COPY

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GRAY DAVIS, Governor

Arthur S. Lujan
Office of the
State Labor Commissioner

August 30, 2002

Paul R. Lynd
Littler Mendelson
650 California Street, 20th Floor
San Francisco, CA 94108

FAXED TO: 415-743-6653

Re: Salary Requirements for Exempt Employees

Dear Mr. Lynd:

This in response to your letter dated June 24, 2002, seeking guidance as to certain issues that arise under the requirement to compensate exempt employees on a salary basis. Your first question is whether an employer may shut down operations for a full workweek (seven consecutive days), and not pay its exempt employees any salary for that workweek, without destroying the employees' exempt status. This question was answered by my letter to Bill Dombrowski, dated March 1, 2002. A copy of that letter is attached hereto. In that letter, we concluded that a weekly salary test may be used to meet the California requirements for a monthly salary, so that an employer may deduct a full week of salary from an exempt employee's salary as a consequence of a full week shut down, without jeopardizing the exemption, provided that this deduction does not reduce the monthly salary to an amount below the minimum level required for exempt status under Labor Code §515(a), presently $2,340. We do not interpret the "monthly salary" language in Labor Code §515 and in the Industrial Welfare Commission ("IWC") wage orders to require that an employer pay an exempt employee his or her full monthly salary if the employee was furloughed for a full workweek during that month.

Your second question is whether, if there is a full week shut down, the employer must allow its exempt employees to use accrued PTO (personal time off) in order to get paid for the week, as each employee may wish. The Division of Labor Standards Enforcement has historically treated PTO in the exact same manner as vacation time, in that PTO can be used by an employee to cover absences for personal reasons. There is no law that would require an employer to allow employees to take vacation or PTO during a week-long shut down. Whether or not the employees have such a right to take

vacation or PTO on any given week would depend on the employment agreement or policy on the use of accrued vacation or PTO.

Your third question is whether, if no work is available for a full week, the employer may require its exempt employees to use their accrued PTO for that week. Insofar as there is no separate obligation to pay exempt employees for a full week in which no work is available (or performed), the only way such employees would get paid for the week is through the use of vacation or PTO. Presumably, the overwhelming number of such employees would readily agree to use their accrued vacation or PTO in order to get paid. As to whether the employer could require those few employees who might wish to save their accrued vacation or PTO for future use, the question boils down to whether the contract of employment requires those employees to take vacation or PTO time during a specified period of time of the year, such as, for example, the week of Christmas or the week of July 4. If the shut down matches those weeks, then the employer may require use of accrued vacation or PTO for the period of the full week shut down. The Division's historic enforcement policy in regards to employer-mandated usage of vacation or PTO is that if the employer wishes to establish a policy mandating use of already accrued vacation or PTO, the employer must give the employee a minimum of nine months notice prior to the week(s) in which the time must be taken, so as to give the employees the opportunity to use that accrued time when they see fit, subject, of course, to any reasonable restrictions. A policy requiring employees to use their accrued vacation or PTO for any full week during which the employer may shut down, without specifically identifying the week(s) when these shutdowns may take place, would, in our view, run afoul of the requirement of advance notice and unfairly deny employees the opportunity to make choices as to when to take accrued vacation. These policies are founded upon the statutory mandate, at Labor Code §227.3, that the Labor Commissioner "shall apply principles of equity and fairness" with regard to issues concerning vested vacation time.

