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Hospitality Employment Law Alert

How Hospitality Industry Employers Can Navigate the New White-Collar Overtime Rules: Turning Legal Change Into Business Opportunity

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The Department of Labor's proposed revisions to the Fair Labor Standards Act's overtime exemptions will impact the American workplace—and especially employers in the hospitality industry (namely hotels and restaurants)—as much as any legal development in the past decade. Exempt job classifications will need to be reassessed and, in many cases, changed. But to view this as merely the moment to endure a major legal audit might be to overlook a broader opportunity. Drawing upon our deep experience counseling and partnering with hospitality industry clients, we advise in this Alert how the legal analysis might be paired with hospitality industry employers' broader business strategies in an evolving market.

As we detailed in *last week's Alert*, the DOL has announced its plan to narrow the FLSA's most litigated overtime exemptions. Among those being narrowed are the executive and administrative exemptions. At present, employees earning $23,660 per year ($455 per week) may be overtime-ineligible if their primary job duties involve (1) managing other employees (executive exemption); or (2) performing nonmanual work that is directly related to management or general business operations of the employer or the employer's customers, and involves the exercise of independent judgment and discretion with respect to matters of significance (administrative exemption). The DOL's proposed revisions would increase the annual salary requirement to at staggering $50,440 ($970 per week) ("salary test"), more than two times the current threshold. The new, increased salary test requirement would be indexed to the 40th percentile of weekly earnings for full-time salaried workers nationally, meaning that it would increase in each year going forward as long as national income levels continue to increase.

The DOL has not yet proposed changes to the exemptions' "duties tests." It has left open, however, the chance that it might change the tests in ways that could make them more like those currently defining who must receive overtime pay under California law. At present, the FLSA's duties tests focus on an employee's key value or most import duty performed for her employer. Instead of this "primary duty test," California law applies a bright line test that requires employers to pay overtime to employees who devote more than 50% of their time to nonexempt work. Though the DOL did not publish a proposed rule to this effect, it has invited public comment on a series of questions on the issue. The questions, which can be found by clicking *here*, may foreshadow the extraordinary shift to such a quantifiable duties test when the DOL releases its final rules.

We encourage hospitality industry members to provide comments on these questions so that the DOL can fully consider, among other things, the critical role managers and back office administrators play in running a hospitality establishment and in ensuring the quality of the guest experience. To this end, Seyfarth will be collecting employer comments through a series of client roundtable discussions and other communications aimed at obtaining the views of the employer community

Even without a change to the duties tests, we cannot overstate the impact that the salary level increase will have on the

hospitality industry, where exempt employees' salaries are often well under $50,000. If the duties tests are changed, the impact will be even more severe.

The public now has a 60-day comment period to respond to the DOL's proposal. That time could be extended by 30 days, but probably not longer. Following this comment period, the DOL will review the comments before issuing its final rules, most likely several months later. This gives members of your industry time to develop protection against the legal risks created by the new rules. It is important to begin the process soon.

In this Alert, we detail not just the necessary first step—assessing exempt-classified employees to determine their status under the new rules—but also a framework for acting on the results in ways that attempt to leverage broader business objectives in an environment where a changing competitive landscape has caused so many in the hospitality industry to rethink guest experience and an effective operating model.

Step 1: Consider Exempt Positions in the Existing Operating Model.

1. Assess salary levels against the FLSA salary test and consider changes.

To assess whether exempt-classified positions might need to be reclassified, hospitality industry employers must assess both salary levels under the salary test and job duties under the duties test. Because it involves a far simpler analysis, the former is the ideal first step. If current salary levels do not meet the new minimum, and if raising them to do so is not an option, then employers need not waste time assessing duties under the potential new duties test.

Assessing salary levels should be relatively straightforward. Most HRIS systems permit employers to run reports showing base salary levels across selected exempt job codes. A base salary report will allow employers to determine which employees and jobs fall below the new salary requirement. For those that do, employers must decide whether to increase salaries to bridge the gap or, alternatively, to reclassify the position. Additionally, if employers are not inclined to change employees' exempt status, a new compensation review process must be implemented to ensure that the salaries are adjusted consistently with the index so they do not fall behind in subsequent years as the salary test minimum rises.

