STATE OF CALIFORNIA **Arnold Schwarzenegger, *Governor***

DEPARTMENT OF INDUSTRIAL RELATIONS
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ANGELA BRADSTREET, STATE LABOR COMMISSIONER

ROBERT R. ROGINSON
Chief Counsel

November 25, 2008

Ms. Nita Parikh, Esq.
Jackson Lewis LLP
725 South Figueroa Street, Suite 2500
Los Angeles, California 90017

Re: Wage Deduction Authorization For Overpayments Due to Payroll Practice

Dear Ms. Parikh:

This responds to your letter dated October 31, 2007, requesting an opinion letter concerning your client's current wage deduction practices. We appreciate your proactive approach in requesting guidance regarding the issue raised in your letter.

According to the facts you provided, your client currently uses a bi-weekly pay period wherein employees routinely are paid for "seventy-five (75) work hours just prior to the end of a two (2) week pay period." After payment has been made, employees submit electronic time sheets reporting hours actually worked. You stated that "[i]f an employee's time sheet indicates the employee took unpaid time during that pay period and was paid for it, this overpayment of wages is reconciled in the employee's pay for the next payroll period."[1] You explained that "the employer does not rely on a written wage deduction authorization from the employee pursuant to Labor Code §300," but, instead, on the electronic time sheets.

You asked for an opinion concerning whether "the employee's submission of an electronic time sheet indicating time off which the employee was paid as an overpayment constitute[s] an acceptable authorization for a wage deduction?" Because your letter assumed, without discussion, that deductions for overpayments are legal, before answering the question you pose, we first answer the preliminary question: whether the deduction for overpayments described in your letter is prohibited under the Labor Code.

Labor Code §221 sets forth the general rule that it is illegal for an employer to collect any part of previously paid wages. Section 224, however, establishes several exceptions for withholdings involving: (1) state or federally required or authorized deductions (such as taxes); (2) deductions for insurance premiums, hospital or medical dues, "or other deductions *not* amounting to a rebate or deduction from the standard wage arrived at by collective bargaining or pursuant to wage agreement or statute," that are authorized in writing by the employee; and (3)

[1] Your letter does not mention the existence of any paid time-off used to pay for employee absences such as vacation or sick leave, and thus, we respond as if such paid leave programs are not involved in your inquiry.

deductions to cover health and welfare, or pension plan contributions.

Labor Code §300, which you referenced in your letter, governs assignments of wages, and sets forth numerous conditions before an employer may make assignments of wages, including a notarized written assignment from the employee "identifying specifically the transaction to which the assignment relates." Section 300, subsections (b) through (h). Although the statute indicates that the employer may be the assignee (see §300(g)), federal law forecloses the employer from being the beneficiary of an assignment of wages. See 29 C.F.R. 531.40 (a), (b). It would appear that the pertinent Labor Code sections do not expressly prohibit deductions for prior overpayments.[2]

Case law makes clear that deductions from an employee's final paycheck for debts owed to the employer are prohibited, even with prior written authorization. In *Barnhill v. Saunders* (1981) 125 Cal.App.3d 1, the employer deducted the balance of a loan from a discharged employee's final paycheck. After discussing the statutes that exempt wages from attachment, the court concluded that "an employer is not entitled to a setoff of debts owing it by an employee against any wages due that employee" on the employee's final paycheck.

Under *Barnhill,* to the extent that your client makes deductions for overpayments in an employee's final paycheck, such practice is unlawful and would also subject the employer to penalties under Labor Code §203 which provides a penalty for an employer who "willfully fails to pay, without abatement or reduction ... any wages of an employee who is discharged or who quits . . .". Although the adjustment in your client's situation occurs as a consequence of the practicalities of the employer's payroll processing, and not repayment of an ordinary loan, the same rationale underlying *Barnhill,* including ensuring that all employees are paid their *final* wages earned, applies. Thus, deductions for overpayments made in a *final* paycheck violate §203 because they deprive the employee of all final wages. Such an action would be willful for the purposes of §203 because the employer chose to engage in self-help prohibited by *Barnhill.*

In *California State Employee's Assn. v. State of California* (1988) 198 Ca1.App.3d 37, the employer concluded after conducting an audit that it had made numerous erroneous overpayments to hundreds of employees. The employer notified the affected employees that it planned to make monthly deductions from employee salaries to recoup the alleged erroneous overpayments. The employer did not have the employees' signed authorizations to make these deductions. Relying upon attachment and wage garnishment laws that exempt wages and the public policy analysis in *Barnhill,* the court held that the employer could not make deductions from pay for prior "erroneous salary advances."

Unlike in *CSEA,* your client makes deductions from wages to recover overpayments made in the immediately preceding pay period that occur due to the payroll practice of paying a set 75

[2] Labor Code §300 provides that no assignment of future wages may be made unless wages have already been earned (except for future wages for necessities of life which, if made, must be made directly to the person(s) furnishing such necessities. Labor Code §300(h). However, when there is a debt based upon an overpayment for hours not worked by the employee, the employee does not transfer a right to earned wages because overpayments are not earned wages. Rather, the basis for the deduction for wages is primarily for the benefit of the employee because it satisfies an obligation (debt) of the employee. (Cf., 3 Ops.Atty.Gen. 178 (deductions are only permitted for items which are for the direct benefit of the employee-not deductions which in any way benefit the employer)

hours every two weeks. Your letter indicated that these deductions occur regularly, and are predictable and expected. The amounts of the deductions are based on electronic time sheets completed and submitted by employees. Like the employer in *CSEA,* however, your client does not have prior written authorization of its employees for these deductions.

