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Re: Labor Code §226 -- Semi-Monthly Pay Periods for Non-Exempt Salaried Employees

Dear Mr. Simmons:

This is in response to your letter of January 2, 2002, concerning the application of Labor Code section 226 to the use of semi-monthly pay periods for non-exempt salaried employees. You state that your client pays its non-exempt salaried employees twice each month, and that they are paid 1/24th of their annual salaries on each payday. The paydays are the 15th (or last working day before the 15th) and the last working day of each month. As is the case with all semi-monthly payrolls, the number of actual work days and thus, non-overtime work hours, varies from pay period to pay period.

You further state that "adjustments for overtime pay and missed work are incorporated within the paycheck for the following payday," which you assert is "as specified in Labor Code section 204." These "adjustments," are based on an hourly rate, which you explain is computed by dividing the annual salary by 2,080 hours (i.e., 40 hours per week X 52 weeks per year).

Next, you state that your client, in seeking to comply with Labor Code section 226's requirement for listing hours worked on the itemized statement attached to a paycheck, lists 86.67 hours as the hours worked per semi-monthly pay period, unless the employee works overtime or misses work. The 86.67 hours is based on dividing the total number of non-overtime hours in a year (2,080) by the number of pay periods in a year (24). You acknowledge, however, that because the number of work days and non-overtime work hours consistently varies from one semi-monthly

pay period to another, pay periods never consist of precisely 86.67 hours. Yet, you suggest that because the hourly rate (also known as the "regular rate of pay" for purposes of computing overtime compensation) is calculated by dividing the annual salary by 2,080 hours, "it will confuse employees" if your client were to use a number other than 86.67 hours as the number of non-overtime hours worked each pay period.

It seems that some of this confusion is caused by your client's use of semi-monthly instead of bi-weekly pay periods (which do not result in varying amounts of scheduled non-overtime hours), and your client's practice of issuing pay checks on the last day of the pay period (thereby necessitating "adjustments" for missed work or for overtime), rather than issuing paychecks after the close of the pay period within the time permitted by Labor Code §204, with all appropriate deductions for missed work and extra payments for overtime encompassed in those paychecks. To be sure, the use of semi-monthly pay periods and payment of employees on the last day of the pay period are lawful pay practices. However, the confusion that may be caused by following such lawful practices cannot be ameliorated by non-compliance with the explicit requirements of Labor Code §226, namely: 1) the obligation to list "the total hours worked by the employee" during the period for which the employee is paid, and 2) the obligation to list "all applicable hourly rates in effect during the pay period and the corresponding number of hours worked at each hourly rate by the employee."

Labor Code §204 provides, in relevant part, that wages earned during the course of employment must be paid no less frequently than "twice during each calendar month, on days designated in advance by the employer as regular paydays. Labor performed between the 1st and 15th days, inclusive, of any calendar month shall be paid for between the 16th and the 26th of the month during which the labor was performed, and labor performed between the 16th and last day inclusive, of any calendar month shall be paid for between the 1st and 10th day of the following month." However, not all wages earned during the pay period must be paid on the next regular payday, as section 204 further states: "Notwithstanding any other provision of this section, all wages earned for labor in excess of the normal work period shall be paid no later than the payday for the next regular payroll period." The term "labor in excess of the normal work period" means all non-regularly scheduled overtime. All other hours worked - i.e., all non-overtime work and all regularly scheduled overtime - does not constitute "labor in excess of the normal work period" within the meaning of section 204, and thus, must be paid on the payday for the pay period in which the work was performed.

Your client's practice of paying its employees on the last day of the pay period, rather than sometime during the 10 or 11 day period after the end of the pay period (as permitted by Labor Code §204), is clearly authorized by Labor Code §219, which provides: "Nothing in this article shall in any way limit or prohibit the payment of wages at more frequent intervals, or in greater amounts, or in full when or before due. . . ."

As a general rule, the obligation to list the total hours worked during the pay period can only be satisfied by listing the precise, actual number of hours worked. The only express exception to this requirement is that hours worked need not be listed for "any employee whose compensation is solely based on a salary *and who is exempt from payment of overtime under subdivision (a) of section 515 or any applicable order of the Industrial Welfare* Commission." (Labor Code §226(a)(2), emphasis added.) With the enactment of AB 2509, the Legislature amended Labor Code §226 to require the listing of hours worked for all non-exempt employees, whether they are paid by salary, commission, piece rate, or on an hourly basis. The reason for this requirement is simple enough--it is designed to provide the employee with a record of hours worked, and to assist the employee in determining whether he has been compensated properly for all of his or her hours worked. The failure to list the precise number of hours worked during the pay period conflicts with the express language of the statute and stands in the way of the statutory purpose. Thus, the answer to the first question posed by your letter -- whether it is permissible under section 226 to list 86.67 hours in the itemized wage statement when that is not a precise reflection of the number of hours worked in the pay period -- is no, this practice violates Labor Code §226.

