

INSIGHTS

USDOL's Final Salary Regulations: Impact on Exempt Employees and the Possibility of Future Litigation

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On September 24, 2019, the U.S. Department of Labor (“USDOL”) announced its new [Final Overtime Rule](#). The 2019 Final Rule comes in the wake of the heavily litigated salary threshold regulations issued by the Obama Administration in 2016. The Obama Administration’s 2016 Final Rule was declared invalid by a federal court in Texas in a major victory for business groups. Formally rescinding the 2016 Final Rule, the 2019 Final Rule establishes more modest salary threshold increases which impact the Fair Labor Standard Act’s Highly Compensated Employee (“HCE”) and Executive, Administrative and Professional (“EAP”) exemptions to minimum wage and overtime pay. In addition to setting the new salary threshold for the EAP exemptions at \$684 per week (\$35,568.00 annually) and HCEs at \$107,432.00 annually, the 2019 Final Rule allows greater flexibility for employers to meet the EAP exemptions’ salary threshold. The 2019 Final Rule’s new regulations are scheduled to take effect on January 1, 2020.

Raising the EAP Exemptions’ “Standard Salary Level”

In order to qualify for the EAP exemptions, an employee must meet three basic requirements: (1) perform work that primarily involves executive, administrative, or professional duties as defined in USDOL regulations, (2) be paid on a “salary basis,” (3) and receive a minimum salary amount (the “standard salary level”). In 2004, the USDOL published new regulations, setting the standard salary level at \$455 per week. The 2019 Final Rule increases that standard salary level to \$684 per week (\$35,568 per year), an increase of \$229 per week. To create the new standard salary level in 2019, the USDOL returned to the same methodology it applied in 2004 – considering the 20th percentile of earnings of full-time salaried workers in the southern census region (the lowest wage-earning region) and the retail sector nationwide.

Nondiscretionary Bonuses and Incentives Count Towards the EAP Exemptions’ Salary Threshold

In a significant retreat from its stringent application of the “salaried basis” prong of the EAP exemptions, the 2019 Final Rule allows employers to consider nondiscretionary bonuses and incentive payments received by the employee towards the annual standard salary level for the EAP exemptions. Under the 2004 regulations and earlier iterations, the USDOL did not allow employers to consider these additional payments in meeting the minimum salary threshold for the EAP exemptions. The 2019 Final Rule permits employers claiming the EAP exemptions to cover up to 10% of the standard salary level through these additional payments.

The 2019 Final Rule also permits a limited “catch up” payment to meet the EAP exemptions. If, after one year of wages and nondiscretionary bonuses, an employee’s earnings fall below the standard salary level, an employer may make a single “catch-up” payment to meet the exemption threshold. “Catch-up” payments may equal up to 10% of the standard salary level. Significantly, if an employer does not use a catch-up payment to obtain the exemption, or if the necessary “catch-up” payment exceeds the 10% limit, the exemption is lost and the employee will be owed overtime for any overtime hours worked during the preceding 52 weeks.

As a result of these 10% limitations, employers should be particularly thoughtful in relying upon the “catch-up” provision as well as nondiscretionary bonus and incentive payment to meet the salary threshold requirements.

Raising the HCE Exemption’s Annual Compensation Level

The USDOL also raised the annual compensation level required to meet the HCE exemption from \$100,000 to \$107,432 per year. Like the 2004 regulations, which created the \$100,000 per year level, the 2019 Final Rule established the annual compensation level by calculating the earnings of the 80th percentile of full-time salaried workers nationwide.

The 2019 Final Rule makes no changes to how bonuses and incentive payments factor into the HCE exemption. Employees must receive the standard salary level (now \$684 per week) on a salary or fee basis, and the remainder of the annual compensation may be provided through salary, commission, nondiscretionary bonuses, or other forms of incentive payment.

Conclusion

Given the fast-approaching implementation date of the 2019 Final Rule (January 1, 2020), prudent employers should begin considering their approach to the new salary levels immediately. Workers who are now properly classified as exempt under the EAP exemptions that fall below the new salary thresholds should be reclassified as non-exempt, absent an increase in salary to the new thresholds (and/or an assessment of how new and existing nondiscretionary bonuses and incentive payments impact the worker’s earnings). Additionally, some workers who were previously classified as HCE exempt may lose that exemption under the new \$107,432 per year threshold. While such workers may still be exempt under one of the EAP exemptions, if the executive, administrative or professional exemption requirements cannot be met, they should also be treated as non-exempt absent an increase in salary.

Under the 2019 Final Rule, the USDOL estimates that approximately 1.2 million workers nationwide previously qualifying for the EAP exemptions and 101,800 workers previously qualifying for the HCE exemption will become eligible for overtime pay unless their employers choose to raise salary levels or nondiscretionary compensation in order to maintain the exemptions. The number of employees affected by the 2019 Final Rule constitutes a dramatic decrease compared to the many millions potentially affected by the now rescinded 2016 Final Rule. Employee advocates have called the regulations a “gift to corporate America” and some predict yet another court challenge.

Employers should view the USDOL’s 2019 Final Rule as a positive development, given its modest increases in salary levels compared to the 2016 Final Rule.¹ Of course, this Final Rule is not the last word and employers need to keep track of USDOL overtime developments moving forward. In announcing the 2019 Final Rule, the Department indicated that it did not intend to

let another fourteen years pass before revising the salary level standards again. As explained by the USDOL, large gaps in time between rules lead to large jumps in salary levels when regulations are finally enacted. While the USDOL considered committing itself to updates once every four years in its Notice of Proposed Rulemaking, the USDOL omitted this proposal from the 2019 Final Rule.

Finally, employers should also keep abreast of developments in state and local laws regulating minimum wage and overtime pay. The USDOL's 2019 Final Rule only establishes federal minimums, and states are permitted to set standards that are more favorable to workers. For example, California law requires that exempt employees be paid a monthly salary equal to all least two times California's minimum wage for full-time employment. As of January 1, 2020, the State's minimum wage for employers with 26 or more employees will rise to \$13.00 per hour, meaning that exempt employees will need to receive a monthly salary that is equivalent to \$54,080 per year.

¹ In another significant development on the concept of "salaried status," the Fifth Circuit recently held that employees paid a high day rate met the salary basis test for the HCE exemption in *Faludi v. U.S. Shale Solutions, L.L.C.*, No. 17-20808 (Aug. 21, 2019). In that decision, an employee who received at least \$1,000 per day worked was found to be paid on a salary basis because he would meet the minimum weekly salary amount (\$455 per week) for any week in which he performed work. With this *Faludi* decision, the Fifth Circuit joined the First and Second Circuits, who have issued similar holding for HCEs. The Sixth Circuit and other courts have issued contrary decisions, and employers should be aware of this circuit split as it progresses.