Hospitality industry employers that decide to reclassify must consider how they will pay their newly-nonexempt employees and how they will communicate the changes. You should navigate this path in conjunction with your legal department or your Seyfarth lawyer. The most common route will be to convert salaries into an hourly rate equivalent, with consideration given to a downward adjustment to account for possible overtime pay.

There may be other options. Some employers might consider, for example, a compensation plan under the FLSA's "7(i)" exception to overtime pay, which generally applies for employees of retail sales or service establishments who earn at least half of their pay in the form of commissions. This exemption has been extended to hospitality industry employees, such as banquet servers, who receive shares of a mandatory service charge (employers should be cognizant that some states' laws contain special requirements for the treatment of such charges). For employers concerned that reclassification from exempt to nonexempt will negatively affect employee morale, a fluctuating workweek plan could be worth considering, in jurisdictions where that is permissible. A tangential benefit of fluctuating workweek plans is that one of their core requirements—a "clear mutual understanding" between the employee and employer about the pay plan—should present a natural hurdle to class certification.

Of course, some employees who are paid less than the new threshold requirement never work more than 40 hours per workweek. For those employees, no change actually needs to be made, as long as their employer takes steps to ensure that they do not work overtime hours and are being paid at least minimum wage for each hour worked.

While the type of pay plan to pursue will vary based on factors specific to the employer and the employees it is reclassifying, the need for a thoughtful communication and change management plan will not. To reduce the likelihood of misplaced rumors or fears filling any gaps in understanding, employers should work with counsel to carefully plan how they communicate changes to those affected. Such a plan should include written materials (e.g., correspondence to those affected, written directives to their supervisors about how to explain the changes, FAQs for either group), as well as a precise timeline for the staging of the changes and communications. Not only does such a plan reduce the likelihood of lawsuits by employees claiming that they should have been classified as non-exempt earlier, but it also helps alleviate concerns by converted employees that they are no longer as important or valued by the company.

Finally, many employers with operations in California may assume that their classifications in that state need not be revisited,

given that California's overtime exemptions were already stricter than those of the FLSA. That assumption is incorrect. Until now, for example, a California employee earning a salary equivalent to $37,440 (i.e., at least 2 times the state minimum wage for full-time employment) satisfied the salary level requirements of both the state and federal overtime exemptions and could, depending on her duties, be classified as exempt. If the DOL's proposed salary level becomes final, that employee would need to be paid more or reclassified, despite the fact that she is paid a sufficient amount under California law.

2. Analyze current duties under the FLSA duties test and consider changes.

Assuming that the salary level changes do not foreclose continued exempt status, employers should consider relying on their legal and human resources departments to identify and assess exempt employees most likely to be impacted by a California-like duties test. Doing this now will put employers in a better position to respond when the final regulations are announced. Employers should take care to examine duties both in design and in practice. As to the former, employers should review job descriptions, training materials, performance evaluation materials, and the like. While not dispositive of exempt status, these documents reflect what the employer expects employees to do, how it trains them to do those things, and how it monitors performance against expectations.

Just as important is the practical consideration of what duties the employees are actually performing. Are they performing the duties reflected in the supporting documentation? How much time are they spending on those duties? What additional duties are they performing, how much time are they spending on them, and do those duties impact the analysis under the duties test? These and other related questions will need to be answered.

The process of evaluating duties will not be a one-size-fits-all endeavor. For some, we might recommend a careful approach limited to interviews with a sampling of the employees' supervisors, even their supervisors' supervisors. For others, a campaign to speak to as many employees as possible might be the better course. Or the solution may be something of a hybrid. Hospitality industry employers will need to decide what is best for them. Factors that will impact the decision include, for example, the number of employees in the position, the depth of the employer's current understanding of the position, and, of course, the employer's resources and risk tolerance.

