

June 17, 2010

The Honorable Peter Orszag
Director
Office of Management and Budget
Eisenhower Executive Office Building
1650 Pennsylvania Ave., NW
Washington, DC 20503

SUBJECT: Draft 2010 Report to Congress on the Benefits and Costs of Federal Regulations, OMB–2010–0008, 75 Fed. Reg. 22631 (April 29, 2010)

Dear Mr. Orszag:

We appreciate the opportunity to respond to your request for “suggestions about regulatory changes that might serve to promote economic growth, with particular reference to increasing employment, innovation, and competitiveness.” You also express an interest “in identifying both new initiatives and current regulations that might be modified, expanded, or repealed in order to promote those goals.”

HR Policy Association represents the chief human resource officers of more than 300 large employers doing business in the United States and globally. The Association’s member companies employ more than ten million Americans, nearly nine percent of the private sector workforce in the United States. In responding to this request, we would like to accomplish two goals. First, we articulate a holistic approach towards employment regulation that could help achieve the administration’s goals of economic recovery and growth.

Second, and more specifically, we wish to highlight a particular area of needed reform—the Fair Labor Standards Act—a statute which was written for a different era whose regulations have failed to keep pace with changes in the workplace. The Fair Labor Standards Act, or FLSA, sets the federal regulatory floor for minimum wage and overtime matters. Further, it defines which employees are subject to overtime requirements and which are not. The law was first written in 1938, and the regulations promulgated under it reflect a mid-Twentieth Century industrial workplace, not today’s 21st Century Digital Age work environment knit together by technology. Because of its myriad anomalies, the FLSA impedes employers in achieving progress toward the kinds of flexible workplace policies the administration is seeking to promote.¹ These restrictions apply primarily to the 92.6 million wage and salary employees who are not exempt from the Act.² Moreover, the enforcement trend being promoted by the Labor Department is towards toughening rules that no longer fit today’s workplace instead of seeking to make them more relevant to contemporary needs.

The Economic Recovery and Factors Associated with Job Creation

Given the current economic situation, the OMB report comes at a critical point for employment policy because the ability of employers to compete on a global scale is unequivocally tied to the workplace and the laws and regulations that shape it. Although we are encouraged by indications that the Great Recession may be over, the number of payroll jobs is still 7.4 million below the level that preceded the downturn and there are more than five unemployed Americans for every job opening.³ Attempts to jump-start the recovery have involved massive federal expenditures coupled with sweeping policy changes touching virtually all areas of the economy. However, we are deeply concerned that existing employment policy—and the direction it appears to be heading—is undermining these expenditures because of its impact on U.S. competitiveness, innovation, and employment growth.

The comprehensive structure of U.S. workplace laws, regulations, and taxes plays a role in virtually every decision by an employer with respect to hiring, promotions, terminations, scheduling, sharing of data, use and design of facilities, and changes in operations. All of these laws and policies have a cost, and with each additional mandate or tax, another cost is layered onto employment decisions.

At the same time, the ability of employers to add new jobs to the economy depends to a large extent on the costs associated with those jobs. This is not just a question of the dollar amounts involved in wages and benefits. It also includes numerous other factors that influence the decision by an employer as to whether it is economically feasible to even continue an existing position, let alone adding new ones. When it comes to workplace regulation, these factors include, among other things:

- the administrative costs associated with compliance with a law or regulation, including the tracking and recordkeeping associated with the data needed to demonstrate compliance;
- the time spent by human resource officers, supervisors, managers, and company leadership in planning and ensuring compliance with each workplace rule;
- the legal costs associated with establishing protocols to ensure compliance while maintaining continuous internal auditing to make certain that these protocols are being followed;
- the potential legal costs for addressing complaints and, ultimately, litigation or defending against enforcement actions brought by the government or private parties where allegations of noncompliance are involved (including the costs of settlement where the expense of defending such actions may exceed the potential liability); and
- the inability to achieve savings or competitive advantages as a result of restrictions that preclude the development of more efficient and productive workplace policies and procedures, even where they may be to the mutual benefit of both the employer and the employees.

As the administration continues to strive for a full economic recovery, it is essential that it consider the interplay between the goals of adding and restoring jobs and the costs of employment regulation associated with each job.

The Current Regulatory Climate

Employers are deeply concerned about the relationship between government and business and the extent to which it becomes highly adversarial in the employment policy context. The most significant driver of the American economy for the past two centuries has been the ability of the private sector to create economic opportunities and jobs. Yet, we see a disturbing trend in the recent regulatory climate that instead seems to view employers as a malevolent force that must constantly be placed under severe restraints. There appears to be a general belief among many policymakers that, absent a strong governmental enforcement scheme, employers will not treat employees fairly and will take advantage of them. There is no question that there have been many instances over the years of certain companies taking actions that harmed employees, and it can be said that to some extent, business has brought this trend on itself. However, the political system in the United States is such that public policy results in the sins of the bad actors being punished by foisting harsh regulatory schemes on all employers regardless of their past behavior.

Association members believe that instead of continuing the adversarial relationship between government and business, particularly at a time of high unemployment, the government should try to work with employers to help create both jobs and the conditions for their placement in the United States. This can be manifested in numerous policy areas, including education, training, tax, and trade policy. Yet, when it comes to employment regulation, this is not the message they receive from the repeated statements and threats by government officials that employers should expect far stiffer enforcement of existing employment laws coupled with even tougher measures and mandates. What is needed instead are statements pledging a partnership with business to create new markets and long term employment opportunities.

