NFIB
The Voice of Small Business.

September 3, 2015

Wage and Hour Division
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

RE: RIN 1235–AA11; Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees

These comments are submitted for the record to the Wage and Hour Division of the U.S. Department of Labor (DOL) on behalf of the National Federation of Independent Business (NFIB) in response to the notice of proposed rulemaking regarding "Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees" published in the July 6, 2015 edition of the *Federal Register*.

NFIB is the nation's leading small business advocacy association, representing members in Washington, DC, and all 50 state capitals. Founded in 1943 as a nonprofit, nonpartisan organization, NFIB's mission is to promote and protect the right of its members to own, operate, and grow their businesses. NFIB represents about 350,000 independent business owners who are located throughout the United States.

NFIB believes that the proposed rule will have a substantial negative impact on small businesses and their employees. Accordingly, NFIB urges DOL to withdraw the proposed rules for the following reasons. First, the proposed salary threshold increase will not result in increased pay for employees of small businesses, but instead will result in the limiting of employee hours and diminished career growth opportunities. Second, while no changes to the duties test were proposed, DOL should not adopt a new duties test in the final rule based simply on feedback provided in the comment period. DOL should propose specific language on which the public can comment. The reasons are explained further below.

Summary of the proposed rule

The Fair Labor Standards Act (FLSA) generally requires covered employers to pay their employees overtime premium pay of one and one-half times the employee's regular rate of pay for all hours worked over 40 in a workweek. However, there are a number of exemptions from the FLSA's minimum wage and overtime requirements. Section 13(a)(1) of the FLSA, codified at 29 U.S.C. 213(a)(1), exempts from both minimum wage and overtime protection "any employee employed in a bona fide executive, administrative, or professional capacity…or in the capacity of outside salesman." The FLSA does not define the terms "executive," "administrative," "professional," or "outside salesman."

DOL has consistently used its rulemaking authority to define and clarify the section 13(a)(1) exemptions. Since 1940, the implementing regulations have generally required each of three tests to be met for the exemptions to apply. First, 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"). Second, the amount of salary paid must meet a minimum specified amount (the "salary level test"). Third, the employee's job duties must primarily involve executive, administrative, or professional duties as defined by the regulations (the "duties test").

In this proposed rule, DOL proposes changes only to the salary level test. Currently, the minimum salary that a worker must receive is $455 per week ($23,660 annually). The proposal seeks to more than double that amount to $970 per week ($50,440 annually). In addition, DOL seeks – for the first time – to automatically increase the salary threshold at either the 40th percentile of all salaried wage earners, or at a rate equivalent to the Consumer Price Index for All Urban Consumers (CPI-U). No timeframe for how frequently this increase will take place is proposed, however.

While DOL does not propose a specific change to the third test – the duties test – the agency seeks feedback on if it should be revised, and if so, in what manner.

Negative impacts of proposed salary threshold increase on small businesses

The proposed rule represents an unprecedented effort by DOL to vastly expand non-exempt status to workers. It is unprecedented because of its ambition to automatically make non-exempt anyone who makes less than the 40th percentile of all salaried wage earners in the United States. By comparison, the current threshold – promulgated in 2004 – was set at roughly the 20th percentile of salaried employees in the South region and in the retail industry. The 2004 rule recognized that the cost of living varies in different parts of the country and adjusted accordingly. This proposed rule makes no such effort. The proposed rule is also unprecedented because for the first time the salary threshold will automatically increase going forward.

The proposed rule has thus far been marketed by the administration as win for workers because it will ensure that employees are paid "fairly." Unfortunately, the true consequences of this proposed rule will be greater costs and burdens on small businesses and less flexibility, benefits, and even pay for most of the workers it purports to benefit. The proposed changes will have a negative impact on employee morale, which will in turn hurt the small business's quality, customer service, and reputation.

Increased labor and regulatory compliance costs

According to DOL's initial regulatory flexibility analysis (IRFA), small businesses will face nearly $750 million in new costs in the first year if the rule is finalized as proposed. These costs are made up of $186.6 million in costs associated with implementing the rule and $561.5 million in additional wages that will now be paid to workers[1]. Unfortunately, these estimates simultaneously underestimate the compliance costs to small businesses and overestimate the transfers to employees.

