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Labor & Employment Alert
News Concerning Recent Labor and Employment Issues

COZEN O'CONNOR

DOL Issues Final Rule on FLSA Overtime Rules: Action Items for Employers

Today the U.S. Department of Labor (DOL) released final regulations regarding the Fair Labor Standards Act's (FLSA) executive, administrative and professional overtime exemptions, also known as the "white collar" exemptions. Employers have been bracing for the changes since the DOL released its proposed rule last summer, and the final rule confirms a more-than-doubling of the salary threshold and promises to raise the salary threshold every three years. Some highlights:

- The final rule raises the salary threshold for the exemptions from $455/week to $913 ($47,476 per year);
- DOL will update (i.e., raise) the salary threshold every three years, based on wage growth over time;
- Bonuses and commissions may be credited by an employer for up to 10 percent of the salary threshold;
- The final rule will become effective on December 1, 2016; and
- The final rule does not make any changes to the duties test for executive, administrative and professional employees.

These changes are expected to expand the right to overtime pay to an estimated 4.2 million workers. Here is what you need to know, and do, to be in compliance when the changes take effect on December 1, 2016.

Action Item #1: Review your payroll and consider your merit increase cycle

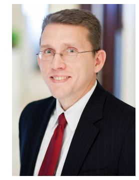
Since 2004, to qualify for one of the white collar exemptions under the FLSA, employees had to be paid, on a salary basis, at least $455 per week (or $23,660 per year), and their "primary duty" had to be executive, professional or administrative, as those categories are defined under DOL regulations. Under the new final rule, that threshold has more than doubled, to $47,476 per year (or $913 per week), which represents the 40th percentile of weekly earnings for full-time employees. If your payroll includes exempt, salaried employees paid less than $913 per week, you will need to re-classify or increase the salary before December 1, 2016 for the position to remain exempt.

In addition, federal law provides that certain "highly compensated" employees qualify for exempt status if they customarily and regularly perform **some** executive, professional or administrative duties (as opposed to the primary duty standard for a white collar exemption). Under the final rule, only employees who are in the 90th percentile of weekly earnings, i.e., $134,004 annually, will meet the salary threshold for this exemption.

Employers also should consider what effect, if any, the December 1 effective date will have on their standard cycle for awarding salary increases. For those that typically make such increases in December, this effective date should not present a problem, but those that make increases at other times of the year might want to reconsider that schedule. This will be particularly important in light of fact that the thresholds are subject to change, as discussed below.

Action Item #2: Set up a reminder to revisit salaries regularly

In another significant break from past practice, the final rule provides that the DOL will automatically **raise** the salary thresholds for the white collar and highly compensated employee exemptions every three years, starting on January 1, 2020. Through these adjustments, DOL will maintain the standard salary level at the 40th percentile of full-time salaried workers in the lowest-wage Census region, and maintain the highly compensated employee exemption at the 90th percentile of full-time salaried workers annually. That means employers must keep a watchful eye



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out for future changes to the salary levels applicable to these exemptions, and review their payroll at least every three years in light of any and all such changes.

Given the newly fluid nature of previously stagnant salary thresholds, employers must bear in mind that not giving an exempt employee a raise, or not giving a large enough raise to keep an employee at or above the minimum salary threshold, could lead to that employee suddenly becoming eligible for overtime.

Action Item #3: Analyze non-discretionary bonus and commission payments

The old rule contained no provision to count nondiscretionary bonuses and commissions toward the minimum salary level. The DOL requested comments on this issue when it released the proposed rule, and under the final rule, up to 10 percent of an employee's standard salary level can come from nondiscretionary bonuses, incentive payments, and commissions that are **paid at least quarterly**. That means if an employee's salary is close to the threshold for exempt status, it is important to dig deeper and factor in these other forms of compensation, because now they could push the employee into exempt status (assuming the employee also meets the duties test).

Action Item #4: Carefully review job duties for exempt positions

When the DOL issued its proposed rule, it refrained from proposing specific changes to the duties test to qualify for the white collar exemptions. Instead, it asked for public comments on the subject, and received more than a quarter million of them. At the end of the day, the duties test remains unchanged. Nevertheless, now is a good time to take stock of the duties employees classified as exempt are **actually performing** to ensure that they qualify for an exemption.

Action Item #5: Bone up on unaffected exemptions

While the changes finalized in the new rule will touch almost every for-profit, nonprofit and government employer, there are still specific jobs — and even entire professions — that can remain exempt even if they are paid less than the minimum salary required for the white collar exemptions. For example, most teachers remain exempt from overtime under federal law even if paid less than $47,476 annually. Similarly, outside salespeople are not required to be paid on a salary basis, so the new minimum threshold will not apply. The FLSA computer employee exemption actually has two parts, but only one part is impacted by the final rule. The DOL did not make changes impacting employees who are currently classified as exempt under FLSA Section 13(a)(17) because they earn at least $27.63 per hour and perform certain duties that fit within the exemption of section 13(a)(17). However, if a computer employee is paid on a salary basis (and less than $27,63 per hour) and classified as exempt under section 13(a)(1), then the new salary levels do apply to that employee. Accordingly, it would be prudent to assess the impact of the proposed salary increase on all IT employees who are paid on a salary basis.

Employers should work with counsel to ensure that they have a firm grasp on how the final rule will, and will not, impact them and their employees.

Action Item #6: Consider individualized options

Determining how best to address the ballooning population of employees who will be deemed non-exempt under the new rule requires careful, individualized analysis. First, identify each exempt employee on your payroll who is paid a salary of less than $47,476 annually. For each employee identified, consider the following options available to you for addressing the new requirements: (1) raise their salary above the minimum threshold (assuming they continue to meet the duties tests of the white collar exemptions); (2) reclassify them as non-exempt so they become eligible for overtime going forward; (3) if they are reclassified as eligible for overtime, adjust their hourly rate to reflect the impact overtime pay will have on their overall compensation; or (4) as part of any reclassification, reduce or manage their hours to minimize any overtime costs.

Bear in mind that some of these options can have an impact on employee morale, which should be taken into consideration when deciding on a course of action. While some workers undoubtedly will welcome eligibility for overtime, others might consider any reclassification to be tantamount to a demotion.

Further, if any of your exempt employees are covered by collective bargaining agreements, or have individual employment contracts, consider whether negotiations will be necessary to address any planned changes to their compensation, classification or hours of work.

Action Item #7: Nail down your talking points

Employee reclassification often carries the potential for discontent, as noted above, which can lead to complaints and even litigation. Some previously exempt employees will not understand why they have been reclassified as non-exempt, and might come to believe that they should have been eligible for overtime all along.

To minimize the risk for misunderstandings and whispers-down-the-lane, employers should take care to explain the reason for the reclassification and maintain open — but careful — communication with employees.

Action Item #8: Take a look at applicable state and local law

When developments like this bring federal law to full boil on the front burner, it can be easy to forget about state laws and local ordinances. However, it is essential to remember that state and local governments may set their minimum wage higher than federal law and have different rules on which workers are eligible for overtime. Many states and even municipalities have overtime pay rules that are more generous for employees than federal law. The DOL's changes to the federal regulation does not impact any state or local wage and hour laws that are not currently tied to the FLSA.

The release of this final rule is a watershed moment in federal wage and hour law, and all covered employers should use it as an opportunity to take stock of the way in which employees are classified. With these revised regulations hot off the presses, the DOL will undoubtedly approach misclassification issues with renewed vigor.

Cozen O'Connor's Labor & Employment attorneys are available to provide counsel and guidance on the issues discussed in this Alert.