

# PUBLICATION

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## Hospitality Industry Targeted in Proposed White Collar Overtime Regulations

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In a March 13, 2014 memorandum, President Barack Obama directed the Department of Labor (DOL) to "modify," "streamline" and "simplify" the federal regulations regarding exemptions to overtime under the Fair Labor Standards Act (FLSA). The goal? To increase the number of workers eligible for overtime. From the outset, both the President and the Secretary of the DOL declared that they believed many positions in the hospitality industry should qualify for overtime.

"The assistant manager at a fast food restaurant who puts in 60-70 hours a week for \$455 and spends almost all of their time performing the same work as the employees they supervise and who does not get overtime is getting a raw deal," says Labor Secretary Tom Perez. "We are updating the rule to prevent this situation."

On June 30, 2015, the DOL announced the highly anticipated proposed changes to the overtime regulation. Although there was much speculation about the DOL attempting to simplify the job duties test for overtime exemption, they made no such changes. Instead, the department proposed an increase in the salary level required for exemption to overtime from \$455/week (\$23,660/year) to \$970/week (\$50,440/year) for 2016. The DOL also increased the salary level for highly compensated individuals from \$100,000/year to \$122,148/year. Additionally, the DOL indicated that they intend to include a mechanism to update automatically the salary level annually through a percentage tied to the Consumer Price Index. Although the DOL made no changes to the job duties test required for exemption, there is still a possibility that a future change could be proposed, since the department asked for comments on such changes.

The 295-page Notice of Proposed Rulemaking (NPRM) outlines the DOL's proposed changes and also includes extensive commentary on the rationale for the changes and the expectations regarding its applications. Throughout the NPRM, the department references positions in the hospitality industry as examples of where changes in classification need to occur. This industry has always been subjected to a disproportionate amount of interest from the DOL. The latest statistics from the department website show that 55 percent of the DOL audits in 2014 were of restaurants and hotels. The new proposed regulations will certainly create a new challenge for the hospitality industry. At a recent webinar conducted by Baker Donelson, there were a number of questions from attendees in this industry, seeking to understand how the proposed regulations may impact hospitality businesses.

Here are some of the more significant questions and our answers:

1. What is the difference between an "exempt" and "non-exempt" employee? Is this the same as salaried versus hourly?

Short Answer: An exempt employee is ineligible for overtime, while a non-exempt employee is eligible. This distinction is commonly called "classification." Exempt/non-exempt is not the same as salaried/hourly. The FLSA, the federal law governing wage and hour issues, has three basic requirements: payment of the federal minimum wage (\$7.25/hour), overtime pay for time worked over 40 hours in a workweek and record keeping.

The FLSA, however, "exempts" certain employees from the minimum wage and overtime pay requirements. There is a common misperception that paying an employee a salary means they are "exempt" from overtime. This is not true. Payment of a salary is only one of the requirements for exemption. To qualify for the exemption, employees must:

1. Be paid on a salary basis (employers cannot reduce the salary because of quality/quantity of work or when employee works less than a full day);
2. Be paid a certain salary level (currently \$455/week or \$23,660 annually); and,
3. Meet a designated job duties test (that shows the employee primarily performs certain supervisory duties, compared with hourly workers performing "line" work).

These requirements are set forth in detail in the DOL overtime regulations. If all three of these requirements are not met, the employee is non-exempt. Job titles do not determine exempt status. Employers are required to pay non-exempt employees overtime and to maintain certain records of work hours for non-exempt employees.

## 2. Do I have to increase my affected managers' pay?

Short Answer: No. Although this is one of the myths that is being spread about the proposed regulation, there is no requirement to increase any individual's pay. Businesses have other options such as placing managers and other previously exempt employees on an hourly rate or classifying the employee as a salaried non-exempt employee where the employee is quoted a salary rate, with the realization there will be overtime owed for all hours over 40 per work week.

## 3. Can I just make sure my managers do not work more than 40 hours per week?

Short Answer: You can make it a policy that managers cannot work overtime but if they violate the policy, and they do not qualify for exemption, you must pay them overtime. Unless the manager meets all the tests for being exempt, including the new salary level requirement, the employer has an obligation to keep track of the employee's hours. Failure to do so can have two consequences. First, it is a violation of the record-keeping requirements and can subject an employer to a fine from the DOL, and we expect the DOL will be sending plenty of auditors out to hospitality industry businesses. Second, if the employee claims to have worked overtime hours for which he or she was not paid, and the company has not kept adequate records, the employer is at the mercy of whatever believable story the employee can produce as to how many hours he or she worked during the relevant period. An employer can have a policy in place that prohibits an employee from working overtime; however, if the employer "knew or should have known" that the employee worked in excess of 40 hours in a workweek, they will still be required to pay the overtime. However, the employee can be disciplined for violating the overtime policy.

