I. Introduction

Times of recession by their nature breed cost-saving instincts in individuals and in companies. The shrinking bottom line compels employers to consider what measures are available to them to control expenses and are practical considering their unique circumstances. Employers and companies across the nation have recognized the need to implement some sort of measure to contain the costs of labor, both skilled and unskilled, and maximize the company’s resilience in these trying economic times.

A reduction in force (“RIF”) or a layoff is often utilized to balance the losses suffered by a company as a result of a diminished market. While the RIF serves an important function, there are other measures that save costs and, unlike RIFs, maintain the employment relationship with the employee albeit in a different form. Those cost-saving measures – furloughs, reduced workweeks, reduced wages, job sharing – as well as their potential pitfalls, are the topic of this paper and are discussed in depth below.

II. Furloughs

A furlough refers to a non-permanent, unpaid leave of absence implemented by an employer as a cost-saving measure. As one might expect, the major advantage to the furlough option is that an employer can tread water during periods of slow-moving business by avoiding the costs of maintaining working employees but without losing those employees who are necessary to the running of the business.

This is especially useful in the context of higher-level employees who offer specialized skills and perhaps institutional knowledge about the employer company. As an example, an architecture firm may choose to place its architects and/or engineers on furlough during periods of slow business until the firm obtains enough projects to regain its ability to fund its work. That way, the architecture firm does not lose its specialized talent but avoids the full costs associated with working employees.

There are also advantages to implementing a furlough as opposed to a RIF. In contrast to a RIF, the employer implementing a furlough may avoid the potential costs of severance benefits related to a RIF. And, depending on the nature of the furlough and the particular state’s law, the employer may also minimize or avoid the costs associated with unemployment insurance benefits.

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While furlough has a general meaning, it takes many forms. Furloughs can have short or long durations, can be for a definite period or an indefinite one. The employer may offer the employees the option of taking furlough or may make it mandatory. Finally, furlough can be paid, unpaid or partially paid. The central shared components of a furlough are that it is non-permanent, occasional and prompted by the employer.

A. Furlough and Non-exempt Employees

Under the Fair Labor Standards Act, non-exempt employees must be paid at least the minimum wage for all hours worked and must be paid overtime wages for all hours worked in excess of forty hours per workweek.ii Because the law only requires that non-exempt employees be paid for hours worked in accordance with the minimum wage and overtime requirements, employers implementing furloughs with respect to non-exempt employees need only concern themselves with complying with those two rules. If the employees perform work during the furlough period, the employer must pay the non-exempt employee only for any hours actually worked.

B. Furlough and Exempt Employees

By contrast, when an employer furloughs exempt employees, the issue of what consequences arise when the employees perform work during the furlough becomes a more complex issue.

To begin, exempt employees are those employees who fall under one of the Fair Labor Standards Act’s recognized exemptions. The most common exemptions are the so-called “white-collar exemptions;” the executive, administrative, or professional exemptions. To be exempt under one of the white-collar exemptions, an employee must be compensated on a salary basis at a rate of not less than $455.00 per week as well as meet the requisite duties test. The term “salary basis” is defined at 29 CFR §541.602:

An employee will be considered to be paid on a “salary basis” within the meaning of these regulations if the employee regularly receives each pay period on a weekly, or less frequent basis, a predetermined amount constituting all or part of the employee’s compensation, which amount is not subject to reduction because of variations in the quality or quantity of the work performed. Subject to the exceptions provided in paragraph (b) of this section, an exempt employee must receive the full salary for any week in which the employee performs any work without regard to the number of days or hours worked. Exempt employees need not be paid for any work week in which they perform no work. An employee is

ii 29 USC §206, 207.
not paid on a salary basis if deductions from the employee’s predetermined compensation are made for 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.iii

In implementing furloughs, employers must be mindful of the salary basis rule when dealing with exempt employees. Exempt employees typically have some access to work and work matters even during off-work time. Indeed, the prevalence of work cell phones and personal portable devices such as the Blackberry and the iPhone mean that work is accessible during non-working hours. In spite of the ease of accessibility of these devices, during furlough, any work performed by exempt employees may trigger the employer’s obligation to pay the employee the minimum rate of pay for the entire workweek.iv In other words, if exempt employees work for any part of the workweek designated by the employer, they still must be paid at least $455 for the entire week.v As alluded to above, in this world of constant access to work, exempt employees will be tempted, if not eager, to perform some work during the furlough.

In order to avoid paying exempt employees while on furlough, employers must clearly and affirmatively instruct exempt employees that they are prohibited from performing any work during the furlough. If an employee disregards this instruction or if the employer requests that the employee perform work, the employer will have to pay that employee for the entire workweek. Given the obligation imposed on the employer, employers should make sure to designate full weeks for furlough that coincide with the employer’s designated workweek.