Prior to the enactment of AB 2509, Labor Code §226 did not apply to any employees who were paid by salary, even if they were non-exempt. But with the amendment of section 226, which took effect on Janaury 1, 2001, the procedure followed by your client of listing "averaged" hours each pay period that do not reflect actual hours worked became unlawful. Although we do not read section 226 as prohibiting an employer from paying its employees in advance of the date that wages are due under Labor Code §204, it is fairly obvious that such advance payments (if made on the last day or prior to the last day of the pay period) would make it impossible for the employer to accurately list all hours worked (as some of those hours would not yet have been worked) on the itemized wage statement attached to the paycheck. We can think of two possible solutions to this dilemma. Of course, the simplest solution would be to change the paydays so that paychecks are issued after the close of the pay period, within the time permitted under section 204, so as to allow the employer to accurately list all hours worked during the pay period.

Alternatively, if the employer decides to continue its practice of making advance payments, it would still need to list the "total hours worked" during the pay period, which would have to include both the hours that were worked prior to the time the paystub is prepared, and the scheduled hours yet to be worked for the remainder of the pay period. Obviously, to the extent that these "hours worked" would be based, in part, on a projection of hours not yet worked, the paystub attached to the next regular paycheck should contain a category showing corrections to hours worked that were listed on the prior paystub. These "corrections" should reflect missed scheduled work that had been listed as "hours worked" on the prior paystub, and unscheduled overtime work that had not been listed as "hours worked" on the prior paystub. Any corrections set out in a subsequently issued paystub must state the inclusive dates of the pay period for which the employer is correcting its initial report of hours worked.

You also ask whether the requirement of section 226(a)(9) for listing "all applicable hourly rates in effect during the pay period" can be satisfied by reporting one hourly rate each pay period (i.e., that determined by dividing the annual salary by 2,080 hours) even though the number of work days and non-overtime hours varies from one pay period to another. The hourly rate for a non-exempt salaried employee must be determined in accordance with Labor Code §515(d), which codifies the DLSE enforcement practice that was upheld in *Skyline Homes v. Department of Industrial Relations* (1985) 165 Cal.App.3d 239. Labor Code §515(d) provides: "For purposes of computing the overtime rate of compensation required to be paid to a non-exempt full time salaried employee, the employee's regular hourly rate shall be 1/40 the employee's weekly salary." A non-exempt full time[1] employee compensated by an annual salary would have his or her weekly salary determined by dividing the annual salary by 52, and then, the hourly rate would be determined by dividing that weekly salary by 40, i.e, the annual salary would be divided by 2,080. Thus, the "applicable hourly rate," within the meaning of section 226(a)(9), would remain constant as long as the full-time employee's annual salary remains unchanged, regardless of variations in the number of workdays and non-overtime work hours in each semi-monthly pay period.

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[1] For purposes of computing the regular hourly rate of pay, the term "full time employment" means employment in which the employee is employed for 40 hours per week. (Labor Code §515(c).) In accordance with *Skyline Homes*, the regular hourly rate of a part time non-exempt salaried employee would be determined by dividing the employee's weekly salary by the number of weekly hours the employee is regularly scheduled to work. For example, a non-exempt employee who is employed to normally work 30 hours a week, and who is paid a salary of $600 a week, is employed at a regular hourly rate of $20 per hour.

To minimize the possibility of confusion on the part of any non-exempt salaried employee, it may be advisable for the employer to specify, on the itemized wage statement, that this hourly rate is based on the employee's annual (or monthly, or weekly) salary, and to then set out the amount of that salary. The employer may further choose to specify that overtime pay, based on this hourly rate, is required for all hours worked in excess of 8 in any workday or 40 in any workweek, and that otherwise, this salary is deemed to compensate the employee for all non-overtime hours worked, and that the amount of non-overtime hours worked will vary each semi-monthly pay period.

