On May 18, 2016, the U.S. Department of Labor ("DOL") issued its final changes to the federal overtime regulations. The final regulations make significant changes to common white collar exemptions from the federal overtime requirements, including those applicable to executive, administrative, and professional employees. Millions of employees who were previously not eligible for overtime will be eligible when the new regulations take effect on December 1, 2016.

Specifically, the final regulations:

1) Increase the minimum salary level required for exemption for salaried workers to $913 per week or $47,476 annually (previously the minimum salary level was $455 per week or $23,660 annually);

2) Increase the minimum total annual compensation for highly compensated employees from $100,000 to $134,004;

3) Amend the salary basis test to allow employers to use nondiscretionary bonuses and incentive payments (including commissions) to satisfy up to 10 percent of the new standard salary level; and

4) Establish a mechanism to automatically update minimum salary and compensation levels every three years, which will be tied to the 40th percentile of full-time salaried workers in the lowest income Census region (the first update will take effect on January 1, 2020).

Importantly, the final regulations do not make changes to the "duties" tests applicable to the exemptions. The DOL had previously requested comments regarding potential changes to the duties tests, but no specific regulatory changes were proposed.

Again, employers must comply with the new regulations by December 1, 2016. The initial increases to the standard salary level (from $455 to $913 per week) and the highly compensated total annual compensation requirement (from $100,000 to $134,004 per year) will be effective on that date.

At first glance, the options available seem straightforward. Employers with a $40,000.00-salary employee working 50 hours a week could either (1) increase the salary by $7,476.00 to reach the threshold, (2) limit the employee to 40 hours per week and assign the work to other employees, which may result in hiring more employees, or (3) pay time-and-a-half overtime pay, which would amount to $15,000.00 per year. Employers who currently pay many employees a salary between $23,660.00 and $47,476.00 will see labor costs substantially increase if these options are the only ones considered.

No doubt, most employers addressing the changes will choose one of these three options to bring their formerly-exempt employees who have been paid between $23,660.00 and $47,475.99 per year into
compliance. However, the FLSA does allow for other creative alternatives for those employers who cannot absorb the increased labor costs the above options would produce or have other reasons to reject these options. The most common alternatives are described and compared below, including the three listed above, plus (4) modifying the employee’s pay by adjusting the salary or hourly rate, (5) paying a salary that compensates for more than 40 hours in a week, or (6) adopting the fluctuating workweek method. The option that works for a particular employer will depend on that employer’s needs and the pay and time worked of its employees.

1) RAISE SALARY TO THRESHOLD

HOW IT WORKS: The employer simply increases the employee’s current salary to the new $47,476.00 annual threshold. Because the new regulations call for the Secretary of Labor to publish a revised threshold every three years based on the 40th percentile of earnings for full-time salaried workers, the salary may have to be adjusted subsequently to satisfy the threshold.

COST INCREASE: For an employee with a $40,000.00 annual salary, the yearly labor cost increase would be $7,476.00 per employee for 2016 with the potential to increase thereafter due to the automatic threshold adjustments.

PROS: The employee will undoubtedly be happy with the salary increase. The position can be maintained as a salaried exempt position without paying overtime pay.

CONS: The labor cost increase is significant for employees with a salary that is not close to the threshold. The proposed automatic threshold escalation may result in a required increase at least every three years.

MAKES SENSE FOR: Employees with salaries already near the $47,476.00 threshold.

2) LIMIT TO FORTY HOURS

HOW IT WORKS: The employee works a set schedule and is prohibited from working over 40 hours. Alternatively, the employee may work overtime only upon receiving proper authorization, which is provided only under limited circumstances.

COST INCREASE: None, if the employee works no overtime.

PROS: The labor costs will not increase unless additional employees must be hired to cover for the reduced hours. The employees’ families will see them more.

CONS: Limiting an employee who used to work more than 40 hours to less than 40 hours will likely require adjusting job responsibilities and/or assigning work to other staff. Depending on the positions and the work performed, it may result in a need for additional staff. Additionally, enforcing a 40-hour limitation can be difficult, but failure to do so may cause liability for unpaid overtime. We recommend implementing a detailed timekeeping policy for salaried employees limited to 40 hours or that impose limitations on their ability to work over 40 hours.

MAKES SENSE FOR: Generally, an absolute overtime prohibition makes sense only for salaried employees who have little need to work over 40 hours. For employees who are allowed to work some limited overtime under a detailed overtime policy, cost increases will be small for the overtime they do work.
3) **PAY SALARY PLUS TIME-AND-A-HALF OVERTIME PAY**

**HOW IT WORKS:** The employee formerly paid only by salary will now receive 1.5 times his salary divided by 40 for every hour of overtime he works. Alternatively, converting the employee to an hourly rate of his former salary divided by 40 accomplishes nearly the same result. The only difference for the hourly employee would be that he would only be paid his actual hours worked and not the full salary if he did not work 40 hours.

**COST INCREASE:** Potentially substantial. The sample employee would receive $15,000.00 in additional pay annually, calculated by the weekly salary divided by 40 times 10 overtime hours for 52 weeks of the year. Employees who work more than 50 hours per week would receive even more.

