

Exempt or Nonexempt?

New Salary Level Requires
Employers to Revamp
Pay Practices

By LINDSEY A. STRACHAN

On Sept. 24, 2019, the U.S. Department of Labor announced a final rule raising the salary level for white-collar employees to be exempt from the Fair Labor Standards Act's overtime requirements by roughly 33% — from \$23,660 to \$35,568 annually, or from \$455 to \$684 weekly.¹ This means that as of Jan. 1, 2020, administrative, executive, professional, and computer professional employees either needed to receive salary increases to the new minimum salary level to remain exempt or those employees now are considered non-exempt and eligible for overtime pay.

BACKGROUND

Generally, an employee covered by the FLSA must receive overtime pay (time-and-one-half of the regular rate for all hours worked over 40 during a workweek) unless the employee is exempt. To be exempt from the FLSA's overtime requirements, an employee must:

- 1) be paid on a salary basis (a predetermined and fixed salary not subject to reduction due to variation in the quality or quantity of work);
- 2) be paid at the minimum salary level; and
- 3) perform duties exempt in nature.²

The change increases only the salary level threshold for the exemption and does not change the salary basis or duties test.

This marks the first change to the FLSA's salary level since 2004. The Obama administration attempted to raise the salary level more dramatically (to \$47,476 annually, or \$913 weekly) on Dec. 1, 2016,³ but the U.S. District Court for the Eastern District of Texas issued a nationwide injunction, saying the rule exceeded the DOL's authority and was invalid.⁴ Under the Trump administration, the DOL abandoned any efforts to revive the invalidated 2016 final rule and initiated new regulatory review. The result was the 2019 final rule, which formally rescinds the 2016 final rule.

KEY PROVISIONS FOR EMPLOYERS AND EMPLOYEES

Besides raising the minimum salary level to qualify for white-collar exemptions, the final rule also raises the total annual compensation level for highly compensated employees⁵ from \$100,000 to \$107,432 annually, set at the 80th percentile of full-time

salaried workers in 2018,⁶ and requires that highly compensated employees earn at least \$684 per week if the remainder of their total annual compensation includes commissions, nondiscretionary bonuses, and other nondiscretionary compensation.⁷ For white-collar exemptions, the final rule also allows employers to use nondiscretionary bonuses and incentive payments (including commissions), paid at least annually, to satisfy up to 10% of the minimum salary level, and permits employers to make a one-time catch-up payment of up to 10% of the total salary level within one pay period of the end of the 52-week pay period for those employees who have not earned enough to maintain their exempt status. This makeup payment counts toward the previous 52-week salary amount and not for the salary in the year it was paid. Finally, the DOL also asserted in the final rule its intention to update the minimum salary level more regularly through notice-and-comment rulemaking, rather than through automatic increases.

IMPACT ON EMPLOYEES

According to the DOL's News Release for the 2019 final rule, this "update to overtime regulations," the first of its kind "in over 15 years, ... will put overtime pay into the pockets of more than a million working Americans" and helps provide "prosperity for American workers."⁸ Specifically, the increase, calculated to correspond with inflation and the 20th percentile of earnings for full-time salaried workers in the South Census Region, the lowest-wage census region, expands the FLSA's overtime requirements to include 1.3 million more workers. An additional 101,800 workers are entitled to overtime pay as a result of the increase to the highly compensated employee compensation level.⁹ Moreover, an estimated \$298.8 million in annualized income will be transferred from employers to employees in wages because of these DOL changes.¹⁰

Despite these increases and DOL promises, many employee-advocates argue that the final rule was not enough and should have instead at least matched, if not exceeded, the changes proposed under the Obama administration three years ago. According to the Economic Policy Institute, about 8.2 million workers would be left behind by the final rule, assuming 3.1 million workers would have obtained overtime protections under the 2016 final rule, and 5.1 million workers would have obtained strengthened protection

under the 2016 final rule.¹¹ Still, others worry that the final rule will face legal challenges similar to the Obama administration's final rule.¹²

