IWC Seeks to Clarify Uncertainty Regarding Salary Basis Rules

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Both state and federal law contain overtime pay exemptions for executive, administrative, and professional employees who meet the applicable salary and duties tests. Employees must spend a majority of their time on exempt work to satisfy the duties test. In addition, they must receive a salary that meets specific standards to satisfy the salary test. There are two features to the salary test – (1) the amount of the salary (which must be at least $26,000 a year in 2001 and $28,080 a year in 2002) and (2) it must be paid in the form of a true salary.

1. Background

On May 30, 2001, the former chief counsel of the California Division of Labor Standards Enforcement ("DLSE") issued a controversial opinion letter to Attorney Richard J. Simmons of the law firm of Sheppard, Mullin, Richter & Hampton LLP. The opinion noted that the DLSE, the state enforcement agency, intended to reject the federal standards as to what constitutes a true salary. The opinion appeared flawed in several respects and stirred a substantial controversy that caused the agency responsible to issue the regulations, the Industrial Welfare Commission ("IWC"), to invite testimony on June 15, 2001. Testimony was presented by Richard J. Simmons and representatives of the California Chamber of Commerce, the California Manufacturers Association, and organized labor.

One of the key controversies surrounding the May 30, 2001 opinion involved the DLSE's view that the new Wage Orders which became effective on October 1, 2000 required employees to be paid their full monthly salary if they worked any portion of a month. In addition, employers would often be unable to charge an employee's vacation or paid leave benefits for absences of a portion of a day or full days even under circumstances where such benefit charges were allowed under federal law. The May 30th opinion created even greater confusion and controversy in an area that has already prompted more than 250 class action lawsuits challenging the exemptions.

Seven days after the hearing, the State Labor Commissioner, Mr. Arthur Lujan, wrote a letter on June 22, 2001, withdrawing the May 30, 2001 opinion letter of the DLSE chief counsel. Mr. Lujan directed his letter to Richard J. Simmons and noted that the DLSE would await further clarification from the IWC before it issued a final enforcement policy.

2. IWC Clarification Of The State Salary Basis Rules

On October 29, 2001, the IWC amended the "personal attendant" exemption in Wage Order 5-2001. While addressing that exemption, the IWC clarified the differences between it and the "white collar exemptions" for executive, administrative, and professional employees. In the process of doing so, the IWC clarified its original intention with respect to the salary basis requirements and squarely rejected the position set forth in the May 30, 2001 opinion letter of the DLSE's former chief counsel. The IWC noted that it intended to follow the federal

standards set forth in 29 C.F.R. Section 541.118, which provide that employees must receive their full salary for a week in which any work is performed, subject to certain exceptions where deductions may be made. For example, an employee's salary need not be paid for a workweek in which no work is performed. In addition, federal cases have made it clear that vacation, sick leave, and other paid leave benefits may be charged for absences of a full day and, in some cases, for partial day absences as well.

On October 29, 2001, the IWC voted 4-to-1 to adopt a Statement As To The Basis for Wage Order 5 that confirms its intention to follow the federal standards in this area. Significantly, the same four individuals who voted to adopt the clarification were members of the IWC when it adopted the new Wage Orders that became effective on October 1, 2000, and January 1, 2001. Thus, they confirmed their original intent in the clarification. The explanation was justified for two stated reasons. First, the IWC sought to clarify the differences between the partial overtime exemption being adopted for personal attendants and the broader exemptions for individuals who qualify under the executive, administrative, and professional exemptions. The language explained the scope of the broader exemptions for "white collar employees," and the fact that the personal attendant exemption does not depend on the amount of pay received by personal attendants or whether they are paid in the form of a salary. In contrast, both the amount and form of compensation are relevant to the white collar exemptions.

Second, the public and the Labor Commissioner sought clarification from the IWC. The IWC explained that California law had used a "monthly" remuneration requirement for many decades. The incorporation of the term "monthly salary" in AB 60 and the new Wage Orders therefore did not introduce a new concept. Even though the term "salary" was substituted for the term "remuneration" in the new Wage Orders, the term "remuneration" had been construed to mean a weekly salary, as that term had been defined under the federal regulations. In short, the "monthly salary" provisions in AB 60 and the Wage Orders simply preserved the status quo, i.e., the federal standards that had been followed by the DLSE.

Specifically, the IWC stated: "Subject to the requirement that the minimum amount of the salary must be higher under state law than federal law, the IWC intended to follow the federal salary standards set forth in 29 C.F.R. § 541.118." The clarification added a discussion of the circumstances where deductions from the predetermined salary are permissible under state and federal law, noting:

"The exceptions in the federal regulations regarding deductions also apply under state law. The federal standards have been construed by the U.S. Supreme Court and the Ninth Circuit Court of Appeals to allow a fair system for using and charging paid leave, vacation, and sick leave benefits in a manner that affords employees workplace flexibility. The regulations also recognize the ability to pay a proportionate part of the employee's salary for the time actually worked in initial and terminal weeks of employment. In addition, they allow adjustments in compensations where other statutory requirements are met, such as the family and medical leave rules that provide eligible employees the flexibility they need to take leaves on a "reduced leave" or "intermittent leave" basis. The IWC sought to preserve the same flexibility under state law."

