PROSKAUER ROSE LLP

Employment Law Counseling & Training

MAY 09

Published by Proskauer Rose, the "Employment Law Counseling & Training Tip of the Month" provides best practice tips to assist employers in meeting today's challenging workplace environment. Our Employment Law Counseling & Training Practice Group counsels employers with respect to the interplay of multiple federal, state, and local laws governing today's workplace, helping them avoid workplace problems, and improve employee satisfaction.

Law & the Workplace℠

Tip of the Month

Tip: If planned correctly, and in advance, employers may reduce workweeks and cut the pay of exempt employees, without jeopardizing the ineligibility of exempt employees for overtime, where the reductions in workdays and pay are not tied to short-term business needs, the changes are planned well in advance, the schedule and paycuts are fixed in identified workweeks, and the fluctuations in pay and shortened workweeks are not recurring.

Salary Reductions and Reduced Workweeks: Are Your Exempt Employees Still Exempt?

For many employers, as the economic downturn unfolded, employee layoffs were an unavoidable first option earlier this year to cope with declining revenues and orders. Now, as the economy flattens out, many employers are looking for alternative ways to cut costs, without necessarily laying off additional personnel. As a result, some companies have planned week-long shutdowns of operations (often either at the end of the year or during a known slow-period), the institution of four-day workweeks in certain advance-designated weeks (with a corresponding 20% reduction in salary in those weeks), mandatory unpaid holidays, and voluntary, or in some cases, mandatory unpaid leave programs.

This Counseling Tip of the Month will address whether reduced workweeks and voluntary and mandatory unpaid leave programs violate the Fair Labor Standards Act's ("FLSA") salary basis test for exempt employees, endangering the impacted employee's classification status and, thereby, unwittingly convert him/her to overtime eligibility. For a description of other layoff alternatives and cost-saving measures, see Proskauer's March 2009 Special Report.

The Salary Basis Test for Exempt Employees

To qualify as an exempt executive, administrative, or professional employee under the FLSA, an employee must not only be paid $455/weekly, satisfy a complex duties test, but also be paid on a "salary basis." An employee is considered to be paid on a salary basis if s/he receives during each pay period a minimum predetermined amount of compensation that cannot be reduced "because of variations in the quality or quantity of the work performed" or because of "absences occasioned by the employer or by the operating requirements of the business. If the employee is ready, willing and able to work, deductions may not be made for time when work is not available." 29 C.F.R. § 541.602(a). Thus, a full-time exempt employee with an annual salary of $52,000 must typically receive at least $1,000 per week, whether s/he works 30 hours or 80 hours in a particular workweek. Of course, this prohibition on deductions from an exempt employees' salary is subject to certain well-defined exceptions identified in the FLSA's regulations which have been further refined in countless U.S. Department of Labor ("DOL") Opinion Letters and court decisions, which are beyond the scope of this month's Tip. At the same time, however, the regulations indicate that in scheduled, fixed weeks where an employee performs no work – either due to a complete shutdown of operations, or because of a mandatory or voluntary unpaid leave resulting from economic conditions – the deductions prohibition is lifted and there are no such salary obligations.

Reducing Exempt Employees' Salary and Workweek

Question: Does the Fair Labor Standards Act preclude our business, in these trying economic times, from reducing the salaries we are paying our workforce?

Answer: No, but careful planning is recommended. Changes to *non-exempt* employees' work schedules and wages typically do not raise federal or state wage/hour issues, so long as non-exempt workers continue to be paid at least the minimum wage and overtime, and are afforded advance notice of changes to pay and workweek schedules, so as not to unwittingly violate state wage and wage supplement laws. However, *exempt* employees must be treated carefully because the salary basis test mandates that exempt employees be paid a fixed and predetermined salary which is not subject to reduction because of variation in the quality or quantity of the work performed. Notably, the DOL regulations do not identify when or how frequently this fixed element of compensation is determined.

Question: Under what circumstances would a cut in salary jeopardize an employee's exempt status?

Answer: According to the DOL, *irregular* salary reductions due to day-to-day or week-to-week determinations of the operating requirements of the business, are inconsistent with the guaranteed salary basis of payment required by the FLSA's regulations, and defeat an employee's exempt status. In fact, the DOL believes that

"[R]ecurrent changes in the normal scheduled workweek…more likely would appear to be designed to circumvent the salary basis requirement."

Question: Well, if that's the case, how can our business cut working time and salaries of our employees, including exempt executives, managers and supervisors, without opening ourselves to a lawsuit for violating the salary basis test for exempt workers?

Answer: The DOL has issued three Opinion Letters over the last half-century that appear to permit employers to reduce the work schedules of exempt employees and, correspondingly, reduce their pay, without jeopardizing the employees' exempt status. Thus, according to the DOL, in the face of serious economic downturns where the reductions were *not* tied to short-term business needs, the changes in schedule/pay were *not* made so frequently as to render the shortened workweek and reduced salary a sham designed to undermine the exempt status, salaries and workweeks of exempt employees can be reduced without, necessarily, endangering the exemption from overtime. In each of those instances, the shortened workweeks and related salary reductions were planned far in advance, and the planned reductions took place during the course of several months and pursuant to a fixed schedule, reflecting a long-term business plan.

Question: I don't want to endanger the exempt status of our business executives, managers and supervisors, so can you tell me how I determine whether the reduction in hours/pay is considered related to *short-term* business needs?

Answer: This is a difficult question and the answer varies with facts and circumstances. However, the DOL recently issued two Opinion Letters that shed some general insights.

In one situation, a health care provider proposed that its salaried exempt employees to stay home or leave work early during periods of low patient census. The employer proposed deducting the non-work time from the employees' accrued paid time-off ("PTO") accounts. For those exempt employees who had exhausted their accrued PTO, their salaries would be reduced in full-day increments for each non-work period (but in no event below the minimum salary required for the exemption, $455 per week).

