Employer Update

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Untangling the Morass of the Overtime Threshold under U.S. Federal and State Laws

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In This Issue

Employers across the United States who had been diligently restructuring their payrolls to comply with anticipated changes to the federal salary threshold for overtime eligibility experienced a "Texas two-step" in late November when a Texas district court – to the surprise of most observers – granted a nationwide injunction sought by a consortium of business organizations and twenty-one states, led by Texas and Nevada, blocking implementation of the new rule barely a week before it was set to go into effect. That fight is far from over, as the U.S. Department of Labor has appealed the injunction order. But even if the appeal succeeds, proponents of the new rule may face a challenge in the new leaders in Washington, who have already sought to pump the brakes on the Final Rule and could seek action to overturn or modify it. And while these developments proceed at the federal level, many states have quickly stepped into the void to increase the salary thresholds of their workers, quashing any sense of ease that employers might have felt after learning of the injunction. In this article, we seek to untangle the confusion, shed light on the current status of the salary threshold for overtime eligibility at both the federal and state levels, and provide some practical strategies that employers may choose to consider in navigating these uncertainties.

Current Status of the U.S. DOL's Final Rule

On May 23, 2016, the U.S. Department of Labor published its final rule (the "Final Rule") regarding changes to the salary threshold for the "white collar" exemptions to the overtime requirements under the Fair Labor Standards Act.[1] As readers of this publication are aware, under the Final Rule, which was set to go into effect on December 1, 2016, the minimum salary for white collar workers to be exempt from the overtime requirements would have been raised to $913 per week or $47,476 per year – more than double the prior threshold – with automatic increases in the salary basis every three years beginning in 2020. The Final Rule would not have changed the duties test, which also must be satisfied in order for any of the exemptions to apply.

The announcement of the Final Rule led many employers to scramble to examine their exempt population making less than $47,476 per year. Many employers, such as Carrols Restaurant Group (the largest franchisee of Burger King locations), made plans to reclassify such workers as non-exempt and pay them on an hourly basis.[2] Other employers chose to grant pay hikes to satisfy the forthcoming new threshold; this group included

Wal-Mart, which raised annual salaries for its entry-level managers from $45,000 to $48,500 beginning in September 2016.[3] And other employers sought to utilize the provision in the Final Rule allowing for nondiscretionary bonuses and incentive payments paid on at least a quarterly basis to satisfy up to 10 percent of the salary threshold. As December approached, most employers across the country were locked and loaded to comply with the new law.

However, the day before Thanksgiving, Judge Amos Mazzant of the U.S. District Court for the Eastern District of Texas issued an order heard 'round the country, "enjoin[ing] [the U.S. Department of Labor] from implementing and enforcing the [Final Rule] … pending further order of [the] Court."[4] The judge determined that the plaintiffs, a group of states and business organizations (whose separate lawsuits had been consolidated), had established a likelihood of success on the merits warranting the injunction order because the Final Rule "exceeds [the Department of Labor's] delegated authority and ignores Congress's intent by raising the minimum salary level such that it supplants the duties test."[5] Specifically, in analyzing the language in the FLSA regarding the executive, administrative and professional (the "EAP" or "white collar") exemptions, as well as Supreme Court precedent regarding statutory interpretation, the court concluded that "Congress intended the EAP exemption to depend on an employee's duties rather than an employee's salary."[6] Acknowledging that a salary threshold had been part of the white collar exemptions for many years before the DOL sought to implement the Final Rule, the court stated that it was "not making a general statement on the lawfulness of the salary-level test for the EAP exemption" but was "evaluating only the salary-level test as amended under the Department's Final Rule."[7]

The consequences of the "Thanksgiving surprise" injunction are still in flux. Employers which had already announced or implemented changes to comply with the Final Rule, whether through pay increases or reclassifications, were faced with the quandary of whether to proceed as planned or roll back these changes. Of course, rescinding expected raises has potential consequences, including impacting employee morale, recruitment and retention, and perhaps throwing open the door to individual and class action lawsuits. Wal-Mart, for one, has indicated that it does not anticipate rolling back the raise it gave to entry-level managers.[8] Meanwhile, the DOL promptly appealed the injunction order to the Fifth Circuit Court of Appeals, which agreed to expedite the appeal by holding oral argument "for the first available sitting after the close of briefing."[9] Both sides have filed their opening briefs, as have several amici, and briefing had been set to close by January 31, 2017 – until, less than a week before its reply brief was due, the DOL filed an unopposed motion for a 30-day extension through March 2, 2017, stating that the extension is "necessary to allow incoming leadership personnel adequate time to consider the issues."[10]