IMPACT ON EMPLOYERS

This change is not without costs to employers. The DOL reported that the total “annualized direct employer costs over the first 10 years [of the final rule] were estimated to be \$173.3 million, assuming a 7% discount rate.”¹³ In calculating this figure, the DOL accounted for the cost to employers to familiarize themselves with the new regulations, the cost to adjust and comply with the final rule, and managerial costs of implementation.¹⁴

Employers affected by the final rule were essentially left with two options to comply:

- 1) maintain the employees' exemption status by raising the salaries of the affected employees to the new salary level of the final rule; or
- 2) reclassify the employees as nonexempt, making them eligible for overtime beginning Jan. 1, 2020. Both options could incur costs to employers.

While increasing salaries may boost the morale of the affected employees and present fewer administrative challenges, it may cause pay compression with the next pay level of exempt employees in the brackets just north of \$35,568. Additionally, those exempt employees who receive a raise in salary to the new minimum level may not see salary increases again for some time even if their performance is exemplary because they will bump into more senior white-collar employees. This may cause a decrease in long-term morale.

Similarly, the reclassification from exempt to nonexempt, while allowing the employee's base salary to remain relatively consistent (through a reduced salary plus overtime, or a new hourly rate plus overtime), requires increased administrative costs through the development and enforcement of time-reporting obligations and overtime policies. Also, employees reclassified from exempt to nonexempt may view the change as a backward career move, which may contribute to decreased morale and productivity. Rightly or wrongly, many

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employees perceive being paid on an hourly basis as being grouped in a less desirable employment category.

IMPACT ON MISCLASSIFICATION LAWSUITS

The impact of the final rule on FLSA lawsuits is yet to be seen. With FLSA cases generally on the rise, including roughly 7,600 cases filed in federal courts in 2018 alone,¹⁵ the final rule's effect on employee classifications will almost certainly have an impact on misclassification cases, in which plaintiffs allege that they were misclassified as exempt from the FLSA's overtime regulations when they should have been nonexempt, and as a result, they are owed unpaid overtime for the hours they worked in excess of 40 in a workweek.

The DOL seems to suggest that its final rule will contribute to a decrease in these cases by clarifying overtime eligibility and offering “con-

sistency and certainty for employers,” which will presumably limit the population of potential misclassification plaintiffs.¹⁶ According to the DOL, “4.1 million employees paid between \$455 and \$684 per week who fail the standard duties test (i.e., that are and will remain nonexempt) will have their overtime eligibility made clearer because their salary will fall below the specified threshold.”¹⁷

Recognizing that the final rule does not change the duties test, though — the test with arguably the most uncertainty in application — the final rule leaves the door open for parties to continue to argue over whether the primary job duties qualify as exempt or nonexempt (particularly for the administrative exemption and lower-level management positions). Because salary level is one of only three tests necessary for determining exemption status, the final rule may have little impact on the quantity of misclassification cases. Also, by raising the salary level for exemption status, higher earning plaintiffs may raise misclassification claims, causing the value and cost of misclassification cases to rise. Time will tell what effect the final rule will have on misclassification lawsuits. Given the monetary impacts on employers and employees, it's worth continuing to monitor. ■

