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November 2008

FLSA Focus

WAGE AND HOUR PERILS OF LAYOFFS, REDUCED WORKWEEKS AND OTHER PAYROLL REDUCTION MEASURES

Today's difficult economic and financial climate has many companies considering various cost-cutting measures, including layoffs, reduced workweeks, pay reductions and voluntary furloughs. These actions raise wage and hour questions that often are overlooked. The unwary employer may reduce payroll costs but wind up with a wage and hour lawsuit as a result. The good news is that a well-informed employer can avoid such risks.

What Payroll Reduction Measures Are Available?

Reducing payroll costs can take many forms including:

- Involuntary layoffs, job eliminations and workforce reductions
- Temporary shutdowns during summer, holidays or other seasonal slow periods
- Voluntary furloughs
- Reduced workweeks
- Temporary or permanent reductions in salaries or hourly pay rates
- Elimination of bonus programs or other incentive compensation

What Are the Legal Considerations and Risks?

Employers contemplating any of these measures must carefully consider EEO implications to ensure that no protected class is singled out or disparately impacted. The WARN Act and similar state laws must also be considered. Employers should ensure compliance with any individual employment agreements and applicable company policies. Unionized employers must consider applicable collective bargaining agreements and bargaining obligations. Of course, employee relations issues must also be evaluated.

What often gets overlooked, however, are wage and hour considerations. As the storm of wage and hour litigation continues, it is extremely important to ensure that any payroll reduction measures comply with the Fair Labor Standards Act, as well as state wage and hour laws.

The main wage and hour risk associated with these cost-saving measures relates to exempt employees. Employees who are classified as exempt under the executive, administrative, and professional exemptions generally must be paid on a "salary basis" to remain eligible for the overtime exemption. This means that the employee must receive the same amount of pay each pay period (at least $455 per week under the FLSA) regardless of the quality or quantity of work performed. Making certain deductions or reductions to the employee's salary can result in the exemption being lost, not only for the affected employee, but also for other employees in the same job classification.

There are seven exceptions where salary deductions may be taken without jeopardizing the salary basis of pay and,

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hence, the exemption. These exceptions were explained in the July 2006 edition of *FLSA Focus*. They include full-day absences for personal reasons, sickness or disability.

As a general rule, an exempt employee's salary cannot be docked for an absence caused by the employer or the operating requirements of the business. The Department of Labor's ("DOL") regulations interpreting the FLSA put it this way: "If the employee is ready, willing and able to work, deductions may not be made for time when work is not available." So, if the operation is slow due to a struggling economy, the employer cannot tell exempt employees to stay home on Friday and then deduct a day's worth of pay from the exempt employee's salary.

The prohibition on salary deductions presents an obstacle to employers wishing to curtail payroll expenses via reduced workweeks, temporary layoffs, shutdowns and furloughs that impact partial workweeks.

Nonexempt employees do not pose the same problem. They have to be paid only for hours worked. So the employer may direct them to take Friday off, and the nonexempt employees need not be paid for the time off.

The prohibition on salary deductions presents an obstacle to employers wishing to curtail payroll expenses via reduced workweeks, temporary layoffs, shutdowns and furloughs that impact partial workweeks. Fortunately, there are ways to implement these payroll reduction measures without violating the wage and hour laws.

What Are the Solutions?

There are a number of steps employers may take to achieve payroll expense reduction without causing improper salary deductions.

Full Week Shutdowns. One way to avoid the salary deduction problem is to implement shutdowns, layoffs and furloughs in full workweek increments. Exempt employees do not have to be paid their salary for any workweek in which they do not perform any work. So closing for a full workweek at the holidays or during a slow seasonal period eliminates the risk of improper salary deductions. In this scenario, it is important to ensure that exempt employees do not perform any work, even from home, during the shutdown.

Reduce Pay in Connection with Adopting Formal Reduced Workweek Schedule. Another option is to formally adopt a reduced workweek schedule and adjust exempt employees' salaries commensurately. While the salary basis rule requires payment of the exempt employee's full salary in workweeks where work is performed, it is permissible for employers to implement a reduced workweek schedule and lower salaries accordingly. For example, an employer may announce to employees in November that it will be implementing four-day workweeks for the months of December and January due to slow operations, and at the same time inform exempt employees that their salaries will be lowered commensurately.

