Published on *The National Law Review* https://natlawreview.com

DOL Makes Last-Minute Tweaks to New Overtime Exemption Rules

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In March 2014, *President Obama* signed an executive order directing the ***Department of Labor*** to revise its aging rules governing overtime pay for white collar employees. The Department solicited comments from the public on an earlier draft in July 2015. Yesterday, the Department of Labor released the final version of the new rules. The new version includes a number of changes—some expected, but others less so.

The ***Fair Labor Standards Act ("FLSA")*** requires employers to pay covered employees time-and-a-half for all hours they work in excess of 40 each week. But certain categories of employees are exempt from this rule, including executive, administrative, professional, and outside sales employees if (1) their work duties meet certain requirements and (2) they are paid at least a certain minimum salary. These are known as the white collar exemptions.

The most visible change the new rules make is roughly to double the minimum salary needed to qualify as exempt. Under the old rules, the minimum was $455 per week, or $23,660 per year; the July 2015 draft of the new rules set the bar at $970 per week, or $50,440, which the DOL calculated is the 40th percentile of full-time salaries earned nationally. The final version released yesterday unexpectedly reduces this number to $913 per week, or $47,476, which represents the 40th percentile for salaried in the lowest-wage Census Region (the South). The DOL has explained that it made this change in response to criticism that a national standard failed to account for the lower salaries typically paid in the South and other regions with lower cost of living.

The new rules also allow employers to count nondiscretionary bonuses and incentives like commissions toward up to 10 percent of the $47,476 annual minimum. This is one of a number of related proposals the Department considered.

A third change affects the so-called "highly compensated employee" exemption. Previously, this exemption applied to employees earning at least $100,000 per year. The Department proposed raising the minimum to $122,148, but ultimately decided to raise the number all the way to $134,004, which the Department identified as the 90th percentile for salaried workers in the lowest-wage Census Region.

The Department also adopted a system meant to update these salary limits automatically over time. Under the original proposal, the thresholds would have changed annually. Stakeholders expressed concern that such frequent changes would impose too heavy a burden on employers trying to comply with the law, so the Department switched to a three-year standard. Starting on January 1, 2020, and every three years thereafter, the salary thresholds discussed above will automatically adjust to the then-current 90th (highly compensated employees) and 40th (other exemptions) percentiles of full time salaried employees in the lowest-wage Census Region. The department considered pegging the thresholds to the Consumer Price Index, which is designed to measure inflation, but ultimately settled on the percentile model instead.

The Department considered a number of other changes, but ultimately rejected them. Most notably, it decided not to adopt various proposed changes to the duties tests for the white collar exemptions. Had they been adopted, those changes would have required employers to ensure that their exempt employees spend at least 50 percent of their time on exempt duties – a requirement under California law, but not necessarily typical in other jurisdictions.

The new rules take effect on December 1, 2016. According to the Department, these changes are intended largely to create certainty as to whether any given employee is entitled to overtime pay. It remains to be seen whether that happens.

What is certain, though, is that this is not an easy fix. Shifting employees from salary to hourly or from overtime-exempt to overtime-eligible will have a wide range of operational and legal implications for employers. Employers must create a plan to manage their business through these changes. Back in July 2015, we advised that a study commissioned by the National Retail Federation (“NRF”) estimated that, even if workers saw no additional take-home pay, the process of converting currently-exempt employees to a non-exempt status could cost employers over $800 million (i.e., updating payroll systems, establishing ways to track employee hours and other administrative expenses). Employers must also carefully consider the consequences of potential responses on company culture. Employers can certainly offset projected costs by reducing the wages, discretionary compensation, and hours of full-time workers; but those “savings” must be balanced against the “costs” of decreased morale and production. Reclassifying exempt employees to non-exempt will have immediate effects on the morale of employees who feel they have been stripped of their professional status and workplace flexibility options. And, a reduction in exempt status positions will have lingering effects on both exempt and non-exempt employees who will feel discouraged by the reduction in future career opportunities and potential for advancement.

National Law Review, Volume VI, Number 140