

Restructuring and Resizing the Workforce: Legal Issues for the California Employer

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Since the start of the recession in December 2007, employers across the United States have faced tough economic conditions, in which survival depends upon the immediate conservation of cash, while at the same time reducing liabilities, avoiding litigation risks, and preserving the company's future in the form of its human capital. The immediate need to reduce expenses resulted in widespread layoffs. Although the economy is showing signs of renewed life, the term "jobless recovery" – as evidenced by continuing job losses and double-digit unemployment -- is frequently heard. The impact of the recession is keenly felt in California, where unemployment rates topped 12 percent statewide in September 2009. In rural counties in California, unemployment rates have reached 20 percent. Meanwhile the number of high-tech jobs in Silicon Valley has decreased by over 16 percent since 2001.

Layoffs are not, however, the sole means that have been used by employers to reduce expenses. In a September 2009 survey conducted by salary.com of 400 human resource departments nationwide, 78 percent of the employers reported changes to their human resources policies affecting everything from work schedules to pay increases. A majority of the employers (53 percent) reported wage freezes, and the average merit pay increase was 1.5-2 percent -- far lower than in prior years.

This paper discusses some of the legal issues surrounding the measures available to employers for restructuring and resizing the workforce, particularly in California. These measures include: hours reduction, pay and benefits reductions (including management of PTO and paid vacation accrual), temporary shut-downs, early retirement programs, as well as layoffs. In Attachment A, the authors have summarized for California employers some of the major considerations relating to these workforce measures.

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What Can An Employer Do?

Reduce Payroll by Reducing Working Hours and/or Pay Rates

The flexibility to reduce an employee's work schedule and thereby reduce payroll varies between exempt and non-exempt employees.² Employees are presumed to be non-exempt, and therefore subject to minimum wage, overtime and meal and rest break laws. The employer bears the burden of overcoming this presumption.

Non-exempt employees are paid based on the number of hours worked. In contrast, exempt employees receive a fixed salary, which does not vary based upon the time it takes to perform their assigned duties. Exempt employees do not earn overtime wages, nor do they enjoy the protections of meal and rest break laws.

Both Federal and State laws require that in order to be exempt, the employee must be paid a salary that meets or exceeds a certain fixed sum. Federal statutes and regulations use a fixed weekly salary. California law requires that the monthly salary equal or exceed a sum not less than two times the current state minimum wage, i.e. currently \$33,280 per year.³ In the case of "computer professionals", the annual base salary must be \$75,000 per year or more, or they must earn not less than \$36 per hour, in order to be considered exempt from overtime.⁴ In addition, exempt employees must spend the predominant part of their working time performing duties that meet the standards of administrative, managerial, professional or computer professional exemptions.⁵ The nature of recognized exemptions and the duties that qualify for each of these exemptions varies between state and federal laws.⁶

Companies may elect to reduce the working hours of some or all of their non-exempt employees. Because non-exempt employees are only paid for the time worked, reductions in working hours correlate directly to a reduction in payroll. For example, a company may decide to reduce the number of hours that non-exempt employees regularly work from 40 hours per week to 32 hours per week, and thereby reduce payroll expenditures by 20 percent. Such reductions may be achieved by reducing the number of hours worked each day and/or by reducing the number of working days in the work week, or in the month.

The Federal Fair Labor Standards Act (FLSA) allows for reductions in the working hours of exempt employees and a proportionate reduction in salary without jeopardizing the exempt status of the employee. Until recently, however, opinion letters issued by California's Division

² The determination of whether an employee is exempt or non-exempt is extremely fact-intensive and subject to extensive litigation in both state and federal courts. The criteria vary considerably depending upon the place of employment. Information regarding the criteria for establishing exemptions under California law can be found in the California Department of Industrial Relations' Industrial Welfare Commission's wage orders at <http://www.dir.ca.gov/iwc/wageorderindustries.htm>. Employment counsel in the jurisdiction where the employee is working should be consulted for assistance in any particular situation.

³ California Labor Code § 515.

⁴ Labor Code § 515.5(4), as amended by AB 10 effective January 1, 2009.

⁵ In California, the recognized exemptions are identified in Labor Code § 515.5.

⁶ For example, there is an "outside salesperson" exemption under Federal law, but no such distinct exemption exists under California state law.

of Labor Standards Enforcement (DLSE) suggested that such practice would violate the California Labor Code provision requiring exempt employees be paid a fixed monthly salary regardless of the hours worked. On August 19, 2009, recognizing the economic difficulties that California employers currently face, the DLSE issued an opinion letter⁷ stating that employers may *temporarily* reduce the salaries of their exempt employees along with a matching reduction in work schedules during periods where the employer operates shortened workweeks due to economic conditions, without the presumption that such a change destroys the exempt status of those employees.