A Reexamination of Employment Policy

With this in mind, we seek a broad re-examination of the impact of the nation's regulatory structure covering the workplace and the employment relationship. We need to ask whether the nation has reached a tipping point where the nation's labor, employment, and benefit laws have become so complex, burdensome, and difficult to administer that they have become both counterproductive and job killers. In addressing this issue, we must recognize that many of these laws, including the Fair Labor Standards Act discussed herein, were formulated in a period when the workplace was significantly different than today, and there was less concern about goods and services being performed outside our borders under different, and often more flexible, regulatory schemes.

We wish to emphasize that we are not suggesting a race to the bottom that abandons fundamental employment protections. Indeed, the vast majority of laws regulating the workplace address legitimate concerns and they rest upon a set of core principles that nearly all people believe should be part of the employer-employee relationship. For example, there is a broad consensus that:

- Employees should be treated with respect by employers.
- Employees should not be taken advantage of by employers.
- Employees should not be discriminated against in hiring, compensation, advancement, and termination using inappropriate factors or criteria.
- Employees should not have to fear or suffer from bodily harm in their workplace that is reasonably preventable.
- Employees should be able to form a union and engage in collective bargaining if they choose to do so in an atmosphere free of coercion by either the employer or union organizers.

Although there will always be a small minority of employers that will try to take advantage of their employees just as there will always be a small minority of employees who will try to take advantage of their employer, it is important to recognize that the vast majority of employers understand that running a workplace that lacks respect for employees, fair compensation, essential health and safety protections, and non-discriminatory treatment ultimately becomes a self-defeating practice that results in a loss of competitive edge.

The frustration employers have with the existing regulatory regime is that it often takes overly prescriptive approaches that, if not adhered to in a very careful manner, can result in “gotcha” penalties for employers who had no intent to either violate the law or take advantage of their employees. Indeed, “one size fits all” prescriptions can inhibit the employer’s ability to accommodate both its employees’ needs as well as its own in a mutually satisfactory manner. Thus, as is often the case under the FLSA, companies and their employees often find themselves having to force the workplace into a construct designed solely to comply with the law. Several examples of this are provided below.

The problems employers confront in complying with workplace regulations are further exacerbated by the potential for costly litigation. The United States is one of the few nations that provides for enforcement of many of its employment laws through private actions before juries, frequently resulting in significant monetary damages. For many employers, even where their practices are in compliance with the law and regulations, it is far more cost effective and predictable to simply settle claims of noncompliance with the government agency or private attorney, rather than spend years in litigation where even a victory will not secure reimbursement for huge legal expenses.

Even employers who are in compliance with the law spend a considerable amount of time and resources dealing with nuisance lawsuits driven by the plaintiffs’ bar. These suits are filed with the objective of shaking the employer down for a settlement in return for withdrawing the case. And after the lawyers take their cut of the settlement for both fees and “expenses,” plaintiffs are often left with the crumbs. In the case of class actions which are now available for most employment laws, the problem is compounded as lawyers often walk away with huge fees while individual plaintiffs may only receive a modest share of the recovery. It should come as no surprise that the United States, among all the industrialized nations, has the highest number of lawyers per capita.⁴

Because of these concerns, we strongly urge the Administration before it launches new regulatory and enforcement initiatives to undertake a thorough review of what is already on the books and determine whether these regulations need to be revised or abandoned by asking the following questions--

- How does the law and its regulations impact the hiring and retention of employees in the United States as well as the expansion of business here?
- Are the regulations up-to-date and readily understandable by all those affected by them?
- Can the regulations be easily and consistently applied and enforced?
- Is there sufficient flexibility in the rules such that employers can accommodate the need for family friendly policies without running afoul of the law?
- Are the rules consistent with what today's employees genuinely want and need while providing sufficient protections for low-wage workers?
- Can the regulations account for and allow for changes in the use of technology, the workplace, and employee lifestyles?
- Can the requirements be applied consistently across the 50 states and in the counties and cities of those states?
- Do policymakers and regulators fully understand the consequences of the regulatory scheme they have designed before it has been implemented?
- Do the rules demand information that employers do not have or cannot easily obtain without incurring new costs?
- Do the regulations contain any elements or requirements that unnecessarily create ill will among employees?
- What is the objective of the regulatory requirement, and what is the best way to achieve that objective without causing undue disruptions to employers?
- Do regulations impose requirements that are not contained in the statute?

The Fair Labor Standards Act Generally

With these questions in mind, we would ask you to consider the Fair Labor Standards Act. On its face, the FLSA is a very simple and defensible attempt to protect employees against exploitation and "sweatshop" working conditions. The dual purpose of the law is to provide a minimum wage (currently \$7.25 per hour) and ensure that workers who are not otherwise exempt are paid time-and-a-half overtime for hours worked in excess of forty in a given workweek. Most employees who are exempt are "white collar" employees who must be paid a salary. However, these simple concepts have been translated into countless vague and inconsistent rules and exceptions that are increasingly out of step with the times.

