PROSKAUER ROSE LLP

Special Report:

Managing Change/Reductions in Force Practice Group

MARCH 2009

Cost-Saving Alternatives to Layoffs

As the economy continues to decline, employers are faced with increasing pressure to reduce operating costs. While many companies are considering layoffs, there are alternatives that can achieve similar cost-cutting goals while saving jobs and allowing employers to retain their investment in current staff. These approaches also can avoid the expensive severance payments, burdensome notice obligations under federal and state law, negative publicity and potential legal liability that often accompany layoffs, while leaving employers in a better position to respond to an upturn in the economy without needing to recruit, hire and train new employees at great expense.

These "layoff alternatives" include:

- **Pay Cuts**
- **Reduction in Hours (and Pay)**
- **Mandatory Furloughs/Shutdowns of Operations**
- **Work Share Programs**

While these alternatives offer varied benefits and costs, and may require some administrative creativity, they also present opportunities for a company to achieve cost savings without reducing its workforce. We discuss the practical and legal considerations of the most common of these alternatives below.

Pay Cuts

A company generally is free to change prospectively the terms and conditions of employment of at-will employees, including reducing the rate of pay. Before compensating an employee at a reduced rate of pay, the employer must ensure that advance notice is given to the affected employees before they start working at the new salary/pay rate. For non-exempt (often hourly) employees, their hourly rate would be reduced. For exempt (typically salaried) employees, their annualized salary would be reduced. The wage cut can take the form of an across-the-board reduction for all employees–10% for example–or be made on an individual basis.

Law & the Workplace℠

There are several legal issues that employers must look out for when making wage cuts:

First, the employer must identify any relevant employment contracts and offer letters to determine whether there is a contractual compensation guarantee to the affected employees. The risk associated with poorly drafted, or ambiguously worded, offer letters must be assessed carefully. Employees with offer letters that set forth their annual salary (or hourly rate) should be notified in writing of their new salary or hourly rate of pay to avoid potential breach of contract disputes down the road. Of course, any new communication should reiterate the "at-will" nature of their employment.

Second, employees must be informed of the rate at which they will be working before they actually perform any work during that day or pay period. While not all states explicitly outline how much advance notice is required, some, including Iowa, Kansas, Maryland, Missouri, Nevada, North Carolina and South Carolina, require varying lengths of advance notice, between 1 and 30 days. Some states also require the notice to be in writing. Where possible, we recommend providing at least 30 days advance written notice of any changes to an employee's rate of pay. The notice should be provided in advance of the next pay period–not just the next pay check. This is particularly important for employers who operate payrolls on a lag basis. However, state law should be reviewed for specific requirements.

Third, employers must make sure that non-exempt employees' hourly rates do not fall below the applicable federal or state minimum wage.

Fourth, exempt employees must continue to earn a weekly salary of at least $455 per week (or higher, depending on state law) so that they continue to remain exempt from federal and state overtime requirements. New York, for example, has set the minimum weekly salary at $536.10, and California has a minimum salary for exempt employees of $640 per week.

Fifth, employers cannot reduce the wages of unionized employees operating under the terms of a collective bargaining agreement without first bargaining with the union.

Finally, where wage cuts are not made equally on a company-wide or department-wide basis, employers must take care that employees protected by Title VII, the ADEA, the ADA, the FMLA and similar federal and state anti-discrimination laws are not disparately treated or impacted by the reductions, and that the cuts are made for legitimate business reasons that can be justified on non-discriminatory grounds.

Reduction in Hours (and Pay) and Mandatory Furloughs/Shutdowns of Operations

While reducing pay will certainly save a company money, it also can create morale issues for employees who continue to work just as hard for less money. In addition, cutting pay does not address one of the most common downsides of slow economic times–the fact that there simply isn't as much work to go around. Therefore, two similar alternatives are to reduce employees' hours and their pay by a proportionate amount, institute mandatory furloughs (unpaid leave) or shut down operations for certain days or weeks of the year.

Many of the same legal principles and issues discussed above with respect to pay cuts also apply to furloughing employees or reducing hours and pay simultaneously. Advance notice must be provided, and we recommend a 30-day period where possible. For unionized employees and those with employment contracts, the contract typically will govern and likely will prevent the reductions absent bargaining and/or renegotiation.

