



## Time to Act - Employers Have Fewer than Six Months to Comply With New Federal Overtime Exemption Rule

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On May 18, 2016, the United States Department of Labor ("DOL") announced its much-anticipated final overtime exemption rule under the Fair Labor Standards Act ("FLSA"), as tasked to do by President Obama in 2014. The DOL received more than 270,000 comments since it published its Notice of Proposed Rule Making on July 6, 2015, which helped shape the final rule. Ultimately, the DOL issued a new overtime exemption rule that promises to have a profound impact on employers and employees alike when it takes effect on December 1, 2016.

The new changes to the rule are the first changes since 2004, which was the only update since 1970. This time, the DOL's new rule promises to be more significant than the 2004 update. The new rule is expected to extend overtime protection to 4.2 million more Americans who are not currently eligible for overtime under federal law. It is further expected to increase wages for workers by \$12 billion over the next 10 years. It is anticipated that mid-level positions such as store managers, assistant managers and front line supervisors will be substantially affected by the new rule. The new rule is also going to have a substantial financial impact on employers, particularly on small businesses subject to the FLSA. Although the new rule is likely to have the greatest effect on industries such as the hospitality, retail, fast food and food service industries, employers across all industries should, in consult with legal counsel, take steps now to address this impact.

### Current Overtime Exemptions Under the FLSA

Currently, to qualify for an exemption from overtime under the FLSA, a "white collar" employee must:

- 1) be paid a predetermined and fixed salary that is not subject to reduction because of variations in the quality or quantity of work performed (the "salary basis test");
- 2) be paid at a specified weekly salary level, which is at least \$455 per week (the equivalent of \$23,660 annually for a full-year worker) (the "salary level test"); and
- 3) primarily perform executive, administrative, or professional duties, and satisfy other requirements related to their duties, as defined in the Department's regulations (the "duties test").

There are some employees who are not subject to either the salary basis or salary level tests (e.g., doctors and lawyers). The DOL also exempts from overtime certain highly compensated employees ("HCE") who earn above a higher total annual compensation level (currently \$100,000) and satisfy a minimal duties test.

### The DOL's New Overtime Exemption Rule

The new rule more than doubles the current salary level in the salary basis test -- from \$455 per week or \$23,660 per year to \$913 per week or \$47,476 per year. It guarantees overtime for employees who do not meet this new salary threshold, regardless of whether the employees meet the duties test.

A few additional key components of the DOL's new overtime exemption rule are:

- 1) The new salary level for the federal overtime exemption under the FLSA is set to update automatically every three years, and it will be indexed to the 40th percentile of all salaried workers in the lowest wage Census region at that time. The salary level is expected to increase to more than \$51,000 at the first automatic adjustment on January 1, 2020. The DOL will publish all updated rates in the Federal Register at least 150 days before their effective date, and it also will post them on the Wage and Hour Division's website.
- 2) Employers may now use nondiscretionary bonuses and incentive payments (including commissions) to satisfy up to 10 percent of the new salary threshold under the FLSA. For employers to credit nondiscretionary bonuses and incentive payments toward this 10 percent of the new salary threshold, such payments must be paid on a quarterly or more frequent basis. The new rule permits an employer to make a "catch-up" payment, provided that this payment is made within a certain time frame.
- 3) The rule raises the total annual compensation requirement for highly compensated employees from \$100,000 to \$134,004 under the FLSA. These



employees are exempt if they meet this new compensation level and a minimal duties test.

- 4) The new rule does not impact the “duties test.” The DOL considered modifying the FLSA’s duties test by moving toward a more “quantitative” test, but after seeking comments on this topic did not revise the FLSA duties test. Both the standard duties test and the HCE duties test remain unchanged. The DOL reasoned that as a result of the change to the salary level, the number of workers for whom employers must apply the duties test to determine exempt status is reduced, thus simplifying the exemption.
- 5) The Department also is updating the special salary level for employees in American Samoa (to \$767 per week) and the special “base rate” for employees in the motion picture industry (to \$1,397 per week), and then automatically every three years.

