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Helping AD Distributors Prepare for The Upcoming Overtime Rule Changes

September 1, 2016

Presented by:

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Overview

- The FLSA "white collar" exemption regulations were last revised in 2004; new regulations will become effective December 1, 2016.

- The revised regulations will require employers to reclassify an expected 4.2 million exempt employees as non-exempt.

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Background – FLSA Overtime Exemptions

- The FLSA requires that covered employees be paid a minimum wage and overtime at a rate not less than 1.5 times their regular rate of pay for all hours worked over 40.

- To be exempt from overtime requirements, most employees must (1) be paid a predetermined minimum weekly salary at a certain level and (2) primarily perform certain job duties qualifying for the executive, professional or administrative “white collar” exemptions, or another less common exemption.

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Executive Exemption

- *The Test:*
  - Primary duty is management of an enterprise or subdivision;
  - Regularly directs two or more employees therein;
  - Has authority to hire and fire, etc., or whose suggestions on these topics are given particular weight.
  - <u>Examples</u>: CEO, Warehouse Manager, Assistant or Department Manager (maybe)

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Administrative Exemption

- *The Test*:
  - Primary duty is the performance of office or non-manual work directly related to the management of general business operations of the employer or the employer’s customer;
  - Primary duty requires the exercise of discretion and independent judgment with respect to matters of significance.
  - <u>Examples</u>: HR Professional; Office Manager (maybe)

Professional Exemption

- *The Test:* Primary Duties are Either:
  - Work requiring knowledge of advanced type in field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction ("Learned Professionals"), or
  - Work requiring invention, imagination, originality or talent in a recognized field of artistic or creative endeavor ("Creative Professionals").
  - <u>Examples</u>: Accountant (CPA), Engineer

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Inside Sales "Exemption"

- No "Inside Sales" Exemption, But "Retail Sales" Exemption May Apply
- Requirements:
  - Must Be a "Retail or Service Establishment" (Tricky) – More than 75% of Annual Dollar Value of Sales of Goods or Services is Not for Resale
    - Not for companies selling primarily to contractors
  - Rate of Pay Greater Than 1.5x Minimum Wage
  - >1/2 Employee's Total Earnings From Commissions
- No salary requirement, so new rule has no impact!

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Outside Sales Exemption

- Primary Duty is Making Sales or Obtaining Orders; and
- Is Customarily and Regularly Engaged in Performing Duties Away from Employer's Place of Business.
- No minimum salary requirement. Therefore, no change with new rule!

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Highly-Compensated Employees

- Employee earns total annual *compensation* (not just salary) of $100,000 or more (2004 revisions);
- Employee's primary duty includes performing office or non-manual work; and
- Employee customarily performs *at least one* (but not all) of the exempt duties and responsibilities of an exempt executive, administrative or professional employee.
- Examples: head of sales, department head

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Salary Basis Test

- Now (2004 Revisions)
  - Exempt employees must be paid on a salary basis of at least $455 per week ($23,660 per year)
  - Thus, usually not a factor in the exemption analysis.
- Effective December 1, 2016 (Final Rule)
  - Minimum salary more than doubles. Exempt employees must be paid **$913 per week** ($47,476 per year).

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Litigation Consequences of Misclassification / Failure to Pay Overtime

- Recent increase in individual and collective action litigation in which employees claim they were wrongfully classified as exempt and seek wages for overtime hours worked
  - 2004: 3,606 FLSA cases filed
  - 2013: 7,904 cases
  - 2014: 8,086 cases
  - 2015: 8,954 cases

Litigation Consequences of Misclassification / Failure to Pay Overtime

- FLSA is a fee-shifting statute – i.e., employers must pay the attorney's fees of prevailing employees
- Liquidated (double) damages
- 2 Year statute of limitations (3 years if violation is "willful")

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Timeline of the Final Rule

March 23, 2014: President Obama issues a Presidential Memorandum to the Secretary of Labor directing revisions to the exemption regulations.

July 6, 2015: The DOL publishes a "Proposed Rule" in the Federal Register. The DOL thereafter accepts public comments on the "Proposed Rule," and begins drafting the "Final Rule."

May 18, 2016: The DOL announces publication of the "Final Rule," which will become effective December 1, 2016.

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The Final Rule

Increase in Salary Basis Requirement

- Minimum weekly salary increased from $455 to $913 ($23,660 to $47,476 annually);
- Minimum weekly salary will adjust automatically every three years to a rate equaling the 40th percentile of full-time salaried workers in the nation’s lowest-wage Census region (currently the South);
- Minimum salary adjustments under the Final Rule will be published at least 150 days before their effective dates, with the first adjustment being effective January 2020.

