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Considerations for Retail Industry Employers as They Continue to Prepare for New Salary Thresholds Under White-Collar Overtime Exemptions

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Employers in the retail industry should act now to address recent changes to the overtime exemptions for "white-collar" employees. On May 18, 2016, the U.S. Department of Labor (DOL) published its highly anticipated final rule, which more than doubles the salary threshold required for certain executive, administrative, and professional employees to qualify for an exemption from overtime pay under the Fair Labor Standards Act (FLSA). The new rule will take effect on December 1, 2016. In this relatively short time frame, employers must review their current practices, determine which positions should be reclassified and how they should be classified and paid, consider related policies that should be revised, and plan how to communicate changes to employees.

The final rule is likely to have a disproportionate impact on the retail industry, where profit margins are slim and entry-level salaries for first-line managers and supervisors are often well below the new salary threshold requirement. These issues were repeatedly addressed in comments on the proposed new rules. DOL's response in the final rule was to admit that the 40th percentile of full-time employees in the retail industry is a salary of $889 per week (well below the new threshold), and to argue that 35 percent of first-line supervisors and 18 percent of all exempt retail workers are misclassified as exempt based on their duties. Thus, DOL projects that the final rule will affect 23 percent of exempt employees in the retail industry, resulting in approximately $365 million in additional costs. These estimates are probably quite low. A 2015 study by Oxford Economics suggests that almost twice as many employees will be affected, with a total cost of about a billion dollars. Regardless of the numbers, employers in the retail industry should pay particular attention to the final rule and the related opportunity to correct any positions that are currently misclassified as exempt from overtime.

What Does the New Rule Change?

The minimum salary for the white-collar exemptions subject to the salary basis test will increase from $455 per week (or $23,660 annually) to $913/week (or $47,476 annually). DOL set this number based on the 40th percentile of earnings of full-time salaried workers in the lowest-wage Census Region (currently, the South). The final rule also permits employers to include nondiscretionary bonuses, incentives, and commissions to account for up to 10 percent of the required salary for these exemptions, as long as those amounts are paid on at least a quarterly basis. Catch-up payments are permitted at the end of the quarter.

The minimum salary for workers treated as exempt under the highly compensated employee exemption will be raised from $100,000 to $134,004 annually, which is the 90th percentile of full-time salaried workers nationally.

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Beginning on January 1, 2020, both salary thresholds will be automatically adjusted and published every three years to keep pace with the 40th percentile and 90th percentile, respectively.

What Stays the Same?

The final rule makes no changes to the current duties tests. Additionally, the required salary still cannot be pro rated for a part-time employee. Part-time employees who satisfy the applicable duties test, but do not receive at least the minimum salary, must be classified as nonexempt. Their hours must be recorded and, any time they work more than 40 hours in a workweek, employers must pay them overtime of 1.5 times their regular rate.

What Can Employers Do to Prepare?

Employers should proactively audit exempt positions to review, reclassify, and correct any existing misclassifications. For employees who fall below the salary necessary to meet an exemption, employers should consider whether to classify those employees as nonexempt — and record hours and pay overtime — or increase their salaries to meet the new levels.

If they are considering an increase in salaries, retail employers should carefully assess whether employees meet the relevant duties tests. Key issues include whether supervisors are engaged in hiring, firing, promoting, and demoting, and whether administrative employees exercise discretion and judgment on matters of significance. If employers are going to invest money in a high salary, they should be certain that they will not ultimately have to pay overtime to the employee at a much higher rate because of misclassification.

If they decide to reclassify employees as nonexempt, retail employers may need to implement new timekeeping procedures, practices, or policies to record newly nonexempt employees' total hours worked each day and workweek and to train supervisors on them. Employers should also look at hours worked by currently exempt employees who might be reclassified as nonexempt to determine an appropriate new rate. Dividing their current salary by 40 (or even by their average hours worked) will increase payroll and will not be cost neutral, so employers may want to consider a lower hourly rate for employees who typically work overtime and will now be entitled to additional overtime pay. If any functions or tasks are redistributed among employees, job descriptions should also be updated.

As part of any internal audit or review process to address exempt/nonexempt classifications, retail industry employers may also want to take the opportunity to review any contractor arrangements to make sure the contractors are properly classified and should not be considered employees.[1] DOL issued guidance in July 2015 that made clear that misclassification of employees as independent contractors is a focus of DOL's enforcement efforts.[2] Potential areas of risk for retail employers include challenges to subcontractor arrangements for janitorial and other services where the subcontractors are not licensed or operating as independent businesses and where retail businesses exert too much control over the contractors and any employees.

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[1] In any compliance review, it might be worthwhile to watch for other wage and hour issues. Common issues that arise in the retail industry include off-the-clock work at the start and end of the workday, as well as rest and meal-period violations.

[2] *See* K&L Gates Legal Insight, "DOL Issues New Guidance on Independent Contractors," (July 23, 2015); *see also* K&L Gates Webinar, "Assessing Independent Contractor Relationships: Can They Survive the USDOL's Interpretation?" (September 2015).

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What Other Issues Should Employers Consider?