Non-Exempt Employees

For non-exempt employees, there are few potential legal issues in reducing employee workhours so long as they continue to earn at least the minimum hourly wage. Generally, employers are free to schedule the work day or week of non-exempt employees at their discretion, because hourly employees are simply paid for each hour worked. Therefore, if they are scheduled to work fewer hours going forward, they will simply be paid for fewer hours. If they are instructed not to work on a particular day (or week), they simply are not paid for that day (or week). Keep in mind, however, that if non-exempt employees perform any work during a day, even if they are not scheduled to work at that time, they must be paid at their regular hourly (or overtime) rate for the time worked. In addition, employers should be aware that some states have minimum hours of pay requirements for employees who are "called in" to work but do not work a full shift.

One potential side-benefit of reducing work hours for non-exempt employees is that it also will necessarily reduce the number of overtime hours (paid at time-and-a-half) that are worked each week. While state law and individual employer policies may differ, federal law does not require premium pay (time-and-a-half) until forty hours are worked. Managing, and reducing, overtime is an important first step towards controlling costs that should be taken before an employee's full-time schedule is reduced. Other legal alternatives–such as a fluctuating workweek–also may be considered.

Exempt Employees

Exempt employees, on the other hand, present unique issues under the Fair Labor Standards Act and similar state wage/hour laws that must be analyzed carefully before implementing a reduction in hours or furlough plan. To qualify as an exempt executive, administrative, or professional employee under the FLSA and many state laws, an employee must, among other things, be paid on a "salary basis." In other words, an employee generally must receive the same amount of compensation in each week (while meeting federal and state minimum weekly thresholds), without regard to how many hours worked, and with only limited exceptions. For example, a full-time exempt employee with an annual salary of $52,000 typically must receive at least $1,000 per week, whether he or she works 30 hours that week or 80 hours. In weeks where an employee performs no work, of course, there are no such salary requirements.

However, if certain guidelines are followed, an employer can reduce exempt employees' work hours or furlough them for certain days or weeks consistent with rulings by the U.S. Department of Labor ("DOL"), as well as two recent decisions by federal Courts of Appeal. These rulings and decisions make clear that an employer legally can reduce the salary of exempt employees in advance-designated reduced workweeks, where the reduction is due to economic conditions and is not an attempt to evade the salary basis test. However, employers must plan carefully, as multiple changes in an employee's schedule and salary throughout the year may lead to an across-the-board denial of the exemption.

Weekly Furloughs/Shutdowns

Where exempt employees are furloughed for an entire week, or where a company shuts down operations (or closes a department) for an entire week, there is no legal obligation to pay employees for that week–assuming, of course, that employees perform no work. For exempt employees, particular care should be taken to avoid the use of BlackBerries, cell phones, laptops, e-mail, and voice mail, as the performance of work during a furlough or shutdown could require them to be paid their full weekly salary even if the employees perform only a minimal amount of work.

Reducing Hours and Pay/Daily Furloughs or Shutdowns

Sometimes, it is not feasible for a company to shut down operations or furlough groups of employees for week-long periods of time. However, if planned carefully, there are also ways to reduce hours and pay or structure furloughs/company shut-downs for periods of less than one week at a time.

A typical example of reducing hours and pay would be to reduce employees' hours from 40 per week to 35 per week, so that they work one less hour each day, and their overall salary would be reduced by 12.5%. Another example is to convert employees to a four-day work week schedule, with a corresponding salary reduction of 20%. This could be done either by changing their schedule or by closing operations or furloughing certain departments for one day each week or for a set number of weeks throughout the year. Essentially, it would be like an unpaid vacation day for affected employees. Keep in mind, of course, that exempt employees must continue to earn at least $455 per week (or higher, depending on the state) to qualify for exempt status.

To comply with the FLSA, the change in work hours or schedule must be made prospectively, and should be made either indefinitely or on a long-term basis for a fixed period of time (e.g., for the remainder of the year, for a three-month period, etc.). Employers should not change an exempt employee's work schedule more than 2-4 times in any twelve-month period. In addition, a written policy and schedule should be established and disseminated well in advance. Finally, the change in hours or work schedule should be made, where possible, on a company-wide, division-wide, or department-wide basis, rather than individually. While individual reductions in schedule can be structured so as to comply with the DOL's interpretation of the FLSA, there is some increased risk that a court will find the practice to violate the salary basis test. It should be noted that even if the reduced workweek does result in a change from exempt to non-exempt status for any reason, the change to non-exempt status would be prospective and likely would revert back to exempt upon resumption of full-time work. As noted, such changes should be planned, pre-announced and done on a very episodic basis.