Another option to consider with respect to exempt employees is to change the position into a non-exempt, hourly position. Employers must be cautious and diligent in considering and ultimately implementing this option. It must be a bona fide change, one which the employer will not un-do once the business increases. Any back-and-forth between the exempt status of the position may indicate to the DOL that the status is only a “sham”.vi This may jeopardize and undermine the employer’s position in the future that the employee’s duties do not qualify as exempt.

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iii 29 CFR § 541.602(a)(emphasis added).
iv The Fair Labor Standards Act defines the term “employ” to include where an employer “suffers” or “permits” an employee to work. 29 U.S.C. § 203(g). See also, 29 C.F.R. § 785.11 (“Work not requested but suffered or permitted is work time.”).
v See 29 C.F.R. § 541.602.
C. Use of Paid-Time-Off ("PTO") or Accrued Vacation Time

As a further cost-saving measure, employers may explore the option or requirement that employees pull from a PTO bank or accrued vacation time while on furlough, or during a reduced workweek schedule as described below. Under federal law, the DOL has concluded that an employer may require exempt employees to use accrued vacation time during a work shutdown of less than a week without forfeiting the exemption. State law, of course, must be consulted in addition to federal law whenever dealing with wage & hour practices.

Employers seeking to require non-exempt or exempt employees to use PTO during a furlough of less than one week should be aware that some states impose restrictions on how employers may administer their vacation policies. So, state law may prevent employers from requiring employees to utilize PTO or accrued vacation time in a given situation. Likewise, employers should review their individual employment contracts, if any, and effective collective bargaining agreements before implementing a mandatory policy that employees use PTO during furlough. The effect of any contractual limitations on implementing cost-saving measures is discussed more thoroughly below.

III. Reduced Workweeks

Reducing the work week also represents an attractive cost-saving measure. It not only decreases labor costs but also may decrease utility payments or other expenses incidental to a live workplace, increase employee morale and productivity, and decrease the incidence of employee absenteeism. The state of Utah, in 2008, adopted a mandatory four-day/ten-hours-a-day work week for most state employees after estimating that the change would save $3 million per year in utility costs. Since this implementation, the state has found that the reduced workweek has resulted in a 13% reduction in energy use and estimated a $6 million savings in employee gasoline costs. One survey suggested that 82% of the Utah state workers want to keep the new schedule.

The city of El Paso, Texas implemented a four-day/ten-hours-a-day work week just recently for the summer months of 2009. In the months of June and July, the city saw a 3.2% reduction in electricity, a 14% savings on natural gas, and a 23.7% savings on custodial services. All said, the city saved $100,000 in operational costs.

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A. Reduced Workweeks and Non-Exempt Employees

As with furloughs, reducing workweeks for non-exempt employees does not present unique or particularly complex legal issues. The only pitfalls to avoid are following the minimum wage and overtime requirements of the Fair Labor Standards Act, and considering issues of notice, effect on other policies, and limitations imposed by contract or collective bargaining issues, which are discussed below.

B. Reduced Workweeks and Exempt Employees

Despite the benefits of the reduced workweek, a reduction in an exempt employee’s work hours accompanied by a reduction in salary could suggest that the employee is no longer paid on a salary basis and therefore may lose exempt status. The Wage and Hour Division of the U.S. Department of Labor ("DOL") has issued three opinion letters on this issue. In each of the opinion letters the Department has taken the position that:

a fixed reduction in salary effective during a period when a company operates a shortened work week due to economic conditions would be a bonafide reduction not designed to circumvent the salary basis payment and the exemption would remain in effect as long as the employee received the minimum salary required by the regulations and met all other requirements for the exemption.\textsuperscript{x}

The DOL does, however, take the position in each of the Opinion Letters that “recurrent changes in an employee’s status may lead to an across-the-board denial of the exemption.”\textsuperscript{xi} Thus, while an employer may not reduce pay for a pay period in which the time has already been worked and for which the salary was already set, the employer may do so on a prospective basis provided the changes are not so frequent that the salary is, in effect, an hourly rate of pay.

Nevertheless, employers should be cautious when reducing exempt employees’ salaries and work weeks. This is because the DOL has also indicated that if a company were to vary employees’ schedules such that it appeared that the employees was paid by the day and not by the week, the exemption would no longer apply. The DOL recently reiterated its interpretation of the law, stating: “Unlike a salary reduction that reflects a reduction in the normal scheduled work week and is not designed to circumvent the salary basis requirement, deductions from salary due to day-to-day or


week-to-week determinations of the operating requirements of the business are precisely the circumstances the salary basis requirement is intended to preclude.\textsuperscript{\text{xii}}

