must correspond to the levels that would have been in effect under each rule had the rule been promulgated in 2017. These figures are the Department’s best approximation for impacts starting in 2020, the earliest year the Department expects the proposed earnings levels to be implemented.

However, this approach means that the estimated costs presented here for the 2016 final rule are not directly comparable to those published in the Federal Register (81 FR 32391). The

differences between the previously published 2016 cost estimates and those presented here are primarily due to: an increase in the number of establishments that would incur regulatory familiarization costs to account for economic growth between 2012 (estimates for the 2016 final rule were based on 2012 SUSB data) and 2015 (this proposed rule is based on 2015 SUSB data); the use of more recent CPS MORG data (the 2016 final rule used pooled CPS data for 2013 through 2015 inflated to represent FY 2017); an increase in the wage rates used to value staff time spent on regulatory familiarization, adjustment, and monitoring; incorporating a 17 percent overhead rate in those wage rates; and minor improvements to the model.<sup>258</sup>

Table 29 presents the estimated number of affected EAP workers, and direct regulatory, adjustment, and managerial costs for the 2016 final rule calculated using the 2018 analytic model.

Table 29: Adjusted 2016 Final Rule Projected Costs and Transfers, Standard Salary and HCE Compensation Levels

Year	Affected EAP Workers (Millions)	Costs			
		Reg. Fam.	Adjustment [a]	Managerial	Total
		(Millions FY2017\$)			
Year 1	4.1	\$324.9	\$215.2	\$241.2	\$781.3
Year 2	4.0	\$0.0	\$1.5	\$231.6	\$233.1
Year 3	3.8	\$0.0	\$1.7	\$221.8	\$223.5
Year 4	4.5	\$27.6	\$14.3	\$262.3	\$304.2
Year 5	4.4	\$0.0	\$2.9	\$253.7	\$256.6
Year 6	4.3	\$0.0	\$3.5	\$247.5	\$251.0
Year 7	4.9	\$28.2	\$9.4	\$279.1	\$316.6

<sup>258</sup> As previously discussed, one such improvement is the Department's application of conditional probabilities to estimate the number of HCE workers. *See supra* note 193.

Year 8	4.8	\$0.0	\$3.3	\$270.5	\$273.7
Year 9	4.7	\$0.0	\$3.4	\$267.9	\$271.2
Year 10	5.4	\$28.8	\$13.7	\$303.2	\$345.6
Annualized value					
3% real rate	--	\$45.1	\$29.7	\$256.2	\$331.0
7% real rate	--	\$50.8	\$33.5	\$254.2	\$338.6

[a] Adjustment costs occur in all years when there are newly affected workers, including years when the salary level is not updated. Adjustment costs may occur in years without updated salary levels because some workers' projected earnings are estimated using negative earnings growth.

The Department then subtracted direct regulatory costs expected to have been incurred under the 2016 final rule from the direct costs estimated under this proposed rule (*see* Table 27). As shown in Table 30, direct employer costs of the proposed rule are estimated to be, on average, \$224.0 million lower per year in perpetuity than the 2016 final rule (using a 7 percent discount rate).

Table 30: Difference in Costs between 2016 Final Rule and this Proposed Rule

Year	Reduction in Affected EAP Workers (Millions)	Reduction in Costs			
		Reg. Fam.	Adjustment [a]	Managerial	Total
		(Millions FY2017\$)			
Year					
Year 1	2.8	\$0.0	\$148.6	\$168.5	\$317.1
Year 2	2.7	\$0.0	\$0.0	\$158.9	\$158.9
Year 3	2.6	\$0.0	\$0.0	\$153.3	\$153.3
Year 4	3.4	\$27.6	\$12.1	\$195.8	\$235.5
Year 5	3.3	\$0.0	\$0.0	\$190.7	\$190.7
Year 6	3.2	\$0.0	\$0.1	\$185.1	\$185.1
Year 7	3.9	\$28.2	\$6.1	\$218.7	\$253.1
Year 8	3.8	\$0.0	\$0.0	\$209.6	\$209.6
Year 9	3.6	\$0.0	\$0.0	\$206.1	\$206.1

Year 10	4.3	\$28.8	\$10.1	\$238.9	\$277.8
Annualized Value: 10-Year Time Horizon					
3% real discount rate	--	\$8.1	\$19.6	\$190.6	\$218.4
7% real discount rate	--	\$7.6	\$22.4	\$188.2	\$218.2
Annualized Value: Perpetual Time Horizon					
3% real discount rate	--	\$9.0	\$7.5	\$210.9	\$227.4
7% real discount rate	--	\$8.3	\$12.6	\$203.1	\$224.0

[a] Adjustment costs occur in all years when there are newly affected workers, including years when the salary level is not updated. Adjustment costs may occur in years without updated salary levels because some workers' projected earnings are estimated using negative earnings growth.

The cost savings from the proposed rule are primarily attributable to two factors. First, a lower standard salary level will result in fewer affected workers in any given year. If fewer workers are affected, then management must consider and make earnings adjustments for fewer employees, and must monitor hours worked for fewer employees. Second, this analysis does not incorporate automatic updating whereas the 2016 final rule incorporated a triennial automatic updating mechanism. Therefore, regulatory familiarization costs are now only incurred in Year 1 and adjustment costs are primarily incurred in Year 1. Additionally, managerial costs now gradually decrease over time rather than increasing every three years.

In the 2016 final rule, the Department estimated average annualized transfers of \$1,189.1 million over a ten-year period using a discount rate of 7 percent. The Department also estimated that avoided litigation costs resulting from the rule could total approximately \$31.2 million per year.<sup>259</sup> The Department includes these values here for reference.

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<sup>259</sup> In this proposed rule, the Department has revised how it calculates avoided litigation costs so the number referenced here for the 2016 final rule is not directly comparable to the calculation of reduced litigation costs for this proposal.

## VII. Initial Regulatory Flexibility Analysis (IRFA)

The Regulatory Flexibility Act of 1980 (RFA) as amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA), hereafter jointly referred to as the RFA, requires that an agency prepare an initial regulatory flexibility analysis (IRFA) when proposing, and a final regulatory flexibility analysis (FRFA) when issuing, regulations that will have a significant economic impact on a substantial number of small entities. The agency is also required to respond to public comment on the NPRM.<sup>260</sup> The Chief Counsel for Advocacy of the Small Business Administration was notified of this proposed rule upon submission of the rule to OMB under Executive Order 12866. The Department invites commenters to provide input on data analysis and/or methodology used throughout this IRFA.

### A. Reasons Why Action by the Agency is Being Considered

The standard salary level and HCE total compensation levels have not been updated since 2004<sup>261</sup> and, as described in detail in section VI.A.ii., the standard salary level has declined considerably in real terms relative to the 2004 value. As a result, the standard salary level's usefulness in identifying nonexempt workers has eroded over time. Similarly, the HCE annual compensation requirement is out of date; more than twice as many workers earn at least \$100,000 annually compared to when it was adopted in 2004. Additionally, the Department's

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<sup>260</sup> See 5 U.S.C. 604.

<sup>261</sup> The Department revised the EAP salary levels in 2004. In 2016, the Department also issued a final rule revising the EAP salary levels, however, on August 31, 2017, the U.S. District Court for Eastern District of Texas held that the 2016 final rule's standard salary level exceeded the Department's authority and was therefore invalid. See *Nevada v. U.S. Dep't of Labor*, 275 F. Supp. 3d 795 (E.D. Tex. 2017). Until the Department issues a new final rule, it is enforcing the part 541 regulations in effect on November 30, 2016, including the \$455 per week standard salary level set in the 2004 final rule.

2016 final rule updating the standard salary level and the HCE annual compensation requirement was declared invalid because the rule would make nonexempt too many employees whose exemption status should have been determined by their duties. Therefore, the Department believes that rulemaking is necessary in order to correct the deficiencies in the 2016 final rule and restore the effectiveness of the salary levels.

#### B. Statement of Objectives and Legal Basis for the Proposed Rule

Section 13(a)(1) creates a minimum wage and overtime pay exemption for bona fide executive, administrative, professional, and outside sales employees, and teachers and academic administrative personnel, as those terms are defined and delimited by the Secretary of Labor. The regulations in part 541 contain specific criteria that define each category of exemption. The regulations also define those computer employees who are exempt under section 13(a)(1) and section 13(a)(17). To qualify for exemption, employees must meet certain tests regarding their job duties and generally must be paid on a salary basis at not less than \$455 per week.

The Department's primary objective in this rulemaking is to ensure that the revised salary levels will continue to provide a useful and effective test for exemption. The premise behind the standard salary level is to be an appropriate dividing-line between employees who are nonexempt from employees who may be performing exempt duties. The threshold essentially screens out obviously nonexempt employees whom Congress intended to be protected by the FLSA's minimum wage and overtime provisions. If left unchanged, the effectiveness of the salary level test as a means of determining exempt status diminishes as nonexempt employee wages increase over time.

Given that the 2016 final rule was invalidated, the Department last updated the salary levels in the 2004 final rule, which set the standard test threshold at \$455 per week for EAP employees. The 2004 final rule also created a new “highly compensated” test for exemption. Under the HCE exemption, employees who are paid total annual compensation of at least \$100,000 (which must include at least \$455 per week paid on a salary or fee basis) are exempt from the FLSA’s overtime requirements if they customarily and regularly perform at least one of the duties or responsibilities of an exempt EAP employee identified in the standard tests for exemption.<sup>262</sup>

Employees who meet the requirements of part 541 are excluded from the Act’s minimum wage and overtime pay protections. As a result, employees may work any number of hours in the workweek and not be subject to the FLSA’s overtime pay requirements. Some state laws have stricter exemption standards than those described above. The FLSA does not preempt any such stricter state standards. If a state law establishes a higher standard than the provisions of the FLSA, the higher standard applies as a matter of state law in that specific state.<sup>263</sup>

To restore the function of the standard salary level and the HCE total compensation requirements as appropriate bright-line tests between overtime-protected employees and those who may be bona fide EAP employees, the Department proposes to increase the minimum salary level necessary for exemption from the FLSA minimum wage and overtime requirements as an EAP employee from \$455 to \$679 a week for the standard salary test, and from \$100,000 to

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<sup>262</sup> § 541.601.

<sup>263</sup> *See* 29 U.S.C. 218

\$147,414 per year for the HCE test. To ensure that these levels continue to function appropriately in the future, the Department intends to update these levels every four years.

### C. Description of the Number of Small Entities to Which the Proposed Rule Will Apply

#### i. Definition of Small Entity

The RFA defines a “small entity” as a (1) small not-for-profit organization, (2) small governmental jurisdiction, or (3) small business. The Department used the entity size standards defined by SBA, in effect as of October 1, 2017, to classify entities as small.<sup>264</sup> SBA establishes separate standards for individual 6-digit NAICS industry codes, and standard cutoffs are typically based on either the average number of employees, or the average annual receipts. For example, small businesses are generally defined as having fewer than 500, 1,000, or 1,250 employees in manufacturing industries and less than \$7.5 million in average annual receipts for nonmanufacturing industries. However, some exceptions do exist, the most notable being that depository institutions (including credit unions, commercial banks, and non-commercial banks) are classified by total assets (small defined as less than \$550 million in assets). Small governmental jurisdictions are another noteworthy exception. They are defined as the governments of cities, counties, towns, townships, villages, school districts, or special districts with populations of less than 50,000 people.<sup>265</sup>

Parameters that are used in the small business cost analysis, and a summary of the effects, are provided in Table 31.