For positions the employer determines can pass muster under the new salary test and a potential time-based duties test, care should be taken to document the review, the results, and the rationale. Should there be litigation regarding the decision—and we expect there will be, just as when the regulations were last modified in 2004—the employer will have evidence of its efforts to comply with the law, beyond mere, "I remember we did something like…." Even if a judge were to determine that the conclusion was wrong, the employer's exemption assessment could establish the basis for a "good faith" defense, which, for an employer facing a large class action, could save millions of dollars.

Many hospitality industry employees currently classified as exempt might not survive a time-based duties test, depending on how the DOL reacts to comments received in response to its questions. Similar to the salary test, employers will have to determine how to address the gaps, if any, between what the employees are currently doing and what they need to be doing to be exempt. For example, employers might consider whether the delta can be bridged by adding duties to the position at issue. The answer to this question will invariably depend on the employer and the position at issue.

As described above, any reclassification should be preceded with a change management plan that accounts for the timing of changes and appropriate messaging about those changes.

Step 2: In Deciding to Reclassify, Take Time to Identify Possible Future Operating Structures.

Beyond answering and acting on the most obvious question—do we need to reclassify—employers should take the opportunity to pause and consider current and future business objectives. Any changes to exempt-classified positons will impact operations, and the solution of simply converting exempt employees to hourly nonexempt status may be tempting as the easiest solution. But the range of possible solutions is limited only by the bounds of creative thinking (and, of course, the law), and spans from changing duties to bolster the exemption, to converting them to salaried nonexempt status (rather than hourly), to changing the management structure and labor model altogether (e.g., eliminating a management layer, combining manager roles, etc.).

Approaching this task creatively, we suggest that there may be ways to build a holistic plan that both accounts for the new FLSA requirements and maximizes guest experience as part of the overall long-term business strategy. Employers with long-

term strategic plans should revisit those plans through the lens of these new regulations. Below are some examples of the kinds of planned operational changes that might be leveraged alongside efforts to meet the new requirements:

- If staff reductions are anticipated at locations, consideration should be given to consolidating management functions and bolstering the exempt duties of the remaining managers. Heightened exempt-duty expectations (e.g., marketing, menu design, evaluating how to achieve better service) would both bolster exempt status and justify higher salaries.
- If there is a plan to extend the assessment of mandatory service charges, consideration should be given to whether the 7(i) overtime exception could be applied to employees currently considered exempt.
- If exempt employees are spending large amounts of time on non-exempt duties because doing so is necessary to meet guest service expectations, employers could consider increasing staffing levels of non-exempt employees to fill the need, so that exempt employees have the time to focus on exempt duties.
- If formerly exempt employees will be reclassified as non-exempt, employers should consider attractive pay or benefit proposals such as bonus incentives, vacation or leave availability, and other fringe benefits, to ensure that they remain in a position to competitively attract and maintain managers who may view a non-exempt position as less prestigious or important to the company.

With respect to bottom-line payroll spend, the good news is that converting certain job codes does not mean added payroll. As alluded to above, employers are free to convert to a lower hourly rate than the 40-hour per week, 2,080-hour per year salary equivalent, perhaps because they anticipate a certain level of overtime costs. Of course, business considerations (e.g., talent retention, employee relations) may cause some to avoid any such adjustment. If this is the case, hospitality industry employers might look at ways to take labor hours out of the hotel or restaurant by, for example, outsourcing certain jobs or functions to third party vendors.

Conclusion

Not only do we know that the hospitality industry will be impacted by the new FLSA regulations, but we know the impact will be significant. Hospitality industry employers should act now. As many continue to evolve their business model to meet an ever-evolving competitive landscape, these changes present an opportunity to incorporate legal solutions into business strategies. In building legal mitigation into the core strategy, hospitality employers can reduce business disruption of these regulatory changes.

Please contact your Seyfarth attorney or any member of the Firm's 541 Amendments Task Force, listed below, to discuss these legal changes and what your company can do now to prepare to comply with the new regulations.

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