STATE OF CALIFORNIA — Arnold Schwarzenegger, *Governor*

DEPARTMENT OF INDUSTRIAL RELATIONS
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ROBERT R. ROGINSON
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August 19, 2009

Kirby Wilcox
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Re: Salary Basis Test - Work Schedule and Salary Reduction to Avoid Layoff

Dear Mr. Wilcox:

This is in response to your letter dated March 23, 2009, requesting an opinion of this office concerning the salary basis test for payment of an exempt employee covered by Wage Order 4. Specifically, an employer represented by your firm would like to reduce the work schedule of its exempt employees, coupled with a reduction in their salaries, as an alternative to avoiding or limiting the need for job layoffs in the current difficult economic environment. You seek an opinion as to whether this reduction is consistent with the salary basis test for exempt employees under California law. As described more fully below, it is the opinion of the Division of Labor Standards Enforcement (DLSE) that neither the Labor Code and Industrial Welfare Commission wage order provisions, nor the federal law upon which the pertinent provisions of California law is based, prohibits the employer described in your letter from implementing its proposed reduction in the work schedule and salary of the affected exempt employees.

Factual Background

According to the information provided by you, the employer represented by your firm (Employer) is experiencing significant economic difficulties due to the present severe economic downturn facing California and the nation. The Employer seeks to cut costs until the business conditions improve and has already conducted job layoffs. The Employer would like to reduce the number of its employees' scheduled work days from five days to four days per week. In implementing this reduction, the Employer would not pay non-exempt employees for the day that they were not required to work and would reduce the salaries of the exempt employees by 20% or some other proportion. You represent that the Employer views this measure as highly unusual and temporary, in light of the economic challenges presented. As soon as the business conditions permit, you indicate that the Employer intends to restore both the full five-day work schedule and the full salaries of its exempt employees.

The White Collar Exemptions

Although your letter does not expressly articulate it, we presume from the facts and analysis described, that the question presented by your opinion letter request concerns the exemptions described in Section 3 of Wage Order 4-2001, the so-called "white-collar" exemptions known as the executive, administrative, and professional exemptions. Under California law, there is a presumption that an employee is non-exempt, and accordingly, is entitled to overtime. This presumption will be defeated only if the specific employee in question comes within the exemptions that are set out in the applicable wage order. The burden to establish that the exemption exists in the specific case is on the employer. (*Ramirez v. Yosemite Water Co., Inc.* (1999) 20 Cal.4th 785, 794; *Hodge v. Superior Court* (2006) 145 Cal.App.4th 278) Furthermore, the exemptions are narrowly construed against the employer and their application is limited to those employees plainly and unmistakably within their terms. (*Nordquist v. McGraw-Hill Broadcasting* (1995) 32 Cal.App.4th 555)

The Salary Basis Test

The salary basis test is set forth in Labor Code § 515(a) and the applicable wage order. In particular, Wage Order 4, Section 1(A)(1)(f) provides that in order for an employee to meet the salary basis test portion of the exemption: "[s]uch an employee must also earn a monthly salary equivalent to no less than two (2) times the state minimum wage for full-time employment. Full-time employment is defined in Labor Code Section 515(c) as 40 hours per week."

There is no express restriction in California law to having a fixed reduction in a salary during a period when the company operates a shortened workweek due to economic conditions. In particular, no such restriction exists under the wage order or California Labor Code. Nor are there any identified California cases addressing this issue. While there are several differences between the federal and state salary requirements (e.g. minimum dollar amounts), DLSE follows the general federal interpretations under the federal Fair Labor Standards Act ("FLSA") salary basis test with respect to allowable deductions for absences to the extent there is no inconsistency with specific provisions in the Labor Code or IWC Orders. (DLSE Enforcement Policies and Interpretations Manual (June 2002) [hereafter "DLSE Manual"], §§ 51.6.4 and 51.6.6; DLSE Opinion Letter 2002.03.01 [the salary requirements of state law are generally consistent with the federal "salary basis" regulations set forth in 29 CFR § 541.118 (now § 541.602), including DLSE's enforcement position regarding deductions from salaries]).

Under such circumstances, it is appropriate to consider federal authorities in the interpretation of state laws that are patterned after federal law. (*Bell v. Farmers Ins. Exchange* (2001) 87 Cal.App.4th 805) This is not an example where California law is more protective than federal law. For instance, in *Ramirez v. Yosemite Water Co.*, where the issue before the court concerned the definition of the exemption for "outside salesmen" and the court concluded that the state law provided greater protection for employees than its federal analog, the court held that the trial court erred in relying upon federal authorities in interpreting the wage order, stating "where the language or intent of state and federal labor laws substantially differ, reliance on federal

regulations or interpretations to construe state regulations is misplaced." (*Ramirez v. Yosemite Water Co.*, *supra*, 20 Cal.4th at p. 798)

The applicable federal regulations and interpretations by the federal Department of Labor (DOL) support the conclusion that the Employer may reduce its exempt employees' work schedule and salary, as proposed, without violating the salary basis test.