As a result, California employers may, for example, temporarily reduce employee salaries by 20 percent and implement a temporary four-day workweek, without calling into question the exempt status of the employees. However, the reductions must be due to economic conditions, be temporary in nature, and employers must still pay the employees' full salary in any week in which they perform work. Most importantly, the post-reduction base salary must still meet the minimum threshold established for the exemption, i.e. an amount equal to twice the minimum wage, or in the case of computer professionals, either \$36/hour or \$75,000/year. Failure to meet these criteria can result in the loss of exempt status for the employee, and the obligation of the employer to pay overtime if the employee works more than eight hours in a single workday or forty hours in the workweek.

Employees must be paid for all time worked, and cannot be made to forego payment after they have already provided their services. Accordingly, employees should be given notice of reductions to hours or compensation before they work the time. In the case of non-exempt employees, this means prior to the start of the workday. For exempt employees, this means prior to the start of the pay period.

Companies may also elect to reduce the pay rates of both non-exempt and exempt employees (without a correlating reduction in work schedule) to achieve a direct reduction in payroll. Such reductions may be achieved by prospectively reducing the regular salaries or hourly rates of pay for employees. However, the reductions must not result in the pay rates for non-exempt employees falling below the applicable minimum wage⁸. In addition, as discussed above, exempt employees' salaries must not be reduced below two times the current state minimum wage in order to avoid destruction of the exempt status.

When electing to reduce the working hours or pay of employees, companies must keep in mind that such actions are considered "employment actions" for purposes of various state and federal laws prohibiting discrimination, harassment or retaliation. State and Federal Equal Pay laws, Title VII of the Civil Rights Act, the Age Discrimination in Employment Act, and the Americans with Disabilities Act, as well as, the California Fair Employment and Housing Act require that hour or pay reductions be implemented in a non-discriminatory manner. In order to

⁷ No. 2009.08.19. The full text of the opinion letter can be found at <http://www.dir.ca.gov/dlse/opinions/2009-08-19.pdf>.

⁸ As of January 1, 2010, the California minimum wage is \$8 per hour. It should also be noted that some cities and counties have minimum wage requirements greater than the California minimum wage. For example, as of January 1, 2010, the minimum wage for employees working in the City and County of San Francisco is \$9.79 per hour. Employers should review local ordinances carefully and adhere to any applicable minimum wages in excess of the state minimum wage.

avoid and/or defend claims of discrimination, employers should document the financial hardship(s) that necessitated the reduction as well as the legitimate, non-discriminatory reasons for selecting certain employees (and not others) for reductions prior to implementing the reduction.

For example, an employer who reduces the pay of married female employees but not male employees – on a theory that married women can better afford to work for less money, would be engaging in intentional discrimination on the basis of gender or marital status. If the reduction results in a woman who performs the same job, and has the same skills and qualifications as a man, being paid a lower amount, there may be liability under the Equal Pay Act. Similarly, an employer who ties the amount of pay reduction to productivity might create a discriminatory impact against employees who took time off from work due to disability, pregnancy or other protected leave of absence.

Employers must also remain aware of wage and hour laws when implementing hours or pay reductions for non-exempt employees. The rate of pay cannot fall below the applicable minimum wage for non-exempt employees. Pursuant to California Labor Code Section 512, non-exempt employees working more than five hours per day must be provided a meal period of not less than 30 minutes⁹, even though they now work a reduced schedule.

Additionally, (subject to limited exceptions) reporting time pay requirements remain in effect pursuant to Section 5 of the California Industrial Welfare Commission Wage Orders. Reporting time pay generally applies when an employee reports to work at the scheduled time but is given no work or is given less than half of the scheduled day's work. Pursuant to the California Industrial Welfare Commission Wage Orders, the employee must be compensated for reporting time pay for half of the scheduled hours with a minimum of two hours and a maximum of four hours reporting time pay.

Further, the ability to alter the rate of pay or hours worked may be limited by contract or other legal obligation. The contract may consist of a collective bargaining agreement, or an individualized employment contract. In a recent unpublished California Court of Appeals case¹⁰, the court found that where the employment contract provided for an annual bonus and could be modified only by writing, the employer could not unilaterally eliminate the bonus compensation without the employee's written agreement.

Employers should also consider executive employment agreements, which frequently provide that a salary reduction below a certain level constitutes a "constructive" termination of employment which triggers a severance payment, benefits, stock options, and/or accelerated vesting schedules. Prevailing wage statutes, or a representation by the employer to pay the prevailing wage in support of the employee's visa application, will also limit the ability of the employer to pay less than that prevailing wage.

⁹ However, under California Labor Code Section 512, if an employee's total work period for a day is not more than six hours, the mandatory meal period may be waived if mutual consent of both the employee and the employer exists and there is a writing signed by both memorializing the same.