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<sup>264</sup> See [https://www.sba.gov/sites/default/files/files/Size\\_Standards\\_Table\\_2017.pdf](https://www.sba.gov/sites/default/files/files/Size_Standards_Table_2017.pdf).

<sup>265</sup> See <http://www.sba.gov/advocacy/regulatory-flexibility-act> for details.

Table 31: Overview of Parameters used for Costs to Small Businesses

Small Business Costs	Cost
<b>Direct and Payroll Costs</b>	
Average total cost per affected entity [a]	\$4,053
Range of total costs per affected entity [a]	\$1,146-\$100,536
Average percent of revenue per affected entity [a]	0.18%
Average percent of payroll per affected entity [a]	0.97%
Average percent of small business profit	0.06%
<b>Direct Costs</b>	
Regulatory familiarization	
Time (first year)	1 hour per establishment
Hourly wage	\$41.91
Adjustment	
Time (first year affected)	75 minutes per newly affected worker
Hourly wage	\$41.91
Managerial	
Time (weekly)	5 minutes per affected worker
Hourly wage	\$48.72
<b>Payroll Increases</b>	
Average payroll increase per affected entity [a]	\$3,187
Range of payroll increases per affected entity [a]	\$0-\$92,869

[a] Using the methodology where all employees at an affected small firm are affected. This assumption generates upper-end estimates. Lower-end cost estimates are significantly smaller.

## ii. Data Sources and Methods

The Department obtained data from several sources to determine the number of small entities and employment in these entities for each industry. However, the Statistics of U.S. Businesses (SUSB, 2012) was used for most industries. Industries for which the Department

used alternative sources include credit unions,<sup>266</sup> commercial banks and savings institutions,<sup>267</sup> agriculture,<sup>268</sup> and public administration.<sup>269</sup> The Department used the latest available data in each case, so data years differ between sources.

For each industry, the SUSB data tabulates total employment, establishment, and firm counts by both enterprise employment size (*e.g.*, 0-4 employees, 5-9 employees) and receipt size (*e.g.*, less than \$100,000, \$100,000-\$499,999).<sup>270</sup> The Department combined these categories with the SBA size standards to estimate the proportion of establishments and employees in each industry that are considered small or employed by a small entity, respectively. The general methodological approach was to classify all establishments or employees in categories below the SBA cutoff as in “small entity” employment.<sup>271</sup> If a cutoff fell in the middle of a defined category, a uniform distribution of employees across that bracket was assumed to determine what proportion should be classified as small. The Department assumed that the small entity share of

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<sup>266</sup> National Credit Union Association. (2012). 2012 Year End Statistics for Federally Insured Credit Unions. <https://www.ncua.gov/analysis/Pages/call-report-data/reports/chart-pack/chart-pack-2018-q1.pdf>.

<sup>267</sup> Federal Depository Insurance Corporation. (2018). Statistics on Depository Institutions - Compare Banks. Available at: <https://www5.fdic.gov/SDI/index.asp>. Data are from 3/31/18 for employment and data are from 6/30/2017 for share of firms and establishments that are “small”.

<sup>268</sup> United States Department of Agriculture. (2014). 2012 Census of Agriculture: United States Summary and State Data: Volume 1, Geographic Area Series, Part 51. Available at: [http://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1,\\_Chapter\\_1\\_US/usv1.pdf](http://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1,_Chapter_1_US/usv1.pdf).

<sup>269</sup> Hogue, C. (2012). Government Organization Summary Report: 2012. Available at: [http://www2.census.gov/govs/cog/g12\\_org.pdf](http://www2.census.gov/govs/cog/g12_org.pdf).

<sup>270</sup> The SUSB defines employment as of March 12th.

<sup>271</sup> The Department’s estimates of the numbers of affected small entities and affected workers who are employees of small entities are likely overestimates as the Department had no credible way to estimate which enterprises with annual revenues below \$500,000 also did not engage in interstate commerce.

credit card issuing and other depository credit intermediation institutions (which were not separately represented in FDIC asset data), is similar to that of commercial banking and savings institutions. The estimated share of employment in small entities was applied to the CPS data to estimate the number of affected workers in small entities.

The Department also estimated the number of small establishments by employer type (nonprofit, for-profit, government). The calculation of the number of establishments by employer type is similar to the calculation of the number of establishments by industry. However, instead of using SUSB data by industry, the Department used SUSB data by Legal Form of Organization for nonprofit and for-profit establishments, and data from the 2012 Census of Governments for small governments. The 2012 Census of Governments report includes a breakdown of state and local governments by the population of their underlying jurisdiction, allowing us to estimate the number of governments that are small. The Department welcomes comments on the data sets used in the analysis and alternative sources of data.

### iii. Number of Small Entities Affected by the Proposed Rule

Table 32 presents the estimated number of establishments and small establishments in the U.S. (hereafter, the terms “establishment” and “entity” are used interchangeably and are considered equivalent for the purposes of this IRFA).<sup>272</sup> Based on the methodology described

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<sup>272</sup> SUSB reports data by “enterprise” size designations (a business organization consisting of one or more domestic establishments that were specified under common ownership or control). However, the number of enterprises is not reported for the size designations. Instead, SUSB reports the number of “establishments” (individual plants, regardless of ownership) and “firms” (a collection of establishments with a single owner within a given state and industry) associated with enterprises size categories. Therefore, numbers in this analysis are for the number of establishments associated with small enterprises, which may exceed the number of small

above, the Department found that of the 7.8 million establishments relevant to this analysis, more than 80 percent (6.3 million) are small by SBA standards. These small establishments employ about 51.5 million workers, about 37 percent of workers employed by all establishments (excluding self-employed, unpaid workers, and members of the armed forces), and account for roughly 36 percent of total payroll (\$2.6 trillion of \$7.4 trillion).<sup>273</sup>

Table 32: Number of Establishments and Employees by SBA Size Standards, by Industry and Employer Type

Industry / Employer Type	Establishments (1,000s)		Workers (1,000s) [a]		Annual Payroll (Billions)	
	Total	Small	Total	Small Business Employed	Total	Small
Total	7,754.0	6,270.4	139,636.5	51,542.2	\$7,359.5	\$2,621.7
Industry [b]						
Agriculture	9.2	8.5	[c]	[c]	[c]	[c]
Forest., log., fish., hunt., and trap.	13.1	12.8	[c]	[c]	[c]	[c]
Mining	29.2	23.6	[c]	[c]	[c]	[c]
Construction	682.4	663.0	7,955.8	5,153.8	\$421.2	\$271.5
Nonmetallic mineral prod. manuf.	14.7	11.3	[c]	[c]	[c]	[c]
Prim. metals and fab. metal prod.	59.3	55.7	1,636.3	992.3	\$87.3	\$50.8
Machinery manufacturing	23.8	21.7	1,267.0	678.3	\$78.1	\$41.7
Computer and elect. prod. manuf.	12.7	11.3	1,211.3	562.2	\$107.2	\$50.3
Electrical equip., appliance manuf.	5.7	4.9	[c]	[c]	[c]	[c]

enterprises. We based the analysis on the number of establishments rather than firms for a more conservative estimate (potential overestimate) of the number of small businesses.

<sup>273</sup> Since information is not available on employer size in the CPS MORG, respondents were randomly assigned as working in a small business based on the SUSB probability of employment in a small business by detailed Census industry. Annual payroll was estimated based on the CPS weekly earnings of workers by industry size.

Transportation equip. manuf.	11.9	10.2	2,522.2	711.3	\$165.9	\$43.9
Wood products	14.1	12.9	[c]	[c]	[c]	[c]
Furniture and fixtures manuf.	15.1	14.7	[c]	[c]	[c]	[c]
Misc. and not spec. manuf.	26.6	25.6	1,464.6	861.7	\$86.3	\$49.8
Food manufacturing	26.8	23.6	1,761.2	834.6	\$75.1	\$34.2
Beverage and tobacco products	8.0	7.1	[c]	[c]	[c]	[c]
Textile, app., and leather manuf.	16.7	16.2	590.2	391.1	\$25.5	\$17.0
Paper and printing	29.9	27.8	883.7	475.9	\$47.8	\$24.2
Petroleum and coal prod. manuf.	2.1	1.2	[c]	[c]	[c]	[c]
Chemical manufacturing	13.2	10.5	1,377.9	545.5	\$109.4	\$41.6
Plastics and rubber products	12.3	10.3	[c]	[c]	[c]	[c]
Wholesale trade	413.4	329.1	3,453.2	1,617.5	\$208.4	\$96.5
Retail trade	1,070.2	689.6	15,784.9	5,357.8	\$582.8	\$221.6
Transport. and warehousing	228.4	181.7	6,019.2	1,580.3	\$301.8	\$74.2
Utilities	18.0	7.7	[c]	[c]	[c]	[c]
Publishing ind. (ex. internet)	26.9	20.7	484.9	208.8	\$35.4	\$14.3
Motion picture and sound recording	25.5	22.3	[c]	[c]	[c]	[c]
Broadcasting (except internet)	8.4	4.7	577.5	136.8	\$39.9	\$8.5
Internet publishing and broadcasting	7.8	6.6	[c]	[c]	[c]	[c]
Telecommunications	53.0	11.9	885.4	177.7	\$66.9	\$13.1
Internet serv. providers and data	13.6	9.0	[c]	[c]	[c]	[c]
Other information services	4.3	3.7	[c]	[c]	[c]	[c]
Finance	291.4	128.0	4,446.7	818.7	\$347.4	\$65.0
Insurance	178.7	139.5	2,702.7	711.2	\$184.0	\$49.0
Real estate	324.4	275.8	2,015.4	1,208.9	\$112.5	\$66.5
Rental and leasing services	53.2	26.5	[c]	[c]	[c]	[c]

Professional and technical services	896.0	812.3	9,445.1	4,433.7	\$790.6	\$360.7
Management of companies and enterprises	53.9	33.2	[c]	[c]	[c]	[c]
Admin. and support services	380.4	325.0	5,029.6	2,285.4	\$196.3	\$82.6
Waste manag. and remed. services	23.9	17.9	[c]	[c]	[c]	[c]
Educational services	102.0	89.3	13,911.5	2,916.7	\$737.2	\$145.7
Hospitals	7.0	1.6	7,158.8	327.9	\$436.3	\$19.4
Health care services, except hospitals	690.2	567.3	9,760.5	4,673.4	\$457.1	\$218.4
Social assistance	178.9	145.8	2,937.6	1,643.5	\$104.0	\$54.4
Arts, entertainment, and recreation	133.6	123.0	2,680.8	1,360.4	\$99.7	\$49.7
Accommodation	66.0	55.2	1,558.4	600.6	\$56.6	\$21.1
Food services and drinking places	621.6	488.8	8,766.3	2,399.7	\$217.4	\$59.5
Repair and maintenance	213.5	198.6	1,584.2	1,181.1	\$67.1	\$49.2
Personal and laundry services	225.6	197.5	1,651.7	1,209.7	\$50.1	\$36.1
Membership associations & organizations	307.0	296.2	2,083.4	1,534.2	\$104.6	\$75.3
Private households	[d]	[d]	[c]	[c]	[c]	[c]
Public administration [e]	90.1	72.8	7,269.7	687.0	\$467.3	\$38.3
Employer Type						
Nonprofit, private	579.1	500.4	10,019.23	4,123.0	\$541.2	\$200.5
For profit, private	7,084.8	5,682.7	107,980.07	45,149.1	\$5,579.2	\$2,303.6
Government (state and local)	90.1	72.8	17,811.69	2,270.1	\$960.8	\$117.7

Note: Establishment data are from the Survey of U.S. Businesses 2015; worker and payroll data from CPS MORG using pooled data for 2015-2017 adjusted to reflect 2017.

