PUBLICATION

Controversial Overtime Rule Comes in For a Landing

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After two years of wait, debate and overall angst for employers across the country, the new overtime rules were announced on May 18, 2016, and published in the Federal Register on May 23, 2016. As we discussed in an earlier Hospitalitas article, this rule is going to have a tremendous impact on the hospitality industry, but there are some significant and positive changes in the final version of the rules that differ from the rule initially proposed by the Department of Labor (DOL) last year. The most important news is that the Office of Management and Budget (OMB) listened to employers' concerns about the complexity of compliance and provided an extended period, until December 1, 2016, before the Final Rule becomes effective and employers are required to be in compliance.

"Exemption" From Overtime

The Fair Labor Standards Act (FLSA), the federal wage law, requires employees to be paid at least the federal minimum wage and overtime for any time worked in excess of 40 hours in a workweek. In addition, the FLSA provides strict record-keeping requirements for employees to track their working hours. There are employees, however, who are "exempt" from the FLSA's minimum wage, overtime and record-keeping requirements. Exemption depends upon three things:

How An Employee Is Paid - Salary Basis
The first requirement for exemption is that the employee must be paid on a "salaried basis," meaning the employee receives a fixed, guaranteed minimum amount for any workweek in which the employee performs any work. Simply stated, there is no change in salary regardless of the hours worked.

How Much An Employee Is Paid - Salary Level/Threshold
Besides being paid on a salary basis, to qualify for an exemption, the employee currently must be paid a minimum of $23,600 per year ($455 per week). There is also an exemption for "highly compensated employees" who earn $100,000 per year.

The Kind of Work the Employee Does - Job Duties Test
An employee who meets the salary basis and salary level/threshold tests is exempt only if the employee also performs exempt job duties. There are three primary "white collar" exemptions: Executive, Administrative and Professional. Regardless of the job title, the employee must meet each job duty requirement under one of the exemption categories to satisfy this test.

To qualify for exemption from overtime, all three of these tests must be satisfied. Paying salary alone is not enough. A salaried employee is not the same as an "exempt" employee, although the two phrases are often used interchangeably.

The Process – How Did We Get Here?

Back in March 2014, President Barack Obama sent an executive memorandum directing Secretary of Labor Thomas Perez to "modernize and streamline" the overtime exemption regulations. On June 30, 2015, the DOL published its proposed changes to the overtime regulations – more than doubling the $23,660 salary level to

$50,440 (or $970 per week) and increasing the salary level for the highly compensated exemption from $100,000 to $122,148. Additionally, the DOL proposed a mechanism to automatically update the salary level annually using a fixed percentile of wages or the Consumer Price Index. The DOL's final regulation was sent to the OMB for review, which was completed on May 18, 2016. The Final Rule was published in the Federal Register shortly thereafter on May 23, 2016.

What is the Final Rule?

The salary threshold is still doubling so it is difficult to call this "good news," but the Final Rule looks a bit different from the DOL's proposed rule and contains some concessions that will make it a little more palatable for employers:

- The 2016 salary threshold will be $913/week, which is $47,476/year. This is $2,964 less than the originally proposed $50,440 salary threshold. The threshold will be based upon the 40th percentile of the lowest-wage region, currently the South, rather than the entire country as initially proposed. This change is likely the result of criticism the DOL received for basing its proposed rule on national statistics, which did not take into account regional salary fluctuations. For the highly compensated employee exemption (HCE), however, the DOL is still basing the new salary threshold on the weekly earnings of the 90th percentile of full-time salaried workers nationally, which will mean an increase in the HCE annual salary threshold from $100,000 to $134,004.
- One of the biggest concessions to employers in the hospitality industry is that bonuses and incentives (including commissions) can be included to satisfy up to 10 percent of the standard salary level (i.e. up to $4,747 of the annual salary). For the first time, non-discretionary bonuses and incentives (including commissions – which is a shocker, since the DOL basically said no commissions in the proposed rule) can be included AND (also for the first time) the rule even allows employers to make a "catch up" payment. For employers to credit nondiscretionary bonuses and incentive payments toward a portion of the salary threshold, the Final Rule requires such payments to be paid on a quarterly or more frequent basis. If an employee does not earn enough in nondiscretionary bonuses and incentive payments (including commissions) in a given quarter to retain their exempt status, employers may make a lump-sum "catch-up" payment at the end of the quarter. The employer has one pay period to make up for the shortfall.
- The automatic updates will occur every three years beginning January 1, 2020. Rather than the initially proposed annual updates, the Final Rule provides for updates every three years. This will be based on the 40th percentile of weekly earnings of full-time salaried workers in the lowest-wage region, which is currently and will likely remain the South. The HCE will also be updated every three years based upon the 90th percentile, using the nationwide statistics. Based upon current trends, it is estimated the standard threshold will be approximately $51,168 and the HCE $147,524 in 2020.
- No changes to the duties test. There was some speculation that the DOL would revise the duties test in the Final Rule, but they did not touch them . . . but that doesn't mean they won't make changes to the test in the future.

When Will The Final Rule Be Effective?

The final rule was published in the Federal Register on May 23, 2016. Although, by law, the OMB was only required to give employers 60 days to comply, it extended the compliance date until December 1, 2016. Employers have between now and the end of November 2016 to get their affairs in order.

What Should The Hospitality Industry Do Now?

Every business sector is preparing for these changes, but the hospitality industry, in particular, should brace itself for impact. Wage and hour claims are old news for hospitality employers. The National Economic Research Associates, Inc. estimated that between January 2014 and March 2015, the food service industry accounted for 17 percent of all settlement dollars paid in wage-and-hour cases. Nevertheless, wage-and-hour litigation will only increase under the Final Rule as employers grapple with the many positions in the industry just barely meeting the current threshold requirements, including assistant managers, housekeeping supervisors, back office administrators, sales employees, and catering staff.

So What Should You Do Now?

Here are some initial steps:

1. Identify employees who will need to be reclassified, i.e. employees who are currently exempt but paid less than $47,476 annually.
2. Determine the number of hours the employee works. This seems simple but exempt employees are not required to track their hours and, therefore, employers may not be fully aware of the hours an exempt employee is working.
3. Analyze the financial impact. Will you raise pay to the new threshold level, reclassify employees as nonexempt and pay overtime, or lower pay to offset the overtime requirement?
4. Review job descriptions and tasks of impacted positions to determine if certain exempt tasks may be reassigned or maintained with the current position.
5. Consider how pay changes or other changes in job assignments may impact your organization. Will you need to make process or structural changes?
6. Develop administrative plans to ensure compliance when the regulations become official. This means you will need to prepare and train your managers.

Lastly, don't hesitate to seek legal help to ensure compliance and help maneuver through the DOL regulations and classification changes. These rules are complex, and there are serious financial consequences if you are found to be in violation of them. The DOL's budget for FY2017 includes $277 million for wage and hour division enforcement, an increase of $50 million from FY2016. Now that the rule is finalized, the DOL will send out its auditors to ensure employers are in compliance.

Hang on – it's going to be a bumpy ride.