EMPLOYMENT
LAW UPDATE

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LEGISLATIVE

Federal

2026 Employer Duty to Track and Report Qualified Overtime

Under the One Big Beautiful Bill Act, starting in 2026, employers must separately track and report qualified overtime compensation per pay period and on their employees' Form W-2s (Box 12 Code TT). The Federal law does not impose any new requirements for qualified overtime to be reported on California wage statements.

Qualified overtime compensation is limited to overtime pay that is required under the Fair Labor Standards Act ("FLSA"). FLSA-covered employees are required to be paid at least 1.5 times their regular rate of pay for hours worked over 40 in a workweek (subject to certain industry-specific exceptions). Overtime pay under state law, collective bargaining agreements, or employer policy beyond what the FLSA requires does not qualify for the deduction.

The "qualified" amount is limited to the portion of FLSA-required overtime pay that exceeds the employee's regular rate of pay — the 0.5x premium itself, the "half" in "time-and-a-half." For example, if an eligible employee's regular rate of pay is $40/hour and he/she is paid $60/hour for overtime, only the $20 premium amount would qualify.

The IRS has issued a new Fact Sheet with answers to frequently asked questions about the deduction: Questions and answers about the new deduction for qualified overtime compensation | Internal Revenue Service.

Employers should consult with their tax advisors and payroll providers to confirm accurate tracking and reporting of qualified overtime compensation. It also serves as a good reminder for employers to verify they are properly calculating the regular rate of pay for overtime compensation and for purposes of properly quantifying "qualified overtime compensation."

California

LWDA Proposed PAGA Regulations Amendment

On February 6, 2026, the California Labor and Workforce Development Agency ("LWDA") issued a Notice of Proposed Rulemaking to adopt new formal regulations governing Private Attorneys General Act ("PAGA") administration. While the proposed rulemaking is targeted on preventing abusive litigation practices associated with the statute, it would also allow claimants with other pending PAGA actions to possibly intervene in a settlement and prevent a settlement from including additional Labor Code violations not pled in the PAGA Notice—both of which would significantly impact employer's resolution options and strategy.

The comment period runs through March 23, 2026. Comments may be submitted by mail to Danielle West, PAGA Rulemaking and Policy Analyst, Labor and Workforce Development Agency, 1416 Ninth Street (MIC-55), Sacramento, CA 95814 or by email at Danielle.West@labor.ca.gov. Although the LWDA has not scheduled a public hearing, it will hold one if it receives a written request to do so on or before March 8, 2026.

PAGA Notices

The proposed provisions would require notices to be submitted through an LWDA form and that the notice include "short and plain" factual statements and theories suffered by the claimant, rather than boilerplate allegations. "Conclusory statements, generalized or vague allegations of violations without supporting facts particular to the claimant's circumstances or working conditions, or statements summarizing or restating the law or legal requirements are not sufficient." The regulations would limit subsequent litigation and settlements to the Labor Code violations and theories of liability included in the PAGA notice (or amended notice).

High-Frequency & Vexatious Filers

The proposed regulations add new controls targeted at deterring mass, template-driven PAGA filings through specific "high-frequency filer" notice requirements. A "high-frequency filer" is defined to be any attorney or law firm who has filed 200 or more PAGA notices in the preceding 12 months (with an exception for certain nonprofit legal aid organizations). Between July 1, 2024, through June 30, 2025, eight law firms and four attorneys would meet the criteria. Five law firms accounted for nearly a quarter of total filings (8,846 PAGA notices). Of note, three firms filed more than one PAGA notice *per day* on average, one attorney filed 597 PAGA notices, and another filed 368.

A high-frequency filer would have to include a cover letter with each PAGA notice filed that identifies that the firm or attorney is designated as a high-frequency filer and submit a certification signed by the claimant attesting to the accuracy of the violations alleged.

The regulations would also allow the LWDA to designate specific attorneys or law firms as a "vexatious filer," which would require their submissions be subject to prefiling screening orders and their information be maintained on a public list of "vexatious filers" on its portal. A "vexatious filer" is defined as any person or attorney that has repeatedly filed PAGA notices that do not comply with legal requirements, including on grounds the notices fail to allege adequately the facts and theories supporting the violations alleged or where the allegations appear frivolous or intended to harass. The prefiling screen will verify that the PAGA notice filings are complete and compliant with all applicable requirements before they are accepted for filing.

Wage Statement Cure Process

The proposed regulations clarify that any employer, regardless of size, may use the cure process when the only violation to be cured involves an alleged violation of Labor Code section 226. The cure notice must be filed with the LWDA and served on claimant (by certified mail) within 33 days of the postmark date of the PAGA notice. The notice must also be accompanied by a declaration from an individual with personal knowledge of the employer's cure actions and include a copy of the notice issued to aggrieved employees.

Cure Process for All Other Alleged Violations

The proposed provisions specify that a cure proposal must be submitted within 33 days of the PAGA notice, identify the date the notice was received, and specifically state the total number of employees it employed during the one-year period before a PAGA notice was filed. This cure process is only available to employers that employed less than 100 employees total – exempt or non-exempt – during this period.

For any cure proposal or notice (including cure of wage statements), the regulation would add a provision that limits an employer's ability to submit a cure proposal or cure notice to one in a 12-month period for the same Labor Code violations, regardless of the location or worksite.

