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

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After receiving over 116,000 comments on its Proposed Rule to revise the version of the *Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees* Rule ("Overtime Rule") promulgated in 2016, the U.S. Department of Labor ("DOL") has issued a final, revised version of the Overtime Rule. On September 24, 2019, the DOL announced the final Overtime Rule ("revised Overtime Rule") through a press release touting the impact of the Rule and highlighting its major changes. Notably, the press release reflects the significant impact the change in the threshold salary level for the white-collar exemptions is projected to have on employees – lowering the number of employees likely to become eligible for overtime pay from 4.2 million under the 2016 version of the Overtime Rule to 1.3 million. This is due to the DOL decreasing the salary threshold level from $913.00 per week to $684.00 per week under the revised Overtime Rule.

Significantly, the Rule takes effect on January 1, 2020 – in just under 100 days. This timeline does not provide for a phase-in period as advocated for by many commenters and trade associations, and is a much shorter time period than 192 days employers were given in 2016 when the Overtime Rule was promulgated, and the 120 days given in 2004. As justification for this timeline, the DOL stated that this final rule is a "more modest increase" in the threshold level and affects fewer workers than the 2016 version, and "an overwhelming majority of commenters agreed" that the threshold level needed to be updated. The DOL also pointed out that January 1st may be convenient for those who use the calendar year as their fiscal year or for other policy purposes. Accordingly, employers should start evaluating their options and transitioning their workforces as necessary now to ensure the requirements of the final rule are implemented in a compliant and effective manner.

Threshold Salary Level of $35,568.00 Per Year

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; and (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 revised Overtime Rule is a substantial decrease in this threshold salary level to $35,568.00 – an $11,908.00 difference from the level set by the 2016 final rule. The DOL calculated the new salary threshold level by reverting to the same method it used in 2004 – the earnings of the 20th percentile of two subpopulations (1) salaried employees in the South and (2) salaried employees in the retail industry nationwide. The DOL returned to this method of calculating the salary threshold level after a district court determined that the level set in the 2016 final rule was impermissible in large part because it would exclude "so many employees who perform exempt duties" from the white-collar exemptions.

The DOL believes the level under the revised Overtime Rule meets the purpose of the salary level test portion of the exemption – to screen out obviously non-exempt employees. Under the 2004 threshold salary level, which is the current standard, employers were required to pay exempt employees at least $455.00 per week. Now, employers will be required to pay their exempt employees at least $684.00 per week.

Therefore, any exempt employee making less than $684.00 per week, or $35,568.00 per year, must be (1) paid total compensation equal to the new salary threshold; or (2) reclassified as a non-exempt employee, who will be entitled to overtime pay.

Factoring Incentive Pay into the Salary Basis

In determining whether employees meet the salary threshold level, the revised Overtime 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. However, to count toward meeting the new salary level threshold, these payments must be made on at least an annual basis. Employers can use any 52-week period for this purpose; i.e., calendar year, fiscal year, or an anniversary of the hire year.

The revised Overtime Rule also permits employers to meet the salary level requirement using a catch-up payment within one pay period of the end of the designated 52-week period. In other words, the employer must pay an exempt employee at least 90% of the standard salary level each pay period and, if at the end of the 52-week period the total salary paid, with all nondiscretionary bonuses and incentive payments, does not equate to the minimum salary threshold level, an employer has one pay period in which to make up for the deficit (up to 10% of the required level).

Finally, 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 ("HCE") exception, but they do continue to count toward the total annual compensation level for such employees.

Removal of Mandatory Salary Level Increases

The 2016 version of the Overtime Rule included an automatic increase in the threshold salary level every three years based on the 40th percentile for salaried workers in the lowest-wage region. However, when the district court granted summary judgment and found the 2016 salary level threshold unlawful, it also held that the mechanism to automatically update that level on a triennial basis unlawful. In revising the Overtime Rule, the DOL chose not to establish automatic increases to the salary threshold level, but it did confirm its intent to update

the standard salary level more regularly going forward through notice-and-comment rulemaking. The DOL did not commit itself to any set time period for these updates in the final revised Overtime Rule because it agreed with commenters that this would allow more flexibility to adapt to current conditions.

New Highly Compensated Employee Test

Additionally, the revised Overtime Rule raises the minimum salary needed to meet the highly compensated employee ("HCE") exemption. The final rule explains that the minimum annual compensation level for the HCE exemption is equal to the 80th percentile of all full-time salaried workers nationally using pooled 2018/2019 CPS data. Based on this calculation, the annual minimum salary amount must be set at or above $107,432.00 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 $684.00 per week on a salary or fee basis.

No Changes to the Duties Test

As advocated for by a number of commenters, the DOL has again decided to make no changes to the current duties test. Therefore, employers must continue to evaluate the responsibilities of an employee to determine whether they primarily perform duties appropriately characterized as executive, administrative, or professional duties. 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 this final rule.

Next Steps for Employers

Now that the final rule is set to take effect on January 1, 2020, employers must determine how to effectively handle the exempt employee classification of all those currently exempt employees below the new threshold salary level. 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 and who are eligible for non-discretionary bonuses and/or incentive payments, 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 could be the more financially practical 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.

Keep in mind that any employees reclassified to non-exempt will likely need training on applicable time recording policies and practices. Generally, 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. Time tracking systems may also need to be evaluated and restructured to ensure they reflect any changes in pay structure.

The implementation period provides employers a good opportunity to also ensure that those classified as exempt are properly characterized pursuant to the applicable duties test. As the DOL may engage in enforcement efforts after the final revised Overtime Rule goes into effect on January 1st, employers should ensure all current employee classifications are proper. Finally, employers should review any related policies and procedures to

determine if any 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 would likely be useful for employee classification and policy review.