



# Legal Considerations in Layoffs, Salary Reductions and Furloughs

A Nonprofit HR White Paper

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## Introduction

If your organization is thinking about salary reductions or furlough programs, there are several legal issues to take into account to minimize and avoid the possibility of lawsuits.

## Key Issue

Faced with the worst economy in decades, organizations appear to be contemplating or have implemented salary reductions, furloughs and/or other methods to save money without actually firing people.

## Key Solution

An across-the-board reduction in pay can be perfectly legal as can a reduction in hours. However, since both can create several legal complications, an organization will want to ask itself whether it can achieve its stated goals by reducing pay scales and/or delaying salary increases, rather than by furloughing staff.

## Nonprofit HR Solutions' Guidance

If your organization is seeking guidance or consultation concerning HR matters related to layoffs, furloughs or other benefits and compensation reductions, please contact Lisa Brown Morton at Nonprofit HR Solutions, (202) 785-2060 or via email at [lmorton@nonprofithr.com](mailto:lmorton@nonprofithr.com).

If your organization is seeking counsel regarding the legal implications related to layoffs, furloughs, and/or other benefits or compensation reductions, please contact Gerard Panaro at Howe & Hutton, (202) 466-7252 x. 102 or via email at [gpp@howehutton.com](mailto:gpp@howehutton.com).

## Introduction

Faced with the worst economy in decades, several nonprofit organizations are contemplating or have implemented salary reductions, furloughs and other methods to cut costs without actually firing people.

As one commenter stated: “You can’t read a newspaper these days without reading about organizations that are implementing employee furloughs in order to save money and to avoid layoffs...Firms that have deployed them recently include newspaper giant Gannett, network appliance superstar Cisco, computer chip maker Intel, the state of California, Arizona State University, and the #1 car maker in the world Toyota.” (Sullivan, “Employee Furloughs Can Be a Bad Alternative to Layoffs,” Feb 09, 2009).

If you are thinking about salary reductions or furlough programs, there are several legal issues to take into account to minimize and avoid the possibility of lawsuits:

1. Will a salary reduction or forced days off result in a breach of contract?
2. How will reduced hours affect benefits?
3. Will the program comply with state wage payment laws?
4. Will the program comply with the Fair Labor Standards Act?
5. Will the program have a “disparate impact” on protected categories?

This whitepaper explores both the legal and HR implications for implementing furloughs within an organization and provides general guidance on how to do so legally and effectively.

Disclaimer: The Information contained in this communication is intended only as general guidance and is not intended to be legal advice. Should your organization require legal counsel, we recommend consulting with an experienced employment attorney familiar with the laws of the state in which you operate.

## Know Your Employment Contracts

If an employee has an employment contract, then you may need to amend the contract in order to reduce that employee's pay. A contract is any agreement, written or verbal, that has a definite offer, consideration and acceptance. For example, a simple offer and acceptance letter saying, "We are pleased to offer you the position of chief bottle washer at an annual salary of \$35,000" is considered a contract. If you reduce the employee's salary, you are breaching the contract. Contracts may even be created by "course of dealing" or past practice.

Without contract disclaimer language, an employee handbook can also be considered a contract. If the handbook has a provision for annual reviews, salary increases, withholding raises, cost of living adjustments, bonuses, etc., it can also give rise to claims.

Therefore, any salary reduction plan should not be implemented without a reasonable notice period and evidence that the employee(s) affected have consented to the plan. If an employee is told, "If you don't agree to the [contract change], our only alternative will be to fire you." This conversation does not negate consent.

## Will Decreased Hours Affect Benefits?

It is no secret that benefits are a large part of most organization's HR budgets. Most full-time, and increasingly more part-time, employees are eligible to participate in their organization's benefit plans. There is no statutory definition of what constitutes "full time" or "part time employment", but there are statutes which do specify that employees must work a certain minimum number of hours to qualify for certain benefits. For example, under ERISA, an employee must work a minimum of 1,000 hours to qualify for coverage and under the Family Medical Leave Act, an "eligible employee" is one who works at least 1,250 hours in the preceding twelve months (state FMLA statutes may specify a lower threshold).

COBRA may be the most significant statute. COBRA applies to group health plans for employers with 20 or more employees on more than 50 percent of its typical business days in the previous calendar year (state equivalents to COBRA may apply to employers with fewer than 20 employees). One of the qualifying events that will trigger COBRA coverage is a reduction in the number of hours of employment. Exactly how many hours must be reduced is not stated, but it would certainly seem that if an employee's hours were reduced to below what is necessary under the plan that would be sufficient to activate COBRA. Health insurance plans usually limit coverage to "active employees" who work a minimum number of hours per week.

Also to be considered are the employer's own criteria for accumulating vacation, personal leave and/or sick pay. For example, if the employer's policy is that an employee accumulates four hours of vacation time for every 80 hours worked and an employee's hours are reduced to 70 hours, his/her leave time will accumulate at a slower rate.

Given this complication – that a reduction in hours may disqualify an employee from coverage under certain statutes and/or trigger COBRA coverage – organizations may want to see if they can get by with pay cuts only and consider furloughs or reduced working hours as a last resort.

