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Management Alert

Federal Shutdown Poses Risk for Private Employers With Federal Contracts, Especially in California

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Seyfarth Synopsis: *With the federal government shut down as of this morning, private employers – federal contractors especially – are considering their options. No matter who or what is responsible for the shutdown happening, it poses two overarching issues for private employers who may need to stop work on federal contracts. Both relate to some form of furlough – a temporary layoff that may occur for days or weeks. The first is whether such action by private employers risks jeopardizing the exempt status of employees properly classified as exempt, thereby triggering potential back pay and overtime obligations. Because that risk arises under the federal Fair Labor Standards Act (FLSA) plus various state and local laws, it's a risk faced by federal contractors everywhere. The second risk, like so many faced by private employers, is unique to California. Under a recent court case binding across California, even short-term layoffs must be preceded by 60 days' notice. Absent that notice, the employer owes back pay and benefits for whatever part of that period the employer fails to provide a California-compliant notice.*

Wage and Hour Issues

Reductions in Wages and Salaries

Across-the-board wage and salary reductions are one possible way to reduce operating costs without employee layoffs. Employers can generally reduce wages prospectively, provided the employee is not working under a collective bargaining agreement or an employment contract governing pay. Those circumstances aside, unilateral reductions are permissible under the Fair Labor Standards Act (FLSA) plus state wage and hour laws, because those laws don't protect an employee's hourly rate above minimum wage. (For government contractors subject to a prevailing wage law including the Service Contract Act, any decrease in employee pay must stay at or above the applicable prevailing wage.) Employers must exercise caution in reducing exempt employees' pay, however. Under the FLSA, the minimum salary for most exempt employees remains $455 per week; some state laws impose a much higher threshold (e.g., $880/week in California). Reducing salary below these amounts will result in the loss of exempt status for that employee and could create overtime obligations.

Even reducing salary to an amount above the required minimum requires care. If salary reductions occur on a week-to-week or even month-to-month basis, an employer may lose the exemption if it is determined that reductions were intended as short-term fixes intended to evade the salary-basis requirement. In order to ensure continued exempt status, salary reductions should be prospective and applied over the long-term – an impractical or otherwise undesirable prospect for employers in a tight labor market facing what may be a very short-term federal shutdown.

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In addition, a few states require advance notice for reductions to wages or salaries. (The FLSA does not.) For example, employers in Iowa must provide written notice at least one pay period before implementing changes. North Carolina employers must notify employees at least 24 hours before any wage changes. Even in states where advance notice is not legally required, it is a good practice from an employee relations standpoint. That makes an indeterminate shutdown all the more frustrating for federal contractors and others impacted by federal shutdown.

Furloughs/Reduced Schedules/Temporary Shutdowns

Rather than simply reducing pay, many employers may consider reducing an employee's hours. Hours reductions can be achieved through various mechanisms, including furloughs, reduced hours schedules, and temporary plant shutdowns. In most jurisdictions, such hours reductions are legally safe under the FLSA and state law as to non-exempt (hourly) employees. Regardless of what the decrease in hours/compensation is called, however, employers should consider the following factors before proceeding:

- First, employers should comply with notice requirements discussed above. The fact that a decrease in pay is tied to a decrease in hours will not necessarily change an employer's obligation to negotiate or provide notice.
- Second, employers must exercise caution if certain employees will be "on call" for all or part of their non-work hours. Under the FLSA, "on call" employees may still be deemed to be "working"; if so those hours must be compensated (and will trigger an overtime obligation if total hours for the workweek exceed 40). Similarly, employees who perform even some of their normal duties during a furlough day – even if those duties are performed at home – are "working" while performing those duties.
- Third, "reporting pay" or "show-up pay" create additional complications for non-exempt employees. 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. In New York, employees who report for work on any day must be paid the basic minimum hourly wage for at least 4 hours, or the number of hours in the regularly scheduled shift, whichever is less. Similarly, if a California employee is required to and does report for work but works less than half of his/her usual day's work, the employee must be paid for half the usual day's work at the employee's regular rate.

Reduced schedules or compensation for exempt employees is more complex. In brief, partial week furlough of exempt employees may jeopardize their exempt status. Under the FLSA, exempt employees must receive their full salary (above $455 per week) in any workweek in which the employee performs any services. As noted above, under no circumstances may an exempt employee's salary fall below the minimum. Exempt employee generally may not have their 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 receive 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 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 employee's salary basis status. Alternatively, the employer can reduce an exempt employee's salary and substitute paid leave so long as the employee still receives pay equal to his/her regular salary in any week during which any work is performed. This is true even if the employee has no leave remaining (and such reduction puts the employee in a "negative leave" situation). This approach does not reduce 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. Employers can also furlough exempt employees for an entire week and not pay any salary. Failure to pay salary for a workweek in which an exempt employee performs no work does not jeopardize salary basis status.

