

BACKGROUND

On July 31, 2008 – 31 days into a record-long budget stalemate that was not resolved until September 23rd – Governor Schwarzenegger issued Executive Order S-09-08¹ which directed the Department of Finance and the Department of Personal Administration to work with the State Controller to reduce the regular wage rates of all state employees who are covered by the federal Fair Labor Standards Act (FLSA) to the federal minimum wage of \$6.55 per hour and the salaries of all FLSA-exempt State employees to \$455.00 per week.

Controller John Chiang refused² to implement the executive order on the following grounds:

- The order violates the FLSA, which contains a minimum wage standard to protect employees from employer wage exploitation. Contrary to the Governor's viewpoint, the FLSA was never intended to authorize employers to pay the minimum wage in lieu of regular wages during times of fiscal distress.
- The State's 40-year-old payroll system (which is scheduled to be decommissioned, starting in 2012), coupled with its collective bargaining agreements and labor laws, make it practically infeasible for minimum wage to be implemented so as to not incur violations of provisions of the FLSA relating to the timely payment of full wages.³

Governor Schwarzenegger filed a lawsuit (David A. Gilb, et al. v. John Chiang, et al., Appellate Case No. C061947, Sacramento County Superior Court No. 34-2008-8000026-CU-WM-GDS) seeking a court order to compel the Controller to comply with the executive order. The trial court ruled in the Governor's favor. The decision, which came subsequent to the passage of the budget, was appealed and is currently pending before the 3rd District Court of Appeal.

UPCOMING COURT DECISION

On May 5, 2010, the 3rd District Court of Appeal (3rd DCA) scheduled oral arguments to be held on June 21st. While appellate court rulings generally come within 30 days of oral arguments, the Court's sudden interest in the case suggests that it is interested in rendering an immediate decision in order to impact this year's budget cycle.

Given the 3rd DCA's right-leaning composition and its past history of adverse rulings relating to labor interests, we should prepare for a ruling which affirms the trial court's decision that the executive order is lawful, and sets aside the Controller's infeasibility arguments. If this occurs, the Controller may be ordered to pay minimum wage as early as the July payroll, which is scheduled to be paid on August 1st.

¹ <http://gov.ca.gov/executive-order/10333/>

² <http://www.sco.ca.gov/Press-Releases/2008/pr08042.pdf>

³ See section of this memo entitled "Impact to the State" for additional details.

IMPACT TO THE STATE

- Hundreds of millions of dollars, if not more, in liquidated damages for violating the FLSA (Note: the payment of minimum wage has no budget solution value. In other words, it does nothing to reduce the current \$19.1 billion deficit. Ironically, to the extent that the FLSA is violated, it could actually increase the deficit.)
- The State is currently spending \$300 million to construct a state-of-the-art payroll system, known as the “21st Century Project.” Attempts to upgrade the current legacy system – when it is scheduled to be decommissioned starting in 2012 – would be a waste of taxpayer dollars and would cause budget and schedule slippage for the modernization project.
- Costly, protracted litigation filed by employees who do not timely receive their correct wages.

Implementing minimum wage with the SCO’s current Vietnam-era payroll system and within the confines of existing state labor laws and collective bargaining agreements cannot be successfully achieved. “Success” is defined as not exposing the State to violations of the FLSA and the resultant liquidated damages.

There are too many challenges to list here, but the following are a few examples:

- The FLSA provides that an employee who works even one hour of overtime during a pay cycle is entitled to full pay. Because the State has a negative payroll system (i.e., workers are paid in advance of the conclusion of the payroll period based on the presumption that they will work full-time, with a reconciliation occurring in the subsequent month) and does not have a daily time reporting system, the State would not have the information necessary to determine who worked overtime and therefore should be paid their full wages.
- The current payroll system requires the State to calculate payroll beginning on or about the 20th of every month. It begs the question: Assuming there is a budget impasse on July 20th, should payroll be calculated on the assumption that there will be no budget agreement reached during the remaining ten days of the month? Should the State guess wrong, the State will have paid its employees less than the wages to which they are legally entitled on their payday, which is a violation of the FLSA.
- Retirement contributions are constitutionally-protected and, therefore, must be paid as if employees were receiving their regular, full wages. Because the existing payroll system calculates the employer and employee contribution as a percentage of the employee’s gross pay for the month, the system would underpay these contributions.
- While reducing pay at the onset would be near impossible, it would be even more difficult to ensure that employees timely receive their correct owed wages once a budget is enacted. Payroll experts estimate that it could take as many as six months before employees are made whole after the budget is signed.

IMPACT TO EMPLOYEES

- Inability to pay bills and other necessities of daily living (e.g., mortgage, automobile, tuition, insurance, etc.)
- Inability to comply with spousal or child support orders
- Credit score downgrades
- Uncertainty as to when full wages will be repaid, which could take up to six months following the enactment of a budget

This decision could impact 314,184 state employees (240,990 state and 73,194 CSU).

The Schwarzenegger Administration believes that the ability to lower wages to the federal minimum level during a budget impasse will be a “game changer” both during budget negotiations and at the collective bargaining table. The Administration’s theory is that once employees are faced with losing their homes or credit, labor leaders and Democrats will be pressured to avoid protracted budget battles.

The scope of the impact may not be limited to state employees. Many, if not most, local governments also are barred from making expenditures in the absence of an enacted budget or other special provision allowing for a continuous appropriation of funds. Like the State, local governments historically have continued to pay their workers during the absence of a budget. The impending 3rd DCA ruling in the *Gilb v. Chiang* case could provide local government officials with powerful leverage in future labor and budget negotiations.

REQUEST

Seek Labor Secretary Hilda Solis’ immediate intervention on an unprecedented pay practice that, if allowed to proceed in California, could become the new norm for all state and municipal governments that have late budgets or face fiscal distress.

When she was still a member of Congress, Secretary Solis joined Controller Chiang in publicly opposing the Governor’s minimum wage executive order. As the current head of the U.S. Department of Labor, which is charged with the enforcement of the FLSA, she is in a position to determine the legality of the Governor’s proposed new pay practice. Specifically, we should seek her advice on the proper interpretation of federal law to this State with regard to the following:

1. Whether the FLSA permits employers to pay federal minimum wage in lieu of regular wages.
2. Whether the Governor’s order violates the FLSA by preventing prompt payment of wages.
3. Whether the Governor’s order violates the FLSA in the first instance by reducing regular wage and salary rates of state employees.