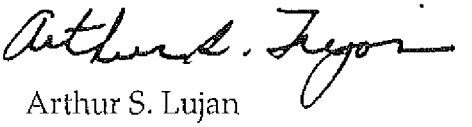
Your final question is whether an exempt employee who takes a partial day off because of a "light workload" can have his or her PTO deducted for the partial day; and if the employee has no accrued PTO, whether his or her salary can be deducted for the hours not worked. Whether the partial day off is the result of the employee freely choosing to leave work early for personal reasons, or the result of the employer sending the employee home, the answers are the same. In the latter scenario, there can be no deduction from salary for a furlough of less than a full workweek. 29 CFR section 541.118(a)(1) provides: "An employee will not be considered to be 'on a salary basis' if deductions from his predetermined compensation are made for absences occasioned by the employer or by the operating requirements of the business. Accordingly, if the employee is ready, willing, and able to work, deductions may not be made for time when work is not available." The only exception to this under the federal regulations is

that "an employee need not be paid for any workweek in which he performs no work." (29 CFR §541.118(a)) Turning to the scenario in which an employee chooses to take part of a day off when work is available, the federal regulations clearly provide that while deductions from salary may be made for a full day absence for personal reasons, deductions may not be made from salary for a partial day absence for personal reasons. (29 CFR §541.118(a)(2))

Under federal law, an employer can deduct from a vacation or PTO leave bank to cover hours that were taken off during a day for personal reasons or to cover hours that were not worked during a partial week shutdown, under the theory that vacation or PTO is no more than a "benefit", and that the purpose of that benefit is to provide a source of salary when the employee is away from work. However, state law does not permit the deduction of accrued vacation or PTO when the employer already has an independent obligation to pay the exempt employee's salary. The reason that state law operates differently than federal law in this regard is that state law has long treated accrued vacation not as a "benefit", but rather, as *accrued wages that are not subject to forfeiture.* (Labor Code §227.3, *Suastez v. Plastic Dress-Up Co.* (1982) 31 Cal.3d 774.) And if an employer already has a pre-existing obligation to pay full salary to an exempt employee who takes part of a day off for personal reasons, or who is furloughed for part of a week; that obligation cannot be discharged by requiring the employee to use his or her own *accrued wages* to pay his or her salary.

Thank you for your interest in California wage and hour law. Please feel free to contact me with any further questions.

Sincerely,



Arthur S. Lujan
State Labor Commissioner

ASL/ml
cc: Tom Grogan
Anne Stevason
Greg Rupp
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GRAY DAVIS, Governor

Arthur S. Lujan
Office of the
State Labor Commissioner

March 1, 2002

Bill Dombrowski, Chairman
Industrial Welfare Commission
770 L Street, Suite 1170
Sacramento, CA 95814

Re: Salary Requirements For Exempt Employees

Dear Mr. Dombrowski:

This letter responds to the your inquiry regarding the enforcement position of the Division of Labor Standards Enforcement ("DLSE") regarding the salary requirements for exempt status under California law. Prior to the enactment of AB 60 (the "Eight-Hour-Day Restoration and Workplace Flexibility Act of 1999"), the DLSE determined that the salary requirements of state law were generally consistent with the federal "salary basis" regulations set forth in 29 C.F.R. § 541.118. The DLSE does not interpret AB 60 or the wage orders issued by the Commission in 2000 or 2001 to require a change in this enforcement position. In fact, as explained below, the Labor Code and the wage orders plainly support this conclusion.

In order to explain the position set forth in this advice letter, it may be helpful to explain the DLSE's prior position on this subject, the effect of the statutory provisions added by AB 60 and SB 88, and the wage orders issued subsequent to January 1, 2000, AB 60's effective date. Each of these subjects is reviewed below.

1. DLSE's Enforcement Position Prior To AB 60

An examination of the wage orders in effect prior to 2000 reveals that the concept of a "monthly" compensation system was not introduced by AB 60 or the wage orders that became effective on October 1, 2000. Rather, the wage orders required that exempt employees receive "remuneration" in excess of specified levels "per month" for many decades. Although the Commission increased the amount of the monthly remuneration periodically as it determined appropriate (e.g., from $900 to $1,150 per month), the monthly remuneration standard remained unchanged. In short, the monthly

compensation concept is not new. While Labor Code Section 515(a) refers to "monthly salary" instead of monthly remuneration, the concept of a monthly sum was well established long before AB 60 incorporated the concept within Section 515.