Examples of Problems. Employers regularly deal with following kinds of situations forced by the statute's inflexibilities:

- Work schedules are carefully designed to avoid excessive overtime. Thus, even if employees would prefer to work eight days in a row, with six days off in a row, the employer cannot afford such a schedule because it would involve at least two full days of overtime.
- Because employers fear that FLSA violations will occur because of employees engaging in work that is not being tracked, they impose restrictions on the use of social media outside of working hours. Thus, nonexempt employees are discouraged or prohibited from checking emails off-hours due to the risk of not reporting their time worked, even though they may prefer to do this. In occupations, such as off-site repairmen, where the use of Blackberries or other personal digital assistants (PDAs) is essential, some employers require the employee to keep these at one of the employer's locations, picking it up and dropping it off there, regardless of the locations of site visits.
- The law creates disincentives toward engaging nonexempt employees in trouble-shooting and decision-making:
 - When something goes wrong on a shift and the current shift needs to call someone on the prior shift, the administrative burden of reporting the "time worked" for the prior-shift employee's six-minute phone call discourages the contact.
 - Nonexempt employees may be routinely excluded from off-site meetings or trips which could be beneficial to them and the company because of the administrative difficulty of determining what time is compensable and the actual cost, once determined.
 - In team situations where nonexempt employees are actively involved in deciding how the work is to be performed, the employer often has to discourage them—to the point of imposing discipline—from engaging in "after hours" discussions with their co-workers or engaging in any other work, such as writing a proposal for addressing a particular problem.

Such division of employees based on job classification is increasingly out of sync with corporate cultures which depend on team-work. Further, the inability to participate in off-hours or off-site events stunts the career growth of nonexempt employees who lose the benefit of these activities.

- Nonexempt employees are often at a disadvantage when their employers offer non-work-related events during the workday for employees to participate in, such as Earth Day celebrations, diversity network events, corporate United Way campaign events, and so forth. In 24/7 operations, these events will always be taking place during the working hours of some segment of the workforce. Thus, in order to participate, those nonexempt employees must be compensated for that time and are thus less likely to get management support for participating as fully as exempt employees, including being able to serve as leaders or organizers.
- Employers are discouraged from paying bonuses and other forms of incentive pay to nonexempt employees because the law requires such amounts to be included in the

employees' rate of pay for purposes of calculating overtime. For example, an employer may want to extend pay-for-performance incentives to nonexempt employees by offering annual incentive payments for achieving certain performance targets. However, payment of the incentive will require recalculation of overtime pay for the year. Moreover, when making the decision to provide such incentives, the employer often doesn't know how much overtime the employees will work, thus preventing an accurate projection of costs. To avoid this administrative complexity and potential legal exposure, some employers might simply conclude that they are not going to extend incentive pay programs to nonexempt employees.

The FLSA Workplace. In considering the FLSA, it is important to understand the state of the American workplace when the 1938 law was enacted. The Depression-era workplace was characterized by:

- a fixed beginning and end to both the workday and the workweek in most American workplaces;
- with the exception of certain occupations (*e.g.*, repairmen and truck drivers), the performance of the vast majority of work taking place in the workplace because of the lack of communications technology allowing the performance of jobs from remote locations;
- a far more stratified and predictable designation of occupations, as compared to today's workplaces where there is a greater blurring of distinctions and a more rapid evolution of job descriptions; and
- a greater preponderance of manual labor because of the relative absence of technology and mechanization that transformed the way work is performed today.

The FLSA was passed at a time when Ford Motor Company was making Model A's on its production line with manual labor and relatively very little automation. With technology and robotics, today's production workers use their minds and computers to an extent that was beyond the imagination of science fiction writers in the Depression. Today, the entire concept of work is changing as the United States moves from a manufacturing to a service economy that is highly dependent on technology and much more mobile.

Yet, the basic structure of the FLSA has never been fundamentally reexamined. The FLSA and its regulations simply have not kept pace with the changes in the workplace. The FLSA was enacted in 1938 and, though it has been amended in a noteworthy manner 17 times, those amendments have for the most part been limited to expanding coverage to specific categories of employees and increasing the minimum wage, while occasionally addressing very narrow aspects of the law.⁵ Even though the minimum wage seems to generate far greater attention in public policy discussions, most of the difficulties created by the FLSA fall under the overtime requirement. As a result, there is a tremendous amount of litigation brought by the plaintiffs' bar exploiting the differences between Depression-era regulations and 21st Century workplace practices.

A considerable share of the friction within the FLSA arises from the "white collar" regulations, discussed below, which have created numerous difficulties in figuring out which

employees are subject to overtime requirements and which are exempt. In 2004, the Bush Administration updated the regulations defining the white collar exemptions.⁶ However, the revised regulations continue to cause compliance difficulties and generate significant litigation because of the continuing evolution of the workplace. Meanwhile, despite predictions that the changes would result in six million Americans losing overtime,⁷ no studies have been offered since to verify that this happened. Moreover, our own informal contacts with our members indicate that, if anything, most employees whose status changed in the wake of the regulations were shifted from exempt to nonexempt.

Explosion of Litigation. In considering the FLSA's regulatory framework, it must be recognized that the statute provides not only for enforcement by the Department of Labor, but also by private actions. As a result, the private bar has taken advantage of the law's lack of clarity in pursuing highly lucrative class actions against employers who struggle to ascertain what is required. Thus, the number of FLSA lawsuits has quadrupled from about 1,500 per year in the early 1990s to over 6,000 in 2009,⁸ and this does not count the number of cases brought under state laws which often vary from the federal law. Faced with the uncertainties of the law, companies often settle these cases, with a median settlement cost of \$7.4 million for federal cases and \$10 million for state cases.⁹

Lack of Preemption. On top of all the problems created by the federal wage and hour laws, additional inflexibilities and complexities are created by state laws, which are not preempted as long as they are more "protective."¹⁰ Thus, California has significantly narrower criteria for which employees are exempt from overtime. For example, in order to be considered an exempt computer employee in California, an individual must perform duties involving the exercise of discretion more than 50 percent of the time in each work week and earn at least \$79,050 annually.¹¹ Under Federal law, there is no discretion requirement, the exemption is measured over a longer period of time, is not based on a hard-and-fast percentage test, and the employee needs to earn \$23,660 annually. Thus, two different employees, one working in California and another working in another state for the same company, may be subject to entirely different scheduling and compensation schemes even though they are performing exactly the same kind of work.

