

DETERMINING EXEMPT OR NON-EXEMPT STATUS UNDER CALIFORNIA LAW FOR MANAGERS

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Introduction

What do the terms exempt and non-exempt mean? Why is this distinction important and why is it relevant to managers? First, the definition of these two terms. Exempt and non-exempt refer to one's employment status within certain geographic areas (www.dol.gov/). An employee or a geographic area may be exempt or non-exempt as defined in the Fair Labor Standards Acts of 1938 (FLSA). An exempt employee is one who is not covered by the minimum wage and overtime provisions of the FLSA. A non-exempt employee, therefore, is one who is covered by the minimum wage and overtime provisions of the act. The act also defined these terms as they relate to geographic areas. This article is for managers of employees in California, therefore, the law as it applies to other geographic areas will not be covered.

FLSA establishes minimum wage and overtime pay for more than 100 million full and part-time workers in the private sector and in federal, state and local governments (U.S. Department of Labor, 1999). Defining exempt and non-exempt status at times is difficult and there can be high monetary penalties for improper classification. Difficulties arise due to the rapidly changing workplace and the wording of the FLSA, which does not cover every situation. The evolving workplace and technology is causing thousands of different jobs to change every day. Additionally, there are labour laws at the state level that also must be considered.

Every manager should try to have a clear understanding of these terms as they apply to their subordinates and also, in some cases, to employees of subcontractors.

Minimum Wage

Both the State of California and the federal government set a legal minimum wage. An employee must be the higher of the two rates (if they differ). The current minimum under California law is \$5.75 versus the federal minimum wage of \$5.15. This amount cannot be reduced by any amount. For example, an employer cannot charge an employee for supplies or reduce their income if they receive tips or gratuities from customers. Some employees are entitled to a higher minimum wage (Braconi, 1994). If the employer is receiving state or federal funds (like on a public works project) or if you work in a convalescent hospital or other long term care facility receiving Medicare funding the minimum wage may be higher. In addition, some cities and counties, particularly in high-cost urban areas, are enacting "livable wage" laws of their own. Generally, these laws require companies doing business with or subcontracting duties usually performed by city workers to be paid a wage at a level considered to be "livable" or sufficient to sustain a family of four above the poverty level. In November, the City of San Jose, California passed a local ordinance requiring contractors to pay their workers at least \$9.50 an hour with health benefits or \$10.75 on all contracts where city services are performed.

While some employers may be required to pay at least the minimum wage or higher, some job functions are exempt from these requirements. Apprentices in identified industries, certain handicapped workers in sheltered workshops licensed by the state and U.S. Department of Labor, certain learners, minors and white collar workers, outside salespeople, and attendants, babysitters and companions all may qualify for exemption from the minimum wage. Welfare recipients who work under "workfare" programmes are currently also considered to be exempt from the minimum wage (Miller, 1999).

Overtime

A California employee is entitled to overtime compensation at 1 1/2 times his or her regular rate of pay for all hours worked over 40 in a work week unless he or she is exempt from overtime pay requirements of both state and federal laws (www.dir.ca.gov/).

An employee is considered to be automatically non-exempt unless it is specifically determined that the employee is exempt and the burden is on the employer to make the correct determination. As with minimum wage, there are exemptions both for specific industries and for certain positions. These positions fall under what are known as white-collar exemptions (www.workforceonline.com/).

White Collar Exemptions

Under this classification, employers are allowed to exempt executives, professionals, administrative employees and salespersons from overtime compensation. The following is a brief description of these exemptions:

Executives

Executives are those who manage the work of two or more employees, and whose primary duty involves management functions. They must direct the work of at least two people, have hiring and firing authority, and use discretionary powers. They cannot spend more than 20 per cent (40 per cent if retail) of their work week in non-exempt work.

Administrative employees

Their primary duty must be either: one, performing office work related to management policies or general business practices or, two, the administration of a school system. Also included are staff employees who perform special assignments, like purchasing agents or auditors. Like executives, they must use independent judgment and discretion in their positions. Also like executives, they can spend no more than 20 per cent (40 per cent if retail) of their work week performing non-exempt tasks.