First, the IRFA underestimates compliance costs because it does not take into account business size when estimating the time it takes to read, comprehend and implement the proposed changes. As an example, DOL "estimates that each establishment will spend one hour of time for regulatory familiarization." This assumption erroneously disregards a basic reality of regulatory compliance – the smaller the business, the longer and more expensive it is to comply. Numerous studies have identified that federal regulatory compliance disproportionately affects small businesses. The most recent one, performed in 2014 for the National Association of Manufacturers, found that businesses with fewer than 50 employees spent 30 percent more per employee per year than their larger counterparts[2]. This study was performed by the same authors that have previously done similar studies for the U.S. Small Business Administration's Office of Advocacy.

Common sense also dictates that small businesses are impacted disproportionately from larger ones. Primarily, this is because small companies typically lack specialized compliance personnel. Typically, the duty of compliance officer falls to the business owner or the primary manager. These individuals are generally not experts in wading through regulatory text, so familiarization time is greater than for large companies. Alternatively, a small business could hire an outside expert to devise a compliance plan, but this cost will also be significantly greater than what a firm with in-house compliance staff would endure.

In this case, complying with the rule requires far more than simply looking at a salaried employee's weekly wages. This is just one piece of the puzzle. If an employee is currently salaried and makes greater than the currently threshold of $455 per week, but less than the proposed $970 per week, the small business owner must now spend a considerable amount of time calculating out varying scenarios – none of which is beneficial for anyone involved.

Proposed rule will harm relationships between small business owners and affected employees

As an example, suppose the employee in question is Geno, a manager at the small business who works an average of 50 hours per week at a weekly salary of $865 ($45,000 annually). As the administration would make it seem, Geno's new pay would increase to $951.50 per week ($49,478 annually). However, this is not a realistic projection of what would happen in a small business where margins are tight. What is more likely to happen is that the business owner, Jane, will determine that she can only afford to continue paying Geno's position $45,000 per year in order for the business to be sustainable. Therefore Jane has three options under the proposed rule when promulgated.

Option one is for Jane to make sure that Geno works no more than 40 hours under his current hourly rate of $865, and take on the ten hours of lost productivity herself. Option two is to reduce Geno's hourly rate of pay by enough so that, even with ten hours of time-and-a-half overtime pay, he still only earns $45,000 in a year. Option three is to bring in a new employee to fill the lost productivity, but to do so in a way so that Jane is only paying $45,000 per year total to Geno and the new employee. One thing is constant under these options – Jane will now have to carefully track Geno's hours worked. So automatically her compliance costs are increasing.

Under option one, whereby Geno would be best off, Jane determines that she is already spending all of her available time operating the business, generating sales, monitoring inventory, and other necessary duties. Plus, now she has to track Geno's hours. Jane simply doesn't have time to take on the ten hours lost. In addition, Jane decides that Geno is now essentially an hourly employee and is no longer suited to be given the title of manager. Geno loses access to the benefits that come along with being a manager – such as healthcare coverage and paid time off, to less obvious ones like being able to leave work early on days when he has to pick up his children from school. Geno is also offended that he now has to use a time clock like hourly employees and feels as though has been demoted.

Under option two, Jane determines that in order keep Geno working 50 hours and earning $45,000 with time-and-a-half overtime pay, she has to again make Geno an hourly employee but at an hourly rate of $15.73. In addition to losing his benefits as above, now Geno must work exactly 50 hours each week in order to earn $865. Before, if he only worked 40 hours because of an emergency at home, he was still ensured his full weekly salary. Again, Geno feels slighted by the change.

Under the third option there are several different variations Jane could choose that are all worse than the arrangement she and Geno have under the current rule. In this case, Jane hires an additional employee, Ryan, to split the 50 hours with Geno. This split could be 40 hours for Geno and ten for Ryan; it could be even at 25 hour each; or any combination in between. Regardless of what Jane decides, the hourly rate for the position will be $17.30. If she lets Geno work 40 hours, his pay is now $692 per week ($35,984 annually). Geno again not only feels slighted, but he now has to figure out where he can get a side job to make up the $9,016 difference from his pay under the current rule versus what he will get under the proposed rule. It's possible that he will have to work more than 10 additional hours at a new job to make up the difference. Geno now works two jobs at more than 50 hours plus additional time spent commuting just to earn what he makes today. Meanwhile, Ryan is not looking to stay in a ten-hours-per-week job for the long term. After a few months, he finds a better job and resigns. Jane now has to spend time and money looking for a new employee and training him or her to replace Ryan.

As these examples illustrate, DOL's assumption that $561.5 million will automatically be transferred to workers is deeply flawed because small businesses will aim to control their costs by limiting overtime. The result is greater compliance costs for small businesses by having to track hours and employees being no better off, and in many instances, worse off.

