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California Labor Commissioner Greenlights Proportionate Reduction in Managers' Hours and Compensation

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In an about-face that is certain to bring much-needed relief to California employers still struggling in the present economic downtown, the California Division of Labor Standards Enforcement (the "DLSE") issued an Opinion Letter on August 19, 2009, concluding that an employer facing economic difficulties will not violate California law by reducing the work schedules (and compensation) of managers, supervisors and other employees who are exempt from overtime.

In an earlier opinion letter from 2002, the DLSE took the opposite position and thereby put California at odds with federal law. In that earlier opinion, the DLSE relied on an opinion from a New York district court judge (which the DLSE now views as "not well-reasoned and misguided") and concluded that reducing an exempt employee's salary following a corresponding reduction in hours would violate the "salary basis" test, which requires that exempt employees be paid for the entire week if they work any part of it. However, several opinion letters from the U.S. Department of Labor as well as a pair of recent federal court decisions involving Wal-Mart reflect a broader interpretation of federal law on this topic. Those opinion letters and cases reasoned that so long as an employer does not alter its employees' salaries so frequently as to render their exempt status a "sham," an employer does not violate the salary-basis test by effecting such changes.

The practical impact of the DLSE's new Opinion Letter is that employers who are facing economic difficulties are free to reduce exempt employees' work schedules and salaries as a cost-savings measure – for example, an employer may instruct some or all of its exempt employees not to come to work on Fridays and reduce their salaries by a corresponding 20 percent. Employers should note that the Opinion Letter specifies several important caveats: (1) that the employer is experiencing "significant economic difficulties"; (2) that once business conditions permit, the employer intends to restore the prior workweek and salary levels; and (3) the affected employees will still be earning a monthly salary of at least twice the state minimum wage for full-time employment. Note also that this Opinion Letter does not involve non-exempt (so-called "hourly") employees – in the absence of an agreement to the contrary, an employer always was and remains free to reduce their hours.

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