

# Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Debra Figone

**SUBJECT: POTENTIAL OPTIONS FOR  
AN ALTERNATIVE MINIMUM  
WAGE ORDINANCE**

**DATE:** July 23, 2012

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## INFORMATION

### BACKGROUND

On January 19, 2012, proponents of an initiative which would amend the San José Municipal Code, Title 4 filed a Notice of Intent to circulate a petition which would increase the minimum wage paid in San José to \$10.00 per hour and provide cost of living increases based upon the Consumer Price Index annually thereafter. On March 29, 2012, the proponents of the initiative petition submitted to the City Clerk 36,225 signatures. On April 2, 2012, the petition was transferred to the County of Santa Clara Registrar of Voters and the Registrar reported on April 24, 2012 that the petition had qualified with the sufficient number of signatures and provided a Certificate of Sufficiency to the City Clerk.

The Certificate of Sufficiency was accepted by the City Council on May 1, 2012 and staff was directed to provide a report consistent with Elections Code Section 9212 on the effects of the ordinance. The 9212 report was accepted by the Council on May 22, 2012 and staff was directed to proceed with the necessary steps to place the measure on the November 6, 2012 ballot. The resolution calling that election will be considered by the City Council at its August 7, 2012 meeting. The final date for the submission of ballot measures to the Registrar for the November 2012 election is August 10, 2012.

During the May 1 Council meeting, the Council briefly discussed Councilmember Liccardo's April 30 memorandum which, among other things, directed the City Manager to analyze an alternative proposal that the Council could adopt on the same date, which might:

- a) Phase in the minimum wage increase over time, to reach the \$10/hour level within an extended period (i.e., 2 or 3 years);
- b) Exempt very small businesses, and/or businesses in which employees generally rely on tips or commissions for a large percentage of their income. Consider how small businesses might qualify for that exemption by demonstrating - perhaps through an affirmative requirement to submit income tax returns or other documentation - revenues beneath a specific threshold;
- c) Exempt employees under the age of 18;

- d) Allow for a "complaint-driven" enforcement mechanism that would relieve businesses of affirmative reporting obligations, and minimize the cost of enforcement to the City.

The Council action directed staff to report back with policy alternatives after the Council considered the 9212 report. That direction was reaffirmed by the Council on May 22. The Council also briefly discussed the City's role in outreach on the Minimum Wage Initiative. This topic is summarized in the "Outreach" section of this memorandum.

The following analysis is intended to provide policy options for the Council that may be considered if Council were to direct staff to draft an alternative ordinance and to answer questions raised by Councilmembers during the May 22 Council discussion regarding the minimum wage ordinance. Because the City Council is required under the Elections Code to submit the Minimum Wage Initiative to the voters and is prohibited by the City Charter from submitting an alternative ordinance to the voters for the November 6 ballot, any alternative ordinance adopted by the City Council would only become effective if the Minimum Wage Initiative does not receive a majority of votes on November 6 and, consequently, fails to pass.

## ANALYSIS

For different elements of the initiative minimum wage ordinance, several options are provided that a) may have a policy rationale and b) are deemed to be administratively feasible.

### **A. Later Effective Date of Wage Increase**

The ordinance proposed in the initiative becomes effective 90 days following certification of the election results. Assuming the initiative passes and the Santa Clara County Registrar of Voters provides the certification to the City Clerk in December; the ordinance would become effective in late February or early March 2013, depending on the date of certification.

One option the Council may consider would be to have a later effective date for an alternative ordinance. A deferred effective date would provide employers additional time to prepare for the implementation of a minimum wage in San José, and allow time for City staff to inform employers and employees about the law and gear up for enforcement responsibilities. Among the options the Council could consider for an alternate ordinance are:

Option A1: Effective date of July 1, 2013 (about 4 or 5 months later than the initiative would provide)

Option A2: Effective date of January 1, 2014 (about 9 or 10 months later than the initiative would provide)

Option A3: Another effective date as recommended by the City Council

## **B. Phase In Wage Increase Over Multiple Years**

One of the concerns expressed by employers is the effect of an immediate 25% increase in the minimum wage – from \$8.00 to \$10.00 per hour, and lack of sufficient time for employers to adjust.

