THE RECORDER
ESSENTIAL CALIFORNIA LEGAL CONTENT

Employers Pull Out Overtime Win

Court of appeal held a mutual wage agreement valid, but employers should be careful not to violate federal law in utilizing them, explains Lisa Lawson of Pennington Lawson.

Lisa Lawson

2011-06-17 12:00:03 PM

In an unexpected and somewhat startling ruling, California's Second District Court of Appeal held earlier this year that an employer and its employee may agree that a fixed salary compensates the employee for both regular hours and overtime hours worked. The ruling seems to pave the way for employers to use such "explicit mutual wage agreements" to control overtime expenses and better predict and manage labor costs overall. But is it the panacea it appears to be?

California employers sued for overtime violations stemming from their misclassification of employees as exempt have learned the hard way that paying nonexempt employees on a "salary" basis can dramatically increase overtime liability. Merely paying a high salary not specifically tied to hours worked does not excuse the payment of overtime. Indeed, that high salary increases the hourly rate that is used as the basis for calculating overtime rates because a salaried, nonexempt employee's hourly rate is computed by dividing the weekly salary by 40. It does not take "Watson-the-Supercomputer" to determine that the larger the salary paid to the nonexempt employee, the greater the "regular rate of pay," and the greater the amount of overtime pay owed. While employers often prefer the convenience of paying a flat amount, and some employees prefer to be known as salaried rather than hourly workers, California law has not traditionally allowed this mutual interest in a salary arrangement to immunize the employer from overtime liability.

Now there may be a way around this result. The court of appeal's decision in *Arechiga v. Dolores Press*, 11 C.D.O.S. 1733, may provide some relief for employers paying nonexempt employees a salary that more than compensates them for overtime hours worked. In *Arechiga*, the court of appeal held that an employer and employee may lawfully enter into an agreement under which a fixed salary compensates the employee for both "straight-time" hours and anticipated overtime hours. The decision flies in the face of post-AB60 guidance set forth by the state's Department of Labor Standards Enforcement. According to the DLSE, AB60 expressly abolished the use of such agreements. *Arechiga* not only disagreed with this guidance, but found it nonbinding and entitled to no deference.

As the California Supreme Court recently denied review of *Arechiga*, the decision is good law — at least for the time being. How other courts of appeal will interpret it remains to be seen. In the meantime, the following are some "*Arechiga* basics" all employers should know before making any dramatic changes to the way they compensate nonexempt employees.

FACTS OF 'ARECHIGA'

Carlos Arechiga and his employer, Dolores Press, entered into an agreement regarding Arechiga's

work schedule and pay as a janitor. They orally agreed that Arechiga would work 11 hours a day, six days a week, for a total of 66 hours per week, including 26 hours of overtime. The only part of their agreement that was reduced to writing was an agreement that Arechiga be paid a "salary" of $880 per week. While the evidence was disputed, following a bench trial, the trial court found that the employer had further informed Arechiga that the hourly rate upon which his salary was based was $11.14, and his salary was intended to cover both his regular and overtime hours.

Arechiga's suit attempted to collect overtime pay for the 26 hours of overtime he worked each week. Arechiga argued that, pursuant to Labor Code §515(d), his weekly salary of $880 could only be held to cover his straight-time hours, and therefore, his regular rate of pay was $22 per hour ($880 divided by 40) — not $11.14 per hour. According to Arechiga, this meant each overtime hour should have been paid at the rate of $33, and he was entitled to an additional $858 of overtime pay for each week he worked.

The employer maintained that Arechiga was entitled to no additional overtime pay because the parties had an "explicit mutual wage agreement," by which they had agreed that Arechiga's salary was intended to fully compensate him for all hours worked, including the 26 hours of overtime per week. The trial court agreed with the employer. The court of appeal affirmed, approving the trial court's ruling that "[u]nder California law, when there is an explicit mutual wage agreement between the parties, even a fixed salary like the one [Arechiga] received serves to adequately compensate him for both overtime and regular pay."

The court of appeal held that to be enforceable, the explicit mutual wage agreement must (1) specify the days worked each week, as well as the hours worked each day; (2) provide a guaranteed salary of a specific amount; (3) identify the hourly rate upon which the employee's salary is based; (4) indicate that the salary covers both regular and overtime hours; (5) be reached before the work is performed; and (6) result in the employee being paid at least 1.5 times his hourly rate of pay for overtime hours worked. The trial court found that the agreement at issue satisfied all of these criteria.

The parties had stipulated that they reached an oral agreement as to the days and hours Arechiga would work and that he would receive a guaranteed salary of $880 (the first and second criteria). The trial court found the remaining criteria were "overwhelmingly established" by the employer's witnesses, who testified that Arechiga was shown a piece of paper indicating that his salary was based on the hourly rate of $11.14, that Arechiga was told his guaranteed salary covered both his regular and overtime hours, and that the agreement was reached before he performed any work. The court of appeal held that substantial evidence supported the trial court's findings.

