DOL Releases Final Rule May 18, 2016

On May 18, 2016, Vice President Joe Biden, Secretary of Labor Thomas Perez and Sen. Sherrod Brown (D-Ohio) announced the U.S. Department of Labor’s (DOL) final rule on overtime pay. The rule amends regulations under the Fair Labor Standards Act (FLSA) that determine which employees are eligible for overtime pay, and nearly doubles the maximum salary for overtime eligibility from $23,660 to $47,476. The rule will take effect on December 1, 2016 and applies to executive, administrative and professional employees – collectively referred to under FLSA as “white collar” workers.

This change will make millions of previously ineligible employees eligible for overtime pay, and will significantly impact county governments, which are a major employer across the United States. In fact, the nation’s 3,069 counties employ more than 3.6 million people, providing services to over 308 million county residents.

While America’s counties are dedicated to the goal of ensuring that all employees are compensated adequately and fairly, we are concerned that the new rule could have the unintended impact of placing additional strain on already limited county budgets throughout the country, hindering counties’ ability to provide critical services to local communities. We are also concerned that the new wage threshold is more of a “one-size-fits-all” amount, rather than accounting for regional and geographic differences.

MAJOR CHANGES

Salary Level Threshold Change: $23,660 to $47,476 per year
Effective Date: December 1, 2016
Automatic Adjustments: Will occur every three years with the first update to take place in 2020
Duties Test: The rule does not change any of the existing job duty requirements or “duties test” to qualify for exemption
The Final Rule’s Impact on County Governments

DOL’s final rule on overtime pay will have significant impacts on counties. Doubling the current salary threshold amount all at once, rather than phasing-in the increases, could have harmful consequences on county budgets — and ultimately on county employees — particularly as counties struggle to recover from the recession. According to the National Association of Counties’ (NACo) County Economies 2015 report, only 214 county economies have fully recovered by 2015 (based on four indicators — jobs, unemployment rates, economic output (GDP) and median home prices) to their pre-recession levels.1 However, even if local economies have improved, county government revenues often lag, especially property tax values.

Some counties have calculated the impact of the overtime pay change on their payroll costs and are expecting dramatic increases to payroll in the first year of implementation and beyond. For example, according to Berks County, Penn., 97 of the 419 county employees who are currently ineligible for overtime pay because of their salary levels would be newly eligible under the proposed rule. Berks County has estimated that the resulting additional financial burden could cost the county as much as $1.5 million in the first year alone.

Payroll increases of this scale are difficult for counties to absorb because most must operate on a balanced budget and thus cannot go into fiscal deficit to meet additional overtime requirements. Further, many counties do not have the financial resources to absorb sudden spikes in pay increases without reducing current service levels, decreasing employee benefits and/or reducing their county employee work hours or staffing levels.

Increasing taxes to pay for overtime increases is not often a solution for counties, beyond the political difficulty of instituting additional taxes. In fact, 43 states impose some type of limitation on counties’ ability to increase property taxes, including 38 states with statutory limitations on property tax rates, property tax assessments or both. There are not many other revenue solutions at counties’ discretion. Twenty-nine (29) states allow counties to collect local option sales taxes, but in only 15 states have counties gained approval from voters to impose local option sales taxes.

Given these fiscal limitations, many counties may have to reduce the service levels for critical programs (public transportation and infrastructure, justice and public safety, public health, search and emergency rescue, and 911 operations) and cut any non-mandated services such as critical such as support for economic development — to comply with the new final rule.

Counties’ budget cycles further complicate our ability to comply with the new rule. For almost 40 percent of counties, the fiscal year ends by June 30 and their new budgets are already in place to begin on July 1. Some counties even operate on a biennial budget, meaning their finances are already set for the coming fiscal year excluding the additional costs of the new rule. Because the final rule was announced on May 18, counties have had very little time to conduct analysis and calculate the additional costs of the increased salary threshold and determine where these resources would come from.

Additionally, as is often the case with federal regulations, the new salary threshold will likely have an even greater impact on small and rural county governments. One-size-fits-all regulations like DOL’s overtime rule often do not take into consideration the measurable differences — such as, in this case, differences in cost of

living – between small and rural communities and larger population centers. Further, small and rural counties must often spend a disproportionate amount of time and money to ensure that they are in compliance with federal regulations, because they have limited human resources personnel, legal counsel and financial advisory staff.