Proposed salary threshold is too high and does not take into account geographic differences

As mentioned previously, the proposed rule is a departure from the current rule because the proposed salary threshold is set at such a high level as to create severe consequences for areas of the country with lower costs of living. The current salary threshold may appear low at $455 per week, but it was purposely set low to recognize that in rural areas wages are lower than urban areas. By contrast, DOL's proposed salary threshold is higher than minimums set under any state laws, nearly $10,000 higher than that of California and nearly $15,000 higher than New York, two of the states with the highest cost of living.

The proposed rule will particularly hurt small businesses in rural areas. These businesses pay employees at wage rates they can afford. Gross revenues in rural areas are far less than those in urban areas. There is simply not extra money available to pay employees overtime under the conditions set forth in the proposed rule.

Lower salaries also go further in rural areas. As an example, a manager in Washington, D.C. currently making $55,000 annually has the same purchasing power as a manager in Enid, Okla. earning $37,121, according to the Council for Community and Economic Research's cost of living calculator[3]. Small businesses in Enid should not be forced to pay rates currently paid in cities like Washington when the cost of living does not justify such an increase.

NFIB encourages DOL to maintain the current methodology for determining the salary threshold to be fair to small businesses and employees in lower cost-of-living areas. By promulgating the proposed rule, DOL would be triggering the scenarios mentioned in the section above, and disproportionately hurting small businesses in rural areas.

Concerns with automatically updating the threshold

The proposed rule would – for the first time – establish a mechanism to automatically increase the salary threshold at specified intervals. Indexing the minimum salary threshold would likely result in instability in labor and administrative costs for small businesses in perpetuity. Though no schedule was specifically proposed, at set intervals – presumably annually – DOL would issue a new salary threshold via the *Federal Register*, and small businesses would have only 60 days to implement the changes. That means every year small businesses would be forced to reconsider the classifications given to their employees and reassess potential raises, bonuses, or promotions for those employees.

Small businesses will need to constantly review the impact the automatic increases have on salary compression, merit increases and budgets. This reconsideration of positions costs time and money and if it occurred during a downturn in the economy the increased costs would exacerbate the problems for small businesses at inopportune times.

Accordingly, NFIB believes that DOL should abandon its proposal to automatically increase the salary threshold.

Current duties test should remain in place

Though DOL has not proposed changes to the duties test, it has sought feedback on the current test. While this current test is not perfect, small businesses have had more than a decade of working with it and generally understand its application. Therefore, NFIB would not support any change of the duties test because it would require small businesses to familiarize themselves with a new set of standards and would still likely have flaws. Changes would only serve to increase compliance costs.

Specifically, NFIB strongly opposes any change to the duties test that would set a specific percentage-of-time component – akin to California's 50 percent primary duty rule – for certain tasks in order to claim the duties exemptions. Any such requirement, *at any percentage*, would be an administrative nightmare for small businesses and their employees. Under such a scheme, a manager would have to carefully track each moment of his or her day and determine whether the task they performed was an exempt duty or a non-exempt duty. Such changes could require salaried employees to spend a specific percentage of their time performing or not performing certain duties. This means a manager who is responsible for store operations, and thus by virtue of the position is “managing,” would often be prohibited from performing tasks such as attending to customers’ needs, training employees in nonexempt tasks, and managing inventory. The manager would also be required to track his or her activities, undermining the discretion and flexibility that comes with being exempt.

As previously mentioned, California already applies this “quantification requirement.” To be exempt under California state law, an employee must spend more than 50 percent of his or her time performing primary duties. As a result, exemptions from overtime are very difficult to implement, resulting in many managers being denied the opportunities and flexibility that come with exempt status.

Lastly, because there were no proposed changes to the test, NFIB strongly believes that if DOL intends to include changes in the final rule, it must issue a noticed of proposed rulemaking regarding that change. It is our opinion that failing to do so would violate the requirements of the Administrative Procedure Act and the Regulatory Flexibility Act (RFA). The public should be given proper notice and opportunity for comment on such a change, and DOL should also perform an IRFA since it has already recognized that a change to the overtime rules will have a significant economic impact on a substantial number of small entities.

One NFIB member’s story

NFIB believes it would be illustrative to include the story of a member to demonstrate the real and negative effects likely to occur if DOL promulgates a final rule similar to what has been proposed.

Robert Mayfield owns five Dairy Queens in and around Austin, Texas and is very concerned about the impact that the proposal would have on his businesses and the individuals whom he employs. In his words, the rule would be “bad news” for both employers and employees.

