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## The Final Overtime Rule Explained: What Every Employer Must Do Next

The day that has been looming over employers for the past 2 years since President Obama directed the U.S. Department of Labor (“DOL”) to update and modernize the existing Fair Labor Standards Act’s (“FLSA”) white collar exemptions has finally arrived. Today, the DOL released its final rule revising the regulations governing who is exempt from overtime, along with guidance on its major provisions. The final rule, *Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees*, largely reflects what the DOL had proposed in 2015, with some important revisions, including a slightly lower salary threshold level at \$47,476.00. However, that salary floor still sits at more than double the current salary threshold of \$23,660.00.

There is no doubt that the final rule will dramatically increase the number of workers who will now qualify for overtime pay, forcing every employer in the country to carefully assess how to handle the additional financial burden. Indeed, the DOL projects that the rule will extend overtime eligibility to 4.2 million workers.

Significantly, the rule takes effect on December 1, 2016 (in just under 200 days), which is a much shorter time period than that for which many business groups had advocated, but almost 80 days more than the 120 days that employers were given in 2004 when the FLSA was last amended. Accordingly, employers should start evaluating their options and transitioning their workforces now to ensure that the requirements of the final rule are implemented in a compliant and effective manner. Indeed, it may take multiple attempts to find a new and feasible workforce structure.

### \$47,476 is the New Floor

As employers are aware, the FLSA provides a number of exemptions, known as “white collar exemptions,” for executive, administrative, and professional employees. To be classified as exempt, an employee must (i) be paid a certain minimum salary; (ii) perform certain types of tasks related to his or her primary job duties. Therefore, to even make it to an assessment of the duties performed by the employee, the employee’s salary must meet an established minimum level.

The most significant change in the final rule is the \$47,476.00 minimum threshold salary required to qualify as an exempt employee. The new threshold level is set at the 40th percentile for salaried workers in the nation’s lowest wage region (the Southeast). Despite that the DOL attempted to set the threshold salary level to account for the nation’s lowest wage region, it is still over a 100% increase from the present level and a huge financial undertaking for employers. Currently, employers have to pay their exempt employees a salary of at least \$455.00 per week. Now, employers must pay their exempt employees a minimum of \$913.00 per week. All employers throughout the country must meet this same mandatory salary level to classify an employee as exempt, despite the substantial differences in cost of living from state to state and region to region.

Therefore, any exempt employee making less than \$913.00 per week, or \$47,476.00 per year, must be (1) given a raise to make their total compensation equal to the new salary threshold; or (2) reclassified as a non-exempt employee, who will now be entitled to overtime pay. Both of these options could significantly increase employer labor costs. Moreover, the reclassification of employees has the potential to negatively impact employee morale because workers may perceive this shift as a demotion in pay and status, as well as a threat to the reliability of their fixed take home pay. Although the financial impact will likely be the driving factor in determining how to adapt to these new regulations, effect on workplace culture may also be an important consideration for employers.

### Factoring Incentive Pay into the Salary Basis

In determining whether employees meet the salary threshold level, the rule permits employers to use non-discretionary bonuses and incentive pay, including commissions and incentive bonuses tied to productivity and profitability, to satisfy up to 10% of the threshold salary level. This means that even where employers pay more significant bonuses, the amount attributable to the employee's standard salary computation is capped at 10% of the required salary amount. The DOL limits an employer's ability to credit non-discretionary bonuses and incentive payments toward the calculated salary level, however, to those paid on a quarterly or more frequent basis. Furthermore, non-discretionary bonuses and incentive pay cannot be factored into the standard salary received per pay period for an employee who is exempt under the highly compensated employee exception, but they do continue to count toward the total annual compensation level for such employees.

### New Mandatory Triennial Threshold Salary Increases

The new rule also implements an automatic increase in the threshold salary level every three years based on the 40th percentile for salaried workers in the lowest-wage region. The first automatic increase would take place January 1, 2020. Although an improvement from the annual increases recommended by the DOL in its proposed rule, this triennial increase could still have a significant impact on employers. First, it makes it harder for employers to determine whether to raise the salaries of their exempt employees or reclassify them because it is difficult to predict exactly what the salary level will be in three years. Such a raise may become more burdensome to employers as the average salary level gets higher from year to year, particularly if employers are unable to continuously raise salary levels prior to the automatic increase. This could force employers to reevaluate their exempt employee classifications every three years to determine whether it is financially feasible to take on that additional salary increase to maintain exempt status.

Second, a mandatory increase guarantees a raise in the minimum salary threshold even during difficult economic times when employers may be less likely to afford such a pay increase. Finally, it permits the DOL to avoid its responsibility to assess the financial impact of such an increase prior to its implementation. The 40th percentile for salaried workers could be significantly higher in three years (currently the DOL is predicting \$51,168.00 in 2020), yet the DOL will not be required to contemplate and address the consequences that this could have, particularly for small employers. Despite these drawbacks, a triennial increase is part of the final regulations and employers must plan accordingly in determining how to handle employee classification and workforce restructuring.