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Employers should be cautious in these situations, however, because – as with non-exempt employees – exempt employees may often perform "work" while away from the normal work location, including sending or reading e-mails or participating in phone calls, which may require payment of the weekly salary under FLSA. In addition, some state rules limit an employer's ability to reduce exempt employee's salary and/or schedule in the ways discussed here. For example, Washington prohibits deductions due to lack of work for any amount of time less than a full week.

California WARN Act Concerns

Under the federal WARN ACT, a temporary layoff of six (6) months or less is not an "employment loss" triggering notice requirements. However, according to a recent California Court of Appeal decision, California's WARN Act (Cal-WARN) requires sixty days' notice of a wide range of short-term layoffs (such as furloughs). Failure to provide that notice triggers liability for back pay, lost benefits, medical expenses, civil penalties, and attorneys' fees. International Brotherhood of Boilermakers v. NASSCO Holdings, Inc. (Cal. Ct. App. Nov. 30, 2017).

The *NASSCO* Decision

NASSCO Holdings needed to temporarily reduce its workforce – much of it represented by the Boilermakers Union – because of a lack of work. NASSCO ultimately laid off ninety employees for four to five weeks. During this furlough, employees did not receive wages, did not earn vacation pay, and did not accrue service credit for pension purposes. NASSCO gave no prior notice of the furlough. The Boilermakers Union and three individual employees sued NASSCO under Cal-WARN for failing to provide a 60-day notice of the furlough. The plaintiffs sought back pay and millions of dollars in civil penalties. When the parties cross-moved for summary judgment, the trial court ruled against NASSCO, holding that the laid-off employees were entitled to back pay and lost pension benefits, but not to civil penalties.

NASSCO argued on appeal that the furlough was not a "separation from a position" that triggered Cal-WARN's 60-day notice obligation. The Court of Appeal disagreed. Looking to the plain meaning of "separation," the Court of Appeal noted that separation could be "an action of moving apart" that need not be either "permanent" or "temporary." Thus, being "separated *from a position*" does not mean that the employment relationship must entirely end. Instead, Cal-WARN notice requirements apply to "a temporary job loss, even if some form of the employment relationship continues and the employees are given a return date."

The Court of Appeal was unwilling to specify how long a furlough must be to constitute a "separation" that would trigger Cal-WARN. Rather, the court advised more generally that Cal-WARN applies to temporary layoffs "where advance notice would provide the workers time to plan and prepare for their sudden wage loss," even if workers subject to a temporary layoff would not need training for a new job. In reaching this conclusion, the Court of Appeal underscored the California Legislature's "judgment that California employers, not California employees, should bear the risk of surprise resulting from an unexpected layoff," and that Cal-WARN is a remedial statute akin to "a wage workers' equivalent of business interruption insurance." In so holding, the court rejected the employer's argument that pointed to language in the statute deeming employers "liable to each employee entitled to notice who lost his or her employment." It concluded that this language neither triggers liability nor affects the definition of "mass layoff," which is defined elsewhere in the statute. While the Court of Appeal indicated that the *de minimis* doctrine would keep extremely short furloughs from triggering Cal-WARN, the Court of Appeal did not specify a threshold.

What *NASSCO* Means for Employers Contemplating Furlough

Not every workforce reduction or temporary layoff is covered by Cal-WARN. Among other triggers, there must be a "mass layoff," which includes layoffs of at least fifty employees over a rolling thirty-day period. Additionally, those layoffs must be due to a "lack of funds or lack of work." Further, the layoffs must occur at a "covered establishment," which means an industrial or commercial facility that has employed seventy-five or more people within the preceding twelve months.

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Unfortunately, all of those conditions likely apply to defense contractors and other large employers contemplating furlough in California during a federal government shutdown. Under those conditions, *NASSCO* says the employer may need to provide a 60-day WARN-compliant notice for planned layoffs of any length, particularly where income loss equivalent to the kind of furlough in *NASSCO* is a possibility. While the Court of Appeal's reference to a *de minimis* exception suggests that furloughs lasting just a few days may not trigger the statute, the decision fails to identify the tipping point. In any event, the decision implies that the employer will get little leeway absent a compelling reason why it could not have provided compliant notice. Whether loss of funds occasioned by a federal shutdown would excuse the duty to provide notice under Cal-WARN is unexplored territory – rarely firm ground for employers in California.

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