SEYFARTH SHAW

Retail Detail

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

By Cindy Westervelt and Kevin M. Young

The Department of Labor's proposed revisions to the Fair Labor Standards Act's overtime exemptions will impact the American workplace—and especially the retail workplace—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 retail clients, we advise in this Alert how the legal analysis might be paired with retailers' broader business strategies in an evolving market.

As we detailed in Tuesday's Alert, the DOL is tightening the FLSA's most litigated overtime exemptions. The exemption most relied upon in retail field operations—the executive exemption—will be harder to meet. Until now, it was generally enough if a retail manager earned a salary of $23,660 ($455/week) and management was her most important duty, even if she spent most of her time assisting with non-managerial work, like stocking shelves. Under the DOL's proposed rules, the annual salary requirement would more than double to $50,440 ($970 per week) ("Salary Test"). Moreover, the requirement would be indexed to the 40th percentile of weekly earnings for full-time salaried workers nationally, thereby automatically increasing over time.

In addition to an amplified salary requirement, it remains quite possible that the DOL will overhaul the exemptions' duties requirements as well. 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. Those questions, which can be found by clicking here, may foreshadow a major shift to a quantifiable duties test when the DOL releases its final rules (e.g., requiring that managers spend a minimum percentage of time on management). ("Duties Test"). We encourage retailers to provide comments on these questions so that the DOL can fully consider, among other things, the critical role a store manager plays in running a retail store. 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.

In a retail industry where average assistant manager salaries hover around $38,000 nationwide and all store employees, exempt or otherwise, are often relied upon to help accomplish the day's work, the impact of these changes cannot be understated.

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 take some time to review the comments before issuing its final rules, most likely several months later. This gives retailers time to take steps to protect themselves against legal risks created by the new rules, but it is important to begin this process soon.

©2015 Seyfarth Shaw LLP. All rights reserved. "Seyfarth Shaw" refers to Seyfarth Shaw LLP (an Illinois limited liability partnership). Prior results do not guarantee a similar outcome.

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 a retail environment where omni-channel shopping trends and a changing competitive landscape have caused so many retailers to rethink customer experience and the 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, retailers 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 minimums, and if raising them to do so is not an option, then retailers 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 retailers to determine which employees and jobs fall below the new salary requirement. For those that do, retailers will have to decide whether to increase salaries to bridge the gap or, alternatively, to reclassify the position. Additionally, if retailers are inclined to keep the managers exempt, 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.

Retailers 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.

But 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. Or, for retailers concerned about the morale hit that can accompany turning salaried managers into hourly employees, a fluctuating workweek plan could be worth considering. 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.

While the type of pay plan to pursue will vary based on factors specific to each retailer 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, retailers 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 retailers 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 the FLSA. That assumption is incorrect. Until now, for example, a California retail manager 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. Once the FLSA's Salary Test is finalized, however, that manager 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, retailers should consider partnering with their legal and human resources departments to audit field managers in anticipation of a possible change to a time-based

©2015 Seyfarth Shaw LLP. All rights reserved. "Seyfarth Shaw" refers to Seyfarth Shaw LLP (an Illinois limited liability partnership). Prior results do not guarantee a similar outcome.

Duties Test. Doing this now will put employers in a better position to respond when the final regulations are announced. Retailers should take care to examine duties both in design and in practice. As to the former, retailers should review job descriptions, training materials, performance evaluation material, and the like. While not dispositive of exempt status, these documents reflect what the retailer expects incumbents 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 incumbents 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 incumbents' supervisors, even their supervisors' supervisors. For others, a campaign to speak to as many incumbents as possible might be the better course. Or the solution may be something of a hybrid. Retailers will need to decide what is best for them. Factors that will impact the decision include, for example, the number of incumbents in the position, the depth of the retailer's current understanding of the position, and, of course, the retailer's resources and risk tolerance.

For positions the retailer 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 retailer 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 retailer's exemption assessment could establish the basis for a "good faith" defense, which, for a retailer facing a large class action, could save millions of dollars.

Of course, many retail managers 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, retailers will have to determine how to address the gaps, if any, between what the managers are currently doing and what they need to be doing to be exempt. For example, retailers 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 retailer 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—retailers should take the opportunity to pause and consider current and future business objectives. Any changes to exempt-classified positons will impact store operations, and the solution of simply converting exempt managers 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 managers' 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 customer experience as part of the overall long-term business strategy. Retailers 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 the plan calls for the store format to shrink or change to drive more online traffic, will there be a possibility of less store management and more hourly key-holders?

©2015 Seyfarth Shaw LLP. All rights reserved. "Seyfarth Shaw" refers to Seyfarth Shaw LLP (an Illinois limited liability partnership). Prior results do not guarantee a similar outcome.

- If low-volume stores are closing, other stores "on the bubble" might be worth a look with an eye toward staffing changes that may be necessary.

- If the supply chain strategy is evolving to build multi-channel delivery locations, with stores serving as distribution centers for online orders, how will this impact store management, including store managers' responsibility for inventory and customer service?

- On the merchandising front, new lines of products and services may require more management time to coach store employees to interact differently with customers and to educate customers on these new services or products.

- Conversely, if the number of in-store SKUs are reduced as more are sold only online, the impact on the need for staff training and supervision may change.

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, retailers 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, retailers might look at ways to take labor hours out of the store, for example through upstream changes to supply chain operations in packaging and delivery to the store (which would, of course, have its own costs) or visual merchandising in the layout of end-caps and dump bins.

Conclusion

Not only do we know that the retail industry will be impacted by the new FLSA regulations, but we know the impact will be significant. Retailers should act now. As many continue to evolve their business model and store formats 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, retailers 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.

Seyfarth Shaw 541 Amendments Task Force

Richard L. Alfred, *ralfred@seyfarth.com*

Brett C. Bartlett, *bbartlett@seyfarth.com*

Noah A. Finkel, *nfinkel@seyfarth.com*

Kristin G. McGurn, *kmcgurn@seyfarth.com*

Alexander J. Passantino, *apassantino@seyfarth.com*

Andrew M. Paley, *apaley@seyfarth.com*

Cindy Westervelt, *cwestervelt@seyfarth.com*

Robert S. Whitman, *rwhitman@seyfarth.com*

Kevin M. Young, *kyoung@seyfarth.com*

www.seyfarth.com

Attorney Advertising. This One Minute Memo is a periodical publication of Seyfarth Shaw LLP and should not be construed as legal advice or a legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult a lawyer concerning your own situation and any specific legal questions you may have. Any tax information or written tax advice contained herein (including any attachments) is not intended to be and cannot be used by any taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer. (The foregoing legend has been affixed pursuant to U.S. Treasury Regulations governing tax practice.)

©2015 Seyfarth Shaw LLP. All rights reserved. "Seyfarth Shaw" refers to Seyfarth Shaw LLP (an Illinois limited liability partnership). Prior results do not guarantee a similar outcome.