

Question received by e-mail at DLSE Info Web Site:

February 27, 2002

I have read the DLSE's recent opinions about cutting the salaries of exempt employees. Specifically, these involved instances where the employer presumably cut the salaries because of a change in hours worked; the DLSE has said that this is the same as making a deduction based on hours worked and is inconsistent with the "salary basis" standard. I can understand this interpretation when the cut in hours is the reason for the salary change, and/or the salary reduction is temporary and periodically recurring.

However, does this interpretation eliminate the employer's traditional right to decide an exempt employee is simply over paid (for reasons other than simply hours worked) and therefore cut his/her salary? Are you saying that an employer can never reduce an exempt employee's salary level, once that level has been set? Or are you saying there are specific conditions under which an employer may lower an exempt employee's salary?

In addition to the foregoing, please tell me how the DLSE would view the following situations (all examples are based on hourly people never dropping below minimum wage and exempt employees never dropping below \$2,340 per month):

1. A company has just laid off one-third of its workforce and cannot afford the current payroll burden of the remaining-but essential-employees. The company decides on an across-the-board pay cut. All employees will continue to work their normal schedule, but every employee will see a 20% cut in either hourly rate or monthly salary. The company has no idea how long this will last.
2. Same situation as Example 1; however, production levels have also crumbled. There is not enough work to keep people busy full-time. Rather than pay people less per hour and have them idle much of the time, the company decides to cut the payroll by having the production employees work only four days (32 hours) a week, Monday through Thursday. This way, the employees' pain may be offset somewhat by an extra day off to play or get other part-time work. As a result of this and the layoff, the managers have substantially fewer people to supervise, less production responsibilities, and generally less to do. Regardless of whether the managers want to keep coming in Monday through Friday, they now have less responsibility, and they are adding less value under these conditions. The employer decides that a cut in salary is appropriate, and, in an effort to equally "share the pain," decides to cut exempt salaries by 20%. While the employer hopes that this entire situation will change soon, this is not just a "peak or valley" or seasonal variation, and the change is for an indefinite time. During this crisis, the managers will not be charged vacation unless they choose to be out (vacation) on a day during the Monday through Thursday schedule; however, if they are out for a partial day, nothing in their salary is affected.
3. The same situation as in Example 2; however, the employer decides to do one more thing to help the employees. The employer decides to participate in the EDD's workshare program. The employer decides to include the exempt people-after all, regardless of hours worked, the pay cut is just as hard on them as it is on the non-exempt people.
4. A different company, not facing any problems, has an exempt employee who just does a poor job in several respects. Nevertheless, the company needs to keep him, because of some key customer contacts that he has and certain other things that he does exceptionally well. They take away a number of his responsibilities and assign them to others who will be more effective; no new responsibilities are added. Because of all this, they cut his salary by 40%. For the purpose of this example, although he does not have a lot to do, when he does work, he still spends virtually all of his time engaged in bona fide exempt duties.
5. Same situation as in Example 4, but they also tell this weak executive that, since he has so little to do now, they do not want him in the office so much. The company believes that having this employee in the office while idle is a bad idea. So they tell him that he should come into work only on Tuesday through Thursday each week. He would be charged vacation only if he chose to take off one of those days; he would not be charged vacation or have pay deducted for any partial-day absence.

For each example, would the affected "exempt" employee no longer be exempt? If not, then under what circumstances may an employer decide to reduce an exempt employee's salary without destroying the exemption?

Thank you for your anticipated prompt response.

Susan Waag

Response By DLSE Info:

March 12, 2002

In answer to your initial question, barring discrimination, there is no law in California which would prevent an employer from reducing the wages (or salary) of any non-exempt employee, so long, of course, that the employee is paid at least the minimum wage.

There are, obviously, any number of reasons why an employer might wish to reduce the salary of a salaried exempt employee as well. Failure of the exempt employee to perform at the level which the employer feels justifies the salary paid would be one of those reasons. Subject to the exception discussed below, a reduction in salary which is the result of a turn down in the business of the employer is a common reason for the reduction. There would be no loss of exemption as a result of such reductions in salary so long as the salary test (i.e., currently \$2340.00 per month) is met.

