CLIENT ALERTS & INSIGHTS

The Cost of Exemption: Dep't of Labor Final Rule Jettisons Salary Thresholds for Exemption Under the Fair Labor Standards Act

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Authors: W. Eric Baisden, Johanna Fabrizio Parker, Adam Primm

On April 23, 2024, the Department of Labor ("DOL") issued its widely anticipated Final Rule adjusting the minimum annual salary that an employee must be paid as of July 1, 2024, in order to qualify under some of the FLSA's most frequently invoked exemptions: the executive, administrative, and professional ("EAP") exemptions, [1] and the highly-compensated employee ("HCE") exemption. The Final Rule comes seven months after the DOL issued its Proposed Rule in September 2023 (see our prior alert here).

These changes will have a profound impact on the number of employees subject to the Fair Labor Standards Act's ("FLSA") minimum wage and overtime guarantees-the Economic Policy Institute estimated that 3.4 million employees will be affected by the EAP exemption threshold, with another 248,000 workers affected by the new HCE threshold.

New EAP Exemption Thresholds

The EAP threshold increase is significant: effective July 1, 2024, employees classified as exempt under the EAP exemptions must be paid at least $844 per week (or $43,888 per year), marking a 23% increase from the current $684 per week (or $35,568 per year) threshold.

The Final Rule does not stop there, and prophylactically imposes a new threshold of $1,128 per week (or $58,656 per year) effective January 1, 2025-a near 65% increase from the current threshold. In addition, beginning July 1, 2027, and every three years thereafter, the Final Rule calls for additional updates to the EAP salary threshold based on then-current earnings data "using the methodologies in place at the time of the update."

New HCE Exemption Thresholds

The HCE exemption threshold faces the same percentage increase later this year: effective July 1, 2024, employees classified as exempt under the HCE exemption must be paid at least $132,964 per year, up 23% from the current $107,432 threshold. Of that $132,964, an amount equal to the EAP exemption threshold-at least $844 per week-must be paid on a salary or fee basis.

And, like the EAP threshold update, the HCE update also comes with forward-looking increases, with an increase to $151,164 on January 1, 2025, and updates every three years beginning on July 1, 2027, calculated using the methodologies then in effect.

Duties for Exemption Remain Unchanged

Exemption under the FLSA is made up of two components: an employee's compensation and their duties. The duties required to warrant a particular exemption depend on the exemption, but for the EAP exemptions, generally require that the employee's primary duties be non-manual and related to management or other business operations, involve the exercise of independent discretion relating to matters significant to the company, or involve the performance of work requiring advanced knowledge and instruction. [2] None of the "duty tests" for the EAP exemptions are changed by the Final Rule.

The DOL's Justification of the Final Rule

The EAP threshold to be in effect January 1, 2025, indexes "the 35thpercentile of weekly earnings of full-time salaried workers in the lowest-wage Census Region" The new HCE threshold is commensurate with the 85thpercentile of weekly earnings *nationally*.

The Final Rule asserts that it strikes a balance between its 2016 rulemaking, which would have set the threshold higher under current data, and the 2004 and 2019 rulemakings, which would have set the threshold lower under current data. Specifically with respect to the new HCE salary threshold, the DOL reasoned that it "is high enough to reserve the test for those employees who are 'at the very top of the economic ladder.'"

What Employers Can (and Should) Do to Prepare

The DOL's authority to adjust these salary thresholds (and the extent to which it can increase them) has been successfully challenged in the past. Following the DOL's 2016 rulemaking which would have more than doubled the salary floor then in effect, a federal court in Texas enjoined the rule before it could take effect, ruling that the significant hike in the salary test "effectively eliminate[d] the duties test" beyond the DOL's authority. More recently, another federal court in Texas rejected a claim that the DOL did not have authority to issue the 2019 rule that gave rise to the current exemption threshold. It remains to be seen whether a challenge against the current Final Rule, which is all but inevitable, would successfully prevent it from taking effect.

In any case, employers should prepare on the expectation that the Final Rule will take effect. As an initial step, employers should review their exempt staff and salary levels to understand how significant (or not) these changes may be for their organization. With respect to employees currently exempt but earning under the new threshold, employers should begin evaluating whether the cost of paying overtime would exceed the cost of increasing the employee's salary compensation to meet the new threshold and maintain their exempt status.

We will continue to provide updates as challenges are lodged and the July 1, 2024, effective date approaches.

For more information on this Final Rule or to learn how it can affect your business, contact a member of Benesch's Labor & Employment Practice Group.

W. Eric Baisden at ebaisden@beneschlaw.com or 216.363.4676.

Johanna Fabrizio Parker at jparker@beneschlaw.com or 216.363.4585.

Adam Primm at aprimm@beneschlaw.com or 216.363.4451.

Eric M. Flagg at eflagg@beneschlaw.com or 216.363.6196.

[1] Computer employees do not need to be paid a salary to be deemed exempt under the Computer-Related Occupations exemption. However, those that are paid on a salary basis are subject to the new EAP threshold.

[2] Note: for HCE exemption, in addition to the salary threshold, an employee's primary duties only need to be non-manual and to satisfy at least one of the exempt duties of EAP exempt employees.