Storm Clouds and Silver Linings for Employers: An Analysis of the DOL’s Final FLSA Part 541 Regulations

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The minimum salary threshold to qualify for the executive, administrative, and professional exemptions to the Fair Labor Standards Act (FLSA) will more than double on December 1, 2016, from $23,660 per year to $47,476 per year. This is the most notable—but not the only—change to the FLSA exemption requirements under the final Part 541 regulations that the U.S. Department of Labor (DOL) released today. Another noteworthy provision in the final Part 541 rule is one to automatically adjust this salary amount every three years beginning on January 1, 2020.

In this article, we analyze the final regulations and compare them to what the DOL’s Wage and Hour Division (WHD) had proposed. As is discussed below, although the final regulations do offer a few silver linings for employers, they still will create a storm of controversy because their implementation will impose significant costs and challenges, particularly in certain market sectors and geographic regions.

New Minimum Salary Threshold of $47,476

Under the final regulations, the new minimum salary for the executive, administrative, and professional exemptions will increase from $455 per week, or $23,660 per year, to $913 per week, or $47,476 per year. This means that employees who do not receive the new minimum salary level when the final regulations become effective on December 1, 2016, will not qualify for any of these three exemptions from the FLSA’s overtime compensation requirements, regardless of their job duties. Nonexempt employees must be paid overtime compensation when they work more than 40 hours in a workweek, and the Obama administration estimates that the new salary threshold will make 4.2 million more employees eligible for overtime compensation if their salaries are not increased to meet the new minimum.

Although this new salary threshold is slightly more than double the current minimum salary level, the new standard actually is lower than the $970 per week figure that had been projected when the DOL’s Wage and Hour Division (WHD) issued its proposed Part 541 regulations in 2015. The WHD had stated in the proposed regulations that it planned to set the new threshold to correspond to the 40th percentile of weekly earnings for full-time salaried workers in the United States based on statistics maintained by the U.S. Bureau of Labor Statistics (BLS). That proposed approach was the subject of much criticism, including the fact that it did not take into account pay differentials among various regions of the country.
When the DOL issued its proposed regulations, the 40\textsuperscript{th} percentile figure for all salaried workers nationally was $921 per week, which equated to $47,892 per year. Notably, the final rule sets the new minimum annual salary at $416 less than this amount. The DOL had anticipated using first quarter 2016 statistics to set the new threshold and had predicted that $970 per week, or $50,440 per year, would be the final number. As we recently reported, the actual first quarter figure for 2016 was $972 per week, or $50,544 per year.

In the final rule, the WHD tied the salary figure to the 40\textsuperscript{th} percentile of all salaried employees in the lowest-wage Census region, which is the South. This was intended to mute criticism that the proposed salary level would render too many bona fide exempt executive, administrative, and professional employees eligible for overtime. However, the bottom line for employers is that it still increases the threshold by more than 100 percent in a single stroke, and it still will be more difficult to implement. Furthermore, while some businesses may be able to adjust to the changes by raising prices, other businesses—particularly many small businesses, retailers and non-profits—will be placed in a particularly challenging situation.

The DOL is implementing a time-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 policy will run from December 1, 2016, to March 17, 2019. While this should provide some relief for this single group of employers, it does not appear that the DOL intends to provide similar carve-outs to other service providers whose income streams are based on Medicaid-funding, grant-funding, or similar sources.

**Timing—Effective Date of December 1, 2016**

The final rule is scheduled to be published in the Federal Register on Monday, May 23, 2016, and to become effective on Thursday, December 1, 2016. The DOL was required to provide at least 60 days between the publication date and the effective date, which would have been an extremely short time period to finalize plans and implement changes following the announcement of the new rule. The December 1 effective date means that employers will have about six and one-half months to make changes, which should make the process more manageable and should be seen as a concession to the needs of a broad spectrum of employers. However, it also represents a rejection of employer requests that such a major leap in the new threshold be phased in over time.

Of particular interest, the new rule will become effective less than one month after the presidential election. Most commentators had anticipated that the DOL would want to establish an effective date that was at least a couple of months prior to the election. In addition, the December 1 effective date is curious in that the final rule also calls for indexing the new salary threshold every three years, starting on January 1, 2020. In light of the January 1 effective date for indexing, the fact that January 1 marks the start of a new calendar quarter, and the reality that a large number of businesses budget and operate on a calendar year, it would have made more sense for the DOL to establish a January 1, 2017, effective date for the final regulations. In addition, December 1, 2016, is a Thursday, whereas January 1, 2017, is a Sunday, and many employers start their workweek on a Sunday or a Monday.

**Inclusion of Bonuses and Incentive Pay When Calculating Salary**
For the first time, employers will be able to use nondiscretionary bonuses and incentive payments (including commissions) to satisfy up to 10 percent of the standard salary level, as long as those payments are made on a quarterly or more frequent basis. The DOL had stated in the proposed regulations that it was considering such a move, and it sought comments as to whether to include such a provision in the final regulations. The fact that the DOL created such a provision, specifically included commissions, and also decided to include payments made on a quarterly or more frequent basis—as opposed to a monthly or more frequent basis—certainly does constitute a silver lining for employers.

From a practical standpoint, employers will need to become comfortable with how this new provision will work. Since it applies to 10 percent of the salary level, this means that up to $91.30 in nondiscretionary bonus and incentive payments per week, or $47,476 in nondiscretionary bonus and incentive payments per year paid no less frequently than on a quarterly basis, can count toward meeting the $47,476 threshold. This also means that even if the employer can make use of the full 10 percent, the employee still will need to receive a salary of at least $821.70 per week, or $42,728.40 per year.

