



## Labor & Employment ADVISORY ■

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### Department of Labor Issues Final Rule to Amend Overtime Regulations

On May 18, 2016, the U.S. Department of Labor (DOL) announced the publication of a final rule amending the “white collar” exemptions from the minimum wage and overtime pay requirements of the Fair Labor Standards Act (FLSA). The final rule significantly increases the minimum salary threshold currently required to satisfy the FLSA’s white collar exemptions and provides for automatic increases in the threshold amount in the future. In addition, the final rule amends the salary-basis test to allow employers to use bonuses and commissions to satisfy up to 10 percent of the new salary threshold. The rule, which goes into effect on December 1, 2016, also raises the salary threshold for the highly compensated employee exemption.

The FLSA requires most employers to pay their employees at least the minimum wage for each hour they work and to provide employees with overtime pay at a rate of one and one-half (“time-and-a-half”) times their regular rate of pay for any hours worked exceeding 40 per week. Employees who are paid on a salary basis and earn a certain minimum weekly salary, however, are exempt from the FLSA’s overtime requirements if they also satisfy the “duties test” of one of the white collar exemptions, which include the executive, administrative, professional, outside sales and computer employee exemptions. There is also a special rule for highly compensated workers – employees who earn a certain minimum amount each year, currently \$100,000.

#### **What the Final Rule Does**

The final rule amends the current white collar exemptions from the minimum wage and overtime pay requirements of the FLSA in the following ways:

- Increases the minimum salary threshold required to qualify for the white collar exemptions to \$913 a week, or \$47,476 annually.
- Amends the salary basis test to allow employers to use nondiscretionary bonuses, incentives and commissions to satisfy up to 10 percent of the new salary threshold, as long as such amounts are paid on a quarterly or more frequent basis. The rule also allows for a quarterly “catch-up” payment if the sum of an employee’s salary plus nondiscretionary incentive payments for a particular quarter fails to meet the applicable threshold amount.
- Increases the salary level for highly compensated employees from \$100,000 to \$134,004.
- Establishes a mechanism to automatically update the minimum salary and compensation levels for the white collar exemptions every three years.

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By increasing the minimum salary threshold for the white collar exemptions, the final rule will make an additional 4 million U.S. workers eligible for overtime pay. To comply with the new rule, employers will be required either to pay overtime to currently exempt employees whose salaries are below the higher threshold or to increase salaries to meet that threshold amount, keep the employees as exempt and thereby avoid paying overtime. In other words, exempt employees who no longer meet the minimum salary threshold under the new rule will have to be converted to nonexempt status or be paid higher salaries to remain overtime-exempt. Inevitably, this will significantly increase costs for employers and also require changes to policies and payroll practices.

## **What the Final Rule Does *Not* Do**

The final rule is also noteworthy for what it does *not* do, given that the changes to the white collar exemptions included in the final rule are not as drastic as those proposed by the DOL last year. In July 2015, the DOL published a proposed rule amending the white collar exemptions that provided for an even larger increase to the minimum salary threshold and contemplated possible changes to the duties tests for the exemptions. But the DOL changed its course somewhat in the final rule. Here is what the final rule does *not* do:

### ***The final rule does not change the duties tests.***

Although the DOL's 2015 proposed rule did not propose specific regulatory changes to the duties test for the white collar exemptions, certain language in the proposed rule suggested that the final rule might include a change to the duties tests. Somewhat surprisingly, the 2016 final rule does not change the duties tests. In the final rule, the DOL states that it "recognize[s] that changes to the duties test can be more difficult for employers and employees to both understand and implement" and that "the standard salary level adopted in [the final rule] coupled with the automatic updating in the future will adequately address the problems" with the duties test. For these reasons, says the DOL, the duties tests will remain the same.

### ***The final rule does not increase the salary level threshold for the white collar exemptions to the level contemplated by the 2015 proposed rule.***

In 2015, the DOL proposed to set the salary level equal to the 40th percentile of earnings for all full-time salaried workers. The DOL projected that by 2016, when the final rule would go into effect, the salary level would be at or near \$970 per week or \$50,440 per year – a significantly higher level than the current threshold of \$23,660. Under the final rule, the salary level threshold is equal to the 40th percentile of weekly earnings for full-time, salaried workers in the nation's *lowest-wage Census Region*, which is currently the South. This results in a salary level of \$913 per week, or \$47,476 annually – a salary level that is slightly lower than expected based on the proposed rule. In the final rule, the DOL acknowledges that its "change to a standard salary level based on the lowest-range Census Region has decreased the salary amount from the proposal, resulting in a smaller number of affected workers" than estimated in the proposed rule.

### ***The final rule does not call for an annual increase in the salary level threshold.***

The 2015 proposed rule established a mechanism to automatically update the minimum salary threshold for the white collar exemptions on an annual basis. Under the proposed rule, the updated salary rate would be published annually at least 60 days before the year-end, giving an employer only two months' notice of the upcoming year's minimum salary threshold prior to its effective date. In addition, under the proposed rule, an employer would have to worry about complying with higher salary thresholds every year.

Under the final rule, the DOL will automatically update the salary and highly compensated employee compensation levels every three years on the first of the year, and the DOL will publish the updated rates in the *Federal Register* at least 150 days before their effective date. The first automatic update will take effect on January 1, 2020. The final rule

thus provides employers with more time to adjust their budgets to account for salary increases and/or increased overtime costs in response to updated salary thresholds, and it makes the threshold changes occur less frequently.

## **Opportunities for Employers**

Despite its challenges, the final rule provides some opportunities for employers. First, now is an excellent time for employers to take a close look at their FLSA classifications to determine if they comply with current requirements – especially the duties tests – and the new rules. In the time leading up to the December 1, 2016, effective date of the final rule, employers should strongly consider working with counsel to conduct audits of their current FLSA compliance and to prepare for the upcoming changes. Further, to the extent that an employer's current FLSA classifications may not comply with present standards or the new standards, the impending rule changes provide an opportunity to explain to employees that changes in their compensation are being made to comply with the new rules, which may help to minimize employee questions about prior classification decisions.

Second, because the final rule was announced well in advance of its effective date, employers have a relatively long window of time to consider the rule and their options for minimizing its impact on the bottom line. Employers have a variety of options for offsetting the additional costs associated with the final rule. For example, an employer could consider salary reductions for currently exempt employees so that their overall earnings remain nearly the same when they become overtime eligible and are due overtime wages. Employers can also consider converting salaried workers to hourly workers and setting a lawful hourly rate that would account for any additional overtime payments based on employees' typical work schedules, assuming the employees' work schedules are consistent from week-to-week. Employers could also restructure shifts by limiting certain workers to a 40-hour workweek and assigning additional work to other employees.

## **Conclusion**

Employers should take time to prepare for sweeping changes to their FLSA exemption classifications and related increases in labor costs as a result of the final rule. The new rule is certainly not employer-friendly, but it does not change the white collar exemptions as drastically as expected. Understanding what the final rule does and does not do, as well as taking advantage of the time leading up to its December 1 effective date, may provide employers with opportunities to minimize the rule's impact on labor costs.

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