The IWC's action of October 29th provides employees, employers, and the public much needed clarification and guidance regarding a critically important issue. The exact language adopted by the IWC in its Statement As To The Basis is reproduced below.

EXCERPT FROM THE IWC'S STATEMENT AS TO THE BASIS

"The revision of the California rules for personal attendants to more closely resemble the federal standards promotes the IWC's intention to make the state and federal exemptions consistent where the Legislature has not expressed a clear contrary intention. The IWC sought to achieve this goal when it adopted the Orders that became effective on October 1, 2000, and January 1, 2001. In keeping with this objective, the white collar exemptions for executive, administrative, and professional employees in the Order incorporate many of the federal standards set forth in 29 C.F.R. Part 541.

The partial exemption for personal attendants differs from the "white collar exemptions" for executive, administrative, and professional employees. The personal attendant exemption is limited to some of the Order's overtime rules and does not depend on the level of a personal attendant's pay or whether it is paid in the form of a salary. The standards for the white collar exemptions differ. In accordance with the provisions of Labor Code Section 515(a), Section 1(A) of the Order requires that an employee earn "a monthly salary equivalent to no less than two times the state minimum wage for full-time employment" to qualify as exempt. Labor Code Section 515(c) defines "full-time employment" to mean "employment in which an employee is employed for 40 hours per *week*." For many decades prior to AB 60's effective date on January 1, 2000, the Orders required that exempt employees receive "remuneration" in excess of specified levels "*per month*." While the IWC increased the amount of remuneration from time to time, the m*onthly remuneration* standard remained unchanged.

That standard was construed by the Division of Labor Standards Enforcement in 1997 and 1998 in published interpretations in a manner that was generally consistent with the federal "salary basis" regulations set forth in 29 C.F.R. §541.118. In reviewing these federal regulations, the Division expressed the opinion that it "intended to insure that, as far as possible, the overtime requirements under the IWC Orders are consistent with those of the requirements under the FLSA." The Division construed the monthly remuneration standard to parallel the federal regulations that require a predetermined salary that "may not be subject to reduction because of variations in quality or quantity of work performed during the course of any *workweek*." It further noted that "an employer is not required to pay *salary for a workweek* during which the employee performs no work." Both the "monthly" and the "salary" standards now in the Wage Orders thus existed and were well known prior to the enactment of AB 60.

The IWC intended to incorporate those standards, including the "salary for a workweek" standards, within its 2000 and 2001 Orders. This is consistent with Section 515(c)'s and the Order's use of the *weekly* standard to compute the amount of the required salary. The IWC incorporated the standards of Section 515(a) within the new Orders. Subject to the requirement that the minimum amount of the salary must be higher under state law than federal law, the IWC intended to follow the federal salary standards set forth in 29 C.F.R. §541.118.

An opinion issued by a representative of the Division on May 30, 2001, misinterpreted the IWC's intent and failed to implement its goal of harmonizing state and federal law on this important issue. In a June 22, 2001 letter, the Labor Commissioner rescinded the May 30 opinion and requested clarification of the criteria for determining the correct interpretation of "salary." Comments from the public at the hearings and in letters to the IWC also

requested clarification.

The IWC is providing this clarification of its intention so that the distinctions between the partial exemption for personal attendants and the broader exemptions for white collar employees will be clear and both will be properly construed. The IWC also wishes to make clear that it wishes to follow the federal salary basis standards it previously adopted for the white collar exemptions. Under those standards, an employee must be paid a predetermined amount constituting all or part of his or her compensation on a weekly or less frequent basis. A salary that is no less than the equivalent of twice the state minimum wage for employees who work 40 hours a week and that meets the standards in 29 C.F.R. §541.118 satisfies the state salary rule. The exceptions in the federal regulations regarding deductions also apply under state law. The federal standards have been construed by the U.S. Supreme Court and the Ninth Circuit Court of Appeals to allow a fair system for using and charging paid leave, vacation, and sick leave benefits in a manner that affords employees workplace flexibility. The regulations also recognize the ability to pay a proportionate part of the employee's salary for the time actually worked in initial and terminal weeks of employment. In addition, they allow adjustments in compensation where other statutory requirements are met, such as the family and medical leave rules that provide eligible employees the flexibility they need to take leaves on a "reduced leave" or "intermittent leave" basis. The IWC sought to preserve that same flexibility under state law.

The IWC does not intend that these salary rules apply to the personal attendant exemption. Although personal attendants may be paid on a salary, hourly or other basis, they must be paid overtime in accordance with the new standards."

Attorneys

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Practice Areas

Labor and Employment Counseling