Statement
On behalf of the
National Restaurant Association
&
Bardenay Restaurants & Distilleries

ON: THE CONSEQUENCES OF DOL'S ONE-SIZE-FITS-ALL OVERTIME RULE FOR SMALL BUSINESSES AND THEIR EMPLOYEES

TO: U.S. HOUSE OF REPRESENTATIVES, COMMITTEE ON SMALL BUSINESS, SUBCOMMITTEE ON INVESTIGATIONS, OVERSIGHT, AND REGULATIONS

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By: Kevin Settles

On Behalf of the National Restaurant Association & Bardenay Restaurants & Distilleries

House Committee on Small Business, Subcommittee on Investigations, Oversight, and Regulations
2360 Rayburn House Office Building
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Good Morning Chairman Hardy, Ranking Member Adams, and distinguished members of the Subcommittee. Thank you for the opportunity to testify today on the impact that the proposed overtime regulations would have on small businesses like mine and the concerns small businesses have with some of the ideas being considered by the Department of Labor ("Department") for the final regulation.

My name is Kevin Settles and I own and operate Bardenay Restaurants & Distilleries with three locations: Boise, Eagle and Coeur d'Alene, Idaho. I'm honored to share the perspective of my company and the National Restaurant Association, where I serve on the organization's Board of Directors and its Jobs & Careers Committee.

Today, my testimony will focus on some of the issues that my company, and the restaurant industry, have been struggling with while trying to provide feedback to the Department on its proposed changes to the current overtime regulations. I will also touch on some of the potential changes we are considering if the rules are adopted as presented. These are changes that need to be considered if Bardenay is to be fully compliant with the law while remaining economically healthy and vibrant.

Some of the issues I will address today include:

1. The time period allowed to evaluate and comment on the Department's proposed overtime rule and its Regulatory Flexibility Act analysis.
2. The proposed salary level.
3. The proposed automatic increases to salary levels.
4. The adjustments to the duties test being considered.

I must point out that the these overtime regulatory proposals add to the tremendous amount of uncertainty created by new and expanding federal regulations over the last five years. This uncertainty has been a key factor in extending the longest time period without expansion in my years as an independent businessman.

Bardenay Restaurants & Distilleries

Bardenay Restaurants and Distilleries are a cornerstone of Idaho's restaurant and bar industry; our three locations capture the spirit of Idaho and the Northwest. Employing about 200 people, Bardenay is a small business with a goal of being the employer of choice in our industry.

As the nation's first restaurant distillery, Bardenay has set an industry precedent as a full service restaurant and bar with the ability to create handcrafted liquor on-site. We made history on April 25, 2000, when we served the first cocktail to include spirits distilled in a restaurant in the United States.

The Restaurant and Foodservice Industry

The National Restaurant Association is the leading trade association for the restaurant and foodservice industry. Its mission is to help members like me establish customer loyalty, build rewarding careers and achieve financial success. The industry is comprised of one million restaurant and foodservice outlets and employs 14 million people. The majority of restaurants in America qualify as small businesses yet our industry is the nation's second-largest private sector employer. Restaurants are job-creators and we currently employ approximately ten percent of the U.S. workforce.

Restaurants can provide great careers but we are also the employers of choice for people looking for flexible work schedules. We employ a high proportion of the population looking for part- time and/or seasonal work. As an industry of small businesses, more than seven out of ten eating and drinking establishments are single-unit operators. As popular as the restaurant business is to be in, the industry averages relatively low profit margins; only four to six percent before taxes, with labor costs being one of the most significant line items for a restaurant.

The time period allowed for comments was inadequate for a proper economic analysis of the proposed regulations.

It would have been helpful to the regulated community to have had more time to review and comment on the proposed rules. In denying requests from the U.S. Small Business Administration Office of Advocacy as well as thousands of employers for an extension, the Department referred to the "listening sessions" it held. The proposed changes are lengthy and complicated and an insufficient time was allowed for the data to be gathered and analyzed plus the listening sessions were held prior to the proposed regulations publication. In addition, more time would have enabled our industry to better assist the Department in gathering substantive and more accurate information on the impact the proposed revisions would have on the nation's employers.

I personally participated in one of the early listening sessions, along with other leaders from our industry. While we appreciated the listening sessions, they were focused on general ideas and were no substitute for the robust notice and comment requirements mandated by law. While I can see from the Department's Proposed Rules documentation that they at least took

notes on our comments, I see very little indication that the Department actually listened to our main concerns.

The Department's proposed minimum salary level is inappropriate for our industry and makes the exemption inoperative in my part of the country.

The Department's proposal to tie the indexing of the salary level to the 40th of non-hourly employees is a huge overreach with very negative consequences. Preliminary research points to it resulting in a death spiral that would render the exemption obsolete in just a few years. The relevant data used to determine the 40th percentile of full-time salaried workers is found in the Current Population Survey from the Bureau of Labor Statistics (BLS). The data consists of the total weekly earnings for all full-time, non-hourly paid employees and represents a major shift from previous methods.