The regulations also allow employers to make a catch-up payment at the end of a quarter to make up any shortfall in the nondiscretionary 10 percent portion of the salary amount. If, by the last pay period of the quarter, the sum of the employee’s actual weekly salary, plus received nondiscretionary bonus, incentive, and commission payments, does not equal $11,869 (i.e., 13 times the weekly minimum of $913); an employer may make one final payment to reach the $11,869 level no later than the next pay period after the end of the quarter. Any such final payment made after the end of the 13-week period may count only toward the prior quarter’s salary amount and not toward the salary amount in the quarter it was paid.

Employers should note that although nondiscretionary bonuses, commissions, and other incentive payments still will count toward the total compensation requirements for the highly compensated employee exemption, they cannot count such payments toward the minimum salary requirements for the highly compensated employee exemption.

**Indexing Every Three Years Starting January 1, 2020**

As was noted previously, the minimum salary threshold for the executive, administrative, and professional exemptions will be indexed every three years, with the first change resulting from indexing to occur on January 1, 2020. The new salary threshold will be indexed to the 40th percentile of all salaried workers in whatever is the lowest-wage Census region. The DOL will post this figure and publish it in the Federal Register at least 150 days prior to the effective date, which means that employers will have approximately five months’ notice of the new minimum salary threshold.

*The White House has stated in a fact sheet* that it expects the new salary level to rise to more than $31,000 per year when the first update occurs in January 1, 2020. If, however, this projection does not take into account the artificial increase in salary levels that will be forced onto employers as a result of the final regulations (i.e., employers will increase some employees’ salaries to meet the new threshold and will convert many of their lower salaried employees to hourly employees, thus removing them from the sample), then the new 40th percentile figure could be much higher than this projection.
In the proposed regulations, the WHD stated that it was planning to index the salary level annually, so the shift to three-year indexing should be of consolation to employers. The WHD also had stated in its proposal that it planned to index the salary level to either the 40th percentile of all salaried employees nationally or else to the Consumer Price Index for all urban consumers (CPI-U). In a recent blog post, we discussed several of the problems associated with indexing, not the least of which will be legal challenges to the DOL’s authority to engage in such a practice. The DOL’s decision to engage in indexing every three years, instead of every one year, may have been made for strategic reasons, as any courtroom efforts to enjoin or invalidate the indexing portion of the final regulations likely could be resolved within three years without affecting the remainder of the regulations.

Total Compensation Requirement for the HCE Exemption Increases to $134,004

In addition to the executive, administrative, and professional exemptions, another exemption in Part 541 is the highly compensated employee (HCE) exemption. Besides meeting a minimal duties test, an HCE’s total annual compensation under the current (i.e., 2004) regulations must be at least $100,000, of which at least $495 per week must be in the form of a salary. Under the final regulations, the new minimum total compensation threshold is $134,004, of which at least $913 per week must be in the form of a salary.

The DOL based the $134,004 figure on the 90th percentile of all salaried employees nationally and did not make any distinctions based on Census region. This is exactly what the DOL had proposed doing in the final regulations. As we reported in an earlier post, the 90th percentile would annualize to $134,004, based on fourth quarter statistics for 2015. However, the 90th percentile figure actually decreased in the first quarter of 2016 and now would annualize to $131,196 using first quarter of 2016 figures. Thus, the new HCE number is arguably inflated.

HCE Total Compensation and Salary Level Indexing

The final rule also indexes the total compensation and salary level requirements for the HCE exemption every three years, consistent with the timing of the indexing of the minimum salary level for the executive, administrative, and professional exemptions. The total compensation level will track the 90th percentile of all employees nationally, and the salary level will be the same as for the other three exemptions. This use of indexing is subject to the same criticisms as we have previously discussed.

No Changes to the Duties Test

The DOL did not make changes to the duties tests for any of the exemptions in the final regulations. In the proposed regulations, the DOL had solicited comments as to whether a percent of time test should have been added into the regulations similar to the test that exists in California. Employers should be pleased that the DOL heeded the comments and did not make any such changes to the duties tests or requirements to qualify for the exemptions.

Next Steps

In conjunction with the release of the final regulations, the DOL has created a final rule webpage, which includes a number of fact sheets and guidance papers. Likely in anticipation of a harsh pushback by certain groups of employers that will be hardest
hit by the dramatic increase in the salary level, the DOL has included specific fact sheets and guidance for non-profit organizations, higher education institutions, and state and local governments.

The final regulations will be published in the Federal Register on Monday, May 23, 2016. A pre-publication of the regulations was made available on May 18, 2016.

Although the final regulations may be subject to challenges in Congress and in the courts, employers should not assume that any of these challenges will result in a delay of the December 1 effective date. Accordingly, employers need to start developing and finalizing their compliance and communications plans now, with implementation occurring no later than December 1.

Ogletree Deakins will continue to cover the final regulations in depth on our Wage and Hour blog in addition to the firm’s Overtime Solutions Center, which includes a variety of resources on the overtime rule and is frequently updated.

For a detailed discussion of the new regulations, join us for a one-hour webinar, “The Final Overtime Regulations: What The New Minimum Salary Requirements Mean for Employers,” on Friday, May 20, 2016, at 2:00 p.m. Eastern. Our speakers, Washington, D.C. shareholder Alfred B. Robinson, Jr. and Greenville, S.C. shareholder Charles E. McDonald III, will explain the new overtime regulations, their impact on employers, and what the future may bring. To register for this timely program, click here.