¹⁰ *Shiring v. Certified Alloy Products* (Fourth Appellate District, 12/17/09).

Temporary Shutdowns

Furloughs and temporary shutdowns are increasingly used as a means of coping with the economic downturn. A furlough is generally considered to be an involuntary leave of absence from work, with a definite date of return. If, however, an employee is “furloughed” for more than 10 days without a definite date of return, the employee may be considered “terminated” for purposes such as eligibility to receive full unemployment benefits. Similar to a furlough, a temporary shutdown occurs when the entire business operation or facility is closed for a defined period (a day or a week).

A furlough or temporary shutdown is an easily managed and effective means to reduce costs for an employer that employs large numbers of non-exempt employees (who need not be paid for furlough or shut down days). Where, however, exempt employees will be affected by furlough or shutdown, careful consideration must be given to the weekly salary rules discussed above in connection with pay reductions.

Federal law requires that exempt employees be paid their full week salary without reduction even where only a partial week is worked. Accordingly, many employers have scheduled furloughs or shutdowns that last an entire workweek. Other employers implement temporary shutdowns on a regular schedule (e.g. every other Friday) and reduce salaries by a proportionate amount, in order to avail themselves of the recent DLSE opinion letter discussed above.

A more troubling issue for California employers has arisen when an employer wants to reduce its liability for accrued but unused vacation by mandating that employees use accrued vacation or paid time off during the furlough or shut-down period. Recent cases and opinion letters have made clear that so long as the employee receives his or her full week’s salary, it does not matter if the pay is for time worked, vacation, or a combination thereof. Several years ago, a DLSE opinion letter required that employers provide not less than nine months advance notice of any required use of vacation or PTO during a shut-down. A more recent DLSE opinion letter required only adequate notice, and found that 90 days notice was sufficient.

The mandatory use of vacation or PTO during a furlough or shutdown is complicated where an exempt employee did not have adequate accrued vacation or PTO to provide a full-week’s pay. In order to avoid jeopardizing the employee’s exempt status, many employers require that exempt employee use vacation or PTO only to the extent it provides a full week’s pay or advance to the employee a couple of extra days of vacation or PTO so that an entire week is taken off with pay.

Work Sharing Versus Partial Unemployment under CA Unemployment Insurance Code

Employers that implement temporary shut-downs, furloughs, or reductions to work schedules are frequently asked by affected employees about the availability of unemployment benefits. In California, such benefits are administered by the Employment Development Department (EDD). There are two distinct types of benefits that may apply: partial unemployment and work share.

The California Work Sharing program, created in 1978, was the first of its kind. The program was designed to be a temporary alternative to layoffs. It allows employees to collect

unemployment insurance benefits for the reduced hours. The Employment Development Department (“EDD”) provides a practical illustration of the program:

Due to an economic downturn, an employer with 100 employees finds it necessary to lay off 20 employees. However, rather than lay off these employees, the employer participates in the Work Sharing program. The employer keeps all 100 employees on the payroll but reduces their workweek from five days to four days, thereby achieving the same desired 20 percent reduction in payroll. All 100 employees continue to earn wages for four days and also are eligible for Work Sharing benefits for the fifth (nonworking) day. The employer retains all trained staff and, when business improves, the employees resume their five-day work schedule.

Work Sharing Program	Partial Unemployment
Enables employers to keep trained staff during periods of slow business and avoid layoffs.	
Employers must have at least two employees participating in the program.	No minimum number of participating employees.
Participating employees must have hour and wage reductions of at least 10 percent.	Employers must have temporarily reduced working hours (and employee’s gross earnings, less the greater of \$25 or 25 percent, resulting pay must be less than the weekly unemployment benefit amount).
Work sharing does not provide for furloughs.	Employers may also use the partial program if employees are furloughed for no more than two consecutive weeks (if the furlough lasts more than two consecutive weeks, the employee must claim general unemployment benefits).
Employers must complete DE 4581WS for each work sharing week.	Employers must complete the first portion of DE 2063.
Employers must issue form DE 4581WS to participating employees within 14 calendar days from the week ending date.	Employers must issue form DE 2063 to employees by the 5th day after the end of the payroll week in which the employer reduced hours (employer should also advise employees to call the EDD and file a claim for unemployment benefits immediately).
Employees must complete and submit DE 4581WS to the EDD within 14 calendar days from the date it was issued by the employer.	Employees must file a claim, complete the claimant sections of form DE 2063, and send the form to the EDD within 28 days from the date it was issued by the employer.