In addition, states may provide varying definitions of the workweek or other factors determining when overtime must be paid. In California, most employees must be paid overtime for any hours worked in excess of eight in a single day, regardless of how many hours he or she works the rest of the week. In addition, an employer must provide a 30 minute meal break during which the employee is relieved of all duties, unless the job requires the employee to be on duty during meals, such as a security guard at a remote location.¹² Thus, a nonexempt employee must be forced by the employer to take a half-hour lunch break, even if the employee would prefer a working lunch that would enable him or her to leave work a half hour earlier. In situations where nonexempt employees work closely with exempt employees, this is yet another situation where the wage and hour law creates divisions in the workplace.

With this as a basic background on the law, the following is a brief discussion of some of the problems that have evolved as the 1930s law remains fixed while the workplace continues to change.

Workplace Flexibility

The administration is strongly encouraging employers to adopt workplace flexibility policies to help employees address the competing demands of work and family. On March 31, 2010, the White House conducted a Forum on Workplace Flexibility at which President Obama encouraged employers to “embrace telecommuting, flextime, compressed work weeks, job sharing, flexible start and end times, and helping your employees generally find quality childcare and eldercare.”¹³ Yet, the Fair Labor Standards Act, which was written for a traditional, mid-Twentieth Century workplace, repeatedly frustrates the ability of employers to embrace such policies for employees who are covered by the statute (often referred to as “nonexempt employees”).

Except for those employees who are exempt, the employer is required to pay employees overtime for all “hours worked” in excess of forty in a specific workweek. This requirement, coupled with the very strict, but often murky, rules regarding tracking hours breaks down when employers try to implement flexible workplace policies. For example, employers often have to reject individual arrangements sought by employees. Thus, two employees may want to do a shift swap between weeks, which would benefit their individual work-life balance. Jim wants to swap Friday shift for Sue’s Monday shift. Both are willing, but doing so would convert what would be straight time to overtime for both employees, working 32 hours of straight time in one week and 48 hours in the next. Thus, accommodating the employees’ request imposes additional costs on the company.

Telecommuting. For obvious reasons, many employees desire telecommuting, which enables them to work from home or other locations outside the workplace. The flexibility of a telecommuting arrangement can benefit both employees and employers. However, neither the FLSA nor the U.S. Department of Labor’s interpretative regulations directly addresses nonexempt telecommuting employees; telecommuting was unknown when they were written. In fact, neither the words nor the concept of “telecommuting, flextime, compressed work weeks, job sharing, flexible start and end times, and helping your employees generally find quality childcare and eldercare” are found in the FLSA regulations.

Thus, where an employer is required to track the “hours worked” by an employee, telecommuting can raise serious litigation/enforcement risks that discourage employers from offering such arrangements. For example, even with computer or telephone tracking systems that generate time reports showing login and logout times, an employer must still ensure that it accurately records all other hours worked when the employee is not “logged on.” Moreover, even if an employer attempts to control the hours worked by nonexempt telecommuters by requiring agreements that set specific work-hour requirements and requiring that any overtime be approved in advance, this will not protect an employer from litigation or enforcement actions.¹⁴

Another FLSA issue that arises with telecommuting arrangements has to do with whether or not commuting time is compensable. Generally, travel time to and from work does not constitute hours worked. If, however, travel occurs after an employee’s first principal activity in the workday, say telecommuting from home in the morning and then driving into work in the afternoon for a meeting, the “continuous workday” rule could be interpreted to make such travel

compensable. Designing and implementing a policy and practice that will exclude travel-time pay by telecommuters is very difficult and by no means certain.

Flexible Scheduling. The strictures of the Fair Labor Standards Act also impede the ability of employers to respond to the wishes of nonexempt employees for flexible scheduling. A flexible work schedule is an alternative to the traditional "9-to-5" 40-hour work week that allows employees to vary their arrival and/or departure times or the days that they work. Because employees must be paid overtime for every hour worked in excess of forty *in a given workweek*, there is a financial disincentive for an employer to honor a request by employees to work longer hours in some weeks in exchange for shorter hours or longer weekends in others.

The FLSA only allows flexible schedules that remain within the weekly 40-hour limit, *i.e.*, working four 10-hour days each week, working three 10-hour days and two 5-hour days each week, and varying one's start and end times each day around some core hours while working no more than 40 hours each workweek. Unlike the public sector, private-sector employees are not allowed to "bank" over-time hours worked as comp-time in order to take paid time off in future pay periods for family situations or extra vacation days. Private-sector employees have no choice; they must be paid cash for the overtime they work in a pay period.

Beyond the standard five-day, 40-hour workweek, the FLSA does allow one inflexible variation—the so-called 9/80 model that creates a fictitious beginning and end to the workweek. Using this model, employees work a full two-week, 80-hour schedule in nine days rather than 10 and take a day every other week off, usually Friday. To do this, the employer must first artificially redefine the work week by designating a particular day, usually a Friday, where the workweek begins at noon on that day. Using this definition, which splits one day a week into two, the employees never work more than 40 hours in a week. When employees take off every other Friday, they are reducing two work weeks by four hours each, and making up the difference by working 36 hours Monday through Thursday. Thus, in each artificially defined "workweek," they are working 40 hours, even though in one normally-defined workweek they would be working 36 hours and in the other 44.¹⁵ However, any variation on this—such as extending the time frame to a three or four week period, with two or three extra days off—would not be permitted, even if requested by the employees.