We take the view that periodic deductions from wages authorized in writing by an employee to recoup predictable, expected overpayments that occur as a consequence of the payroll practice do not run counter to *Barnhill* or *CSEA,* which clearly prohibit involuntary deductions used to set off for a debt owed to the employer by an employee. *Barnhill* does not hold that employers are prohibited from making periodic set offs of wages (other than in final paychecks) to repay a loan owed to the employer where the employee has signed an express written consent to periodic set offs from wages. The decision focuses on the balloon payment deducted from the employee's final paycheck, and concludes that such set off violates Labor Code §201. The *CSEA* case did not involve employee-authorized deductions for predictable, expected overpayments.

Employee authorization is critical to permitting such deductions. Labor Code §224 provides that a deduction "not amounting to a rebate or deduction from the standard wage arrived at by collective bargaining or pursuant to wage agreement or statute," that is authorized in writing by the employee does not violate the prohibition in Labor Code §221 against unlawful collection of wages. DLSE has previously opined that a deduction for previous overpayment of wages is not unlawful if there is a previous written agreement based upon voluntary consent of employee, provided that the amount of the deduction does not exceed the authorized amount and, after making the deduction, the employee still receives no less than the minimum wage for all hours worked in the pay period. (DLSE Op. Ltr. 1999.09.22-1)

The deduction you describe does not reduce the standard wage but simply implements an agreed upon overpayment recovery of an ascertainable amount (based upon hours not worked in the prior pay period) which is then deducted under authorization by the employee from the established standard wage. The effect is that the employee receives his or her full expected wages for time worked, less a deduction permitted under §224.

The effect of your client's payroll practice which pays for 75 hours for the pay period is *mechanically* similar to an employer's recoupment of advances of commission wages. In *Steinhebel v. Los Angeles Times Communications* (2005) 126 Cal.App.4th 696, the court held that an employer charge back of advanced commissions involving sales of newspaper subscriptions that were cancelled within 28 days was not an illegal kickback under Labor Code §§ 221-224 because the employees signed agreements authorizing the charge back. [3]

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[3] In *Steinhebel,* the court reasoned that:

> The essence of an advance is that at the time of payment the employer cannot determine whether the commissions will eventually be earned because a condition to the employee's right to the commission has yet to occur or its occurrence as yet is otherwise unascertainable. An advance,

Although the *Steinhebel* case addressed advances of commissions which involve a specific type of wage which may be earned differently from wages based upon hours worked, we believe the same reasoning would apply to subsequent recovery for "advances" for hours not worked which result in overpayments that occur as a consequence of an employer's payroll system. See also, *Brennan v. Veterans Cleaning Service, Inc.* (1973) 482 F.2d 1362 (interpreting similar anti-kickback provision under federal law to allow deductions for loans/advances made to employee).

Additionally, like the charge backs for advances of commissions at issue in *Steinhebel,* here, we understand that periodic deductions for overpayments that occur due to the consequences of an employer's payroll system are not an uncommon practice, and we found no case law or Labor Code provisions that expressly bar such practice. See, *Steinhebel,* 126 Cal.App.4th at 709. Notably, the concerns underlying Labor Code §§ 221, 224, and 300, namely that employers may improperly use "kickbacks" to deprive employees of wages, do not come into play in the situation where, with employee consent, an employer recoups in the immediately subsequent pay period, an overpayment for hours not worked. See, *Kerr's Catering Service v. Dept. of Industrial Relations* (1962) 57 Cal.2d 319, 328-29 ("The use of the device of deductions created the danger that the employer, because of his superior position, may defraud or coerce the employee by deducting improper amounts."). The deductions you described in the factual scenario at issue do not amount to an improper or unfair deduction to the employee's wages, so long as affected employees provide written authorizations and the employee still receives, after such deductions, not less than the minimum wage.

As previously stated, §224 requires that such deduction must be "expressly authorized in writing by the employee." In our view, the simple submission of an electronic timesheet by the employee does not constitute the required written authorization if it does not expressly and voluntarily authorize a specific prospective deduction.

In summary, an employer may make deductions from wages to reflect predictable and expected wage overpayments made in the immediately prior paycheck that resulted from the employer's payroll system, if the employee provides voluntary, written authorization. The electronic time sheet your client relies upon does not constitute a voluntary, written authorization. Further, pursuant to *Barnhill*, an employer may not make deductions from a final paycheck to reflect prior overpayments made; such action would subject the employer to section 203 penalties.

This opinion is based exclusively on the facts and circumstances described in your request and is given based upon your representations, express or implied, that you have provided a full and fair description of all facts and circumstances that would be pertinent to our consideration of the questions presented. Existence of any other factual or historical background not contained in your letter might require a conclusion different from the one expressed herein. You have represented that this opinion is not sought by a party to pending private litigation concerning the issues

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therefore, by definition is not a wage because all conditions for performance have not been satisfied. *Steinhebel,* 126 Cal.App.4th at 705.

Similarly, in the scenario presented in your letter, amounts paid for hours not worked are not earned wages because the labor services were not performed.

addressed herein. You have also represented that this opinion is not sought in connection with an investigation or litigation between a client or firm and the Division of Labor Standards Enforcement.

We hope that the above responds to your inquiry and will assist the Company in complying with California wage and hour laws.

Very truly yours,

Robert R. Roginson
Chief Counsel

RRR:

Cc: Labor Commissioner Angela Bradstreet