On the surface, this may seem akin to an impermissible salary deduction due to operating requirements of the business. After all, the employee is ready, willing and able to work—the employer simply is not making work available one day per workweek. Nevertheless, the DOL has approved this practice in a series of opinion letters, and courts have also upheld the practice. The idea is that a deduction is not being taken from the employee's salary. Rather, his salary has been set to match the shortened workweek.

The DOL has stated that a "fixed reduction in salary effective during a period when a company operates a shortened workweek due to economic conditions would be a bona fide reduction not designed to circumvent the salary basis payment." The key is to ensure that the reduced workweek/reduced

salary plan is clearly announced to employees before implementation. If an employer makes workweek and salary adjustments so frequently and haphazardly as to make the employee's salary a sham, and more akin to an hourly wage, the employer will risk losing the exemption for failure to pay a bona fide salary.

Reduce Pay Without Any Reduction in the Workweek. Absent contractual requirements that set salaries or wage rates, employers generally are free to set pay at whatever level they wish. Of course, nonexempt employees must be paid at least the minimum wage and time and one-half their regular rate for hours worked over 40 in a workweek (or over 8 hours in a day in some states), and exempt employees generally must be paid a salary of at least $455 per week. Beyond those minimum thresholds, employers have wide latitude in setting (or reducing) pay.

Thus, an employer faced with difficult economic conditions may implement pay reductions affecting both exempt and nonexempt employees. For example, an employer may announce to employees that pay is being reduced by 5% across the board, due to difficult economic conditions. Obviously, this won't help to win any "employer of the year" awards, and there are significant employee relations and employee retention issues to consider. But it is lawful.

Require Employees to Use Vacation Time and Paid Time Off. A common question employers ask is whether they can force employees to use their earned vacation and paid time off ("PTO"). The answer under the FLSA is yes.

For example, if the employer decides to impose a one-week shutdown because business is slow, it can require employees to use their earned vacation and PTO during the shutdown. This can also be done in single-day or even partial-day increments. The rationale is that the employee is receiving his or her full salary for the workweek, albeit portions are composed of vacation or PTO. In a 2005 opinion letter, the DOL explained:

> Since employers are not required under the FLSA to provide any vacation time to employees, there is no prohibition on an employer giving vacation time and later requiring that such vacation be taken on a specific day(s). Therefore, a private employer may direct exempt staff to take vacation or debit their leave bank . . . provided the employees receive in payment an amount equal to their guaranteed salary.

Likewise, in a prior opinion letter, the DOL stated that an employer may "make deductions from an exempt employee's leave bank for days when the employee is instructed by the employer not to report to work because of budgetary constraints."

Once the employee has used all of his or her vacation or PTO, then the employer must pay the full salary. This may mean that, in a total shutdown for a partial workweek, where the employer requires use of earned vacation, employees who already used their vacation will receive their full salary while those with vacation time remaining will be required to use vacation time for the days off.

Caution Advised. The practices discussed above are permissible under the federal Fair Labor Standards Act. However, state wage and hour laws sometimes impose different and more restrictive requirements. For example, California wage and hour law does not permit any employer to force the use of paid vacation to compensate exempt employees for a partial week layoff unless the employer has provided at least three months' notice. Prior to implementing any payroll reduction measures, employers should consult legal counsel to ensure compliance with federal and state law. ■

COMPUTER EMPLOYEES—THE NEXT WAGE AND HOUR THORN FOR EMPLOYERS?

Does your Company classify all its Information Technology (IT) employees as exempt under the Fair Labor Standards Act's computer employee exemption? If the answer is "yes," then your organization likely operates under what a federal appellate court judge called the "common misperception that all jobs involving computers are necessarily highly complex and require exceptional expertise."

the FLSA's computer employee exemption applies only to a narrow group including "computer systems analysts, computer programmers, software engineers or other similarly skilled workers"

Martin v. Indiana Michigan Power Co. Contrary to many employers' policies and practices, the FLSA's computer employee exemption applies only to a narrow group including "computer systems analysts, computer programmers, software engineers or other similarly skilled workers" who earn more than $27.63 per hour or $455 a week and whose primary duty involves:

- Application of systems analysis techniques and procedures, including consulting with users to determine hardware, software or system functional specifications; or
- Design, development, documentation, analysis, creation, testing or modification of computer systems or programs, including prototypes, based on and related to user or system design specifications; or
- Design, documentation, testing, creation or modification of computer programs related to machine operations systems; or
- A combination of these duties, the performance of which requires the same skill. 29 C.F.R. § 541.400.