State Laws

Unfortunately for employers, not all states have interpreted their own wage/hour laws in the same manner as the DOL, and employers should consult with legal counsel ahead of time to ensure proper analysis and review of applicable laws in each state in which it operates. Employers in California probably would not be permitted to reduce exempt employees' salaries due to a temporary reduction in hours, a prospective four-day workweek, or a furlough plan of less than one week, 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. This arguably leaves California employers in the strange position of being permitted to reduce exempt employee salaries by 20%, but not being allowed to tie the reduction in salary to a corresponding temporary 20% reduction in hours. It is possible, however, that employers could prospectively reduce hours (and wages) on a permanent or long-term basis.

Additional Vacation Days in Lieu of Reduced Hours

One possible alternative to reducing hours that may comply with California law (and would certainly comply with federal law) is to provide employees with an additional number of vacation days to be used throughout the year, but to reduce employees' overall salary by a corresponding

percentage–so that the end result is that those extra vacation days essentially are unpaid. By way of example, an employer could provide employees with 10 additional vacation days (two weeks), but reduce their overall salary by 2/52 (3.8%). Employees would receive the same salary in every week going forward (albeit lower than what they had received previously), but would receive an additional 10 days off that year. Employers that choose to provide these extra "unpaid" vacation days, however, should make sure they have a clear written policy that the extra vacation days are for that calendar year only, do not carry over to the next year if unused, and, except in California, are not paid out if unused by the end of the year. California employers who would implement such a program should make sure that their employees use up all of the vacation days to avoid having to pay out the balance at the end of the year.

Work-Share Programs

In many states, rather than laying off a percentage of the work force to cut costs, employers can submit a plan to their state Department of Labor (or unemployment insurance division) to reduce the hours and wages of all or a particular group of employees, who will then "share" the remaining work. Those employees will then be eligible to receive partial unemployment benefits to supplement their lost wages–typically a percentage of unemployment benefits equal to the same percentage that wages were reduced for that week. Keep in mind, however, that employers may have to pay higher unemployment benefit premiums–so the ultimate cost of such a program must be considered in the context of achieving cost-savings goals.

States that offer work share or job share programs include Arizona, Arkansas, California, Connecticut, Florida, Iowa, Kansas, Maryland, Massachusetts, Michigan, Minnesota, Missouri, New York, Oregon, Rhode Island, Texas, Vermont and Washington. Because each state's program has different eligibility and legal standards, provides different levels of benefits, has varying administrative burdens, and requires different "plans" to be submitted, it is important to consult with legal counsel to obtain more information and weigh the benefits and costs on a case-by-case basis.

By way of example, New York's "Shared Work" Program is open to employers with five or more full-time employees who have paid unemployment insurance for at least four calendar quarters. Employers must submit a plan that provides for the following: (i) a reduction in employees' wages by at least 20% and not more than 60%; (ii) only full-time employees who normally work between 35 and 40 hours per week are eligible; (iii) the employees' fringe benefits cannot be reduced or eliminated; (iv) the plan cannot exceed 53 weeks; (v) the employer cannot hire additional full-time or part-time employees for that work group during the term of the plan; and (vi) the plan must be in place of a layoff of an equivalent percentage of employees.

Unemployment Benefits

Employers should keep in mind that employees whose hours are reduced or who are furloughed for extended periods of time may qualify for unemployment or partial unemployment benefits from their state, depending on state law, the employee's past earnings, and the extent to which wages or hours are reduced. As with Work-Sharing programs, this in turn could increase the cost of the employer's unemployment benefit tax burden and should be factored carefully into any decision to reduce hours or implement a furlough plan.

The WARN Act

Depending on the extent to which hours are reduced, the length of any planned furloughs and the number of employees affected, employers may trigger significant notice requirements under the federal Worker Adjustment and Retraining Notification Act ("WARN") and similar state plant closing/mass layoff advance notification statutes. Under WARN, employers with at least 100 full-time employees must give 60 days advance written notice to employees who suffer an "employment loss" due to a mass layoff or plant closing. Employment loss is defined specifically to include a reduction of hours of more than 50% during each month of any six-month period, or a layoff of more than six or more months. Thus, the failure to provide required notice when, for example, a temporary layoff unexpectedly extends to a period that becomes a statutory "loss of employment" may result in substantial unexpected employer liability for back wages and the cost of benefits to the affected employees. State "mini" WARN laws are typically even stricter than the federal statute. New York, for example, requires 90 days advance notice. Employers should consult with legal counsel well in advance of any planned action to determine whether federal and/or state WARN laws may be triggered.