Endnotes

1. U.S. Department of Labor, Wage and Hour Division, *Final Rule: Overtime Update*, available at <https://www.dol.gov/whd/overtime2019/> (accessed 10/15/2019).
2. See 29 U.S.C. § 213(a)(1).
3. See Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Outside Sales and Computer Employees, 81 Fed. Reg. 32,391 (May 23, 2016) (to be codified at 29 C.F.R. § 541), available at <https://www.govinfo.gov/content/pkg/FR-2016-05-23/pdf/2016-11754.pdf> (accessed 10/15/2019).
4. U.S. Department of Labor, Wage and Hour Division, *Fact Sheet: Final Rule to Update the Regulations Defining and Delimiting the Exemptions to Executive, Administrative, and Professional Employees* (Sept. 2019), available at https://www.dol.gov/whd/overtime2019/overtime_FS.pdf (accessed 10/15/2019).
5. “Highly Compensated” employees under the FLSA are employees whose primary duties include performing office or nonmanual work, who customarily and regularly perform at least one exempt duty or responsibility of an exempt executive, administrative, or professional employee (such as directing the work of two or more other employees), and who earn, under the 2019 final rule, annual compensation of at least \$107,432 as a salary or fee. See U.S. Department of Labor, Wage and Hour Division, *Fact Sheet #17H: Highly Compensated Employees and the Part 541 Exemptions Under the Fair Labor Standards Act (FLSA)*, available at https://www.dol.gov/whd/overtime/fs17h_highly_comp.pdf (accessed 10/15/2019).
6. U.S. Department of Labor, Wage and Hour Division, *Highlights of the Final Rule on Overtime Eligibility for White Collar Employees*, “How did the Department determine the new total annual compensation requirement for highly compensated employees (HCEs)?” available at https://www.dol.gov/whd/overtime2019/overtime_FAQ.htm (accessed 10/15/2019).
7. U.S. Department of Labor, Wage and Hour Division, *Highlights of the Final Rule on Overtime Eligibility for White Collar Employees*, “Does the Final Rule change how employers may use bonuses to satisfy the salary level for highly compensated employees (HCEs)?” available at https://www.dol.gov/whd/overtime2019/overtime_FAQ.htm (accessed 10/15/2019).

While increasing salaries may boost the morale of the affected employees and present fewer administrative challenges, it may cause pay compression with the next pay level.

8. U.S. Department of Labor, News Release: *U.S. Department of Labor Issues Final Overtime Rule* (Sept. 24, 2019), available at <https://www.dol.gov/newsroom/releases/whd/whd20190924> (accessed 10/15/2019).
9. U.S. Department of Labor, Wage and Hour Division, *Fact Sheet: Final Rule to Update the Regulations Defining and Delimiting the Exemptions to Executive, Administrative, and Professional Employees* (Sept. 2019), available at https://www.dol.gov/whd/overtime2019/overtime_FS.pdf (accessed 10/15/2019).
10. U.S. Department of Labor, Wage and Hour Division, *Highlights of the Final Rule on Overtime Eligibility for White Collar Employees*, “What are the estimated transfers from the ‘Overtime’ Final Rule?” available at https://www.dol.gov/whd/overtime2019/overtime_FAQ.htm (accessed 10/15/2019).
11. Heidi Shierholz, Economic Policy Institute, *More Than Eight Million Workers Will Be Left Behind by the Trump Overtime Proposal* (Apr. 8, 2019), available at <https://www.epi.org/publication/trump-overtime-proposal-april-update/> (accessed 10/15/2019).
12. As of the date of this article, the 2019 final rule has yet to be legally challenged.
13. U.S. Department of Labor, Wage and Hour Division, *Highlights of the Final Rule on Overtime Eligibility for White Collar Employees*, “What are the costs of the Final Rule?” available at https://www.dol.gov/whd/overtime2019/overtime_FAQ.htm (accessed 10/15/2019).
14. U.S. Department of Labor, Wage and Hour Division, *Highlights of the Final Rule on Overtime Eligibility for White Collar Employees*, “What are the costs of the Final Rule?” available at https://www.dol.gov/whd/overtime2019/overtime_FAQ.htm (accessed 10/15/2019).
15. United States Courts, *Statistics & Reports*, available at <https://www.uscourts.gov/statistics-reports> (accessed 10/15/2019).
16. U.S. Department of Labor, News Release: *U.S. Department of Labor Issues Final Overtime Rule* (Sept. 24, 2019), available at <https://www.dol.gov/newsroom/releases/whd/whd20190924> (accessed 10/15/2019).
17. U.S. Department of Labor, Wage and Hour Division, *Highlights of the Final Rule on Overtime Eligibility for White Collar Employees*, “How many employees does the Department estimate will be impacted by the salary level increases?” available at https://www.dol.gov/whd/overtime2019/overtime_FAQ.htm (accessed 10/15/2019).

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