[a] Excludes the self-employed and unpaid workers.

[b] Summation across industries may not add to the totals reported due to suppressed values and some establishments not reporting an industry.

[c] Data not displayed because sample size of affected workers in small establishments is less than 10 due to reliability concerns.

[d] SUSB does not provide information on private households.

[e] Establishment number represents the total number of governments, including state and local. Data from Government Organization Summary Report: 2012.

As discussed in VI.B.iii, estimates of workers subject to the FLSA do not exclude workers employed by enterprises that do not meet the enterprise coverage requirements because there is no reliable way of identifying this population. Although not excluding such workers would only affect a small percentage of workers generally, it may have a larger effect (and result in a larger overestimate) for non-profits, because revenue from charitable activities is not included when determining enterprise coverage.

#### iv. Number of Affected Small Entities and Employees

To estimate the probability that an exempt EAP worker in the CPS data is employed by a small establishment, the Department assumed this probability is equal to the proportion of all workers employed by small establishments in the corresponding industry. That is, if 50 percent of workers in an industry are employed in small entities, then on average small entities are expected to employ 1 out of every 2 exempt EAP workers in this industry.<sup>274</sup> The Department applied these probabilities to the population of exempt EAP workers to find the number of workers (total exempt EAP workers and total affected by the rule) that small entities employ. No data are available to determine whether small businesses (or small businesses in specific industries) are more or less likely than non-small businesses to employ exempt EAP workers or

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<sup>274</sup> The Department used CPS microdata to estimate the number of affected workers. This was done individually for each observation in the relevant sample by randomly assigning them a small business status based on the best available estimate of the probability of a worker to be employed in a small business in their respective industry (3-digit Census codes). While aggregation to the 262 3-digit Census codes is certainly possible, many of these industry codes contain too few observations to be reliable.

affected EAP workers. Therefore, the best assumption available is to assign the same rates to all small and non-small businesses.<sup>275, 276</sup>

The Department estimated that small entities employ 483,400 of the 1.3 million affected workers (38.0 percent) (Table 33). This composes less than 1.0 percent of the 51.5 million workers that small entities employ. The sectors with the highest total number of affected workers employed by small establishments are: professional and technical services (67,500); health care services, except hospitals (53,000); and retail trade (46,300). The sectors with the largest percent of small business workers who are affected include: telecommunications (2.9 percent); insurance (2.3 percent); and broadcasting (except internet) (2.0 percent).

Table 33: Number of Affected Workers Employed by Small Establishments, by Industry and Employer Type

Industry	Workers (1,000s)		Affected Workers (1,000s) [a]	
	Total	Small Business Employed	Total	Small Business Employed
Total	139,636.5	51,542.2	1,271.3	483.4
Industry				
Agriculture	[c]	[c]	[c]	[c]
Forest., log., fish., hunt., and trap.	[c]	[c]	[c]	[c]
Mining	[c]	[c]	[c]	[c]
Construction	7,955.8	5,153.8	38.1	27.4

<sup>275</sup> There is a strand of literature that indicates that small establishments tend to pay lower wages than larger establishments. This may imply that workers in small businesses are more likely to be affected than workers in large businesses; however, the literature does not make clear what the appropriate alternative rate for small businesses should be.

<sup>276</sup> Workers are designated as employed in a small business based on their industry of employment. The share of workers considered small in nonprofit, for profit, and government entities is therefore the weighted average of the shares for the industries that compose these categories.

Nonmetallic mineral prod. manuf.	[c]	[c]	[c]	[c]
Prim. metals and fab. metal prod.	1,636.3	992.3	7.9	3.8
Machinery manufacturing	1,267.0	678.3	10.2	4.2
Computer and elect. prod. manuf.	1,211.3	562.2	11.8	3.6
Electrical equip., appliance manuf.	[c]	[c]	[c]	[c]
Transportation equip. manuf.	2,522.2	711.3	13.3	4.2
Wood products	[c]	[c]	[c]	[c]
Furniture and fixtures manuf.	[c]	[c]	[c]	[c]
Misc. and not spec. manuf.	1,464.6	861.7	10.4	4.7
Food manufacturing	1,761.2	834.6	8.2	3.6
Beverage and tobacco products	[c]	[c]	[c]	[c]
Textile, app., and leather manuf.	590.2	391.1	4.5	3.9
Paper and printing	883.7	475.9	8.4	5.1
Petroleum and coal prod. manuf.	[c]	[c]	[c]	[c]
Chemical manufacturing	1,377.9	545.5	10.8	4.9
Plastics and rubber products	[c]	[c]	[c]	[c]
Wholesale trade	3,453.2	1,617.5	44.0	21.6
Retail trade	15,784.9	5,357.8	132.9	46.3
Transport. and warehousing	6,019.2	1,580.3	34.7	7.8
Utilities	[c]	[c]	[c]	[c]
Publishing ind. (ex. internet)	484.9	208.8	9.9	4.1
Motion picture and sound recording	[c]	[c]	[c]	[c]
Broadcasting (except internet)	577.5	136.8	10.2	2.7
Internet publishing and broadcasting	[c]	[c]	[c]	[c]
Telecommunications	885.4	177.7	14.9	5.2
Internet serv. providers and data	[c]	[c]	[c]	[c]
Other information services	[c]	[c]	[c]	[c]
Finance	4,446.7	818.7	80.7	15.9
Insurance	2,702.7	711.2	61.6	16.2
Real estate	2,015.4	1,208.9	24.3	14.1
Rental and leasing services	[c]	[c]	[c]	[c]
Professional and technical services	9,445.1	4,433.7	149.4	67.5
Management of companies & enterprises	[c]	[c]	[c]	[c]
Admin. and support services	5,029.6	2,285.4	38.1	15.3
Waste manag. and remed. services	[c]	[c]	[c]	[c]
Educational services	13,911.5	2,916.7	71.9	13.9
Hospitals	7,158.8	327.9	67.6	2.9
Health care services, except hospitals	9,760.5	4,673.4	106.2	53.0

Social assistance	2,937.6	1,643.5	47.8	26.1
Arts, entertainment, and recreation	2,680.8	1,360.4	48.3	24.1
Accommodation	1,558.4	600.6	8.0	3.9
Food services and drinking places	8,766.3	2,399.7	25.6	7.2
Repair and maintenance	1,584.2	1,181.1	8.9	4.9
Personal and laundry services	1,651.7	1,209.7	7.6	5.3
Membership associations & organizations	2,083.4	1,534.2	35.4	25.5
Private households	[c]	[c]	[c]	[c]
Public administration [b]	7,269.7	687.0	54.6	6.5
Employer Type				
Nonprofit, private	10,019.2	4,123.0	126.5	60.3
For profit, private	107,980.1	45,149.1	1,012.3	408.1
Government (state and local)	17,811.7	2,270.1	132.5	15.1

Note: Worker data are from CPS MORG using pooled data for 2015-2017 adjusted to reflect 2017.

[a] Estimation of affected workers employed by small establishments was done at the Census 4-digit occupational code and industry level. Therefore, at the more aggregated 51 industry level shown in this table, the ratio of small business employed to total employed does not equal to the ratio of affected small business employed to total affected for each industry, nor does it equal the ratio for the national total because relative industry size, employment, and small business employment differs from industry to industry.

[b] Establishment number represents the total number of state and local governments. Data from Government Organization Summary Report: 2012.

[c] Data not displayed due to reliability concerns; sample size of affected workers in small establishments is less than 10.

Because no information is available on how affected workers are distributed among small establishments that employ affected workers, the Department estimated a range for effects. At one end of this range, the Department assumed that each small establishment employs no more than one affected worker, meaning that at most 483,400 of the 6.3 million small establishments will employ an affected worker. Thus, these assumptions provide an upper bound estimate of the number of affected small establishments (although it provides a lower bound estimate of the effect per small establishment because costs are spread over a larger number of establishments).

The impacts experienced by an establishment would increase as the share of its workers that are affected increases. Establishments that employ only affected workers are most likely to experience the most severe effects. Therefore, to estimate a lower-end estimate for the number of affected establishments (which generates an upper-end estimate for impacts per establishment) the Department assumed that all workers employed by an affected establishment are affected.

For the purposes of estimating this lower-range number of affected small establishments, the Department used the average size of a small establishment as the typical size of an affected small establishment.<sup>277</sup> The average number of employees in a small establishment is the number of workers that small establishments employ divided by the total number of small establishments in that industry (SUSB 2012). Thus, the number of affected small establishments in an industry, if all employees of an affected establishment are affected, equals the number of affected small establishment employees divided by the average number of employees per small establishment.

Table 34 summarizes the estimated number of affected workers that small establishments employ and the expected range for the number of affected small establishments by industry. The Department estimated that the rule will affect 483,400 workers who are employed by somewhere between 64,100 and 483,400 small establishments; this composes from 1.0 percent to 7.7 percent of all small establishments. It also means that from 5.8 million to 6.2 million small

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<sup>277</sup> This is not the true lower bound estimate of the number of affected establishments. Strictly speaking, a true lower bound estimate of the number of affected small establishments would be calculated by assuming all employees in the largest small establishments are affected. For example, if the SBA standard is that establishments with 500 employees are “small,” and 1,350 affected workers are employed by small establishments in that industry, then the smallest number of establishments that could be affected in that industry (the true lower bound) would be three. However, because such an outcome appears implausible, the Department determined a more reasonable lower estimate would be based on average establishment size.

establishments incur no more than minimal regulatory familiarization costs (*i.e.*, 6.3 million minus 483,400 equals 5.8 million; 6.3 million minus 64,100 equals 6.2 million, using rounded values). The table also presents the average number of affected employees per establishment using the method in which all employees at the establishment are affected. For the other method, by definition, there is always one affected employee per establishment. Also displayed is the average payroll per small establishment by industry (based on both affected and non-affected small establishments), calculated by dividing total payroll of small businesses by the number of small businesses (Table 32) (applicable to both methods).

