FLSA Playbook: The Trick Play

Oct 11 2016

Practice Area: School Law

On May 18, 2016, the Department of Labor announced publication of its Final Rule updating the FLSA overtime regulations. In revising its rules, the DOL has updated the salary level required for exemption in an attempt to simplify and modernize the rules so they are easier for employers to understand and apply.

Key Provisions of the Final Rule

1. Increases the Standard Salary Level.
The primary focus of the rule is updating the salary and compensation levels needed for the executive, administrative, and professional exemption categories. The Final Rule raises the salary threshold indicating eligibility from $455/week to **$913/week** or **$47,476** per year. The Rule sets the standard salary level at the 40th percentile of earnings of full-time salaried workers in the lowest-wage Census Region (which is currently the South).

The Rule also sets the total annual compensation requirement for highly compensated employees ("HCE") subject to a minimal duties test to the annual equivalent of the 90th percentile of full-time salaried workers nationally, which is $134,004.

Importantly for school districts, as under the former regulations, certain occupations that meet the definition of being a professional, such as teachers, doctors and lawyers, have no minimum salary requirement. This means teachers and some academic administrative personnel may continue to be classified as exempt even if their salary does not exceed $47,476 per year.

2. Automatic Updates.
The Rule provides for automatic updates to the salary threshold every three years to maintain the levels at a threshold equal to the 40th percentile of weekly earnings of full-time salaried workers in the lowest-wage Census Region. The stated goal of the DOL is that the automatic updates provide predictability and more graduated salary changes for employers.

3. Nondiscretionary Bonuses and Incentive Payments Included in Salary.
Employers may now include nondiscretionary bonuses and incentive payments to satisfy up to 10% of the new standard salary basis. Such payments may include nondiscretionary incentive bonuses tied to productivity and profitability and commissions. For employers to credit nondiscretionary bonuses and incentive payments toward a portion of the standard salary level test, the Final Rule requires such payments to be paid on a quarterly or more frequent basis and permits the employer to make a "catch-up" payment.

Note that the DOL does not permit employers to use nondiscretionary bonuses and incentive payments to satisfy the standard salary amount for HCEs because employers are already permitted to fulfill almost two-thirds of the total annual compensation requirement with commissions, nondiscretionary bonuses, and other forms of nondiscretionary deferred compensation.

Effective Date
The effective date of the Final Rule is December 1, 2016. Future automatic updates will occur every three years, beginning on January 1, 2020.

Duties Tests
As anticipated, the Final Rule did not change any of the existing job duty requirements to qualify for exemption.

Strategies for Responding to the New Rule

If you have yet to act, the time is **now**.

1. Identification of Employees Who Fail to Meet the New Salary Basis Test.
First, school districts should identify employees designated as exempt who fail to meet the new, increased salary basis test of $913/week or $47,476 annually. For those exempt employees who do not meet the salary basis test, an employer should either: (1) convert the employee to a nonexempt employee and pay time and one-half for overtime work; or (2) raise the employees' salaries above the new threshold to satisfy the salary basis test of the exemption.

School districts must be cautious that the increased salary level will likely wipe out exempt positions offered on a part-time basis, which were still possible at the former $455/week level.

2. Identify Cost Savings Strategies.
To reduce costs, a school district may elect to limit an employee who loses his/her exemption status to no more than 40 hours per week to avoid paying the premium overtime rate from hours worked beyond 40 in the workweek.

a. Workload Adjustments
One way school districts can adjust workloads is to consider reassigning and transfer job duties amongst nonexempt employees, as some nonexempt employees may have the ability to take on additional tasks and still work 40 or fewer hours in a workweek. Alternatively, it might be more cost effective to hire additional part-time employees and assign them any excess work so as to avoid paying out overtime to nonexempt employees.

b. Adjustments to Wages to Account for Overtime Expense
School districts may need to consider lowering employee hourly pay to offset the impact of the overtime requirement for employees who are reclassified as nonexempt. Because school districts will now be required to pay premium overtime for all hours worked over 40 in the workweek, an employee's wages may need to be lowered to take into account the higher rate that will be paid for those hours worked over 40 in a workweek. If school districts choose to take this approach, they should thoroughly explain to employees that, despite the optics of the change in hourly pay, employees will still be compensated roughly the same amount as before due to the overtime compensation they will now be receiving.

