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BNA Insights Employee Benefits

Responding to the Department of Labor's Final Rule On White Collar Overtime Regulations

BY JONATHAN S. KRAUSE

On May 18, 2016, the U.S. Department of Labor (“DOL”) announced its Final Rule for the “white collar” overtime exemption regulations under the Fair Labor Standards Act (“FLSA”), which will greatly increase the number of employees who must be paid overtime by increasing the minimum salary required under these exemption to \$47,476 annualized and making several other important changes. According to the DOL, the Final Rule will create overtime eligibility to 4.2 million workers and additional wage payments of \$1.2 billion, and, while those numbers likely overstate the change, they are emblematic of the significant impact these

revised regulations will have on business operations. This article provides the background giving rise to these changes, their implications and recommended actions for businesses and their legal counsel impacted by them.

Background

The FLSA is the federal statute that governs federal overtime and minimum wage requirements. While there is a presumption that employees are entitled to overtime pay for all hours worked over 40 in a week, the FLSA provides exemptions from this requirement if certain conditions are met. Currently, under the executive, administrative

and professional exemptions, employees are exempt from federal overtime requirements if they: (1) are salaried, meaning they are paid a predetermined and fixed salary not subject to reduction because of variations in the quantity or quality of their work; (2) are paid more than the salary threshold of \$455/week (\$23,660/year) and (3) primarily perform executive, administrative or professional duties as provided in DOL regulations and courts’ interpretations of those regulations (think many of the traditional white collar jobs paid via salary—hence the phrase, “white collar exemptions.”).

The FLSA also provides a highly compensated employee exemption, which exempts from the law’s overtime requirement employees who have an annual salary of \$100,000 or greater (including a minimum of \$455/week), whose primary duty includes performing office or non-manual work and who customarily and regularly perform at least one

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of the exempt duties of a “white collar” exempt employee. The salary minimum was last adjusted in 2004 and there had been no changes to account for inflation or other market conditions until the Obama administration directed the DOL to consider making certain changes to the wage and hour regulations to protect employees and update the regulations.

The Final Rule

After extensive public comment in response to the proposed regulations, the DOL released its Final Rule. Below is a summary of the key provisions:

- Increases the minimum salary to \$913/week (\$47,476 annually) to satisfy the salary basis piece of the test. In other words, employees whose duties meet a white collar exemption’s test must receive a salary equaling \$47,476 annually to qualify for the exemption (subject to limited attribution permitted to non-discretionary, incentive, or commission comp addressed below). The amount is pegged to the standard salary level at the 40th percentile of full-time salaried workers in the lowest-wage Census region, which is currently the South.

- Increases the minimum compensation for highly compensated employee exemption from \$100,000 to \$134,004. The amount is pegged to the equivalent of the 90th percentile of full-time salaried workers nationally, not the lowest-wage Census region.

- Automatically updates every three years the salary minimums to maintain exempt status by pegging the minimum to the 40th and 90th percentiles.

- Permits employers to use non-discretionary bonuses, incentive payments, commissions, and catch-up payments to satisfy up to 10 percent of the new standard salary level if the payments are made at least on a quarterly basis.

- Part-time, white collar employees cannot have their compensation pro-rated to qualify for the exemption. Otherwise stated, to be exempt, the employee must make the weekly salary minimum even if the employee is only expected to work part-time.

- The regulations become effective **December 1, 2016**.

Next Steps for Employers

While businesses and their advisors have until December 1 to make necessary compensation changes, the planning must begin now, if it has not already started. Any business subject to the FLSA that pays white collar workers a fixed salary between \$23,660 and \$47,476 is affected by the Final Rule and, whether it is for hundreds of employees employed by, for example, a national retailer or a handful of employees at a family-run accounting firm, changes must be made to remain in compliance with the law. Businesses would be wise to engage in the following exercise:

- Identify the impacted employee population whose compensation will need to be adjusted. Businesses should also identify the employee population making just above the new floor to determine if it would be a good time to make changes as to their compensation both to react to the diminished salary contrast among workers and account for the automatic increase to the compensation floor every three years.

- Assess the economic impact of the various pay options available to remain compliant. Although there are many paths available to employers, the most prominent options include:

- Convert the current salary to an hourly rate by dividing the salary by 40 hours and then paying 1 ½ times overtime of that rate for all hours worked over 40. This option may not be desirable or feasible from a labor budget perspective if these employees currently work well in excess of 40 hours weekly.

- Increase the compensation to the \$47,476 minimum. For employees getting paid close to that amount, it may be advantageous from an administrative, morale and labor budget perspective simply to bump the salary to keep these workers exempt. However, for employees making considerably lower than \$47,476, this bump may not be economically viable.

- Determine the hourly rate needed for employees to earn approximately their current salary if converted to non-

exempt, factoring in the average amount of hours they work. This option would maintain greater consistency in the labor budget, but companies will have to feel comfortable with the hours estimate (which is challenging given that exempt workers generally don’t have their time tracked), may create morale issues and does not keep the employee “whole” for paid vacation days or other use of paid time off where there is no overtime.

- Consider whether a 60 hour/week, full-time position can be divided into two 30 hour part-time positions. This split can curb overtime, but there can be diminished quality and institutional knowledge in dividing up positions, and certain roles will not be conducive to such an arrangement.

- Use the opportunity to confirm that currently exempt employees satisfy the duties portion of the test. These changes will result in more employees contacting plaintiffs’ attorneys in reaction and increased litigation is expected. To the extent there is a need to re-classify currently exempt employees because of duties deficiencies, now is a good time to conduct that analysis. Also, remember that business have to comply with federal AND state wage law, so take care that any compensation changes do not run afoul of state requirements. The state law concern is particularly acute for national employers or employers who are new to states.

- Develop a communications and training plan both for the affected employees and their managers. Many white collar workers take pride in not having their hours tracked and will need an explanation as to why their compensation is changing and why the hours they work may need to be curtailed to limit overtime costs. These workers are used to checking and responding to e-mail remotely before and after the start of the work day and engaging in other non-hour based activity that may now be compensable. They will need training and explanation as to why those activities either must be limited or cannot occur. In tandem, their managers must be trained to understand the new

rules, so that they do not require their employees to work off the clock without compensation or incur substantial overtime charges. Both manager and employee will have to track time and work within the confines of the Final Rule.

The changes required by the DOL's Final Rule will require thoughtful analysis and coordination across stakeholders in the organization. There is no one "right" solution to maintain compliance, and businesses will need to have thoughtful conversations internally and with

outside counsel to determine what works best for them.

The one certainty is that the path forward cannot be determined overnight and, while December 1 is several months away, the compliance process should not be left to the last moment.