Table 34: Number of Small Affected Establishments and Employees by Industry and Employer Type

Industry	Affected Workers in Small Entities (1,000s)	Number of Small Affected Establishments (1,000s) [a]		Per Establishment	
		One Affected Employee per Estab. [b]	All Employees at Estab. Affected [c]	Affected Employees [a]	Average Annual Payroll (\$1,000s)
Total	483.4	483.4	64.1	7.5	418.1
Industry					
Agriculture	[d]	[d]	[d]	[d]	[d]
Forest., log., fish., hunt., and trap.	[d]	[d]	[d]	[d]	[d]
Mining	[d]	[d]	[d]	[d]	[d]
Construction	27.4	27.4	3.5	7.8	409.5
Nonmetallic mineral prod. manuf.	[d]	[d]	[d]	[d]	[d]
Prim. metals and fab. metal prod.	3.8	3.8	0.2	17.8	913.1
Machinery manufacturing	4.2	4.2	0.1	31.2	1,919.0
Computer and elect. prod. manuf.	3.6	3.6	0.1	49.8	4,454.5
Electrical equip., appliance	[d]	[d]	[d]	[d]	[d]

manuf.					
Transportation equip. manuf.	4.2	4.2	0.1	69.6	4,297.1
Wood products	[d]	[d]	[d]	[d]	[d]
Furniture and fixtures manuf.	[d]	[d]	[d]	[d]	[d]
Misc. and not spec. manuf.	4.7	4.7	0.1	33.7	1,943.5
Food manufacturing	3.6	3.6	0.1	35.4	1,448.9
Beverage and tobacco products	[d]	[d]	[d]	[d]	[d]
Textile, app., and leather manuf.	3.9	3.9	0.2	24.1	1,046.6
Paper and printing	5.1	5.1	0.3	17.1	870.6
Petroleum and coal prod. manuf.	[d]	[d]	[d]	[d]	[d]
Chemical manufacturing	4.9	4.9	0.1	52.1	3,973.8
Plastics and rubber products	[d]	[d]	[d]	[d]	[d]
Wholesale trade	21.6	21.6	4.4	4.9	293.3
Retail trade	46.3	46.3	6.0	7.8	321.3
Transport. and warehousing	7.8	7.8	0.9	8.7	408.2
Utilities	[d]	[d]	[d]	[d]	[d]
Publishing ind. (ex. internet)	4.1	4.1	0.4	10.1	690.8
Motion picture and sound recording	[d]	[d]	[d]	[d]	[d]
Broadcasting (except internet)	2.7	2.7	0.1	29.2	1,803.8
Internet publishing and broadcasting	[d]	[d]	[d]	[d]	[d]
Telecommunications	5.2	5.2	0.4	14.9	1,096.7
Internet serv. providers and data	[d]	[d]	[d]	[d]	[d]
Other information services	[d]	[d]	[d]	[d]	[d]
Finance	15.9	15.9	2.5	6.4	507.9
Insurance	16.2	16.2	3.2	5.1	351.6
Real estate	14.1	14.1	3.2	4.4	240.9
Rental and leasing services	[d]	[d]	[d]	[d]	[d]
Professional and technical services	67.5	67.5	12.4	5.5	444.1
Management of companies and enterprises	[d]	[d]	[d]	[d]	[d]
Admin. and support services	15.3	15.3	2.2	7.0	254.3

Waste manag. and remed. services	[d]	[d]	[d]	[d]	[d]
Educational services	13.9	13.9	0.4	32.6	1,630.5
Hospitals	2.9	1.2 [e]	0.0	200.9	11,892.0
Health care services, except hospitals	53.0	53.0	6.4	8.2	384.9
Social assistance	26.1	26.1	2.3	11.3	373.0
Arts, entertainment, and recreation	24.1	24.1	2.2	11.1	404.4
Accommodation	3.9	3.9	0.4	10.9	381.9
Food services and drinking places	7.2	7.2	1.5	4.9	121.8
Repair and maintenance	4.9	4.9	0.8	5.9	248.0
Personal and laundry services	5.3	5.3	0.9	6.1	183.0
Membership associations & organizations	25.5	25.5	4.9	5.2	254.4
Private households	[d]	[d]	[d]	[d]	[d]
Public administration [f]	6.5	6.5	0.7	9.4	526.1
Employer Type					
Nonprofit, private	60.3	60.3	7.3	8.2	400.6
For profit, private	408.1	408.1	51.4	7.9	405.4
Government (state and local)	15.1	15.1	0.5	31.2	1,615.2

Note: Establishment data are from the Survey of U.S. Businesses 2012; worker and payroll data from CPS MORG using pooled data for 2015-2017 adjusted to reflect 2017.

[a] Estimation of both affected small establishment employees and affected small establishments was done at the most detailed industry level available. Therefore, the ratio of affected small establishment employees to total small establishment employees for each industry may not match the ratio of small affected establishments to total small establishments at more aggregated industry level presented in the table, nor will it equal the ratio at the national level because relative industry size, employment, and small business employment differs from industry to industry.

[b] This method may overestimate the number of affected establishments and therefore the ratio of affected workers to affected establishments may be greater than 1-to-1. However, we addressed this issue by also calculating effects based on the assumption that 100 percent of workers at an establishment are affected.

[c] For example, on average, a small establishment in the construction industry employs 7.8 workers (5.2 million employees divided by 663,000 small establishments). This method assumes if an establishment is affected then all 7.8 workers are affected. Therefore, in the construction industry this method estimates there are 3,500 small affected establishments (27,400 affected small workers divided by 7.8).

[d] Data not displayed due to reliability concerns; sample size of affected workers in small establishments is less than 10.

[e] Number of establishments is smaller than number of affected employees; thus, total number of establishments reported.

[f] Establishment number represents the total number of state and local governments.

#### D. Projected Reporting, Recordkeeping, and Other Compliance Requirements of the Proposed Rule

The FLSA sets minimum wage, overtime pay, and recordkeeping requirements for employment subject to its provisions. Unless exempt, covered employees must be paid at least the minimum wage and not less than one and one-half times their regular rates of pay for overtime hours worked.

Every covered employer must keep certain records for each nonexempt worker. The regulations at part 516 require employers to maintain records for employees subject to the minimum wage and overtime pay provisions of the FLSA. The recordkeeping requirements are not new requirements; however, employers would need to keep some additional records for additional affected employees if the NPRM became final without change. As indicated in this analysis, the NPRM would expand minimum wage and overtime pay coverage to 1.3 million affected EAP workers (including HCE workers and excluding Type 4 workers who remain exempt). This would result in an increase in employer burden and was estimated in the PRA portion (section V) of this NPRM. Note that the burdens reported for the PRA section of this NPRM include the entire information collection and not merely the additional burden estimated as a result of this NPRM.

### i. Costs to Small Entities

For small entities, the Department projected various types of effects, including regulatory familiarization costs, adjustment costs, managerial costs, and payroll increases to employees. The Department estimated a range for the number of small affected establishments and the impacts they incur. However, few establishments are likely to incur the effects at the upper end of this range because it seems unlikely that the proposed rule would affect all employees at a small firm. While the upper and lower bounds are likely over- and under-estimates, respectively, of effects per small establishment, the Department believes that this range of costs and payroll increases provides the most accurate characterization of the effects of the rule on small employers.<sup>278</sup> Furthermore, the smaller estimate of the number of affected establishments (*i.e.*, where all employees are assumed to be affected) will result in the largest costs and payroll increases per entity as a percent of establishment payroll and revenue, and the Department expects that many, if not most, entities will incur smaller costs, payroll increases, and effects relative to establishment size. The Department seeks comments on the estimates for regulatory familiarization, adjustment costs, managerial costs, and transfers, as discussed below.

The Department expects total direct employer costs will range from \$55.5 million to \$72.0 million for affected small establishments (Table 35) in the first year after the proposed rule is finalized. Small establishments that do not employ affected workers will incur an additional \$242.5 million to \$260.1 million in regulatory familiarization costs. The three industries with the highest costs (professional and technical services; healthcare services, except hospitals; and retail

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<sup>278</sup> As noted previously, these are not the true lower and upper bounds. The values presented are the highest and lowest estimates the Department believes are plausible.

trade) account for about 35 percent of the costs. The hospitals industry is expected to incur the largest cost per establishment (\$22,000 using the method where all employees are affected), although the costs are not expected to exceed 0.19 percent of payroll. The food services and drinking places industry is expected to experience the largest effect as a share of payroll (estimated direct costs compose 0.48 percent of average entity payroll).

Table 35: Year 1 Small Establishment Direct Costs, Total and per Establishment, by Industry and Employer Type

Industry	Cost to Small Entities in Year 1 [a]					
	One Affected Employee			All Employees Affected		
	Total (Millions) [b]	Cost per Affected Entity	Percent of Annual Payroll	Total (Millions) [b]	Cost per Affected Entity	Percent of Annual Payroll
Total	\$72.0	\$149	0.04%	\$55.5	\$867	0.21%
Industry						
Agriculture Forest., log., fish., hunt., and trap.	[c]	[c]	[c]	[c]	[c]	[c]
Mining	[c]	[c]	[c]	[c]	[c]	[c]
Construction	\$4.2	\$151	0.04%	\$3.2	\$894	0.22%
Nonmetallic mineral prod. manuf.	[c]	[c]	[c]	[c]	[c]	[c]
Prim. metals and fab. metal prod.	\$0.6	\$151	0.02%	\$0.4	\$1,994	0.22%
Machinery manufacturing	\$0.6	\$151	0.01%	\$0.5	\$3,461	0.18%
Computer and elect. prod. manuf.	\$0.5	\$151	0.00%	\$0.4	\$5,499	0.12%
Electrical equip., appliance manuf.	[c]	[c]	[c]	[c]	[c]	[c]
Transportation equip. manuf.	\$0.6	\$151	0.00%	\$0.5	\$7,667	0.18%
Wood products	[c]	[c]	[c]	[c]	[c]	[c]

