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Department of Labor Finalizes New Overtime Regulations

DOL Substantially Raises Salary Thresholds Used in Determining Overtime Exemptions but Does Not Change Regulations Defining Duties Required of Exempt Employees

SUMMARY

On May 18, 2016, the Department of Labor released its long-awaited revisions to its overtime regulations. The final rule, which takes effect on December 1, 2016, was the result of a process that began in March 2014 when President Obama issued a directive to the Secretary of Labor to revise existing overtime regulations, with the express purpose of increasing the number of workers who qualify for overtime payments. The Department published a Notice of Proposed Rule-Making in June 2015, which engendered nearly 300,000 comments.¹

The final rule, which spans over 160 pages of rule-making as well as discussion of comments to the earlier Notice of Proposed Rule-Making, includes the following significant changes:

- A substantial increase to salary thresholds for the “white collar” exemptions under the Fair Labor Standards Act (executive, administrative, professional, computer, and outside sales employees) from \$455 per week (\$23,660 per year) to \$913 per week (\$47,476 per year). The new rate was established based on the 40th percentile of weekly earnings of full-time salaried workers in the lowest-wage Census Region, currently the South. The Department estimates that this change will impact 4.2 million white collar workers in fiscal year 2017.²
- Employers may satisfy up to 10 percent of the standard salary requirement with nondiscretionary bonuses, incentive payments, and commissions, provided that these forms of compensation are paid at least quarterly.³
- A significant increase to the salary thresholds for the highly compensated employee exemption from \$100,000 per year to \$134,004. The Department estimates that this change will impact 65,000 workers in fiscal year 2017.⁴

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The minimum salary thresholds for both the “white collar” and highly compensated exemptions will automatically update every three years on January 1 (beginning in 2020) using a fixed percentile of wages. Finally, the Department did not change any of the existing job duty requirements to qualify for exemption (the so-called “duties test”), even though it had requested comments on the same.

BACKGROUND

Employees covered by the Fair Labor Standards Act must receive time-and-a-half pay for all hours worked in excess of 40 in any work week. The Act exempts from overtime eligibility five categories of employees: executive, administrative, professional, computer, and outside sales employees, and also has some other occupationally specific exemptions. To be exempt from overtime requirements, an employee (a) must be paid above a salary threshold and (b) certain of his or her “primary duties” must fall within one of the exemption categories. Employers must classify each of their employees as exempt or non-exempt and treat them accordingly.

THE KEY CHANGES

A. INCREASE IN MINIMUM SALARY LEVEL FOR “WHITE COLLAR” EXEMPTIONS

Under current law, to be exempt as an executive, administrative, professional, computer, or outside sales employee, an employee must be paid on a “salary basis” and earn more than \$455 per week (\$23,660 per year). An employee is considered to be paid on a salary basis if the employee regularly receives a predetermined amount constituting all or part of the employee’s compensation, and the amount is not subject to reduction because of variations in the quality or quantity of the work performed. All employees earning less than the threshold amount must receive overtime pay regardless of their duties.

The final rule retains the salary-basis test but increases the salary threshold to the “40th percentile of earnings of full-time salaried workers in the lowest-wage Census Region (currently the South). This results in a salary level of \$913 per week, or \$47,476 annually for a full-year worker, based on data from the fourth quarter of 2015.”⁵ The Department initially proposed using the 40th percentile of weekly earnings of full-time salaried workers nationally in its Notice of Proposed Rule-Making, but after considering a multitude of comments on that proposal changed to using earnings data from the “lowest-wage region” to correct for regional variations in salary and cost of living.⁶

B. USE OF NONDISCRETIONARY BONUSES

The Department will permit “employers to satisfy up to 10 percent of the standard salary requirement with nondiscretionary bonuses, incentive payments, and commissions, provided these forms of compensation are paid at least quarterly.”⁷ The Department reaffirmed that “it is appropriate to treat commissions like other types of nondiscretionary bonuses and permit them to be used to satisfy a portion of the salary level test” to ensure that “certain ‘registered representatives’ in the securities and financial services industry who receive commissions may qualify for the administrative exemption.”⁸

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The Department also will permit employers to make a catch-up payment within one pay period of the end of the quarter to meet the minimum standard salary level; however, the employer must have already paid the exempt employee at least 90 percent of the standard salary level. “[I]f at the end of the quarter the sum of the salary paid plus the nondiscretionary bonuses and incentive payments (including commissions) paid does not equal the standard salary level for 13 weeks, the employer has one pay period to make up for the shortfall (up to 10 percent of the standard salary level).”⁹

C. INCREASE IN SALARY-BASIS TEST FOR HIGHLY COMPENSATED EMPLOYEES

Current overtime regulations contain a category of “highly compensated employees” for whom the overtime exemption standards are more easily met. An employee is exempt from overtime requirements as highly compensated if the employee earns total annual compensation of \$100,000 or more (which must include at least \$455 per week paid on a salary or fee basis), the employee’s primary duty includes performing office or non-manual work, and the employee regularly meets any one of the standards set forth in the regulations for an executive, administrative, or professional employee. Thus, for example, an employee may qualify as an exempt highly compensated executive if the employee regularly performs one but not all of the exempt duties of an executive.

