

U.S. DEPARTMENT OF LABOR ANNOUNCES FINAL OVERTIME RULE

Labor & Employment Alert
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Today, the United States Department of Labor finalized its overtime rule amending the “white collar” exemptions to the federal Fair Labor Standards Act. Two years in the making, the final rule is expected to cause 4.2 million employees nationwide, including some 380,000 in New York State, to become eligible for overtime pay. The Department estimates that the new rule will cost employers approximately \$12 billion over the next ten years.

By way of background, the Fair Labor Standards Act exempts from the minimum wage and overtime requirements individuals who are employed as bona fide executive, administrative, and professional employees. To qualify for one of these exemptions, an employee generally must:

1. be paid a minimum salary amount on a weekly or less frequent basis;
2. be paid on a fee or “salary basis,” which means that he or she receives a predetermined and fixed salary that is not subject to reduction because of variations in the quality or quantity of work performed, subject to limited exceptions; and
3. have as his or her primary duty the performance of exempt executive, administrative, and/or professional duties, as defined more specifically by Department of Labor regulations.

Under the rules which have been in effect since 2004, the federal minimum salary requirement has been \$455 per week, or \$23,660 annually. In New York State, the minimum salary requirement for executive and administrative employees is substantially higher: \$675.00 per week, or \$35,100 annually. In addition, certain highly compensated employees are currently exempt from overtime if their total annual compensation is at least \$100,000, they are paid at least \$455 per week on a salary or fee basis, and they customarily and regularly perform at least one of the exempt duties of an executive, administrative, or professional employee.

The new final overtime rule significantly amends the minimum salary and salary basis requirements. Specifically, the final rule:

1. More than doubles the current minimum salary requirement needed to qualify for the executive, administrative, and professional exemption to \$913 per week, or \$47,476 annually

Attorneys

Joseph Braccio
Ryan Everhart
Andrew Freedman
Peter Godfrey
John Godwin
Karl Kristoff
Elizabeth McPhail
Jeffrey Swiatek

Practices & Industries

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2. Increases the total annual compensation requirement needed to qualify for the highly compensated employee exemption to \$134,004 per year
3. Creates a mechanism for automatically updating the minimum salary requirement every three years
4. Amends the salary basis test to allow employers to use nondiscretionary bonuses and incentive payments (including commissions) to satisfy up to 10 percent of the new minimum salary requirement

With respect to automatic updating, the minimum salary requirement for executive, administrative, and professional employees will now be indexed to the 40th percentile of full-time salaried workers in the lowest-wage Census region (currently, the South of the United States). And beginning on January 1, 2020, and every three years thereafter, the minimum salary requirement will automatically increase to align with this figure.

For the highly compensated employee exemption, the total annual compensation requirement will now be indexed to the 90th percentile of full-time salaried workers nationally and updated on the same three-year cycle. The Department of Labor will publish a notice of the new minimum salary requirement in the Federal Register and on its website at least 150 days before the updated amounts take effect (in early-August). Based on current projections, the minimum salary level for executive, administrative, and professional employees is expected to increase to more than \$51,000 on January 1, 2020.

In one of the few concessions to employers, the final rule allows employers to use non-discretionary bonuses, incentive payments, and commissions to satisfy up to 10 percent of the \$913 per week minimum salary requirement, or \$91.30 per week. This incentive compensation, however, must be paid at least quarterly to be used as an offset to the new minimum salary requirement. Incentive compensation that is paid less frequently may not be considered. The final rule also allows employers to make a “catch-up payment” in the event that an employee’s incentive compensation actually earned in a particular quarter is not sufficient to ensure that the employee meets the minimum salary requirement. Employers will have one pay period to provide this make-up payment for any shortfall attributable the preceding quarter.

The final rule, however, does not allow employers to use nondiscretionary bonuses or incentive compensation to satisfy any portion of the minimum standard salary requirement for the highly compensated employee exemption. To claim the highly compensated employee exemption under the final rule, employers must pay employees at least the minimum salary (now \$913 per week) on a salary or fee basis. Because employers may fulfill the remainder of the \$134,004 total annual compensation requirement through non-discretionary incentive compensation, the Department determined that it would not be appropriate to permit employers to use such compensation to satisfy the \$913 minimum salary component.

Importantly, the final rule makes no changes to the duties test. Instead, the Department has stated that the final rule’s substantial increase to the salary requirement, coupled with automatic updating every three years, sufficiently addressed its concern that some workers who were spending substantial amounts of time performing non-exempt work (e.g., operating cash registers, stock shelves) nonetheless still qualified for one or more of the white collar exemptions.

The final rule becomes effective December 1, 2016.[1] This is a Thursday, so salary increases for employees who will continue to be treated as exempt must be made for the workweek that includes December 1.

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Employers should immediately prepare for compliance with the final rule. Employers have a number of options for dealing with the increased salary requirements. Specifically, for each impacted employee, employers may: (a) increase the salary to the new level to retain the employee's exempt status; (b) reduce or eliminate overtime hours through reducing or reorganizing workloads, or spreading work hours among other employees; (c) pay the current salary (or its hourly equivalent) plus overtime at one-and-one-half times the employee's regular rate of pay for any overtime hours worked; and/or (d) adjust the employee's rate of pay to account for overtime obligations in an effort to hold total weekly pay constant.

In determining which option(s) to pursue, employers will need to be mindful of a number of important considerations, including:

- the hours worked by the affected employees (the Department estimates that 60% of affected employees do not work overtime, 19% only occasionally work overtime, and 20% regularly work overtime)
- variability of affected employees' hours of work, both individually on a week-to-week basis and as compared to others in the same or similar titles
- how to address employees within impacted titles that span the new minimum salary level
- the potential impact on benefit eligibility for employees who will now become non-exempt
- how overtime pay obligations, incentive compensation, paid time-off programs and other factors impact efforts to hold weekly pay constant
- the potential impact pay changes will have on employee morale and productivity
- training formerly exempt employees on timekeeping policies and practices
- complying with applicable state law notice obligations concerning pay rate adjustments
- ensuring compliance with non-discrimination obligations in connection with pay rate adjustments
- salary compression for employees who are not directly impacted by the final rule

As these considerations illustrate, the changes ushered in by the final rule present employers with challenging compensation decisions. Thankfully, employers have several months to evaluate the relevant considerations and carefully make these decision before the effective date of the final rule. If you need assistance in complying with the final rule or evaluating your various compliance options, please contact any one of our labor and employment attorneys.

To further assist our clients in better understanding what the final rule this new regulation will mean to their businesses and discuss strategies for compliance, Hodgson Russ will hold informational sessions in both our Buffalo Office on Thursday, May 26 and New York City office on Thursday, June 2. [Click here to register.](#)

[1] The Department of Labor has announced a limited non-enforcement policy for providers of Medicaid-funded services for individuals with intellectual or developmental disabilities in residential homes and facilities with 15 or fewer beds. This non-enforcement period will extend from December 1, 2016 to March 17, 2019.