Counties with federal land in their jurisdictions are even more limited in their ability to raise additional revenue to pay for the new overtime rule. Sixty-two percent of counties nationwide have federal land within their boundaries and in each case, those county governments provide important local services to federal public lands visitors and federal employees every day. However, once the federal government acquires land, it is removed from county tax rolls and no longer subject to local property taxes. Although the federal government has traditionally provided some relief for this lost revenue through the Payments in Lieu of Taxes (PILT) program, PILT often reimburses at a rate well below the land’s taxable value per acre.

According to the Small Business Administration’s Office of Advocacy, DOL’s statutorily required impact analysis on small entities was far from thorough, and DOL failed to utilize available data to take into account the wide fiscal and economic diversity of local communities across the country in determining the new salary threshold.

Putting the Final Rule into Context:
Background on the FLSA

In considering DOL’s final rule on overtime pay, it is important to understand the basics of the Fair Labor Standards Act (FLSA). Established in 1938, FLSA (P.L. 75-718) is the federal law that regulates minimum wage, overtime pay eligibility, recordkeeping and child labor standards affecting full-time and part-time workers in the private sector and within federal, state and local governments.

Section 13(a)(1) of the FLSA exempts “any employee employed in a bona fide executive, administrative, or professional capacity” from minimum wage and overtime pay protections. The exemption reflects the idea that these workers typically earn salaries well above the minimum wage, and enjoy other privileges — such as above-average fringe benefits, greater job security and better opportunities for advancement — that set them apart from workers entitled to overtime pay. The law gives the secretary of Labor the authority to define and limit the terms of the exemption.

According to DOL, FLSA regulations had become outdated, and the department set out to make revisions that would better distinguish between overtime-eligible white collar employees who Congress had originally intended to make eligible for FLSA’s minimum wage and overtime provisions, and those Congress had intended to exempt.

DOL’s stated goal was to “ensure that white collar employees who should receive extra pay for overtime hours will do so and that the test for exemption remains up-to-date so future workers will not be denied the protections that Congress intended to afford them.”

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In 1938, DOL issued the first regulations that defined the scope of the white collar exemption. Since that time, the regulations that determine which white collar employees are exempt – and thus ineligible for overtime pay – generally required each of three tests to be met for the employee to be exempt:

1. **The Salary Basis Test:** 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

2. **The Salary Level Test:** The amount of salary paid must meet a minimum specified amount

3. **The Duties Test:** The employee’s job duties must primarily involve executive, administrative, or professional duties as defined by the regulations

Since FLSA was first established, DOL has updated the salary level requirements seven times, most recently in 2004, when the salary level an employee must be paid to be ineligible for overtime pay under white collar exemption was set at $455 per week ($23,660 per year for a full-year worker). This change nearly tripled the existing $155 per week minimum salary level required for exemption up to that point.

On March 13, 2014, President Obama signed a [Presidential Memorandum](link) directing DOL to update the regulations defining which white collar workers are eligible for FLSA’s minimum wage and overtime standards. Specifically, the department was instructed to look for ways to modernize and simplify the regulations while ensuring that the FLSA’s intended overtime protections were fully implemented.

DOL commented on why they embarked on the rulemaking process:

“One of the department’s primary goals in this rulemaking is updating the standard salary requirement, both in light of the passage of time since 2004, and because the department has concluded that the effect of the 2004 Final Rule’s pairing of a standard duties test based on the less rigorous short duties test

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**BLUE COLLAR EMPLOYEES**

Eligible for overtime if:
- Always eligible for overtime
- DOL rule would not impact blue collar workers

County examples include: public works and road maintenance workers, equipment operators, parks maintenance workers, landfill operators

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**WHITE COLLAR EMPLOYEES**

Eligible for overtime if:
- Salary is under $23,660
- DOL rule would increase the maximum eligible salary to $47,476

County examples include: accountants, engineers, information system managers
with the kind of low salary level previously associated with the more rigorous long duties test was to exempt from overtime many lower paid workers who performed little EAP work and whose work was otherwise indistinguishable from their overtime eligible colleagues. This has resulted in the inappropriate classification of employees as EAP exempt — that is overtime exempt — who pass the standard duties test but would have failed the long duties test. As the department noted in our proposal, the salary level’s function in helping to differentiate overtime-eligible employees from employees who may be exempt takes on greater importance when the duties test does not include a specific limit on the amount of nonexempt work that an exempt employee may perform.”