Moreover, the 9/80 schedule requires employers to keep careful track of work hours daily. For example, if an employee requests a deviation from the schedule in order to meet a personal need, such as offering to work the Friday that is supposed to be "off" in order to take the following Friday, the employer would be deterred from granting the request by having to pay overtime for that Friday. The situation becomes even more complicated in California, which requires an employee vote to implement a 9/80 work schedule and then has even more restrictive requirements than Federal law.

Electronic Communications Devices. The proliferation of electronic communication devices has a powerful potential for not only improving productivity but also helping employees, both salaried and hourly, accommodate the competing demands of work and family. However, the requirement to pay employees for "hours worked," when interpreted literally, can strain the

ability of employers to comply with the law. As a result, many employers are imposing severe restrictions on the use of these devices outside the workplace.

If a nonexempt employee has access to his or her email account away from work—either through a laptop or a personal digital assistant—he or she is very likely to access that account outside normal working hours. If he or she is performing a significant amount of work, the employer would be expected to compensate the employee for that work. However, the employee may be simply checking to see if something needs urgent attention or taking a quick look to get a preview of the coming workday. He or she may even be checking to see if a co-employee has responded on a non-work-related matter but, in doing so, also glance at one that is work-related. At present, it is not clear whether such “de minimis” activities have to be compensated. Employers are also uncertain as to when such activities trigger the commencement of the workday or extend it past normal working hours.

Because the employee is essentially on his or her time, it is virtually impossible for the employer to track such occurrences or try to minimize them. The absence of clarity in the law on this issue, coupled with the aforementioned proliferation of wage and hour lawsuits, tends to drive many employers’ policies, rather than employee preferences. Indeed, many employers who would otherwise be willing to purchase such devices for their employees—and allow them to also be used for personal needs—are deterred from doing so by the inability to effectively control the amount of work the employee may try to perform with them. The safest course for employers is to ban the use of electronic communications devices outside the workplace, despite the wishes of the employee. These complications created by the extraordinary advances in communications technology were not at issue when the FLSA was formulated.

Determining Exempt Status

These flexibility issues do not arise where employees are exempt from the FLSA. Yet, the most difficult problems in recent years under the FLSA have revolved around determining which employees are or are not exempt. Because the FLSA’s original purpose was to focus the statute’s protections upon the “unprotected, unorganized and lowest paid” manufacturing workers,¹⁶ comprehensive coverage was not contemplated. As described by the Department of Labor:

Exemptions were premised on the belief that the workers exempted typically earned salaries well above the minimum wage, and they were presumed to enjoy other compensatory privileges such as above average fringe benefits and better opportunities for advancement, setting them apart from the nonexempt workers entitled to overtime pay. Further, the type of work they performed was difficult to standardize to any time frame and could not be easily spread to other workers after 40 hours in a week, making compliance with the overtime provisions difficult and generally precluding the potential job expansion intended by the FLSA’s time-and-a-half overtime premium.¹⁷

Minimal Impact of Exempt Status on Earnings. Implicit in the arguments of those who press for the narrowest possible definition of the exemptions is the assumption that, by being exempt, employees are being underpaid. However, apart from the minimum wage, the FLSA

does not regulate the amount that employees are paid. Rather, it determines how they are paid. Thus, being covered by the FLSA does not necessarily guarantee that an employee will earn more. The rules are the same regardless of whether he or she is paid \$10 an hour or \$100 an hour. The only issue is determining whether and when the employee must be paid one and one half times this amount for every hour worked over 40. Thus, if the value of the work of an employee to an employer is \$950 after working 45 hours per week, the economics for the employer and the employee are the same regardless of whether the employee is exempt and earns a salary of \$950 per week, or if the employee is nonexempt and earns \$20 per hour (\$20 times 40 plus \$30 times 5 equals \$950).

The amount an employee is paid is determined by a variety of factors, including market rates, education, experience, performance and so forth. Employers will generally establish compensation for an employee based on these factors. If an employee is exempt, the employer will provide a salary that reflects these factors. That salary will also likely be shaped by the number of hours contemplated in the job. If the job involves significant amounts of time beyond a normal forty hour workweek, which many white collar jobs do, the salary will reflect that as part of the objective of attracting and retaining the talent needed to meet the company's needs.

If, on the other hand, the employee's duties fail to meet the test for any of the exemptions, the employer will have to determine an appropriate hourly wage, based on the same kinds of factors that will also meet its talent attraction and retention needs. In setting that wage, the employer will consider the amount of overtime the employee is likely to work.

The point is that in today's economy, an employee over a period of time is likely to earn roughly the same amount, regardless of whether he or she is exempt or nonexempt. In addition to greater scheduling flexibility, the advantage of being exempt is that it is, by requirement, a salaried position, so there is a great deal more certainty by the employee regarding the amount that will be earned, even if it may involve a certain number of overtime hours that do not receive premium pay.

White Collar Exemptions Generally. As described previously, the most common exemptions are the so-called white collar exemptions:

- the administrative exemption, for those whose primary duty involves “the performance of office or nonmanual work directly related to management policies or general business operations of his employer or his employer’s business” where the work includes “the exercise of independent judgment and discretion;”
- the professional exemption, for those who are either of “a learned or educational profession requiring the consistent exercise of discretion and judgment” or “perform work requiring invention, imagination, or talent in a recognized field of artistic endeavor;” and
- the executive exemption, for those whose primary duty is “managing the enterprise, or managing a customarily recognized department or subdivision of the enterprise.”

