

Labor Commission Issues New Exemption Standards

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On May 30, 2001, the California Division of Labor Standards Enforcement ("DLSE") issued an important opinion regarding the state overtime exemption rules. The opinion announced a significant departure from the prior salary requirements for the state white collar exemptions. The opinion was issued to the author of this article and released to the public due to its broad-based significance.

The DLSE's new standards widen the gap between the state and federal laws in many ways. They may surprise the employer and business communities by creating new standards that will require serious changes to many employers' practices. Because they will also cause some employees now treated as exempt to become non-exempt, they will undoubtedly be viewed as unfavorable by employers and employees who wish to be treated as exempt. If the standards are not met, employees will lose their exempt status and be subject to the same overtime, meal period, rest period, and record-keeping rules as apply to other non-exempt employees.

1. What are the exemptions?

California employees are entitled to overtime pay, meal periods, and rest periods unless they qualify as "exempt." The key exemptions are called the "white collar exemptions" and are available to executive, administrative and professional employees who meet the applicable rules.

In order to qualify under California's exemption standards, employees (1) must be paid on a salary basis, and (2) must devote a majority of their time to exempt duties. The federal salary rules allow employees to be paid weekly salaries. Even though the DLSE previously issued opinions indicating that it followed the federal standards, its May 30th opinion switches positions. It interprets state law in a manner that differs dramatically from the federal salary requirements in several respects. It justifies the new standards based on language in A.B. 60, the "Eight-Hour-Day Restoration and Workplace Flexibility Act of 1999," and the new IWC Wage Orders. Because A.B. 60 took effect on January 1, 2000, the opinion appears to be retroactive to that date.

2. What is a salary?

A salary is described as a fixed sum of money that is paid without deductions due to variations in the quantity or quality of an employee's work. An employee must be paid a salary to qualify for the executive, administrative or professional exemption. Employees who are paid on an hourly, piece-rate or commission basis therefore cannot qualify for these exemptions. The May 30th opinion of the DLSE explains what the salary rules are in California. It takes the position that they differ from the federal rules. (Cautionary Note: Even if a salary is paid, the employee must also meet the duties test to be exempt.)

3. What is the difference between the weekly and monthly salary rules?

The federal salary rule requires that exempt employees receive their salary on a weekly or "less frequent" basis (such as semi-monthly or monthly basis). If an employee receives a weekly salary, the salary must normally be paid for a week in which the employee performs any work. For instance, if an employee works only three or four days in the week, the full salary must be paid unless an exception exists.

The DLSE now construes California law to require that exempt employees receive a monthly salary. No deductions may be made from an exempt employee's salary based on the quantity or quality of the work performed. Consequently, an exempt employee must receive the full salary for any month in which the employee performs any work without regard to the number of days or hours worked. Of course, an employee need not be paid for any month in which he or she performs no work. Deductions are also permitted in limited instances where an exception exists. For example, if an employee misses a full day of work for personal reasons and has used up all vacation, a deduction appears permissible.

4. What problems are created by the DLSE's new policy?

Several portions of the DLSE's opinion are of particular significance. One deals with the consequences of temporary shutdowns and business closures. According to the DLSE, if an exempt employee is ready, willing and able to work, salary deductions may not be made for time when work is not available. For instance, if a temporary business "closure" or shutdown occurs, an exempt employee who works any portion of the month must receive his or her full salary for that month, without deduction for time missed due to the temporary closure. This may occur during holidays or seasonal periods.

This is far more costly and difficult than the federal rules. Federal law requires payment of the salary only for the workweek in which the closure occurs, not the entire month. In addition, under federal law, employees can be asked to use accrued vacation to meet the salary requirements for days missed due to the temporary closure of the business.

The DLSE has rejected this approach under state law. It has stated that an employer may not require employees to use vacation to meet the salary obligation. It reasoned that "vacation plans . . . may not be drawn upon to pay for pre-existing obligations such as salary." This also means that exempt employees who are ready, willing and able to work cannot be required to suffer salary deductions, or use their vacation or paid time off benefits, if asked to leave work early in a day, week or month because of low amounts of work.

5. Are there any other problem areas?

The DLSE opinion also states that California will not follow the federal rules with respect to absences resulting from suspensions due to safety violations. Federal law permits employers to take deductions from an exempt employee's salary for suspensions resulting from violations of safety rules of major significance. The DLSE indicated that no provision in California law allows employers to deduct "penalties" for safety violations. The provisions of federal law may therefore not be utilized in California.

The DLSE also opined that "deductions may not be made from an exempt employee's monthly salary for absences caused by jury duty, attendance as a witness, or temporary military leave." Consequently, if an employee works during a month and is absent for a portion of the month because of jury duty, witness duty, or a temporary military leave, the full monthly salary must be paid. This will probably have a serious impact on many employers' policies. If an employee is absent for an entire month this problem will not arise. That is because an

employee need not be paid for any month in which he or she performs no work.