Reduce Benefits

Benefits offered and/or provided to employees span a broad range, from health insurance to paid time off, and represent significant expenses for employers. Even without the employer mandates that are currently the subject of Congressional debate, many employers have paid for or subsidized health care benefits for their employees. Aside from the immediate cash expenses for such benefits, paid time off and guaranteed severance compensation are unfunded liabilities that many employers carry. For example, if an employee receives paid vacation, the California employer is obligated to consider the accrued but unused vacation time an earned wage, which is payable upon termination, and thus carried as a liability of the employer.¹¹

Many employers are considering or have already reduced benefit plans as a cost cutting measure. Some of the most common benefit cuts include: freezing future bonus and/or commission plans, freezing future vacation accrual, reducing the rate of future vacation accrual, imposing vacation accrual caps, freezing vacation use, converting paid time off plans to separate vacation and sick leave plans, eliminating employer sponsored 401(k) plan matches, terminating or reducing the contributions by the employer to health insurance coverage, and eliminating guaranteed severance policies. While California employers are not currently required to provide any of the aforementioned benefit plans¹², changing or eliminating existing benefits triggers a host of legal concerns for employers.

Similar to pay rate reductions, changes to or elimination of benefit plans can only act prospectively. Thus, if an employee earned a 30 percent commission or bonus on sales closed in the 3rd quarter, payable the first regular payday of the following quarter, the employee must be paid the commission as agreed. The employer cannot simply decide at the start of the next quarter that it will pay a lower percentage or dollar amount because its overall profits are not as good as anticipated. In this situation, the commission or bonus would be considered wages earned that cannot be forfeited. Although the company is free to define the conditions under which incentive compensation is deemed earned, if the company wants to change the amount of commission or bonus paid, it must communicate the change to employees before they perform the work or provide the services for which the commissions or bonuses are earned.¹³

Similarly, earned and/or vested vacation leave cannot be forfeited. For example, if an employee has 200 hours of accrued but unused vacation time the employer cannot simply decide to eliminate the vacation accrual balance, or impose a “use it or lose it” policy. The employer may eliminate or reduce the rate of future vacation accrual, but, as accrued vacation is considered an earned wage, it cannot be forfeited.

¹¹ Cal. Labor Code § 227.3.

¹² Congress has yet to pass a final version of health care reform legislation. Both the House and Senate have passed widely divergent forms of such legislation. Significantly, each of these bills mandates that at least some employers (e.g., those with 50 or more employees in one bill) provide some form of health insurance coverage to their employees. Before eliminating or reducing their participation in employee health care, employers should carefully consider new obligations that may be implemented.

¹³ *Schachter v. Citigroup, Inc.* (2009) 47 Cal.4th 610 (incentive compensation is a form of wages, but it can be made subject to specified conditions and is not earned until such conditions are fulfilled).

Employers can limit the vacation liability by imposing a cap on how much vacation employees can accrue (e.g. employees who earn two weeks paid vacation per year, will cease accruing additional vacation if they have three weeks or more of accrued but unused vacation). According to a California DLSE opinion letter dated July 25, 1998, employers may only impose a vacation accrual cap if employees are given a reasonable amount of time to use their accrued vacation time before the cap prevents them from earning additional vacation time. California DLSE opinion letters and interpretations have stated that vacation accrual caps that are at least 1.5 times the vacation accrual rate are reasonable. However, reasonability may vary depending upon the nature of the business. An employer that prohibits vacation use during the “busy season” or freezes vacation use to conserve cash, may be found to have rendered its vacation accrual cap unreasonable because employees were denied the opportunity to use accrued vacation altogether for significant periods before the cap prevented them from earning additional vacation.

Employers must also consider notice requirements when altering or eliminating benefits. Many benefit plans are governed by ERISA, such as health insurance plans, 401(k) plans, and guaranteed severance policies which require some level of management administration. Welfare benefit plans are governed by ERISA’s reporting and disclosure requirements, and fiduciary responsibility standards. Although an employer has the right to terminate an ERISA governed-plan, “the broad fiduciary responsibilities imposed by ERISA require a plan administrator to provide timely notification to employees of termination of their benefits.”¹⁴ The definition of “timely notification” varies. As an example, there is a 60-day deadline for notification of a material reduction in a group health plan.¹⁵ In terminating other types of benefits, such as severance plans, “timely notification” may consist of prompt notification after a change has been effectuated; and in other circumstances may require prior notice so that employees may purchase replacement coverage or consider alternative employment.¹⁶ In addition to statutorily-required notice requirements, employers must also consult their plan documents and/or policies. Plan documents that require advance notice of modifications or reductions in benefits must be followed, even if the notice requirements exceed those under federal or state law.