The DOL opined that the employer could substitute or reduce an exempt employee's accrued leave, for the time the employee was absent from work, *without* affecting the salary basis of payment, *provided* that the employee still received payment in an amount equal to the employee's guaranteed salary. However, if an exempt employee's accrued PTO was exhausted, and the periods of low patient census continued, the employer could *not* schedule the exempt employee for less than a forty-hour workweek *and* reduce their pay, on an *ad hoc* basis without defeating the employee's exempt status. *See* Wage and Hour Opinion Letter, FLSA 2009-18 (January 16, 2009).

In another situation, an employer proposed *occasionally* reducing the hours worked by exempt employees whenever there was a low patient census, and in such cases, offering employees "voluntary time off" (VTO) on a first-come, first-served basis. If there were insufficient volunteers for VTO, the employer proposed requiring "mandatory time off" (MTO) under a seniority-based rotational method. Under both the VTO and MTO programs, if an exempt employee did not have sufficient accrued leave to cover the time off, the employer would make deductions from the employee's salary if the leave was shorter than one workweek. In this instance, the DOL reasoned the salary deductions arising from the MTO, lasting *less* than a workweek would violate the salary basis requirement and defeat the employee's exempt status because the deductions were based on day-to-day or week-to-week determinations of the operating requirements of the business. *See* Wage and Hour Opinion Letter, FLSA 2009-14 (January 15, 2009).

Question: What have the courts said about salary reductions and reduced workweeks for exempt employees?

Answer: So far, the recent decisions have permitted furloughs of less than a week, without jeopardizing the salary bonus test, for exempt employees when announced in advance and provided they reflect a long-term response to severe economic times.

In *Archuleta v. Wal-Mart Stores, Inc.*, 543 F.3d 1226 (10th Cir. 2008), the U.S. Court of Appeals for the Tenth Circuit adopted the DOL's prior rulings and held that "an employer may prospectively reduce salary to accommodate the employer's business needs unless it is done with such frequency that the salary is the functional equivalent of an hourly wage" (emphasis added). The court held that two pay adjustments in a year were certainly permissible, but that weekly changes in pay would destroy the exemption. Similarly, the Second Circuit, in *Havey v. Homebound Mortgage, Inc.*, 547 F.3d 158 (2d Cir. 2008) upheld prospective quarterly adjustments to salary based on a compensation scheme that was clearly outlined in advance and communicated in writing to all employees well in advance of its implementation. Finally, in April, 2009, in *Robinson v. Tellabs, Inc.*, No. 1-07-2731, 2009 WL 1151801 (Ill. App. 1st Div. Apr. 27, 2009), the appeals court upheld the employer's business plan that had prospectively announced unpaid holiday time-off in certain workweeks for salaried exempt employees based on bona fide business needs, and rejected claims that the compensation scheme violated the salary basis test.

Conclusion

In order to maximize compliance and minimize potential risks, any changes to work schedules and wages calling for reduced workweeks and salaries for exempt employees are best made prospectively pursuant to a formal written policy, identifying the reduced workweeks or unpaid holidays, and should be made on a division or department-wide basis. Changes made too frequently and/or on an

individual basis could raise legal issues under the FLSA, as well as under state laws. In addition, with smart planning, use of employee leave banks may even allow employers to make temporary workweek adjustments but these require a careful planning to avoid legal pitfalls.

Reduced workweek/pay plans must *also* be analyzed separately under state law to ensure compliance. Employers in California, for example, would likely *not* be permitted to reduce exempt employees' salaries due to a temporary reduction in hours, a shutdown of operations of less than a week, or a prospective four-day workweek, as the state's Department of Labor Standards Enforcement has explicitly rejected the DOL's position under the FLSA, and has prohibited any reduction in salary that is tied to a reduction in hours.

As this subject requires consideration of both federal and state laws, as well as review of employer Handbooks and policies, employers should consult with their Human Resources professionals and counsel ahead of time to ensure that the proposed business plan does not violate wage and hour laws, jeopardizing exempt employees' classification status.

Employment Law Counseling and Training Practice Group

The Proskauer Rose Employment Law Counseling and Training Practice Group is a multidisciplinary practice group throughout the national and international offices of the firm which advises and counsels clients in all facets of the employment relationship including compliance with federal, state and local labor and employment laws; review and audit of employment practices, including wage-hour and independent contractor audits; advice on regulations; best practices to avoid workplace problems and improve employee satisfaction; management training; and litigation support to resolve existing disputes

For more information about this practice group, click here or contact:

New York

Fredric C. Leffler
212.969.3570 – fleffler@proskauer.com

Marc A. Mandelman
212.969.3113 – mmandelman@proskauer.com

Katharine Parker
212.969.3009 – kparker@proskauer.com

Joshua F. Alloy
212.969.3351 – jalloy@proskauer.com

Los Angeles

Harold M. Brody
310.284.5625 – hbrody@proskauer.com

Arthur F. Silbergeld
310.284.5624 – asilbergeld@proskauer.com

Boca Raton

Allan H. Weitzman
561.995.4760 – aweitzman@proskauer.com

Boston

Mark W. Batten
617.526.9850 – mbatten@proskauer.com

Newark

John P. Barry
973.274.6081 – jbarry@proskauer.com

Wanda L. Ellert
973.274.3285 – wellert@proskauer.com

New Orleans

Charles F. Seemann
504.310.4091 – cseemann@proskauer.com

Washington, D.C.

Lawrence Z. Lorber
202.416.6891 – llorber@proskauer.com

Leslie E. Silverman
202.416.5836 – lsilverman@proskauer.com

Special thanks to associate Lauren Palais for her contributions to this article.