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U.S. DEPARTMENT OF LABOR ISSUES ITS NEW OVERTIME RULE

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By: Tom Geidt

Yesterday the U.S. Department of Labor ("DOL") issued its much-anticipated Final Rule establishing the new requirements that must be met for an employee to be classified as exempt from overtime under the Fair Labor Standards Act.

When the Rule Will Take Effect

The new rule will go into effect on Thursday, December 1, 2016. This means that employers will have more than six months to prepare for it.

New Minimum Salary to be Exempt: $47,476

Under the FLSA's "white-collar" exemptions from overtime, employees must meet a salary test to be exempt as well as a duties test. Under the new rule, the minimum salary threshold for exempt status will more than double, from $23,660 ($455 per week) to $47,476 ($913 per week). This is the first change in the minimum salary since 2004. This salary threshold will apply to persons who are classified as exempt under the administrative, executive, professional, and computer professional exemptions of the FLSA.

When it first announced its proposed overtime rule last year, the DOL was considering a formula that would have brought the minimum salary to $50,440. In its Final Rule, however, the agency adopted a slightly different salary index – the 40th percentile of earnings of full-time salaried workers in the lowest-wage Census Region (currently the South) – which had the effect of dropping the minimum salary by about $3,000 from last year's projection.

The DOL estimates that this salary increase will enable more than 4.2 million workers across the U.S. to become eligible for overtime for the first time.

Some Bonuses and Commission Payments May be Counted

For the first time, employers will be permitted under the new rule to allocate a portion of the $913 minimum "salary" as nondiscretionary bonuses, commissions, or other incentive payments. Specifically, employers will be permitted to apportion up to 10% of the minimum amount as nondiscretionary incentive payments, as long as those payments are paid on a quarterly or more frequent basis.

For example, if an employer pays a salary of $825 per week to its exempt employees (slightly more than 90% of $913), and pays the employees some form of incentive pay that makes up the 10% difference, this would be sufficient to comply with the salary test. If an employee's incentive pay by the end of the quarter is less than projected, causing the total weekly pay to average less than $913 for all the workweeks in the quarter, the employer can make a "catch-up" payment at the end of the quarter to satisfy the minimum requirement. This payment must be made no later than the next pay period after the end of the quarter.

New Salary for Highly Compensated Employees: $134,004

The new rule increases the minimum salary under the FLSA's "highly compensated employee" ("HCE") provision from $100,000 to $134,004. This is somewhat of a surprise, because the DOL's proposed rule last year projected an HCE level of only $122,148. As before, the DOL is basing the HCE amount on the 90th percentile of earnings for full-time salaried workers nationally.

To satisfy the HCE test under the new rule, employees must receive a salary of at least $913 per week (without deducting the 10% allocation for incentive pay). However, the remainder of the total compensation above that level – up to $134,004 – can be paid in the form of nondiscretionary bonuses, incentives and/or commissions. As in the past, employers will be permitted to make a "catch-up" payment at the end of the calendar year to bridge the difference between the actual pay received by an employee during the year and the minimum HCE salary.

Employees who meet the HCE test are not automatically exempt under the FLSA, but they can be classified as exempt under a more lenient set of duties criteria; they only need to meet at least *one* of the duties criteria for the administrative, executive, or professional exemption rather than all of the criteria for the applicable exemption.

Automatic Adjustments Every Three Years

The DOL's proposed rule announced last year would have allowed *annual* increases to these salary thresholds. In its Final Rule, the DOL opted instead to allow automatic adjustments only every *three* years, beginning on January 1, 2020, using the same formulas that it used to set the new December 2016 salary levels. The DOL will announce the adjusted salaries at least 150 days before they take effect. Based on historical data, the DOL projects that the new 2020 minimum salary could be approximately $51,168 ($984 per week), and the new HCE salary could be approximately $147,500. However, the actual amounts could end up being higher or lower than these projections (most likely higher).

No Change to Duties Tests

The DOL considered whether to make changes not only to the salary test but also to the duties tests for exempt status under the FLSA. However, it ended up deciding to leave the existing duties criteria unchanged. The new regulations make no changes to the duties tests as they were last modified in 2004.

No Change in the Minimum Wage

The new overtime rule will have no effect on the FLSA minimum wage. The current federal minimum wage is $7.25, and it will remain at that level unless and until it is changed at some future time by legislative action.

Guidance on DOL's Website

The DOL has published on its website a Fact Sheet, FAQs, and various other explanatory materials regarding its new overtime rule, including the full text of the Final Rule. These can be found at https://www.dol.gov/whd/overtime/final2016/.

Impact on California Employers

California's minimum salary for exempt status is currently $41,600. Therefore, as of December 1, the FLSA will have a higher minimum threshold than California's by about $6,000 per year. Employers in California, as elsewhere, will need to comply with whichever salary minimum – state or federal – is higher at any one time.

California's minimum salary threshold is tied to the California minimum wage, which will increase annually. Thus, the minimum exempt salary will increase to $43,680 for most employers on January 1, 2017; $45,760 in January 2018; $49,920 in January 2019 (overtaking the federal salary level); $54,080 in January 2020; $58,240 in January 2021; and $62,400 in January 2022.

The California duties tests for exempt status are more stringent than the federal duties tests in several key respects. Moreover, California does not recognize any lenient duties test for highly compensated employees. As before, California employers will need to ensure that the applicable duties criteria are met when they classify an employee as exempt, regardless of the employee's salary level.

What Employers Should Do in Response to the New Overtime Rule

As widely reported in the media, opponents of the overtime rule in Congress may try to overturn or delay the implementation of the rule. Whether those attempts are successful remains to be seen.

Meanwhile, all employers should use the next six months to plan and prepare to comply with the new rule by the scheduled deadline, December 1. Employers have various compliance options, including raising salaries, reclassifying some exempt employees to non-exempt status, modifying staffing levels, adjusting work schedules to reduce the volume of overtime, taking other cost-cutting measures to offset the new overtime costs, or any combination of the above.

If you have any questions about these important new regulations, please feel free to contact us.

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