October 21, 2022

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| **VIA ELECTRONIC MAIL ONLY**  Lenny Segal  PACE Recovery Center, Inc.  20051 Southwest Birch St.  Newport Beach, CA 92660  *lsegal@pacerecoverycenter.com* |  |

Re: *The Law Regarding the Difference Between Exempt v. Non-Exempt Employees*

Dear Lenny,

Because even the inadvertent misclassification of employees by an employer could result in crushing financial penalties, I decided to create a primer for you explaining the differences between *exempt* and *non-exempt* employees. I also created a handy tool to help PACE Recovery Center, Inc. (“PACE”) properly classify its employees, which I will send you at the same time that I send you this letter. This tool, **Questionnaire—Classification of Exempt/Non-Exempt Employees** (the “Questionnaire”), is designed for *your* use (there’s no need to ever send it to me), is fill-in-able, and may be completed by you and saved electronically. You should go through this letter, and complete the attached Questionnaire, with all of your employees in mind to ensure that you’ve properly classified them.

As I indicated above, the issue of employee classification is extremely important because *misclassification* of even a single employee can result in monumental financial liability for employers.

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As you may have gathered, the issue of properly classifying employees as exempt or non-exempt is a hot button issue for the State of California for several reasons, not the least of which is that misclassifications “cost” California millions of dollars in lost revenue (e.g., from reduced payroll and income taxes, etc.). The official reason that the state gives, of course, is much more “noble”—the exempt status deprives an employee of certain protections of the Industrial Welfare Commission Orders. These protections touch on a variety of issues, such as:

— overtime compensation/premium;

— minimum wage;

— reporting time pay;

— record keeping (but not including records required by the Labor Code);

— uniforms or equipment requirements (in compliance with Labor Code);

— meals and lodging requirements; and

— rest period requirements.

And, as it turns out, California is one of several states to have entered into a memorandum of understanding with the United States Department of Labor to pursue employers for employee misclassification. Now, California’s wage and hour laws generally happen to be far more restrictive on employers than federal law (e.g., such as under the federal Fair Labor Standards Act). This means that it is more difficult for California employers to establish that an employee is exempt from overtime requirements under California law than under federal labor laws. When viewed alongside the fact that California courts interpret the exceptions narrowly, and *employers*, like PACE, bear the burden of establishing that an exemption applies, I’m sure you recognize the deep water that employers must swim in if they want to do business in California.

As a result of the above-referenced memorandum of understanding between the Dept. of Labor and the State of California, the California Dept. of Labor Standards Enforcement (“DLSE”) is now aggressively investigating potential violations of wage and hour laws. At the present time, the DLSE is largely complaint driven—meaning that once they receive an actual complaint (often from a disgruntled employee), they initiate an investigation. From there, however, things can escalate quickly to an investigation of all the employer’s payroll practices, including recordkeeping and classification of all its workers. In short, it doesn’t take much for PACE to end up on the DLSE’s radar, and once that happens, it can be extremely difficult to emerge unscathed by the long arm of the government.

Now that you’ve been properly informed, let’s discuss how to ensure that PACE can operate in compliance with the law.

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**Basic Differences Between Exempt and Non-Exempt Employees**

Despite what many employers think, the distinction between exempt and non-exempt employees is not characterized by whether the employees are payed on an hourly basis or by salary. Rather, the law is far more complex. Under Labor Code section 515, an employee will only be considered exempt if the employee falls into one of the following five exemption categories:

— executive;

— administrative;

— professional;

— computer software; or

— outside sales.

Each of those five exemption categories has a “test” associated with it, and if an employee does *not* meet the elements of at least one of the “tests” associated with each of these five categories, then the employee must be considered *non-exempt*. The five categories are:

(i) **Executive Exemption**. An employee in a company like yours is exempt under this category if the employee earns at least double the state minimum wage for full-time employment (i.e., at least $62,400)[[1]](#footnote-2) and is primarily engaged in *all* of the following:

• Managing *at least* a department or subdivision of his/her place of employment.

• Directing the work of two or more other employees.

• Asserting authority to hire or fire other employees, or providing an opinion that is influential in the hiring, firing, or alteration of an employee’s status.

• Exercising discretion and independent judgment regarding his/her job duties.