Actually, your question essentially asks whether a salaried exempt employee's salary may be reduced as a result of "absences occasioned by the employer or by the operating requirements of the business" (to quote from 29 C.F.R. § 541.118, the federal regulations on this subject which the DLSE has chosen to follow in view of the lack of specific language in the IWC Orders or the Labor Code regarding the subject of the salary requirement).

The federal regulations (29 C.F.R. § 541.118) provide, *inter alia*:

"Subject to the exceptions provided below, the employee must receive his full salary for any week in which he performs any work without regard to the number of days or hours worked." (§ 541.118(a))

The federal regulations, in the following paragraph (29 C.F.R. § 541.118(a)(1), state, *inter alia*:

"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 federal regulations at 29 C.F.R. § 541.118(a)(6) state:

"The effect of making a deduction which is not permitted under these interpretations will depend upon the facts in the particular case. Where deductions are generally made when there is no work available, it indicates that there was no intention to pay the employee on a salary basis. In such a case the exemption would not be applicable to him during the entire period when such deductions were being made."

The California Labor Code at Section 515(a) provides that the IWC may establish exemptions from the overtime rate of compensation for employees who meet the duties requirements of the exempt position and is paid a monthly salary equivalent to "two-times the state minimum wage for full-time employment. Labor Code § 515(c) provides that "full time employment" means "employment in which the employee is employed 40-hours per week."

This discussion must, we feel, begin with the premise that in California a court "will not lend its aid to accomplish by indirection what the law or its clearly defined policy forbids to be done directly" (*Timberline, Inc. v. Jaisinghani* (1997) 54 Cal.App.4th 1361, 1369). With this premise in place, we will look at the proposals you have made.

In your first example, you ask us to assume that a company wishes to introduce an across-the-board pay cut because of business setbacks. All employees will receive a 20% reduction in pay. As we pointed out, above, there is no law in California which would prevent an employer from implementing such a pay reduction and, so long as the other requirements of the exemption are met, that would not impact on the exempt status of any exempt employee.

In your second example, you add to the scenario that since production levels have crumbled and there is not enough work to keep people busy full-time, rather than pay people less per hour and have them idle much of the time, the company decides to cut the payroll by having the production employees (non-exempt) work only four days (32 hours) a week, Monday through Thursday.

You then expand your second example and the employer decides to cut the salary of exempt employees so that the exempt employees may "share the pain". During this time when the exempt employees are

“sharing the pain” of the other employees, they are told that if they take a vacation day on any day from Monday through Thursday, they will be charged vacation for that day. We assume, therefore, that if the exempt employee takes off a day on Friday, no vacation will be charged to the exempt employee. Thus, the exempt employee is reduced to a four-day workweek which, coincidentally, matches the 20% reduction in his or her salary. This may be couched anyway you please, but the fact is, the employer has reduced the time he is making work available, and has reduced the salary pro rata to reflect this reduction.

The federal courts which have addressed the definition of “salary” have held, as did the Third Circuit in *Brock v. Claridge Hotel and Casino*, 846 F.2d 180, 184 (3d Cir.), *cert. denied sub nom. Claridge Hotel & Casino v. McLaughlin*, 488 U.S. 925, 109 S.Ct. 307, 102 L.Ed.2d 326 (1988): [s]alary is a mark of executive status because the salaried employee must decide for himself the number of hours to devote to a particular task. In other words, the salaried employee decides for himself how much a particular task is worth, measured in the number of hours he devotes to it.” In the Ninth Circuit, the court has concluded that: “A salaried employee is compensated not for the amount of time spent on the job, but rather for the general value of services performed. It is precisely because executives are thought not to punch a time clock that the salary test for “bona fide executives” requires that an employee’s predetermined pay not be “subject to reduction because of variations in the ... quantity of work performed”.... *Abshire v. County of Kern*, 908 F.2d at 486 (9th Cir.1994).

This having been said, it must be noted again that the DLSE has taken the position that it will utilize the provisions of 29 C.F.R. § 541.118 in enforcing the salary requirement of the Orders. The adoption by the DLSE of the language of the federal regulation usually involves the adoption of the interpretation of that regulation by the U.S. Department of Labor, the agency which promulgates the regulations.

