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Alternate Routes

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Not a day goes by without news of more corporate layoffs. The Bureau of Labor Statistics reported that over 660,000 jobs were lost in March alone. So, as employers attempt to ride out the economic downturn and have already made steep cuts in their workforce, many have begun exploring alternatives to layoffs that would allow them to reduce costs, maintain capacity and preserve the jobs their employees need.

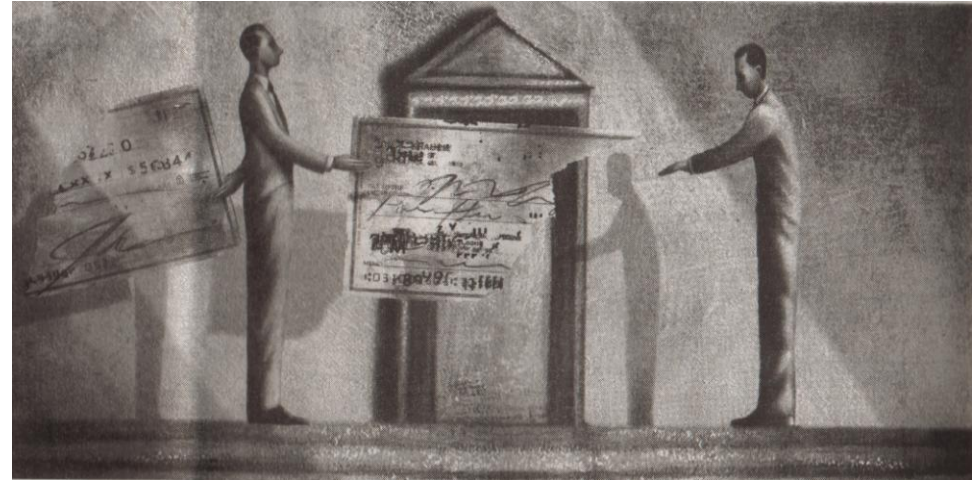
As demand slackens, one frequently proposed alternative to layoffs involves reducing employee workweeks and salaries to reduce total payroll without reducing headcount. In fact, strategies like this - including across-the-board pay cuts and reductions in work time - are often suggested by employees themselves, who would rather work three or four day workweeks, often with the flexibility to pick up additional outside work, than risk being laid off altogether. However, while payroll reductions have obvious attractions, they can be fraught with potential long-term pitfalls for employers, particularly as they relate to exempt employees.

Employers trying to navigate these troubled economic times must

be aware of the potential effect of such changes on the exempt status of their employees and the ensuing long-term legal liability. Somewhat counter-intuitively, a number of the steps employers might wish to take to ease the effect of difficult economic times on their employees can actually lead to major misclassification liability down the road.

Most employers know that employees classified as exempt must meet both requirements of a two-pronged test. First, they must spend more than 50 percent of their workweek engaged in duties that meet the requirements of the exemption applied to them (generally the administrative, executive or professional exemption), using independent judgment and discretion. Second, they must be paid at least twice the minimum wage "on a salary basis." It is this second requirement employers must consider carefully before reducing any employee's salary. If an employer improperly reduces an exempt employee's salary, that reduction can jeopardize not just the exempt status of the employee directly affected, but the status of every company employee in the same position.

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As part of the salary basis test, federal regulations (followed by California's Division of Labor Standards Enforcement), hold that a salaried employee must receive "his full salary for any week in which he performs any work without regard to the number of days or hours worked." The potential liability is steep: An employee found to have been misclassified as exempt is entitled to receive back pay for any overtime worked during the applicable statute of limitations period (usually three or four years). In addition, misclassified employees often bring claims for unpaid meal and rest period payments, pay stub violations and waiting time penalties, and misclassification claims are often brought as class actions, exponentially increasing an employer's potential liability. These claims can be expensive and difficult to defend, and employers should be cautious about taking any action that

jeopardizes an exempt employee's status.

It is important to note that since 2000, California law does not recognize the concept of the "part time" exempt employee - no matter how many hours an employee works each week, he or she must be paid a salary that exceeds two times the minimum wage - that is, each employee must be paid a minimum of \$33,280 per year, or \$640 per week for any week in which the employee performs any work. This minimum is not subject to reductions based on hours worked - even an employee who is only expected to perform 20 hours of work each week must be paid this minimum amount. Any salary reduction that brings an employee below this threshold will be held to invalidate that employee's exempt classification.

In most cases, exempt employees are paid a great deal more than the baseline salary, which leads to the question of whether employers may reduce the salaries of exempt employees to ride out tough economic times. The answer is yes, but they must first ask themselves some tough questions about any reduction.

Is the reduction in salary directly related to a reduction in working time?

If the answer is yes - if, for example, the employer cuts an employee's workweek to four days and concomitantly reduces the employee's salary by 20 percent - the reduction is likely to be found to be inconsistent with the definition of the salary basis described above. Per federal regulation and California's Division of Labor Standards Enforcement, an employee is not considered to be "on a salary basis" if "deductions from his predetermined compensation are made for absences occasioned by the employer or the operating requirements of the business. Thus, if the employee is ready, willing, and able to work, deductions may not be made for time when work is not available."

This rule is generally applied in the situation where an employer furloughs an employee for a day or two because work is unavailable to that employee on a short-term basis. Simply put, because exempt employees are compensated, not for

the quantity of their work, but for the quality of the work they perform, the Division of Labor Standards Enforcement has opined that reducing salary at the same rate as an employer reduces working time will jeopardize the exempt status of employees.

The better course for employers is to reduce salaries at a fixed rate, and to make it clear to those employees that they are to determine for themselves how much time to devote to the tasks they are assigned. Such changes are likely to be unpopular, and many employers inquire as to whether they can mitigate the effect of this by allowing employees to take a predetermined day off each week without charging them vacation for this time (i.e., an employer may elect to give employees Fridays off without charging them for vacation). The Division of Labor Standards Enforcement has made it clear that any such plan would be closely scrutinized to ensure it is not a sham to avoid the legal requirements described above.

Is the reduction permanent or temporary?

Temporary reductions in salary are more likely to be seen by courts and the Division of Labor Standards Enforcement as tied to fluctuations in the quantity of work available, and are therefore more likely to raise red flags with courts and administrative agencies. However unpopular they may be, salary reductions should always be presented to exempt

employees as permanent changes and not simply a temporary "fix" to compensate for a slowdown in business.

Will the employer permit exempt employees to participate in California Employment Development Department's Work Share program?

This is another common pitfall for employers who act out of concern for their employees. An employer who allows exempt employees to participate in this program (and to therefore receive some portion of the unemployment benefits those employees would have been entitled to had they been laid off altogether), is likely to be held to have misclassified those employees. The Employment Development Department's program has been held by the Division of Labor Standards Enforcement to be based on a reduction of hours, not pay, and has therefore opined that employees who are permitted to participate in the Work Share program will no longer be considered to have been paid on a salary basis.

Employers reducing their exempt employees' pay must also consider the reduction's effect on contracts, severance pay obligations and benefits plans. Employees who no longer work full time may become ineligible for vacation or benefits, and hours reductions may trigger the employer's COBRA and/or other obligations. Due to all of these factors, employers are advised to proceed with caution and consult legal counsel before embarking on these potentially costly plans.

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