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U.S. Department of Labor Promulgates Final Overtime Exemption Rule

On September 27, 2019, the U.S. Department of Labor (“DOL”) published its final rule (the “Final Rule”)¹ that raises the earnings threshold to qualify for overtime and minimum wage exemptions under the Fair Labor Standards Act (“FLSA”) to \$684 per week (equivalent to \$35,568 per year for a full-year worker) and allows employers to count nondiscretionary bonuses and incentives to satisfy up to 10 percent of the new earnings threshold, as long as such amounts are paid at least annually.

The new threshold reflects a slight increase from the proposed threshold of \$679 per week or \$35,308 per year in the Notice of Proposed Rulemaking (“NPRM”)² issued in March but is lower than the \$913 per week or \$47,476 threshold in the previous final rule (the “2016 Rule”). The 2016 Rule was implemented during the Obama Administration but was struck down by the U.S. District Court for the Eastern District of Texas, leaving the 2004 regulations (implemented under the Bush Administration) in place.³ The Final Rule, for the first time in 15 years, thus updates the current threshold of \$455 per week or \$23,660 per year (the “2004 Rule”)⁴. In announcing the new rule, the DOL stated that the new thresholds will “make 1.3 million American workers eligible for overtime pay” and “bring[] a commonsense approach that offers consistency and certainty for employers as well as clarity and prosperity for American workers.”⁵ The Final Rule contains four major changes from the current 2004 Rule:

¹ Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees, 84 Fed. Reg. 51230 (Sep. 27, 2019) (to be codified at 29 C.F.R. pt. 541), available at <https://www.govinfo.gov/content/pkg/FR-2019-09-27/pdf/2019-20353.pdf>.

² Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees, 84 Fed. Reg. 10,900 (proposed Mar. 22, 2019) (to be codified at 29 C.F.R. pt. 541), available at <https://www.govinfo.gov/content/pkg/FR-2019-03-22/pdf/2019-04514.pdf>.

³ See *Nevada v. United States Dep’t of Labor*, 275 F. Supp. 3d 795 (E.D. Tex. 2017).

⁴ Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees, 69 Fed. Reg. 22,260, 22,261 (Apr. 23, 2004) (codified at 29 C.F.R. pt. 541), available at <https://www.dol.gov/whd/overtime/regulations.pdf>.

⁵ Department of Labor, *U.S. Department of Labor Issues Final Overtime Rule* (Sep. 24, 2019), available at <https://www.dol.gov/newsroom/releases/whd/whd20190924>.

1. Raising the minimum salary level that certain executive, administrative, professional, outside sales, and computer employees must earn to be exempt from overtime pay to \$684 per week or \$35,568 per year;
2. Raising the minimum annual compensation that “highly compensated employees” must earn to be exempt from overtime pay to \$107,432 per year;
3. Allowing employers to use nondiscretionary bonuses and incentive payments, including commissions, that are paid at least annually to satisfy up to 10 percent of the minimum salary level for white collar employees; and
4. Revising the special salary levels for workers in U.S. territories and in the motion picture industry.

The Final Rule is set to become effective on January 1, 2020.

The FLSA “White Collar Exemption”

The FLSA requires covered employers to pay employees a minimum wage and, for employees who work more than 40 hours in a week, overtime pay at a rate not less than one and half times the regular rate.⁶ Section 213(a)(1) of the FLSA, commonly referred to as the “white collar” exemption, exempts from the minimum wage and overtime pay requirements “any employee employed in a bona fide executive, administrative, or professional capacity” (the “white collar employees”).⁷ The statute grants the Secretary of Labor the authority to “define[] and delimit[]” the definition of such terms by regulations.⁸

Since 1940, the DOL regulations implementing the white collar exemption have required that an employee satisfy each of the following three tests⁹:

1. The employee must 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. The amount of salary paid must meet a minimum specified amount (the “salary level test”); and
3. The employee’s job duties must primarily involve executive, administrative, or professional duties as defined by the regulations (the “duties test”).

⁶ See 29 U.S.C. §§ 206, 207.

⁷ 29 U.S.C. § 213(a)(1).

⁸ *Id.*; see also *Auer v. Robbins*, 519 U.S. 452, 456 (1997).

⁹ 84 Fed. Reg. at 51230.

