



California Employers Will Soon Face Increased Wage-And-Hour Obligations

NEW FEDERAL REGULATIONS INCLUDE A HIGHER MINIMUM SALARY REQUIREMENT

Insights

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As of December 1, 2016, the minimum salary for salaried exempt employees under the federal Fair Labor Standards Act (FLSA) will increase from \$455 to \$913 per week. Because the federal salary standard will be higher than California's (currently \$800 per week), all California employers paying exempt workers under \$913 per week (or \$47,476 per year) will be required to either increase minimum salaries for such exempt employees or pay them overtime wages. The salary increase was among the limited, but no less significant, changes to the FLSA regulations announced yesterday by the U.S Department of Labor (USDOL).

Unless postponed, by December 1 you must have done what is necessary to continue to rely upon one or more of the salaried exemptions (or another exemption) as to each affected employee, or forgo exempt status as to any employee who no longer satisfies all of the requirements.

These regulations will have a dramatic impact in the state of California. The USDOL reports that nearly 10% of California salaried exempt employees, or over 390,000 individuals, will be eligible to receive overtime if their salary is not increased to meet the new levels.

Remuneration-Salary Test

Among the changes are the following:

- The minimum salary threshold for executive, administrative, professional, skilled computer-employee, and highly compensated exemptions, is increasing to \$913 per week, which annualizes to \$47,476 (up from \$455 per week, or \$23,660 per year). This eclipses California's current \$800 minimum salary requirement, but was not as high as initially projected (i.e., \$970 per week).
- The final \$913 amount is set at the 40th percentile of data representing what the USDOL calls "earnings of full-time salaried workers" in the lowest-wage Census region (currently the South). This amount will now be "updated" every three years (meaning that it will likely increase with each "update"), beginning on January 1, 2020. The USDOL will announce these changes 150 days in advance.
- You will be able to satisfy up to 10% of this new threshold for the executive, administrative, and

professional exemptions through nondiscretionary bonuses and other incentive payments, including commissions, provided that the payments are made at least quarterly.

- The total-annual-compensation threshold for the “highly compensated employee” exemption, not recognized in California, will increase from \$100,000 to \$134,004 (which will also be “updated” every three years). California employers cannot rely on this exemption for their California employees.

Duties Test Remains Unchanged

For now, the USDOL has not changed any of the exemptions’ requirements as they relate to the kinds or amounts of work necessary to sustain exempt status (commonly known as the “duties test”). The FLSA currently applies a *qualitative* test based on an employee’s primary duty, looking to the time test standards only as a rule of thumb.

Although the USDOL has asked for comments directed to whether there should be a strict more-than-50% “quantitative” requirement for exempt work, that won’t make a difference for California. That’s because California uses the “time” or *quantitative* test, meaning that exempt employees must perform exempt duties more than 50% of their actual working time each week. Of course, because exempt employees are not required to keep track of their time, it is risky to classify employees who do not clearly exceed the 50% threshold each week based upon their realistic job requirements.

Action Plans For California Employers

Although there are certain members of Congress considering action aimed at stopping these changes, and it is possible that lawsuits will be filed with the same goal, California employers should assume for the time being that the new requirements will take effect as scheduled. Therefore, you should consider implementing proactive and effective approaches in response to the USDOL actions. As acknowledged by the USDOL, California employers have a number of practical options, such as:

1. Increase the salary of any affected employees who meet the duties test to at least \$913 to retain their exempt status under the FLSA as well as California law. For salaried exempt employees in California who are presumably already receiving \$800 per week (or more), any salary increase should be slight (up to 14%).
2. Maintain salary of affected employees at \$800 per week to preserve the California exemption (assuming the duties test is satisfied) without increasing the salary to \$913 per week, and pay FLSA overtime at one-and-a-half times their regular rate of pay for hours worked over 40 in a week. This option would allow California employers to continue to exempt the affected employees from California’s daily overtime and double time rules, as well as avoiding the state’s onerous meal and rest period requirements.
3. Reclassify the affected employees to non-exempt status and pay an overtime premium rate of one-and-a-half times or double (if applicable) their regular rate of pay for any overtime hours worked. This option may be desirable for exempt employees in risky jobs whose duties place them near California’s 50% threshold.

4. In addition to reclassifying the employees to non-exempt, restructure compensation to offset anticipated overtime labor costs, such as reducing the affected employees' base salaries or other wages (subject to at least the applicable hourly minimum wage), then allocate saved labor funds to help pay for any overtime worked. This way your total weekly pay obligations remain near the same levels.
5. In addition to reclassifying the employees to non-exempt, adopt an alternative work week schedule (for example, 4 x 10 or 9/80) which, if passed by 2/3 of the affected employees in a properly implemented secret ballot election, could exempt an employer from paying daily overtime of up to 10 hours in a day or up to 40 hours in a week.
6. Reclassify the employees to another applicable exemption, if expedient, such as outside salesperson or inside commission salesperson. The requirements of satisfying these exemptions may be less costly than increasing the salary or paying the overtime.
7. Reduce or eliminate overtime hours.
8. Adopt a combination of the above approaches.

Going forward, California employers should take the opportunity to look at their workforce strategically, including taking a fresh look at all salaried exempt positions and reexamining whether such positions have been classified properly into a particular exemption category. You should also evaluate whether job restructuring could bring questionable jobs into a stronger exempt versus non-exempt status. Now would be a good time to develop compensation plans that are compliant with both California and the FLSA for employees retained as exempt or reclassified as non-exempt.

Finally, with the aid of legal counsel, you should consider whether structuring employees from exempt to non-exempt jobs, or any other strategic changes to compensation, should include an attempt to obtain release agreements (to the extent permitted by law) to avoid or reduce the risk and cost of defending lawsuits (individual, representative, or class actions). You can also use this opportunity to address potential liability for any arguable misclassifications based on exempt status, derivative claims alleging unpaid meal or rest period premiums, or other claims involving unpaid wages and penalties.

If you have any questions about these new regulations, or how they may affect your organization, please contact your Fisher Phillips attorney or one of the attorneys in any of our California offices:

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