### Check Applicable Wage Laws

Wage laws are different from minimum wage statutes. Wage laws usually mandate when and how employees are to be paid and prohibit deductions from an employee's pay unless expressly authorized by law, a court or the employee. However, a deduction from pay is not the same as a reduction in pay. For example, it may be illegal to deduct the cost of uniforms or lost equipment from the pay of an employee, but it is not illegal for the employer to change the rate of pay (so long as it isn't below the minimum wage).

A further example is §34:11-4.4 of the New Jersey Wage Payment Law states that "no employer may withhold or divert any portion of an employee's wage unless" the action falls within one of the categories permitted by the statute. But §34:11-4.6.b states that an employer shall "notify his employees of any changes in the pay rates or paydays prior to the time of such changes." No notice period is specified, so clearly the New Jersey statute contemplates that an employer may change (reduce) its pay rates. However, the employer must give notice of the change. A good rule of thumb would suggest that at least one pay period would be reasonable notice.

### Furloughs and the Fair Labor Standards Act

When considering the reduction of wages or hours an employer must take the Fair Labor Standards Act (FLSA) into consideration. Any pay reductions, in the case of exempt employees, cannot run afoul of the FLSA salary basis test. The salary basis test states that to be exempt an employee must be paid the same amount of money per workweek regardless of the quantity of work. These reductions may inadvertently convert an exempt employee into a nonexempt employee making them eligible for overtime. Deductions from the salary of an exempt employee, unless specifically authorized by FLSA, will break the salary basis and convert the employee into a nonexempt employee.

As an example, if you have an exempt employee earning a salary of \$700 a week and you reduce her pay to \$600 a week that will not violate FLSA. But if you require her to take one day off a week and deduct one day's pay from her salary that will violate FLSA. FLSA does not permit deductions from an exempt employee's salary for involuntary days off. Only if the employee voluntarily absents herself from work (always in full day increments), can you make the deduction not if the employee is ready, willing and able to work.

### Avoid Actions That Create Disparate Impact

Any pay and hours cuts have to be implemented in a balanced pattern that does not create issues of illegal discrimination. The reduction of pay and/or hours of all employees, generally will not raise any issues of illegal discrimination. However, the reduction of pay or hours of only certain employees or classifications of employees can raise discrimination issues. When pay and hour reductions affect a disproportionate number of persons in a protected category then "disparate impact" under federal and state anti-discrimination laws may occur. An example of this would be if a mostly white sales department does not have its hours cut but a support department composed largely of persons of color does. This action has opened the door for a discrimination lawsuit. The decision gives rise to a disparate impact charge because the burden of the cuts fall mainly on the minority employees, who are in a protected category.



## Final Considerations

An across-the-board reduction in pay can be perfectly legal as can a reduction in hours. However, since both can open several legal complications, an organization will want to ask itself whether it can achieve its goals of saving money and avoiding layoffs simply by reducing pay scales and/or delaying salary increases, rather than by furloughing staff.

An added consideration is that apart from the legalities, furloughs can create practical problems for a business that may be undesirable. For example, in the article cited above, a dozen problems apart from potential lawsuits can be caused by furloughs:

1. Most furloughs save less money than layoffs would.
2. The workload doesn't decrease.
3. Treating everyone the same isn't fair to top performers.
4. Furloughs can create turmoil in the workplace.
5. Furloughs don't always forestall layoffs.
6. Furloughs anger customers, clients and communities.
7. Furloughs affect product quality.
8. Furloughs affect innovation.
9. The uncertainty of furloughs will put employees into "job search mode".
10. Potential new hires will "think twice" about accepting a job offer.
11. Teamwork will deteriorate.
12. Furloughs are a nightmare to scheduling managers.



## Additional (Non-legal) Considerations in Layoffs, Salary Reductions and Furloughs

### Be Aware of Survivor Guilt

When deciding to engage in organization-wide lay-offs, it is imperative that leadership also take into consideration the mental state of the surviving employees. Organizations do not often benefit from downsizing efforts because of the lack of concern shown towards survivors. Often times poorly planned lay-offs result in voluntary turnover and a lack of productivity.

Following mass lay-offs, surviving employees tend to exhibit tardiness [4], a lack of trust, a lack of loyalty and a decreased amount of organizational commitment [5]. In order for an organization to not only survive downsizing, but to thrive and maintain growth, there are a number of factors to keep in mind.

First, the organization should conduct the appropriate research to ensure that there is no unnecessary or avoidable need for a second, third or fourth round of layoffs. Second, the organization should conduct the layoffs in a systematic way taking into account fairness. If employees feel as if the process was unfair, unorganized or poorly communicated, they are more likely to feel anger and resentment towards the organization which may lead to lower rates of productivity and voluntary turnover [3].

Lastly, the organization should be considerate of the survivors' feelings and give them time to grieve. Sometimes losing a co-worker to layoffs can be extremely emotional. If the organization has not already instituted an Employee Assistance Program (EAP), this may be a good solution to help with employee motivation and commitment [4].

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