Employee Benefits

Employers also must make sure to coordinate planned furloughs, reduced schedules and pay cuts with their employee benefit plans and policies, including medical or dental insurance plans, 401(k) plans, and leave and other fringe benefits policies. For example, reduced workweeks may affect the level of benefit contributions to a 401(k) plan, particularly if the employee had planned to spread out the maximum annual contribution over the course of the year. Likewise, if an employee is furloughed for an entire week, he or she may need to make additional premium payments in other weeks to ensure health or dental coverage for the month.

Additional Alternatives

In addition to the steps discussed above, there are many other cost-saving measures that could also help a company avoid layoffs. These include: (i) freezing wages; (ii) establishing a hiring freeze so that no new employees are hired, and no positions are filled when employees leave through natural attrition or termination; (iii) implementing alternative compensation arrangements such as deferred compensation, or increased incentive pay or productivity bonuses in conjunction with salary reductions or freezes; (iv) reducing benefit contributions to health plans, eliminating 401(k) matching programs, and decreasing fringe benefits; (v) initiating better control over employees' work hours to ensure that employees are working full days and/or are not working unnecessary overtime; (vi) setting caps or implementing "use it or lose it" policies for vacation pay or paid time off (except in California); (vii) offering a voluntary retirement or separation program to encourage employees to leave without having to resort to an involuntary reduction in force; and (viii) offering a voluntary sabbatical program or unpaid time off. Because many of these measures could raise unique state law issues, special care must be taken to consult with legal counsel to ensure compliance in each state in which a company operates.

Best Practices Tips

Where possible, employers should:

- Identify any contractual arrangements which might preclude unilateral changes to employee terms and conditions of employment;
- Provide at least 30-days advance notice to all employees of any reduction in pay and/or hours, or any planned furlough or shutdown program;
- Implement a formal written policy outlining any planned reduction in pay/hours, furlough program or shutdown;
- Apply the pay reduction or furlough policy on a company-wide, division-wide, department-wide or group-wide basis;
- Change work schedules/salaries of exempt employees no more than 2-4 times in a calendar year;
- In lieu of (or before) reducing salaries during furloughs or in partial workweeks, consider requiring employees to use their vacation, PTO, or other accrued leave, if permissible under applicable state law;
- Ensure that employees do not perform any work during a day or workweek in which they are furloughed or operations are shut down;
- Carefully consider whether and how benefits will accrue during furlough or shutdown periods, and how and at what rate benefit premiums and contributions (to a pension plan or 401(k), for example) will be paid in weeks when salaries are reduced or eliminated;
- Consult with legal counsel to ensure compliance with all federal and state laws.

This Special Report was brought to you by Proskauer's Managing Change/Reductions in Force Practice Group.

The Proskauer Rose Managing Change/Reductions in Force Practice Group is a multi-disciplinary practice group resident in the national and international offices of the Firm that specializes in partnering with our clients to address all legal aspects of the planning and implementation of workforce change in connection with job restructurings, reductions in force and corporate transactions.

Proskauer's nearly 175 Labor and Employment lawyers are capable of addressing the most complex and challenging labor and employment law issues faced by employers.

If you have any questions or concerns regarding this subject or related issues, please contact one of the attorneys listed below:

NEW YORK

Marc A. Mandelman
212.969.3113 – mmandelman@proskauer.com

Fredric C. Leffler
212.969.3570 – fleffler@proskauer.com

Joshua F. Alloy
212.969.3351 – jalloy@proskauer.com

Edward A. Brill
212.969.3015 – ebrill@proskauer.com

NEWARK

John Barry
973.274.6081 – jbarry@proskauer.com

WASHINGTON, D.C.

Lawrence Z. Lorber
202.416.6891 – llorber@proskauer.com

BOCA RATON

Allan H. Weitzman
561.995.4760 – aweitzman@proskauer.com

NEW ORLEANS

Howard Shapiro
504.310.4085 – howshapiro@proskauer.com

BOSTON

Mark W. Batten
617.526.9850 – mbatten@proskauer.com

LOS ANGELES

Anthony J. Oncidi
310.284.5690 – aoncidi@proskauer.com