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# Perils of layoffs, reduced workweeks and other payroll reductions 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, 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.

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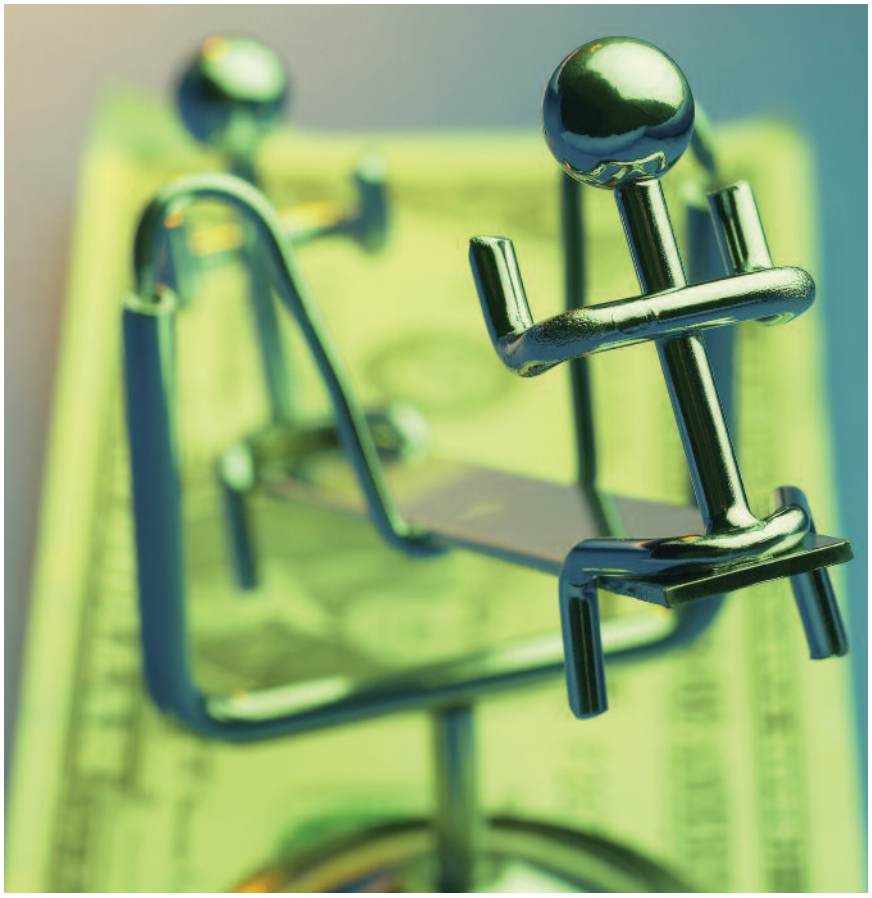

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# REDUCTIONS

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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.

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 eight 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 five percent 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

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salary. This may mean that, in a total shutdown for a partial workweek, where the employer requires use of earned vacation, employees who have 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. ■

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**The Illinois Manufacturer**

*The Illinois Manufacturer* is the official publication of the Illinois Manufacturers' Association (IMA)
220 East Adams Street • Springfield, Illinois 62701 • 217-522-1240 • Fax: 217-522-2367
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