Furniture and fixtures manuf.	[c]	[c]	[c]	[c]	[c]	[c]
Misc. and not spec. manuf.	\$0.7	\$151	0.01%	\$0.5	\$3,730	0.19%
Food manufacturing	\$0.5	\$151	0.01%	\$0.4	\$3,917	0.27%
Beverage and tobacco products	[c]	[c]	[c]	[c]	[c]	[c]
Textile, app., and leather manuf.	\$0.6	\$151	0.01%	\$0.4	\$2,685	0.26%
Paper and printing	\$0.8	\$151	0.02%	\$0.6	\$1,915	0.22%
Petroleum and coal prod. manuf.	[c]	[c]	[c]	[c]	[c]	[c]
Chemical manufacturing	\$0.7	\$151	0.00%	\$0.5	\$5,754	0.14%
Plastics and rubber products	[c]	[c]	[c]	[c]	[c]	[c]
Wholesale trade	\$3.3	\$151	0.05%	\$2.5	\$580	0.20%
Retail trade	\$7.0	\$151	0.05%	\$5.3	\$893	0.28%
Transport. and warehousing	\$1.2	\$151	0.04%	\$0.9	\$995	0.24%
Utilities	[c]	[c]	[c]	[c]	[c]	[c]
Publishing ind. (ex. internet)	\$0.6	\$151	0.02%	\$0.5	\$1,146	0.17%
Motion picture and sound recording	[c]	[c]	[c]	[c]	[c]	[c]
Broadcasting (except internet)	\$0.4	\$151	0.01%	\$0.3	\$3,237	0.18%
Internet publishing and broadcasting	[c]	[c]	[c]	[c]	[c]	[c]
Telecommunications	\$0.8	\$151	0.01%	\$0.6	\$1,672	0.15%
Internet serv. providers and data	[c]	[c]	[c]	[c]	[c]	[c]
Other information services	[c]	[c]	[c]	[c]	[c]	[c]
Finance	\$2.4	\$151	0.03%	\$1.8	\$743	0.15%
Insurance	\$2.5	\$151	0.04%	\$1.9	\$600	0.17%
Real estate	\$2.1	\$151	0.06%	\$1.7	\$522	0.22%
Rental and leasing services	[c]	[c]	[c]	[c]	[c]	[c]
Professional and technical services	\$10.2	\$151	0.03%	\$7.9	\$640	0.14%
Management of	[c]	[c]	[c]	[c]	[c]	[c]

companies and enterprises						
Admin. and support services	\$2.3	\$151	0.06%	\$1.8	\$812	0.32%
Waste manag. and remed. services	[c]	[c]	[c]	[c]	[c]	[c]
Educational services	\$2.1	\$151	0.01%	\$1.5	\$3,619	0.22%
Hospitals	\$0.4	\$151	0.00%	\$0.3	\$22,051	0.19%
Health care services, except hospitals	\$8.0	\$151	0.04%	\$6.1	\$944	0.25%
Social assistance	\$4.0	\$151	0.04%	\$3.0	\$1,277	0.34%
Arts, entertainment, and recreation	\$3.7	\$151	0.04%	\$2.7	\$1,254	0.31%
Accommodation	\$0.6	\$151	0.04%	\$0.4	\$1,235	0.32%
Food services and drinking places	\$1.1	\$151	0.12%	\$0.9	\$580	0.48%
Repair and maintenance	\$0.7	\$151	0.06%	\$0.6	\$694	0.28%
Personal and laundry services	\$0.8	\$151	0.08%	\$0.6	\$713	0.39%
Membership associations & organizations	\$3.9	\$151	0.06%	\$3.0	\$609	0.24%
Private households	[c]	[c]	[c]	[c]	[c]	[c]
Public administration	\$1.0	\$151	0.03%	\$0.7	\$1,076	0.20%
Employer Type						
Nonprofit, private	\$8.8	\$146	0.04%	\$6.6	\$898	0.22%
For profit, private	\$63.0	\$154	0.04%	\$48.0	\$935	0.23%
Government (state and local)	\$2.2	\$148	0.01%	\$1.6	\$3,339	0.21%

Note: Pooled data for 2015-2017 adjusted to reflect 2017.

[a] Direct costs include regulatory familiarization, adjustment, and managerial costs.

[b] The range of costs per establishment depends on the number of affected establishments. The minimum assumes that each affected establishment has one affected worker (therefore, the number of affected establishments is equal to the number of affected workers). The maximum assumes the share of workers in small entities who are affected is also the share of small entity establishments that are affected.

[c] Data not displayed due to reliability concerns; sample size of affected workers in small establishments is less than 10.

It is possible that the costs of the proposed rule may be disproportionately large for small entities, especially because small entities often have limited or no human resources personnel on staff. However, the Department expects that small entities will rely upon compliance assistance materials provided by the Department or industry associations to become familiar with the proposed rule. Additionally, the Department notes that the proposed rule is quite limited in scope as it primarily makes changes to the salary component of the part 541 regulations. Finally, the Department believes that most entities have at least some nonexempt employees and, therefore, already have policies and systems in place for monitoring and recording their hours. The Department believes that applying those same policies and systems to the workers whose exemption status changes will not be an unreasonable burden on small businesses.

Average weekly earnings for affected EAP workers in small establishments are expected to increase by about \$8.12 per week per affected worker, using the incomplete fixed-job model<sup>279</sup> described in section VI.D.iv.<sup>280</sup> This would lead to \$204.1 million in additional annual wage payments to employees in small entities (less than 0.8 percent of aggregate affected establishment payroll; Table 36). The largest payroll increases per establishment are expected in the sectors of transportation equipment manufacturing (up to \$92,900 per entity); computer and

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<sup>279</sup> As explained in section VI.D.iv., the incomplete fixed-job model reflects the Department's determination that an appropriate estimate of the impact on the implicit hourly rate of pay for regular overtime workers, if the NPRM is finalized as proposed, should be determined using the average of Barkume's and Trejo's two estimates of the incomplete fixed-job model adjustments: a wage change that is 40 percent of the adjustment toward the amount predicted by the fixed-job model, assuming an initial zero overtime pay premium, and a wage change that is 80 percent of the adjustment assuming an initial 28 percent overtime pay premium.

<sup>280</sup> This is an average increase for all affected workers (both EAP and HCE), and reconciles to the weighted average of individual salary changes discussed in the Transfers section.

electronic product manufacturing (up to \$44,400 per entity); and chemical manufacturing (up to \$39,800 per entity). However, average payroll increases per establishment exceed 2 percent of average annual payroll in only three sectors: food services and drinking places (4.7 percent), primary metals and fabricated metal products (2.3 percent), and transportation equipment manufacturing (2.2 percent).

Table 36: Year 1 Small Establishment Payroll Increases, Total and per Establishment, by Industry and Employer Type

Industry	Increased Payroll for Small Entities in Year 1 [a]				
	Total (Millions)	One Affected Employee		All Employees Affected	
		Per Estab.	Percent of Annual Payroll	Per Estab.	Percent of Annual Payroll
Total	\$204.1	\$422	0.10%	\$3,187	0.76%
Industry					
Agriculture Forest., log., fish., hunt., and trap.	[b]	[b]	[b]	[b]	[b]
Mining	[b]	[b]	[b]	[b]	[b]
Construction	\$9.8	\$356	0.09%	\$2,768	0.68%
Nonmetallic mineral prod. manuf.	[b]	[b]	[b]	[b]	[b]
Prim. metals and fab. metal prod.	\$4.4	\$1,172	0.13%	\$20,889	2.29%
Machinery manufacturing	\$4.5	\$1,054	0.05%	\$32,885	1.71%
Computer and elect. prod. manuf.	\$3.2	\$892	0.02%	\$44,405	1.00%
Electrical equip., appliance manuf.	[b]	[b]	[b]	[b]	[b]
Transportation equip. manuf.	\$5.6	\$1,334	0.03%	\$92,869	2.16%
Wood products	[b]	[b]	[b]	[b]	[b]
Furniture and fixtures manuf.	[b]	[b]	[b]	[b]	[b]

Misc. and not spec. manuf.	\$5.0	\$1,066	0.05%	\$35,874	1.85%
Food manufacturing	\$1.6	\$448	0.03%	\$15,837	1.09%
Beverage and tobacco products	[b]	[b]	[b]	[b]	[b]
Textile, app., and leather manuf.	\$1.7	\$429	0.04%	\$10,355	0.99%
Paper and printing	\$0.5	\$91	0.01%	\$1,556	0.18%
Petroleum and coal prod. manuf.	[b]	[b]	[b]	[b]	[b]
Chemical manufacturing	\$3.8	\$764	0.02%	\$39,839	1.00%
Plastics and rubber products	[b]	[b]	[b]	[b]	[b]
Wholesale trade	\$20.6	\$957	0.33%	\$4,705	1.60%
Retail trade	\$29.4	\$635	0.20%	\$4,935	1.54%
Transport. and warehousing	\$1.9	\$242	0.06%	\$2,104	0.52%
Utilities	[b]	[b]	[b]	[b]	[b]
Publishing ind. (ex. internet)	—	\$0	—	\$0	—
Motion picture and sound recording	[b]	[b]	[b]	[b]	[b]
Broadcasting (except internet)	\$0.0	\$6	0.00%	\$167	0.01%
Internet publishing and broadcasting	[b]	[b]	[b]	[b]	[b]
Telecommunications	\$3.1	\$604	0.06%	\$8,986	0.82%
Internet serv. providers and data	[b]	[b]	[b]	[b]	[b]
Other information services	[b]	[b]	[b]	[b]	[b]
Finance	\$7.0	\$442	0.09%	\$2,829	0.56%
Insurance	\$3.2	\$196	0.06%	\$1,000	0.28%
Real estate	\$5.4	\$386	0.16%	\$1,692	0.70%
Rental and leasing services	[b]	[b]	[b]	[b]	[b]
Professional and technical services	\$22.6	\$335	0.08%	\$1,826	0.41%
Management of companies and enterprises	[b]	[b]	[b]	[b]	[b]
Admin. and support services	\$3.7	\$245	0.10%	\$1,720	0.68%
Waste manag. and remed. services	[b]	[b]	[b]	[b]	[b]
Educational services	\$8.2	\$591	0.04%	\$19,278	1.18%
Hospitals	—	\$0	—	\$0	—
Health care services, except hospitals	\$8.7	\$165	0.04%	\$1,358	0.35%

Social assistance	\$2.8	\$109	0.03%	\$1,228	0.33%
Arts, entertainment, and recreation	\$11.5	\$475	0.12%	\$5,259	1.30%
Accommodation	\$1.3	\$331	0.09%	\$3,602	0.94%
Food services and drinking places	\$8.4	\$1,168	0.96%	\$5,736	4.71%
Repair and maintenance	\$1.4	\$293	0.12%	\$1,742	0.70%
Personal and laundry services	\$0.8	\$150	0.08%	\$921	0.50%
Membership associations & organizations	\$6.4	\$252	0.10%	\$1,307	0.51%
Private households	[b]	[b]	[b]	[b]	[b]
Public administration	\$2.4	\$363	0.07%	\$3,426	0.65%
Employer Type					
Nonprofit, private	\$21.3	\$353	0.09%	\$2,911	0.73%
For profit, private	\$177.2	\$434	0.11%	\$3,449	0.85%
Government (state and local)	\$5.7	\$376	0.02%	\$11,710	0.72%

Note: Pooled data for 2015-2017 adjusted to reflect 2017.

[a] Aggregate change in total annual payroll experienced by small entities under the updated salary levels after labor market adjustments. This amount represents the total amount of (wage) transfers from employers to employees.

[b] Data not displayed due to reliability concerns; sample size of affected workers in small establishments is less than 10.

Table 37 presents estimated first year direct costs and payroll increases combined per establishment and the costs and payroll increases as a percent of average establishment payroll. The Department presents only the results for the upper bound scenario where all workers employed by the establishment are affected. Combined costs and payroll increases per establishment range from \$1,150 in publishing industries (except internet) to \$100,500 in the transportation equipment manufacturing sector.<sup>281</sup> Combined costs and payroll increases

<sup>281</sup> When a single affected worker is employed, combined costs and transfers by industry were estimated to range from \$151 (in both the publishing (except internet) and hospitals industries) to \$1,500 (in transportation equipment manufacturing) per establishment.

compose more than 2 percent of average annual establishment payroll in four sectors: food services and drinking places (5.2 percent), primary metals and fabricated metal products (2.5 percent), transportation equipment manufacturing (2.3 percent), and miscellaneous and not specified manufacturing (2.0 percent). In all other sectors, they range from 0.2 percent to 1.9 percent of payroll.