The regulations also address how notice of conferences will be provided; information the parties will need to submit prior to conferences; and states a claimant must submit a cure hearing request within 10 days after the LWDA issues its cure determination. It further states that a cure hearing request will be dismissed if the claimant fails to attend the scheduled hearing and the LWDA's determination will be deemed final; however, the hearing will proceed if the employer fails to attend the scheduled hearing, but the employer will not have the opportunity to present evidence in support of its position a violation has been cured, unless good cause exists to excuse the employer's failure.

Settlement

The proposed regulations would drastically expand what parties must do when settling a PAGA case.

For employees, they would be: 1) prohibited from amending a PAGA notice to add alleged Labor Code violations after a settlement has been reached, or during the settlement process; 2) required to provide notice of the settlement in all overlapping cases; and 3) obligated to locate and notify every other person with a pending PAGA action against the same employer about the settlement. The LWDA has stated its intent is to prevent employers from extinguishing claims against them that were not investigated, litigated or pursued in the case before being settled.

Moreover, the regulations would require that the parties provide the LWDA with the fully executed settlement agreement and all court filings supporting the settlement (including motions and declarations). After submission, the LWDA would have 45 days to review the proposed settlement. Claimants with other pending PAGA actions can submit comments regarding the settlement and whether it is fair, adequate, and reasonable by email within 21 days after the employee receives notice of the proposed settlement. This would provide claimants with a viable means of intervening in the settlement of another case with overlapping PAGA claims.

JUDICIAL

Federal

Misclassification Alone Does Not Establish Overtime Liability

In *Merritt v. Tex. Farm Bureau*, Jerry Merritt ("Merritt"), an agency manager for the Texas Farm Bureau ("Farm Bureau"), was classified as an independent contractor, earning between $552,000 and $627,000 annually. In 2019, Merritt sued the Farm Bureau for alleged Fair Labor Standards Act ("FLSA") violations, claiming he had been misclassified and was entitled to unpaid overtime. Merritt worked with substantial independence - managed his own schedule, was compensated by commission, and did not track hours. While a court later concluded he should have been classified as an employee and worked approximately 800 hours of overtime, a jury ultimately determined the employer lacked the necessary knowledge of any alleged overtime. The Fifth Circuit affirmed that verdict finding employers are not liable for unpaid overtime under the FLSA unless they have *actual* or *constructive* knowledge that an employee worked overtime hours. Constructive knowledge exists only when an employer, through reasonable diligence, would have discovered the overtime (i.e. where employer discouraged reporting or altered time records). The court found that allowing an employee to set his own hours does not, by itself, establish employer knowledge of overtime.

California

Hard-to-Read Arbitration Agreements Subject to Close Scrutiny of Substantive Terms

In *Fuentes v. Empire Nissan, Inc.,* when Evangelina Yanez Fuentes ("Fuentes") applied for work at Empire Nissan ("Nissan"), she signed an "Applicant Statement and Agreement" containing a broad arbitration clause covering "all disputes which may arise out of the employment context" and a clause requiring that any future modification be "in writing and signed by the President of the Company." The document was printed in a very small font, with blurry, nearly unreadable text, and was filled with legal jargon and statutory references. Fuentes was provided five minutes to review the packet containing the agreement and was not given the opportunity to ask questions.

Years later, Fuentes' employment was terminated after taking medical leave. Fuentes filed a lawsuit against Nissan for wrongful termination and related claims. Nissan moved to compel arbitration. Fuentes opposed the motion arguing that there was no valid agreement to arbitrate, and even if valid, the agreement was unenforceable because it was unconscionable.

The trial court denied the motion to compel arbitration, finding the small, difficult-to-read print supported the finding of both procedural and substantive unconscionability.

The Court of Appeal reversed and ordered arbitration, holding the "tiny and unreadable print" was a problem of procedural unconscionability only and should not be double counted as a problem of substantive unconscionability.

The California Supreme Court reversed and remanded, generally agreeing with the Court of Appeals, finding a contract's format generally is irrelevant to the substantive unconscionability analysis, which focuses on the fairness of the contract's terms. However, it also held that courts must closely scrutinize the terms of difficult-to-read contracts for unfairness or one-sidedness. The case serves as a reminder for employers to ensure arbitration agreements are formatted for readability – proper font size and style, be in layman-friendly terms, and have appropriate headings.

This is Pettit Kohn Ingrassia Lutz & Dolin PC's employment update publication intended to be educational regarding recent legislative changes and court decisions affecting California employers. If you would like more information regarding our employment team, please contact Tom Ingrassia, Jennifer Lutz, Ryan Nell, Shannon Finley, Christine Clark, Kristin Kameen, Nicole Allen, Ethan Anderson, Ruby Carlon, Melina Corona, Alec Dea, Will Dischmann, Kendall Garald, Emma Hill, Gabriella Kelly, Celeste Leung, Haley Murphy, Jessica O'Malley, Nia Perkins, Mariam Saleh, Shayan Shirkhodai, Jenny Sturman, Jackson Sullivan, or Ben Watson at our San Diego office: 11622 El Camino Real, Suite 300, San Diego, CA 92130, (858) 755-8500; or Colette Asel, Steven Dawson, Jenny Che, Brett Greenberg, or Alysha Zapata at our Los Angeles office: 101 Continental Blvd., Suite 820, El Segundo, CA 90245, (310) 649-5772.