Early retirement or voluntary separation program

Many employers have implemented early retirement or voluntary separation programs prior to or as an alternative to involuntary lay-offs. By affording employees the opportunity to elect to terminate employment, generally in exchange for an enhanced retirement or severance payment, an employer can decrease its risks of claims for discrimination or breach of contract. Voluntary separation programs, where the employee has the choice to terminate employment, do not require advance notice under Federal or State WARN statutes, discussed further below. Most employers prudently require employees volunteering for early retirement or voluntary separation to confirm the election in writing, and if they are receiving additional severance or other monetary benefits to which they would not otherwise be entitled, to sign a release of claims.

¹⁴ Peralta v. Hispanic Business, Inc., 419 F.3d 1064 (9th Cir. 2005).

¹⁵ 29 U.S.C. §1024(b)(1).

¹⁶ See Peralta v. Hispanic Business, Inc., *supra*, 419 F.3d 1064

Voluntary programs shift control of the restructuring from the employer to the employees. The employer cannot accurately predict how many and which employees will choose to participate in the program. Frequently, the most valuable employees are those who are most likely to secure new employment. An employer may lose some of the more experienced or productive employees, or those who are cross-trained to perform a range of roles, who it would most rely on to continue operations with a reduced workforce.

Another important factor to consider when deciding to implement a voluntary program is the potential for over-acceptance. To protect against the damaging effects of losing too many key employees, employers should carefully define the maximum number of employees (with specific caps for departments and job functions) who are permitted to volunteer for the program.

In deciding the parameters of any voluntary program, it is important for the employer to consider the terms of existing employment contracts, retirement plans, policies and past practices within the company. Offering voluntary separation without a complete understanding of existing obligations, or whether such separation will trigger severance obligations, can result in unanticipated costs. Further, without careful legal review of the voluntary program and the criteria for eligibility, the employer may unwittingly create liability for discrimination claims (particularly under the Age Discrimination in Employment Act “ADEA”) or trigger the onerous tax burdens and risk of penalties under Section 409A of the Internal Revenue Code. As discussed further below, Section 409A applies to many forms of deferred compensation, including severance payments.

Layoffs

Despite the implementation of other cost-cutting measures, many employers have found that they must reduce their workforce. Where a layoff is the result of bona-fide economic reasons and implemented through a non-discriminatory selection process, many courts have held that the layoff is legally supportable. Further evidence that the layoff was carried out in good faith exists where efforts are made to place employee in another available position and the eliminated job was not filled by new hire.¹⁷

Where, however, the employer selects employees for impermissible reasons, such as membership in a protected class or in retaliation for engaging in protected activity,¹⁸ or fails to follow its own policies and procedures, a layoff can become a source of significant legal liability. Merely claiming that a termination was due to a layoff will not protect the employer.¹⁹

In California, selection for layoff based on highest rate of pay creates a presumption of age discrimination.²⁰ Selections based upon absenteeism or productivity numbers may

¹⁷ See, e.g., *Clutterham v. Coachmen Indus.*, 169 Cal.App.3d 1223.

¹⁸ See, e.g., *EEOC v. Go Daddy Software, Inc.* (9th Cir. 2009) 581 F.3d 951 (\$400,000 verdict in favor of Muslim employee when jury found he had been selected for layoff based on retaliation for having complained of discrimination).

¹⁹ See, e.g., *Sasco Electric v. Fair Employment and Housing Commission* (2009) 176 Cal.App.4th 532 (female employee “laid off” five days after announcing her pregnancy awarded back pay, \$85,000 in emotional distress damages and the employer is fined \$25,000 for contriving a layoff defense to hide their discriminatory intent).

²⁰ Cal. Government Code § 12941.

discriminate on the basis of work-related injury, disability, pregnancy or family medical leave. If an employer had been engaged in active efforts to diversify the racial composition of its workforce, “last hired/first fired” selection criteria may reverse diversity measures and adversely impact ethnic minorities.

It is, therefore, important that employers consider the impact of layoff selections on protected classes in the workforce. In order to answer the question of whether or not a particular protected class (e.g. females, employees over the age of 40, Hispanics, etc.) are over-represented among the workers selected for layoff, employers will conduct an EEO statistical analysis. This analysis uses one or more statistical tests (such as Chi-Square or Fisher’s Exact Test) to compare the number of employees selected for layoff as compared to the number who are not. There are separate comparisons run based on protected classifications such as age, gender, ethnicity or national origin. The statistical test used depends on the size of the workforce or workgroups that are being analyzed.

If these tests show that there are more members of the protected class included in the layoff than would result from mere operation of chance, there is a “statistically significant” disparate impact on that protected class. Statistically significant results do not bar a layoff; but require that the employer demonstrate legitimate, non-discriminatory business reasons for selection. For example, if the selection is skills and performance based, the employer can present the resumes and performance reviews of the employees who are being compared to show that the selection was based upon legitimate non-discriminatory factors.