According to the Final Rule, the DOL “has long used the salary level test”—whether the employee’s amount of salary paid meets a minimum specified amount—to help define the white collar exemption on the basis that “employees paid less than the salary level are unlikely to be bona fide [white collar employees], and, conversely, that nearly all bona fide [white collar employees] are paid at least that much.”¹⁰

Under the Final Rule, employees with a salary below \$684 per week or \$35,568 per year must be paid overtime if they work more than 40 hours a week, which is substantially similar to the threshold in the NPRM. The Final Rule used the same method to arrive at this number that was used to calculate the threshold in the 2004 Rule and NPRM: tying the salary level to the 20th percentile of full-time worker earnings in the lowest-wage census region (which was and remains the South) and/or in the retail sector nationwide.¹¹ The slight difference between the threshold in the Final Rule and the NPRM is due to the DOL’s decision not to inflate the salary level to the rule’s effective date.¹²

Once above this threshold, eligibility for overtime depends on job duties under “duties test,” which is used to help identify employees who are legitimate white-collar employees that are FLSA-exempt. The 2004 Rule provided different multi-factored tests for each of the executive, administrative, professional, computer, and outside sales employees categories.¹³

By way of example, the duties test for two of the most common exempt job categories are as follows: to satisfy the executive employee test, an employee, in addition to meeting the minimum salary threshold, must (1) perform the primary duty of managing the enterprise, or a customarily recognized department of the enterprise; (2) customarily and regularly direct the work of at least two or more other full-time employees; and (3) have the authority to hire or fire other employees or the employee’s suggestions and recommendations as to such decisions must be given particular weight.¹⁴

To satisfy the administrative employee test, the employee’s primary duty must (1) be the performance of office or non-manual work that is directly related to the management or general business operations of the

¹⁰ *Id.*

¹¹ 84 Fed. Reg. at 51,231.

¹² The NPRM proposed to inflate the salary level to January 2020 using the compound annual growth rate in earnings since the 2004 rule in order “to reflect employees’ anticipated compensation at the time the rule would become effective.” The Final Rule sets the salary level using the most recent data available at the time the DOL has drafted the Final Rule, based on the comments by employer representatives, past DOL practices in prior rulemaking, and the DOL’s historical practice of declining to use inflation to adjust the salary level for the exemption. *See* 84 Fed. Reg. at 51,245.

¹³ *See* 69 Fed. Reg. at 22,261–69.

¹⁴ 29 C.F.R. § 541.100; *see also* Department of Labor, *Fact Sheet #17A: Exemption for Executive, Administrative, Professional, Computer & Outside Sales Employees Under the Fair Labor Standards Act (FLSA)*, available at https://www.dol.gov/whd/overtime/fs17a_overview.htm.

employer or the employer's customer; and (2) also include the exercise discretion and independent judgment with respect to matters of significance.¹⁵

Under the duties test, an employee's job duties must be assessed on a case-by-case basis to determine that the employee's primary job duty satisfies at least one of these categories.¹⁶ The regulations defining each of these tests have been further interpreted by case law in different jurisdictions. No changes to the duties test have been made in the Final Rule.¹⁷

The Highly Compensated Employees Exemption

In addition to the white collar exemption, the 2004 Rule provided that an employee whose annual compensation meets the "highly compensated" threshold are exempt if they "customarily and regularly perform at least one of the duties or responsibilities" of an exempt white collar employee identified in the duties test.¹⁸ The duties test under the highly compensated employees exemption is "much less stringent" than that under the standard white collar exemption.¹⁹

The Final Rule also modestly increases the annual compensation required for highly compensated employees to be exempt from overtime requirements from \$100,000 to \$107,432 per year. This threshold is about \$40,000 lower than what the NPRM proposed and about \$26,000 lower than what the Obama Administration had proposed in the 2016 Rule. The Final Rule set the threshold at the 80th percentile of full-time salaried workers nationally, noting that it agreed with the comments that increasing the threshold so dramatically would "result in significant administrative burdens and compliance costs . . . on employers for a limited effect."²⁰

Other Key Elements of Final Rule

The DOL also explained that "in recognition of evolving pay practices,"²¹ the Final Rule allows employers to use nondiscretionary bonuses and incentive payments (including commissions) to satisfy up to 10 percent of the standard salary test requirement as long as they are paid at least annually.²² Such bonuses include,

¹⁵ See 29 C.F.R. § 541.200.