It is also clear that the DLSE had definitively construed the monthly remuneration standard prior to AB 60's effective date to require a *salary* that was consistent with that required under the Fair Labor Standards Act ("FLSA"). For example, the DLSE construed the standard in 1997 and 1998 in a manner that was generally consistent with the federal "salary basis" regulations set forth in 29 C.F.R. § 541.118. The DLSE's Chief Counsel wrote an advice letter to Attorney Richard Simmons dated April 28, 1997, which expressed the opinion that the monthly remuneration requirement of the wage orders

> "is met when under the employment agreement the worker receives each week a predetermined sum constituting all or part of his compensation which predetermined amount is not less than the remuneration required by the specific order the employee is subject to, multiplied by 12 and divided by 52. Such weekly sum shall not be subject to reduction because of variations in the quality of the work performed."

The letter construed the monthly remuneration standard to parallel the federal regulations that require a predetermined salary. It stated: "The definition and its application will be more *compatible with the federal standard of the weekly salary test.*" It further noted that the "employee need not be paid for any week in which he or she performs no work," and that the DLSE would look to federal and state case law, "which defines the provisions of 29 C.F.R. § 541.118," to construe the salary/remuneration standards.

The DLSE reaffirmed these principles by publishing and disseminating the 1997 advice letter. Moreover, it reaffirmed and clarified this position in a subsequent letter to Mr. Simmons dated September 3, 1997 that clarified the DLSE's intention to follow a recent Ninth Circuit opinion (Boykin v. Boeing Co., 128 F.3d 1279 (9th Cir. 1997)), which had recognized the ability to pay supplemental sums to exempt employees without transgressing the salary basis rules. The DLSE reproduced both advice letters in its 1998 Enforcement Policies and Interpretations Manual, and continued to follow the same enforcement position before and after AB 60's effective date.

It is clear that the "monthly salary" standards now found in Section 515 and the wage orders were well established prior to AB 60. The Legislature and the

Commission presumably were aware of this well publicized enforcement position when AB 60 was enacted and the 2000 and 2001 wage orders were adopted. Yet, they did nothing to indicate that they did not agree with the attempt by the DLSE to make the California wage orders compatible with the federal standards by amending the remuneration standards. Further, the DLSE did not adopt a change to that enforcement position after AB 60 took effect in 2000.

2. AB 60 Calls For The Calculation Of A Weekly Salary

AB 60 restored the daily overtime provisions to California law that had been deleted in five of the Commission's wage orders in 1998. Although AB 60 was aimed primarily at California's overtime rules, it also addressed the "white collar exemptions" for executive, administrative, and professional employees. It added Section 515(a) to the Labor Code to authorize the Commission to establish such overtime exemptions, provided employees meet specified duties standards and earn "a *monthly salary* equivalent to no less than two times the state minimum wage for full-time employment." For this purpose, Section 515(c) specifies that "full-time employment" and the amount of salary be measured on a *weekly* basis, not a monthly basis.

This is demonstrated by the term "full-time employment," which is defined in Section 515(c) to mean "employment in which an employee is employed for 40 hours per *week*." Based on this weekly standard, the *minimum* salary is determined by multiplying 40 hours times a sum equivalent to twice the minimum wage. For example, in 2002, the minimum salary is computed first by multiplying 40 weekly hours times $13.50 (2 x the minimum wage of $6.75). This equates to a salary that equals $540 per week.[1] From the weekly sum calculated under the statutory formula in Section 515, an annual or monthly sum can be computed, e.g., by multiplying the weekly sum by 52 ($540 x 52 = $28,080/year) and thereafter dividing the annual salary by 12 to determine the monthly amount ($28,080 ÷ 12 = $2,340/month). *Significantly, AB 60's formula calls for the calculation of a weekly salary.* It does not specify a formula for computing a monthly salary. This is entirely consistent with the weekly system used under the FLSA and the principles of state law described by the DLSE's Chief Counsel in 1997.

