

## In This Issue:

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An important new opinion letter from the California Division of Labor Standards Enforcement (DLSE) withdraws a 2002 opinion letter precluding partial week furloughs of exempt employees, and in the process conforms California law on furloughing exempt employees to federal law.

## DLSE Agrees California's Partial-Week Furlough Options Are Coextensive With Federal Law

By Daniel Thieme and Alison Hightower

As the old cliché goes, “better late than never.” This applies to an important new opinion letter from the California Division of Labor Standards Enforcement (“DLSE”). In the opinion, the DLSE acknowledges, contrary to its prior view, that California’s approach to furloughing salaried “white collar” exempt employees follows the federal approach. This about face substantially reduces an area of potential legal risk for California employers who follow the federal guidelines for reducing both the workweeks and salaries of exempt employees.

### Background – Prior California Opinion Disapproved Partial-Week Unpaid Furloughs of Exempt Employees

As the recession of 2008 continued into 2009, and layoffs were not sufficient to remedy revenue shortfalls or cut too deeply into critically needed employee resources, many employers considered requiring their employees to take unpaid time off (furloughs) as another cost-cutting option. While the employer reduces payroll expenses, the employee receives free time to do whatever he or she chooses. The employer does not have to hire and train new employees when the economy improves, and the employees still receive most of their normal pay.

Employers considering furloughs frequently were drawn to offering employees a reduced workweek, such as four instead of five days, with a corresponding reduction in pay. A three day weekend appeals to employers and employees alike as a meaningful *quid pro quo* for a significant pay reduction.

Partial-week furloughs of exempt employees, however, present legal challenges for employers because of the salary requirements for exempt employees under both federal and California law. Thus, implementing this cost-cutting measure for salaried exempt employees has involved certain risks of losing the employees’ exempt status, particularly in California due to an unfavorable 2002 DLSE opinion.

## The Salary Basis Test and Its Relevance to Furloughs

In most cases, a key element of the “white collar” overtime exemptions is the “salary basis test.” Under that test, if a salaried exempt employee performs any work in a workweek, deductions may not be made from the full weekly salary for absences occasioned by the employer or by the operating requirements of the business.<sup>1</sup> Thus, it is well established that an employer that imposes a reduced workweek may not correspondingly “dock” the salaries of salaried exempt employees without jeopardizing their exempt status.

The solution to this problem under federal law has been to impose an advance reduction in the employee’s salary rate in connection with the reduced work schedule. The federal Department of Labor (DOL) has opined that this approach does not involve an improper “docking” of salary under federal law, so long as the reductions are relatively “fixed” and not the result of week-to-week determinations.<sup>2</sup> The California DLSE, however, had expressed a conflicting viewpoint.

## The California DLSE 2002 Opinion Letter

In 2002, the California DLSE issued an opinion letter frowning on the approach blessed by the federal DOL, and indicating that any reduction in salary rates made in connection with the introduction of a reduced workweek would violate the salary basis requirements under California law. No California case has addressed the legality of reducing exempt employees’ salaries for a partial workweek, and as of 2002 only a few federal courts had considered the issue. Those federal courts reached opposite conclusions. In Massachusetts, a federal district court followed the federal DOL’s approach and interpreted the applicable federal regulations as prohibiting **deductions** from pay already earned, but as not prohibiting all **prospective** reductions of future work periods and the corresponding salary **rate**. That court upheld an unpaid furlough of exempt employees for less than a week because the furlough and pay reduction were implemented in an upcoming pay period, not midway during a current payroll period.<sup>3</sup>

By contrast, a New York federal district court disapproved of the reduction of a workweek to four days with a corresponding reduction in salary of 20 percent as violating the salary basis test, relying on the federal regulation, which the court concluded “makes it clear that a reduction in work time that is imposed by the employer may not be the basis for a reduction in salary.”<sup>4</sup> The New York decision did not discuss the federal DOL opinion letters that had taken the contrary position.

In its 2002 Opinion Letter, the California DLSE followed this New York opinion, and rejected the interpretation of the Massachusetts federal court and the federal DOL as supposedly violating the “plain language” of the federal regulations implementing the “salary basis test” for exempt employees. Therefore, according to the DLSE, California employers could reduce the salaries of exempt employees without reducing the employees’ workweeks, or furlough them for an entire workweek without pay, but could not reduce the number of workdays expected of exempt employees in a workweek while also reducing their salary.

DLSE opinions are not binding on the courts. Nonetheless, the 2002 Opinion Letter was a yellow if not red light, cautioning California employers to consider limiting unpaid furloughs of exempt employees to an entire work week, or simply reducing salary rates without reducing their work schedules.

## The DLSE’s About Face

On August 19, 2009, the DLSE responded to an employer’s request that the DLSE’s 2002 Opinion Letter be withdrawn with a refreshing acknowledgement that its prior opinion was misguided. After acknowledging that California generally follows the federal approach to the salary basis test for white collar exempt employees, and upon a review of the federal case law and DOL opinion letters interpreting the federal regulations, the Chief Counsel of the DLSE concluded:

[T]he DLSE’s prior reliance upon [the New York federal decision in] *Dingwall* for the conclusion that the federal regulations prohibit the simultaneous reduction of a workweek schedule and salary presented in this case is not persuasive ...