The Department believes that its proposed salary level will not exclude from exemption a high number of employees which meet the duties test. When applied to my industry, the contrary is true. The proposed rules are a radical departure from the traditional formula used to set the minimum salary. They not only double the current salary target but also serves to eliminate the consideration of regional economies.

Most managers and crew supervisors in our industry would not meet the proposed salary level of $970 per week. However, more would qualify as exempt under the new proposed salary level if the Department allows bonuses to be used to calculate the employee's salary level. Nondiscretionary bonuses based on restaurant performance are common in our industry and can make up a significant portion of a Manager's pay.

Historically, a key purpose of a set salary level has been to provide a method for screening out obviously nonexempt employees. In other words, the salary level should be set at a level at which the employees below it would clearly not meet a duties test. With the proposed changes, the Department is upending this historic rationale and setting the salary level at a point at which all employees above the line would be exempt. This would greatly limit the number of employers in the restaurant industry able to use the exemption.

For example; the median annual base salary paid to crew and shift supervisors in our industry is $38,000. Even those in the upper quartile at $47,000 would not qualify as exempt under the Department's proposed $50,440 salary level for 2016. Likewise, the median base salary for restaurant managers is $47,000, while the lower quartile stands at $39,000.

These are employees who would meet the duties test but who would become non-exempt under the proposed salary level. It is clear that, at least in reference to the restaurant industry (the nation's second-largest private-sector employer), the proposed salary level does exclude from exemption an unacceptably high number of employees who meet the duties test. The impact would be magnified in many regions of the country.

In my company, the proposed minimum salary level of $50,440 per year would represent an outsized income for mid-level managers. These would be the Assistant Managers and Sous

Chefs; generally, people that are learning the position and moving up. The increase would be too large for us to absorb, so those positions would end up being moved back to an hourly rate—a rate that would net them the equivalent of what they earn today during the 45 hour work week we currently request that they schedule for.

While this would be an easy transition to make from a management and bookkeeping standpoint, it removes a key part of the reason that exempt status was originally created; above average fringe benefits, greater job security and better opportunities for advancement. Not only does it remove the certainty of a fixed paycheck that they currently have, it would have numerous other impacts. We currently use salaried versus non-salaried to set eligibility for extra paid vacation (currently two to three weeks annually) as well as management investment/ownership pool and annual holiday bonuses. Probably the biggest benefit is that we have been able to extend sick leave for a few salaried employees; paying full wages while they have battled life threatening issues such as cancer, kidney failure and septicemia.

The ability to delineate programs and perks by salaried versus non-salaried has been a great tool for upper management as well as a great benefit for our employees. Setting a minimum rate that is inappropriate for entry-level managers in rural areas in our country will end up reducing the benefits of our mid-level managers, not because we want to, but because of secondary consequences of the proposed changes.

The National Restaurant Association has suggested, as better options, three alternatives considered by the Department. They are outlined in the proposed regulations as:

1) "Alternative 1" calculate a new salary level by adjusting the 2004 salary level of $455 for inflation from 2004 to 2013, as measured by the CPI–U. This would result in a salary level of $561 per week ($29,250 per year).
2) "Alternative 2," use the 2004 method to set the salary level at $577 per week ($30,085 per year).
3) Acknowledging that the Department now finds the salary level it set in 2004 as too low, the industry is also willing to support "Alternative 3," set the salary level at $657 per week ($34,255 per year).

I would like to point out that the Department estimated that 75 percent of newly overtime-protected employees would see no change in compensation and no change in hours worked based on the proposed regulations. However, in the restaurant industry salaried employees enjoy a number of benefits not available to hourly employees, as shown by my own example. Thus, in addition to getting paid a salary regardless of the fact that they may not be working over 40 hours a week, these newly overtime-protected employees could lose flexibility as well as benefits, including substantive bonuses, paid vacation, flex time, paid holidays, and health insurance.

Finally, throughout the proposed regulation, the Department created the impression that salaried employees feel they are being taken advantage of by virtue of their exempt status. In reality, employees often view reclassifications to non-exempt status as demotions, particularly

where other employees within the same restaurant continue to be exempt. Most employees view their exempt status as a symbol of their success within my company.

Automatic salary level increases will only perpetuate bad policy.

In the current proposed rulemaking, the Department wants to announce a new salary level each year in the Federal Register without notice-and-comment, without a Regulatory Flexibility Act analysis, and without any of the other regulatory requirements established by various Executive Orders.

The Department is charged with regular review and update of the minimum salary level and they acknowledge that they have not done this. The reason they give is the "overall agency workload and the time-intensive nature of the notice and comment process have hindered the Department's ability to achieve this goal." I take this to mean that they are willing to put a key task for the Department on auto-pilot at the expense of employers and employees.

Putting aside legal objections to the Department's attempt to permanently index the salary level at $50,440, an automatic yearly increase at this level tied to CPI-U would make the exemption perpetually unusable for large portions of our industry.

As the new salary level becomes effective, the number of workers who will report to the BLS that they are paid on a non-hourly basis will decrease. As workers fail the salary test and are moved to hourly due to the loss of exemption there will be a dramatic upward swing of compensation levels for non-hourly employees. If the 40th percentile test is adopted and then updated annually without review, in the years following the proposal, the salary level required for exempt status would be so high as to effectively eradicate the availability of the exemptions in our industry.