¹⁶ *Id.*

¹⁷ See 84 Fed. Reg. at 51,245.

¹⁸ 84 Fed. Reg. at 51,289.

¹⁹ 84 Fed. Reg. at 51,259.

²⁰ 84 Fed. Reg. at 51,250.

²¹ Department of Labor, *Final Rule: Overtime Update* (Sep. 24, 2019), available at <https://www.dol.gov/whd/overtime2019/>.

²² 84 Fed. Reg. at 51,245.

for example, nondiscretionary incentive bonuses tied to productivity or profitability, *e.g.*, a bonus based on the specified percentage of the profits generated by a business in the prior year. Employers are permitted to make an annual one-time “catch-up” payment at the end of the 52-week period if an employee does not earn enough in nondiscretionary bonuses and incentive payments in a given 52-week period to retain his or her exempt status.²³

The Final Rule additionally establishes certain special minimum salary level of \$455 per week for Puerto Rico, the U.S. Virgin Islands, Guam, and the Commonwealth of the Northern Mariana Islands; a special salary level of \$380 per week for American Samoa; and an updated weekly base rate of \$1,043 per week for the motion picture producing industry.²⁴

Significantly, the Final Rule, like the NPRM,²⁵ eliminates the provision proposed by the Obama Administration for automatic adjustments to the salary threshold, opting instead for a commitment to “update these thresholds more regularly in the future.”²⁶

Guidance for Employers

The Final Rule becomes effective on January 1, 2020, and leaves employers across the country only a few months to comply with its requirements, unless the Final Rule is challenged. Many positions that were previously clearly exempt under the old thresholds will become non-exempt. As discussed above, the DOL estimates that the Final Rule will change the exemption statuses of over one million workers.

Currently, white collar employees making more than \$23,660 are exempt from overtime pay. Under the new rule, the threshold salary for qualifying for the exemption becomes \$35,568. This means that any employees making between \$23,660 and \$35,568 who previously qualified for the exemption are no longer exempt under the new rule, irrespective of their job duties and responsibilities. Similarly, highly compensated employees who previously made between \$100,000 and \$107,432 and were exempt no longer qualify for an exemption.

²³ Department of Labor, *Highlights of the Final Rule on Overtime Eligibility for White Collar Employees*, available at https://www.dol.gov/whd/overtime2019/overtime_FAQ.htm#21.

²⁴ 84 Fed. Reg. at 51,235.

²⁵ The NPRM opted for a commitment to engage in a “periodic review to update the salary threshold” that would “continue to require notice-and-comment rulemaking.” Department of Labor, “Notice of Proposed Rulemaking: Overtime Update,” (Mar. 7, 2019), available at <https://www.dol.gov/whd/overtime/FAQ2019.htm>.

²⁶ 84 Fed. Reg. at 51,231.

As with any such changes to the DOL rules, to prepare for and ensure compliance with the new overtime exemption rules, as we have recommended in the past, employers should consider taking the following actions:

- Audit payrolls to determine which employees and positions that are currently classified as overtime exempt are or may be affected.
- Update payroll and time-tracking systems to take into account impacted employees.
- Determine whether impacted employees should be reclassified as non-exempt or have their salaries raised above the new minimum salary levels (with particular attention to employees that now fall below the highly compensated employee threshold, but who may not have been evaluated based on the duties test in the past).
- Train new non-exempt employees on tracking and recording their time to account for overtime hours.
- Create a plan to clearly communicate and discuss the overtime rule changes with employees.

Finally, because minimum salary and compensation requirements will likely be updated in the future (although not automatically), employers should also consider the following actions to ensure long-term compliance with the new overtime rules:

- Analyze whether a restructuring of the organization is necessary to better accommodate anticipated increases in payroll costs such as consolidating roles or reallocating duties.
- Modify compensation and payroll structures to incorporate the capacity to track and comply with automatic minimum salary level and compensation adjustments.

The Final Rule can be found here: <https://www.govinfo.gov/content/pkg/FR-2019-09-27/pdf/2019-20353.pdf>.

The NPRM can be found here: <https://www.govinfo.gov/content/pkg/FR-2019-03-22/pdf/2019-04514.pdf>.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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