Whatever the outcome of the appeal, it may not mark the end of this ongoing saga. If the injunction is upheld, the DOL could seek to appeal the decision to the U.S. Supreme Court. Of course, the Supreme Court is currently operating with only eight justices and confirmation hearings for any nominee to fill the vacancy are expected to be contentious, setting up the possibility that even if the case is heard it could result in a 4-4 split decision, which would effectively

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uphold the Fifth Circuit's ruling. But the DOL might elect not to seek Supreme Court review, or to withdraw its appeal or otherwise not continue litigating in the lower courts perhaps even amending their answer to concede that the Final Rule is unlawful, given the political leanings of "incoming leadership personnel." Significantly, Andrew Puzder, the fast food executive who is the nominee for Secretary of Labor, wrote an opinion piece in May 2016 that strongly criticized the Final Rule as requiring employers to "offset increased labor expense by cutting costs elsewhere," reducing employers' ability to incentivize entry-level managers with performance-based bonuses, and eliminating the "prestige and financial benefits that come with a salaried position."[11] Puzder, whose confirmation hearing is currently scheduled for February 7, 2017, has a history of publicly opposing business regulations, including in a 2010 book titled "Job Creation: How It Really Works and Why Government Doesn't Understand It," in which he and his co-author argued that most federal regulations thwart job creation and concluded that "government has become, and looks to remain, the enemy of growth."[12]

In theory, the new administration could decide to support the Final Rule, given that a sizeable block of its voters are lower-income workers for whom the Final Rule could result in pay raises or overtime eligibility. But early indications suggest that such support is unlikely: in addition to the DOL's extension request on the appeal briefing, the White House has already taken its first shot at the Final Rule, issuing a memorandum on January 20, 2017 directing executive agencies to "temporarily postpone," by at least 60 days from the date of the memorandum, the effective date of regulations that have been published in the Federal Register but have not yet taken effect – an order that appears directed at the Final Rule, among others.[13] In other words, should the Fifth Circuit uphold the injunction, that decision could effectively be the death knell for the Final Rule.

Employers who are banking on the demise of the DOL's Final Rule need to be acutely aware of actions at the state level which have sought to mirror or approximate the Final Rule.

On the other hand, if the Fifth Circuit overturns the injunction, that could present different scenarios. Plaintiffs might seek review by the Supreme Court, which could hear the case even if the new DOL leadership is effectively siding with Plaintiffs. Meanwhile, with the injunction overturned, the Final Rule would presumably go into effect – at least after the expiration of the 60-day delay ordered by the White House's January 20, 2017 memorandum – requiring employers to quickly comply even while possible Supreme Court review remains pending. Moreover, the White House could pick up where it left off with its January memorandum by seeking to revise or overturn the Final Rule through regulatory or legislative action, whether in whole or in part (such as by proposing a compromise salary threshold, or by keeping the threshold set forth in the Final Rule but eliminating the automatic update mechanism). Either approach would face obstacles, as the regulatory process can be slow and requires periods for comment and review, while the legislative process would very likely require overcoming objection from Democrats in the Senate. However, another tack the new administration might take would be to introduce a resolution of disapproval under the rarely-used Congressional Review Act, 5 U.S.C. § 801 *et seq*., which allows Congress (with the President's signature) to repeal regulations of which it disapproves through an expedited 60-day legislative process.

Actions at the State Level

Employers who are banking on the demise of the DOL's Final Rule need to be acutely aware of actions at the state level which have sought to mirror or approximate the DOL's Final Rule. Foremost among those states are New York and California.

