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June 21, 2016

U.S. Department of Labor Increases Salary Thresholds for Overtime Exempt Employees — Planning Should Begin Now for December 2016 Roll-Out

Effective December 1, 2016, for the "executive," "administrative" and "professional" exemptions, DOL will increase the minimum annual salary threshold from its current level of $23,660, to $47,476 — more than doubling the current minimum.

Employer wage obligations are expected to rise in the United States in 2017, now that the U.S. Department of Labor ("DOL") has announced the implementation date of its new regulatory Rule increasing the minimum salary that must be paid to employees for them to qualify as overtime "exempt" under the federal Fair Labor Standards Act ("FLSA").

Under the FLSA, employees are entitled to overtime pay — typically one and one-half times their regular hourly rate of pay — for all hours worked over 40 in a workweek, unless they are exempt from overtime requirements by virtue of (i) the specific duties required by their jobs (the "duties test")[1] *and* (ii) they are paid an amount, on a salary basis (including earned commissions and certain other non-discretionary payments), that is sufficient to meet FLSA salary threshold requirements established by the DOL (the "salary basis" test).

Effective December 1, 2016, for the "executive," "administrative" and "professional" exemptions,[2] DOL will increase the minimum annual salary threshold from its current level of <u>$23,660</u>, to <u>$47,476</u> — more than doubling the current minimum. For highly compensated employees (who must satisfy only a less stringent "duties" tests), the minimum salary will increase from $100,000 to $134,004. The new Rule mandates periodic future increases in these figures, as well, with DOL estimating the annual minimum threshold in 2020 to be <u>$51,168</u> assuming current wage inflation rates.[3]

Thus, beginning December 1 of this year, exempt employees who earn less than $47,476 per year must either be reclassified as non-exempt and begin receive overtime pay, or have their salaries increased above the new threshold. Failure to do so will expose an employer to the FLSA's costly remedial scheme, which provides for payment of all unpaid overtime wages for up to three years in arrears, which amount is then doubled (as liquidated damages), plus plaintiffs' legal costs and fees, as well as the employer's own costs and fees.[4] There are other important considerations. For instance, FLSA wage cases typically are tried before federal or state courts as collective or class action lawsuits, which generate higher litigation costs, liability risks and settlements than individual litigated claims.[5] Wage laws in some states — notably California and New York — impose longer look-back periods with additional or different remedies, often enabling federal plaintiffs to augment their FLSA claims. And, significantly, employees are more likely than usual to hear about this Rule because DOL is actively promoting awareness of the new salary minimums, and the Rule's merits will be argued in upcoming election campaigns shortly before its implementation date.

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The higher salary thresholds do not necessarily mean that labor costs will immediately and materially increase for all companies. Employers are free to re-classify exempt employees to non-exempt status, making them overtime-eligible, but can then establish and strictly enforce limits on the amount of overtime employees are permitted to work. Appropriate hourly rates can be extrapolated from current salary figures of affected employees (coupled with realistic overtime estimates for such employees) to ensure that those who work the same amount "this year" will receive the same pay as last year. Highly compensated employees can remain exempt even if they do not receive raises to the higher new threshold, so long as their duties — which can be augmented — meet the traditional long-form duties test. Exempt employees whose salaries are already near the new thresholds can be given raises sufficient to push them over the minimums. Restructuring of job titles and job content can result in savings, with lower-paid jobs being created even while some employees are being paid more. Nevertheless, greater upward pressure on overall labor costs is anticipated.

Employers also must take employee reactions and workplace morale into account, especially when crafting announcements that explain the changes. Salaried employees who suddenly are thrust into hourly jobs, with new time-keeping requirements, may feel demoted or demeaned. Salaried middle managers who see rising salaries among their subordinates may become dissatisfied if their pay is not similarly increased. Newly reclassified employees receiving overtime pay for the first time, when their jobs have not substantively changed, could come to suspect that they may have valid wage claims for past unpaid overtime. Company-wide planning is needed in the near-term to account for operational cost increases that could result from the Rule, as well as the impact — psychological and otherwise — on affected employees and entire workforces.

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1 For each exemption, federal regulations impose specific "duties" tests, which have not changed under the new Rule.

2 Along with the "learned professional," "computer professional", and "outside sales" exemptions, these are the most frequently applied of the so-called "white collar" overtime exemptions.

3 Using the same wage inflation assumptions, the 2020 "highly-compensated employee" threshold would increase to $147,524.

4 The new Rule is not retroactive to its December 1, 2016 implementation date.

5 In addition to class/collective lawsuits, violations can surface during enforcement agency investigations conducted by federal or state labor departments, which have the statutory right to conduct employer audits randomly or in response to employee wage complaints. Agencies can bring

their own class/collective lawsuits, on behalf of affected employees, when employers either refuse to cooperate with investigations or do not agree to settle with the agencies on terms providing make-whole relief to employees.

Kirkland & Ellis' Employment & Labor Practice Group is available to discuss the Rule in more detail and help develop appropriate planning strategies. If you have any questions about the matters addressed in this *Kirkland Alert*, please contact the following Kirkland authors or your regular Kirkland contact.

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