Outside salespeople

Outside salespeople are exempt if they meet two requirements: one, they are customarily engaged in selling or obtaining orders for a company's products or services, and, two, they spend less than 20 per cent of their work week in non-sales activities.

Professionals

The primary work requires either one, advanced knowledge customarily acquired by specialised study or, two, originality and creativity. They must use discretion and independent judgement. Their work must be intellectual and varied, not standardised. No more than 20 per cent of their work week can be spent in non-exempt tasks. The professional exemption includes anyone whose position requires the possession of an advanced educational degree in a field of specialised study, such as a CPA, physician or engineer. All white-collar exemptions are subject to minimum salary requirements in addition to the above criteria.

Industry Exemptions

The title of this section would be more accurately described as exemptions, exemptions and more exemptions. There are many classes of employees with specific exemption from both the minimum wage and from overtime compensation (US Department of Labor, Feb. 1999). They are:

- Employees of certain seasonal amusement or recreational establishments.
- Employees of certain small newspapers and switchboard operators of small telephone companies.
- Seamen employed on foreign vessels
- Employees in newspaper delivery
- Farm workers employed on small farms
- Babysitters and persons employed as companions of the elderly and infirm.

The following are exempt from overtime pay requirements only:

Certain commissioned employees of retail or service establishments

Auto, trust, trailer, farm implement, boat or aircraft sales workers, or parts clerks and mechanics servicing autos, trucks or farm implements, who are employed by non-manufacturing establishments engaged in selling items to ultimate purchasers.

Businesses Covered

Not every business is subject to FLSA. Covered businesses are those having sales over \$500,000 per year, are engaged in interstate commerce or producing, selling or working on goods or material that have been moved in or produced for interstate commerce. Some employers are covered regardless of their annual sales. These include hospitals and institutions who take care of the sick, aged, mentally ill or disabled who reside on premises; schools for children who are mentally or physically handicapped or gifted; pre-schools, elementary, secondary and institutions of higher learning, and federal, state, and local government agencies (US Department of Labor Feb. 1999).

Federal vs. State Law

Employers are required to be in compliance with the more restrictive of the state or federal laws and California law does differ in certain areas. For example, California does not have a specific exemption for computer professionals, which is available under the federal law (www.workforceonline.com/). Therefore California employers should classify computer programmers who spend more than 50 per cent of their time writing code as non-exempt. In some cases, programmers can qualify as exempt even if paid on an hourly basis, provided certain conditions are met. The first condition requires that an employee must receive an hourly rate of pay that is not less than \$27.63 an hour. Prior to September 1, 1996, the rate had to exceed six and one-half times the federal minimum wage. The second condition involves a duty test. The test requires that an employee's primary duty consist of one or more of the following duties which include the design, documentation, testing, creation or modification of computer programmes related to machine operating systems.

Computer employees also can be eligible for exemption under the administrative exemption. According to the Department of Labor, the employee would have to exercise discretion and independent judgement and perform work directly related to the management policies or general business operations of the employer. Job duties should include planning, scheduling or co-ordinating activities that are required to develop systems for processing data to obtain solutions to complex business problems.

Sub-Contractor Liability

Not only does a manager need to be aware of the proper classification of their subordinates but if they contract with outside vendors to perform services for the company, they also should determine that sub-contractors are in compliance with FLSA (Sunoo, 1999). Many firms sub-contract with janitorial companies that hires a predominantly immigrant and non-English speaking workforce where wage and overtime violations are common. A company may become jointly liable if in an employee lawsuit, the plaintiff could prove the joint employment of the firm and the tenant employer. If the employer/tenant exercised some control over the janitors like making them sign in and sign out or telling them when and how to clean, they may be exercising joint control. Companies should be concerned because these people are working at their premises. Companies should double-check that sub-contractors have been asked to sign an agreement stating their compliance with FLSA labour laws.