29 CFR § 541.602 provides as follows:

> (a) General rule. An employee will be considered to be paid on a "salary basis" within the meaning of these regulations if the employee regularly receives each pay period on a weekly, or less frequent basis, a predetermined amount constituting all or part of the employee's compensation, which amount is not subject to reduction because of variations in the quality or quantity of the work performed. Subject to the exceptions provided in paragraph (b) of this section, an exempt employee must receive the full salary for any week in which the employee performs any work without regard to the number of days or hours worked. Exempt employees need not be paid for any workweek in which they perform no work. An employee is not paid on a salary basis if deductions from the employee's predetermined compensation are made for absences occasioned by the employer or by the operating requirements of the business. If the employee is ready, willing and able to work, deductions may not be made for time when work is not available.

In a series of opinion letters extending as far back as at least 1970, the DOL has consistently concluded that the salary basis test does not preclude a bona fide fixed reduction in the salary of an exempt employee to correspond with a reduction in the normal workweek so long as the reduction is not designed to circumvent the requirement that the employees be paid their full salary in any week in which they perform work. [1] Further the salary reduction may not reduce the amount paid to the employee in any workweek to less than the minimum salary required under the applicable law. In an opinion letter dated November 13, 1970 (1970 WL 26462), the DOL considered the circumstance of an employer in the aerospace industry which had already had extensive layoffs and was considering either reducing the existing workweek or laying off additional workers. Specifically, the employer proposed to change from 52 five-day workweek schedule to 47 five-day workweeks and 5 four-day workweeks, with the four-day workweeks occurring at the end of that and succeeding calendar years. The DOL concluded that the proposed change was not contrary to 29 CFR § 541.118 (now § 541.602, quoted above, following a revision and renumber in 2004), stating:

[1] The DOL's Wage and Hour Division issues opinion letters to explain the requirements of the FLSA and its regulations and how they apply to particular circumstances. The DOL considers these opinion letters to be "rulings." 29 C.F.R. 790.17(d). Federal courts have concluded that they are entitled to great weight when they interpret the DOL's own ambiguous regulations. (See *Archuleta v. Wal-Mart Stores, Inc.* (10th Cir. 2008) 543 F.3d 1226 at fn. 7)

> Section 541.118 does not preclude a bona fide reduction in an employee's salary which is not designed to circumvent the salary basis requirement. A reduction in salary resulting from a temporary reduction in the normal workweek (such as you describe) is, therefore, permissible and will not defeat an otherwise valid exemption, provided that the reduction does not reduce the amount paid to the employee in any workweek to less than the minimum salary required by the regulations (currently $125 per week for executive and administrative employees and $140 per week for professional employees)."

The many opinion letters issued subsequently by the DOL on this subject reach the same result. They include an opinion letter issued March 4, 1997 (1997 WL 998010), in which the DOL considered the proposal of an employer in the mental health field that wished to reduce the workweek of certain exempt employees from 40 hours to 32 hours with a commensurate reduction in pay. The DOL concluded that the proposal was not contrary to § 541.118. Similarly in an opinion letter issued February 23, 1998 (1998 WL 852696), the DOL considered an industrial manufacturer's progressive three-step plan to deploy staff when serious and persistent work shortages occur in the defined work-unit. The second step of the plan included a reduction of hours worked to 32 hours a week with corresponding pay reduction. The DOL concluded that the plan, including the reduction in work schedule and pay, did not violate § 541.118. Citing an earlier opinion letter, the DOL stated:

> [W]e have stated that a fixed reduction in salary effective during a period when a company operates a shortened workweek due to economic conditions would be a bona fide reduction not designed to circumvent the salary basis payment. Therefore, the exemption would remain in effect as long as the employee receives the minimum salary required by the regulations and meets all other requirements for the exemption."

(Emphasis in original.) Other opinion letters issued by the DOL are in accord. *See*, DOL opinion letter (June 3, 1999) 1999 WL 1002416 and DOL opinion letter (June 25, 2004) 2004 WL 2146925.

We were unable to identify any California appellate decisions addressing specifically the issue presented in your request. Several federal appellate and district courts, however, have addressed the issue of simultaneous reductions in work schedules and salaries under the FLSA. (See *Archuleta v. Wal-Mart Stores, Inc.* (10th Cir. 2008) 543 F.3d 1226; *In re Wal-Mart Stores, Inc.* (10th Cir. 2005) 395 F.3d 1177; *Caperci v. Rite Aid Corporation* (Dist. Mass 1999) 43 F.Supp.2d 83) These federal appellate and trial court decisions support the conclusion that the Employer's proposal to reduce simultaneously its exempt employees' work schedule and salary for the specific reasons described above does not violate the salary basis test. In *Archuleta*, the Tenth Circuit considered whether a compensation practice used by the retailer for its fulltime pharmacists

