

## ***First Wednesday — A Monthly Discussion of Employment Law Issues and Other Hot Topics for Management***

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***By Jeffrey A. Snyder - Issue No. 23: June 2, 2004***

Jeff is a Shareholder of Thoits, Love, Hershberger & McLean, specializing in employment law and commercial litigation. He can be reached at (650) 327-4200 or [jsnyder@thoits.com](mailto:jsnyder@thoits.com).

### **Basics of Overtime Pay – The Exempt/Non-Exempt Issue**

One of the most heavily-litigated issues in employment law is the alleged failure to pay overtime. This issue can have huge consequences. In a class action suit brought against Farmers Insurance Company, an Alameda County jury awarded \$90 million to a group of approximately 2,000 Farmers claims adjusters who had been improperly classified as managers and, therefore, denied overtime. As explained below, the mere title of “manager” is not determinative and Farmers paid for it. \$88 million of the award was recently upheld in a decision by the California Court of Appeal.

The California Supreme Court has also confirmed that overtime violations can form the basis of an unfair competition claim, since a business’s failure to pay overtime inherently creates an unfair business advantage over companies that comply with overtime laws. Many overtime claims are routinely filed and reviewed by the California Labor Commissioner’s Division of Labor Standards Enforcement.

The question of how to avoid overtime problems is not easy to answer. But if the issues are addressed early, companies will minimize the risk of liability exposure. This bulletin highlights the main issues and some common misconceptions about this complex and fact-intensive area.

1. **What Law Applies?** California employers must comply with both the Federal Fair Labor Standards Act (29 U.S.C. § 207) and California state law. California's basic overtime law is found in Labor Code section 510. The California regulations are found in the 17 Wage Orders issued by the Industrial Welfare Commission. Section 3 of the Wage Orders discuss overtime.

All employers in California are required to post the appropriate Wage Order in a conspicuous place in its workplace. An employer determines which Wage Order is applicable to it by classifying the "main purpose" of its business. For example, Wage Order No. 1 covers the manufacturing industry, Wage Order No. 2 covers the personal service industry, etc. If a business cannot be classified under a specific industry order, then an occupational order will apply. These occupational orders are Wage Order No. 4 and Nos. 14-17.

2. **Who is Entitled to Overtime Pay?** All non-exempt employees working over 8 hours per day or 40 hours per week are entitled to overtime pay in the amount of one and one-half times their regular rate of pay. Any work in excess of 12 hours in one day must be compensated at twice their regular rate of pay. "Regular rate of pay" includes not only base pay but commissions, production-based (non-discretionary) bonuses, and certain other compensation. Proper calculation of the amounts to be paid as overtime can get complicated due to intricate compensation systems.

There is a presumption that all employees are non-exempt from the overtime laws. Thus, the burden is always on the employer to prove that a particular employee is exempt.

To qualify for exempt status, the employee needs to receive a salary and fit within one of three "exempt" categories based on the employee's duties: the professional exemption, the executive exemption, or the administrative exemption. Briefly, a professional is someone whose work requires an advanced degree and who is actually working in a learned profession, such as a college professor, lawyer, physician, etc. To fit within the executive exemption, the employee must exercise discretion and independent judgment for the company and manage at least two other workers as a prominent part of his work day. Thus, it is not enough to simply label the person as a

manager “in charge of the office,” when the person is basically managing himself or spending most of the day doing routine clerical tasks. The administrative exemption applies to those who exercise independent judgment and discretion for the company, and perform non-manual work duties, including advising management, and negotiating or purchasing on the company’s behalf.

In addition to meeting these “duties” tests, all exempt employees must receive a salary of not less than twice the prevailing minimum wage. With limited exceptions, the salary cannot be “docked” or otherwise subject to reduction for tardiness or absence.

Essentially, the way to think of an exempt employee is that he is paid for the accomplishment of work as opposed to being paid for his time. Non-exempt employees are paid for time worked (including vacation and sick pay, if appropriate) on an hourly basis, and detailed time records must be kept of their hours worked.

In addition to the professional, executive and administrative exemptions, there are some miscellaneous exemptions. One is the computer software employee exemption. This is the only exemption in which the employee need not be paid a salary. The minimum amount of pay is currently set at \$41 per hour, which amount can be adjusted by the Labor Department each year. In addition, the work must be intellectual or creative, and the employee must exercise discretion and independent judgment (other requirements are listed in Labor Code section 515.5). Another important exemption is the outside salesperson exemption. Generally, the salespeople must be over the age of eighteen and spend more than fifty percent of their working time away from the office, either selling or obtaining orders for products, services or use of facilities. There is also an exemption for certain artists, as well as commissioned inside salespeople under Wage Order Nos. 4 and 7.

3. **When Can Make-up Time Be Used To Avoid Overtime?** Make-up time allows a non-exempt employee to request personal time off and make up the time on another day without receiving overtime pay. The make-up time rules are found in the wage orders. It is crucial that all rules be followed, or else the excess time worked (over 8 hours in a day or 40 hours in a week) will be considered overtime. Basically, for each incident of make-up time: (1) the employee must submit a signed, written request;

(2) the time must be made up within the same work week; (3) the employee may work no more than 11 hours on another work day, and no more than 40 hours in a work week; and (4) the employer may not encourage or solicit the employee to request make-up time.

4. **Alternative Work Schedules.** Another way to possibly avoid overtime is to use appropriate alternative work week scheduling, such as a 4-day week of 10 hours per day or a 2-week schedule of nine 8-hour days. Before implementing these programs, certain steps are required, including an employee group meeting, a secret ballot vote, a formal agreement, and a filing with the Labor Commissioner.

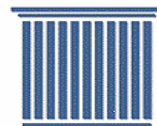
5. **Conclusion.** These are the main issues, but the devil lies in the factual details. Overtime violations can result in steep fines and expensive lawsuits. Remember that neither impressive job titles nor the fact of paying a salary is determinative of “exempt” status. The judge or jury will necessarily analyze the type of industry and duties actually performed by the particular employee. If litigation is filed or an investigation commenced into the employer’s practices, it will be the employer’s burden to prove the exempt status of each employee.

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Jeffrey A. Snyder  
Thoits, Love, Hershberger & McLean  
245 Lytton Avenue, Suite 300  
Palo Alto, California 94301-1426  
Telephone: (650) 327-4200  
Facsimile: (650) 325-5572  
E-mail: [jsnyder@thoits.com](mailto:jsnyder@thoits.com)

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