

[The Resource] New FLSA Regulations —Take Two

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Employers across the country went to great lengths in 2016 to prepare for the implementation of updated regulations from the US Department of Labor that would have nearly doubled the amount a white collar worker must receive in order to remain exempt from overtime under the Fair Labor Standards Act. At the last minute, courts intervened and blocked the proposed regulations from taking effect. Now nearly three years later, the Department of Labor is proposing a revised regulation which would increase the minimum salary level for exemption to \$679/week (\$35,308 annually) along with other changes. While not as large an increase as proposed in 2016, if this change goes into effect, it will represent a nearly 50% increase over the current minimum salary requirement. This issue of The Resource will provide an overview of the proposed regulation and provide strategies for preparing for the changes to the white collar exemptions.

The Fair Labor Standards Act

The Fair Labor Standards Act (FLSA) is the federal law that mandates the payment of a minimum wage and overtime pay to workers who do not fall within a specific exemption. Because workers employed as managers, administrators and professionals were thought to be in charge of the workplace and better able to influence their compensation, from the adoption of the FLSA in 1938, these so-called “white collar employees” were exempt from the FLSA protections of minimum wage and overtime. The first regulations laid out two tests, both of which had to be met in order for a worker to be covered by the white collar exemption: a salary test whereby the employee must receive a fixed minimum salary of at least \$30 per week, and a duties test requiring that the employee exercise real managerial or executive authority in the workplace.

Over the next seven decades, the duties tests were refined and modified from time to time, including a major overhaul in 2004, which simplified the tests for executive, administrative and professional employees and created a relaxed duties test for employees receiving over \$100,000 per year in compensation. However, while the initial salary threshold of \$30 per week in 1938 was 2.73

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times the then-current minimum wage, the law did not include any mechanism for adjusting the salary threshold for the white collar exemption based on inflation or consumer pricing. The salary threshold was rarely increased—only eight times since the FLSA was adopted—and never indexed to inflation or the cost of living. As a result, in 2016, an employee making a salary of \$455 per week (or \$23,660 per year) could qualify as an exempt white collar worker, ineligible for overtime, even though his earnings were below the federal poverty level for a family of four.

In March 2014, President Obama issued a memorandum asking the US Department of Labor (DOL) to “modernize and streamline” the existing overtime regulations to update existing protections consistent with the intent of the FLSA. Acting on this directive, the DOL issued a proposed rule in July 2015 that would have increased the salary threshold for white-collar employees by tying it to data from the Federal Bureau of Labor Statistics and invited interested parties to submit written comments. The DOL received over 270,000 comments in response to the proposed rule from a variety of interested stakeholders.

The 2016 Rule

Following the comment period, a final rule updating the overtime regulations was announced on May 18, 2016, with an effective date of December 1, 2016 (the “2016 Rule”). Under the 2016 Rule, the salary threshold for executive, administrative and professional employees was set at \$913 per week (\$47,476 per year)—more than two times the prior salary threshold. The 2016 Rule also established a mechanism for automatic updates of the salary level every three years, with the first scheduled to occur on January 1, 2020.

The 2016 Rule allowed up to 10% of the white collar minimum salary to be fulfilled with incentive pay, such as bonuses, commissions, catch-up payments and other non-discretionary incentive pay. In order to count toward the minimum salary figure, the 2016 Rule required that incentive pay be paid at least quarterly, and, if there were a gap between the salary threshold and the actual pay, the employer would be required to make it up with catch-up payments.

Under the 2004 regulations, employees paid \$100,000 annually were exempt if they customarily and regularly perform at least one exempt duty. The 2016 Rule changed this “Highly Compensated Employee” threshold salary to the 90th percentile annualized salary for full-time salaried workers nationally, or \$134,004 annually.

Other than changing the amount of the required salary level, the 2016 Rule did not change the “salary basis” test, that is, the requirement that exempt white-collar workers receive the same salary each week in which they perform any work without deductions for quantity or quality of work. The 2016 Rule also made no changes to the white collar duties tests: exempt employees were still required to meet the primary duties tests for the executive, professional or administrative exemptions.

The Courts Intervene

In late 2016, a number of business groups and states filed a lawsuit against the DOL in a federal court in Texas challenging the validity of the 2016 Rule. On November 22, 2016, just nine days before the 2016 Rule would have gone into effect, Judge Amos Mazzant entered a preliminary injunction delaying implementation of the 2016 Rule. In August 2017, Judge Mazzant entered a final order concluding that the 2016 Rule was unlawful. With the 2016 Rule rejected, the 2004 salary threshold has remained in effect.

