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PERSPECTIVE

## New federal overtime rules set to take effect in December

By David Harris and Yvette Davis

Starting next month, millions of additional American workers will be entitled to overtime pay. Why? Because Dec. 1, 2016, is the effective date of changes to 29 CFR 541, which were enacted in May by the U.S. Department of Labor (DOL). The new rules doubled the minimum annual compensation requirements for classifying executive, administrative and professional (EAP) salaried employees as exempt from overtime pay. This is the first time in 12 years that the DOL changed the EAP salary threshold. The new rules will result in larger checks for many American workers.

Important questions result: How will these rules impact California employers? Did the Federal government go far enough? And what makes an employee exempt from overtime in the first place?

*What makes an employee exempt from overtime?* Contrary to conventional wisdom, salaried employees are not automatically exempt from receiving overtime pay. Salaried employees, are in fact, entitled to overtime any time they work more than 40 hours in any work week, unless they fit into a narrow category of exemptions (i.e., executive, administrative or professional.)

*Federal salary threshold for exempt salaried employees to double.* The existing federal salary threshold was set 12 years ago and has not been changed since that time. The prior threshold was vastly outdated and had not kept up with inflation and general changes in the labor market. Therefore, the system was widely seen as unfair as it allowed employers in many cases to correctly classify lower paid workers as “exempt.” Ironically, these employees, who were managers, ended up receiving a lower salary than the employees they supervised. After a lengthy public comment period, the DOL agreed to double the salary threshold, and in-

stitute automatic adjustments that are intended to keep up with inflation. The new salary threshold is \$47,476 per year (\$913 weekly), an increase from \$23,660 annually or \$455 weekly.

*How does the federal change affect California employers?* In the short term, the new rules will have a limited impact on California employers. California employers will not see a huge number of new employees suddenly eligible for overtime because California maintains its own rules for determining overtime exemptions. The California rules were broader than the previous federal rules such that more employees were entitled to overtime. Under California’s rules, employees are exempt from overtime only if they earn twice the state’s minimum wage and meet a strict “duties test.” The state’s current minimum wage is \$10 per hour. Therefore, the state’s threshold is \$800 per week or \$41,600 per year. California’s threshold was substantially more than the previous federal threshold, but is about \$6,000 below the new Federal threshold. Accordingly, a small group of California employees will now be entitled to overtime.

However, this group will increase as California increases the state’s minimum wage. The state’s minimum wage is set to increase to \$10.50 per hour on Jan. 1, 2017, which will increase the salary threshold in California for exempt status to \$43,680. By 2019, California’s minimum wage will reach \$12 per hour and once again, California’s salary threshold will exceed the federal threshold. Until that time, however, employers can safely rely on the federal standard for guidance when classifying exempt and nonexempt employees.

*Nondiscretionary bonuses and highly compensated employees.* Additional changes made by the DOL should also be noted even though they will have limited impact on California’s employees. The first, is the DOL’s decision to allow 10 per-

cent of a nondiscretionary bonus to be used to determine an employee’s threshold salary. California does not permit employers to include nondiscretionary bonuses in computing an employee’s threshold salary.

The new federal rules also affect the thresholds for highly compensated employees (HCE). The current salary threshold for HCEs is \$100,000. Under the new rules, an HCE will be defined as an employee who earns more than \$134,004 per year. California does not recognize the HCE exemption. Accordingly, unless the California employee is deemed to be exempt under California’s “primary duty” rule, a California HCE will still be entitled to overtime even if he or she earns more than the \$134,004 threshold!

*Will California experience a change in the number of nonexempt employees?* While the new federal rules are long overdue, the impact on California’s employers will be relatively small. Simply put, existing California law was well ahead of the federal rules, and the salary threshold in this state was already in line with inflation. The increase in the federal minimum threshold will result in the reclassification of a group of formerly exempt employees. How large this group will be is unknown, but it will certainly be substantially less than in other states that only followed the federal rules. Still, if a currently exempt EAP employee’s salary is close to the new threshold, it may make sense to consider raising the employee’s salary to maintain the employee’s exempt status. A review of how an employer classifies its employees should also be reviewed regardless of whether salary increases are implemented.

*Did the rules go far enough?* The DOL’s FLSA overtime rules were established to ensure that most American workers would be entitled to overtime if they worked more than a 40 hour work week. Because the DOL’s description of the job duties

that qualified an employee for an exemption (executive, administrative and professional) was broad, and a salary threshold was far out of date, a large number of lower paid workers did not qualify for overtime.

While the federal government did not agree to tighten the rules on what job duties fell within the EAP exemptions, it did take an important step forward by substantially raising the minimum threshold salary. Even though some may argue that the revised threshold is still inadequate, the increased threshold is certainly a substantial step forward and will allow a greater number of workers to enjoy wage equity with their nonexempt peers. Whether the DOL will take steps to tighten up the EAP duty test rules or even adopt California’s “primary duty” rule remains to be seen in the coming years. Adopting California’s duty test, will likely limit the number of employees who are incorrectly classified as “exempt” simply because they, on the surface, meet the EAP duty tests.

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