(ii) **Administrative Exemption**. An employee in a company like yours is exempt under this category if the employee earns at least double the state minimum wage for full-time employment (i.e., at least $62,400)[[2]](#footnote-4) and is primarily engaged in:

• Performing duties and responsibilities that involve either: (a) office or non-manual work directly related to management policies or general business operations of the employer or the employer’s customers; or (b) the administration of a school system, educational establishment or institution, or are directly related to academic instruction or training.

• Exercising discretion and independent judgment.

• Assisting a proprietor or an employee working in an executive or administrative capacity.

• Performing, under only general supervision, specialist or technical work.

• Executing, under only general supervision, special assignments and tasks.

(iii) **Professional Exemption**. An employee in a company like yours is exempt under this category if the employee earns at least double the state minimum wage for full-time employment (i.e., at least $62,400)[[3]](#footnote-6) and is *either*:

• Licensed or certified by the State of California *and* is primarily engaged in the practice of:

— Law

— Medicine[[4]](#footnote-7)

— Dentistry

— Optometry

— Architecture

— Engineering

— Teaching

— Accounting

*or*

• Primarily engaged in an occupation commonly recognized as a learned or artistic profession. These professions are usually ones where employees are primarily engaged in work that: (a) *requires advanced knowledge* in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction and study (distinguished from general academic education, apprenticeships, and training in routine mental, manual, or physical processes); (b) *is original and creative in character* in a recognized field of artistic endeavor (as opposed to work that can be produced by a person endowed with general manual or intellectual ability and training) and the result of which depends primarily on the invention, imagination, or talent of the employee; (c) *is predominantly intellectual and varied in character* (as opposed to routine mental, manual, mechanical, or physical work) and cannot be standardized in relation to a given period of time; and (d) *involves exercising discretion and independent judgment* in the performance of the duties listed above.

(iv) **Computer Software Exemption**. With certain exceptions, an employee is exempt under this category if he/she:

• Is primarily engaged in work that is intellectual or creative and requires the exercise of discretion and independent judgment.

• Is primarily engaged in duties that consist of: (a) applying systems analysis techniques and procedures, including consulting with users, to determine hardware, software or system functional specifications; (b) designing, developing, documenting, analyzing, creating, testing or modifying computer systems or programs, including prototypes, based on and related to user or system design specifications; or (c) documenting, testing, creating or modifying computer programs related to the design of software or hardware for computer operating systems.

• Is highly skilled and proficient in the theoretical and practical application of highly specialized information to computer systems analysis, programming and software engineering. Job titles do not determine whether an exemption applies.

• Earns at least $50 per hour (or $104,149.81 per year).[[5]](#footnote-8)

(v) **Outside Salesperson Exemption**. Any person at least 18 years old is exempt if he/she regularly works more than half the working time away from the employer’s place of business selling tangible or intangible items or obtaining orders or contracts for products, services or use of facilities.

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You should use the attached Questionnaire to help you determine whether an employee is exempt or non-exempt under the California Labor Code and IWC wage orders. So, for example, use the Questionnaire whenever you:

— create a new position or modify the job duties or compensation of an existing employee;

— audit or otherwise review wage and hour practices for risk analysis purposes; or

— defend a misclassification case.

**Don’t let the length of this Questionnaire (22 pages) worry you. Chances are that you’ll only be answering questions in 2 sections—the Salary Basis Test and whatever exemption you’re trying to qualify your employee under. So, in reality, you’ll only be using a few pages of the Questionnaire and ignoring the rest.**

As always, if you have any questions regarding the issues discussed in this letter, or use of the Questionnaire, do not hesitate to contact me.

Sincerely yours,

/s/

Michael B. Kushner

1. On January 1, 2023, this number will increase to $64,480. [↑](#footnote-ref-2)
2. On January 1, 2023, this number will increase to $64,480. [↑](#footnote-ref-4)
3. On January 1, 2023, this number will increase to $64,480. [↑](#footnote-ref-6)
4. For physicians, the minimum hourly rate is now $91.07, but will increase to $97.99 on January 1, 2023. [↑](#footnote-ref-7)
5. On January 1, 2023, this number will increase to $53.80 per hour (or $112,065.20 per year). [↑](#footnote-ref-8)