Fast Forward to 2019: The DOL Tries Again

Given the change in administration, it is probably no surprise that the current DOL did not aggressively try to preserve the 2016 Rule. Following a formal request for information seeking public input and a series of public listening sessions, on March 7, 2019, the DOL issued a new proposed rule (the “Proposed Rule”) that would formally rescind the 2016 Rule and impose a new salary threshold. Specifically, the Proposed Rule includes the following key components:

1. **The salary threshold for exempt executive, administrative and professional employees would increase to \$679/week (\$35,308 annually),** up from the current \$455/week, but well below the \$913/week set in the 2016 Rule.
2. **The total compensation required for exempt “highly compensated employees” would increase to \$147,414 annually,** up from \$100,000 under current law, and higher than the \$134,004 level under the 2016 Rule.
3. **Employers could use nondiscretionary bonuses or commissions to satisfy 10% of the minimum salary requirements,** carrying forward a concept from the 2016 Rule that departed from the longstanding DOL position that bonuses and similar incentive payments do not count toward the salary threshold.
4. **No mechanism for automatic increases of the salary threshold.** The 2016 Rule included a mechanism for automatic updates to the salary threshold every three years. While acknowledging the need for more frequent increases in the salary threshold, in the Proposed Rule, the DOL suggests that it will increase the salary threshold every four years, but only through a formal rulemaking procedure (rather than automatically, as under the 2016 Rule).

While the proposed increase to the salary threshold is significant, it is certainly less far-reaching than the 2016 Rule would have been. The DOL estimated that the 2016 Rule would have made 4.2 million exempt workers eligible for overtime pay. By comparison, the DOL estimates that under the Proposed Rule, approximately 1.1 million currently exempt employees would become eligible for overtime pay.

What Should Employers Do Now?

First, employers should recognize that the Proposed Rule is exactly that: a proposed rule. While we can safely assume that the DOL will ultimately adopt a final rule that will be similar to the Proposed Rule, the exact provisions of the final rule will not be known until it is published later this year. The DOL anticipates that the final new rule will take effect in approximately January 2020, though this date could be delayed. Implementation could also be delayed by litigation, as a number of state attorneys general are expected to challenge the Proposed Rule for setting a salary threshold that they perceive as too low.

Second, employers should be aware that whatever salary threshold the DOL sets under the FLSA, many states impose requirements in excess (and sometimes well in excess) of the FLSA requirements. For example, exempt administrative or executive employees in New York City must receive a salary of at least \$1,125/week (\$58,500/year), with slightly lower levels for small employers or employees working outside of New York City. Similarly, large employers in California must pay exempt employees at least \$49,920/year (and higher in some municipalities). Fortunately for local employers, North Carolina law tracks the FLSA regulations, but employers with multi-state workforces must remain cognizant of the law of each state in which they have employees.

As was the case with the now-rejected 2016 Rule, the Proposed Rule impacts only the salary threshold. No changes have been proposed with respect to the duties requirements for exemption. Thus, many employers will need to make no changes to how their employees are classified and compensated as a result of the Proposed Rule. Only employees who are classified as exempt and who are earning less than the new salary threshold will be affected. We anticipate that the employers that will be most impacted are those in retail, hospitality and food service industries.

In order to assess compliance with the Proposed Rule, employers should first identify all employees who are classified as exempt from overtime and review how those employees are compensated. If any exempt employee is paid a salary that is less than the proposed threshold of \$679 per week, taking into account up to 10% in any permitted non-discretionary incentive pay, adjustments will be required to maintain exempt status.

Options for compliance with regard to these affected employees include: (1) raising their salaries to meet the new threshold, or (2) adjusting their salaries so as to re-allocate pay between the regular rate for non-overtime hours and the overtime rate. Of course, an employer can also choose to make no change to their compensation, re-classifying them as non-exempt and paying them overtime for hours worked in excess of 40 in any workweek once the new rule takes effect. In this scenario, employers may also consider adjusting employees' schedules, re-allocating job duties or hiring additional workers to minimize the payment of overtime to newly non-exempt workers. Employers will also need to ensure that any newly non-exempt employees' hours are tracked and recorded

to comply with the recordkeeping requirements of the FLSA.

A summary of the new rule, Q & A, fact sheets, the language of the Proposed Rule itself and much more is available at:
www.dol.gov/whd/overtime2019.