

New California DLSE Opinion Letter Provides Flexibility For Employers Seeking Reductions In Exempt Employee Work Schedules

Employers faced with increased pressure in this economic climate have implemented a variety of cost-cutting measures to stay afloat. But what if layoffs and other cost-cutting measures fail to right the ship? Can an employer reduce the work hours and salary of exempt employees? In 2002, the California Division of Labor Standards Enforcement (DLSE) had issued an opinion letter concluding that employers could not.

On August 19, 2009, the DLSE issued a new opinion letter reversing its earlier conclusion and determining that an employer may reduce the work schedules of its exempt employees, accompanied by a reduction in the exempt employees' salaries, without violating the salary basis test.

The Salary Basis Test

In addition to satisfying certain duties tests, an employee must be paid a salary of no less than two times the state minimum wage based on full time employment (\$640 per week) to qualify as exempt from the overtime pay requirements (and other requirements) of the California Labor Code and associated Wage Orders. In addition to being paid a certain salary level, employees must also be paid on a "salary basis."

California has not promulgated regulations relating to the salary basis test. For the most part, and as a matter of enforcement policy, the DLSE follows federal regulations. The Code of Federal Regulations generally prohibits an employer from making "deductions" from the salary of an exempt employee during any workweek in which the exempt employee performs any work. The salary that an exempt employee receives must be a predetermined sum that is not subject to change based on the number of hours the employee works. If improper deductions are made, the exemption is lost.

The DLSE's March 12, 2002 Opinion Letter

In its 2002 opinion letter, the DLSE responded to an employer questioning whether an employee would retain her exempt status if the company reduced payroll by having the exempt employees work only four days (or 32 hours) per week. The DLSE relied in part on a New York district court case, *Dingwall v. Friedman Fisher Assoc.*, 3 F.Supp.2d 215 (N.D.N.Y. 1998), and concluded that the federal regulations precluded an employer from reducing the salary of an exempt employee during a period when a company operates a shortened workweek due to economic conditions. Although many practitioners believed the DLSE's opinion was wrong, it created a real problem for California employers.

The DLSE Reverses Its Position

In the new August 19, 2009, opinion letter, the DLSE has changed course. The new opinion letter relies on U.S. Department of Labor guidance that the salary basis test does not preclude a bona fide fixed reduction in the salary of an exempt employee corresponding with a reduction in the normal workweek, so long as the reduction is not designed to circumvent the salary basis requirement. The new opinion letter notes that the *Dingwall* case, relied upon in the 2002 opinion letter, had been repudiated as "not well-reasoned and misguided." Instead, the new opinion letter relies on a Tenth Circuit Court of Appeals decision, *In re Wal-Mart Stores, Inc.*, 395 F.3d 1177 (10th Cir. 2005), holding that the federal regulations refer only to deductions during the current pay period, not to reductions in future salary.

The DLSE concluded that, under the circumstances presented, an employer may reduce an exempt employee's workweek to four days, accompanied by a corresponding reduction in salary, provided that the employee continues to meet the minimum salary requirement (\$640 per week). The DLSE noted that the employer at issue was experiencing significant economic difficulties due to the current economic downturn, and that the employer indicated it intended to restore its regular five day workweek schedule as well as the full salaries of its exempt employees once business conditions permitted.

What the DLSE Opinion Letter Means for Employers

The DLSE Opinion Letter will provide direction to DLSE hearing officers. The letter is not binding on courts, but would likely be considered persuasive authority, particularly since it is consistent with U.S. Department of Labor opinions.

Employers confronted with the prospect of layoffs may now reduce exempt employees' work schedules in less than full-week increments and may make proportional reductions in their salaries without compromising exempt status. However, as the August 19, 2009 opinion letter points out, any such reductions should be bona fide. An exempt employee's salary must not fluctuate on a week-by-week basis in accordance with the number of hours worked. Otherwise, the exempt status of the affected employees will be lost.