Employers must record and pay for any work suffered or permitted by nonexempt employees. As a result, new issues may arise when previously exempt positions are classified as nonexempt, and employers are required to determine what constitutes hours worked and whether (and how) they will track and pay for time spent in certain activities, including:

- Screening, pass down, equipment start-up, and other activities at the start and end of the workday.
- Travel time, especially between retail locations.
- "On-call" time and duties.
- Attendance at meetings or training sessions.
- Responding to email or other work performed away from the retail store.

Issues at the Start and End of the Workday

Retail employers have become accustomed to off-the-clock litigation focused on the start and end of the workday. Many such activities may be preliminary and postliminary activities that are excluded from hours worked under the Portal-to-Portal Act of 1947. For example, in its 2014 decision in *Integrity Staffing Solutions, Inc. v. Busk*, the Supreme Court found that security screening for employees to protect against loss of product and shrinkage was prototypical preliminary and postliminary activity and did not have to be compensated (reversing a contrary determination by the U.S. Court of Appeals for the Ninth Circuit). One of the keys to the *Integrity Staffing* decision was that the screening was peripheral to the actual work performed at that location. Other issues at the start and end of the workday may present a different case. For example, if supervisors (who are no longer exempt) spend time discussing workplace issues (pass downtime) at the transition between shifts, retail employers must be certain that both supervisors are on-the-clock regardless of their schedule. Very short exchanges may be *de minimis* (and therefore not compensable), but longer exchanges are compensable work. Employers rely too heavily on the *de minimis* rule at their peril. Similarly, time spent sharpening knives or turning on ovens, deep fryers, computers, and other equipment is compensable time, as is time spent by employees waiting for work assignments or activities. To the extent any of these responsibilities were assigned to supervisors who will be reclassified as nonexempt, retail employers must evaluate whether such activities will need to be tracked and compensated.

Travel Time

Although travel time issues have not traditionally been a substantial concern for retail employers, the potential reclassification of some managers and other employees who may have responsibilities at more than one retail location could present an expanded area of risk. Retail employers should thus review policies and practices regarding compensation of travel time to ensure proper payments are made to any employees who are converted to nonexempt status.

Employers typically do not have to pay employees for time spent in ordinary travel between home and work. Similarly, if an employee's worksite changes daily and the travel is a normal

occurrence for the position, time spent commuting between home and the first worksite of the day (and returning home from the last worksite of the day) may not need to be compensated.

However, if a nonexempt employee is traveling out of town for a job that keeps him or her away from home overnight, the general rule under the FLSA is that the employer must compensate the employee for any travel that takes place during what would otherwise be his or her normal work hours, including those corresponding hours on regularly scheduled days off (e.g., Saturday and Sunday). If the employee is traveling outside of his or her normal work hours, travel time spent driving must be paid, but time spent as a passenger in a plane, train, bus, boat, or car generally need not be paid.

If an employee has to travel between work locations during a workday, the travel time is compensable. Similarly, if an employee goes home after the regular work day ends and is called back to work and required to travel a substantial distance to handle a customer emergency, the time spent traveling may also need to be compensated.

Waiting/On-Call Time

Employers are required to pay for time that a nonexempt employee spends on-call if the employee is unable to use the time effectively for his or her own purposes. The key question is whether the employee is "waiting to be engaged" (likely not compensable) or "engaged to wait" (compensable). If the employee is required to remain on the employer's premises, the employer is most likely required to pay the employee for that time. A retail employer should also consider the frequency and duration of any calls, how quickly the employee needs to respond when called, and whether the employee can conduct personal activities during the on-call period.

Meeting/Training Time

The time that nonexempt employees spend in meetings, lectures, or training is considered hours worked and must be paid, unless all four of the following criteria are met:

- Attendance is outside regular working hours.
- Attendance is voluntary.
- The course, lecture, or meeting is not job-related.
- The employee does not perform any productive work during attendance.

Retail employees who are reclassified as nonexempt could present challenges in this regard. Store and other managers often try to meet with first-line supervisors to assess staff, work challenges, and other issues. This time must be tracked and compensated.

Email/Remote Access

First-line supervisors and other employees who may be reclassified as a result of the final rule may be contacted at home (by email or otherwise) and may be called on to complete paperwork or other work outside of their normal work hours. Retail employers may be required to pay employees for any non-*de minimis* time addressing work-related phone calls or email messages as well as any other work performed remotely. If they do not want to pay for after-hours work, retail employers should consider methods for limiting such work by

restricting remote access and limiting the ability to perform work away from the business location. Alternatively, retail employers should be certain that they have an exception time reporting system in place so that they can effectively track time spent on work-related matters away from the retail location and outside of normal working hours.

Additional Resources

For a more in-depth discussion of how employers can use the new rule as an opportunity to evaluate and make changes in their practices, *see* K&L Gates Webinar, "Leveraging the USDOL's Proposed White Collar Exemption Changes: What Employers Should Be Doing Now" (April 2016) and "Implementing USDOL's New Minimum Salary Requirements for White-Collar Exemptions" (June 30, 2016).

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