### **Consequences for Failing to Comply with the New Federal Overtime Exemption Rule**

Employers who do not comply with the DOL’s new rule may face the following:

- 1) Lawsuits by the DOL or by employees either individually or through collective action to recover back pay, liquidated damages, interest, attorneys’ fees and court costs.
- 2) Independent or complaint-driven administrative investigations, charges and audits by the DOL.
- 3) Administrative injunctions, including injunctions on the shipment of goods in interstate commerce if the goods were produced in violation of the FLSA (which includes a violation of overtime rules).
- 4) Civil fines for willful and repeated violations, including up to \$1,100 per violation.
- 5) Criminal charges for willful violations, which could include up to \$10,000 in fines, imprisonment for up to six months or both.

### **How the DOL’s New Rule Stacks Up Against California’s Overtime Exemptions**

The new salary level for the federal overtime exemption is nearly \$6,000 more than California’s minimum annual salary threshold of \$41,600. To be exempt from overtime, California’s “white collar” employees must earn a minimum monthly salary of no less than two times the state minimum wage for full-time employment, as well as satisfy California’s stringent duties requirements. This amounts to \$3,466.67 per month or \$41,600 per year based on California’s current \$10 an hour minimum wage.

That federal law under the DOL’s new overtime exemption rule is going to be more protective of California employees than California law with respect to the salary threshold is significant. It denotes one of the first times in a very long time that this has occurred, and its impact is far reaching. California has the most workers of any state potentially affected by the DOL’s new rule - more than 392,000, amounting to nearly 10% of the total number of workers affected nationwide. Given this widespread impact, ensuring compliance with both California and federal rules, including the DOL’s new rule, is sure to keep employers and their legal counsel on their toes. California employers must comply with both laws, satisfying the requirements of the law that affords the most protection to employees.

Note that there are other significant differences between the DOL’s new rule and California’s overtime exemption requirements, such as the following: Unlike the new federal rule, California does not allow employers to use nondiscretionary bonuses and incentive payments to satisfy any portion of its salary threshold. Moreover, California does not have a special exemption for “highly compensated employees.” Further, California quantitatively caps the amount of non-exempt work that employees may perform, whereas the FLSA exemption does not have a hard-and-fast quantitative requirement.

### **Preparing for the Increase in the Federal Salary Threshold Requirement**

Although there are challenges to the DOL’s new rule, employers should prepare for its implementation on December 1, 2016. Given the consequences noted above, employers do not want to be out of compliance. At a minimum, employers may wish to take the following measures:



- 1) Become familiar with the new rule and identify which employees will be impacted. Employers should review exempt/non-exempt classifications. If employees are exempt, employers should review each employee's salary, including its highly compensated employees' salaries, to see if they meet the minimum salary threshold requirements to qualify for the overtime exemption under the DOL's new rule.
- 2) Identify whether any of its employees who are currently classified as exempt are paid nondiscretionary bonuses or incentive payments (including commissions). Under the DOL's new rule, this compensation may be used to satisfy up to 10% of the new salary threshold of \$47,476 per year.
- 3) Reclassify employees who do not meet the minimum salary level by December 1, 2016 or raise the salaries of these employees to ensure that they meet the minimum threshold requirements under the new DOL overtime exemption rule.
- 4) Provide education and training to human resources, compensation and payroll, managers and supervisors regarding the new rule and its requirements, as well as its implications for the work force, including its impact on formerly exempt employees who are now reclassified as non-exempt.
- 5) Train managers, supervisors and non-exempt employees on wage and hour policies and practices, such as clocking in and out before and after the shift and meal periods, tracking overtime and obtaining pre-approval from managers prior to working overtime, recordkeeping requirements, schedules, business hours and hours of work.
- 6) Communicate any changes, such as changes to classification, compensation, schedules, hours of work and rules regarding time off from work, to accounting, payroll, compensation, human resources, managers, supervisors and newly reclassified non-exempt employees impacted by the new DOL rule.
- 7) Determine whether or not the employer can reallocate work or adjust schedules to minimize overtime.
- 8) If a policy does not already exist, establish one that requires non-exempt employees to obtain pre-approval from a supervisor for overtime hours.
- 9) Check for the 150-day advance announcements of the automatic salary updates to the DOL's rule, which will take place every three years commencing on January 1, 2020.
- 10) Make certain that non-exempt employees comply with any state law requirements, such as in California.

The foregoing list is by no means exhaustive, and only time will tell the true impact of the DOL's new overtime exemption rule under the FLSA. The important thing is for employers to take advantage of the window of time prior to December 1, 2016 to ensure compliance with this new rule. Employers should consult with legal counsel to familiarize themselves with the new rule, and to determine its applicability and the employer's best course of action.



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