

# THE DAILY RECORDER

June 10, 2006

## Exempt Employees and Partial Day Absences

by Jennifer Brown Shaw

For the past several years, the California Division of Labor Standards Enforcement (DLSE) has taken the position that employers may not deduct partial-day absences from exempt employees' accrued vacation leave banks. Recently, however, the First District Court of Appeal ruled in *Conley v. Pacific Gas & Electric Co.* that such deductions are lawful in certain circumstances.

### Background

State and federal law contain overtime pay exemptions for executive, administrative, and professional employees who meet the applicable "salary basis" and duties tests. Under state law, which is generally provides more protections to employees than federal law in this area, employees must spend a majority of their time (i.e., more than 50%) on exempt work to satisfy the duties test. In addition, to meet the salary basis test, employees must receive a salary equivalent to at least two times the state's minimum wage for full-time work (\$28,080 per year in 2006) which is not subject to change based on the quantity or quality of the employees' work. This rule is based on the concept that exempt employees are paid for the work they perform, and not the hours they work.

There are a variety of regulations under state and federal law regarding the salary basis test. For example, under both federal and state law, an employer cannot made deductions from an exempt employee's wages for personal absences of less than a full work day. In other words, if an employee only works three hours in a workday and takes the rest of the day off for personal reasons,

the employer must still pay the employee for the full day.

Under the federal Fair Labor Standards Act, while employers may not make deductions from an exempt employee's wages resulting from the employee's partial-day absence for personal reasons, employers may deduct time for such absences from the employee's accrued but unused vacation. If the employee does not have any accrued vacation time, however, then the employer may not dock the employee's wages for partial days missed.

By contrast, in California, the DLSE historically has ruled that because accrued vacation time is a form of vested wages under the California Supreme Court's decision in *Suastez v. Plastic Dress-Up Co.*, employers cannot make any deductions to exempt employees' accrued vacation time for partial-day absences. The *Conley* decision rejected this interpretation and adopted the federal rule.

### The *Conley v. Pacific Gas & Electric* Decision

In *Conley*, several classes of exempt employees sued the organization, asserting they were improperly classified as exempt and therefore entitled to overtime compensation under state law. To support their claims, the employees argued PG&E's vacation policy violated the salary basis test (i.e., that the employee regularly receives on a weekly or less frequent basis a predetermined amount constituting all or part of the employee's compensation, which amount is not subject to reduction because of variations in the quality or quantity of work performed).

The vacation policy required exempt employees to use their accrued vacation time for any absences of four or more hours in a single workday. According to the employees, this constituted an impermissible "deduction" in the amount of compensation they received based on the quantity of work they performed, and therefore violated the salary basis test. They cited the California Supreme Court's decision in *Suastez v. Plastic Dress-Up Co.* to support their position.

In *Suastez*, the court ruled that a policy whereby the employer refused to pay employees for their accrued vacation time if they were terminated prior to their anniversary date violated California Labor Code section 227.3. Section 227.3 requires that accrued vacation time be treated as vested "wages" upon an employee's separation of employment for any reason which must be paid out at the employee's then regular rate of pay. In other words, California employers cannot impose "use-it-or-lose-it" policies that are lawful in other jurisdictions.

The employees in *Conley* attempted to extend the *Suastez* decision by arguing that if PG&E could not make deductions to exempt employees' pay for partial-day absences, the organization could not make deductions to exempt employees' accrued vacation balances either, since accrued vacation is a form of vested wages (i.e., pay.) The court rejected the argument, finding that *Suastez* did not support any such conclusion. Under PG&E's vacation policy, exempt employees received all of their accrued vacation time—they were simply required to use that time for partial-day absences.

The court held that because PG&E's policy only required deductions to be made from exempt employees' accrued vacation balances if the employees missed at least four hours of work in the workday, the policy did not prevent vacation pay from vesting as it is earned and was consistent with federal law. In the court's view, the organization's policy simply regulated the timing of exempt employees' use of their vacation time, which the Court in *Suastez* ruled was within the lawful discretion of the employer.

### What About the DLSE?

On August 30, 2002, the then California Labor Commissioner issued a controversial advice letter regarding the state's salary basis requirements applicable to exempt employees. The opinion letter examined, in part, whether an exempt employee may be required to use accrued vacation for a partial-day absence, and whether the employee's salary can be deducted for the hours missed if no accrued vacation is available.

The DLSE agreed with the U.S. Department of Labor's interpretation that no salary deduction is permitted for partial-day absences if the employee's eligibility for vacation has not vested, or the employee has exhausted all accrued vacation. However, the DLSE deviated from the federal rule regarding the use of accrued time by opining that employees could not be required to use vacation time in partial-day increments without violating the state's salary basis test.

In its advice letter, the DLSE concluded that "state law does not permit the deduction of accrued vacation or PTO when the employer already has an independent obligation to pay the exempt employee's salary." This reasoning constituted the foundation for the DLSE's finding that, in contrast to federal law, exempt employees in California could not be allowed or required to use accrued vacation in partial-day increments.

As discussed above, in *Conley*, the First District Court of Appeal disagreed with the DLSE's interpretation and declined to follow the August 30, 2002, advice letter. The court addressed an internal memorandum written by former California Labor Commissioner Donna Dell in May 2005, withdrawing the August 30, 2002, letter. Ms. Dell's May 31, 2005, memorandum recognized that an exempt employee cannot be subject to a partial-day deduction of salary for hours not worked without jeopardizing the employee's exempt status. However, the memorandum also opined that employers can lawfully deduct accrued vacation time from exempt employees for partial-day absences.

Interestingly, the recently revised DLSE "Enforcement Policies and Interpretations Manual" seems to be at odds with Ms. Dell's memorandum and the *Conley* decision. The Manual provides that deductions cannot be made for partial-day absences from "vested wages," and explicitly prohibits the use of accrued vacation to "pay for" partial-day absences.

### Practical Tips for Employers

The *Conley* decision was not appealed to the California Supreme Court and remains binding precedent. Employers should therefore review their vacation policies and practices to ensure consistency with the decision, keeping in mind the DLSE's seemingly contrary interpretation.

---

*Reprinted by permission of The Daily Recorder.*



[jshaw@shawvalenza.com](mailto:jshaw@shawvalenza.com)

Jennifer Brown Shaw is a partner at Shaw Valenza LLP. Her practice includes providing regular advice and counsel to private and public sector employers. She also develops and presents seminars on legal issues in the workplace for management and non-supervisory employees.



300 Montgomery Street, Suite 788  
San Francisco, California 94104  
Tel: (415) 983-5960  
Fax: (415) 983-5963

[www.shawvalenza.com](http://www.shawvalenza.com)

520 Capitol Mall, Suite 630  
Sacramento, California 95814  
Tel: (916) 326-5150  
Fax: (916) 497-0708