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In November, Arizonans approved a ballot initiative that not only increases the minimum wage, but threatens to have significant repercussions for employers beyond what to pay employees.

Arizona Edition

A Littler Mendelson Arizona-specific Newsletter

Arizona Adopts Sweeping Wage Reforms (Proposition 202)

By Neil M. Alexander and Laurent R.G. Badoux

In the recent November elections, Arizonans voted in favor of a ballot initiative to increase the minimum wage. In all likelihood, however, few people realized the proposition also contained language with significant legal implications modifying the relationship between employers and employees.

Introduction

Regardless of one's ideological or political beliefs about whether raising the minimum wage from $5.15 to $6.75 per hour is beneficial to Arizonans and the State's economy, most people would agree that implementing a new minimum wage should not have required four pages of statutory language. The provisions create significant new legal presumptions, penalties and potential liabilities for Arizona employers.

Calculation of the New Minimum Wage

For the first time in the history of the State of Arizona, Ballot Initiative Proposition 202, identified as the "Raise the Minimum Wage for Working Arizonans Act" (the "Act") has created a minimum wage higher than the federal requirement under the Fair Labor Standards Act (FLSA). The new minimum wage is $6.75 per hour, effective January 1, 2007. In addition, the Act provides for an automatic annual cost of living adjustment (COLA) based upon the federal consumer price index (CPI). This should probably be identified as a COLI (cost of living increase), since it is unlikely the number will ever decrease. The COLA increase will be rounded to the nearest multiple of five cents. Based on current statistics, the minimum wage could increase to $6.90 per hour on January 1, 2008.

The new minimum wage is applicable to all employers, except "small businesses," which are defined as businesses that generate less than $500,000 in gross sales and that are not involved in interstate commerce. As a result, only the very smallest companies will be deemed exempt from the provisions of the Act. The Industrial Commission of Arizona (ICA), which will administer and enforce the Act, promulgated emergency enforcement regulations on December 14, 2006 (pending approval from the office of the Attorney General). Under these regulations, small employers may seek relief from some of the record-keeping provisions of the Act if they are too burdensome.

The Act allows covered employers to deduct a tip credit of up to $3.00 per hour for employees who receive tips as part of their wages. The employer bears the burden of proving that it is not taking a tip credit larger than the amount of tips actually received by the employee. Accordingly, employers applying a tip credit should audit their records periodically to confirm that each tipped employee earns enough in tips to equal or exceed the tip credit.

Additional Provisions

The Act also directly affects an organization's relationships with independent contractors. It creates a rebuttable presumption that any worker receiving payments from an employer is an employee rather than an independent contractor. There is a heightened burden of "clear and con-

vincing evidence" for a company to prove its consultants and other service providers are truly independent contractors, rather than misclassified employees. Employers will need to examine the economic realities of such relationships carefully, especially consultants who may perform work for a company on a full-time basis, to determine any potential exposure under the new law. Volunteer relationships will also likely be scrutinized. Although volunteers are not specifically exempt from the Act, the ICA regulations provide that volunteers for public entities or charitable organizations could be regarded as exempt if they meet the applicable exemption test under the FLSA. However, whether the ICA has the authority to exempt these volunteers is doubtful.

Employers now will be required to provide their full name, address and phone number to employees at the time of hire, and maintain records of all hours worked by (including breaks) and wages paid to all employees for four years. With the exception of the four-year requirement, the ICA regulations incorporate most of the recordkeeping elements of the FLSA, which should provide uniformity in recordkeeping for employers. All required records must be made available for review to the ICA within 72 hours of any request. A failure to maintain records of wages and hours creates a presumption that the employer did not pay the minimum wage. Additionally, federally exempt employees are not exempt from the Arizona minimum wage requirements. Accordingly, any employees compensated at an actual rate less than the Arizona minimum wage for all hours worked, even if the employee is exempt under federal law, may have a claim of underpayment against their employer. The ICA regulations are somewhat conflicting in this area. On one hand, they do not require that an employer maintain records of hours of work (in addition to pay records, which are required) for employees exempt under the FLSA white collar exemptions. On the other hand, they require employers to maintain records that are sufficient to allow a determination that the salary paid is sufficient to meet the minimum wage requirements of the Act. Accordingly, when taking into account the total number of hours worked by a federally exempt employee, if it is theoretically possible his or her wage would be below the minimum wage, records of all hours worked should be maintained.

Administrative Enforcement

Although a relatively small portion of the ICA's workload involves wage and hour compliance (the ICA primarily enforces Arizona's workers' compensation scheme and its occupational safety and health regulations (ADOSH)), the Act does not provide any additional funding for the ICA's new enforcement obligations, other than funds from fines the agency may collect from companies that violate the new law. The Act sets a minimum $250 civil money penalty for a first offense and a penalty of at least $1,000 for any subsequent violation. The ICA also has the authority to impose special monitoring and inspection requirements and provided in its regulations for potential fines against employers that hinder its investigations. The regulations also require that a complaint be brought to the ICA within one year of its occurrence.

Private and Union Enforcement

"[A]ny person or organization" may file a complaint with the ICA against an employer alleging noncompliance. Although neither the drafters nor the ICA defined the term "organization," it is clear that unions will claim they qualify as "organizations" under the Act. In addition, the Act allows an employee or "designated representative(s)" to inspect and copy all wage and hour records pertaining to that employee. This inspection right by unions carries the potential for abuse in both unionized and non-unionized environments. A prevailing union tactic for many years has been to allege unlawful practices by a company and to help initiate class action wage and hour lawsuits. While once relatively rare in Arizona, class action lawsuits alleging wage and hour violations have increased in frequency over the last three years. Nationally, these claims now outnumber all other categories of class action claims combined. Not surprisingly, California, which has significant state statutory provisions in this area of the law, leads the pack in these types of claims. Only time will tell the extent to which this national trend will affect Arizona, but this new law appears to be a step in that direction.

If the employee prevails in a private lawsuit, he or she is entitled to all unpaid wages, including interest, plus an amount equal to twice the amount of unpaid wages as liquidated damages, and attorneys' fees and costs. A prevailing defendant employer is not allowed to recover its attorneys' fees. Unlike federal law, there may not be a maximum three-year statute of limitations (the default period is two years unless the violation is deemed willful). The new provisions allow for continuing violations to arguably go back the entire length of employment, or until January 1, 2007, whichever is shorter. In addition, the statute of limitations is automatically tolled during an investigation, another departure from federal law. These provisions could spell "big bucks" for employees alleging violations over an extended period of time.

Retaliation

If any adverse action is taken against an employee who asserts any right under the Act, by raising a complaint or assisting someone with a complaint, within 90 days of the protected activity, a legal presumption is created that the employee was retaliated against. This presumption can only be rebutted by clear and convincing evidence. In practice, employers will likely have a very difficult task ahead of them to justify terminations, demotions or other adverse actions that fall within this window of time. In addition to paying damages to an employee for alleged retaliation, a company can be directly fined by the ICA at least $150 per day for the entire period of the retaliatory conduct (which adds up quickly for a disputed termination).

Recommendations

When the revised federal regulations for white collar exemptions were rolled out a few years ago, many companies reacted proactively by conducting internal wage and hour practice audits. The time probably has come again for Arizona employers to conduct such audits to ensure compliance with these new provisions. Employers need

to closely scrutinize pay rates, recordkeeping, independent contractor and consulting (or similar) relationships, and other related employment practices to properly minimize their risk of receiving fines or paying significant damages.

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