

# ORANGE COUNTY BUSINESS JOURNAL

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## First Paid Sick Leave and Now You're Telling Me Some Employees May No Longer Be Exempt from Overtime

by Christy D. Joseph and Erin D. Leach, Snell & Wilmer

A series of changes and new rules at the state and federal level over the last few months have compelled employers to re-evaluate and update their policies and practices. One of the latest changes, which takes effect on December 1, 2016 and is expected to affect 4.2 million workers, is a change to the standard for classifying white-collar employees as exempt from overtime under the federal Fair Labor Standards Act (FLSA).

You may be asking yourself, "why does that matter to me?" After all, California law is typically more generous to employees than federal law. The answer – this is one instance where federal law is actually the more generous of the two.

While most employers in California need to comply with both California and federal law when determining whether employees are properly classified as exempt from overtime compensation, the FLSA does not apply to all employers or all employees. Subject to the FLSA are employees of entities with annual revenues of at least \$500,000, measured by volume of sales or receipts, as well as individual employees who engage in interstate commerce or in the production of goods and services for interstate commerce. This interstate commerce requirement can be satisfied by such activities as regularly making out-of-state phone calls, receiving and sending mail or email, ordering goods from out-of-state suppliers or handling credit card transactions.

While the overtime exemption test under both state and federal law has two components – a salary test and a duties test – what makes up those components is a bit different. Under either test, if an employee does not earn a high enough salary, or does not qualify under the duties test, the employee cannot qualify as exempt under either California or federal law and must be paid overtime pay under the applicable law. Under California law, employers must pay non-exempt employees overtime pay for all hours worked over eight in a workday and over 40 in a workweek. Under the FLSA, overtime pay is only required to be paid on hours worked over 40 in a workweek.

At this time, there are no changes to the California overtime exemption test. The federal rule, however, has changed. The new FLSA rule includes the following changes in the overtime rules:

1. Currently, the effective salary test to be exempt from overtime compensation eligibility, as long as all other applicable "duties tests" are also met, is \$455 per week, which equates to a \$23,600 minimum annual salary. Under the new rule, the minimum salary level will more than double. It will increase to \$913 per week, or a \$47,476 minimum annual salary – setting the standard salary level at the 40<sup>th</sup> percentile of earnings of full-time salaried workers in the lowest-wage Census Region, currently the South.
2. Under the new rule, employers may count nondiscretionary bonuses and incentive payments (including commissions) to satisfy up to 10 percent of the new salary exemption level above. The nondiscretionary bonuses and incentive payments must be paid on a quarterly or more frequent basis in order to apply.
3. The total annual compensation requirement for the highly compensated employees overtime exemption, subject to a minimal "duties test," will be raised from \$100,000 to \$134,004 under the new rule – setting the standard to the annual equivalent of the 90<sup>th</sup> percentile of full-time salaried workers nationally.
4. The new rule establishes a mechanism every three years, beginning on January 1, 2020, for automatically updating the minimum salary test level and the highly compensated employee compensation level.

The new FLSA rule does not change the standard duties tests.

The analysis to determine whether an exempt employee is properly classified is detailed and complex, especially given the many differences between the California and federal requirements. Therefore, it is imperative that California employers understand which laws apply to their employees and ensure that they follow all applicable laws. The set of rules that provides the employee with more rights and protections is usually the law that governs. For example, to qualify as

an overtime exempt employee under California law, the employee must be paid the equivalent of two times the state minimum wage for full-time employment. As of January 1, 2016, with the state minimum wage at \$10 per hour, the annual salary must be at least \$41,600 to qualify for the California white-collar exemptions. This is less than the annual salary of \$47,476 or \$913 per week as set by the new FLSA rules. Accordingly, in order to avoid paying overtime for work over 40 hours in a week, assuming the duties test is met, California employers will need to pay the higher salary required by federal law by the December 1, 2016 deadline.

Employers should use the new FLSA rules as an opportunity to audit their workforce to determine if employee classifications need to be altered prior to the December 1, 2016 implementation date of the new rules. Where applicable, employers may need to increase individuals' salaries in order to maintain their exempt status. In addition, while the Department of Labor changed the salary level required to qualify as exempt, employers must also remember that exempt employees must meet the requirements of the duties test, which generally requires employees to perform high-level managerial, administrative or professional duties for a substantial portion of their worktime. For employers with concerns regarding an exempt employee's exempt status, this is also an ideal time to reclassify those employees as nonexempt without raising questions as to why the reclassification is taking place.

Accordingly, in anticipation of the December 1, 2016 changes, it is time to reevaluate how you classify your employees to ensure they are properly classified as exempt or non-exempt under both the federal and state duties test and the salary test to comply with applicable state and federal law.

### Christy D. Joseph

Christy D. Joseph is a practice group leader for the firm's labor and employment law group and is a partner in the Orange County office of Snell & Wilmer. Her employment-related litigation experience includes representation of employees in federal and superior courts, as well as before administrative agencies in matters involving wrongful termination, discrimination claims, sexual harassment, ADA and medical condition claims, wage and hour claims including class action, tortious interference, unfair competition, breach of fiduciary duty and trade secrets. Christy's practice further includes counseling employers not involved in litigation regarding contractual, statutory and legal rights and employment obligation matters. Reach Christy at 714.427.7028 or [cjoseph@swlaw.com](mailto:cjoseph@swlaw.com).



### Erin D. Leach

Erin Leach's practice is concentrated in employment litigation and counseling. She provides clients with ongoing counseling on a wide range of personnel matters including hiring and termination decisions, employment agreements, policy drafting, wage and hour issues and employee medical leave. Erin represents employers in state and federal courts and arbitration, as well as before administrative agencies, in disputes regarding wrongful termination, discrimination, sexual harassment, unfair competition, trade secrets, reasonable accommodation of disabilities, retaliation, wage and hour (individual and class actions) and other types of employment matters. Reach Erin at 714.427.7008 or [eleach@swlaw.com](mailto:elech@swlaw.com).