For an employee to fall within any of the white collar exemptions, he or she must be paid “on a salary basis.” This creates a financial advantage for exempt employees that is not shared by nonexempt employees, who must rely on the availability of work to gain a full week’s earnings. Generally, the exempt employee must be paid the full predetermined salary amount “free and clear” for any week in which the employee performs any work without regard to the number of days or hours worked. Deductions may not be made from the employee’s predetermined salary for absences occasioned by the employer or by the operating requirements of the business. If the employee is ready, willing, and able to work, deductions may not be made for time when work is not available. Except for certain limited situations, salary deductions result in loss of the white-collar exemption and the potential risk of having to pay three years of back wages for any overtime worked.¹⁸

Examples of Areas of Uncertainty. The rules governing the exemptions are riddled with ambiguities and imprecision that employers and even the Department of Labor struggle with in applying them to a real workplace:

- *Entry-level degreed engineers and accountants.* The FLSA regulations state that to be an exempt professional, an employee must perform “work requiring advanced knowledge in a field of science or learning” involving the “consistent exercise of discretion and judgment.”¹⁹ Often, as new graduates start their first jobs, they exercise very little discretion or judgment. Instead, they follow the highly complicated rules and principles of the profession and/or directions from those to whom they report, until they acquire sufficient experience on the job. The quandary faced by the employer is determining when new engineers and accountants who, by every other standard would clearly be considered a professional, cross the threshold into the blurry FLSA definition of a professional.
- *Computer employees.* The FLSA regulations include an exemption for so-called “computer employees,”²⁰ but the definition is rooted in the technology of 1992, a time before many people had Internet access or email. Thus, computer programming or systems design are the type of work that is explicitly exempted under this exemption. Yet, other areas of computer related work that are complex, require specialized technical knowledge of computer hardware and software, and require independent judgment and discretion may be excluded simply because the work also involves using manual effort and tools for setup, accessing, and maintaining computer systems. At the same time, however, the type of work performed by a network or database administrator earning \$80,000 a year are not. Keeping computer networks up and running, fixing bugs, and improving the system are not “programming” work under FLSA regulations even though the individuals are clearly highly skilled and well-paid. Even where other exemption tests may apply, guidance for applying the exemption tests to information technology jobs is inadequate (*e.g.*, determining whether the work is related to management or the general business operations). Thus, employees may have highly similar educational backgrounds may be classified differently because of the narrow definition of computer employee in the regulations. Even a network or database administrators may have to punch a time clock every day while programmers and system designers do not have to, even if on a monthly or yearly basis they are receiving the same compensation.

- *Credentials.* For professional employees to be exempt, the advanced knowledge required for the exemption must be “customarily acquired through a prolonged course of specialized intellectual instruction.” It is not clear what “customarily” means. As currently interpreted by some courts, an employer could have employees performing complicated engineering duties but they would have to be paid and treated differently if they acquired their knowledge and expertise in different ways. For example, the Second Circuit Court of Appeals recently decided that an engineer with 20 years experience who was a member of the American Society of Mechanical Engineers and performed work that involved complicated technical expertise and responsibility was nevertheless a nonexempt employee.²¹
- *Administrative exemption.* Particularly nettlesome is determining what level of “discretion and independent judgment” employees must have to qualify for the administrative exemption. Not even the Wage and Hour Division (WHD) can make up its mind about whether or not particular jobs qualify for the administrative exemption. For example, on September 8, 2006, the WHD determined that mortgage loan officers are *bona fide* administrative employees who are exempt under the FLSA.²² Yet, on March 24, 2010, WHD reversed itself and determined that they do not qualify for the exemption.²³ If the WHD cannot consistently determine who is a *bona fide* administrative employee, how are employers supposed to figure it out?
- *Executive exemption.* Applying the FLSA executive exemption where a manager directs the work of two or more full-time employees or their full-time employee equivalents can be difficult if the establishment experiences fairly regular turnover and one or more of the positions is vacant for some period of time. The regulations should be updated to clarify that the executive exemption is not lost in these situations.

Irrelevance of Employee Preferences Creates Morale Issues Adding to the problems employers encounter in deciphering the murky rules surrounding each exemption is the issue of employee morale, which frequently gets overlooked by policymakers. While there is an assumption by many that employees generally prefer to be paid overtime, that is not necessarily the case. Many employees view exempt salaried positions as a sign of status, as opposed to “having to punch a time clock.” They enter their professions knowing that hours will fluctuate, often involving extra evening and weekend work with a corresponding ability to often take time off as needed without having to worry about lost wages. The guaranteed pay associated with a salary is viewed by many employees as far more desirable than the fluctuations of hourly pay, even where that may occasionally mean a slightly larger paycheck. In situations where nonexempt employees work closely with exempt employees, such as paralegals working with attorneys, the distinction between exempt and nonexempt can create cultural tensions and resentment where the nonexempt employees covet the flexibilities and status of being a salaried employee.

Many positions that in recent years have come into question over exempt status have historically been considered exempt by common industry practice and thus individuals enter those occupations with that expectation. Moreover, employees generally recognize that the

amount they will be paid will be based on what the employer views the job to be worth, regardless of what the strictures are on precisely how that amount is to be calculated.

The explosion of wage and hour class actions, and the enormous costs associated with contesting one, have exacerbated the tensions in this area. Many employers who believe there is a strong argument for retaining exempt status of employees have decided to nevertheless reclassify those positions as nonexempt for fear of litigation being initiated or as a result of a settlement of litigation where the outcome was uncertain. In many instances, those employers have confronted serious morale problems among those employees who have lost the exemption and the flexibility and status that go with it. Those employers have found that the employees draw little comfort in knowing that they will now face the uncertainties and inflexibilities of being paid a wage rather than a salary. Yet, the FLSA does not allow for employee preference in dictating whether an employee must be paid hourly as opposed to salaried.