Employees who engage in the manufacture or repair of computer hardware or related equipment are specifically excluded from the exemption. Also excluded are employees whose work is highly dependent on computer software programs and who are skilled in computer-aided design software, but who are not engaged in computer systems analysis or programming. Trainees learning to become proficient in exempt computer work are also not exempt. Of course, computer employees who do not qualify for the computer employee exemption may nevertheless qualify for the FLSA's administrative, executive or professional exemptions.

In the May 2005 edition of *FLSA Focus*, we cautioned against assuming that all IT employees (especially Help Desk employees) are exempt under the FLSA. Three years later, the stakes of such a misclassification are growing as plaintiff's wage and hour lawyers have begun to focus their attention on computer employees. Indeed, plaintiff's attorneys have had significant recent success challenging the exempt status of large groups of computer employees. For example, IBM settled an overtime class-action lawsuit filed on behalf of 32,000 technical service and IT employees for $65 million; Siebel Systems settled a California state lawsuit filed on behalf of 800 systems engineers for $27.5 million; and EA settled a lawsuit filed by game developers for $14.9 million.

More of these lawsuits are being filed every day. In a lawsuit that could have significant ramifications for employers in the computer and other industries, a former network engineer recently filed a class-action lawsuit against Apple Computers alleging that he and others in the same and similar jobs were misclassified under the FLSA and California law. This lawsuit is particularly noteworthy because employers have long concluded that network engineers comfortably fit within the computer employee exemption. A determination that Apple's

network engineers are nonexempt (or a significant settlement between the parties) could open the floodgates to copycat lawsuits.

The lawsuit against Apple is consistent with trends in the last 20 years of wage and hour litigation. A category of employees long considered exempt is the subject of a class action lawsuit contending the employees are nonexempt and owed overtime. The initial high-profile target, in this instance Apple, is just the first in a series of copycat lawsuits challenging the status of employees long thought to be exempt. In the 1990s, plaintiff's lawyers filed class-action lawsuits against almost every major insurance company challenging the exempt status of claims adjustors. Once all of the insurance companies were hit, lawsuits were filed against the major financial brokerage and mortgage houses challenging the exempt status of stock and mortgage brokers. Most recently, more than 25 lawsuits have been filed against pharmaceutical companies challenging the exempt status of pharmaceutical sales representatives.

One of the primary reasons plaintiff's lawyers are willing to challenge these long accepted industry practices is that the claims adjustors, mortgage/financial brokers, pharmaceutical sales representatives and computer employees are highly compensated. Therefore, any judgment or settlement for back overtime wages (not to mention the plaintiff's lawyers' fees) likely will be significant. For example, if a misclassified computer employee earning a salary of $80,000 a year worked just four hours of overtime per week for the past three years (the maximum statute of limitations under the FLSA), he would be owed, at a minimum, over $10,000 in overtime wages, plus an equal amount in liquidated damages. If he were just one of a class of 50 similar employees, the class damages could easily exceed $1 million. Tack onto that the fees of the plaintiff's lawyers and defense costs, and the numbers become even more daunting. It is thus no surprise that plaintiff's lawyers are foregoing their personal injury practices in favor of wage and hour cases.

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Plaintiff's lawyers are also attracted to these lawsuits because they are generally easier to win than other types of cases. Unlike in personal injury and discrimination cases, the burden of proof rests with the employer to demonstrate that an employee qualifies for a particular exemption. Similar to the other white-collar exemptions, the burden for the FLSA's computer employee exemption is often difficult to satisfy as it applies only to a narrow group of employees. One plaintiff's lawyer aptly proclaimed on his website that "the Computer Professional exemption is the one that employers frequently make mistakes on. You will see that it is very difficult to meet."

Consistent with the DOL's regulations regarding the computer employee exemption, the courts have interpreted the exemption very narrowly. Unless an employee is engaged in sophisticated computer work such as programming, network design, software development, or determining hardware, software or system functional specifications, the employee likely does not fit the exemption. For example, in *Hunter v. Sprint Corp.*, a federal district court found that a technically proficient help desk employee whose primary duty was customer service was not exempt even though some of the employee's tasks could be described as "consulting," "analysis" or "testing" related to computers. However, in *Pellerin v. Xspedius Mgmt. Corp. of Shreveport L.L.C.*, another federal district court determined that a computer programmer was exempt where he maintained and supported pre-existing software applications. Although the employee was instructed by his employer what particular software modifications were needed, the employee chose the computer language and how to code the modifications.