For example, the Department predicts that the initial salary level increase will impact 4.6 million currently exempt workers. Employers must then choose to:

1) Reclassify such workers as nonexempt and convert them to an hourly rate of pay;
2) Reclassify such workers as nonexempt and continue to pay them a salary plus overtime compensation for any overtime hours worked; or,
3) Increase the salaries of such workers to the new salary threshold to maintain their exempt status.

The Department estimates that only 67,000 currently exempt workers will see an increase in their salaries, bringing them up to the new salary threshold and maintaining their exempt status. We believe the majority of affected employees would be reclassified as non-exempt. In our industry, particularly under the proposed $970 per week salary level, most of these employees will be converted to an hourly method of payment.

One economic analysis that we were able to review states that if just one quarter of the full-time, non-hourly workers earning less than the proposed 40th percentile were reclassified as hourly workers each year, in five years the new 40th percentile salary level would be $1,393 per

week ($72,436 per year). The more likely scenario is that an even greater percentage of employees would be reclassified from salaried to hourly. If just half of full-time, non-hourly employees are converted to hourly positions, the 40th percentile salary level would increase to $1,843 per week ($95,836 per year) by 2020; a 47% increase!

Adjustments to the duties test are not necessary and should be avoided.

While the proposed rules indicate a desire to reduce litigation, it is clear to us in the industry that any reduction would be lost if there are changes to the duties test. The industry is extremely troubled by the notion that the Department is looking at California's over-50% quantitative requirement for an exempt employee's primary duty. In meetings with the Secretary of Labor and others, my colleagues with businesses in California emphasized that the state's labor law changes have resulted in considerably higher levels of litigation, as plaintiff's lawyers and employers fight over the percentage of time spent on various tasks and whether those tasks are appropriately classified as exempt or nonexempt.

I am currently looking to open my first location outside of the state of Idaho and am focusing on states nearby. While California meets my travel and population parameters, it does not meet my regulatory parameters. In addition to its over regulation, making it a very difficult state to do business in, it is certainly not a low-litigation state.

It appears that the Department may decide to enact changes to the duties test based only on answers to the general questions asked in the proposed regulations. Changes should be based upon comments made on specific proposals. If they are not, the requirements of the Administrative Procedure Act ("APA"), the Regulatory Flexibility Act, and the various Executive Orders related to regulatory activity will not have been followed. The Department needs to seek input based on actual proposals, not hypotheticals. It should provide actual regulatory proposals that the regulated community can consider, evaluate, and comment upon. Adding new major regulatory text to a final regulation with no opportunity to see it beforehand directly contradicts the goal of the APA.

The Department optimized the duties test in 2004 to reflect the realities of the modern economy, a move that recognized the unique roles and responsibilities restaurant managers have. The Department now says that this was a mistake; our industry disagrees. Our managers need to have a "hands-on" approach to ensure that operations run smoothly. Any attempt to artificially cap the amount of time exempt employees can spend on nonexempt work would place significant administrative burdens on restaurant owners, increase labor costs, cause customer service to suffer and result in an increase in wage-and-hour litigation.

I am also extremely concerned that the Department expresses throughout the proposed regulations its belief that any amount below its proposed salary level would necessitate a more rigorous and restrictive long duties test. We strongly disagree. The current test works regardless of the salary level chosen by the Department. A more rigorous and restrictive long duties test would place significant administrative burdens on restaurant owners.

The Department should leave the concurrent duties rule in place and untouched. The concurrent duties test rule recognizes that front-line managers in restaurants play a multi-faceted role in which they often perform nonexempt tasks at the same time as they carry out their exempt, managerial function. It recognizes that exempt and nonexempt work are not mutually exclusive.

The Department's own Field Operations Handbook highlights that "performing work such as serving customers or cooking food during peak customer periods" does not preclude exempt status. Exempt supervisors make these decisions while remaining responsible for the success or failure of business operations under their management and can both supervise subordinate employees and serve customers at the same time.

Conclusion

The Department should have granted at least as much time for review and comment as it did in 2004. The proposal's complexity and unusual new theories and mandates make this even more important. I cannot emphasize enough that the restaurant industry would find the use of a long duties test to be the wrong approach. The Department claims it is attempting to "modernize" and "simplify" the applicability of the exemption, but a return to a long duties test would certainly achieve the opposite. If the Department is determined to mandate a new duties test, it should comply with all regulatory requirements and allow for notice and comment on any specific new duties test proposal.

In closing, I would like to state that I am not against increasing the salary threshold for exempt status but it has to be a reasonable level so small employers like me, and those in rural areas, can also benefit. I am both proud and grateful for the responsibility of serving America's communities—creating jobs, boosting the economy, and serving our customers. My industry is committed to working with Congress to find solutions that foster job growth and truly benefit our communities.

Thank you again for the opportunity to testify before you today regarding small business concerns with the proposed overtime regulations. I look forward to your questions.