On December 28, 2016, the New York Department of Labor issued a notice of adoption of a new rule, effective December 31, 2016, intended "to maintain the longstanding historical relationship between minimum wage and salary threshold amounts, where the weekly salary threshold is always equal to 75 times the hourly minimum wage rate."[14] Consistent with the recent and forthcoming increases to the minimum wage in New York, the new rule amends the state regulations to provide that the salary threshold for the white collar exemptions for employers in New York City with 11 or more employees will be $825 per week effective December 31, 2016 (*i.e.*, 75 times the minimum wage rate of $11 per hour); $975 per week effective December 31, 2017 (*i.e.*, 75 times the minimum wage rate of $13 per hour); and $1,125 per week effective December 31, 2018 (*i.e.*, 75 times the minimum wage rate of $15 per hour).[15] Thus, for such employers, the overtime threshold is far higher than the existing federal level, and within a year *will be higher than the threshold* that the Final Rule would have implemented. For employers in other parts of the state, or smaller employers in New York City, the minimum wages (and, consequently, the salary thresholds) are slightly lower, though they too increase on an annual basis.[16]

Similarly, in California, recent increases to the minimum wage have resulted in corresponding increases to the overtime threshold. Under Section 11040 of the California Code of Regulations, employees must receive a "monthly salary" that is "equivalent to no less than two (2) times the state minimum wage for full-time employment" of 40 hours per week (*i.e.*, a weekly salary of at least 80 times the minimum wage rate) to qualify for the white collar exemptions. As California's minimum wage rate for employers with 26 or more employees increased to $10.50 per hour effective January 1, 2017, the salary threshold for such California employers is now $840 per week.[17] And as that minimum wage rate continues to rise, first to $11 per hour in 2018 and then by another dollar per year until reaching $15 per hour in 2022, the salary threshold will rise each year as well, *surpassing the Final Rule threshold* in 2019 and reaching a height of $1,200 per week (or $62,400 per year) in 2022.[18]

Other states are likely follow suit with state-level increases to the overtime threshold. Democrats in Rhode Island, Connecticut, Maryland, Wisconsin and Michigan have stated that they plan to introduce bills modeled on the Final Rule.[19] Meanwhile, minimum wage increases went into effect as of the start of 2017 for a total of 19 states, many by way of voter-approved ballot initiatives this past November, with similar actions on the horizon in other states.[20] As state minimum wage rates continue to rise, salary thresholds for the white collar exemptions under state laws are poised to rise as well.

Strategies for Easing the Transition

During the current purgatory-like period, as the fate of the Final Rule remains opaque, employers may wish to consider certain interim actions that could make for an easier transition once the federal salary threshold issue is settled:

- At a minimum, all employers should familiarize themselves with the overtime thresholds for the states in which they operate to ensure compliance, including implementing a mechanism for an annual review if they have workers in such states as New York or California, where minimum wage rates will automatically rise each year for the next several years.
- If the Fifth Circuit overturns the injunction and the Final Rule goes into effect at least temporarily (subject to possible action from Washington), employers should consider taking advantage of the provision in the Final Rule allowing for nondiscretionary bonuses and incentive payments paid on at least a quarterly basis to satisfy up to 10 percent of the salary threshold. Under this provision, up to 10 percent of the $47,476 annual salary threshold – *i.e.*, up to $4,747.60 – could come from quarterly bonuses of at least $1,186.90 each. In the event of changes to the Final Rule, employers may find it preferable, from an administrative and employee morale and hiring and recruitment perspective, to eliminate or reduce a quarterly bonus program rather than to reduce employees' base salaries. Because only $4,747.60 in bonuses can count toward the salary threshold, employees would still need to have salaries of at least $42,728.40 to remain exempt – which is just under the current salary thresholds for large employers in New York City and California. Employers therefore may wish to consider raising employees' salaries to the approximately $43,000 range, taking into account state law requirements, and then bridging the gap between the annual salaries and the threshold under the Final Rule via nondiscretionary bonuses.
- Another approach to compliance with the Final Rule could be to utilize the so-called "fluctuating workweek," in which the employee is classified as non-exempt but paid on a salary basis, plus an additional one-half of the regular rate of pay for any hours worked over 40 in a workweek.[21] The benefits of this approach for employers can be two-fold: (1) boosting employee morale (as well as retention and recruitment efforts) by paying a salary instead of an hourly rate, and

otherwise treating employees in exempt-like fashion, and (2) saving on overtime costs for weeks in which the employee works more than 40 hours (because the additional hours are paid at one-half the regular rate instead of one-and-one-half the regular rate). However, employers need to be mindful that employees must still receive their full weekly salaries each week, including weeks in which they work less than 40 hours. The federal regulations only permit the fluctuating workweek approach for employees whose hours *actually fluctuate from week to week*, and who have agreed to be paid in this manner (which agreement, as a best practice, should be in writing). Finally, before implementing this approach, employers should ensure that the fluctuating workweek method is permitted in their applicable state; notably, California does not permit the fluctuating workweek.[22]

