The New Overtime Regulations—A Seismic Shift for the American Workforce

by Dena H. Sokolow

Dena H. Sokolow is a shareholder in Baker Donelson's Tallahassee, Fla., office where she brings more than 20 years of experience counseling and defending employers and management on a wide range of labor and employment matters. With a practice spanning the Southeast, she partners with clients to best position them to avoid employment law claims or, at a minimum, put the company in the strongest position to defend such claims. She may be reached at (850) 425-7550 or by email at dsokolow@bakerdonelson.com.

After two years of wait, debate, and overall angst for employers across the country, the new overtime rules were announced on May 18 and became final when they were published in the *Federal Register* on May 23. This rule will have a tremendous impact on employers, particularly those in the service, retail, and hospitality industries, but there are some significant and positive changes from the rule initially proposed by the Department of Labor (DOL) last year. The most important news is that the Office of Management and Budget (OMB) listened to employers' concerns about the complexity of compliance and provided an extended period until Dec. 1, 2016, before the Final Rule becomes effective.

'Exemption' From Overtime

The Fair Labor Standards Act (FLSA) requires employees to be paid at least the federal minimum wage and overtime for any time worked in excess of 40 hours in a workweek. In addition, the FLSA provides strict record-keeping requirements for employees to track their working hours. There are employees, however, that are "exempt" from the FLSA's minimum wage, overtime, and record-keeping requirements. Exemption depends upon three things:

1. How an Employee is Paid—Salary Basis. The first requirement for exemption is that the employee must be paid on a "salaried basis," meaning the employee receives a fixed, guaranteed minimum amount for any workweek in which the employee performs *any* work. Simply stated, there is no change in salary regardless of the hours worked.
2. How Much an Employee is Paid—Salary Level/Threshold. Besides being paid on a salaried basis, to qualify for an exemption, the employee currently must be paid a minimum of $23,600 per year ($455 per week). There is also an exemption for "highly compensated employees" who earn $100,000 per year.
3. What Kind of Work Does the Employee Do—Job Duties Test. An employee who meets the salary basis and salary level/threshold tests is exempt only if the employee also performs exempt job duties. There are three primary "white collar" exemptions: executive, administrative, and professional. Regardless of the job title, the employee must meet each job duty requirement under one of the exemption categories to satisfy this test.

To qualify for exemption from overtime, all three of these tests must be satisfied. Paying salary alone is not enough. A salaried employee is not the same as an "exempt" employee, although the two phrases are often used interchangeably.

The Process—How Did We Get Here?

Back in March 2014, President Barack Obama sent an executive memorandum[1] directing Secretary of Labor Thomas Perez to "modernize and streamline" the overtime exemption regulations. On June 30, 2015, the DOL published its proposed changes to the overtime regulations—more than doubling the $23,660 salary level to $50,440 (or $970 per week) and increasing the salary level for the highly compensated exemption from $100,000 to $122,148. Additionally, the DOL proposed a mechanism to automatically update the salary level annually using a fixed percentile of wages or the Consumer Price Index. The DOL's final regulation was sent to the OMB for review, which was completed in May 2016, and the Final Rule was published in the *Federal Register* shortly thereafter.

What is the Final Rule?

The salary threshold is still doubling so it is difficult to call this "good news," but the Final Rule looks a bit different from the DOL's proposed rule and contains some concessions that will make it a little more palatable for employers:

- The 2016 salary threshold will be $913/week, which is $47,476/year. This is $2,964 less than the originally proposed $50,440 salary threshold. The salary threshold will be based upon the 40th percentile of the lowest-wage region, the South, rather than the entire country as initially proposed. This change is likely the result of criticism the DOL received for basing its proposed rule on national statistics, which did not take into account regional salary fluctuations. For the highly compensated employee exemption (HCE), however, the DOL is still basing the new wage on the weekly earnings of the 90th percentile of full-time salaried workers nationally, which will mean an increase in the HCE annual salary threshold from $100,000 to $134,004.

