



California's DLSE Clarifies Enforcement Position Regarding Deductions From Exempt Employee's Salary — Employers Beware

In a dramatic reversal to prior interpretations, the California Department of Industrial Relations, Division of Labor Standards Enforcement ("DLSE") has recently revised its position regarding the salary requirements for employees who are classified as exempt. Previously California had followed the federal regulations which required exempt employees to receive a full week's salary for any week in which they perform work. Now, according to the recently issued opinion letter, to retain the exempt status, exempt employees must receive their full monthly salary for any month in which they perform any work. Accordingly, with certain exceptions, if an employee does not receive their full salary for any month in which they perform work, they will not be treated as exempt.

Analysis

One of the requirements for an employee to be considered exempt from the overtime provisions is that the employee be paid on a salary basis. According to the DLSE, an employee will be considered to be paid "on a salary basis" within the meaning of California statute and the Industrial Welfare Commission ("IWC") Orders, if that employee receives a predetermined amount which totals at least two times the California minimum wage per **month**. The DLSE has now stated that it interprets this requirement to mean that, except for a few exceptions, no deductions may be made from an exempt employee's **monthly** salary based on the quantity or quality of the work performed. Whereas previously exempt salary deductions were calculated on a weekly basis, now, in order to be eligible for the exemption, an employee must receive his or her **full** salary for **any month** in which he or she performs **any work** without regard to the number of days or hours worked.

The new enforcement policy has the following implications for employers: Under the DLSE's enforcement policy, no deduction may be made from the exempt employee's salary for absences occasioned by the employer or by the operating requirements of the business. Furthermore, no deductions may be made for absences caused by sickness or accident except to the extent that the employee is absent for a full payroll month. Deductions may be made if the employee has exhausted his or her sickness or disability leave as long as the leave plan provides full compensation for loss of salary occasioned by sickness or accident.

(The DLSE reminds employers that they **may not** compel an employee to use vacation pay to cover payment for absences caused by sickness or accident.) Finally, no deductions may be made for absences caused by jury duty, attendance as a witness, or temporary military leave unless the employee performs no work during the month in which the absence falls.

Another important point for employers to note is that although the federal regulations seem to allow an employer to impose "penalties" for infractions of safety rules without affecting the guaranteed salary requirement, the DLSE has now made it clear that this practice is not allowed for California employers who wish to have their employees considered exempt from overtime. The DLSE also took the opportunity to reiterate its position that vacation pay is viewed as wages. The opinion letter emphasizes that employers should keep in mind that since vacation pay "is not a gratuity or a gift, but is, in effect, additional wages for services performed," it may not be used by employers to pay for an obligation, *i.e.* salary, which the employer already has. Thus, employers may only use vacation pay to compensate for an employee's absence if the use of vacation pay is at the employee's behest. Accordingly, vacation pay may be used if the employee absents him or herself from work for a working day or more for personal reasons. The DLSE also clarified that vacation pay may also be used as a substitute for California Family Rights Act leave.

In short, in order for an employer to benefit from the exemption from the need to pay an exempt employee premium rates for overtime, the employer is obligated to pay the employee a salary which may not be subjected to deductions unless an employee absents him or herself for personal reasons for a working day or more. These deductions must be monitored on a monthly, instead of a weekly, basis.

While the consequences of making a deduction not permitted by California law will depend on the facts in each particular case, employers should be aware that failure to comply with these regulations may result in loss of the exemption. In such a case, the overtime requirements of the IWC Orders would apply and the employee would be entitled to the applicable premium for overtime hours worked. (The statute of limitations for a claim for unpaid overtime wages is three years.) The DLSE pointed out that absent a contractual duty, *i.e.* unless the employment contract requires full payment of the salary, the failure to pay the full salary **does not** give rise to a cause of action for recovery of any deductions made by the employer.

Conclusion

Although the views expressed in the opinion letter is unwelcome news for many employers, employers should bear in mind that the opinion letter from the DLSE is persuasive instead of binding upon courts. In addition, many employer-based groups have been brainstorming different ways to get DLSE's position regarding the salary requirements overruled or modified. To that end, a hearing has been scheduled with the IWC for June 29, 2001 to address the concerns that employers have with this recent opinion. Morgan Lewis expects that there will be much activity on this front and will keep its clients apprised of the latest developments regarding the salary requirements for exempt employees.

The Labor and Employment Practice of Morgan Lewis has considerable experience in all aspects of California Wage & Hour law. If you have any questions or concerns regarding the California requirements for exempt status, please feel free to contact [Jane Howard-Martin](mailto:jhoward-martin@morganlewis.com) by phone at 213.612.1180 or by e-mail at jhoward-martin@morganlewis.com.

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