Getting Into Specifics—New Salary Threshold and Automatic Updates

In DOL’s Notice of Proposed Rulemaking (NPRM) that preceded the 2016 final rule, DOL had initially proposed setting the standard salary level at $50,000 per year. However in the final rule, the agency decided to raise the standard minimum level for salaried, exempt workers from $455 per week ($23,660 per year) to $913 per week ($47,476 per year). The new level is pegged to the 40th percentile of weekly earnings for full-time salaried workers from the lowest wage Census region in the country (currently the South). The South Census region includes Alabama, Arkansas, Delaware, the District of Columbia, Georgia, Florida, Kentucky, Louisiana, Maryland, Mississippi, North Carolina, Oklahoma, South Carolina, Tennessee, Texas, Virginia and West Virginia. In total, according to DOL, the rule will affect an estimated 4.2 million workers across the U.S. who are currently exempt from the overtime pay requirements but will be newly eligible under the increased threshold.

The final rule also raises the compensation level for highly compensated employees (subject to less-stringent duties tests) from the previous amount of $100,000 to $134,044 annually. That rate was established to match the 90th percentile of annual earnings of full-time salaried workers nationally. According to DOL, employers are permitted to satisfy up to 10 percent of the standard salary requirement with nondiscretionary bonuses, incentive payments and commissions, provided these forms of compensation are paid at least quarterly.

While it is encouraging that the rule attempted to take into account regional variations, using Census regions to determine the salary level is too broad and does not provide an accurate picture of the major differences in labor markets across local communities.

Consider local government average wages by state. Based on data from the Bureau of Labor Statistics, in 2015, the average annual wages paid by local governments nationally ranged from $62,482 in Hawaii to $32,911 in South Dakota. In 34 of the 50 states, local government employees earned less than $46,000—which is less than the new DOL salary threshold. The situation is even more uneven at the local level. In 85 percent of counties, local governments do not meet the new salary threshold of $47,476. For example, in Decatur County, Kansas the current average wage in local government is $18,465. In 97 percent of counties in the South Census region, average wages in local government are less than the newly proposed threshold.

As mentioned previously, the final rule does not change any of the existing job duty requirements, or duties tests, that determine which employees are exempt from overtime pay requirements. That said, the existing duties tests will be relevant to a much smaller number of employees, because all employees earning less than $913 per week will automatically qualify for overtime pay under the final rule. The test will still be relevant in
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determining whether those employees who earn more $913 or more per week qualify for overtime pay.

The final rule also provides for an automatic update of salary levels every three years, rather than for annual updates as initially proposed. The automatic update will seek to maintain a salary threshold equal to the 40th percentile of weekly earnings of full-time salaried workers. Under the final rule, the first automatic update will take effect on January 1, 2020, and DOL will publish all updated rates in the “Federal Register” at least 150 days before their effective date.

In response to comments expressing concern about the financial and administrative burdens connected with updating the salary threshold on an annual basis, DOL adopted a new fixed percentile approach to automatic updating, changed the updating frequency from annually to every three years and increased the period between announcing the updated salary level and effective date of the update from 60 days to 150 days.

There has been much disagreement over whether DOL has the authority to establish an automatic updating mechanism through the rulemaking process — without congressional approval. DOL argues that although the FLSA does not explicitly reference automatic updating, the original law gave the secretary of Labor the broad authority to define and delimit its exemptions.

Options for Employers to Implement the Updated Salary Level Requirements

According to DOL, state and local government employers have discretion to choose between several options for complying with the final rule. It is important to note that the law does not require that newly overtime-eligible employees be converted to hourly pay status.

- **Raise salaries:** For workers whose salaries are close to the new threshold and who would otherwise be exempt from overtime pay under the duties test, employers may choose to raise these workers’ salaries to meet the new threshold and maintain their exempt status.

