United States Department of Labor Sets its Sights on the Hospitality Industry – Exemptions, Independent Contractors and Other Compliance Challenges

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The hospitality industry is on the United States Department of Labor's (DOL) radar. The DOL's Wage and Hour Division launched the "Hotel and Motel Resort Pilot Initiative" in 2010 aimed at targeting Hospitality employers on two fronts – compliance with both H2B requirements and the Fair Labor Standards Act. The Wage and Hour Division considers Hospitality to be a "high risk" industry, identifying principally two industry characteristics:

- Hospitality employers hire large numbers of immigrant workers (such as H2B employees) and younger employees, both of which groups the agency believes consist of individuals who are "vulnerable" and are unlikely to complain about violations; and

- "Hospitality" is what the Labor Department calls a "fissured industry", by which it means arrangements it sees as resulting in a dilution of both the employment relationship and the responsibility for compliance.

In 2015, the DOL embarked on two major initiatives that will impact the hospitality industry: proposed changes to overtime regulations and renewed focus on employers' treatment of individuals as independent contractors.

<u>Focus on Independent Contractors</u>

Many hospitality employers treat certain workers performing services for them as independent contractors. Many of those businesses think simply having an agreement with the worker setting forth his or her independent contractor status is sufficient to establish such a relationship. Those businesses are wrong. In fact, whether a worker is an independent contractor, as opposed to an employee, will depend on the facts and circumstances of the job, the actual relationship between the worker and the business, and context in which the matter is considered—as different tests apply in different situations.

On July 15, 2015, the DOL issued an important Administrator's Interpretation discussing the misclassification of employees as independent contractors to address what it characterizes as the "problematic trend" of allegedly misclassifying workers. Many companies engage independent contractors, rather than employees, to fill temporary and sometimes permanent staffing needs. In doing so, companies avoid paying certain taxes as well as overtime pay, while workers gain flexibility that might otherwise not be available as an employee. Companies come to the conclusion that there is little risk in engaging workers as independent contractors so long as the company does not control the manner and method in which the work is performed. The DOL's latest memorandum, however, is a chilling reminder that this risk analysis is limited and according to the DOL, companies can face stiff damages and penalties for noncompliance.

Different statutes apply varying tests when considering a workers' status. Under the Fair Labor Standards Act ("FLSA"), the employee-favorable standard of "economic realities" is applied. The recent Guidance does not change the current standard which considers the following six factors: (1) the extent to which the work performed is an integral part of the employer's business; (2) the worker's opportunity for profit or loss depending on his or her managerial skill; (3) the extent of the relative investments of the employer and the worker; (4) whether the work performed requires special skills and initiative; (5) the permanency of the relationship; and (6) the degree of control exercised or retained by the employer.

The Administrator's Interpretation, however, does aim to curtail the perceived misclassification phenomenon by clarifying how the standard for determining whether an individual is a FLSA "employee" can help the "regulated community" classify workers correctly.

In doing so, the Interpretation identifies that *most* workers should be classified as employees. The DOL presumes that every worker is an employee and the burden of proof to establish that a worker is actually an independent contractor then lies with the employer. For employers, this means that you should operate under the presumption that every worker is an employee unless there is sufficient evidence to justify that a worker is an independent contractor. Notably, merely labeling an employee as an independent contractor will not factor into the test of economic realities. Rather, it is how the actual day-to-day work and responsibilities are carried out.

The Guidance also offers some factor-by-factor elaboration upon how each factor should be applied and includes illustrative examples and clarifies that no single factor of the economic realities test is dispositive. The overarching thrust of the Guidance is to contend more generally that the multi-factor "economic realities" analysis used by the courts should be applied in a broad manner so as to lead to the conclusion that "most workers are employees under the FLSA."

Finally, the Guidance de-emphasizes the role of individual factors under the economic-realities test in favor of ultimately making a higher-level judgment as to whether the individual is economically dependent on the putative employer. In particular, the Guidance admonishes against giving too much weight to the "degree of control exercised or retained by the employer."

As evidenced by the recent Guidance, the DOL is making it a priority to crack-down on "misclassification" in the independent-contractor arena. While the courts are not required to adopt the DOL's position, they might well come to embrace what the Interpretation has to say. Accordingly, businesses whose operating models are built even in part upon independent contractors by any other name should immediately evaluate what the prospects are that such workers would be deemed to be a true independent contractors under the FLSA.

Proposed Regulations on Overtime Exemptions

In July 2015 the DOL issued the anxiously awaited proposed changes to the regulations defining the federal wage and hour law have been published by the U.S. Department of Labor (USDOL). The changes, if adopted, would impact the determination of which of your employees has to be paid overtime. These regulations will sharply reduce the number of workers across the country who are exempt from OT pay and will work to give many employees a raise in pay.

In order to qualify as exempt from overtime pay, employees must work in positions that meet specific duties tests, and in most cases, also meet minimum compensation tests. Under the proposed regulations there will be significant changes to the compensation tests for exempt employees. The proposed regulations essentially **double** the minimum salary threshold, raising it from $455 to $921 per week. The new figure would annualize to $47,892. And, for the first time in the 75-plus-year history of these exemptions, the DOL is proposing that it would release an "updated salary rate" on an annual basis. The agency's accompanying remarks suggest that this might result in a $970 threshold (annualizing to $50,440) as early as 2016.

Hospitality employers viewing this proposal from the standpoint of longer-range planning and budgeting, would be wise to project for now that the minimum salary will move up steadily. Many predict that it will head toward an annualized level in the mid-$50,000s in the not-too-distant future.

These proposed regulations will hit the hospitality industry hard. Fisher & Phillips recently conducted an informal survey of about 25 hotel and resort properties, asking them what percentage of their current exempt employees do not meet the proposed minimum salary threshold. The average was only 21%, with several properties reporting that over 50% of exempt supervisors and managers would not meet the minimum threshold.

If there is a silver lining to this dark cloud, it's that there are certain employees who will not be affected by these proposed changes at all. One such group consists of those non-exempt employees who are paid on a salary-plus-overtime basis. In other words, the potential salary change would not represent some generalized requirement to pay salaried, non-exempt employees at the minimum salary rate.

There are others who would escape the brunt of these changes. In the hospitality industry these might include sales managers falling within the "outside salesman" exemption, employees whose work meets the computer-employee exemption requirements and who are paid on an hourly basis at a rate of at least $27.63, and employees who fall under the overtime exception for retail employees paid under a commission pay plan (such as banquet servers).

It's difficult to predict when any final changes will actually be put into effect. Based on various conflicting DOL statements, the public might see the actual regulations this spring or early summer. If the regulations are published sometime between March 1 and June 30, the regulations could take effect sometime between April 30 and August 29 (assuming the regulations will take effect 60 days after publication).

Hospitality employers should take immediate action:

- evaluate immediately what these changes would mean for the organization and employees;
- determine whether and how to bolster the FLSA exemption status of those treated as exempt from overtime;
- decide what other FLSA exemptions might apply to various employees;
- select alternative FLSA-compliant pay plans that would serve the needs of your business if the decision is made to convert one or more employees to non-exempt status; and