

The New DOL Overtime Rule Presents Challenges That Employers Must Address Swiftly

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On September 24, 2019, the U.S. Department of Labor (“DOL”) issued its highly anticipated final rule regarding amendments to the overtime exemption criteria for the administrative, executive, and professional (“EAP”) exemptions under the Fair Labor Standards Act (“FLSA”). As expected, the final rule increases the salary threshold for each of the three exemptions, as well as for the highly compensated exemption. Employers must now act swiftly to prepare for the fast-approaching January 1, 2020, effective date of the new rule. The decisions employers may need to make may not be as simple as they seem at first.

How We Got Here

Seemingly a long time ago—in the fall of 2016—the DOL under the Obama administration published its final rule increasing the salary thresholds for the EAP exemptions, providing for a new threshold that would have more than doubled the minimum annual salary requirement from \$23,660 (\$455 per week) to \$47,476 (\$913 per week). The rule rocked the business community, spurring the Chamber of Commerce and scores of other business advocacy groups to promptly seek to enjoin the enactment of this rule. Of course, the rule was ultimately blocked, to the relief of many employers, sending the Trump Administration’s DOL back to the drawing board.

New (and now former) Secretary of Labor Alexander Acosta quickly previewed his vision for a revised new overtime rule that would still focus on an increase to the salary threshold, but it would likely be an increase that would be less disruptive to the business community.

The New Salary Thresholds

The new rule will increase the salary threshold for the EAP exemptions, but not as much as the 2016 rule would have.

Effective January 1, 2020, the salary threshold for the EAP exemptions will increase from \$23,660 (\$455 per week) to \$35,568 (\$684 per week). This increase is but one of the changes that goes into effect on January 1.

In addition, the total annual compensation requirement for “highly compensated employees,” subject to a minimal duties test, will also increase from \$100,000 to \$107,432.

Employers may use commissions, nondiscretionary bonuses, and other incentive compensation to satisfy up to 10 percent of the salary requirement, provided that these payments occur no less frequently than annually, and subject to a single “catch-up” payment within one pay period of the close of the year.

While the amounts of the new thresholds may be different—thankfully, less than those that nearly went into effect three years ago—the challenges for employers remain the same. As we cautioned in 2016, employers should consider and plan for these challenges again—and soon.

What Employers Should Do Now

At first glance, dealing with this new increase to the minimum salaries for the EAP exemptions would not appear to create much of a challenge for employers, as they must decide whether to increase the salaries of those employees whose earnings are below or on the cusp of the new \$35,568 annual salary threshold to maintain the exemption, or convert those employees to non-exempt status. However, many employers that have already reviewed this issue and its repercussions in 2016 would likely disagree with the assessment that this is a simple task. The decisions not only impact the affected employees but also affect the employers’ budgets and compensation structures, potentially creating unwanted salary compressions or forcing employers to adjust the salaries of other employees.

In addition, converting employees to non-exempt status requires an employer to set new hourly rates for the employees. If that is not done carefully, it could result in the employee receiving an unanticipated increase in compensation—perhaps a huge one—or an unexpected decrease in annual compensation.

Assess the Impact on Compensation Structures

For otherwise exempt employees whose compensation already satisfies the new minimum salary threshold, nothing need be done to comply with the new DOL rule. But that does not mean that those employees will not be affected by the new rule. Employers that raise the salaries of other employees to comply with the new thresholds could create operational or morale issues for those whose salaries are not being adjusted. It is not difficult to conceive of situations where complying with the rule by only addressing the compensation of those who fall below the threshold would result in a lower-level employee leapfrogging over a higher-level employee’s compensation, or where it results in unwanted salary compression. Shifts in salary could also affect any analysis of whether the new compensation structure adversely affects individuals in

protected categories. A female senior manager who is now being paid only several hundred dollars per year more than a lower-level male manager might well raise a concern about gender discrimination if her salary is not also adjusted.

Analyze the Impact of Increasing Salaries

For otherwise exempt employees who currently do not earn enough to satisfy the new minimum salary thresholds, employers have two choices: increase the salary to satisfy the new threshold or convert the employee to non-exempt status. Converting employees to non-exempt status can create challenges in attempting to set their hourly rates (addressed separately below).

If, for example, an otherwise exempt employee currently earns a salary of \$35,000 per year, the employer may have an easy decision to give the employee a raise of at least \$568 to satisfy the new threshold. But many decisions are not so simple, and could result in a slippery slope. What about the employee earning \$30,000? Should that employee be given a raise of more than \$5,000 or should she be converted to non-exempt status? It is not difficult to see how one employer would choose to give an employee a \$5,000 raise while another would choose to convert that employee to non-exempt status.

What if the amount of an increase seems small, but it would have a large impact because of the number of employees affected? A salary increase of \$5,000 for a single employee to meet the new salary threshold may not have a substantial impact upon many employers. But what if the employer would need to give that \$5,000 increase to 500 employees across the country to maintain their exempt status? Suddenly, maintaining the exemption would carry a \$2,500,000 annual price tag, before factoring in other additional costs such as the employer's share of taxes for this increased payroll expense.

Analyze the Impact of Reclassifying an Employee as Non-Exempt

If an employer decides to convert an employee to non-exempt status, it faces a new challenge—setting the employee's hourly rate. Doing that requires much more thought than punching numbers into a calculator.

If the employer “reverse engineers” an hourly rate by just taking the employee's salary and assuming the employee works 52 weeks per year and 40 hours each week, it will result in the employee earning the same amount as before *so long as she does not work any overtime*. The employee will earn *more* than she did before if she works any overtime at all. And if she works a significant amount of overtime, the reclassification to non-exempt status could result in the employee earning significantly more than she earned before as an exempt employee. If she worked 10 hours of overtime a week, she would effectively receive a 37 percent increase in compensation.

But calculating the employee's new hourly rate based on an expectation that she will work more overtime than is realistic would result in the employee earning *less* than she

did before. If, for instance, the employer calculated an hourly rate by assuming that the employee would work 10 hours of overtime each week, and if she worked less than that, she would earn less than she did before—perhaps significantly less. That, of course, could lead to a severe morale issue—or to the unwanted departure of a valued employee.

Review State and Local Laws

Lastly, the new salary thresholds apply to federal law. Many states still have higher thresholds for exempt status—and different criteria—than federal law. Employers must be mindful of more onerous state and local wage-hour laws in making any decisions pertaining to employee compensation.

Epstein Becker Green's *Wage & Hour Guide for Employers* app provides summaries of federal, state, and local laws. (It will be updated shortly to address the new federal thresholds.) Learn more about this complimentary app here: <https://www.ebglaw.com/wage-hour-guide-for-employers-app/>

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