One of the options for Council consideration is to provide a phase-in period as was done in both Santa Fe and San Francisco. Santa Fe phased in the wage rate increase over a five-year period.

San Francisco phased in small businesses and nonprofits over a two-year period at a lower wage rate than other businesses (see Section C below).

The Council could consider – among other options – a gradual phase-in period for the increase in wages:

- 1) A fifty cent per hour increase effective January 1, 2014 – raise to \$8.50
- 2) A fifty cent per hour increase effective January 1, 2015 – raise to \$9.00
- 3) A fifty cent per hour increase effective January 1, 2016 – raise to \$9.50
- 4) A fifty cent per hour increase effective January 1, 2017 – raise to \$10.00

## **C. Small Business Exemption**

In San Francisco, businesses with less than 10 employees and nonprofits were exempt from the minimum wage increase for the first two years. In Santa Fe, the 2003 law exempted establishments with fewer than 25 employees until the city council amended the ordinance in 2008 to include these businesses. As referenced in the 9212 report, small businesses generally have less flexibility than larger companies to adjust to rising costs in order to remain competitive.

One of the questions asked during the Council discussion on May 22 involved the definition and characteristics of San José's small business community. The table below shows the distribution of small businesses in San José.

The table provides information for the definition of small business used in San Francisco (fewer than 10 employees) and Santa Fe (less than 25). It also shows the definition of small business currently used by San José in order to provide a preference for small business in city government procurement of supplies, materials, equipment, and consulting services: 35 or fewer employees (San José Municipal Code Section 4.12.060).

Note that the data are based on registered businesses for the City Business Tax and that the table shows the incremental difference of increasing the employee definition of small business. Employment is tracked as full-time equivalent (FTEs) positions, not as actual number of individual employees.

Active Businesses as of May 25, 2012		
Category	Small Business <sup>1</sup>	
	No. of Businesses	Total No. of Employees
Less than 10 FTE employees <sup>2</sup>	16,445	59,990
10 to 25 FTE employees	2,019	30,748
26 to 35 FTE employees	373	11,204
<b>Total Small Businesses</b>	<b>18,837</b>	<b>101,942</b>
<b>Total Businesses (Citywide) <sup>1,2</sup></b>	<b>24,395</b>	<b>283,416</b>

<sup>1</sup> Exclude charitable, non-profit, exempt & governmental organizations

<sup>2</sup> Exclude self-employed individuals

Council directed staff to analyze a potential exemption for small businesses whose revenues fall below a certain threshold -- perhaps through an affirmative requirement to submit income tax returns or other documentation. Staff reviewed the potential to key a minimum wage exemption off of the 'Financial Hardship Exemption Program' that is currently offered for purposes of paying San José's Business Tax. However, staff found that the Financial Hardship Exemption Program is for sole proprietors, husband and wife ownership, or domestic partner ownerships that have *no employees* and have gross receipts are less than twice the poverty level for the income tax reporting year for which the Business Tax is due. A corporation owned by one person, husband and wife, or domestic partnership may also qualify for this program.

Council could decide to exempt any business with employees whose revenue is less than twice the poverty level, or some other standard. However, the Administration does not recommend this because of the additional administrative effort that would be required to implement and enforce the minimum wage. Rather, the more efficient approach would be to exempt small businesses based on the number of employees.

The Council may consider a range of options to exempt small business from the municipal minimum wage increase.

Option C1: Exempt employers with 10 or fewer employees

Option C2: Exempt employers with 25 or fewer employees

Option C3: Exempt employers with 35 or fewer employees

Option C4: Exempt employers whose revenues fall below a certain low threshold. (not recommended; administratively infeasible)

The Council could also consider a time-limited small business exemption, or phase-in of the wage increase for small business—the approach taken by San Francisco.