- **Pay overtime above a salary:** State and local government employers can continue to pay newly-eligible employees their existing salary, and in addition, pay these employees for overtime hours.

- **Evaluate and realign employee workload:** Employers can limit the need for employees to work overtime by ensuring that workloads are distributed to reduce overtime, that staffing levels are appropriate for the workload, and that workers are managing their time well.

- **Utilize “comp” time:** State and local government employers — unlike private sector employers — can provide compensatory time off — or “comp time” — rather than cash overtime payments in appropriate circumstances.

Although the final rule provides specific guidance for how state and local government agencies can arrange for their employees to earn “comp time” instead of cash payment for overtime hours, it is important to note that comp time is not a budget neutral alternative. Any “comp time” arrangement must be established according to a collective bargaining agreement, memorandum of understanding, any other
agreement between the public agency and representatives of overtime-protected employees or an agreement or understanding arrived at between the employer and employee before the performance of the work. This agreement can be demonstrated by a notice to the employee that comp time will be given in lieu of overtime pay (for example, providing the employee a copy of the personnel regulations). The comp time must be provided at a rate of one-and one-half hours for each overtime hour worked.

Certain Local Government Employees Will Not Be Affected by the Final Rule

According to DOL, there are several groups of state and local government employees that will not be affected by the final rule:

- **Hourly workers:** The new salary threshold will have no impact on the pay of workers paid hourly. Generally, all hourly workers — including those employed by state and local government — are entitled to overtime pay or comp time regardless of how much they make if they work more than 40 hours. Nothing in the new rule changes that.

- **Workers with regular workweeks of 40 or fewer hours:** To the extent that many salaried white-collar staff in state and local government have office jobs where they work no more than 40 hours, the changes to the overtime rules will have no effect on their pay. Additionally, for law enforcement and fire protection employees who regularly work hours that conform to the longer work periods permitted for such employees, the changes will also not impact their pay.

- **Workers who fail the duties test:** Salaried workers who do not primarily perform executive, administrative, or professional duties fail the duties test and are therefore already eligible for overtime pay and not affected by the final rule. Those employees already should be getting paid overtime for any hours they work over 40 in one week (or the applicable work period maximum for fire protection and law enforcement employees), as long as comp time is not available.

- **Highly compensated workers:** White collar workers who earn more than $134,004 in a year are almost always ineligible for overtime under the highly compensated employee exemption, which has a minimal duties test. Some high-level managers in state and local government could still qualify for overtime under this test.

- **Police and fire employees in small agencies:** Fire protection or law enforcement employees in public agencies with fewer than five fire protection or law enforcement employees will continue to be exempt from overtime.
  
  - **“Work periods” rather than “workweeks” for fire protection or law enforcement employees:** Employees engaged in fire protection or law enforcement may be paid overtime on a “work period” basis, rather than the usual 40-hour workweek of the FLSA. A “work period” may be from 7 consecutive days to 28 consecutive days in

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length. Overtime compensation is required when an employee’s hours worked in the work period exceed the maximum hours outlined in a formula in the department’s regulations. For example, for a law enforcement employee who works a 14-day work period, the department’s regulations provide that the individual must receive overtime compensation after working 86 hours in the work period.

- **Elected officials, their policymaking appointees, and their personal staff and legal advisors who are not subject to civil service laws**: These state and local government employees are not covered by the FLSA and will not be impacted by the rule.

- **Legislative branch employees who are not subject to civil service laws**: These state and local government employees are not covered by the FLSA and will not be impacted by the rule.

- **Public employees who have a comp time arrangement**: Public sector employers can satisfy their overtime obligation by providing comp time rather than paying a cash overtime premium. State and local government employers may continue to use comp time to satisfy their overtime obligations to employees who have not accrued the maximum number of comp time hours.

The Small Business Administration’s Office of Advocacy Weighs In—The Overtime Rule Will Significantly Impact Small and Rural Counties

The final rule will significantly impact small counties and small businesses in rural areas. The majority of counties, almost 70 percent, are considered rural and have fewer than 50,000 residents. These counties in particular have voiced concerns that this rule could have adverse impacts on their county finances as well as their county employees’ work hours and benefits.