- Bonuses and incentives (including commissions) can be included to satisfy up to 10 percent of the standard salary level. For the first time, nondiscretionary bonuses and incentives (including commissions—which is a shocker, since the DOL basically said no commissions in the proposed rule) can be included *and* the rule allows employers to make a "catch-up" payment. For employers to credit nondiscretionary bonuses and incentive payments toward a portion of the salary threshold, the Final Rule requires such payments to be paid on a quarterly or more frequent basis. If an employee does not earn enough in nondiscretionary bonuses and incentive payments (including commissions) in a given quarter to retain their exempt status, the Final Rule permits a "catch-up" payment at the end of the quarter. The employer has one pay period to make up for the shortfall.
- Rather than the initially proposed annual updates, the Final Rule automatic updates will be every three years beginning Jan. 1, 2020. This will be based on the 40th percentile of weekly earnings of full-time salaried workers in the lowest-wage region, which is currently, and will likely remain, the South.
- No changes to the duties test. There was some speculation that the DOL would revise the duties test in the Final Rule, but it was not changed; that does not mean it will not make changes to the test in the future.

When Will the Final Rule Be Effective?

Employers have until Dec. 1, 2016, when the rule becomes effective, to comply with the new regulations.

What Should Employers Do Now?

Every business sector is preparing for these changes. Wage-and-hour litigation will only increase under the Final Rule as employers grapple with the many positions in the industry just barely meeting the current exemption requirements. Employers have between now and the end of November 2016 to prepare for and implement the changes. It is important to understand exemptions and their impact on the organization's structure, budget, and employees.

Here are some initial steps for employers to take:

1. Identify employees who will need to be reclassified (i.e., current employees who are exempt but paid less than $47,476 annually). Commissions and nondiscretionary bonuses may satisfy up to 10 percent of the standard salary level.
2. Determine the number of hours the employees work. This seems simple but exempt employees are not required to track their hours and, therefore, employers may not be fully aware of the hours an exempt employee is working. Employers will also want to look at waiting time, meal and rest periods, training time, travel time, and other "hidden overtime."
3. Calculate the feasibility and costs of raising pay of currently exempt employees to the new threshold level versus reclassifying employees as nonexempt and paying overtime versus lowering pay to offset the overtime requirement. Projecting these costs will assist in deciding the course of action to take once the Final Rule goes into effect.
4. Identify how much time managerial employees are spending on particular tasks. Review job descriptions and tasks of impacted positions to determine if certain exempt tasks may be reassigned or maintained with the current position.
5. Consider how pay changes or other changes in job assignments may impact the organization. This is the time to determine if the employer needs to make process or structural changes to accommodate, for example, exempt and nonexempt employees who will have the same job title.
6. Develop administrative plans to ensure compliance when the regulations become official. Analyze whether any company policies—including policies that only apply to managers and pay policies—will be impacted and need to be changed. Prepare and train all levels of management.
7. Negative employee morale is a big concern. Reclassifying managers and requiring them to track time will likely be met with resistance. It is important to have a unified message to employees on how and why changes will be implemented. It is also a good idea to have a plan for following up with employees and monitoring their compliance with the new policies. The key message to employees should be that these changes should not result in a decrease in pay and are required by law.
8. Check your time-keeping methods and ensure that they are sufficient for the additional employees who will now be required to use them. Accurate data collection will be an essential part of complying with the Final Rule.
9. Take this golden opportunity to address and correct wage and hour issues without calling attention to them. Now is the time to determine if employees are properly classified as exempt and to make any needed corrections.
10. Lastly, and most importantly, encourage employers to seek legal help to ensure that they are in compliance and to assist them in maneuvering through the DOL regulations and classification changes. These rules are complex, and there are serious financial consequences if an employer is found to be in violation of them. The DOL's budget for FY2017 includes $277 million for wage and hour division enforcement, an increase of $50 million from FY2016. Now that the rule is final, the DOL will be sending out its auditors to ensure employers are in compliance. ⊙

Endnotes

[1]Barack Obama, *Presidential Memorandum—Updating and Modernizing Overtime Regulations* (March 13, 2014), https://www.whitehouse.gov/the-press-office/2014/03/13/presidential-memorandum-updating-and-modernizing-overtime-regulations.