**PROS:** The employees will be happy. The calculation is easy.

**CONS:** Labor costs will increase substantially depending on the number of employees affected and the number of overtime hours worked.

**MAKES SENSE FOR:** Generous employers with cash to spare.

4) **PAY OVERTIME AT MODIFIED PAY RATE**

**HOW IT WORKS:** The new regulations do not prevent employers from modifying an employee’s pay to avoid significant pay increases. Therefore, employers may either lower the salary of the employee who will now receive overtime or convert him to an hourly rate that results in a similar amount of total pay to that he received before becoming eligible for overtime.

For the sample employee, to maintain annual total pay of $40,000.00 for a salaried employee who works 50 hours per week, the employee’s salary would need to be reduced from $769.23 to $559.60 per week. Likewise, if his rate of pay were converted to $13.99 per hour and he continued to average 50 hours per week while eligible for time-and-a-half overtime pay, he would have an annual pay of $40,000.00.

**COST INCREASE:** Potentially nothing, depending on the calculation and if the hours worked by the employee track previous hours.

**PROS:** Adjusting the pay allows employers to minimize additional labor costs while maintaining the same hours worked for the employee.

**CONS:** Morale. Employees may not like having to work a particular number of hours to receive the same amount of pay they did before. Also, a reduction in workload would cause a pay decline.

**MAKES SENSE FOR:** Employers for when it is absolutely critical to prevent any increased labor costs or to better control the increase in labor costs.

5) **FIXED SALARY FOR GREATER THAN 40 HOURS**

**HOW IT WORKS:** Contrary to popular belief, neither the Fair Labor Standards Act nor its regulations require overtime pay at 1.5 times an employee’s salary divided by 40 for hours worked over 40. The appropriate calculation depends on the number of hours for which the salary was intended to compensate. If the salary is intended to compensate for 40 hours of work, the employee must receive 1.5 his hourly rate for hours worked over 40. If the employer
intends the salary to compensate for a different amount of hours, it can designate in writing that an employee’s salary is intended to compensate for a particular number of hours worked each week and the employee would only be entitled to 0.5 times overtime pay for hours worked over 40 up to that number. The employee would be entitled to 1.5 times the regular rate overtime pay for hours worked over that number.

For the sample employee, if he kept the same salary and the employer designated that his salary was to compensate for 50 hours, he would receive overtime pay at a 0.5 rate for time worked between 40 and 50 hours. The rate would be calculated by dividing his weekly salary of $769.23 by 50 hours, which would yield an overtime rate of $7.69 for each hour between 40 and 50. If he worked over 50 hours, he would receive pay for each hour at 1.5 times his regular rate, which would be $23.07.

COST INCREASE: If the employee worked 50 hours each week with his salary compensating him for 50 hours, he would receive an additional $76.90 each week which would amount to just short of $4,000.00 per year. This amount would be larger if he ever worked more than 50 hours because he would then receive time-and-a-half pay.

PROS: Allows employers to maintain an employee’s current salary without the substantial increased costs which would occur through time-and-a-half pay.

CONS: Increases labor costs, albeit at a lower amount than time-and-a-half pay. Does not make sense for employees who may often work over the amount of hours the salary is intended to compensate.

MAKES SENSE FOR: Employers who want to maintain an employee’s salary with limited increased labor costs and whose employees work a fairly steady schedule.

6) FLUCTUATING WORKWEEK METHOD

HOW IT WORKS: Under the fluctuating workweek method, employees must receive at least 0.5 times their regular rate of pay for the week (calculated by dividing their weekly salary by the total hours worked for the week) for any time worked over 40 hours. The regular rate of pay for the week will vary based on the number of hours worked. To utilize this method, employees’ weekly hours should actually fluctuate to some extent. Before implementing the fluctuating workweek method, employers should have a written understanding with each employee. Employers should consult with legal counsel before implementing the fluctuating workweek method to ensure the method is applied correctly and that it is appropriate for the employees covered.

COST INCREASE: For the sample employee, the additional costs would be similar to method 5 above except that if the employee exceeded 50 hours per week, the employer would still only need to pay 0.5 times the regular rate of pay for the week.

PROS: The cost increase for this method is less than any of the other methods (other than adjusting salary or limiting to 40 hours per week).

CONS: The method is more difficult to calculate and more difficult for the employees to understand. The method requires careful attention to ensure it is appropriate for the covered employees and that it is applied correctly.
MAKES SENSE FOR: Employers willing to undertake the administrative burden and whose employees’ hours actually fluctuate to some extent from week to week.

Now that the final regulations have been published and will go into effect December 1, 2016, employers should carefully analyze their employees’ pay and the most effective and appropriate method for complying with the new requirements. One available option includes an attorney-client privileged FLSA audit and pay analysis to discuss the exempt status and pay options for employees covered by the proposed regulation. Burr & Forman attorneys have already begun conducting these audits. Should you desire such an audit or have any other questions, please contact the Burr & Forman attorney with whom you normally work.

If you would like more information, please contact:

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