



## **The Department of Labor's New Overtime Regulations: What They Will Mean for Employers in California and Elsewhere**

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As widely reported, the U.S. Department of Labor ("DOL") has announced its much-anticipated proposal to expand overtime rights for U.S. workers, raising the bar on how much an employee must be paid to be classified as exempt under federal law.

The Fair Labor Standards Act, which has been on the books since 1938, does not define who is exempt from overtime under the so-called "white-collar" exemptions (referred to in the new proposed regulations as "EAP" positions, as an acronym for the executive, administrative and professional exemptions). Instead, Congress delegated this task to the DOL. The DOL has adopted various tests over the past 75 years.

The agency's new proposal, prepared at the direction of President Obama, focuses on the "remuneration test" – how much an employee must be paid to be exempt. The DOL is not proposing any changes to the current "duties" tests – that is, what duties an employee must primarily perform to be exempt. However, the DOL has invited the public to comment in the next 60 days on both its remuneration proposal and the existing duties tests. The agency has reserved the right to announce changes on any aspect of the existing overtime regulations before it issues its Final Rule, which likely will take effect sometime in 2016.

### The New Salary Threshold and Automatic Updates

Since 2004, employers have been required to pay employees a base salary of at least \$23,660 per year (\$455 per week) before classifying them as exempt under the federal EAP exemptions. Under the new proposal, the salary threshold will increase significantly to an amount anticipated to be around \$50,440 per year (\$970 per week) by the time the regulations take effect in 2016. This will apply as well to computer professionals who are paid by salary. (The alternative hourly threshold for computer professionals who are paid by the hour will remain at \$27.63, as this is embedded in the FLSA.)

After much study, the DOL decided to set the salary benchmark at the 40<sup>th</sup> percentile of weekly earnings for all full-time salaried workers in the United States, exempt and non-exempt, according to data compiled by the Bureau of Labor Statistics and the Census Bureau. As of 2013, this equated to \$47,892 per year (\$921 per week), but is likely to be somewhat higher when the DOL issues its Final Rule.

The DOL concluded that this new salary threshold is far enough above the minimum wage to provide an effective means of screening out workers who should be overtime-protected. The agency deemed the existing threshold of \$23,660 to be outdated, noting that it is below the poverty level for a family of four. The DOL estimates that adoption of this new standard will immediately make more than 5 million additional workers eligible for overtime pay, and will result in the transfer of more than \$1.1 *billion* annually from employers to employees in the form of higher earnings.

Currently, the minimum remuneration for the EAP exemptions must be paid as a *salary* (or in some circumstances as a “fee” that is equivalent to the required salary). The DOL is considering allowing employers to use discretionary bonuses or other incentive payments to make up a portion of the required salary threshold, given the reality that many employers pay their exempt employees a combination of salary and bonus. If this is adopted, however, the bonus portion likely will be limited to a small fraction of the total minimum requirement, such as 10%. The agency has invited public comments on this idea and will announce its decision when it finalizes the regulations.

Significantly, the DOL also proposes to automatically update the minimum salary level annually, based on either a fixed percentile of earnings or the Consumer Price Index. Under this proposal, which is similar to the approach currently used under some state and local minimum wage laws, the FLSA salary threshold likely will increase incrementally every year.

#### The Highly Compensated Employee (“HCE”) Provision

The DOL also proposes to increase the threshold amount for “highly compensated employees” from \$100,000 to \$122,148, an amount pegged to the 90<sup>th</sup> percentile of earnings for full-time salaried workers. The DOL also intends to adjust the HCE threshold annually, as with the minimum salary level.

The DOL proposes to retain the existing rule that the HCE amount can be met by considering an employee’s total earnings, including salary and any discretionary bonuses paid during the year.

As is true now, meeting the HCE amount will not automatically mean that an employee is exempt. However, HCE employees need to meet only one of the applicable duties tests to be exempt. As a practical matter, the vast majority of highly compensated employees will meet the relaxed FLSA test for exempt status, provided that they perform office or non-manual work. The HCE provision, however, is not available in California or some other states, as discussed below.

#### No Changes to “Duties” Tests under Current Proposal

The DOL has announced that it has considered – and is still considering – certain changes to the duties tests as well as the remuneration test. Although its new proposal contains no such changes, the agency may propose further changes after receiving public comments, or at some other point in the future.

In particular, the DOL has invited public comment on:

- What, if any, changes should be made to the duties tests?
- Should employees be required to spend a minimum amount of time performing work that is their primary duty in order to qualify for exemption? If so, what should that minimum amount be?
- Should the DOL look to the State of California’s law (requiring that 50% of an employee’s time be spent exclusively on exempt duties) as a model?
- Should the DOL stay with a single test for exempt status or consider alternative tests (such as the “long” and “short” tests used in past years)?

- Is the “concurrent duties” regulation for executive employees (allowing the performance of both exempt and non-exempt duties concurrently) working appropriately or does it need to be modified?
- What specific examples of non-exempt and exempt occupations should be incorporated in the regulations (including, for example, for computer professional employees)?

As currently proposed, the new regulations will not change either the duties test or the remuneration test for the outside sales exemption or the commissioned sales exemption in “retail or service establishments.”

The new regulations also will not affect the FLSA minimum wage, which has remained at \$7.25 since July 2009.

#### Effect on California Employers

The new DOL regulations will address exempt status only under federal law; they will not change California law or the separate overtime laws of other states. Employers in all states must satisfy both the FLSA test and any applicable state-law test for exempt status.

Currently, the minimum salary in California for exempt “white collar” employees is \$37,440 per year (\$720 per week). Effective January 1, 2016, this will increase to \$41,600 (\$800 per week), when the California minimum wage increases from \$9 to \$10.

Once the DOL regulations take effect, the FLSA salary minimum will leapfrog over the California minimum. Any salaried exempt California employees whose salaries exceed \$41,600 but are less than \$50,000 (or whatever is determined to be the new federal threshold) will need to be reclassified to non-exempt status to satisfy the FLSA, or else the salaries will need to be increased to meet the new federal test.

As a practical matter, however, relatively few California employees who are paid salaries in the range of \$37,000 to \$49,000 qualify for exempt status under California’s stringent duties tests covering “white collar” employees. For this reason, the new DOL regulations are not likely to have a dramatic impact on most California employers.

The California minimum for salary-based computer professionals is \$85,981.40 per year, significantly higher than the new FLSA amount. This will likely increase in 2016 based on the Consumer Price Index. Computer professionals in California who are paid by the hour must receive at least \$41.27 per hour for every hour worked. This, too, will likely increase in 2016. (To clarify, under both the FLSA and California law, computer professionals can be paid either hourly or by salary. Employees under the executive, administrative, and professional exemptions, however, must be paid on a salary basis, although they can be paid non-salary amounts on top of the base salary.)

As mentioned, California overtime law does not recognize as valid the DOL’s “highly compensated employee” test. California employers, therefore, do not have the latitude to use a more favorable exemption test merely because its employees are highly paid; some courts have found employees in certain occupations to be non-exempt despite earning significant six-figure incomes.



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Employers who wish to submit comments to the DOL about its proposed regulations will have the opportunity to do so in the 60-day period after the regulations are published in the Federal Register. We will keep you apprised when the Final Rule is issued.

If you have any questions about these proposed changes, please contact us.