Any small business exemption would need to address the treatment of an employer who has multiple locations, such as a restaurant franchisee. Would the number of employees be based on the total number of employees in San José? In the company as a whole? Or would the number of employees be based on the employment levels at each specific location?

In 2004, San Francisco's Minimum Wage Ordinance defined "small business" as "an employer for which fewer than ten (10) persons perform work for compensation during a given week." This definition requires a count of all persons who work for the employer, not just those who work in San Francisco.

#### **D. Definition of Employer and Employee**

Under the initiative ordinance, Employee is defined as:

1. *In a calendar week performs at least two (2) hours of work for an Employer as defined below.*
2. *Qualifies as an employee entitled to payment of a minimum wage from any employer under the California minimum wage law, as provided under Section 1197 of the California Labor Code and wage orders published by the California Industrial Welfare Commission, or is a participant in a Welfare-to-Work program.*

The initiative ordinance defines Employer as:

*" 'Employer' shall mean any person, including corporate officers or executives, as defined in Section 18 of the California Labor Code, who directly or indirectly through any other person, including through the services of a temporary employment agency, staffing agency or similar entity, employs or exercises control over the wages, hours or working conditions of any Employee and who is either subject to the Business License Tax Chapter 4.76 of the Municipal Code or maintains a facility in the City."*

During the public testimony heard at the May 22 Council meeting, concern was expressed regarding the effects of the initiative on people who employ home health care assistants. The concern is that, while a wage increase would be beneficial to the health care assistant, the rising cost may put the person needing care at risk.

Further questions have been raised regarding other home-based employees such as child care providers, "nannies", housekeepers, gardeners, etc. The definition in the ballot language appears to not include an independent contractor who contracts directly to provide services to another party; for example, a personal aide who contracts directly with a private party to provide services would not be subject to minimum wage requirements. However, if a person is employed by a home health care company, the home health care company would be subject to minimum wage requirements.

If Council directs preparation of an alternative ordinance that clarifies treatment of in-home service providers, the City Attorney will conduct appropriate research to address any outstanding issues.

In addition, questions have arisen regarding which employers would be subject to the ordinance. For example: Would an employer who does business in San José, and therefore pays the business tax, but does not have employees located in San José, be subject to the minimum wage provisions for employees outside of San José? If Council directs staff to prepare an alternative ordinance that more clearly delineates treatment of employers with locations outside of San José, the City Attorney will conduct appropriate research to address this issue.

Among the options the Council could consider for an alternate ordinance are:

Option D1: Clarify treatment of in-home service providers

Option D2: Clarify treatment of employers who do business in San José but do not have employees located in San José or maintain a facility in San José

#### **E. Exemption for Employees Who Receive Tips or Commissions**

At the May 22 Council meeting, employers raised concern about the initiative including employees who receive the minimum wage, but who also receive other income through tips or commissions. For those employees, their actual gross income is likely already higher than the minimum wage.

San Francisco did not provide an exemption for employees who receive tips, or unique offsets. In Santa Fe, for workers who customarily receive more than \$100 per month in tips or commissions, any tips or commissions retained by a worker are counted as wages and credited toward satisfaction of the minimum wage provided that, for tipped workers, all tips received by such workers are retained by the workers, except that the pooling of tips among workers shall be permitted.

After preliminary legal review, an exemption for such employees may be permissible in an alternative ordinance. If the Council directs staff to exempt from the alternative ordinance employees that receive tips or commissions, the City Attorney will conduct further research on the legal issues.

It is important to note that treatment of tips varies by establishment and that a certain tip level is generally not guaranteed for the employee. Tips in restaurants are sometimes pooled and divided among staff, including those who are not servers. Enforcement challenges and staff costs would increase if there was an exemption for 'tipped' employees.

Option E1: Exempt employees who receive additional compensation above minimum wage from tips or from commission income.