However, comparing costs and payroll increases to payrolls overstates the effects on establishments because payroll represents only a fraction of the financial resources available to an establishment. The Department approximated revenue per small affected establishment by calculating the ratio of small business revenues to payroll by industry from the 2012 SUSB data then multiplying that ratio by average small entity payroll.<sup>282</sup> Using this approximation of annual revenues as a benchmark, only one sector has costs and payroll increases amounting to more than one percent of revenues, food services and drinking places (1.5 percent).

Table 37: Year 1 Small Establishment Direct Costs and Payroll Increases, Total and per Establishment, by Industry and Employer Type, Using All Employees in Establishment Affected Method

Industry	Costs and Payroll Increases for Small Affected Establishments, All Employees Affected			
	Total (Millions)	Per Estab. [a]	Percent of Annual Payroll	Percent of Estimated Revenues [b]
Total	\$259.6	\$4,053	0.97%	0.18%
Industry				
Agriculture	[c]	[c]	[c]	[c]
Forest., log., fish., hunt., and	[c]	[c]	[c]	[c]

<sup>282</sup> The ratio of revenues to payroll for small businesses ranged from 2.15 (social assistance) to 43.40 (petroleum and coal products manufacturing), with an average over all sectors of 5.35. The Department used this estimate of revenue, instead of small business revenue reported directly from the 2012 SUSB so revenue aligned with payrolls in 2017.

trap.				
Mining	[c]	[c]	[c]	[c]
Construction	\$12.9	\$3,662	0.89%	0.20%
Nonmetallic mineral prod. manuf.	[c]	[c]	[c]	[c]
Prim. metals and fab. metal prod.	\$4.8	\$22,883	2.51%	0.49%
Machinery manufacturing	\$4.9	\$36,346	1.89%	0.39%
Computer and elect. prod. manuf.	\$3.6	\$49,904	1.12%	0.25%
Electrical equip., appliance manuf.	[c]	[c]	[c]	[c]
Transportation equip. manuf.	\$6.1	\$100,536	2.34%	0.34%
Wood products	[c]	[c]	[c]	[c]
Furniture and fixtures manuf.	[c]	[c]	[c]	[c]
Misc. and not spec. manuf.	\$5.5	\$39,603	2.04%	0.48%
Food manufacturing	\$2.0	\$19,753	1.36%	0.12%
Beverage and tobacco products	[c]	[c]	[c]	[c]
Textile, app., and leather manuf.	\$2.1	\$13,040	1.25%	0.23%
Paper and printing	\$1.0	\$3,471	0.40%	0.08%
Petroleum and coal prod. manuf.	[c]	[c]	[c]	[c]
Chemical manufacturing	\$4.3	\$45,592	1.15%	0.11%
Plastics and rubber products	[c]	[c]	[c]	[c]
Wholesale trade	\$23.2	\$5,285	1.80%	0.11%
Retail trade	\$34.8	\$5,828	1.81%	0.18%
Transport. and warehousing	\$2.8	\$3,098	0.76%	0.17%
Utilities	[c]	[c]	[c]	[c]
Publishing ind. (ex. internet)	\$0.5	\$1,146	0.17%	0.06%
Motion picture and sound recording	[c]	[c]	[c]	[c]
Broadcasting (except internet)	\$0.3	\$3,404	0.19%	0.07%
Internet publishing and broadcasting	[c]	[c]	[c]	[c]
Telecommunications	\$3.7	\$10,658	0.97%	0.14%
Internet serv. providers and data	[c]	[c]	[c]	[c]
Other information services	[c]	[c]	[c]	[c]

Finance	\$8.9	\$3,572	0.70%	0.25%
Insurance	\$5.1	\$1,600	0.46%	0.10%
Real estate	\$7.1	\$2,214	0.92%	0.20%
Rental and leasing services	[c]	[c]	[c]	[c]
Professional and technical services	\$30.5	\$2,466	0.56%	0.22%
Management of companies and enterprises	[c]	[c]	[c]	[c]
Admin. and support services	\$5.5	\$2,532	1.00%	0.45%
Waste manag. and remed. services	[c]	[c]	[c]	[c]
Educational services	\$9.7	\$22,897	1.40%	0.54%
Hospitals	\$0.3	\$22,051	0.19%	0.08%
Health care services, except hospitals	\$14.8	\$2,302	0.60%	0.25%
Social assistance	\$5.8	\$2,505	0.67%	0.31%
Arts, entertainment, and recreation	\$14.2	\$6,513	1.61%	0.53%
Accommodation	\$1.7	\$4,836	1.27%	0.32%
Food services and drinking places	\$9.3	\$6,315	5.19%	1.54%
Repair and maintenance	\$2.0	\$2,436	0.98%	0.28%
Personal and laundry services	\$1.4	\$1,634	0.89%	0.31%
Membership associations & organizations	\$9.4	\$1,917	0.75%	0.19%
Private households	[c]	[c]	[c]	[c]
Public administration	\$3.1	\$4,501	0.86%	0.23%
Employer Type				
Nonprofit, private	\$94.40	\$3,570	1.00%	0.30%
For profit, private	\$585.30	\$3,532	1.00%	0.20%
Government (state and local)	\$12.20	\$9,264	0.60%	0.20%

Note: Pooled data for 2015-2017 adjusted to reflect 2017.

[a] Total direct costs and transfers for small establishments in which all employees are affected. Impacts to small establishments in which one employee is affected will be a fraction of the impacts presented in this table.

[b] Revenues estimated by calculating the ratio of estimated small business revenues to payroll from the 2012 SUSB, and multiplying by payroll per small entity. For the public administration sector, the ratio was calculated using revenues and payroll from the 2012 Census of Governments.

[c] Data not displayed due to reliability concerns; sample size of affected workers in small establishments is less than 10.

vi. Projected Effects to Affected Small Entities in Year 2 through Year 10

To determine how small businesses will be affected in future years, the Department projected costs to small business for nine years after Year 1 of the rule. Projected employment and earnings were calculated using the same methodology described in Section VI.B.ii. Affected employees in small firms follow a similar pattern to affected workers in all establishments: the number decreases gradually in projected years. There are 483,400 affected workers in small establishments in Year 1 and 405,200 in Year 10. Table 38 reports affected workers in selected years only.

Table 38: Projected Number of Affected Workers in Small Establishments, by Industry

Industry	Affected Workers in Small Establishments (1,000s)	
	Year 1	Year 10
Total	483.4	405.2
Agriculture	[a]	[a]
Forest., log., fish., hunt., and trap.	[a]	[a]
Mining	[a]	1.7
Construction	27.4	22.3
Nonmetallic mineral prod. manuf.	[a]	[a]
Prim. metals and fab. metal prod.	3.8	3.1
Machinery manufacturing	4.2	4.0
Computer and elect. prod. manuf.	3.6	4.9
Electrical equip., appliance manuf.	[a]	[a]
Transportation equip. manuf.	4.2	3.0
Wood products	[a]	[a]
Furniture and fixtures manuf.	[a]	[a]
Misc. and not spec. manuf.	4.7	5.5
Food manufacturing	3.6	[a]
Beverage and tobacco products	[a]	[a]
Textile, app., and leather manuf.	3.9	[a]

Paper and printing	5.1	[a]
Petroleum and coal prod. manuf.	[a]	[a]
Chemical manufacturing	4.9	3.4
Plastics and rubber products	[a]	[a]
Wholesale trade	21.6	21.3
Retail trade	46.3	34.4
Transport. and warehousing	7.8	7.3
Utilities	[a]	[a]
Publishing ind. (ex. internet)	4.1	3.8
Motion picture and sound recording	[a]	[a]
Broadcasting (except internet)	2.7	[a]
Internet publishing and broadcasting	[a]	[a]
Telecommunications	5.2	[a]
Internet serv. providers and data	[a]	[a]
Other information services	[a]	[a]
Finance	15.9	14.8
Insurance	16.2	11.9
Real estate	14.1	12.4
Rental and leasing services	[a]	[a]
Professional and technical services	67.5	65.6
Management of companies and enterprises	[a]	[a]
Admin. and support services	15.3	10.7
Waste manag. and remed. services	[a]	[a]
Educational services	13.9	14.3
Hospitals	2.9	[a]
Health care services, except hospitals	53.0	44.4
Social assistance	26.1	21.5
Arts, entertainment, and recreation	24.1	18.1
Accommodation	3.9	3.1
Food services and drinking places	7.2	6.7
Repair and maintenance	4.9	4.5
Personal and laundry services	5.3	4.2
Membership associations & organizations	25.5	20.2
Private households	[a]	[a]
Public administration	6.5	5.0

Note: Worker data are from CPS MORG using pooled data for 2015-2017 adjusted to reflect 2017.

[a] Data not displayed because sample size of affected workers in small establishments is less

than 10.

Costs to small establishments vary by year but generally decrease from Year 1 mostly because regulatory familiarization costs are zero in all projected years, and adjustment costs are relatively small. By Year 10, additional costs and payroll to small businesses have decreased from \$259.6 million in Year 1 to \$210.2 million (Table 39). The Department notes that, due to relatively small sample sizes, the estimates by detailed industry are not precise. This can cause some numbers in the data to vary across years by a greater amount than they will in the future.

Table 39: Projected Direct Costs and Payroll Increases for Affected Small Establishments, by Industry, Using All Employees in Establishment Affected Method

Industry	Costs and Payroll Increases for Small Affected Establishments, All Employees Affected (Millions 2017\$)	
	Year 1	Year 10
Total	\$259.6	\$210.2
Agriculture	[a]	[a]
Forest., log., fish., hunt., and trap.	[a]	[a]
Mining	[a]	\$2.4
Construction	\$12.9	\$12.2
Nonmetallic mineral prod. manuf.	[a]	[a]
Prim. metals and fab. metal prod.	\$4.8	\$1.8
Machinery manufacturing	\$4.9	\$2.5
Computer and elect. prod. manuf.	\$3.6	\$3.0
Electrical equip., appliance manuf.	[a]	[a]
Transportation equip. manuf.	\$6.1	\$2.8
Wood products	[a]	[a]
Furniture and fixtures manuf.	[a]	[a]
Misc. and not spec. manuf.	\$5.5	\$0.8
Food manufacturing	\$2.0	[a]
Beverage and tobacco products	[a]	[a]

Textile, app., and leather manuf.	\$2.1	[a]
Paper and printing	\$1.0	[a]
Petroleum and coal prod. manuf.	[a]	[a]
Chemical manufacturing	\$4.3	\$1.4
Plastics and rubber products	[a]	[a]
Wholesale trade	\$23.2	\$14.1
Retail trade	\$34.8	\$25.3
Transport. and warehousing	\$2.8	\$2.4
Utilities	[a]	[a]
Publishing ind. (ex. internet)	\$0.5	\$3.6
Motion picture and sound recording	[a]	[a]
Broadcasting (except internet)	\$0.3	[a]
Internet publishing and broadcasting	[a]	[a]
Telecommunications	\$3.7	[a]
Internet serv. providers and data	[a]	[a]
Other information services	[a]	[a]
Finance	\$8.9	\$15.5
Insurance	\$5.1	\$4.0
Real estate	\$7.1	\$5.5
Rental and leasing services	[a]	[a]
Professional and technical services	\$30.5	\$30.2
Management of companies and enterprises	[a]	[a]
Admin. and support services	\$5.5	\$2.6
Waste manag. and remed. services	[a]	[a]
Educational services	\$9.7	\$7.6
Hospitals	\$0.3	[a]
Health care services, except hospitals	\$14.8	\$9.7
Social assistance	\$5.8	\$5.5
Arts, entertainment, and recreation	\$14.2	\$8.1
Accommodation	\$1.7	\$0.2
Food services and drinking places	\$9.3	\$4.7
Repair and maintenance	\$2.0	\$1.3
Personal and laundry services	\$1.4	\$1.0
Membership associations & organizations	\$9.4	\$6.6
Private households	[a]	[a]
Public administration	\$3.1	\$3.0

Note: pooled data for 2015-2017 adjusted to reflect 2017.