### New Highly Compensated Employee Test

Additionally, the proposed rule raises the minimum salary needed to meet the highly compensated employee ("HCE") exemption. The rule explains that the annual compensation level of an HCE be equal to the 90th percentile of earnings for full-time salaried employees nationally for the exemption to

apply. Based on current data, this annual salary amount must be set at \$134,004.00 or higher if an employer intends to classify a worker as exempt under the HCE exemption. Moreover, to be exempt as an HCE, an employee must receive at least the new threshold salary level of \$913.00 per week on a salary or fee basis. This threshold salary level is also subject to an automatic increase every three years.

### No Changes to the Duties Test

Although the DOL has significantly altered one part of the exempt classification assessment, the rule released by the DOL makes no changes to the current duties test. Therefore, employers must still evaluate the responsibilities of an employee to determine whether they primarily perform duties appropriately characterized as executive, administrative, or professional. Even though the test has not been altered and remains a qualitative assessment, its application will likely be under close scrutiny as the DOL oversees and enforces the new rule.

### Implications of this Rule – Increased Litigation

Aside from the more obvious consequences of this new rule as laid out above, employers are also likely to face increased litigation as a result of the changes to the white collar exemption regulations. Although a bright-line salary test appears to be relatively easy to apply, employers must be careful in calculating new hourly and overtime rates, as well as accurately determining whether total compensation will meet or exceed the threshold salary level. Moreover, employers must be certain they are accounting for any and all hours worked over 40 in a work week and paying newly non-exempt employees at their overtime rate. With a significant rule like this, the DOL is likely to follow-up with increased oversight and enforcement once the rule takes effect, and plaintiffs' attorneys will be closely monitoring employer implementation. Indeed, proper application of the duties test, even though untouched by this rule, will also be closely scrutinized by the DOL and plaintiffs' attorneys as part and parcel of the overall determination of exempt classification.

Additionally, employees will likely have greater awareness of their classification and what is required pursuant to this classification as a result of this rule. The DOL and plaintiffs' attorneys both have plans to engage in outreach and educational efforts during the implementation period to ensure employees are aware of their rights under the FLSA and these regulations. Increased awareness could lead to more lawsuits being filed, particularly if employees are unhappy with their classification (or reclassification as the case may be) and/or a lack of overtime pay. These types of lawsuits are particularly problematic for employers because they are rarely brought by individual plaintiffs and usually take the form of a class action involving multiple employees. They also tend to be difficult to conclude quickly as proper application of the duties test requires close scrutiny of the facts. Thus, increased litigation is another additional expense many employers could face.

### Next Steps for Employers

Now that the final rule is set to take effect on December 1, 2016, employers must determine how to effectively handle the exempt employee classification of all those currently exempt employees below the new threshold salary level. As the process of reclassifying employees, as well as setting up the systems and practices necessary to manage the influx of reclassified non-exempt employees and their hours, will take significant time, it is important that employers begin this process immediately.

For those assistant managers and supervisors earning pay near the new threshold salary level, particularly those who generally work more than 40 hours per week, it may be a more financially feasible decision to raise their salary rather than try to address the issue of potential overtime pay. Alternatively, for those employees currently earning a wage closer to the prior threshold level of \$23,660.00, reclassifying them as non-exempt and closely monitoring hours worked to keep them at or below 40 hours per week would likely be the more feasible option. But every workplace is different and the determination as to how to handle these new requirements must be made on a case by case basis.

As many employers will likely have to reclassify numerous employees to non-exempt, they will also have to provide new training on time recording policies. Exempt employees do not have to track the time they work because they are paid on a salary basis. However, once these employees are reclassified as non-exempt, accurate tracking will become essential, requiring training for these employees, as well as their managers. Furthermore, time tracking systems should be evaluated and potentially upgraded to ensure they have the capacity to track the influx of newly non-exempt employees. Employers must also update pay systems and ensure pay calculations have been properly restructured to reflect the proper hourly pay and overtime rates.

The implementation period also provides employers a good opportunity to ensure that those classified as exempt are properly characterized pursuant to the applicable duties test. As DOL is likely to initiate enforcement initiatives once the implementation period has passed, employers should ensure all current employee classifications are proper. Finally, employers should review their related policies and procedures to determine which need to be updated to reflect the requirements of this new rule. Given the nuances of these regulations and the current duties test, guidance from legal counsel will be useful for any employee classification and policy review.

For assistance with developing lawful policies and procedures regarding FLSA compliance or any other labor and employment issues, contact Kara Maciel, Chair, Labor & Employment, Conn Maciel Carey PLLC.

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