EMPLOYERS MUST IDENTIFY ALL EMPLOYEES PRESENTLY CLASSIFIED AS EXEMPT WHO ARE MAKING LESS THAN THE NEW SALARY THRESHOLD AND TAKE ACTION TO COMPLY WITH THE FINAL RULES.

Nearly a year after releasing proposed regulations, late in the evening of May 17, the U.S. Department of Labor (DOL) issued its much-anticipated amendments to the overtime provisions of the Fair Labor Standards Act (FLSA, available at https://s3.amazonaws.com/public-inspection.federalregister.gov/2016-11754.pdf). Unless specifically exempted by the FLSA, employees must receive overtime pay for all hours worked in excess of 40 hours in a workweek at a rate not less than 1.5 times their regular rate of pay.
What are the key facts regarding the revised regulations?

• The salary threshold for the most common overtime exemptions (i.e., executive, administrative and professional) is increasing from $23,660 a year to $47,476 a year, or from $455 a week to $913 a week, and is indexed to update automatically every three years.¹

• The duties tests are not being changed.

• The salary threshold for the “highly compensated employee” exemption is increasing from $100,000 per year to $134,000 per year and is also indexed to update automatically every three years.²

• For the first time, employers will be able to count certain nondiscretionary bonuses and incentive pay (like commissions) toward as much as 10 percent of the salary threshold, provided, however, that such bonuses must be paid no less frequently than quarterly.

• The effective date of the new regulations will be December 1, 2016.

Have the duties tests changed?

No. Employees must perform certain specified exempt duties identified in DOL regulations to be exempt from the overtime requirements. Employers were concerned that the DOL might make changes to the “duties tests” for white collar overtime exemptions, but no such changes were made.

What must employers do before the effective date of the new rules?

Initially, employers must identify all employees presently classified as exempt who are making less than the new salary threshold of $47,476 per year. Options for dealing with these employees include:

• **Raise salaries**: One acceptable approach is to raise the employee’s salary to at least $47,476 per year. Keep in mind, however, that the DOL’s new rules automatically update the minimum salary requirement every three years. For example, the salary threshold is currently projected to increase to more than $51,000 per year on January 1, 2020.

• **Pay overtime above a salary**: Another acceptable approach would be to continue to
pay the employees on a salary basis, but to begin paying them 1.5 times their regular rate for any hours they work above 40 hours in a workweek.

- **Convert to hourly:** A third acceptable approach is to convert salaried employees to hourly status. The employer would then need to take steps to track hours worked each week and to ensure that employees are compensated at 1.5 times their regular hourly rate for all hours worked over 40 in a workweek. If the employee is converted to hourly status, the employer should consider the following:

  - **Should the amount of pay allocated to base salary be reduced?** Keep in mind that simply dividing an employee’s annual salary by 2,080 hours (i.e., 40 hours/week multiplied by 52 weeks/year) to determine a base hourly rate could be a very costly approach with severe budgetary implications if the employee works any significant amount of overtime. For that reason, when converting from salaried to hourly status, many employers will reduce the base hourly rate to account for potential or expected overtime costs in an effort to keep overall annual compensation constant. The DOL guidance acknowledges that this is an acceptable approach.

  - **Should duties be reassigned to minimize overtime?** Employers may want to take steps, such as restructuring positions, to ensure that employees rarely, if ever, work overtime.

  - **What impact will the changes have on employee morale?** Employees are likely to be upset when informed that they are being converted to nonexempt hourly status, that they are losing responsibilities, and that their base hourly rate is decreasing. Furthermore, based on our experience, many employees take pride in being salaried exempt and may resent a perceived demotion and the new requirement to keep track of hours worked.

  - **Comply with state and local wage and hour laws:** Most states and some municipalities have their own wage and hour standards. If an employer has operations in a state or municipality with stricter wage and hour laws, it is incumbent on the business to ensure that its pay practices meet those requirements.
The circumstances, location, financial status and culture of each employer should guide discussions with upper-level management, human resources and legal counsel about how to implement these new regulations in each unique workforce.

**What else should employers consider doing?**

- **Conduct a privileged review of job duties:** Employers should also consider using this time of tremendous change in our nation’s wage and hour laws to conduct a privileged review of the job duties of their employees making a salary in excess of the salary threshold to ensure that these employees are performing primarily exempt duties and are properly classified as exempt. As has always been the case, the DOL and the courts construe all exemptions narrowly, and, in order for an employer to establish an exemption, the employer must be able to plainly and unmistakably demonstrate that the employee’s duties fall within one of the exemptions.

- **Review incentive pay policies:** As employers will now be able to include incentive payments to satisfy up to 10 percent of the salary threshold requirement, employers continuing to rely on an exemption may also wish to reevaluate their bonus, commission and other incentive pay policies to ensure that they are receiving maximum “credit” toward meeting the minimum threshold. As always, employers should be careful when awarding incentive pay to nonexempt employees. Such payments may be considered part of the base wage from which the overtime rate is calculated and can result in unintended and unpredictable overtime payments.

**Should employers wait to see if the final rules will be challenged?**

No. The DOL was apparently concerned that the final rules might be challenged under the Congressional Review Act (CRA) during the next administration. For that reason, the DOL pushed to have the final rules released much earlier than had originally been anticipated. As a result, any challenge to the final rules under the CRA would need to take place while the current administration is still in office and, undoubtedly, would be vetoed by President Obama.

Nevertheless, it is likely that the final rules will be challenged on other grounds. For example, employer associations may challenge the final rules on the basis that the automatic indexing every three years constitutes an improper delegation of the DOL’s obligation to make periodic assessments of the appropriate salary threshold. In fact, the
last time the salary threshold was raised, the DOL expressly rejected the suggestion that salary thresholds should be indexed on the basis that “such a mechanical adjustment for inflation could have an inflationary impact or cause job losses.” However, because there is no sound basis for believing that the final rules will be blocked or delayed, employers should assume that they will take effect on December 1, 2016 and plan accordingly.

It is likely that the DOL will issue additional guidance and commentary between now and the December 1, 2016 implementation date. We will continue to monitor all DOL communications and work with businesses as they transition their pay practices to comply with these dramatic changes to the way many Americans are paid.

Endnotes
1. This salary threshold is set at the 40th percentile of full-time salaried workers in the lowest income census region (currently the South).

2. This salary threshold is set to the 90th percentile of full-time salaried workers nationwide.