By way of example: Assume a full-time non-exempt employee is paid a salary of $52,000 a year. The regular hourly rate is determined by dividing that annual salary by 52, for a weekly salary of $1,000, and dividing that by 40, for a regular rate of $25 an hour. Overtime must be paid at the rate of $37.50 an hour for those hours for which the employee is entitled to one and a half times the regular rate, and at $50 an hour for those hours for which the employee is entitled to twice the regular rate. This employee is paid 1/24 of his annual salary, $2,166.67, each semi-monthly pay period for all scheduled non-overtime work, despite the fact that the amount of scheduled non-overtime varies from semi-monthly pay period to semi-monthly pay period. In accordance with Labor Code §204, all overtime worked during the pay period must be paid, no later than the payday for the next regular pay period, at the rate of $37.50 or $50 an hour, as applicable. Please note, however, that while Labor Code §204 permits this brief delay in payment of overtime, Labor Code §226 requires that all hours worked, including overtime hours, shall be listed as part of the itemized wage and deduction statement attached to the paycheck issued for the pay period in which the work was performed--i.e., there cannot be a delay in reporting overtime hours worked. We would thus recommend that if the overtime hours are not paid until the pay period following the pay period in which they are worked and reported, that the employer advise the employees, in writing on the itemized wage and deduction statement, that the overtime hours worked in this pay period will be paid on the next paycheck.

Other issues are presented by the "adjustments," at the employee's regular hourly rate, for missed non-overtime work. We will caution you by quoting from an opinion letter authored by then Labor Commissioner Lloyd W. Aubry, Jr. on April 27, 1987:

> Your client's plan to pay wages bi-monthly without regard to number of days actually worked and then deduct any overpayments; i.e., for time not worked during the previous pay period, from the subsequent pay period, would not be violative of Section 204. However,

> any deductions representing overpayments made for the previous pay period should be agreed to in writing by the affected employee and specify the pay period, the date or dates and reason for the lost time, i.e., unearned or unauthorized vacation, illness not covered by sick leave, etc.

Absent such voluntary written authorization, we would view these "adjustments" as violative of Labor Code §221 and inconsistent with *CSEA v. State of California* (1988) 198 Cal.App.3d 374.

You next ask whether the requirements of section 226 could be met, as to employees who receive "adjustments" for overtime work or missed work in the paycheck issued following the pay period during which the work was performed (or missed), by providing those employees, on the day they are paid, with a copy of their time records or time cards disclosing their actual hours worked. As discussed above, section 226 requires that the employer list the employee's *total hours worked* during the pay period for which the employee is being paid -- *total hours worked* necessarily includes all actual non-overtime hours and all overtime hours worked. Section 226 expressly requires an "itemized statement in writing showing ... total hours worked." Time cards or other time records, if attached to a paycheck, would satisfy section 226's requirement for a statement of *total hours worked* if the *total hours worked* during the pay period are separately listed on the time cards or other time records prior to the time these records are provided to the employee. If it is left to the employee to add up the daily hours shown on the time cards or other records so that the employee must perform arithmetic computations to determine the *total hours worked* during the pay period, the requirements of section 226 would not be met.

Finally, you ask whether the $4,000 limit on penalties in Section 226(b) is a limit on the total liability that an employer can face regardless of the number of employes involved (i.e., $4,000 per employer), or whether it is a maximum of $4,000 per employee (e.g., an employer with 10 employees would face a maximum liability of $40,000). Prior to the passage of AB 2509, section 226(b) provided: "Any employee suffering injury as a result of a knowing and intentional failure by an employer to comply with subdivision (a) shall be entitled to recover all actual damages or $100, whichever is greater, plus costs and reasonable attorney fees." The statute now provides: "Any employee . . . shall be entitled to recover the greater of all actual damages or $50 for the initial pay period in which a violation occurs and $100 per employee for each violation in a subsequent pay period, not exceeding an aggregate penalty of $4,000, and shall be entitled to an award of costs and reasonable

attorney's fees."

The maximum "aggregate penalty" that the statute now references is one that, based on the plain language of the statute, is owed to "any employee." It is not a maximum for *all of the employer's employees*. Indeed, the latter interpretation flies in the face of AB 2509's legislative history, and in particular, the final Senate bill analysis which explains that the bill "entitles an aggrieved employee . . . to the greater of actual damages or penal damages . . . up to $4,000." To interpret this statute as establishing a $4,000 maximum penalty for an employer, rather than a $4,000 maximum penalty per aggrieved employee, would fail to provide any sort of meaningful compensation to the employees of a large employer. Such an interpretation would fail to effectuate the purpose of this law.

Thank you for your ongoing interest in California wage and hour law. Feel free to contact us with any other questions.

Sincerely,

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AS/mel

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