[a] Data not displayed because sample size of affected workers in small establishments is

less than 10.

ii. Differing Compliance and Reporting Requirements for Small Entities

This NPRM provides no differing compliance requirements and reporting requirements for small entities. The Department has strived to minimize respondent recordkeeping burden by requiring no specific form or order of records under the FLSA and its corresponding regulations. Moreover, employers would normally maintain the records under usual or customary business practices.

iii. Least Burdensome Option or Explanation Required

The Department believes it has chosen the most effective option that updates and clarifies the rule and which results in the least burden. Among the options considered by the Department, the least restrictive option was taking no regulatory action. Taking no regulatory action does not address the Department's concerns discussed above under Need for Regulation. Pursuant to section 603(c) of the RFA, the following alternatives are to be addressed:

Differing compliance or reporting requirements that take into account the resources available to small entities. The FLSA creates a level playing field for businesses by setting a floor below which employers may not pay their employees. To establish differing compliance or reporting requirements for small businesses would undermine this important purpose of the FLSA and appears unnecessary given the small annualized cost of the rule. The Year 1 cost of the proposed rule for the average employer that qualifies as small was estimated to range from a minimum of \$1,150 (publishing industries, except internet) to a maximum of \$100,500 (transportation equipment, manufacturing), using the upper-bound estimates. The Department

makes available a variety of resources to employers for understanding their obligations and achieving compliance. Therefore, the Department has not proposed differing compliance or reporting requirements for small businesses.

The clarification, consolidation, or simplification of compliance and reporting requirements for small entities. The proposed rule imposes no new reporting requirements. The Department makes available a variety of resources to employers for understanding their obligations and achieving compliance.

The use of performance rather than design standards. Under the proposed rule, employers may achieve compliance through a variety of means. Employers may elect to continue to claim the EAP exemption for affected employees by adjusting salary levels, hire additional workers or spread overtime hours to other employees, or compensate employees for overtime hours worked. The Department makes available a variety of resources to employers for understanding their obligations and achieving compliance.

An exemption from coverage of the rule, or any part thereof, for such small entities. Creating an exemption from coverage of this rule for businesses with as many as 500 employees, those defined as small businesses under SBA's size standards, is inconsistent with the FLSA, which applies to all employers that satisfy the enterprise coverage threshold or employ individually covered employees.<sup>283</sup> Creating a regulatory exemption for small businesses is

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<sup>283</sup> See 29 U.S.C. 203(s).

beyond the scope of the Department’s statutory authority to define and delimit the meaning of the term “employed in a bona fide executive, administrative, or professional capacity.”<sup>284</sup>

E. Identification, to the Extent Practicable, of all Relevant Federal Rules That May Duplicate, Overlap, or Conflict with the Proposed Rule

The Department is not aware of any federal rules that duplicate, overlap, or conflict with this NPRM.

VIII. Unfunded Mandates Reform Act Analysis

The Unfunded Mandates Reform Act of 1995 (UMRA),<sup>285</sup> requires agencies to prepare a written statement for rules for which a general notice of proposed rulemaking was published and that include any federal mandate that may result in increased expenditures by state, local, and tribal governments, in the aggregate, or by the private sector, of \$161 million (\$100 million in 1995 dollars adjusted for inflation) or more in at least one year. This statement must: (1) identify the authorizing legislation; (2) present the estimated costs and benefits of the rule and, to the extent that such estimates are feasible and relevant, its estimated effects on the national economy; (3) summarize and evaluate state, local, and tribal government input; and (4) identify reasonable alternatives and select, or explain the non-selection, of the least costly, most cost-effective, or least burdensome alternative.

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<sup>284</sup> 29 U.S.C. 213(a)(1).

<sup>285</sup> 2 U.S.C. 1501.

### A. Authorizing Legislation

This proposed rule is issued pursuant to section 13(a)(1) of the Fair Labor Standards Act (FLSA or Act), 29 U.S.C. 213(a)(1). The section exempts from the FLSA's minimum wage and overtime pay requirements "any 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, subject to the provisions of [the Administrative Procedure Act]. . .)."<sup>286</sup> The requirements of the exemption are contained in part 541 of the Department's regulations. Section 3(e) of the FLSA<sup>287</sup> defines "employee" to include most individuals employed by a state, political subdivision of a state, or interstate governmental agency. Section 3(x) of the FLSA<sup>288</sup> also defines public agencies to include the government of a state or political subdivision thereof, or any interstate governmental agency.

### B. Assessment of Costs and Benefits

For purposes of the UMRA, this rule includes a federal mandate that is expected to result in increased expenditures by the private sector of more than \$161 million in at least one year, but the rule will not result in increased expenditures by state, local and tribal governments, in the aggregate, of \$161 million or more in any one year.

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<sup>286</sup> 29 U.S.C. 213(a)(1).

<sup>287</sup> 29 U.S.C. 203(e).

<sup>288</sup> 29 U.S.C. 203(x).

Costs to state and local governments: Based on the economic impact analysis of this proposed rule, the Department determined that the proposed rule will result in Year 1 costs for state and local governments totaling \$59.2 million, of which \$17.2 million are direct employer costs and \$42.0 million are payroll increases (Table 40). In subsequent years, the Department estimated that state and local governments may experience payroll increases of as much as \$38.3 million per year.

Costs to the private sector: The Department determined that the proposed rule will result in Year 1 costs to the private sector of approximately \$0.9 billion, of which \$446.7 million are direct employer costs and \$483.7 million are payroll increases. In subsequent years, the Department estimated that the private sector may experience a payroll increase of as much as \$407.1 million per year.

Table 40: Summary of Year 1 Affected EAP Workers, Regulatory Costs, and Transfers by Type of Employer

	Total	Private	Government [a]
Affected EAP Workers (1,000s)			
Number	1,271	1,139	128
Direct Employer Costs (Millions)			
Regulatory familiarization	\$324.9	\$321.2	\$3.8
Adjustment	\$66.6	\$59.7	\$6.7
Managerial	\$72.7	\$65.9	\$6.7
Total direct costs	\$464.2	\$446.7	\$17.2
Payroll Increases (Millions)			
From employers to workers	\$526.9	\$483.7	\$42.0
Direct Employer Costs & Transfers (Millions)			
From employers	\$991.1	\$930.4	\$59.2

[a] Includes only state, local, and tribal governments.

UMRA requires agencies to estimate the effect of a regulation on the national economy if, at its discretion, such estimates are reasonably feasible and the effect is relevant and material.<sup>289</sup> However, OMB guidance on this requirement notes that such macro-economic effects tend to be measurable in nationwide econometric models only if the economic effect of the regulation reaches 0.25 percent to 0.5 percent of GDP, or in the range of \$48.5 billion to \$97.0 billion (using 2017 GDP). A regulation with smaller aggregate effect is not likely to have a measurable effect in macro-economic terms unless it is highly focused on a particular geographic region or economic sector, which is not the case with this proposed rule.

The Department's RIA estimates that the total first-year costs (direct employer costs and payroll increases from employers to workers) of the proposed rule will be approximately \$930.4 million for private employers and \$59.2 million for state and local governments. Given OMB's guidance, the Department has determined that a full macro-economic analysis is not likely to show any measurable effect on the economy. Therefore, these costs are compared to payroll costs and revenue to demonstrate the feasibility of adapting to these new rules.

Total first-year private sector costs compose 0.015 percent of private sector payrolls nationwide.<sup>290</sup> Total private sector first-year costs compose 0.002 percent of national private sector revenues (revenues in 2017 are projected to be \$38.8 trillion).<sup>291</sup> The Department

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<sup>289</sup> 2 U.S.C. 1532(a)(4).

<sup>290</sup> Private sector payroll costs nationwide are projected to be \$6.4 trillion in 2017. This projection is based on private sector payroll costs in 2012, which were \$5.3 trillion using the 2012 Economic Census of the United States. This was inflated to 2017 dollars using the CPI-U.

<sup>291</sup> Private sector revenues in 2012 were \$32.3 trillion using the 2012 Economic Census of the United States. This was inflated to 2017 dollars using the CPI-U.

concludes that effects of this magnitude are affordable and will not result in significant disruptions to typical firms in any of the major industry categories.

Total first-year state and local government costs compose less than 0.01 percent of state and local government payrolls.<sup>292</sup> First-year state and local government costs compose 0.002 percent of state and local government revenues (projected 2017 revenues were estimated to be \$3.7 trillion).<sup>293</sup> Effects of this magnitude will not result in significant disruptions to typical state and local governments. The \$59.2 million in state and local government costs constitutes an average of approximately \$657 for each of the approximately 90,106 state and local entities. The Department considers effects of this magnitude to be quite small both in absolute terms and in relation to payrolls and revenue.

#### C. Least Burdensome Option or Explanation Required

This NPRM has described the Department's consideration of various options throughout the preamble and economic impact analysis (section VI.C.i). The Department believes that it has chosen the least burdensome but still cost-effective methodology to update the salary level consistent with the Department's statutory obligation. Although some alternative options considered would have set the standard salary level at a rate lower than the updated salary level, that outcome would not necessarily be the most cost-effective or least-burdensome alternative for employers. A lower or outdated salary level would result in a less effective bright-line test for

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<sup>292</sup> State and local payrolls in 2015 were reported as \$900 billion. This was inflated to 2017 payroll costs of \$962.9 billion using the CPI-U. State and Local Government Finances Summary: FY2015. Available at <https://www.census.gov/govs/local/>.

<sup>293</sup> State and local revenues in 2015 were reported as \$3.4 trillion. This was inflated to 2017 dollars using the CPI-U. State and Local Government Finances Summary: FY2015. Available at <https://www.census.gov/govs/local/>.

separating workers who may be exempt from those nonexempt workers intended to be within the Act's protection. A low salary level would also increase the burden on the employer to apply the duties test to more employees in determining whether an employee is exempt, which would inherently increase the likelihood of misclassification and, in turn, increase the risk that employees who should receive overtime and minimum wage protections under the FLSA are denied those protections.

Selecting a standard salary level inevitably affects both the risk and cost of misclassification of overtime-eligible employees earning above the salary level, as well as the risk and cost of providing overtime protection to employees performing bona fide EAP duties who are paid below the salary level. An unduly low level risks increasing employer liability from unintentionally misclassifying workers as exempt; but an unduly high standard salary level increases labor costs to employers precluded from claiming the exemption for employees performing bona fide EAP duties. Thus, the ultimate cost of the regulation is increased if the standard salary level is set either too low or too high. The Department determined that setting the standard salary level using the level equivalent to the earnings of the 20th percentile of full-time salaried workers in the South and/or in the retail sector, projected forward to January 2020, balances the risks and costs of misclassification of exempt status.