An employer that fails to follow established layoff processes may also be liable for breach of contract. Written personnel documents covering termination of employment or constituting reduction-in-force guidelines could constitute specific contractual obligations that the employer had imposed upon itself.²¹

Legal Considerations in Restructuring

Federal and State WARN Acts

Faced with financial crisis, an employer may be compelled to layoff a large portion of its workforce or close an entire location. In these instances, it is crucial that the employer understand and seek advice on the implications of the Federal Worker Adjustment and Retraining Notification (“WARN”) Act²² and any applicable state statute that provides for advance notice of mass layoffs and/or plant closings. The Federal statute requires 60 days advance notice of a “mass layoff” or plant closure that affects at least 33 percent and 50 or more employees at a single site of employment for employers of 100 or more employees. Many states have enacted similar statutes. California’s version of the WARN Act, applies to any employer that ceases commercial operations at or lays off 50 or more employees from a single site which employed 75 or more employees within the prior 12 month period.²³

²¹ Guz v. Bechtel National, Inc. (2000) 24 Cal.4th 317.

²² 29 U.S.C. § 2101 et seq.

²³ Cal. Labor Code § 1400 et seq.

The Federal and California versions of the statutes both provide that whichever statutory scheme provides the greater benefits to the employees will apply. Thus, the employer must consider the applicability of both statutes separately to its particular situation. Some of the key differences between the two statutes are summarized below:

Federal WARN	California WARN
Employers with 100 or more full time employees (who must have been employed for six of the preceding 12 months).	Employers with 75 or more full or part time employees (employed for six of the preceding 12 months).
Employers must provide written notice 60 days before a plant closing or mass layoff.	Employers must provide 60 days notice prior to a plant closing, layoff or relocation.
Plant closing affecting at least 50 employees during a 30 day period, layoffs of 50-499 full-time employees (constituting at least 33 percent of the full-time workforce) at a single site of employment, or layoffs of at least 500 employees require notice.	Plant closing, layoff, or relocation of at least 50 employees during a 30 day period (regardless of percentage). Relocation is more than 100 miles away.
Employers that violate WARN may be liable to each employee for up to 60 days of back pay and benefits.	Employers that violate WARN may be liable for a \$500 per day penalty, back pay of up to 60 days to each employee (at the higher of the employee's final rate or three year average), and the cost of any medical expenses incurred by employee that would have been covered by benefits plan.
Notice not required in certain circumstances, such as, a transfer to an alternate site within a reasonable commuting distance or closure due to unforeseeable business circumstances or natural disaster.	Notice not required in certain circumstances, such as completion of a particular project (i.e., motion picture, construction, drilling, logging and mining industries), seasonal employment, physical calamity or act of war necessitates the action taken, and under the faltering company exception.*

*Under the California WARN Act, a faltering employer may be exempt from WARN notice. If a company is actively seeking new capital or business to save it from going under and giving WARN notice would prevent the company from obtaining new capital or business, then the company could be exempted from giving such notice. An employer that seeks to claim such exemption must have documented proof of its efforts to attract investors or obtain business, and immediately following the closure, seek a determination from the DLSE that the exemption applies.

Claims under the WARN Acts can follow an employer into a bankruptcy proceeding. Employees can file claims in the bankruptcy for pay and benefits for up to 60 days. To the

extent that the WARN notice period had not expired prior to the commencement of the bankruptcy, the WARN payments may be considered “administrative expenses” and be paid before many creditors. Alternatively as wage claims, WARN payments enjoy a priority over other unsecured claims. Further, under certain circumstances if the employer’s assets are not sufficient to cover the WARN claims, then individual directors, officers, and shareholders may be held personally and individually liable.²⁴

Severance Agreements and Releases

Whether the separation from employment is the result of the employee’s choice to participate in a voluntary separation program or an involuntary layoff, many employers will seek to avoid any resulting litigation and liability by obtaining the employee’s release of claims in exchange for a severance payment. Severance and release agreements commonly address:

1) The last day of employment. Setting the termination date affects other rights such as the tax treatment of any severance payments (discussed further below), loss of eligibility for insured benefits, end of stock vesting and beginning of post-termination period to exercise stock options, and the start of applicable statute of limitation periods.

2) Whether the separation is voluntary or involuntary, which declaration may affect the employee’s rights under other agreements such as stock option or benefit plans.

3) Amounts of money that the employee has or will earn through employment as of the effective date of separation, and the nature, amount and timing of any additional payments anticipated (e.g. vacation accrual, commissions, expense reimbursements).

4) The nature, amount and timing of any additional payments or benefits that the employee will receive as “severance,” and if it is paid as consideration for a release, the fact that it is not an amount of money already owing to the employee as wages, salary or compensation for services.

