
CALIFORNIA EMPLOYERS BEWARE: THE COST OF PAYING EMPLOYEES IS ABOUT TO GO UP

by KIMBERLY A. CHASE

The cost of paying employees is about to go up for many California employers, potentially in the range of thousands of dollars per employee. The California Legislature is currently considering Assembly Bill 1565, which would increase the minimum salary requirements for exempt employees in 2018 even more so than already called for by existing law. If AB 1565 is passed, California employers will need to decide whether to (a) increase exempt employees' salaries to meet that higher minimum threshold or (b) reclassify those workers as non-exempt, track their hours, and pay them overtime.

Existing California Law

To understand AB 1565's impact, it is first necessary to understand exist-

ing law in this area. For an employee to be exempt from overtime requirements, existing law requires (among other things) that the employee's salary meet a certain minimum threshold. If that salary threshold is not met, the employee is non-exempt and thus entitled to overtime. Unlike federal

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law, which sets the salary threshold at a specific dollar amount (currently \$455 per week or \$23,660 annualized), California law sets the salary threshold at *twice* that of the state minimum wage. Cal. Lab. Code § 515(a). As a result, California's salary threshold automatically increases with every minimum wage hike. For 2017,

the minimum wage in California for employers with twenty-six or more employees is \$10.50 per hour, so for a California employee to be exempt from overtime requirements, he must be paid at least \$3,640 per month or \$43,680 per year (40 hours per week x 52 weeks per year x \$10.50 per hour x 2). Likewise, the 2017 minimum wage in California for employers with twenty-five or fewer employees is \$10 per hour, so these smaller employers must pay exempt employees at least \$3,467 per

month, or \$41,600 per year.

These figures only apply for 2017, however. Pursuant to Labor Code section 1182.12, California's minimum wage will be gradually increased to \$15 per hour for all employers by 2023, with slight increases each year that depend on whether the employer has more or less than twenty-five



employees. Because California's salary threshold for its overtime exemptions is calculated by doubling the current minimum wage, as the state's minimum wage rises, so too will the state's salary threshold. Thus, under existing law, in 2018, the salary threshold will be \$45,760 for employers with 26 or more employees and \$43,680 for employers with 25 or fewer employees (based on the 2018 minimum wages of \$11 and \$10.50); in 2019, the salary threshold will be \$49,920 and \$45,760, respectively (based on the 2019 minimum wages of \$12 and \$11); and in 2020, the salary threshold will be \$54,090 and \$49,920, respectively (based on the 2020 minimum wages of \$13 and \$12).

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The Effect of AB 1565

If passed, AB 1565 would accelerate the annual increases of the applicable salary threshold in California. For an employee to be considered exempt under AB 1565, he must earn a monthly salary equivalent to the *greater* of either (a) \$3,956 per month (*i.e.*, \$47,472 per year) or (b) an amount no less than twice the state minimum wage for full-time employment, "*whichever amount is higher.*" The bill does not distinguish between employers based on the number of employees they have.

This language operates to accelerate the increase of California's salary threshold in the immediate future. For example, the salary threshold in 2018 will be \$3,956 per month or \$47,472 per year (rather than \$45,760 or \$43,680 per year depending on the size of the employer, as called for by existing law). That's an increase of over \$1,700 per employee in 2018 for employers with twenty-five or fewer

employees, and an increase of *almost* \$3,800 per employee in 2018 for businesses with twenty-five or fewer employees. Similarly, in 2019, the salary threshold will be \$3,956 per month or \$47,472 per year, which, again, is an increase of over \$1,700 per year per employee for employers with twenty-five or fewer employees, compared to the \$45,760 per year threshold called for by existing law. Perhaps not surprisingly, business groups have attacked the bill as disproportionately hurting smaller businesses, many of which lack the resources to absorb these accelerated wage increases.

Proponents of AB 1565 note that the bill has no long-lasting effects on the salary threshold, which is already set to increase with time thanks to the annual increases of California's minimum wage. Indeed, AB 1565 would not affect the 2019 salary threshold for employers with twenty-six or more employees because existing law already sets that threshold at \$49,920, which is greater than the proposed alternative of \$3,956 per month (\$47,472 annualized). And AB 1565 would not impact the salary threshold for any employer in 2020 or future years. By that point, the controlling part of the bill would be the "amount no less than twice the state minimum wage" language (same as under current law). In other words, by 2020, twice the minimum wage will be higher than the alternative under the statute (\$3,956), rendering the \$3,956 alternative moot.

Next Steps for Employers

If the proposed legislation passes, employers will need to consider how to classify and compensate employees who are being paid a salary that falls below 2018's \$47,472 per year minimum. Employers may either raise

those employees' salary levels to meet the new minimum for exempt status, or alternatively, they may reclassify those employees as non-exempt and pay them for overtime work. Of course, paying overtime has its own implications on overhead, and employers would also need to ensure compliance with other administrative and scheduling requirements as to any newly converted non-exempt employees, such as timekeeping, overtime calculations, and meal and rest breaks.

Finally, employers should remember that for an employee to be exempt under California law, he must not only meet the salary threshold, but also be "primarily engaged in" exempt duties. Determining whether an employee satisfies these requirements can be a complicated and fact-intensive process. Employers are also reminded that generally speaking, to treat an employee as exempt, the employee must be exempt under both California law and federal law, which differ on several material points. Thus, employers are advised to consult with counsel before deciding whether to classify an employee as exempt or non-exempt.



Kimberly A. Chase is a partner in the Labor & Employment section of Haynes and Boone, LLP. She can be reached at Kimberly.Chase@haynesboone.com.

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