The court rejected Arechiga's argument that the enactment of AB60 abolished the use of explicit mutual wage agreements. The court noted that no California case had so held, and it refused to give any deference to the DLSE's enforcement policies, which supported Arechiga's argument, because they were not adopted in compliance with the Administrative Procedure Act. Looking to cases that predated AB60, the judicial council's current CACI jury instruction, and two unpublished federal district court cases applying California law, the Arechiga court found ample authority for enforcing explicit mutual wage agreements. Interestingly, not a single one of the cases the court cited in support of its holding found the existence of a lawful and enforceable explicit mutual wage agreement based on the facts presented in those cases.

WHAT IT MEANS FOR EMPLOYERS

While it may be tempting for employers to view the *Arechiga* decision as a panacea for containing overtime costs, there are many good reasons for employers not to rejoice quite yet.

First, the *Arechiga* court set forth six very specific criteria that must be met before an explicit mutual wage agreement will be enforced. Presumably, failing to meet any one of them might render the agreement unenforceable. For example, in both *Ghory v. Al-Latham*, 209 Cal.App.3d 1487 (1989), and *Espinoza v. Classic Pizza*, 114 Cal.App.4th 968 (2003) — two of the pre-AB60 decisions upon which the *Arechiga* court relied in reaching its holding — although the employer and employee agreed upon a fixed salary and a set schedule, the courts refused to find an enforceable explicit mutual wage agreement because there was no evidence of an agreement as to the basic hourly rate of

compensation. The basic hourly rate of compensation could have been determined algebraically given the agreed upon schedule and salary, but the parties' failure to expressly agree to the basic hourly rate was deemed a fatal omission. In *Hernandez v. Mendoza*, 199 Cal.App.3d 721 (1988), another pre-AB 60 decision cited in *Arechiga*, the court found no enforceable mutual wage agreement because not only was there no specific agreement as to the basic hourly wage, but also no agreement as to the days and hours to be worked each week.

Second, even if an employer and employee could craft an explicit mutual wage agreement that met all of the criteria, the existence of such an agreement would not relieve the employer of its other wage-and-hour obligations as to nonexempt workers, including the obligations to (1) keep records of hours worked, (2) provide paystubs that accurately reflect hours worked, (3) abide by meal and rest period rules, and (4) provide additional compensation for any hours worked beyond those set forth in the agreement. As a result, it is questionable how much an explicit mutual wage agreement will ease an employer's burdens regarding nonexempt workers under the state's wage-and-hour laws.

Third, the *Arechiga* court only analyzed the enforceability of an explicit mutual wage agreement under California law; it did not address whether the agreement was enforceable under the federal Fair Labor Standards Act. The FLSA applies to many California employers, and a California employer who is covered under the FLSA must comply with both state and federal wage-and-hour laws. The FLSA has long recognized the validity of explicit wage agreements. However, the requirements for a lawful explicit wage agreement under federal law (also called a "Belo" contract) could be construed to be somewhat at odds with what is required under *Arechiga*.

Under federal law, to have a valid explicit wage agreement, the employee's duties must "necessitate irregular hours of work." 29 U.S.C. §207(f). The federal regulations further explain: "The nature of the employee duties must be such that neither he nor his employer can either control or anticipate with any degree of certainty the number of hours he must work from week to week." 29 C.F.R. §778.405. *Arechiga* seems to require, however, that the employer and employee agree to the days worked per week and hours worked per day. This requirement of *Arechiga* is unusual, given that the explicit mutual wage agreement in California appears to have its origins in federal law, and yet it is arguably at odds with federal law on this point. It is unclear how an employer could comply with both state and federal law when one requires that the employer and employee agree to a fixed work schedule and the other requires the employee's hours fluctuate each week.

Finally, while the California Supreme Court's denial of review of the decision renders the decision unchallengeable for now, how other courts of appeal will interpret and apply it remains to be seen. The dearth of California cases upholding an explicit mutual wage agreement leaves California employers with little guidance as to how to craft one. The employer in *Arechiga* was able to get away with reducing very few of the required elements or terms of the agreement to writing. To improve the odds of enforcement, a better practice would be to have all of the required terms of the agreement in writing and signed by the employee. More generally, any employer considering implementing an explicit mutual wage agreement should seek counsel's input first.

Lisa Lawson is a co-founding partner of Pennington Lawson, a women-owned San Francisco boutique firm. Her specialties include employment litigation and counseling, workplace training and investigations, negotiation of employment and separation agreements, and drafting of employment-related policies and documents. She can be reached through the firm's website: www.PenningtonLawson.com.

In Practice articles inform readers on developments in substantive law, practice issues or law firm management. Contact Vitaly Gashpar with submissions or questions at vgashpar@alm.com.