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[1] This is substantially greater than the minimum salary of $250 per week required under the "short test" in federal law.

3. AB 60 Continued To Use A Weekly Standard To Measure Overtime Work and the Exemptions

AB 60 authorized the Commission to review the white collar exemptions, but did not instruct the Commission to alter the salary standards. Labor Code Section 515(b)(2) entrusted the Commission with the authority to keep or change those standards. It states: "Except as otherwise provided in this section and in subdivision (g) of Section 511, nothing in this section requires the Commission to alter any exemption from provisions regulating hours of work that was contained in any valid wage order in effect in 1997 [sic]." In fact, the section then states that "the commission may review, retain, or eliminate any exemption." The Legislature thus contemplated that the Commission could retain the exemptions that were established under the wage orders in effect in 1997, when the DLSE's Chief Counsel issued the April 28, 1997 advice letter. This included the salary features of those exemptions. The Commission's authority was reconfirmed on September 19, 2000, when SB 88 reenacted the provisions of Section 515.

It is evident that the Legislature conferred authority upon the Commission to preserve the status quo regarding the salary requirements. It is also clear that the Commission chose to preserve the status quo in this area and did not intend to depart from the federal standards. As explained above, the established enforcement policy under the wage orders in effect in 1997 followed the federal salary basis standards, including the rule that allowed salaries to be tested based on a weekly standard.

4. A Weekly Standard Is Compatible With The Provisions Of State Law And The Long-Established System Of Wage-Hour Administration

It should also be pointed out that the use of a weekly salary is compatible with the system of wage and hour administration followed under California law. For instance, overtime is paid for work in excess of 40 hours in a workweek, not on the basis of a monthly standard. In fact, months vary in length while workweeks provide a fixed and consistent measuring standard that has been applied for decades. In addition, the provisions of AB 60 consistently use the week as the appropriate standard of measurement. It determines full-time employment on the basis of a "*week*" (Section 515(c)), establishes the minimum amount of salary based on a *weekly* standard (40 *weekly* hours x $13.50 per hour) (Section 515(a)), provides that the overtime rate for salaried employees who are mistakenly treated as exempt shall be 1/40th of the employee's "*weekly salary*" (Section 515(d)), and uses a *weekly* standard to determine

when overtime is worked. Furthermore, many employees are paid weekly in accordance with Labor Code Section 204.

Thus, the weekly standard is an integral part of California's wage and hour scheme and plays a critical role in the administration of many of the standards established under AB 60. Its central role in the administrative scheme is obvious. In contrast, few employers use monthly pay periods or pay "monthly" salaries, and employers are not required to pay overtime based on a monthly standard or to compute the regular rate of pay on the basis of a monthly standard.[2]

In short, the use of a monthly period as the sole basis to measure the salary standard would be incompatible with the normal methods of wage-hour and payroll administration. It could lead to numerous administrative problems, including problems with pay periods, overtime issues where an employee is found nonexempt, and the determination of which "monthly" period to use, e.g., whether it must coincide with the employee's anniversary month, the calendar month, the employer's fiscal month, or whether it could be any 29 to 31-day period that the employer selects. In those instances where vacation is charged for time missed or deductions from salary are permitted (e.g., for initial and terminal months of employment), practical problems and inequities could arise in connection with adjustments to the monthly salary. For instance, it is unclear whether the monthly salary would be reduced by 1/31, 1/30, 1/29 (depending upon the number of calendar days in the month) or by some other fraction based on the number of normal or scheduled work days in the applicable period. A monthly measuring period that interferes with the use of vacation and other paid leave benefits would also impede the flexibility demanded by the California Family Rights Act, Government Code Sections 12945.2(d)-(e), Labor Code Section 230.8(b)(1), [3] and other state and federal statutes.