Pitfalls of Reclassification. In assessing the exempt status of their workforce, employers who decide that they should “play it safe” by reclassifying employees as nonexempt have to grapple with another problem in addition to the morale issues just described. For failure to pay overtime to nonexempt employees, the FLSA provides up to two years back pay, which can be doubled and extended to three years in some cases, depending on a court’s conclusions about whether an employer acted in good faith or should have known overtime was owed. Meanwhile, there is no “safe harbor” for an employer who voluntarily reclassifies its employees. Thus, an employer who reclassifies a large number of employees may very well capture the interest of a plaintiffs’ lawyer, thus triggering a lawsuit. The employer’s ability to defend itself will be hampered by its own actions, which will be perceived as an acknowledgement by the employer that it was violating the law prior to the reclassification.

DOL Recordkeeping Initiative. The problems employers encounter in dealing with these and the numerous other areas of uncertainty will be exacerbated if the Department of Labor Wage and Hour Division proceeds with its announced intention to propose sweeping new recordkeeping requirements. According to the agency’s Spring 2010 Regulatory Agenda:

Any employers that seek to exclude workers from the FLSA’s coverage will be required to perform a classification analysis, disclose that analysis to the worker, and retain that analysis to give to WHD enforcement personnel who might request it.²⁴

This benign-sounding requirement seems to assume that employers in the United States will have very little difficulty in ascertaining the exempt or nonexempt status of nearly every employee in the United States in a manner that will brook little or no disagreement with either a Wage and Hour Division investigator or a plaintiff’s attorney. In a perfect world, that would be the case but, as described in the above illustrations, it frequently is not. Rather than promoting clarity and transparency, the inherent uncertainties in these situations are likely to stimulate litigation to test the employer’s conclusions. At that point, the employer will have to make a determination as to whether a court is likely to agree and whether it will be worth the legal expenses of associated with taking that chance. Even if the employer continues to believe that the employees meet the murky exemption requirements, it may try to contain its costs by settling.

Rather than going forward with this litigation-fomenting approach that will create serious morale issues in workplaces across the United States, we believe the Department should first seek to correct the lack of clarity in the existing rules in a manner that recognizes the needs of both employers and employees. The Department in the previous administration sought to accomplish this goal with mixed results. There was some progress which laid a groundwork for further clarification, but considerable confusion still remains. We would be willing to work closely with the Department to address this need. However, we would emphasize that such an approach will not work if it begins with the assumption that all employees wish to be paid an hourly wage. The end result should be a set of clearly defined rules that ensure that overtime is provided in those situations that meet the traditional characteristics of an hourly wage worker.

Deterrents to Financial Rewards for Performance

The inflexible manner in which overtime pay must be calculated under the FLSA can undermine an employer's ability to reward employees. The law requires the employer to pay a nonexempt employee one and one half times his or her "regular rate of pay" for every hour worked over forty. In its simplest form, an employee's regular rate of pay is his or her base hourly pay rate. However, the FLSA broadly defines the regular rate to encompass "all remuneration for employment paid to, or on behalf of, the employee."²⁵ This means that other kinds of compensation, including most bonuses, are included in the calculation of the regular rate.

The FLSA excludes from the regular rate *ad hoc* bonuses that employers do not announce to employees ahead of time.²⁶ These are called "discretionary bonuses" because the employer maintains discretion over whether the bonus will be paid and how much the bonus will be when paid. Holiday bonuses are a good example. Unfortunately, such bonuses are of limited value to employers and employees because they are not driven by goals set in advance nor are they typically ongoing and thus lack the incentive potential of nondiscretionary bonuses.

In contrast to discretionary bonuses, if an employer announces a program that provides a bonus to employees if they meet certain goals stated in the program, the FLSA requires that the bonuses be included in the employees' regular rates of pay.²⁷ These bonuses are considered "nondiscretionary" bonuses because the employer has surrendered its discretion over whether to pay the bonus. If the employees meet the goals stated in the plan, then they will receive the full bonus. Because payment is automatic, the FLSA considers the bonus as part of the employee's base pay, and the employer must include the bonus in the employees' regular rates of pay when calculating overtime.

This requirement undermines the ability of employers to predict employment costs. The employer may know how much the bonus is, but it may not know how many overtime hours the employee will be working that will carry the additional costs added to the regular rate by the bonus.

The regular-rate requirement also undermines attempts to reinforce teamwork and minimize distinctions between hourly and salaried employees. Many times employers want to reward all employees equally to reinforce the notion of teamwork. When the overtime

recalculation is added, however, the bonus amounts will differ with the amount of overtime worked by each employee. Unless none of the employees worked overtime, or they all worked exactly the same amount of overtime, each employee's bonus will be different.

Adding bonuses to the regular rate in calculating overtime may not be an insurmountable problem for employers but, as with so many other aspects of the FLSA, it creates a strong deterrent to an employee-friendly policy. In the end, the safest and most predictable course for the employer is to not provide bonuses to nonexempt employees.

