

Flexitime

How California employers have greater flexibility in implementing salary reductions for exempt employees

In the current economic climate, businesses are exploring every available option for cutting costs. In terms of labor costs, layoffs have been unavoidable for many businesses, but the need for layoffs can be avoided or mitigated through shifting work schedules and corresponding reductions in wages.

While this has been feasible for non-exempt employees who are paid an hourly wage, the same has not been the case for salaried, exempt employees. For example, if you reduced an exempt employee to four days per week with a 20 percent salary reduction, you'd potentially put that employee's exempt status in peril. However, a recent opinion letter issued by the California Division of Labor Standards Enforcement potentially opens up this additional avenue for relief, giving employers greater flexibility in implementing salary reductions for exempt employees.

"If the reduction is a response to a business suffering significant difficulties, the original salary and hours will be restored once business conditions permit and the affected employees still make at least a minimum salary that's sufficient to maintain their exempt status, then reductions can be made to exempt employees," says Peter B. Maretz, a shareholder with Stokes Roberts & Wagner ALC.

Smart Business spoke with Maretz about this new law, how it helps employers implement salary reductions for exempt employees and how it can benefit your business.

What law is impacted by this opinion letter?

The law provides that employees are presumed to be non-exempt and that the burden is on the employer to show that a particular employee satisfies one of the so-called white-collar exemptions. There are several categories of exemptions under California law, and whether an employee satisfies a particular exemption depends upon that employee's actual duties. Moreover, the employee must satisfy the salary basis test of the exemption, which provides that 'an employee must also earn a monthly salary equivalent to no less than two times the state minimum wage for full-time employment. Full-time employment is defined ... as 40 hours per week.'

California regulations provide further that '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 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 the deductions from



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the employee's predetermined compensation are made for absences occasioned by the employer or by the operating requirements of the business.'

Why were employers hesitant to reduce the workloads of exempt employees?

Based upon the restriction of the salary basis test, employers have been understandably reluctant to implement partial week shutdowns or furloughs of their exempt employees for fear they would jeopardize their exempt status, thereby exposing the business to overtime obligations. Although there was support for these partial week reductions in federal law, until recently, the California Division of Labor Standards Enforcement had taken the position that such an arrangement, in fact, violated the salary basis test.

In confronting the issue most recently, however, the California Division of Labor Standards Enforcement analyzed the wealth of federal law on the issue, and recognized the scarcity of California case law directly on point. In addition, the prior opinion letter of the California Division of Labor Standards Enforcement declaring that partial week reductions in pay and hours violated the salary basis test relied upon federal authority that has since been roundly criticized as misguided and not well-reasoned.

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In endorsing such a concept in its most recent opinion letter, the California Division of Labor Standards Enforcement recognized that the reduction 'is based upon the employer having experienced significant economic difficulties due to the present severe economic downturn.' Moreover, the California Division of Labor Standards Enforcement found it significant that the employer at issue represented that '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,' and that there is 'no indication that the employer intends to adjust the salary any more frequently than is described.'

Will this opinion lead to more employers reducing the hours and salary of exempt employees?

To be sure, the recent California Division of Labor Standards Enforcement opinion letter does not endorse reducing the hours and salary of exempt employees for any reason. The need for the reduction must be driven by significant economic difficulties. The employer must intend to restore the schedule and pay once the business levels support such an action. The reduced salary must still satisfy the minimum amount of the salary basis test — two times minimum wage based upon a 40-hour workweek. And, of course, the exempt employee must still satisfy the duties test of the particular exemption.

Finally, keep in mind that the opinion letters of the California Division of Labor Standards Enforcement are not binding on any judge. Although courts will often look to the opinion letters or even the California Division of Labor Standards Enforcement manual for guidance, they are in no way bound by those sources and owe them no deference.

Why is knowing and understanding concepts like these so important?

Litigation alleging exempt misclassification has reached near epidemic levels in California. If you are going to make any kind of move, or make any kind of cut or reduction, you'd better know what you're getting into. Therefore, before implementing partial salary and schedule reduction plans, you would be well served to understand the law and consult with your wage and hour counsel. <<

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