

# EXEMPT EMPLOYEE OVERTIME PAY: A VERY EXPENSIVE OXYMORON

by *TODD R. WULFFSON* and *ASHLEY A. HALBERDA*

**A**fter a contentious termination of a salaried manager or director, California employers may be surprised to find themselves facing a claim from an ex-employee seeking overtime pay, or costly penalties associated with alleged missed meal breaks. Claims like these can easily cost an employer six figures if they are not adequately protected. With these types of cases, there is no mitigation requirement, and an employee is not required to have previously raised concerns about overtime or missed breaks.

Further complicating this issue is the presumption that all employees in California are entitled to overtime unless an exemption exists. Under California law, most exemptions are based on the amount of hours per day or week an employee spends on certain tasks. By definition, exempt employees don't punch time cards. This can create a challenge for employers who find themselves left with little or no documented evidence of an employee's hours when faced with a claim from an ex-employee seeking overtime pay or missed meal breaks.



An improper classification can leave an employer vulnerable to liability for unpaid overtime, unpaid meal premiums, and additional wage statement penalties accruing up to three years (or four years if the employee claims it was also an unlawful business practice under California Business and Professions Code section 17200). In California, a prevailing employee can also seek attorney's fees, which often eclipse the amount of any underlying overtime award.

A particularly troublesome version of this dispute involves "administrative" employees, since the other exemptions are more clearly defined. Employees who fall within the administrative exemption are directors who supervise fewer than two employees, managers, assistant managers, and employees who are a department of one. As unlikely as it may seem, an IT or HR director making close to \$100,000 per year, along with risk managers, buyers, and senior accounting personnel, with similarly substantial salaries, may all be potential plaintiffs in a future overtime lawsuit. This article will provide best practice tips to help avoid these lawsuits and minimize potential exposure.

### **Applicable California Wage and Hour Laws**

California employers must comply with both federal and state overtime laws. Federal laws are more employer-friendly in terms of proof, and carry less potential exposure. For example, federal law does not require meal or rest periods. As a result, California employees invariably prefer to sue under state law. In the absence of an applicable exemption, employees in California must be paid time-and-a-half for any hours above eight hours worked in a day, up to twelve hours; if an employee works more than twelve hours in a day, he or she must be paid double time. Cal. Lab. Code § 510. Hourly (nonexempt) employees are entitled to a ten-minute rest break for every four hours worked, and a thirty-minute meal period for every five hours worked. *Id.* § 512. For each workday that an uninterrupted thirty-minute meal period is not provided, the employer must provide one additional hour of pay at the employee's regular rate. *Id.* § 226.7.

California employers can avoid compliance with these requirements if an employ-

ee's position falls within an applicable exemption. The four primary exemptions prescribed by California's Wage Orders are: (1) the executive (*i.e.*, "managerial") exemption, (2) the administrative exemption, (3) the professional exemption, and (4) the outside sales exemption. Cal. Code Regs. tit. 8, § 11040.

Given the more bright-line criteria of the other exemptions (supervising two or more employees, licensed professional, or salesperson working away from the business), the administrative exemption is often the catch-all and, consequently, the battleground for many misclassification claims.

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For an employee's position to qualify as exempt under California's administrative exemption, the employee must: (1) be paid a salary equal to at least twice the minimum wage (currently \$37,440/year), (2) perform office or non-manual work directly related to management policies or general business operations of the employer, (3) customarily and regularly exercise discretion and independent judgment, and (4) exercise these exempt duties at least 51% of the time every pay period. *Id.* Accordingly, the main area of dispute in these claims is the type of tasks performed by an employee on a daily basis, leading to a largely "he-said, she-said" style of litigation. Having successfully defended several of these, we note that one of the most important items within an employer's control is the quality of its documentation relating to a position and an employee's performance of his or her duties.

### **Top Five Ways to Win Using the Administrative Exemption in a Misclassification Lawsuit**

#### **1. Pay a Starting Salary Considerably Above \$37,440**

As a threshold issue, an employee's position will not qualify for an exemption if the employee is not paid on a salary basis at least double the minimum wage. *Id.* Juries, however, are much more likely to see a position as exempt if it is a highly paid one. An employer trying to argue that an employee who earned an annual salary of \$38,000 was exempt will have a much more difficult time than one arguing that an employee who earned an annual salary of \$70,000 was exempt. It is often assumed that the higher pay is compensation for the judgment and skills that accompany the higher salary. It is important to note that increases in the California minimum wage may require an adjustment to employee salaries. Even though an employee's salary initially qualified for administrative exemption, the position may become nonexempt if the salary falls below the threshold.

A higher salary may also qualify an employee for other exemptions. For example, in the case of IT professionals, the position may come within the computer professionals' exemption, which in California has a base annual salary requirement of \$84,130.53. *See* Cal. Lab. Code § 515.5; Memorandum from Cal. Dep't Indus. Rel. (Oct. 10, 2014). Similarly, executives making an annual salary of at least \$100,000.00 are exempt if they perform at least one exempt task. This should be considered when assigning compensation to a position.

