# Management Alert

## FISCAL CLIFF NO. 2: Time to Pay (or Not Pay) the Piper

In our first Management Alert addressing the Budget Control Act of 2011, we noted that the impending "fiscal cliff" of tax increases and spending cuts would cause sufficient financial pressure on the nation's employers that many might conclude that there was no option other than to engage in layoffs. But the financial consequences of "going over the cliff" need not be so dire for employers. There are options short of layoffs.

In this Management Alert, we address the wage and hour issues related to some of those options, including temporary plant shutdowns, furloughs, salary and wage reductions, and reduced schedules. Generally, these options fall into two categories: (1) cost savings unrelated to hours worked and (2) pay reductions based on reduced hours.

### Reductions in Wages and Salaries

An across-the-board wage and salary reduction might be an effective way to reduce operating costs without employee layoffs. As a general rule, it is permissible for an employer to reduce wages (on a prospective basis) as long as the employee is not working under an employment contract with a wage guarantee or a collective bargaining agreement. Other than in those circumstances, a unilateral reduction ordinarily would be permissible, as the Fair Labor Standards Act (FLSA) and/or state wage and hour laws do not govern an employee's hourly rate provided it is at least the minimum wage. Likewise, for government contractors subject to a prevailing wage law, such as the Service Contract Act, any reduction in an employee's pay must stay at or above the applicable prevailing wage.

Employers need to be careful, however, for exempt employees. Under the FLSA, most exempt employees must be paid a salary of at least $455 per week; state laws may impose a higher threshold (e.g., $640/week in California and $543.75 in New York). Reducing the salary below these amounts will result in the loss of exempt status for that employee and may give rise to liability for overtime pay.

Even reducing the salary to an amount above the required minimum requires care. Where salary reductions occur on a week-to-week or even month-to-month basis, they may result in a loss of the exemption if it is determined that the reductions were intended as short-term fixes designed to evade the salary-basis requirement. In order to ensure continued exempt status, salary reductions to exempt employees should be prospective and applied over the long-term.

In addition, several states have notice requirements for reductions to wages and/or salaries. (The FLSA does not.) For example, in North Carolina, employers must notify employees at least twenty-four hours in advance of any changes in wages. In Iowa, an employer must give written notification at least one pay period prior to the implementation of the changes. Of course, even in those states where it is not legally required, advance notice is a good practice from an employee relations standpoint.

## Furloughs/Reduced Schedules/Temporary Shutdowns

Rather than simply reducing pay, many employers may find that reducing the hours associated with that pay may be more palatable. Such reduced hours can be achieved through a variety of mechanisms, including furloughs, reduced hours schedules, and temporary plant shutdowns. Regardless of what the reduction in hours/compensation is called, however, the following are important considerations before employers proceed with the reduction.

Initially, employers should comply with the notice requirements discussed above with respect to reductions in pay. The fact that a reduction in pay is tied to a reduction in hours will not necessarily change an employer's obligation to negotiate or provide notice.

Non-exempt employees are paid for the hours they actually work. Thus, a reduction in hours is not likely in itself to cause compliance issues under the FLSA or state law. Employers should be careful, however, if they decide that certain employees will be "on call" for all or part of their non-work hours. Under the FLSA, an employee who is "on call" may still be deemed to be "working," and if so those hours must be compensated (and will trigger an overtime obligation if it pushes the total hours for the workweek over 40). Similarly, employees who perform part or all of their normal job duties during a furlough day -- even if the employee performs the duties at home -- are "working" while performing those duties.

An additional complication for non-exempt employees relates to "reporting pay" or "show-up pay." Under some state laws, employees who report for work but are sent home due to lack of work must be paid a minimum amount for their time. For example, in New York, an employee who reports for work on any day must be paid for at least 4 hours, or the number of hours in the regularly scheduled shift, whichever is less, at the basic minimum hourly wage. Similarly, in California, when an employee is required to report for work and does report, but works less than half of the employee's usual day's work, the employee must be paid for half the usual day's work at the employee's regular rate of pay.

Reducing schedules and compensation for exempt employees is more complex. Under the FLSA, an exempt employee must be paid her full salary (in excess of $455 per week) in any workweek in which she performs any services. As noted above, under no circumstances may an exempt employee's salary fall below the minimum. An exempt employee also generally may not have her salary reduced due to an employer's failure to provide work. For example, if an employer decides to close a plant one Friday, the exempt employee must be paid her full salary for the week, even if she does not perform any work on one or more weekdays during the week.

The Department of Labor's Wage and Hour Division has approved of several mechanisms for employers to address short-term staffing issues for exempt employees. For example, an employer can substitute or reduce an exempt employee's accrued leave for the time an employee is absent from work, even if it is less than a full day and even if the absence is directed by the employer because of lack of work, without affecting the salary basis payment *See here*. The employer can reduce an exempt employee's salary and substitute paid leave (voluntarily or involuntarily), *see here*, provided that the employee still receives payment equal to the employee's regular salary in any week in which any work is performed. This is true even if the employee has no leave remaining (and the employer puts the employee in a "negative leave" situation). This approach does not decrease weekly payroll costs but can help promote an employer's overall financial condition by eliminating some accrued liability in the form of paid leave from the employer's books.

An employer may also furlough exempt employees for an entire week and not pay any salary. The failure to pay a salary for a workweek in which an exempt employee performs no work does not abrogate that employee's salary basis status. *See here*.

Employers should be cautious in these situations, however, because, as was the case with non-exempt employees, exempt employees may often perform "work" while away from the normal work location, including tasks as simple as sending and reading e-mails or participating in telephone calls, which may trigger FLSA obligations -- here, the payment of the weekly salary. And some states may have rules that limit an employer's ability to reduce an exempt employee's salary and/or schedule in the ways discussed here. For example, in Washington, deductions are not permitted for lack of work for any amount of time less than a full week.

## Conclusion

Employers have a variety of options at their disposal when considering staffing and pay adjustments to avoid layoffs. Each alternative must be explored with care to ensure compliance with a maze of wage and hour laws.

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**Next up**

Seyfarth Shaw's next Management Alert in this series discussing the potential impact of the Fiscal Cliff on employers in their employment relations will focus on the enforcement activities of federal agencies that may be impacted by the federal budget cuts.