Violations against janitors are particularly rampant in the computer industry. The Department of Labor has cited several companies in Northern California's Silicon Valley for wage and hour violations. The citing was based on the provision that generally makes it illegal to ship goods in interstate commerce, which have been made in violation of the wage and hour requirements of the FLSA. It would apply to janitors because dust room and cleanliness are such an integral part of chip manufacturing. If a janitor is not being paid in compliance, the produced goods in theory can be seized by the Department of Labor. While there have not been any major seizures, but DOL has issued a number of public warnings to the industry.

Common Violations

There are many common misconceptions that can lead to minimum and overtime violations. One of the most common is that 'salaried' employees are exempt (Sunoo, 1999). This is not true because exemption is not based on salary alone. There are two FLSA requirements that must be met before the position can be considered exempt. The employee must receive each week the same pre-determined salary, regardless of hours worked and also qualify under the job duty test. Both requirements must be met.

The job description means absolutely nothing. It is the actual job tasks that determine whether someone is exempt or non-exempt. If an employer promotes an employee to "manager" or "supervisor", it is often assumed

that he or she is exempt. But while the duties typically associated with the title are exempt, the question is not what the title or job description says, but what the employee is actually doing on a daily basis. If a manager of a fast food establishment is spending part of his time at the counter helping customers during peak times, this can be grounds for losing his or her exempt status. Common jobs businesses typically misclassify include inside sales representatives, customer service representatives, computer-assisted designers, fast food assistant managers and construction foreman who also work alongside their subordinates (Sixel, Mar. 5, 1999).

Failure to pay for "unauthorised" overtime or allowing time worked "off the clock", is another common violation (Sunoo, 1999). Some employees are willing to take extra work home with them or perform extra duties without pay. This is not allowable under current labour law. Employers must pay non-exempt employees for time worked regardless of where the actual work is performed and cannot ask for work to be performed during breaks or at lunch time. Simply asking a secretary to answer the phone during her lunch would require that he or she be paid for this time. Employers must also remember to pay non-exempt employees for the following periods: training, travel during normal workdays, meetings, uniform changing, cleanup and some types of on-call situations.

Employers also are not relieved of liability simply by having a policy against overtime. These violations result from the mistaken belief that a policy against unauthorised overtime allows an employer to not pay for that time worked. This is incorrect. Not paying may seem like the appropriate disciplinary action, however, if the employer knew and allowed the work to proceed, the employer is obligated to pay for the time worked. The same rule applies if the employer learns of overtime performed even after the fact. The employer always has the right to take disciplinary action against the employee such as a suspension or termination but they are still required to pay overtime for the hours already worked.

Sometimes even if you understand the distinction, problems can arise. Violations can occur when employees work in more than one job capacity in the same company doing both non-exempt and exempt tasks but are still being paid straight time for all hours. Labour law generally limits the time white-collar employees can perform non-exempt tasks without losing their exempt status.

It is also not possible for a company to maintain the intent of the "salary" requirement of FLSA and not offer any type of paid sick/personal time. The concept of "salary" means that an employee is paid a fixed wage regardless of the number of hours worked. In determining whether an employee is salaried or an hourly worker, a "totality of the circumstances" test is applied. Under the FLSA, an employer cannot dock an employee in increments of less than one full day without nullifying the exemption.

While you cannot deduct sick/personal time from an exempt employee's wages, you also can not pay them overtime. This can occur when you want to pay a group of lower level salaried employees who are working long hours additional compensation. The simple solution is to pay overtime, but you then may no longer be able to defend the exempt classification of the employee. The easiest solution is to reward the extra hours by granting discretionary vacation, bonuses or other recognition. There is nothing to prevent you from giving out a bonus every month based on performance or hard work.

One solution to overtime may be to swap overtime pay with compensatory time off. However, labour law restricts comp time. Swapping comp time is only permissible if employees take time off in the same week in which they work overtime.