While such measures are not appropriate for all employers, they are certainly worth considering, as under the right circumstances they could allow employers to prepare themselves for changes to the overtime threshold while maintaining employee morale and payroll flexibility. Regardless of whether these strategies are right for any given employer, all employers should be sure not only to pay attention in real time to developments concerning the Final Rule, but also to understand any state-level changes affecting the overtime threshold in their jurisdiction.

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An Update on U.K. Gender Pay Gap Reporting Obligations

by Ivor Gwilliams and Simon Gorham

Introduction

In our employer update article in September 2016, we set out a brief introduction to the new mandatory gender pay gap reporting obligations. These obligations will affect large employers in the U.K. (i.e. those with 250 or more employees in the private and voluntary sectors) from April 2017. In this article, we provide an update on the key aspects of the new obligations and provide some practical suggestions for what employers should do in preparation for the new rules.

The final draft regulations were published on 6 December 2016 and The Equality Act 2010 (Gender Pay Gap Information) Regulations 2017 (the "Regulations") will come into force on 6 April 2017, subject to parliamentary approval (which is unlikely to be withheld). It is expected that detailed non-statutory guidance on the Regulations will be published during the spring of 2017, most likely after the Regulations have been approved by Parliament.

What is the Gender Pay Gap?

The gender pay gap is concerned with the difference between the aggregate hourly pay for men and women regardless of their roles. It is not the same as equal pay which is concerned with the pay difference between men and women who have the same or similar jobs. Employers to which the Regulations apply will be required to publish their first gender pay gap report by 4 April 2018.

Gender Pay Gap Reporting Obligations

The Regulations require employers in England, Scotland and Wales (but not Northern Ireland) who have 250 or more employees on 5 April each year to report:

- the difference between the mean and median hourly rate of pay of male and female employees;
- the difference between the mean and median bonus pay paid to male and female employees in the 12-month period prior to the "snapshot date" (being 5 April each year);
- the proportion of male and female employees who received bonus pay in the 12 months prior to the "snapshot date"; and
- the proportion of male and female employees in quartile pay bands.

Employers subject to these reporting obligations will be required to: (i) analyse their gender pay gap on 5 April each year; (ii) publish their gender pay gap report together with a signed written statement confirming the accuracy of the report on their websites within 12 months (the first reporting date for publishing such information being no later than 4 April 2018 and annually thereafter); and (iii) keep the information there for three years. In addition, the information must be uploaded to a U.K. Government website.

[The gender pay gap] is not the same as equal pay, which is concerned with the pay difference between men and women who have the same or similar jobs.

There is no obligation on employers to publish a narrative with their report to contextualise any pay gap. However, employers should consider including a narrative so as to explain the reasons for any gender pay gap, to provide additional information in relation to the data and, importantly, to set out details of action it has taken or initiatives it proposes to take to close any pay gap.

The Snapshot Date

To calculate the gender pay gap, employers will first need to establish the relevant employees that are employed on the "snapshot date", which is 5 April each year. Employers whose numbers of employees fluctuate around 250 on the snapshot date might find that they are not required to publish a gender pay gap report every year. However, such organisations might decide (in the interests of transparency and for the purposes of maintaining good workforce relations) to publish a gender pay gap report on a voluntary basis for the years where they do not meet the threshold.

Employers Affected by the Regulations

The employer's obligation to prepare a gender pay report will be triggered by having at least 250 or more employees working in an individual entity on 5 April each year. Once the obligation is triggered, an employer will need to publish its gender pay gap within 12 months. For the purposes of the Regulations, each company in a group is a separate entity and therefore the obligation is triggered in respect of each company that has 250 or more employees. Whilst not giving corporate groups the option to report on a group basis might potentially be more onerous for large corporate groups who have to produce several reports, it is possible that an entire group might fall outside the scope of the Regulations if none of the companies have at least 250 employees, even if the group collectively employs more than 250 employees. For employers at or near the threshold on 5 April each year, determining whether or not the Regulations apply may not be straightforward. It is anticipated that the non-statutory guidance on the Regulations will encourage employers to publish their gender pay gap information on a voluntary basis where the number of employees slightly drops below the mandatory threshold in any particular year.