violated the salary basis test because it resulted in adjustments to the employees' base salary. The plaintiff employees contended that although Wal-Mart purported to pay its pharmacists as salaried professionals, it actually changed their salaries so frequently that it treated them, in effect, as hourly non-exempt employees. The court upheld a summary judgment order in favor of the employer, holding that the retailer's policy of prospectively reducing the pharmacists' base hours did not occur with such frequency that their status as salaried employees was a sham. (*Archuleta, supra*, 543 F.3d at p. 1234) In reaching this conclusion, the court relied upon its previous holding in *In re Wal-Mart Stores, Inc.*, the DOL opinion letters issued November 13, 1970 and February 23, 1998, *supra*, and the rationale in two trial court decisions, *Caperci v. Rite Aid Corp.* (D.Mass 1999) 43 F.Supp.2d 83 and *Thomas v. County of Fairfax* (E.D.Va. 1991) 758 F.Supp. 353.

An e-mail letter issued by this office in 2002 affirmed the DLSE policy to follow the federal regulations concerning the salary basis test. (See DLSE Opinion Letter 2002.03.12) In the letter, however, it was concluded that the applicable federal regulations preclude an employer from reducing the salary of an exempt employee during a period in which the company operates a shortened workweek due to economic conditions. This conclusion relied in part upon the federal trial court decision in *Dingwall v. Friedman Fisher Associates, P.C.* (N.D. NY 1998) 3 F.Supp.2d 215. In *Dingwall*, the defendant employer reduced the workweek of its staff from five days to four and simultaneously reduced their salaries by one-fifth. Employees were then able to collect one day of unemployment benefits, a benefit arrangement approved by the New York State Department of Labor. District Court Judge Kahn rejected the defendant employer's argument that this reduction was permissible under the salary basis test, holding that the reduction constituted an actual and improper deduction in violation of the applicable federal regulations. (*Dingwall v. Friedman Fisher Associates, supra*, 3 F.Supp.2d at p. 220) As described more fully by the Tenth Circuit Court of Appeals, however, the decision in *Dingwall* is not well-reasoned and misguided. (*In re Wal-Mart Stores, Inc., supra*, 395 F.3d at p. 1188) The appellate court noted that the federal regulation the trial court relied upon for its ruling (29 C.F.R. § 541.118(a)(1)) "clearly refers only to deductions during the current pay period, for which the salary has been fixed, not reductions in future salary." (*Id.*). "More importantly, and remarkably, the court made no reference to the applicable [DOL] opinion letters." (*Id.*). Of course, the 2002 DLSE letter predates the *In re Wal-Mart* decision and they did not benefit from the thorough discussion of the issue in that case. For all of the foregoing reasons, the DLSE's prior reliance upon *Dingwall* for the conclusion that the federal regulations prohibit the simultaneous reduction of a workweek schedule and salary presented in this case is not persuasive and does not provide an appropriate basis to reject the long line of reasoning and authority set forth in the federal regulation and the federal authorities and DOL opinion letters interpreting these federal regulations.

In the circumstances presented in this letter, the Employer's proposal to reduce the number of its employees' scheduled work days from five days to four days per week, with a corresponding reduction in salary, is based upon the Employer having experienced significant economic difficulties due to the present severe economic downturn. Furthermore, according to the specific representations made by you on behalf of the Employer, as soon as the business conditions permit, the Employer intends to restore both the full five-day work schedule and the full salaries of its exempt employees. In accordance with the several DOL opinion letters and federal district and appellate court decisions interpreting the federal law, which the DLSE has historically followed,

and based upon the facts presented which provide no indication that the Employer intends to adjust the salary any more frequently than described, it is the opinion of this office that the Employer is not prohibited under California law from implementing the proposed scheduled reduction in the work schedule and salary of the affected exempt employees so long as the employee still meets the salary test by earning a monthly salary equivalent to no less than two times the state minimum wage for full time employment as provided in Labor Code §§.515(a) and (c) and IWC Wage Order 4, Section 1(A)(1)(f). Of course, each affected employee must also continue to satisfy the duties test for the applicable exemption as set forth in Section 1 of the wage order.

This opinion is based exclusively on the facts and circumstances described in your request and is given based upon your representations, express or implied, that you have provided a full and fair description of all facts and circumstances that would be pertinent to our consideration of the questions presented. The existence of any other factual or historical background not contained in your letter might require a conclusion different from the one expressed herein. You have represented that this opinion is not sought by a party to pending private litigation concerning the issues addressed herein. You have also represented that this opinion is not sought in connection with an investigation or litigation between a client or firm and the Division of Labor Standards Enforcement.

I hope that the above sufficiently responds to your request and thank you for your interest in ensuring compliance with California's wage and hour laws.

Very truly yours,

Robert R. Roginson
Chief Counsel

RRR:

cc: Labor Commissioner Angela Bradstreet