Currently, Mayfield employs exempt managers at all five locations. These individuals earn on average about $30,000 per year and work between 40-50 hours per week. The managers also receive bonuses, more flexible work arrangements, including paid vacation and sick time, training opportunities, and promotions that Mayfield’s hourly employees do not. Mayfield explained that in his company, promotion to an exempt management position carries a great deal of status with employees who upon promotion to a manager position boast about no longer having to punch time clocks. In Mayfield’s opinion, it would be demeaning to force ‘managers’ to punch a clock. He also noted that his managers have more flexibility for things like doctors’ appointments and kids’ activities. Since they aren’t punching in and out on a time clock they are paid a weekly salary even if they’re out for personal activities.

Under DOL's proposal, Mayfield predicted that he'll need to move the managers back to hourly positions as there is simply no way he can afford to pay over 10 managers $50,000 each. As a result, he predicted the skill level of his managers will decrease. Moreover, Mayfield noted that rather than giving managers overtime, he would likely hire a few more part-time employees. What he would not do would be to pay managers overtime; instead he would continue strictly enforce a no overtime policy. Overtime costs, he said, could not be passed on to customers nor could the business afford to absorb added labor costs.

Overall, Mayfield said the effect would be lower-skilled managers and higher turnover, which would impact the quality of service offered at his restaurants.

"I feel most sorry for the many enthusiastic people who work for me who have worked hard to advance into their dream of a salaried management position," Mayfield said. "They will have their feelings hurt and be insulted to find out that their own government considers them to not be worthy of a salaried position that is eligible for a bonus based on profits that they would have helped to plan. It is a real source of pride and prestige to be on salary and not have to punch a time clock.

"How can you be a manager and punch a time clock? The idea is to do a job, not keep track of your hours. A manager's income is based on results and profits, not hours worked. This is the antithesis of building a management mentality or in training someone to be a manager. It would also disrupt the workplace and lead to fewer management opportunities. It would hurt, not help, the people they claim to want to help."

Proposed rule is an example of the need for small business regulatory reform

NFIB believes that these proposed rules demonstrate the need to reform the RFA and its amending laws. Currently, agencies are required to perform an initial regulatory flexibility analysis prior to proposing a rule that will have a significant economic impact on a substantial number of small entities – as DOL has confirmed this proposed rule will. While these analyses are helpful for agencies to realize the cost and impact a proposed rule will have on small business, agencies would get additional benefit from convening a Small Business Advocacy Review panel for rules of significant impact.

These panels allow an agency to walk through a potential proposal with small business owners, either in person or via telephone, and receive feedback and other input from those who will be directly impacted by the regulation. These panels are currently required for the Environmental Protection Agency, the Occupational Safety and Health Administration, and the Consumer Financial Protection Bureau. NFIB believes all agencies – in particular the entire Department of Labor – would achieve better regulatory outcomes if required to go through such a procedure.

In this case, DOL would have benefitted from presenting the proposed salary threshold to small businesses so that those businesses could have provided DOL feedback on how the drastic increase will impact small businesses and their employees. In addition, DOL also would have been more likely to realize the harm they are doing by not proposing changes to the duties test if, as it appears, the agency has designs on ultimately tweaking the test. Small businesses could have offered to DOL that the lack of specifics makes it difficult to comment. It is also likely that DOL would have realized that if they do in fact make changes to the duties test in the final rule, they should first issue a notice of proposed rulemaking so that the public has a sufficient opportunity to respond.

Conclusion

NFIB strongly believes that DOL should withdraw the proposed rule because it will not achieve the goals that DOL strives for. Instead of topping up wages for certain employees, the proposed rule will force small business owners to take more control of employee hours in order to keep costs in check. This control will come at a cost for small business owners, meaning that the result of the rule – if promulgated – would be that small businesses face higher costs and employees do not earn more money. In addition, employees are likely to see reduced benefits and opportunities for career growth stifled.

In addition, though no changes to the duties test were proposed, NFIB urges DOL to publish a notice of proposed rulemaking if it intends to make changes in the final rule. The public should have the ability to weigh in on such a major change.

We appreciate the opportunity to comment on the proposed rule. Should DOL require additional information, please contact the NFIB's manager of regulatory policy, Dan Bosch, at 202-314-2052.

Sincerely,

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NFIB

[1] *Federal Register*. Vol. 80, No. 128. July 6, 2015. Page 38606.
[2] http://www.nam.org/Data-and-Reports/Cost-of-Federal-Regulations/Federal-Regulation-Executive-Summary.pdf
[3] https://www.coli.org/