Despite the fact that a reduction of hours which is coupled with a reduction in salary for the exempt employee would clearly appear to constitute “deductions from [the employee’s] predetermined compensation...made for absences occasioned by the employer or by the operating requirements of the business”, the Wage and Hour Division of the U.S. Department of Labor has opined on a number of occasions 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.” (Wage and Hour Opinion Letter, February 23, 1998; see also Wage and Hour Opinion Letters dated: June 3, 1999; March 4, 1997; November 13, 1970.)

In fact, there is one federal case which actually alludes to the 1970 DOL Opinion Letter. The federal court, as with the DOL, offers no analysis of the language of the regulations to bolster its conclusory statement that “a fixed reduction in salary effective during a period when a company operates a shortened workweek due to economic condition would be a bona fide reduction not designed to circumvent the salary basis payment.” (*Capeci v. Rite Aid Corp.*, 43 F.Supp.2d 83 (D.Mass.1999))

In the case of *Dingwall v. Friedman Fisher Assoc., P.C.*, 3 F.Supp.2d 215, 220 (N.D.N.Y.1998) which involved a situation where the employer reduced the workweek of its staff, including plaintiff, from five days to four and simultaneously reduced their salaries by one-fifth the defendant argued that its unilateral salary adjustment did not constitute a deduction in salary, but was “merely a change in the ‘regular’ salaries to a new ‘predetermined’ salary amount.” *Id.* The court rejected this interpretation of the FLSA’s salary basis test, stating that:

“Defendant was not merely altering plaintiff’s fixed salary (which it undoubtedly had the right to do), it was altering it on the basis of a reduction in the amount of days worked in response to an insufficient amount of work available. The fact that this was done as an enforced policy of the employer rather than in response to decisions of the employee does not alter the basic fact: plaintiff’s pay was reduced as a result of reduction in days worked.

The Dingwall court also mentions that the language of 29 C.F.R. 541.118(a) “makes it clear that a reduction in work time that is imposed by the employer may not be the basis for a reduction in salary. That is precisely what occurred in this case.” The court concluded that:

“[t]he Court finds that defendant's reductions in the amount of days worked in response to a lack of available work and a proportionate reduction in fixed salary constitutes an actual and improper deduction.”

“Advisory opinions issued by the Wage and Hour Administrator are to guide the DOL in its operations. They are neither final nor binding on employers or employees. Rather they are expressly issued subject to change by the Administrator.” *Taylor-Callahan-Coleman Counties Dist. Adult Probation Dept. v. Dole*, 948 F.2d 953, 957 (5th Cir.1991) The *Dole* court went on to note the position of the Department of Labor in regard to opinion letters:

“Advisory interpretations announced by the Administrator [of the Wage and Hour Division] serve only to indicate the construction of the law which will guide the Administrator in the performance of his administrative duties unless he is directed otherwise by the authoritative ruling of the courts, or unless *he shall subsequently decide that his prior interpretation is incorrect.*” Advisory interpretations announced by the Administrator, 29 C.F.R. § 775.1 (1990)

In California, the Supreme Court has cautioned that deference to agency opinions “will depend upon the thoroughness evident in its consideration, the validity of its reasoning...and all those factors which give it power to persuade...” *Yamaha Corporation of America v. State Board of Equalization* (1998) 19 Cal.4th 1, 9. Obviously, considered in view of the rule announced by our Supreme Court in *Yamaha, supra*, the Opinion Letters of the DOL which purport to allow an employer to reduce the salary of an exempt employee “during a period when a company operates a shortened workweek due to economic conditions” would not be given any deference by California courts. Without any deference, the specific language of the regulations themselves, would require that a California court find that the plain language of the regulations precludes an employer from reducing the salary of an exempt employee during a period when a company operates a shortened workweek due to economic conditions.

As to the issue regarding the vacation plan, the employer may have any vacation policy they desire, so long as that policy does not provide for a forfeiture. If any employer wishes to limit the time during which an employee may take vacation to the period between Monday and Thursday, that is perfectly acceptable. The employer may not, however, adopt a vacation plan which has the effect of allowing through subterfuge that which would not be allowed by application of the law.