The Final Rule

Increase in Compensation Requirement for Highly Compensated Employees

- Minimum annual compensation increased from $100,000 to $134,004;
- This minimum annual compensation also will adjust automatically every three years to an amount equal to the 90th percentile of full-time salaried employees nationally.

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The Final Rule

<u>Non-discretionary Bonuses, Incentive Payments and Commissions</u>

- Employers now may use *non-discretionary* bonuses, incentive pay and commissions to satisfy up to 10% of the new salary minimum, provided they are paid on at least a quarterly basis. Therefore, an employer can pay **$822 per week** in salary, plus a non-discretionary bonus.
- Employers will be able to "catch-up" quarterly the salary of any exempt employee who falls short of the minimum.
- <u>Example</u>: Employee receives a salary of $825 per week (below $913 threshold) and, *on average over a quarter*, gets commissions of *at least* $88 per week.

The Final Rule

Duties Tests

- No changes to “duties test.”
- The DOL determined that no changes in the duties tests were necessary, on the basis that the salary/compensation increases alone were likely sufficient to address concerns about exempt employees performing non-exempt work.

Steps to Ensure Compliance

Review Salary Minimums

- For currently-exempt employees who fall below minimum salary threshold, employers may raise their salaries **or** reclassify as non-exempt and ensure they are paid both the applicable minimum wage and overtime.

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Steps to Ensure Compliance

Review Criteria for Establishing Exempt Status

- Employers may use the Final Rule as an opportunity to review the exemption classifications of all exempt positions to ensure compliance with FLSA standards.

- Employers can expect DOL enforcement initiatives in 2017 and beyond to focus on exemption status.

Steps to Ensure Compliance

Provide Education and Training to Key Employees

- Employers should consider investing in education and training of front-line managers and HR representatives tasked with implement new exemption standards.

- Employers should consider development of a communication strategy and action plan for reclassification of affected employees.

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Examples of Likely Impacted Positions

- Administrative Professionals
  - A variety of positions falling within the administrative exemption – e.g., HR professionals, office managers, and other administrative employees – will in many cases no longer meet the salary basis test.
- Lower Level Managers
  - Low or mid-level manager positions – e.g., assistant or department managers

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Impact

- Recordkeeping Requirements

  - Every covered employer must keep records for each non-exempt worker, including but not limited to the hours worked each day; the time and day of the week when the employee's workweek begins; total hours worked each workweek; regular hourly pay; total daily or weekly straight-time earnings; and total overtime earnings.

  - To the extent an employer decides to reclassify employees as non-exempt in response to the Final Rule, it must also have the logistical ability to track time and keep required records.

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Impact

- Flexibility
  - The benefit in classifying an employee as exempt is that the employer has flexibility to use the employee for different work items at fixed cost.
  - Hourly non-exempt employees are “on-the-clock” whenever engaging in work. Therefore, time in which they engage in work activities such as checking emails or correcting documents is compensable time.
  - Telecommuting and flexible hours more difficult.

Impact

- Labor Costs
  - Nothing in the Final Rule prevents an employer from reclassifying an employee to non-exempt and then setting his or her hourly rate such that, with expected overtime, the employee's total annual compensation is unchanged.
  - However, as a practical matter, this adjustment may be difficult where the amount of overtime each week is unpredictable or varies greatly.

Impact

- <u>Bonuses for Non-Exempt Employees</u>
  - Non-discretionary bonuses must be included within the "regular rate of pay" for non-exempt employees. *Example*: Employee works 40 hours per week and receives $10/hour straight pay and $100 weekly non-discretionary bonus. The employee's "regular rate" is $12.50 / hour (not $10) and thus OT rate is $18.75 / hour (not $15).
  - May present logistical difficulties if there is need to reclassify as non-exempt employees who customarily receive bonuses as a form of compensation.

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Impact

- Morale Issues
  - Moving to non-exempt classification and requiring employees to record hours worked may impact how they view themselves.

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Recommendations Summary

- Make Decisions Prior to 12/1 – Can (1) reclassify, (2) increase pay rate, or (3) move duties
- Messaging – Develop an effective communications strategy and train on how to deliver
- Consider Wider Audit – Now is a good opportunity to look at other positions
- Build Out Infrastructure – More non-exempt employees means more recordkeeping, monitoring and management

QUESTIONS?