Employees Covered by the Regulations.

The definition of "relevant employee" in the Regulations is broad. The explanatory note (which does not form part of the Regulations) states that the definition of employee which is used in the Equality Act 2010 (i.e. the U.K. statute on discrimination) applies to the Regulations and therefore employees, workers and apprentices will all fall within the scope of the Regulations. Casual workers, zero hours workers and contractors (who are under a contract personally to do work) who are engaged directly by the employer will also fall within the scope of the Regulations and will count towards the 250-employee threshold. Employees who receive nil pay or less than their full pay at the snapshot date because they are, for example, on sick leave, family leave or on sabbatical are included for the purposes of determining the 250-employee threshold. However, agency workers and contractors engaged via a personal services company are not included for the purposes of determining the 250-employee threshold.

There is no requirement for the relevant employees to be based in Great Britain and working under a U.K. employment contract. The U.K. Government has suggested that companies should include employees who have a 'strong connection' with Great Britain even if they not based in Great Britain. This could pose difficulties for international organisations when determining the 250-employee threshold and a case-by-case analysis will be required to determine whether or not employees who are based overseas count towards it. Clarity on this issue is to be welcomed in the non-statutory guidance.

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Further, whilst partners, including LLP members, are specifically excluded from the definition of "relevant employee" under the Regulations, the position of salaried and/or fixed-share partners is less clear. This is because they may be regarded as employees or workers for the purposes of determining their employment status and therefore they may still count towards the 250-employee threshold. It is anticipated that this issue will also be clarified in the non-statutory guidance.

Calculating the Gender Pay Gap

To calculate the overall gender pay gap, employers will need to calculate an hourly rate of pay for each relevant employee. Employees on sick leave, family leave or on sabbatical and who receive nil pay or less than their full pay at the snapshot date are excluded from the mean and median gross average hourly pay calculations and pay quartiles but not from bonus pay calculations. The Regulations contain a detailed and prescriptive mechanism for the calculation of hourly pay. Broadly, employers should calculate hourly pay by reference to ordinary pay and bonus pay in a pay period which includes the snapshot date. Therefore, for monthly paid employees, the April payroll will be the relevant pay period and for weekly paid employees it will be the week in which 5 April falls.

Ordinary pay and bonus pay is used to calculate the hourly rate of pay for male and female employees. Ordinary pay includes basic pay, allowances (e.g. car allowances), pay for piecework, pay for leave as well as shift premium pay. Specifically excluded from ordinary pay are: (i) overtime payments; (ii) redundancy payments; (iii) payments referable to termination; (iv) payment in lieu of leave; (v) expenses; and (vi) benefits in kind (e.g. the use of a company car).

The value of salary sacrifice schemes was excluded from the definition of pay in previous drafts but the express exclusion has been removed from the Regulations and therefore it is not clear whether such schemes should or should not be included in the definition of ordinary pay. The exclusion of benefits in kind is likely to make the calculation of the gender pay gap more straightforward as employers do not need to attribute a monetary value to such benefits. However, this could lead to some anomalies: for example, if the employee is offered a choice between a company car and a car allowance, the gender pay gap data might be artificially skewed because of the employee's personal choice. Employers who are affected by this or other anomalies may wish to provide a narrative to accompany their gender pay gap report to explain such issues.

Bonus pay is also included in the calculation of hourly pay for the purposes of the Regulations provided such bonus pay is paid in the pay period including 5 April. If any such bonus is paid, the amount is pro-rated for the purposes of calculating hourly pay. Therefore, for a monthly paid employee who receives a bonus in April, only 1/12th of the bonus will be considered when calculating hourly pay whilst a monthly paid employee who receives a bonus at another time of the year will have such bonus ignored for the purposes of calculating hourly pay. As this may distort the figures, employers may decide that any narrative they provide to accompany the gender pay gap report should explain any such distortion.