#### **2. Do Not Blindly Classify a Position as Salaried to Avoid Paying Overtime**

The payment of a salary to an employee does not remove the employer's obligation to comply with California's wage and hour laws. This is a common misconception. An employee must be paid a salary *and* perform exempt duties. There is no presumption that a position is exempt simply because it is compensated on a salary basis. It is critical to conduct an analysis of the position's duties and determine, before the position is created or filled, whether it qualifies as exempt under an applicable exemption.

### 3. Create a Detailed Job Description

Although not independently dispositive, accurate and detailed job descriptions (exempt and nonexempt) will provide persuasive evidence in favor of the proposed exemption—particularly with a more nebulous administrative exemption. Ideally, the job description for an exempt position should include a percentage allocation of the duties required of that position, clearly indicating those duties that should be performed the majority of the time. The position's classification should be unambiguously stated on the description. This provides an employee with an initial opportunity to question the classification at the time of hire or promotion. Further, this places an employee in the difficult position of having to argue that the reason she did not qualify for the exemption was because she was not doing the job for which she was hired.

To add credence to the job description, it should be created by a third-party human resources professional, rather than in-house (preferably by someone that makes a good witness and/or has a good indemnification provision in their service agreement). Testimony by experienced, independent human resources personnel will fortify the employer's position that the job was properly classified, and can weaken any challenges to the classification. A jury is more likely to believe an experienced and unbiased third party over a senior executive from the company.

As employees often have no documentation regarding the types of tasks they perform on a daily basis, it is difficult to contradict a written job description. This documentary evidence can go a long way toward trumping any obviously biased testimony offered by an employee.

### 4. Consistently Conduct Annual Performance Reviews

Performance reviews should be conducted for all employees, even those employees who are not exhibiting performance issues. Employers commonly relax performance review policies if an employee is doing a good job, but this is unwise. Performance reviews are critical in preventing not only misclassification claims, but also many

other employment-based lawsuits.

Annual reviews provide employees with an opportunity to voice any complaints they have about their employment, including concerns regarding the amount of hours they work and the type of compensation they receive. If an employee believes she should be paid overtime, this can be a topic of discussion during a review. If the employee fails to bring it up during a review, it is a strong argument at trial that it was something the employee did not feel was too important.

Performance reviews also enable an employer to monitor the work being performed by the employee. Addressing an employee's performance of assigned responsibilities, especially when compared to those set forth in the job description (with time percentage allocations), is an easy way to determine whether the employee is actually performing required tasks. Assuming

diligent management, liability engendered from an employee shirking his or her exempt responsibilities, or from a position that has evolved to be nonexempt, can be eliminated or significantly reduced if the issue is reviewed properly on an annual or more frequent basis.

### 5. Do Not Keep a Record of Exempt Employees' Hours

Employers are not required to keep time records for salaried, exempt employees. In fact, doing so can jeopardize the exemption—unless the record keeping is done for some legitimate purpose, such as hourly billing to clients. Accordingly, do not treat exempt employees as if they are hourly: do not record arrival and departure times, do not chastise them for being "tardy," and do not dock them for less than a full day's pay for vacation, sick leave, or personal time off.

Although an employer usually has no record of an exempt employee's hours, oftentimes, the employee similarly lacks a good paper trail. This is significant as it is an employee's burden to present a *prima facie* case in support of her claims before the burden shifts to the employer to prove the exemption. In an overtime case, the employee must prove the amount of hours that she worked and the overtime allegedly owed. Without a record of arrival and departure times, the employee cannot point

to certain days wherein she claims to have worked in excess of eight hours. This can cripple any calculation of overtime damages. In contrast, if the employer maintains a daily log of the employee's hours and the employee is found to be misclassified, she will have determinative evidence of damages.

### Conclusion

It is important to remember that wage and hour claims cannot be waived, and cannot be released unless done properly—usually through a Labor Commissioner document. Therefore, simply settling with employees for their overtime claims may not only be ineffective, it may actually be used as evidence of alleged illegal conduct. Few things add more insult to injury in a wage and hour case than finding out that the employee took the settlement funds you gave her and used it as a bank roll to finance additional lawsuits for penalties, interest, attorneys' fees—or worse—a class action. For this reason, employers in California must be diligent, properly-advised, and take affirmative steps to shield themselves from liability before any misclassification claims are threatened. This is an area where an ounce of prevention can be worth hundreds of thousands of dollars.



**Todd R. Wulffson** is a partner with California employment and labor law firm Carothers DiSante & Freudenberger LLP, where he regularly counsels and defends employers on issues related to wage and hour, human resources, non-solicitation, traditional labor, and social media. Todd may be contacted at [twulffson@cdflaborlaw.com](mailto:twulffson@cdflaborlaw.com). **Ashley A. Halberda** is an attorney with Carothers DiSante & Freudenberger LLP, where she represents California employers in issues related to wage and hour, wrongful termination, harassment, and class actions. Ashley may be contacted at [ahalberda@cdflaborlaw.com](mailto:ahalberda@cdflaborlaw.com).

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