COVINGTON

U.S. Department of Labor Finalizes Changes to FLSA White Collar Exemption Rule

June 7, 2016

Employment

On May 18, the U.S. Department of Labor (DOL) finalized its much-anticipated update to the Fair Labor Standards Act's (FLSA) so-called white collar overtime exemption rule. Effective December 1, 2016, an employee must earn at least $913 per week—the equivalent of $47,476 per year, more than double the current rate—in order to qualify as exempt from overtime under the federal executive, administrative, and professional exemptions. The salary threshold for the federal highly compensated employee (HCE) exemption will increase to $134,004 per year. Beginning January 1, 2020, these thresholds will automatically increase once every three years.

Background

As we detailed in our alert last July, the new rule is an outgrowth of President Obama's April 2015 directive to U.S. Secretary of Labor Thomas Perez and DOL to reform the current white collar exemptions to increase the number of persons eligible for overtime under the FLSA. According to DOL projections, the new rule will increase worker wages by $12 billion over the next decade.

Final Rule Components

The new rule includes the following:

- Increase in Standard Salary Level: The new rule increases the salary threshold required to qualify for the white collar exemption to $913 per week, or $47,476 per year, an amount equal to the 40th percentile of earnings for full-time salaried workers. This is an increase of more than 100 percent from the current threshold of $455 per week or $23,660 per year.
- Increase in Salary Level of Highly Compensated Employees: Under the HCE exemption, employees whose salaries meet the threshold are exempt from the FLSA's overtime requirements if they regularly and customarily perform at least one of the exempt duties or responsibilities of an executive, administrative, or professional employee identified in the standard tests for exemption. The salary threshold for HCEs will rise to $134,004 per year, an amount equal to the 90th percentile of earnings for full-time salaried workers. This is a 34-percent increase from the current threshold of $100,000 per year.
- Inclusion of Bonuses and Incentive Payments: For the first time in history, employers will be able to count nondiscretionary bonuses, incentive payments, and commissions to meet up to 10 percent of the required salary threshold, so long as they are paid at least quarterly. Discretionary bonuses, retirement plan contributions, and other fringe benefits are excluded from this calculus.

- Automatic Updates to Salary Threshold: Beginning January 1, 2020, the minimum salary level will automatically update every three years to maintain the threshold at the 40th percentile of full-time salaried workers in the lowest-wage region of the country. HCE salary thresholds will update to reflect the 90th percentile of annual earnings of full-time salaried workers nationally. DOL will provide 150-days' notice of the new overtime threshold prior to each update.

Changes from Proposed Rule

The proposed rule drew more than 270,000 comments from the public. Small businesses in particular highlighted concerns that DOL discussed in the final rule, including that the proposed increase would be too large for rural and small communities and employers; that it would have a disproportionate impact on small businesses; that it may result in part-time work arrangements rather than better wages; and that changes to the threshold may result in a loss of jobs.

In consideration of these concerns, the final rule makes some concessions to employers:

- The standard salary threshold will increase to $47,476—$3,000 lower than proposed;
- Salary thresholds will automatically increase every three years—not annually, as proposed;
- No changes were made to the duties tests for the exemptions, despite DOL's request for comments on this topic; and
- For the first time, employers may count nondiscretionary bonuses, incentive payments, and commissions to meet up to 10 percent of the threshold salary.

The final rule's automatic increase provision has drawn especially strong criticism. When DOL last updated the salary requirements in 2004, it stated that it lacked the authority to mandate automatic updates. Now, DOL has exercised that authority. Given many employers' opposition to the new rule generally and to the automatic increases in particular, this provision seems poised for judicial challenge. Moreover, the first automatic increase is not scheduled until January 1, 2020, which would allow the next administration time to rescind the provision before it takes effect. In addition, Congress could attempt to pass a Congressional Review Act resolution deauthorizing the new overtime rule; such a resolution has already been proposed.

California Employers

Generally speaking, California law has been more protective of employees than the FLSA, requiring employers doing business in California to pay exempt employees more than the federal minimum to qualify for the California exemptions, which are tied to the state's minimum wage. Beginning December 1, 2016, however, the new FLSA salary threshold will exceed California's current threshold ($41,600 per year), which means that absent a salary increase, some employees who are currently exempt under California law will be entitled to overtime pay under FLSA. This could be temporary, however, since California's minimum wage (and therefore its minimum salary threshold for the exemptions) is set to increase in coming years. Based on expected minimum wage increases, the California overtime exemption salary level will again surpass the FLSA level by 2018.

Next Steps for Employers

The new rule requires employers to carefully analyze their workforce and make appropriate business decisions before the new salary thresholds take effect on December 1, 2016. Employers should consider, among other things, the following:

- Whether to increase salaries for exempt employees earning less than the new threshold, or instead reclassify them as non-exempt, track their hours, and begin paying overtime;
- What methods to use for tracking the hours for any currently exempt employees who will fall below the new threshold and be reclassified as non-exempt;
- How to ensure ongoing compliance in light of the three-year updates;
- Whether there are necessary collateral changes to company policies such as after-hours email use or eligibility for employee benefits;
- Whether to adjust cycles for awarding salary increases or bonuses to take advantage of the ability to count certain bonuses in the threshold;
- Whether to reorganize workloads to minimize overtime work; and
- How to balance any workplace changes with company culture, employee morale, and turnover, including any messaging to employees concerning changes to employees' classifications.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Employment Practice Group:

Lindsay B. Burke	+1 202 662 5859	lburke@cov.com
M. Michael Cole	+1 415 591 7030	mmcole@cov.com
Daniel E. Johnson	+1 202 662 5224	dejohnson@cov.com