**F. Exemption for Minors Under Age 18**

Questions were raised about exempting employees under the age of 18. An increased entry-level wage could particularly affect employment prospects for minors as well as young adults (19-24) and other job seekers with barriers to initially entering the workforce (e.g., people with basic skills deficiencies, people with limited work experience, ex-offenders). Employers may become even more sensitive to getting value commensurate with their expenditure on entry level workers. Competition from the regional labor pool for entry level jobs in San José will likely increase because of their higher pay. San José's youth unemployment rate (age 16-19) is estimated to be more than triple the adult rate, or 30-35%.

Minors are not exempted under the state's minimum wage laws but an exemption for minors may be permissible if the City can provide a rational basis for the exemption and as long as state and federal minimum wage requirements are met. If the Council directs staff to exempt minors from the alternative ordinance employees, the City Attorney will conduct further research on the legal issues.

Option F: Exempt employees under the age of 18

**G. Exemption for Paid Internships**

Questions were raised about exempting interns. Interns are people who work for an organization at a reduced wage or no wage in return for experiential learning that improves their ability to enter the workforce and secure a job in their chosen profession. They are typically, but not necessarily, youth or young adults.

In Santa Fe, interns working for a business for academic credit in connection with a course of study at an accredited school, college, or university or people working for an accredited school, college or university while also attending that school, college or university, or people working for a business in connection with a court-ordered community service program such as teen court or workers who are in an apprenticeship program in a 501c(3) organization are not counted as a worker for purposes of the city minimum wage.

Certain interns are exempt under state minimum wage laws. If the Council directs staff to exempt paid internships from an alternative ordinance, the City Attorney will conduct further research on the legal issues.

Option G: Exempt employees who are paid interns

## **H. Cost-of-Living Adjustment**

One of the concerns expressed by employers and shared by the City's Office of Economic Development is the ballot initiative's annual increase in the minimum wage rate, which is tied to the Consumer Price Index (CPI), and the compounding effect of this over time on San José's competitiveness as a location.

The increased minimum wage will create an immediate cost differential of 25% per hour for entry-level positions. With annual wage increases tied to the CPI, the differential between the cost of operating a business in San José compared with the cost of operating in adjacent communities will widen over time. If there were no increase in California's minimum wage, the minimum wage in San José could rise to double that of adjacent cities over 20 years (9212 Report).

In contrast to San Francisco and Santa Fe, San José has more competitive and attractive communities and business locations immediately adjacent to its borders. There are more opportunities for existing businesses to relocate within the economic region, and more options for new businesses to locate in communities other than San José. San José already has a weak job and fiscal base relative to other cities in the region; the concern is that a widening wage differential may negatively affect the city's ability to retain and attract businesses and jobs.

Alternative policy options could include:

Option E1: Provide no automatic indexing of the municipal minimum wage tied to the CPI. San José's minimum wage would remain at \$10 per hour.

Option E2: Provide no automatic CPI adjustment, but specify that future adjustments be made to maintain the \$2.00 per hour differential between the San José municipal minimum wage and that established by the State of California.

## **I. Complaint-Driven Enforcement Mechanism**

Council directed staff to explore a "complaint-driven" enforcement mechanism that would relieve businesses of affirmative reporting obligations, and minimize the cost of enforcement to the City. The Minimum Wage Initiative already provides enforcement on a complaint basis.



**OUTREACH**

During the Council discussion on May 22 and subsequently, Councilmembers raised the question of additional outreach.

Once the initiative is approved for the November 6 ballot, any City outreach is limited by law to providing facts about the ballot measure. It would be difficult for staff to conduct outreach to obtain feedback on the ballot initiative or on potential alternatives and remain consistent with the “no campaigning” restrictions.

The City Attorney’s Office will draft the impartial analysis of the ballot measure later in August, and will work with the Administration to develop a Fact Sheet about the November ballot measure.

**COORDINATION**

This Memo has been coordinated with the City Attorney, the City Clerk, the Department of Finance, and the Department of Public Works.

  
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