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In these tough economic times, employers are faced with difficult decisions when trying to reduce operating expenses. Employers are looking for lawful alternatives short of laying off employees. Options discussed in this ASAP include mandatory furloughs and reduced workweeks. Both options need to be implemented so as to avoid violating state and federal laws.

Furloughs and Reduced Hours: Cost-Cutting Strategies Other Than Layoffs

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

In these tough economic times, many employers have been compelled to let some employees go. Other employers need to cut costs but are looking for lawful alternatives to layoffs.

Employers do have some other options, as long as they structure those measures to avoid legal pitfalls. While employers may consider reducing employee salaries prospectively as the easiest way to save labor costs, such reductions often are rejected as too demoralizing for the workforce. Mandatory furloughs and reduced hours thus are the two most prevalent options considered by employers seeking to reduce labor costs without layoffs.

Mandatory Furloughs

Some employers may want to reduce overhead by shutting down all or part of their operations during slow times, such as for one or two weeks around holidays. Mandatory furloughs are a viable alternative to layoffs if implemented properly.

Effect on Status of Exempt Employees

Exempt employees under federal law and most state laws must be paid the same minimum salary for each pay period. Moreover, if an exempt employee performs ***any*** work during a workweek that exempt employee must receive his or her ***entire salary*** for that week. Failure to compensate an exempt employee for a week where any work is performed jeopardizes that employee's exempt status. However, if an employer furloughs an exempt employee for an ***entire workweek***, then no salary is owed for that full week and the employee's exempt status is not affected.

Absolutely No Work Permitted

When employees are furloughed, employers should expect that they will not work. With the advent of Blackberries, the ease of remote connections, and the use of voicemail, it

is likely that at least some exempt employees will—with the best intentions—check their voicemail, send an email, or otherwise conduct "work" while on furlough. But an exempt employee is entitled to pay for any workweek in which he or she performs any work. Stated another way, the employer may not make deductions from an exempt employee's predetermined salary for absences "occasioned by the employer" or caused by "the operating requirements of the business."

Employers should therefore inform employees that work is not authorized during the furlough period without advance written approval. Preferably, the discretion to authorize work during the furlough should be limited to one or two high-level executives to minimize the potential that exempt employees would respond to subordinates' requests to perform work during the shutdown and thereby be entitled to pay for the entire week. Moreover, depending on the nature of the business, work may not be appropriate except in the case of an emergency.

Mandatory Use of Vacation/PTO During Furlough

Some employees on a mandatory furlough will want to draw from their vacation or PTO to supplement their income. Similarly, employers often want to compel the use of vacation or PTO during a furlough in order to reduce the liability from the company's books. Employers may provide employees the option to use accrued vacation or may mandate its use, but applicable laws may restrict the employer's options.

Mandatory use of vacation has the advantage of saving the employer's resources by using up paid vacation. While federal law tends to permit this practice, not all state laws allow the employer the discretion to mandate use of vacation during a work furlough. In California, for example, "use it or lose it" vacation policies are prohibited, and "reasonable notice" must be provided before an employer can deprive an employee of accrued vacation or PTO. What constitutes "reasonable notice" has yet to be defined by the courts or the California Labor Commissioner. The latter once found that a full nine months notice was mandated and then argued that a fiscal quarter was the appropriate notice, but later withdrew both opinions. No court has yet to opine on the subject - except to note in the context of an employee seeking time off for personal reasons that no statute limits an employer's ability to control the scheduling of employee's vacations.[1]

Mandatory vacation use also raises issues when some employees do not have sufficient vacation accrued to cover the entire furlough. If exempt employees do not use vacation for the entire week and do some work during that week, then the employer could face liability for pay for the entire workweek or loss of exempt status for that employee. An employer can permit advances of vacation but will need to determine how its policy and the governing state law treat the negative vacation balances should some employees quit or be terminated before that advanced vacation pay is earned.

Many states require that the employee agree to—in advance—any deduction from wages upon separation from employment, including deductions for negative vacation balances. Other states simply forbid such deductions regardless of any agreements between employee and employer.

Voluntary use of vacation/PTO generally is the safest course for an employer to take. That way, if exempt employees want to be paid during a furlough, they have to voluntarily "burn" their PTO – without jeopardizing the employees' exempt status. If exempt employees choose NOT to utilize their PTO and they do not perform any work, the employees' exempt status is still protected, and the employer gets the added benefit of entirely avoiding the payment of the employees' salaries – a nice cost-saving measure in tough economic times.

What About the Union?