Conclusion

The dual objectives of promoting employment growth and encouraging flexible workplace policies should compel the administration to re-examine the Fair Labor Standards Act in light of today's workplace, rather than moving forward with the aggressive enforcement policy that the Department of Labor has outlined. We certainly do not question the need for basic wage and hour protections to protect against the kinds of "sweatshop" conditions that prompted the Act. We also recognize that many of the issues that we raise could only be addressed through changes in the statute itself. We invite the administration to join with us and other stakeholders in a dialogue that seeks to address the many questions we have raised in an informed manner, with the goal of targeting enforcement resources where they are truly needed, while enabling the American workplace to evolve in a manner that best suits the needs of 21st Century employers and employees.

Sincerely,



Daniel V. Yager
Chief Policy Officer & General Counsel

¹ See "Workplace Flexibility at the White House," available at <http://www.whitehouse.gov/blog/2010/04/01/workplace-flexibility-white-house>

² Applied Economic Strategies, estimate based on the economic analysis in the 2004 final rule on 29 CFR Part 541.

³ Applied Economic Strategies, estimate based on the latest available Bureau of Labor Statistics data.

⁴ American Bar Association, Council of European Lawyers and other sources.

⁵ See 54 Stat. 615 (1940), 61 Stat. 64 (1947), 63 Stat. 910 (1949), 69 Stat. 711 (1955), 70 Stat. 1118 (1956), P.L. 87-30 (1961), P.L. 88-38 (1963), P.L. 89-601 (1966), P.L. 93-259 (1974), P.L. 95-151 (1977), P.L. 99-150 (1985), P.L. 101-157 (1989), P.L. 104-26 (1995), P.L. 104-188 (1996), P.L. 105-334 (1998), P.L. 106-202 (2000), and P.L. 110-28 (2007).

⁶ 69 Fed. Reg. 22122, April 23, 2004.

⁷ Ross Eisenbrey, “Longer Hours, Less Pay - Labor Department’s new rules could strip overtime protection from millions of workers,” Economic Policy Institute, Briefing Paper #152, July 14, 2004.

⁸ U.S. Courts, Annual Report of the Director, Table C-2A, various years.

⁹ Samuel Estreicher and Kristina Yost, “Measuring the Value of Class and Collective Action Employment Settlements: A Preliminary Assessment, New York University School of Law, Working Paper No. 08-03, January 2008.

¹⁰ 29 U.S.C. 218.

¹¹ California Labor Code Section 515.5.

¹² Even in those instances, there must be a written agreement for an on-the-job paid meal period that is revocable by the employee at any time. California Code of Regulations, Title 8, §11040.

¹³ Remarks by the President at Workplace Flexibility Forum, March 31, 2010, available at <http://www.whitehouse.gov/the-press-office/remarks-president-workplace-flexibility-forum>.

¹⁴ Although more than 60 years ago the Supreme Court distinguished between employees who are “waiting to be engaged” and those who are “engaged to wait,” that decision did not contemplate today’s telecommuting employees. 323 U.S. 134 (1944).

¹⁵ Thus, the following schedule would not include overtime:

Week one

- Friday –0 hours (entire day off); workweek begins at noon
- Monday – 9 hours
- Tuesday – 9 hours
- Wednesday – 9 hours
- Thursday – 9 hours
- Friday AM– 4 hours
- Workweek ends Friday at noon; employee worked 40 hours that “week”

Week two

- New workweek begins same Friday at noon – 4 hours
- Monday – 9 hours
- Tuesday – 9 hours
- Wednesday – 9 hours
- Thursday – 9 hours
- Friday – 0 hours (entire day off); employee worked 40 hours that “week”

¹⁶ Letter from President Franklin D. Roosevelt to the U.S. Congress, May 24, 1937, reprinted in Report on S. 2475, The Fair Labor Standards Act, H.R. Rep. 1452, 5 (1937).

¹⁷ 69 Fed. Reg. 22124, April 23, 2004.

¹⁸ There is no requirement that a salary be paid if an employee performs no work for an entire workweek, and full-day salary deductions are permissible only under certain limited circumstances. These include when:

- An employee is absent for personal reasons. For example, if a person is absent for 2 full days to handle personal affairs, the employer could deduct from the salary for 2 full-day absences. However, if the exempt employee is absent for one-and-a-half days for personal reasons, the employer can deduct only for the 1 full-day absence.
- An employee is absent for sickness or disability if the deduction is made in accordance with a bona fide plan, policy, or practice of providing compensation for loss of salary.
- Full day deductions may also be made for disciplinary suspensions related workplace conduct violations such as sexual harassment or violence; and
- Full day deductions may be made for penalties imposed in good faith for infractions of safety rules of major significance (for example, smoking in an explosives plant, oil refinery, or coal mine).

The only time partial-day salary deductions for exempt employees is permissible is when an employee takes intermittent leave under the Family and Medical Leave Act. In this case employers only have to pay a proportionate part of the full salary for the time actually worked.

¹⁹ 29 CFR 541.301(b).

²⁰ 29 CFR 541.400.

²¹ *Young v. Cooper Cameron Corporation*, 586 F.3d 201, (2d Cir. 2009).

²² U.S. Department of Labor, Wage and Hour Division, Administrator Opinion Letter FLSA2006-31, September 8, 2006, available at: http://wayback.archive-it.org/1287/20090116135435/http://www.dol.gov/esa/whd/opinion/FLSA/2006/2006_09_08_31_FLSA.pdf.

²³ U.S. Department of Labor, Wage and Hour Division, Administrator's Interpretation No. 2010-1, March 24, 2010.

²⁴ Available at <http://www.dol.gov/regulations/factsheets/whd-fs-flsa-recordkeeping.htm>

²⁵ 29 U.S.C. 207(e).

²⁶ 29 U.S.C. 207(e)(1).

²⁷ 29 U.S.C. 207(e)(1).