6. What are the consequences of violations?

The DLSE has emphasized that the consequences of a violation of the salary basis rules can be severe. If it is determined that a deduction is willful, the exemption could be lost. The employee would therefore be eligible for overtime pay and the other non-exempt employee protections, such as the right to meal and rest periods. If a violation is determined to be inadvertent, but in good faith, the exemption may be kept as long as the employee is reimbursed for the deduction and the employer agrees, in writing, to comply in the future. It is unclear how long an employer has to make the reimbursement and issue the written agreement to comply in the future.

7. Does the new salary policy apply to everyone?

The DLSE's policy does not apply to government entities that are exempt from the IWC Wage Orders. It is also inapplicable to exempt outside sales employees, to hourly employees who qualify for the new highly-skilled computer occupation exemption, and to non-exempt employees. For example, employees who are not exempt from the overtime rules need not be paid for time missed. This includes hourly employees, piece-workers, and many employees paid on a commission basis. Therefore, if an employer temporarily closes its operation for a period of time due to an unexpected business slowdown, it is not required to pay non-exempt employees for their time off. If non-exempt employees wish to use accrued vacation time for that period, the employer may permit them to do so.

The DLSE believes that this flexibility for temporary business closures is unavailable for exempt employees. It believes that such employees must be paid their full salary in any situation where they are ready, willing and able to work and the employer does not provide work. Failure to pay the full salary will result in the loss of the exemption. Moreover, given the obligation to continue the salary, the employer may not "resort to the employee's vested vacation pay" because the employer is already obligated to pay the full salary.

8. What about real vacations?

While it is not entirely clear, it appears that the DLSE will not object to a rule requiring employees to use their vacation benefits when they take a day off for personal reasons. If this remains permissible, employers should also be allowed to deduct a full day's pay from the employee's salary for a day missed for personal reasons where no vacation is available. In these cases, the employee is not "ready, willing, and able to work" yet prevented from doing so. We have asked the DLSE for clarification regarding these points. An employer may also prevent employees from taking vacation at particular times of the year when work loads are heavy or other business concerns prevent employees from taking vacation.

9. What are the rules for sick pay?

The rules regarding sick pay differ between exempt and non-exempt employees. Non-exempt employees can normally be required to use their sick pay for full or partial days missed due to illness or injury. If no sick leave is available, they need not be paid for the time missed.

The rules regarding exempt employees are different. Exempt employees normally must receive their full monthly salary when they work any portion of a month. The DLSE opinion states that their monthly salary must therefore be paid unless an absence for sickness or accident exceeds the monthly period.

An exception to this rule allows deductions for absences of one or more full days if (a) the deductions are made in accordance with a policy of providing "full compensation" for loss of salary due to sickness and disability and (b) the employee has exhausted the sick leave available under the policy. Based on this rule, deductions may not occur when sick leave is available or where the employer does not maintain a plan, policy or practice that provides the "full amount of the salary" for absences occasioned by both sickness and disability.

The opinion specifically states that an employee may not be required to use vacation for an absence due to sickness or disability. It is unclear what impact this will have on paid time off programs that lump sick leave and vacation benefits together. It is also unclear what occurs if an employer's plan provides only a portion of the full salary, such as the difference between an employee's salary and any SDI or workers' compensation benefits.

10. Are other issues raised?

The new DLSE opinion allows employers to provide supplemental payments to exempt employees without violating the salary rules. These include bonuses, lump sums, and payments for extra work. It also recognizes the statutory rules that allow eligible employees to use vacation during family and medical leaves that would otherwise be unpaid. Yet, it leaves many questions unanswered, including the ability to prorate salaries for initial and final months of employment. The DLSE had allowed proration in such cases in the past. Further clarification can therefore be expected.

11. Is the DLSE's opinion valid?

Many questions have surfaced regarding the validity of the DLSE opinion and whether it will be challenged. It is likely that the controversy surrounding the opinion will result in challenges in different forums. It is possible, for example, that efforts to attack the DLSE's enforcement policy will be initiated in the Legislature, before the IWC, or in the courts. These efforts may address the policy implications of the opinion, the manner in which it was adopted, whether it is reasonable, and its validity in light of the standards in the Labor Code and the IWC Wage Orders.

Despite these potential challenges, employers should not ignore the opinion. It represents the interpretations and standards that the state enforcement agency will apply. Every employer should therefore review its compensation practices and policies in light of the opinion. Employers are strongly advised to consult with their labor counsel regarding the implications of the decision and to conduct an internal audit of their written policies and established practices.

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Attorneys

Richard J. Simmons

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