The final rule increases the total annual compensation required for the highly compensated exemption from \$100,000 to “the annualized weekly earnings of the 90th percentile of full-time salaried workers nationally as proposed (\$134,004 based on the fourth quarter of 2015).”¹⁰ Employers may satisfy the portion of salary between the standard salary level applicable to all employees of \$47,476 and the highly compensated level of \$134,004 with “commissions, nondiscretionary bonuses, and other forms of nondiscretionary deferred compensation (paid at least annually).”¹¹ The Department will continue to allow employers to make an annual catch-up payment for highly compensated employees’ “total annual compensation in excess of the standard salary amount.”¹²

D. AUTOMATIC SALARY THRESHOLD UPDATES

For the first time, the Department has implemented a mechanism to adjust the salary thresholds for overtime-exempt employees. The final rule provides for updates every three years, rather than the annual updating originally proposed.¹³ The standard salary-level test will automatically update every three years to “maintain[] the salary level at the 40th percentile of weekly earnings of full-time salaried workers in the lowest wage Census Region.”¹⁴ And the highly-compensated test will automatically update every three years to maintain “the annualized value of the 90th percentile of the weekly earnings of full-time salaried workers nationwide.”¹⁵ “[T]he Department will publish the updated rates in the Federal Register at least 150 days before their effective date, and post the updated salary and compensation levels on [its] website. The first automatic update will take effect on January 1, 2020.”¹⁶

E. NO MODIFICATION TO DUTIES TESTS

The executive, administrative, and professional exemptions currently provide that an employee will be exempt from overtime so long as his or her “primary duties” fall within the exemption. Thus, for example, a bank branch manager may still be exempt under the administrative exemption even if she does some non-managerial work, so long as her “primary duty” is managerial. In its June 2015 Notice of Proposed Rule-Making, the Department solicited comments on “[w]hat, if any, changes should be made to the duties tests?”¹⁷ The Department also asked whether employees should be “required to spend a minimum amount of time performing work that is their primary duty in order to qualify for exemption,” such as a 50-percent threshold, and whether the Department should modify “the concurrent duties regulation for executive employees.”¹⁸ After reviewing comments, the Department “decided against making any changes to the standard duties test or adding new examples to the regulations at this time.”¹⁹

IMPLICATIONS

Well in advance of the December 1 effective date, employers should review their compensation plans for exempt employees to determine whether the new salary requirements set forth in the final rule will be met. For those employees who are below or close to the new minimum thresholds, employers need to address whether to increase their compensation, or to re-classify those employees from overtime exempt to overtime eligible.

Prior to making that decision, employers may wish to analyze the number of hours worked by employees who are currently exempt but no longer would be under the new salary thresholds. An employer can then decide, from a business perspective, whether to make adjustments, such as, for example, potentially hiring additional employees in order to minimize overtime payments or changing compensation rates for employees.

If formerly exempt employees will be re-classified as non-exempt, there will be a need to review internal procedures for monitoring overtime and to instruct newly re-classified employees on compliance with recordkeeping for overtime hours worked. Employers must comply with recordkeeping requirements under the Fair Labor Standards Act for non-exempt employees. Although the Department has emphasized that employers have “flexibility in designing systems to make sure appropriate records are kept to track overtime hours,” employers must ensure that their “records are complete and accurate as to the number of hours worked each day.”²⁰

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ENDNOTES

- 1 Sullivan & Cromwell LLP represented an organization in drafting a comment submitted by it to the Department's Notice of Proposed Rulemaking, which the Department relied upon in its final regulations.
- 2 Dep't of Labor, Wage & Hour Div., Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees, 81 Fed. Reg. 32391, 32393 (May 23, 2016) (to be codified at 29 C.F.R. pt. 541).
- 3 *Id.*
- 4 *Id.*
- 5 *Id.*
- 6 *Id.* at 32408-09.
- 7 *Id.* at 32391.
- 8 *Id.* at 32426.
- 9 *Id.* at 32427.
- 10 *Id.* at 32429.
- 11 *Id.* at 32427.
- 12 *Id.*
- 13 *Id.* at 32393.
- 14 *Id.* at 32430.
- 15 *Id.*
- 16 *Id.*
- 17 *Id.* at 32444.
- 18 *Id.*
- 19 *Id.*
- 20 Dep't of Labor, Wage & Hour Div., Final Rule: Overtime, Questions and Answers, <https://www.dol.gov/whd/overtime/final2016/faq.htm#G13>.

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