

First Wednesday

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A Monthly Discussion of Employment Law Issues and Other Hot Topics for Management

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Payroll Reductions and Alternatives to Layoffs

Many employers face increasingly tough decisions regarding labor costs and retention of good employees in these uncertain times. While a few rounds of layoffs may help separate the wheat from the chaff, additional rounds could mean the loss of solid, loyal employees. This bulletin will explore some of the alternatives to layoffs, including one particular problem area in California labor law.

Reducing Payroll by Shortening the Workweek

Many employers would think it a good and logical idea to implement a 4-day workweek to save costs and accommodate the economic slowdown. This might be a good option depending on the business circumstances and makeup of the workforce at that particular employer. If the employees are non-exempt hourly rate employees, then nothing prevents the company from reducing schedules from five to four days per week. The company could then achieve a 20% payroll reduction. As explained below, this won't necessarily work for salaried exempt employees.

Note that the hourly non-exempt employees would still qualify for overtime if they worked more than eight hours in any day unless their "work unit" adopted an alternative workweek using the criteria of the Industrial Welfare Commission ("IWC") work orders. The company would need to review, among other things, amended California Labor Code section 511 and the relevant work orders, and conduct a secret ballot election to determine whether a 4 x 10-hour per day workweek (or some other alternative schedule) could be implemented.

Another issue to consider before reducing the hours of non-exempt employees is the provision of benefits. Certain health and dental plans, or sick leave and PTO policies described in employee handbooks, might require that employees work 35 or 40-hour workweeks to receive those benefits. If the employee is then scheduled for only 32 hours per week, this could result in an unintended loss of benefits.

The employer should do some additional homework before making a quick decision to reduce hours. Existing employment agreements, including union contracts, should be checked as they might have guaranteed 40 hours per week or otherwise be read to preclude the reduction of hours or wages of any affected employees.

Work Sharing Program

For non-exempt employees, a workweek reduction may qualify them for California's Work Sharing program. The Work Sharing program is administered by the California Employment Development Department ("EDD") and is a type of unemployment insurance for working employees whose hours have been reduced. In essence, a qualifying employer reduces the number of hours that employees work each week, and the weekly wage loss is partially covered by payments from EDD. To qualify for the Work Sharing program, an employer must reduce the wages and hours of at least two employees, and at least 10% of the employer's workforce (or a designated work unit) must be affected. The wages and hours of the affected employees must be reduced by at least 10%.

The Work Sharing program is only available for non-exempt employees. Exempt employees will generally not qualify because they must receive their full weekly salaries. But an employer might choose to reclassify an exempt employee to non-exempt status - with advance notice - on a monthly basis if economic pressures will continue over an extended time.

Special Problems with Exempt Employees

The problem with a shortened workweek or one-day shutdown in California is its potential effect on exempt employees. Reducing the salary of an exempt employee in connection with a reduction in hours or days made available for work will likely destroy the employee's exempt status under California law. This seems like an odd and difficult result, but has in fact been adopted by California's Division of Labor Standards Enforcement ("DLSE") in its enforcement manual. The manual is relied upon by DLSE deputy labor commissioners in wage-and-hour disputes.

Section 51.6.7 of the manual relies upon a March 12, 2002 opinion letter. In the letter, the labor commissioner's attorney responded to a series of questions posed by a private attorney putting forth hypothetical scenarios very applicable in 2009. The main issue was whether an employer facing a slowdown due to economic circumstances could implement an across-the-board salary cut of 20% along with a 20% reduction in time. The company would simply close one day per week. The labor commissioner's attorney opined that the employer could not tie a salary reduction to a time reduction for exempt personnel. This would have the

effect of wiping out the exemption because the salary basis test is not met.

The labor commissioner's opinion is primarily grounded in the rule that private employers must pay an exempt employee for the entire week if the employee performs any work in that week. While exempt employees could be given one week off per month (commonly known as a furlough), they cannot be given one day off per week unless the employer is prepared to reclassify them as non-exempt. (A few comparison points: (1) public employers can use one-day-a-week furloughs, and (2) federal law is not as strict - private employers outside California may have more options, at least for the time being, based on several new Department of Labor opinion letters.)

What to Do?

Assuming the employee is at-will and there is no illegal discrimination or retaliation, the employer can reduce salaries as long as they are not tied to a reduction in time made available for work. The theory is that if an employee can be legally terminated, then he can also have his salary reduced to as low as the minimum level required to maintain the exemption (two times minimum wage assuming a full-time schedule, currently \$2,733.33 per month).

Note that following the law leads to an odd and demoralizing result that is not necessarily favorable to the affected employees. Employers can reduce pay and keep people on full-time but cannot reduce pay and schedules simultaneously.

An employer can also reduce the overall duties of exempt employees so long as the exempt duties test is still met. This gets complicated. In brief, to meet the duties test for most exemptions, the employee must actually perform exempt-type duties (including real management and exercise of independent judgment, discretion, etc.) for more than 50% of the time worked. It is always the employer's burden to prove that an exemption applies. So, any contemplated reduction in overall duties should cause the employer to analyze and possibly audit its workforce to determine whether exemptions would still apply.

Other Alternatives to Layoffs

Other alternatives include termination for cause and delayed hiring decisions. In any termination for cause, it is best to have documentation of the poor performance. Even with documentation, however, many employers will choose not to confront the performance issues and instead

try to include the employee in a layoff. This can be problematic if it is later shown that the employer hired replacements after giving no reasons for the termination of the first employee. If the replacements happen to be younger, or non-disabled, or have certain other characteristics that distinguish the replacement employee from the first employee, then the “layoff” could appear suspicious. If termination for cause is to be used, it is best to make sure the performance reasons are well documented, explained, and the employer has all of its ducks in a row. (See the April 1, 2009 issue of *First Wednesday*, “Employee Termination Meetings — Doing It Right.”)

In delayed hiring decisions, rather than turn down good applicants, some of the large law firms are delaying start dates in exchange for payment of monthly stipends and/or benefits. This may be a good alternative for employers who have found the right people, but aren’t ready to have them begin work. Along these lines, employers might consider offering unpaid leaves of absence or extended vacations on an optional basis to those who may want to travel or have other interests outside of work.

It is difficult to preserve company morale when conducting layoffs and reducing wages. Consideration of the above alternatives should be part of the planning process. With good communication and advance planning the company can try to put its best face on the problem and try to keep the team in place for the future growth of the company, while acting in compliance with California law.

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