c. Fluctuating Workweek
A school district could consider, after careful analysis in consultation with legal counsel, utilizing some of the lesser known tools of the FLSA such as the fluctuating workweek method to reign in increases in overtime costs. The fluctuating workweek method allows an employer to only have to pay an overtime premium equal to "one-half of the regular rate" for hours worked in excess of 40 in the workweek.

d. Salary Increase in Exchange for Benefit Reduction
Another option school districts might consider is increasing compensation for previously exempt employees who will now be significantly below the new salary level in return for a less generous benefit package in an effort to maintain exempt status of those employees while staying within the parameters of the school district's budget. However, school districts should strongly consider the costs and benefits of such a maneuver, as employee morale may suffer from a reduction in benefit offerings.

e. Limitation on Hours
Because the salary requirements are looked at on either a weekly or monthly basis, only the weeks worked must meet the salary level requirement. As such, an employee who works only 10 months (approximately 44 weeks) per year need only be paid $40,172 ($913/week x 44 weeks) for the 10 months worked. However, a school district must ensure the employee does not work any additional days outside the 10-month period, or else the district will be required to pay the employee $913 for any week in which work is performed.

3. Assess the Impact of Change
School districts must keep in mind that maintaining historical distinctions in pay grades or ranges, ensuring you remain competitive in the marketplace, balancing the new level of pay with expectations for performance, as well as understanding the employee's perspective of what it means to be salaried versus hourly, are all important considerations in payroll and personnel practices. School districts should be aware of the potential for reclassification to result in salary compression between exempt and nonexempt employee categories that may deter employees from advancement into exempt, supervisory positions. That is, if a nonexempt employee can earn overtime which sufficiently increases the employee's salary to the same level as a supervisory employee, the employee may be deterred from advancement due to the higher earning potential as a nonexempt employee.

A review of all employee job descriptions should be conducted to ensure those employees who are classified as exempt and who exceed the salary threshold continue to meet the primary duties test for the designated exemption. Any updated job descriptions should be included in the appropriate administrative or employee handbook to ensure employees, supervisors and administrators alike understand the necessary job duties of each employee. This review could also contemplate whether exempt duties of employees who no longer meet the salary threshold could be reassigned to an employee who continues to meet the salary threshold so as to ensure efficiency in operations.

With the new rules will likely come increased scrutiny not just for those employees whose salary falls below the new standard, but for even those exempt employees who are above the new threshold, as DOL continues to aggressively seek compensation for workers it deems have been misclassified or where an employer's salary practices do not fully adhere to the existing regulations.

4. Implementation of the New Rule
Developing implementation plans for administration and payroll to ensure compliance when the rule becomes effective on December 1 is imperative. This includes adequately training administrative staff to ensure employee reclassification and premium overtime issues are effectively managed. The accurate tracking of hours worked is quintessential, as accurate recordkeeping is not only imperative to defending FLSA lawsuits, but it also allows school districts the ability to gauge what job duties can and should be reassigned to increase efficiency in operations. School districts must also update employee and administrative handbooks and policies to reflect the new rules for exempt employees.

The failure to take proactive efforts prior to the December 1 implementation date can, and likely will, result in employee wage claims from improperly classified employees, blown budgets, decreased production, and dissatisfied exempt employees. Finally, employers should keep in mind the ever-so-slight safe harbor for exempt employee salary calculations which allows up to 10% of nondiscretionary bonus and incentive payments to be included in determining whether an employee's salary meets the salary threshold requirements.

The costs of noncompliance are substantial. Remedies include back pay, reinstatement, and even promotion. Penalties under the FLSA range from civil penalties for repeated and willful violations in the amount of $1,100 per repeated or willful violation, to criminal penalties for willful or reckless violations in the amount of $10,000 per violation, imprisonment for up to six months, or both. Employers may also be hit with liquidated damage penalties in an amount equal to the amount of back pay owed to an employee. The costs under state law are no less burdensome. It is imperative to act **now**.

von Briesen & Roper Legal Update is a periodic publication of von Briesen & Roper, s.c. It is intended for general information purposes for the community and highlights recent changes and developments in the legal area. This publication does not constitute legal advice, and the reader should consult legal counsel to determine how this information applies to any specific situation.