Bonus Pay

Employers must also report on the mean and median bonus pay paid to male and female employees in the 12-month period to 5 April each year, and the proportion of male and female employees who received bonus pay during the same 12-month period. Employers are not required to include bonuses paid to relevant employees who have left the organisation prior to the snapshot date. Therefore, for the first gender pay gap report, employers will need to consider bonuses paid between 6 April 2016 and 5 April 2017. Bonus pay includes remuneration in the form of money, vouchers, securities, securities options or interests in securities, or which relates to profit sharing, productivity, performance, incentive or commission. Where the bonus relates to a period of longer than 12 months, there is no provision in the Regulations for pro-rating. Therefore, the entire amount paid within the 12 months to 5 April will need to be taken into account even though part of the bonus may relate to performance in previous years.

The Regulations make it clear that bonus pay awarded as securities, securities options and interests in securities are to be treated as paid, and in the amount in respect of which, at the point in time when they give rise to taxable earnings or taxable specific income. Therefore, the value to be included in the calculation of securities or securities options is the amount that is subject to income tax.

Whilst certain tax-exempt incentive schemes (for example, a save-as-you-earn option) will fall outside the scope of bonus pay for the purposes of the Regulations, matters may become more complicated when certain incentive schemes are eligible for tax exemption in one year but not in others. Employers who offer extensive incentive schemes that are tax-exempt should consider explaining this in a narrative that accompanies the report. In addition, it is not clear whether or not awards made under incentive schemes which are applicable to relevant employees but which are not administered by a U.K. company which employs them will need to be included in the reporting (because they are not payments made to the employee by the reporting company).

The Approach to Salary Quartiles

Under the Regulations, employers are required to report on the proportion (in percentage terms) of male and female employees in each of four pay bands. This is designed to assist employers identify where female employees are concentrated in terms of their remuneration and to identify any blockages to their progression. The Regulations set out the methodology for calculating the pay bands and each pay band must contain an equal number of employees. In short, employers must rank the employees from the highest paid to the lowest paid and divide them into four equal-sized groups. If several employees receive the same amount of hourly pay and fall on the boundary of two pay quartiles, the employer should ensure that the relative proportion of men and women on that hourly rate in each quartile is the same. This prevents an employer from moving the men and women into separate pay bands in order to improve its gender pay gap data.

The Regulations provide that the pay bands are to be described as lower, lower middle, upper middle and upper and employers are not obliged to publish the range of each pay band, nor are they required to disclose the grades of employees in each pay band.

Enforcement and Non-Compliance

The Regulations are silent as to civil or criminal penalties for non-compliance. Previously, the U.K. Government has suggested naming and shaming those employers who do not comply with the Regulations and, therefore, it would appear that the consequences for employers who do not comply will be in the form of adverse publicity and damage to their reputations.

The explanatory notes to the Regulations state that non-compliance of the Regulations would constitute an 'unlawful act' which would permit the Equality and Human Rights Commission ("EHRC") to take enforcement action against an employer. However, at present, it seems unlikely that the EHRC would have the powers or resources to enforce the Regulations.

Practical Tips for Employers

Those U.K. employers that are likely to fall within the scope of the Regulations should start to take steps now in order to ensure that they are able to comply. We suggest U.K. employers should:

- consider trialling the implementation of systems and procedures to gather, analyse and process gender pay gap data in order to prepare gender pay gap reports;
- identify significant gender pay gaps arising from the trial and consider how to manage them. This will include deciding how to contextualise existing gender pay gaps and identifying and implementing initiatives to close them. Employers should evaluate critically why pay gaps exist. For example, if they are due to an underrepresentation of women at senior levels, consider initiatives to recruit and retain female executives;
- check and update their records and undertake an audit of those employees who work overseas and who may have a strong connection with Great Britain;

- ensure that a relevant person from senior management is involved as early as possible in the process because they will be required to sign off on the accuracy of the gender pay gap report;
- consider including a narrative to accompany the gender pay gap information, particularly addressing any anomalies and/or discrepancies in pay across the organisation and details of how, for example, complex bonus schemes, such as those involving non-cash consideration, have been considered and valued for the purposes of the calculations; and
- involve their legal counsel as early as possible when carrying out a gender pay gap audit and, in particular, in the review of any problem areas so that such work is protected by client-attorney privilege.

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