## 4. Under the proposed new rule, which employees will be exempt from overtime?

Short Answer: Salaried employees who make at least \$50,440 annually and perform primarily "white collar" or supervisory duties will be exempt. The new proposed DOL overtime regulations increase the salary level (test #2 above) from \$455/week (\$23,660 annually) to \$970/week (\$50,440 annually). These amounts will also be indexed for inflation, to combat the time lag these amounts experienced from their last adjustment many years ago. To maintain the exemption, the employees will still need to be paid on a salary basis and meet the job duties test (which, at this point, the DOL did not amend).

## 5. Will commissions or bonuses be counted as part of the \$50,440/year salary level test?

Short Answer: Bonuses? Probably, but to a limited extent. Commissions? Doubtful. The DOL is "considering" whether to allow nondiscretionary bonuses that are tied to productivity, profitability and/or specified performance metrics to satisfy some portion of the salary level requirement. The department suggests limiting bonus payments to satisfy only 10 percent of the weekly salary level and that "employees would need to receive the bonus payments monthly or more frequently."

At this point, the DOL is rejecting the idea of counting commissions toward the salary level requirement. The department is seeking comments on the appropriateness of including commissions as part of the nondiscretionary bonus and other incentives that could partially satisfy the salary level test. It also appears that the DOL is not considering counting any other paid benefits toward satisfaction of the salary level test.

6. Can we limit the number of overtime hours these non-exempt employees work?

Short Answer: Definitely. No employer is required to guarantee overtime work or pay an employee more compensation as a non-exempt employee than what the employee was earning as an exempt employee. Employers should have an overtime policy stating when and if overtime is allowed (e.g., if an employee is required to get prior authorization of the overtime and from whom). If an employer knew or should have known an employee is working unauthorized overtime, however, the employer may discipline the employee in accordance with the overtime policy, but will still owe the employee the overtime pay.

7. What are the most important considerations for employers when analyzing these proposed changes?

Short Answer: Hidden overtime or time outside of the normal working hours that must now be tracked. Most exempt employees do not keep records of their hours. Therefore, many employers do not have adequate data on the number of hours their exempt employees are working. When these exempt employees are re-classified as non-exempt (because they no longer meet the salary level test), these hours will need to be tracked and any hours over 40 in a work week will be considered overtime. Many FLSA lawsuits allege employers failed to include time spent by non-exempt employees performing work activities outside of their normal shifts. Non-exempt employees may perform a variety of potentially compensable job-related activities during their "off-the-clock" time, such as taking work home, making/receiving job-related telephone calls and e-mails at home, working through lunch, working before or after regular shifts, taking care of work-related equipment or job-related "volunteer" work. This compensable time must be considered when re-classifying employees and working within the employer's payroll budget.

8. If this rule goes into effect, will we have to convert all of our salaried exempt employees making less than \$50,440/year to hourly employees?

Short Answer: No, hourly is not the same as non-exempt. An employee can be non-exempt and still paid a salary. The FLSA does not require that non-exempt employees be paid hourly. When properly done, it is perfectly legal to have a salaried non-exempt employee. A non-exempt salaried arrangement is simply when an employer pays a non-exempt employee a fixed salary for the week instead of paying the employee by the hour. The employee receives overtime pay based on the salary for every hour worked over 40 during the week. The employer still has to track employees' work hours every week regardless of the method of payment.

9. When will this rule go into effect?

Short Answer: Although we cannot definitively predict when the DOL will publish its final rule, we believe it will happen in early 2016 and employers will have to be in compliance as of the effective date of the rule, which can range anywhere from 30 to 120 days after the final rule is published. The administration has been very vocal about its desire to see this change in the law implemented quickly, so we expect a short compliance

period (i.e., less than 120 days). Some published speculation predicts the timing will precede the fall 2016 election by a sufficient period to allow political campaigns to take credit for increasing take-home pay in the election cycle. The possibility that the effect of the final rule will be to reduce hours worked, rates of pay, bonuses or employment is likely not part of the political calculus.

#### 10. What should we do now?

Short Answer: Take advantage of the time before the final rule is issued to identify and correct any mistakes. Employers should identify the affected employees and possible issues relating to the re-classification of those employees, such as budgetary effects, workforce effects (job/compensation restructuring), employee morale, etc. Does your time-keeping mechanism work with the additional employees? Is it possible to get the same work hours under the employer's current payroll budget? How is the information going to be communicated to employees and what is the potential effect on morale and work performance? Right now is also an opportunity to analyze and to correct any misclassification. The changes in the law are being reported in mainstream news, so employees will be expecting changes of some type. Employers must weigh the increased costs of compensation and recordkeeping against the cost of simply moving managers above the new ceiling to eliminate the cost and risk of compliance. As many labor markets are tightening and pay is rising from market forces, this regulatory uncertainty is one more factor to consider in determining compensation and labor costs.