The DLSE went on to approve of the requesting employer's proposal to reduce the number of its exempt employees' scheduled work days from five to four days per week, with a corresponding reduction in salary, to address significant but temporary economic difficulties, with the expectation that as soon as business conditions permit, the employer intends to restore the full five-day work schedule and the full salaries of these exempt employees.

Although this new DLSE opinion is not binding on the courts, it will be followed in proceedings before the California Labor Commissioner. Also, its issuance substantially reduces the risk of a court finding the adverse 2002 opinion to be persuasive authority on this issue.

## What Restrictions Remain on Partial-Week Furloughs of Salaried Exempt Employees?

This development does not give a green light to *all* partial-week unpaid furloughs. Employers are well advised to proceed with caution, keeping in mind limitations that are noted in the federal regulations and DOL opinion letters.

First, it is advisable to structure any salary reduction as an advance reduction in the weekly salary *rate*, and not as "deductions" from an established salary rate for missed work days. While a recent Illinois Court of Appeals decision provides authority for a "deductions" approach, as long as it is announced in advance,<sup>5</sup> other courts could find such an approach violates the federal regulation prohibiting "deductions from the employee's predetermined compensation ... for absences occasioned by the employer or by the operating requirements of the business."<sup>6</sup>

Second, any combined work schedule and salary rate reductions should be in place for a substantial period of time. The federal DOL has consistently stated that short-term reductions in salaries "due to the day-to-day or week-to-week determinations of the operating requirements of the business are precisely the circumstances the salary basis test is intended to preclude."<sup>7</sup> Indeed, recent federal DOL opinions describe lawful reductions as involving a "fixed" or "permanent" reduction in hours and pay rate.<sup>8</sup> We know that reductions need not last forever – they may be reversed after economic conditions improve.<sup>9</sup> Beyond that, however, no guidance exists as to how briefly a reduction may be in place while still qualifying as "fixed" or "permanent." Given the lack of guidance, we believe it is advisable to describe partial-week furloughs as intended to continue indefinitely while unusual economic difficulties continue.

Third, an employer must not adjust salary rates and schedules too often. This limitation likewise derives from the federal DOL's disapproval of reductions that are made "for short-term business needs,"<sup>10</sup> or that are "occasional ... and transitory."<sup>11</sup> Similarly, the new DLSE opinion approved the employer's partial-week furlough based, in part, on the fact the employer was imposing only an unusual, one-time reduction.<sup>12</sup> A recent Tenth Circuit federal decision expresses that an employer may be able to change an employee's schedule and salary "at least twice during the course of a year,"<sup>13</sup> but it is not clear that all courts would agree. Given the uncertainty that surrounds this question, caution is advised before implementing a partial-week furlough program more often than once in connection with the current economic downturn.

Finally, any reduced salary must not fall below the minimum salary rate required for exempt status – currently \$2,773.33 per month in California.<sup>14</sup>

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 Daniel Thieme is a Shareholder in Littler Mendelson's Seattle office. Alison Hightower is a Shareholder in Littler Mendelson's San Francisco office. If you would like further information, please contact your Littler attorney at 1.888.Littler, info@littler.com, Mr. Thieme at dthieme@littler.com, or Ms. Hightower at aheightower@littler.com.

<sup>1</sup> 29 C.F.R. § 541.602(a); DLSE Opinion Letter 2002.03.12, at 3. In addition, "[i]f the employee is ready, willing and able to work, deductions may not be made for time when work is not available." 29 C.F.R. § 541.602(a).

<sup>2</sup> *E.g.*, DOL Opinion Letter (Unnumbered) (Feb. 23, 1998). This is discussed further below.

<sup>3</sup> *Caperci v. Rite-Aid Corp.*, 43 F. Supp. 2d 83 (D. Mass. 1999).

<sup>4</sup> *Dingwall v. Friedman Fisher Assocs., P.C.*, 3 F. Supp. 2d 215, 220 (N.D.N.Y. 1998).

<sup>5</sup> *Robinson v. Tellabs, Inc.*, 907 N.E. 2d 501, 391 Ill.App.3d 60 (Ill. App. 2009).

<sup>6</sup> 29 C.F.R. § 541.602(a).

<sup>7</sup> DOL Opinion Letter FLSA2009-18 (Jan. 16, 2009), p. 4.

<sup>8</sup> *Id.*, p.3; DOL Opinion Letter (Unnumbered) (Feb. 23, 1998).

<sup>9</sup> DOL Opinion Letter FLSA2009-18, pp. 3-4; Cf. DLSE Opinion Letter 2009.08.19, pp. 1 and 5 (approving “highly unusual and temporary” partial-week furlough that employer intends to reverse “as soon as business conditions permit”).

<sup>10</sup> DOL Opinion Letter FLSA2009-14 (Jan. 15, 2009), p. 2.

<sup>11</sup> DOL Opinion Letter FLSA2009-18, p. 4.

<sup>12</sup> DLSE Opinion Letter 2009.08.19, pp. 5-6.

<sup>13</sup> *Archuleta v. Wal-Mart Stores, Inc.*, 543 F.3d 1226, 1232 (10th Cir. 2008). The court went on to hold that where an employee’s schedule and salary were reduced on five different occasions, a jury question was presented as to whether the employee was, in effect, paid as an hourly employee. *Id.* at 1236. The opinion does not clarify the period of time over which those five reductions occurred.

<sup>14</sup> California Labor Code § 515(a).