Rural counties across the country employ over 410,000 full-time employees who collectively serve almost 40 million Americans. Often, these small counties deliver services over expansive areas, sometimes larger than the size of some states; the average county employee in Western states serves an area of 21 square miles.

The U.S. Small Business Administration’s Office of Advocacy — which represents the views of small entities before federal agencies and Congress — presented DOL with serious concerns about how the final rule will impact small businesses and also local governments with populations 50,000 or below.

When a new federal regulation is expected to have a significant economic impact on a substantial number of small entities (including small local governments), federal agencies are required by the Regulatory Flexibility Act to assess the impact of the proposed rule on these entities and consider less burdensome alternatives.

By law, federal agencies are required to give “every appropriate consideration” to comments provided by SBA’s Office of Advocacy when issuing new regulations and are required to prepare an Initial Regulatory Flexibility Analysis (IRFA). An IRFA must contain:

- A description of the reasons why the regulatory action is being taken
- The objectives and legal basis for the proposed regulation
- A description and estimated number of the regulated small entities
- A description and estimate of compliance requirements
• Identification of duplication, overlap and conflict with other rules and regulations
• A description of significant alternatives to the rule

In official comments submitted on September 4, 2015, the Office of Advocacy stated that DOL's IRFA “does not properly inform the public about the impact of this rule on small entities” and questioned the agency's analysis as it “relies on multiple unsupported assumptions regarding the number of affected small businesses and workers and by extension the regulatory impact of this proposal.”

According to the Office of Advocacy, DOL's IRFA analyzed small businesses and counties very broadly, and ultimately failed to take into account varying economic impacts. Specifically, they cited DOL's failure to provide adequate analysis of the economic impact on governmental jurisdictions serving populations of 50,000 or less, regional differences and wage disparities across the country, and the number of small businesses and counties affected by the final rule. In addition, the Office Advocacy determined that the proposed alternative of comp time for state and local governments to help them comply with the rule is not a valid alternative.

The Final Rule will significantly impact small counties and small businesses in rural areas. The majority of counties, almost 70 percent, are considered rural and have fewer than 50,000 residents. These counties in particular have voiced concerns that this rule could have adverse impacts on their county finances as well as their county employees’ work hours and benefits.

The Office of Advocacy detailed several issues with DOL's Initial Regulatory Flexibility Analysis:

• **DOL provided an inadequate analysis of the number of small entities affected:** According to the Office of Advocacy, DOL made key determinations that unnecessarily “obscure the numbers of affected small businesses in industry subsectors and revenue size categories.” The office further stated that DOL “made assumptions to create hypothetical data points that were otherwise easily available in the [Census’ Survey of U.S. Businesses (SUSB)] data.” Specifically, the agency chose to use very general industry codes when more specific codes were readily available and could have aided in a more thorough and accurate analysis of the number of small entities that would be affected by the final rule. This is significant because different sized entities may be classified under the same general industry code. The Office of Advocacy recommended that DOL use these more specific, readily-available data points — instead of general assertions — to improve the transparency and accuracy of its economic analysis.

• **DOL provided inadequate analysis on the economic impact on small local governments:** According to the Office of Advocacy, DOL did not adequately analyze the economic impact on small governmental jurisdictions serving a population of less than 50,000 — despite this being required by law. After holding a series of roundtable discussions with small entities on the potential implications of the final rule, the office noted that representatives from small entities, including counties, voiced concern that their “operations would have a difficult time complying with these regulations because they do not have the discretionary resources to pay for these extra costs” and that they may need to cut critical services as these job positions become too costly for their limited budgets.
• **DOL provided inadequate analysis of local wage differences:** DOL’s Notice of Proposed Rulemaking (NPRM) initially proposed setting the standard salary level at $50,440 per year. However, in response to comments stating the department’s proposal did not account for regional differences in wages, DOL decided to lower the standard minimum level for salaried, exempt workers to $47,476 per year. The agency justified their decision in determining the new salary threshold stating, “The department is setting the salary level at the 40th percentile of weekly earnings of full-time salaried employees in the lowest-wage Census Region (as opposed to nationally) in part to account for low-wage employers,” including small businesses and counties. While DOL states that the new salary threshold accounts for regional differences, there are still limitations in their analysis. For example, a study conducted by the National Retail Federation and Oxford Economics found wide differences in what constitutes the 40th percentile in three states from the lowest-wage Census Region: Kentucky ($882/week), Louisiana ($784/week) and the District of Columbia ($1,070/week). The Office of Advocacy asserts that DOL could have also analyzed this state data by other factors, including the impact on industry sub-sectors. Although the new rule attempts to account for low-wage employers and regional differences in wages, it is clear that this rule will still have vastly different impacts in terms of the number of small counties affected.