Employers considering mandatory furloughs—with or without compelled use of vacation or PTO—should also consider the impact of collective bargaining agreements (CBA)on these policies. Depending upon existing provisions of their CBAs, employers may have an obligation to bargain before implementing a furlough or requiring use of vacation or PTO during the furlough.

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Reduced Workweeks

What if the employer would rather reduce the work schedule and corresponding pay of all employees, including exempt employees, for example, by 20 percent or one day a week? Although the exempt employees would work some portion of the week, their pay has now been reduced. Clearly such a pay reduction would threaten the exempt status if the 20 percent cut brings the employee's salary below the required threshold amount—currently set at $455 per week under federal law (and higher in some states). An employer also may not deduct 20 percent of compensation from an exempt employee's paycheck during a *current* pay period based on a reduction in work time.

Can the employer reduce the pay and work schedule of an exempt employee for future pay periods if the employee receives at least the statutory minimum of $455 per week on this reduced schedule? The few courts that have considered the effect on exempt employees on a going forward basis have disagreed on the legality of such measures.

Ten years ago a federal district court in New York rejected an employer's attempt to direct exempt employees to work four-day weeks and to reduce salary by 20 percent.[2] But several other courts later found that an employer can make ***prospective*** reductions in an exempt employee's compensation with a like adjustment in scheduled hours to accommodate its business needs.[3] These courts reasoned that the governing federal regulations do not preclude *prospective* reductions that are implemented for future work periods, as opposed to *deductions* from pay for current or past work periods, which would not be legal.

However, even according to those courts who subscribe to the latter viewpoint, employers may not manipulate payments by "sham practices" such as routinely informing exempt staff of the work schedule for the following week and making prospective adjustments accordingly.

An employer considering reducing the compensation and schedules of exempt employees thus must weigh the legal uncertainties of this approach under federal law. In addition, the exempt status of employees who are forced by business slowdowns to work fewer hours may be jeopardized under applicable state law. Accordingly, the least risk is taken by either: (1) reducing pay of exempt employees *without dictating the hours they work* or (2) instituting occasional week long furloughs. Obviously this type of restriction seems counterproductive to the goal of retaining jobs and avoiding layoffs, but the nation's wage and hour laws are not focused on issues beyond pay practices.

Notification: When Do We Tell Employees?

If an employer decides to impose mandatory furloughs or reduced schedules, it should, of course, notify its employees in advance. While all states require advance notice, some specify the amount of notice for any reduction in compensation. For example, Missouri has a requirement of 30 days notice, while Maryland requires one pay period. Written notice is advisable to have a clear record of the information conveyed, even if state law does not require written notice.

In addition, employers must consider whether any employment agreement or applicable law requires not only specific written notice, but consideration for the modification to the terms of employment provided in that agreement. Even if the employees are governed only by employment policies that the employer reserves the right to terminate or modify, some states do not permit those modifications without the employees' express knowledge and consent. However, most states permit an employer to modify a unilateral employment contract—such as by reducing compensation—and deem that the employees' continued employment constitutes acceptance of the reduced compensation without any additional consideration.

In cases where furloughs are for longer periods or where work hours are cut significantly, employers should also be aware that federal WARN and some state WARN laws could apply. In most cases, the cut in hours would have to be 50% or more over a relatively lengthy period for such laws to apply. Nevertheless, employers taking significant actions should talk with counsel about WARN-related concerns.

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Best Practices

Employers should consider whether furloughs present a viable alternative to layoffs - thereby keeping more persons employed, maintaining institutional knowledge for the inevitable upswing in the economy, and reducing the likelihood of lawsuits or grievances. A few smart practices will assist in a smooth process:

- To reduce the risk of losing exempt status, furlough employees for full weeks that coincide with the workweek.
- Check potentially applicable contracts and collective bargaining agreements for possible requirements and limitations.
- Determine whether vacation or PTO must be used or may be used, and whether employees can borrow from yet-to-be-accrued vacation.
- Provide advance notice in compliance with state law.
- Inform all affected employees—including exempt employees—that no work is permitted during furlough, including checking email and voicemail.
- Centralize reporting of any emergency to one or two individuals who will determine whether to suspend the furlough for some or all employees.
- Consider all applicable state as well as federal laws.

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[1] *Conley v. Pacific Gas & Elec. Co.*, 131 Cal. App. 4th 260, 270 (2005).

[2] *Dingwall v. Friedman Fisher Assoc.*, 3 F. Supp. 2d 215 (N.D.N.Y. 1998).

[3] *In re Wal-Mart Stores, Inc.*, 395 F.3d 1177, 1189 (10th Cir. 2005); *Caperci v. Rite-Aid Corp.*, 43 F. Supp. 2d 83 (D. Mass. 1999).

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