5) A release of claims and covenant not to sue by the employee. Some of the provisions in an enforceable release are:

(a) The scope of the release can apply only to claims based upon occurrences as of or prior to the date the agreement has been signed;

(b) The release cannot apply to workers’ compensation, unemployment or wage claims (for amounts already earned), or in California, the employee’s right to be indemnified for third party claims based upon the employee’s actions pursuant to the employer’s directions;²⁵

(c) In California, a general release of claims “known or unknown, suspected or unsuspected” will be void unless accompanied by an express and knowing waiver of the rights under California Civil Code § 1542;

²⁴ Boucher v. Shaw (9th Cir. 2009) 572 F.3d 1087.

²⁵ Edwards v. Arthur Andersen LLP (2008) 44 Cal.4th 937.

(d) If the release applies to claims the employee may have under various employment-related statutes such as Title VII, the Family Medical Leave Act, reference should be made to those statutes by name;

(e) If the release extends to claims under the federal Age Discrimination in Employment Act, the release must refer to and comply with the Older Workers' Benefits Protection Act and the written agreement must state:

(i) The employee's understanding that by signing the agreement employee is releasing any claims of age discrimination that employee has under the Age Discrimination in Employment Act (written in plain English);

(ii) That the employee has been advised that employee may seek an attorney of employee's own choosing to advise employee with regard to signing the release;

(iii) The employee has 45 days to review the release before signing, and if signing in a shorter time, employee is doing so voluntarily;

(iv) The employee has seven days to revoke employee's signature after signing, the means by which the revocation may be accomplished, and the fact that if revoked the severance payments described in the release will not be paid;

(v) The fact that the release does not extend to things that have not yet occurred; and

(vi) The amount paid as consideration for the release is not otherwise owing to the employee; and

(f) The release and any consideration are in settlement of actual or potential claims and may not be used as an admission of fault or liability by any person.

6) Any post-separation obligations of the employee, such as:

- Return of company property
- Continuing obligations with regard to proprietary information or inventions, non-solicitation of employees or customers
- Cooperation with ongoing litigation in which the employee is a witness, and how the employee will be compensated (if at all)
- Refraining from making unauthorized statements about the company
- Non-competition (if enforceable).

7) Any post-separation obligations of the employer, such as:

- References
- Defense or indemnification for third-party claims
- Continuing obligations under stock option, benefit or retirement plans.

8) Any mechanism for resolution of disputes (e.g. binding arbitration).

Internal Revenue Code Section 409A and Termination Payments

Section 409A of the Internal Revenue Code permits the deferral of taxation on benefits provided under a nonqualified deferred compensation plan only if the plan imposes certain restrictions on the distribution of benefits and the employee makes a timely election as to the form and time of payment. On April 10, 2007, the IRS issued final regulations under Section 409A, which became effective January 1, 2008. These regulations specifically discuss the applicability of this statute to “separation pay arrangements.”

In structuring any severance payments to employees who are participating in a voluntary separation program or affected by a layoff, the employer should insure that the requirements of 409A are met or that the payments are timed in such a way that they are excluded from applicability of the statute. Failure to do so can result in all amounts deferred being considered taxable income in the year in which the separation from employment occurred – thereby increasing the tax liability of the employee and creating a risk that the employer under-reported its payroll tax obligations for that year.

Separation payments are frequently timed to take advantage of the “Short-term Deferral Exception” to Section 409A, whereby payment due to involuntary termination, which is made prior to March 15 of the year following the year in which the separation occurred will not be deemed to be deferred compensation. There is a further exception for separation pay that is paid not later than December 31 of the second calendar year following the calendar year in which the separation occurs, provided that the separation pay does not exceed two times the lesser of : (i) the sum of the employee’s annual compensation for services provided to the employer and the employee’s net earnings from self-employment for services provided to the same employer as an independent contractor for the calendar year preceding the calendar year in which the separation from that employer occurred; or (ii) the maximum amount that may be taken into account under a qualified plan pursuant to Section 401(a)(17) for such year.

Section 409A also provides that certain payments at separation are excluded from gross income, and remain deductible business expenses of the employer. These include: reasonable outplacement expenses, reasonable moving expenses directly related to termination, certain medical expenses paid by the employee, certain in-kind benefits, and other expense reimbursements (e.g. legal or accounting services) not exceeding \$5,000 in the aggregate.

It should be noted that there is a special aggregation rule for separation pay arrangements – all amounts deferred with respect to a particular employee under all separation pay arrangements of the employer due to involuntary termination or participation in a voluntary program are treated as if deferred under a single plan. Further, Section 409A requires that the separation pay arrangement must be written and must contain all of the material terms of the arrangement, including the amount (or the method or formula for determining the amount) of deferred compensation to be provided and the time when it will be paid.