#### IX. Executive Order 13132, Federalism

The Department has (1) reviewed this proposed rule in accordance with Executive Order 13132 regarding federalism and (2) determined that it does not have federalism implications. The proposed rule would not have substantial direct effects on the States, on the

relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government.

X. Executive Order 13175, Indian Tribal Governments

This proposed rule would not have substantial direct effects on one or more Indian tribes, on the relationship between the Federal Government and Indian tribes, or on the distribution of power and responsibilities between the Federal Government and Indian tribes.

List of Subjects in 29 CFR Part 541

Labor, Minimum wages, Overtime pay, Salaries, Teachers, Wages.

Signed at Washington, D.C. this 7th day of March, 2019.

Keith E. Sonderling,

Acting Administrator, Wage and Hour Division.

For the reasons set out in the preamble, the Department of Labor proposes to amend title 29 of the Code of Federal Regulations part 541 as follows:

**PART 541--DEFINING AND DELIMITING THE EXEMPTIONS FOR EXECUTIVE, ADMINISTRATIVE, PROFESSIONAL, COMPUTER AND OUTSIDE SALES EMPLOYEES**

1. The authority citation for part 541 continues to read as follows:

Authority: 29 U.S.C. 213; Pub. L. 101-583, 104 Stat. 2871; Reorganization Plan No. 6 of 1950 (3 CFR, 1945-53 Comp., p. 1004); Secretary's Order 01-2014 (Dec. 19, 2014), 79 FR 77527 (Dec. 24, 2014).

2. Revise paragraph (a)(1) of § 541.100 to read as follows:

§ 541.100 General rule for executive employees.

(a) \* \* \*

(1) Compensated on a salary basis pursuant to § 541.600 at a rate of not less than \$679 per week (or \$455 per week if employed in the Commonwealth of the Northern Mariana Islands, Guam, Puerto Rico, or the U.S. Virgin Islands by employers other than the Federal government, or \$380 per week if employed in American Samoa by employers other than the Federal government), exclusive of board, lodging or other facilities;

\* \* \* \* \*

3. Revise paragraph (a)(1) of § 541.200 to read as follows:

§ 541.200 General rule for administrative employees.

(a) \* \* \*

(1) Compensated on a salary or fee basis pursuant to § 541.600 at a rate of not less than \$679 per week (or \$455 per week if employed in the Commonwealth of the Northern Mariana Islands, Guam, Puerto Rico, or the U.S. Virgin Islands by employers other than the Federal government, or \$380 per week if employed in American Samoa by employers other than the Federal government), exclusive of board, lodging or other facilities;

\* \* \* \* \*

4. Revise paragraph (a)(1) of § 541.204 to read as follows:

§ 541.204 Educational establishments.

(a) \* \* \*

(1) Compensated on a salary or fee basis at a rate of not less than \$679 per week (or \$455 per week if employed in the Commonwealth of the Northern Mariana Islands, Guam, Puerto Rico, or the U.S. Virgin Islands by employers other than the Federal government, or \$380 per week if employed in American Samoa by employers other than the Federal government), exclusive of board, lodging, or other facilities; or on a salary basis which is at least equal to the entrance salary for teachers in the educational establishment by which employed; and

\* \* \* \* \*

5. Revise paragraph (a)(1) of § 541.300 to read as follows:

§ 541.300 General rule for professional employees.

(a) \* \* \*

(1) Compensated on a salary or fee basis pursuant to § 541.600 at a rate of not less than \$679 per week (or \$455 per week if employed in the Commonwealth of the Northern Mariana Islands, Guam, Puerto Rico, or the U.S. Virgin Islands by employers other than the Federal government, or \$380 per week if employed in American Samoa by employers other than the Federal government), exclusive of board, lodging or other facilities; and

\* \* \* \* \*

6. Amend § 541.400 by removing the first two sentences of paragraph (b) and adding one sentence in their place to read as follows:

§ 541.400 General rule for computer employees.

\* \* \* \* \*

(b) The section 13(a)(1) exemption applies to any computer employee who is compensated on a salary or fee basis at a rate of not less than \$679 per week (or \$455 per week if

employed in the Commonwealth of the Northern Mariana Islands, Guam, Puerto Rico, or the U.S. Virgin Islands by employers other than the Federal government, or \$380 per week if employed in American Samoa by employers other than the Federal government), exclusive of board, lodging, or other facilities. \* \* \*

\* \* \* \* \*

7. Amend § 541.600 by:

a. Removing the first three sentences of paragraph (a) and adding one sentence in their place; and

b. Revising paragraph (b).

The revisions and additions read as follows:

§ 541.600 Amount of salary required.

(a) To qualify as an exempt executive, administrative or professional employee under section 13(a)(1) of the Act, an employee must be compensated on a salary basis at a rate of not less than \$679 per week (or \$455 per week if employed in the Commonwealth of the Northern Mariana Islands, Guam, Puerto Rico, or the U.S. Virgin Islands by employers other than the Federal Government, or \$380 per week if employed in American Samoa by employers other than the Federal Government), exclusive of board, lodging or other facilities. \* \* \*

(b) The required amount of compensation per week may be translated into equivalent amounts for periods longer than one week. For example, the \$679-per-week requirement will be met if the employee is compensated biweekly on a salary basis of not less than \$1,358, semimonthly on a salary basis of not less than \$1,471, or monthly on a salary basis of not less

than \$2,942. However, the shortest period of payment that will meet this compensation requirement is one week.

\* \* \* \* \*

8. Amend § 541.601 by revising paragraphs (a) and (b) to read as follows:

§ 541.601 Highly compensated employees.

(a) An employee with total annual compensation of at least \$147,414 is deemed exempt under section 13(a)(1) of the Act if the employee customarily and regularly performs any one or more of the exempt duties or responsibilities of an executive, administrative or professional employee as identified in subparts B, C or D of this part.

(b) (1) “Total annual compensation” must include at least \$679 per week paid on a salary or fee basis as set forth in §§ 541.602 and 541.605, except that § 541.602(a)(3) shall not apply to highly compensated employees. Total annual compensation may also include commissions, nondiscretionary bonuses and other nondiscretionary compensation earned during a 52-week period. Total annual compensation does not include board, lodging and other facilities as defined in § 541.606, and does not include payments for medical insurance, payments for life insurance, contributions to retirement plans and the cost of other fringe benefits.

(2) If an employee’s total annual compensation does not total at least \$147,414 by the last pay period of the 52-week period, the employer may, during the last pay period or within one month after the end of the 52-week period, make one final payment sufficient to achieve the required level. For example, an employee may earn \$125,000 in base salary, and the employer may anticipate based upon past sales that the employee also will earn \$22,414 in commissions.

However, due to poor sales in the final quarter of the year, the employee actually only earns \$10,000 in commissions. In this situation, the employer may within one month after the end of the year make a payment of at least \$12,414 to the employee. Any such final payment made after the end of the 52-week period may count only toward the prior year's total annual compensation and not toward the total annual compensation in the year it was paid. If the employer fails to make such a payment, the employee does not qualify as a highly compensated employee, but may still qualify as exempt under subparts B, C, or D of this part.

\* \* \* \* \*

§ 541.602 Salary basis.

9. Revise paragraph (a) (3) of § 541.602 to read as follows:

(a) \*\*\*

(3) Up to ten percent of the salary amount required by § 541.600(a) may be satisfied by the payment of nondiscretionary bonuses, incentives and commissions, that are paid annually or more frequently. The employer may utilize any 52-week period as the year, such as a calendar year, a fiscal year, or an anniversary of hire year. If the employer does not identify some other year period in advance, the calendar year will apply. If by the last pay period of the 52-week period the sum of the employee's weekly salary plus nondiscretionary bonus, incentive, and commission payments received does not equal 52 times the weekly salary amount required by § 541.600(a), the employer may make one final payment sufficient to achieve the required level no later than the next pay period after the end of the year. Any such final payment made after the end of the 52-week period may count only toward the prior year's salary amount and not toward

the salary amount in the year it was paid. This provision does not apply to highly compensated employees under § 541.601.

\* \* \* \* \*

10. Revise § 541.604 to read as follows:

§ 541.604 Minimum guarantee plus extras.

(a) An employer may provide an exempt employee with additional compensation without losing the exemption or violating the salary basis requirement, if the employment arrangement also includes a guarantee of at least the minimum weekly-required amount paid on a salary basis. Thus, for example, an exempt employee guaranteed at least \$679 each week paid on a salary basis may also receive additional compensation of a one percent commission on sales. An exempt employee also may receive a percentage of the sales or profits of the employer if the employment arrangement also includes a guarantee of at least \$679 each week paid on a salary basis. Similarly, the exemption is not lost if an exempt employee who is guaranteed at least \$679 each week paid on a salary basis also receives additional compensation based on hours worked for work beyond the normal workweek. Such additional compensation may be paid on any basis (*e.g.*, flat sum, bonus payment, straight-time hourly amount, time and one-half or any other basis), and may include paid time off.

(b) An exempt employee's earnings may be computed on an hourly, a daily or a shift basis, without losing the exemption or violating the salary basis requirement, if the employment arrangement also includes a guarantee of at least the minimum weekly required amount paid on a salary basis regardless of the number of hours, days or shifts worked, and a reasonable relationship exists between the guaranteed amount and the amount actually earned. The

reasonable relationship test will be met if the weekly guarantee is roughly equivalent to the employee's usual earnings at the assigned hourly, daily or shift rate for the employee's normal scheduled workweek. Thus, for example, an exempt employee guaranteed compensation of at least \$700 for any week in which the employee performs any work, and who normally works four or five shifts each week, may be paid \$210 per shift without violating the \$679-per-week salary basis requirement. The reasonable relationship requirement applies only if the employee's pay is computed on an hourly, daily or shift basis. It does not apply, for example, to an exempt store manager paid a guaranteed salary per week that exceeds the current salary level who also receives a commission of one-half percent of all sales in the store or five percent of the store's profits, which in some weeks may total as much as, or even more than, the guaranteed salary.

11. Revise paragraph (b) of § 541.605 to read as follows:

§ 541.605 Fee basis.

\* \* \* \* \*

(b) To determine whether the fee payment meets the minimum amount of salary required for exemption under these regulations, the amount paid to the employee will be tested by determining the time worked on the job and whether the fee payment is at a rate that would amount to at least the minimum salary per week, as required by §§ 541.600(a) and 541.602(a), if the employee worked 40 hours. Thus, an artist paid \$350 for a picture that took 20 hours to complete meets the \$679 minimum salary requirement for exemption since earnings at this rate would yield the artist \$700 if 40 hours were worked.

12. Amend § 541.709 by revising the first sentence to read as follows:

§ 541.709 Motion picture producing industry.

The requirement that the employee be paid “on a salary basis” does not apply to an employee in the motion picture producing industry who is compensated at a base rate of at least \$1,036 per week (exclusive of board, lodging, or other facilities). \* \* \*

\* \* \* \* \*

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