Individual state laws make it even more precarious for employers in classifying computer employees because when state and federal law differ, employers must follow the law more favorable to the employee. California's computer professional exemption, for example, not only requires employees to meet the federal requirements, but also to be (i) highly skilled and proficient in the theoretical and practical application of highly specialized information to computer systems analysis, programming, and software engineering and (ii) primarily engaged in work that is intellectual or creative and that requires the exercise of discretion and independent judgment. It is therefore not surprising that many of the computer employee class actions are being filed in California under State and Federal Law. Pennsylvania, on the other hand, does not have a computer professional exemption, thus requiring employers to consider whether their computer employees are exempt under the administrative, executive or professional exemptions. Accordingly, prior to making any classification decisions regarding computer employees, employers must consider applicable state laws.

Given the narrow coverage of the FLSA's computer employee exemption and the recent heightened attention to the exemption by plaintiff's lawyers, employers should carefully review the classification of their computer employees. ■

DOL PROPOSES TO "CLEAN UP" FAIR LABOR STANDARDS ACT REGULATIONS

On July 28, 2008 the Department of Labor ("DOL") proposed another round of revisions to its Fair Labor Standards Act regulations. Unlike the August 2004 revisions, which significantly altered the "white collar" exemption regulations, the stated goal of the latest proposed revisions is merely to "clean up" regulations that are out of date due to subsequent legislation and/or court decisions. Among the proposed revisions, the DOL seeks to:

- Document the increase in the minimum wage from $5.85 per hour effective July 24, 2007, to $6.55 per hour effective July 24, 2008 and to $7.25 per hour effective July 24, 2009.
- Clarify the circumstances under which employees must be compensated when using an employer-owned vehicle for home-to-work commuting.
- Exclude stock options meeting certain criteria from the regular rate calculation for overtime purposes.
- Clarify the calculation of the tip credit and the circumstances under which a tip credit may be taken.
- Explain when a meal credit may be taken from an employee's wages, including that the employee's acceptance of the meal credit may be required as a condition of employment.
- Specify that the receipt of a bona fide bonus or premium payment does not invalidate the fluctuating workweek method of calculating overtime pay. See the July 2006 edition of *FLSA Focus* for an explanation of the fluctuating workweek method and how it can reduce overtime costs for nonexempt salaried employees whose weekly work hours vary.
- State that once a public employee requests compensatory time off, the agency must permit the employee to use the time off within a reasonable period after the request.
- Expand the overtime exemptions to include: (i) employees working on ditches, canals and reservoirs where 90% (rather than the current regulation's 100%) of the water is used for agricultural purposes; (ii) employees who engage in "fire protection activities"; and (iii) salespersons primarily engaged in selling boats.
- Eliminate the overtime exemption for partsmen and mechanics servicing trailers or aircraft.

Although these proposed "cleanup" regulations would not significantly modify the current state of the law, some labor unions nevertheless contend in comments submitted to the DOL that the proposed regulations should be revised or withdrawn because they weaken employee rights and benefit only employers. Various pro-business groups and employers are in favor of the proposed revisions. The DOL is currently considering more than 30 comments. ■

If you have questions, please contact **Thomas M. Wilde** (312-609-7821), **Joseph K. Mulherin** (312-609-7725) or any other Vedder Price attorney with whom you have worked.

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VEDDER PRICE RECENT WAGE AND HOUR ACCOMPLISHMENTS

- Defeated class certification in a lawsuit filed in Oregon State Court alleging various violations of the Oregon wage and hour laws. Single plaintiff sought certification of a class composed of all of the company's employees in the state of Oregon in a six-year period.
- Obtained summary judgment and dismissal in Pennsylvania State Court on novel state law claims. Over 150 individual plaintiffs claimed they were owed compensation for time spent commuting in company-owned cars.
- Favorable early settlement of lawsuit alleging collective claims under the FLSA. Plaintiffs alleged that the company used a split-paycheck scheme to avoid overtime obligations.
- Favorable early settlement of class-action lawsuit against multilocation restaurant, alleging failure to pay overtime and improper use of tip credit. Class included over 150 individuals.
- Assisted nationwide employer to implement fluctuating workweek method of overtime compensation to reduce overtime costs relating to more than 1,000 employees.

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