In the next scenario, you ask that we assume the same facts as in Example 2, except that the employer decides to participate in the EDD's Work Share program. The employer, out of a concern for the exempt employees who, he concludes, are just as hard hit by the pay cut as the production workers, decides to include the exempt employees in the work share program. Our understanding of the EDD program is that employees are paid from government funds a portion of the difference between the wage they would have made had they been employed full-time and the wage they are paid as a result of the reduction in hours by the employer. According to the information we received from EDD:

“Employees participating in the Work Sharing program, if otherwise eligible, will receive the percentage of their weekly unemployment insurance benefit amount that equals the percentage of the reduction in normal hours and wages for that week due to Work Sharing. If the percentage of wage reduction differs from the percentage of hour reduction, the amount payable is based on the lesser percentage...” DE 8684 Rev. 7 (1-99)

The Work Share program, then, is based not on a fixed reduction of salary, but on a reduction of hours on a weekly basis. The reduction of hours, of course, is the result of the employer not providing full-time employment in that week. In other words, the employer has failed to make work available as a result of business requirements. Obviously, this fits exactly the explanation of when the employee will not be considered to be on a “salary basis” contained in 29 C.F.R. § 241.118(a). Thus, if the employer puts the exempt employees on a work share program whereby they are paid out of government funds for a percentage of what they would have made but for the reduction in hours which the employer instituted, those employees are no longer, by definition, on a “salary basis”. Thus, exempt employees will no longer be exempt and the employer will be obligated to pay overtime to the exempt employees.

As you indicate, the issues you raise in paragraphs 4 and 5 are not the same as those raised in

paragraphs 2 and 3.

In regard to this new scenario, you ask whether it would be permissible for an employer to reduce an exempt employee's salary based on a poor performance rating. Such a reduction is, of course, permitted so long as the exempt employee receives at least the minimum salary required to sustain the exemption.

Next, you couple this reduction of the salary with a reduction of the hours of work that the employee is asked to perform. You state that inasmuch as this "weak" executive "has so little to do now, the(y) do not want him in the office so much. The company believes that having this employee in the office while idle is a bad idea. So they tell him that he should come into work only on Tuesday through Thursday each week. He would be charged vacation only if he chose to take off one of those days; he would not be charged vacation or have pay deducted for any partial-day absences."

We assume that this "weak" employee would not be charged vacation for failure to come in on Friday, Saturday or Sunday. On the other hand, we would also assume that if the employer required the exempt salaried employee to come in on Friday, Saturday or Sunday, the employer would take the position that, as a salaried exempt employee, no additional compensation is available to the employee. And, of course, if the employee is, in fact, salaried and exempt, that would be true.

We further assume that if the "salaried exempt" employee were required to work twelve-hour days on Monday, Tuesday, Wednesday or Thursday (or for that matter, any other day the employer required), that, again, the employer would take the position that as a salaried exempt employee, there was no overtime compensation due. Again, this conclusion would be correct.

This particular scenario has not been addressed by the Wage and Hour Division and, consequently, we do not have the value of their wisdom on this issue. The reduction in the workweek in the latter scenario is not, as in your other examples, the result of a companywide reduction in hours brought about by changed conditions. It is a clear reduction in the work made available to a particular employee which is coupled with a reduction in the salary paid to that employee. The fact that you have worded the scenario you have presented to us so that the reduction of hours appears to be the result of some motive other than reduction of salary fails to hide the common sense connection.

Returning to the premise that California courts will not lend their aid to accomplish by indirection what the law or its clearly defined policy forbids to be done directly, we have no problem finding that, in fact, your proposal constitute a subterfuge which would not be countenanced.

Frankly, the questions you asked are clearly designed to test the rationale underlying the salary test. The salary requirement, as you may know, is designed to insure that in return for relief from the obligation of the employer to pay premium pay for overtime hours, the employer will provide a fixed and regular sum to the exempt employee. Since the obligation to pay premium pay after eight hours in a day or forty hours in a workweek is based on a public policy in California, any attempt to circumvent the requirement is subject to the strictest scrutiny. Your scenario does not pass the test.

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