Salaried workers often work flexible schedules by utilizing cell phones and logging onto work at computers from home—and employers will now be more likely to stop these types of work agreements.

• **DOL’s analysis underestimates small entities’ compliance costs:** When performing their analysis, DOL underestimated the human resource and financial management costs on small entities that will result from the final rule. DOL estimates that on average, an affected small “establishment” is expected to incur $100 to $600 in direct management costs, a one-hour burden for regulatory familiarization (reading and implementing the rule), a one-hour burden per each affected worker in adjustment costs, and a five-minute burden per week scheduling and monitoring each affected worker. The Office of Advocacy states concerns that these estimates may not reflect the actual experiences of small entities — as they typically spend a disproportionately higher amount of time and money on compliance because they have limited human resources personnel, legal counsel or financial advisory staff. Many small businesses may adjust by hiring outside consultants to help them comply with these types of regulations, which can cost thousands of dollars.

• **DOL does not account for non-financial costs to small entities:** As it conducted roundtable discussions with small entities prior to the rule’s finalization, the Office of Advocacy heard many concerns over the potential for several non-financial costs on small entities. Salaried workers often work flexible schedules by utilizing cell phones and logging onto work at computers from home—and employers will now be more likely to stop these types of work agreements. Similarly, employers stated that they would try to limit travel for work. Further, small entities also commented that they may not be able to hire as many entry-level management positions, and their senior managers would absorb many of these job responsibilities.

• **DOL did not consider less burdensome alternatives that would still accomplish the agency’s objectives:** According to the Office of Advocacy, DOL’s initial analysis (IRFA) did not contain the required regulatory alternatives that would minimize the economic impact of the rule for small entities. In the final rule, DOL asserts that it does not provide any differing compliance or reporting requirements for small businesses because “it appears to not be necessary given the...
small annualized cost of the rule, estimated to range from a minimum of $400 to a maximum of $3,300.” The Office of Advocacy believes that DOL’s numbers of small entities affected and costs estimates are extremely low and recommends that the agency reassess the impact through a Supplemental Initial Regulatory Flexibility Analysis. Further, the office suggests that DOL consider the following alternatives to better reduce the burden on small entities:

1. DOL should consider a salary threshold that is adjusted to reflect regional wages and wages in certain occupations.
2. DOL should consider allowing small entities to have a longer time to implement the final rule (more than the given four months) — giving them more time to understand the rule, evaluate and reclassify their workforce, and plan their budget and raise funding to play for the compliance costs of the regulation.
3. DOL should consider a gradual increase in the salary threshold for small entities — so as to minimize the sudden cost increase.

Conclusion

While NACo supports the overall goal of providing fair, reasonable living wages, we remain concerned with the lack of local government consultation and insufficient analysis conducted by DOL on a rule that could have significant and detrimental impacts on local governments and the communities they serve. NACo will continue to monitor the implementation process of DOL’s final overtime rule and further detail the impact on counties across the country.

Resources:

- NACo’s Official Comments on DOL’s Proposed Rule on Overtime Pay
- NACo’s Overview of DOL’s Proposed Rule on Overtime Pay
- DOL’s Fact Sheet on the Final Rule
- DOL’s Overview of the Final Rule
- DOL’s Webinar for Information on the Final Rule
- State and Local Governments and the Final Rule

For questions, contact: Deborah Cox, NACo Legislative Director at 202.942.4286 or dcox@naco.org.

For press question, contact: David Jackson, NACo Communications Director at 202.942.4271 or djackson@naco.org.