Penalties For Non-Compliance

The consequences for misclassification of employee status, which results in the incorrect payment of wages, can be severe. Successful FLSA plaintiffs are usually entitled to recover double the amount of improperly unpaid back wages. This is called "liquidated damages" and is essentially in lieu of interest. Liquidated damages are mandatory unless the employer proves that it made reasonable efforts to find out how the FLSA governed its employees, and also had an objectively reasonable basis to believe its wage practices were legal under the FLSA.

Shortchanged employees increasingly are filing lawsuits. But that is not the only way employers are being held accountable. The U.S. Department of Labor, regularly conducts major investigations in vulnerable industries such as garment, building-services, constructions, manufacturing and computer. In fact, Department of Labor investigations reveal that in 1998 alone, businesses paid \$120 million in back wages and penalties for overtime violations involving more than 173,000 employees. And these violations barely scratch the surface of

the problem. The amount would be much more if the DOL had not been downsized in recent years. According to the Department of Labor, the agency has 950 investigators; a decade ago, there were approximately 1,600 (Sunoo, 1999).

Recently several well-known companies in California have lost cases brought by employees who believed they were improperly classified under the law. Edwards Cinema based in Newport Beach, and a major movie theatre owner in California was required to pay \$276,000 to four workers for unpaid overtime (Mouchard, Nov. 10, 1998).

The Money Store also is the subject of pending litigation from loan officers and assistant branch managers who routinely worked many hours of overtime per week (Steinberg, 1999). Since the employee felt their jobs did not involve "intellectual, managerial or creative" work, they were improperly classified as exempt employees.

New Workplace Challenges

Remember, each exempt or non-exempt position must be judged on job duties before a decision can be made on an employee's status. This applies not only to those who operate the latest tools, such as computer specialists, but also those who conduct their work in new ways. Telecommuters are the best example.

Not only has the nature of work changed, but where our work is conducted has changed as well. The number of telecommuters in the United States has more than tripled from 3.6 million in 1990 to 11.1 million in 1997, according to New York City-based market research firm Cyber Dialogue (Sunoo, 1999). As the number increases, so do the number of managers who are trying to supervise employees who work remotely. The question of how these employees will be monitored and supervised is a challenging problem for managers. Under the FLSA, there is no current definition or guidance about who is a telecommuter. The law only states an employee must be paid for all time worked regardless of where the work was actually performed.

Within this framework, telecommuters should be treated no differently than in-office workers. For exempt employees, the key to managing at a distance is to focus on results and deliverables and much less on hours worked and activity levels. It is the results that count, not the activity, and, telecommuters must understand that overtime must be approved in advance, just as in the office.

Recommendations for Managers

With employee lawsuits on the rise, managers need to make sure their company is in compliance with the FLSA. The law says that a job is non-exempt unless employers can prove it is exempt. Therefore, the burden of proof is on the employer. The problem is that employers frequently allow job descriptions to be written by Human Resources or allow them to go without being updated for long periods of time.

To avoid any problems, managers can implement the following steps:

- Periodically conduct an audit on all job duties, especially after reorganisation and downsizing.
- Review the FLSA (and California state) regulations with the human resources department and with line managers.
- Keep accurate records of hours worked.
- Know where California laws are stricter than federal laws.

Summary

Exempt and non-exempt status is one of those issues most managers do not give much thought to. I had always assumed that employee status was something negotiated with a worker, especially white-collar ones, kind of like salary is. But I have discovered my thinking was entirely incorrect. Federal and State law require correct classification of employees and payment of overtime for hours worked over 40 in one week for most workers (about 70% according to the DOL).

As a general rule, unless a manager knows that his industry is specifically exempt or employs handicapped workers or trainees, he should assume all workers are subject to the minimum wage. A line manager should also realise that everyone who is below him probably also qualifies for overtime unless he is supervising a group of skilled professionals like engineers. Common sense also dictates that demanding employees to work off-the-clock or during their lunch without pay is wrong.

The workplace has become extremely competitive and there is a lot of pressure on managers to control costs. Saving money, however, is not a legitimate excuse for an employer violating its employee's rights to fair compensation under the law.

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