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[2] Few employers use monthly pay periods due to Labor Code Section 204, which ordinarily requires the use of a weekly, bi-weekly or semi-monthly pay period.

[3] Both statutes explicitly permit employers to require the use of vacation and paid leave benefits for time off. Government Code Section 12945.2(d) also states that an "employer shall not be required to pay an employee for any leave taken" pursuant to Section 12945.2(a).

5. The 2000 And 2001 Wage Orders Preserve The Weekly Standard As The Status Quo

The Commission incorporated the "monthly salary" language and standards contained in Labor Code Section 515 within the wage orders that took effect on October 1, 2000 and January 1, 2001. It is clear that in doing so the Commission did not intend to alter the well-established position that the federal salary standards in 29 C.F.R. § 541.118 be followed. Indeed, no compelling need to alter those standards existed and the Commission had the authority, under Section 515(b), to retain those standards.

On May 30, 2001, a letter was written by a DLSE representative that did not reflect a full understanding of the Commission's intent in this area. After it was discovered that the letter was issued and had possibly misinterpreted the law and the Commission's intent, it was promptly withdrawn on June 22, 2001, so that the subject could be further investigated. Many members of the public, including representatives of organized labor, employees, employers and the legal community, testified before the Commission about the confusion caused by the May 30th letter. The DLSE and others asked the Commission to clarify its intent on this critical subject. The Commission heard testimony on the issue on June 15, 2001, October 29, 2001, and December 7, 2001. It also reviewed comments, evidence, and submissions from representatives of organized labor, employers, employees, and the legal community.

The Commission made its original intentions regarding the salary standards contained in the 2000 and 2001 wage orders unmistakably clear during this period. DLSE interprets the Labor Code and the wage orders that implemented AB 60 to allow salaries to be measured on a weekly basis.

6. The Salary Basis Standards

Based on the discussion set forth above, the DLSE has construed the wage orders, the pertinent statutes, and the Commission's intent to preserve the status quo regarding the applicability of the federal salary standards. Under those standards, a prorated weekly salary test may be used to meet the California requirements of a monthly salary. The following standards are consistent with the DLSE's enforcement position:

(a) An employee will be considered to be paid a "monthly salary" if under his or her employment agreement the employee regularly receives each pay period on a weekly, or less frequent basis, a predetermined amount constituting all or part of his or her compensation, which amount is not subject to reduction because of variations in the quality or quantity of the work performed. A salary that is no less than

of twice the state minimum wage for employees who work 40 hours a week and that meets the standards in 29 C.F.R. § 541.118 satisfies the state salary rule. Subject to the exceptions provided below and in 29 C.F.R. § 541.118, the employee must receive his or her full salary for any week in which he or she performs any work without regard to the number of days or hours worked. This policy is subject to the general rule that an employee need not be paid for any workweek in which he or she performs no work.

(b) The deductions from salaries allowed under 29 C.F.R. §§ 541.118(a)-(c) of the federal regulations also are permitted under state law, as is the payment of extra sums in addition to a salary. However, it must be noted that vacation is treated differently under state law than federal law. Under California law accrued vacation constitutes vested "wages." (Labor Code Section 227.3, Suastez v. Plastic Dress-Up Co. (1982) 31 Cal.3d 774.

(c) The payment of a proportionate part of the employee's salary for the time actually worked in initial and terminal weeks or months of employment is consistent with the salary rules. In addition, adjustments in compensation and/or benefits are permissible where other statutory requirements are met, such as the family and medical leave rules that provide eligible employees the flexibility they need to take leaves on a "reduced leave" or "intermittent leave" basis.

We hope this letter addresses the questions you have posed and clearly articulates the DLSE's enforcement position. If we can offer any further assistance, please feel free to contact us.

Sincerely,

Arthur S. Lujan,
Labor Commissioner

cc: Anne P. Stevason, Acting Chief Counsel
Tom Grogan, Deputy Chief
Assistant Chiefs
Bridget Bane, IWC Executive Officer