This highly simplified summary of Section 409A cannot substitute for legal advice from a tax expert familiar with this complex statutory scheme. If an employer plans to pay money over time to an employee who is separating from employment or significantly reducing employee’s working time with the employer, the employer and the employee should seek legal advice.

Conclusion

In the face of a recession that has extended over two years, employers have restructured their workforces through a variety of measures. While some of the recent statutory and administrative law changes have increased the flexibility given to employers to use reduced work schedules or offer work-share programs, there are a significant number of Federal and state laws that can create liability for the employer that does not carefully consider them. Employers also need to re-examine their own written policies and procedures, to ensure that they are consistent with the current business needs and actions.

EMPLOYMENT ACTIONS AND EMPLOYER RESPONSIBILITIES

	CA WARN	FEDERAL WARN	NOTICE	UNEMPLOYMENT	FINAL PAY	COBRA	VACATION/PTO
LAYOFF	Yes. For employers with 75 or more full time employees, where 50 or more employees at a single site of employment are laid off in a 30-day period.	Yes. For employers with 100 or more full time employees, where 50 to 499 employees consisting of at least 33 percent of the workforce at a single site of employment or 500 or more employees are laid off in a 30-day period.	Yes. 60-days written notice is required if CA WARN or Federal WARN are triggered.	Yes.	Yes. Final pay is due at the time of termination including all accrued but unused vacation and/or PTO time.	Yes. CAL COBRA and COBRA apply to qualified employees. In addition, the American Recovery and Reinvestment Act of 2009 COBRA subsidy applies to qualified employees and requires employers to pay 65 percent of the premiums for 9-months.	Yes. All accrued but unused vacation and/or PTO is due to the employee at the time of termination.
HOURS REDUCTION	No.	Yes. If employees at a covered employer experience a reduction of hours of 50 percent or more in each month in any six-month period.	Yes. 60-days written notice is required if Federal WARN is triggered.	Maybe. Depending on the amount of the hours reduction, employees may be eligible for partial unemployment or work share unemployment benefits.	No.	No.	No.

EMPLOYMENT ACTIONS AND EMPLOYER RESPONSIBILITIES

	CA WARN	FEDERAL WARN	NOTICE	UNEMPLOYMENT	FINAL PAY	COBRA	VACATION/PTO
VACATION CAP	No.	No.	No. However, a vacation cap change cannot be implemented retroactively and the best practice is to provide advanced written notice to employees.	No.	No.	No.	Yes. Employees should be given a reasonable amount of time (generally nine months) to bring their vacation/PTO accrual balance below the new accrual cap.
VACATION ACCRUAL CHANGE	No.	No.	No. However, a vacation accrual change cannot be implemented retroactively and the best practice is to provide advanced written notice to employees.	No.	No.	No.	No.
VACATION/PTO FREEZE (USE OR ACCRUAL)	No.	No.	No. However, a vacation use or accrual freeze cannot be implemented retroactively and the best practice is to provide advanced written notice to employees.	No.	No.	No.	Yes. The vacation/PTO use or accrual freeze must be applied uniformly. In addition, employees should be allowed to use sick or PTO time for absences due to illness with a doctor's note.

EMPLOYMENT ACTIONS AND EMPLOYER RESPONSIBILITIES

	CA WARN	FEDERAL WARN	NOTICE	UNEMPLOYMENT	FINAL PAY	COBRA	VACATION/PTO
BENEFITS CHANGE	No.	No.	Maybe. Benefit plans covered by ERISA such as health care benefit plans and retirement plans require 60-days written notice of any material change in coverage.	No.	No.	Maybe. If an employer discontinues its health care benefit plan, COBRA continuation coverage may also cease.	No.
TEMPORARY SHUTDOWNS (ROLLING SHUT DOWNS/ SHUT DOWN DAYS)	No.	Yes. If employees at a covered employer experience a reduction of hours of 50 percent or more in each month in any six-month period.	Yes. 60-days written notice is required if Federal WARN is triggered.	Maybe. Depending on the amount of the hours reduction and the length of the shut down, employees may be eligible for regular unemployment benefits, partial unemployment benefits, or work share unemployment benefits.	No.	No.	No.
MANDATORY USE OF VACATION/ PTO	No.	No.	Yes. If the employer mandates the use of vacation or PTO during mandatory time off, employees must be given reasonable notice (previously interpreted as 90-days notice).	Maybe. Depending on the amount of employees' vacation/PTO accruals and the length of the time off, employees may be eligible for regular unemployment benefits or partial unemployment benefits.	No.	No.	Yes. If the employer mandates the use of vacation or PTO during mandatory time off, employees must be given reasonable notice (previously interpreted as 90-days notice).