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Updated analysis of the types of furloughs and cost-cutting solutions employers can implement without jeopardizing the exempt status of executives, administrative and professional exempt employees.

An Update on Furloughs and Reduced Hours: New Guidance on Cost-Cutting Strategies Other than Layoffs

By Alison S. Hightower, Eric C. Bellafronto, Barry Y. Freeman and Bryan N. Smith

Last December, as the recession was beginning to deepen, Littler published an Insight, *Furloughs and Reduced Hours: Cost-Cutting Strategies Other Than Layoffs*, discussing several alternatives to layoffs, particularly mandatory furloughs of exempt employees, mandatory use of vacation/PTO during furloughs, and reduced workweeks, based on the limited legal precedent available at that time on these subjects. Recently, the U.S. Department of Labor (DOL) issued three opinion letters that address some of these alternatives. This Insight is an update to the December 2008 Insight and provides the latest legal analysis.

Mandatory Furloughs Of Exempt Employees

Full Workweek Furloughs

Furloughs of nonexempt employees are fairly straightforward, but with exempt employees, furloughs are anything but straightforward. Furloughs that result in the exempt employee being paid less than his/her full weekly salary may jeopardize the exempt status. The December 2008 Insight discussed furloughing exempt employees for entire workweeks, which would not jeopardize their exempt status because no pay is due to exempt employees who perform no work during an entire workweek. According to the DOL's recent pronouncements, this approach remains viable.¹

In addition, if an employer mandates furloughs, but requires exempt employees to use accrued vacation or "paid time off" for those furloughed days, the DOL agrees that the employer does not jeopardize the exempt status of these employees. The reason for this result: the exempt employees still receive their full salaries for the workweek, even if they only worked a small portion of that workweek.

Partial Workweek Furloughs

Many employers considering furloughs need to cut their cash outlays, and thus do not want employees to receive full pay for the furloughed days. A common approach is to reduce salaries by 20% and then reduce workweeks by one day a week to provide the

employees with three-day weekends as compensation for the pay cut. Can an employer mandate this approach for exempt employees without jeopardizing their exempt status?

The December 2008 Insight noted a split amongst the few courts that have considered the effect on exempt status of this reduction in pay and hours. Two courts approved of such work schedule reductions if implemented *prospectively*, reasoning that federal regulations only prohibited making deductions from current or past work periods. One court reached the opposite conclusion.

Recently the DOL opined that, in general, reducing exempt employees' work schedules with a corresponding reduction in salary because of lack of work violated the salary basis test. According to the Department, "salary deductions due to a reduction of hours worked for short-term business needs do not comply with [the salary basis test for exempt status] because they result from 'the operating requirements of the business.'" Indeed, the DOL opined that any deductions from salary due to day-to-day or week-to-week fluctuations of the business' operating requirements "are precisely the circumstances the salary basis requirement is intended to preclude."

There is one ray of hope, however. The DOL further clarified that an employer may make a "fixed" and "permanent" decision to reduce the hours and corresponding pay for exempt employees.² For instance, an employer could reduce the work schedule for the year from 52 five-day workweeks to 47 five-day workweeks and 5 four-day workweeks, and also reduce the pay of exempt employees as a result of the shortened workweeks. The linchpin of the distinction between this permitted approach and the impermissible hours reduction is the permanence of the acceptable schedule reduction as contrasted to a temporary reduction in the normal scheduled workweek to address a short-term work slowdown or temporary economic conditions. Unfortunately, what constitutes a "permanent" change in work schedules has not been clearly defined.

Thus, reducing the pay of exempt employees *in and of itself* does not jeopardize their exempt status, so long as the exempt employee still receives at least the threshold minimum pay (\$455 a week) for exempt status. But reducing the hours expectation of exempt employees creates a risk that those employees will no longer be exempt unless that reduction is considered to be "permanent."

"Voluntary" Furloughs

The DOL also addressed the legality of an employer offering "voluntary time off" to exempt employees who may use paid annual, personal or vacation leave, and then mandating time off if an insufficient number of employees volunteer for "voluntary time off."

First, the DOL found no problem if the employer requires the employee to use accrued vacation or "paid time off" during a furlough of a day or even less than a day. Such reductions in accrued leave do not prevent the exempt employee from being paid on a "salary basis" because the furloughed employee still receives his or her full weekly salary without deductions.³ The DOL noted that the employer may not reduce pay if the employee has exhausted all of his or her accrued leave or would have a negative balance if paid for leave had not yet accrued.

Of course, in tough economic times employers generally are more interested in employees taking unpaid furloughs. If that option is viewed as avoiding layoffs, some employees may be willing to take those unpaid days off. The DOL agreed that an employer can treat such "voluntary time off" as unpaid time off for personal reasons, other than sickness or disability, for one or more full work days. The DOL warned, however, that the employee's willingness to take this "voluntary time off" must be "completely voluntary."⁴

Employers offering "voluntary" unpaid time off therefore should evaluate what paper trail will be required to demonstrate the voluntary nature of unpaid personal leave by exempt employees that spans less than an entire workweek. Volunteers who take an unpaid furlough of an entire workweek do not jeopardize their exempt status.

Other Considerations

As discussed in the December 2008 Insight, employers considering furloughs and pay reductions must consider other potential issues. These include what amount of notice to provide employees, whether vacation/PTO or other policies need to be amended before a furlough policy is implemented, whether union or other contracts restrict the employer's options, the effect of furloughs and pay reductions on benefit plans, and the possible impact of other state and federal laws.

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¹ FLSA 2009-14 (Jan. 15, 2009), citing 29 C.F.R. § 541.602(a).

² FLSA 2009-18 (Jan. 16, 2009), citing FLSA Wage & Hour Opinion Letter Nov. 13, 1970.

³ FLSA 2009-18 (Jan. 16, 2009).

⁴ FLSA 2009-14 (Jan. 14, 2009).