Despite the DOL’s seemingly clear guidance, this issue has been litigated on several occasions with varying results. The 10th Circuit Court of Appeals, for example, in the case of \textit{Archuleta v. Wal-Mart Stores, Inc.} (In Re: Wal-Mart Stores, Inc.) 395 F.3d 1177 (10th Cir. 2005), endorsed the rationale of the DOL’s Opinion Letters, holding that “an employer’s practice of prospectively changing salaries does not convert salaried employees to hourly employees entitled to overtime rates unless the purported salary “becomes a sham – the functional equivalent of hourly wages.”\textsuperscript{\text{xiii}} The Tenth Circuit went further, noting that nothing in the regulations precludes an employer from renegotiating the terms of employment to provide for new work hours and a new salary so long as the changes are prospective and are not done so frequently as to make the salary the equivalent of hourly pay.\textsuperscript{\text{xiv}}

At least one court has taken an opposite position by concluding that a reduction in the workweek of an exempt employee with a corresponding reduction in salary does result in the loss of the exemption. The court in \textit{Dingwall v. Friedman Fisher Assocs.,} 3 F.Supp.2d 215 (N.D.N.Y. 1998) held that a reduction in work time that is imposed by the employer may not be the basis for the reduction in salary without the loss of the exemption. The court concluded that “defendant was not merely altering plaintiff’s fixed salary (which it undoubtedly had the right to do), it was altering it on the basis of a reduction in the amount of days worked in response to an insufficient amount of work available.” The court concluded that the employee was no longer being paid on a salary basis and the exemption was lost. Interestingly, though, the court did not refer to the DOL Opinion Letters. The Tenth Circuit expressly rejected \textit{Dingwall} in its \textit{Wal-Mart} decision.\textsuperscript{\text{xv}}

Another case, \textit{Reeves v. Alliant Techsystems, Inc.,} 77 F.Supp.2d 272 (D.R.I. 1999) made an interesting distinction. It held that an employer could not unilaterally impose a reduced workweek in conjunction with a salary reduction, or the exemption would be lost. However, the court held that the employer’s actions in presenting employees with a choice – they could work an extra five (5) hours per week and keep their salary or, if they chose not to work the extra five hours, have their salaries reduced – did not forfeit exempt status because, according to the court, the employees were “voluntarily reducing their work week.”\textsuperscript{\text{xvi}}

\textsuperscript{\text{xiii}} \textit{In re Wal-Mart Stores}, 395 F.3d at 1179.
\textsuperscript{\text{xiv}} \textit{See also, Caperci v. Rite Aid Corp.,} 43 F.Supp.2d 83 (D. Mass. 1999)(no loss of exempt status where employer could prospectively lower employees’ salaries in anticipation of reduction in hours employees were expected to work)
\textsuperscript{\text{xv}} 395 F.3d at 1188.
\textsuperscript{\text{xvi}} 77 F.Supp.2d at 256.
Finally, although outside of the context of reducing work time at the same time as pay, the court’s opinion in *Havey v. Homebound Mortgage, Inc.*, 547 F.3d 158 (2d Cir. 2008) would support the position that a prospective reduction in pay even when accompanied by fluctuations in work time does not necessarily violate the FLSA. In *Havey*, the Second Circuit held that the employer’s policy and practice of adjusting its exempt employees’ salaries prospectively depending on the quantity and quality of their work did not violate the Fair Labor Standards Act. The employees in *Havey* were insurance underwriters; each quarter they and the employer set their earnings for the upcoming quarter based on the goals regarding the volume of quality policies the underwriters estimated they would write and based on the quantity and quality of their work in the previous quarters.xvii This meant that, although the employees were exempt employees, the company would increase and decrease the amount they would earn each quarter based, in part, on their volume of quality work.

In holding that this arrangement did not violate the FLSA, the court relied on evidence that (1) regardless of the quality or quantity of their work, the underwriters always received a known minimum salary each quarter that exceeded the requirements of the salary basis rule; and (2) the adjustments were made only prospectively such that the employer did not make deductions for work the underwriters had already performed. Because the employees’ pay did not fall below the salary basis and was not subject to retroactive deductions, the employer’s policy did not violate the FLSA.xviii

**IV. Reduced Wages/Salary**

Reducing wages or salary without decreasing employees’ workload is perhaps the least popular cost-saving measure available to employers. US Airways experienced the effect of reducing wages in an extreme way after it made drastic pay and benefits cuts in 2004.xix The reductions inspired bad will among employees, a decrease in productivity and efficiency, and an increase in absenteeism. The employees’ reactions were widely known. When US Airways later recalled pilots from furlough, about 600 pilots “turned down the chance to return because of pay and benefit cuts, they have moved on to other jobs, or they don’t like the sloppy way the airline [was] being run.”xx

Thus, reducing wages for non-exempt employees must be balanced with the risk of lowered morale, productivity and workplace satisfaction. Recent suggest that employee happiness is more connected to work productivity than companies may have previously imagined.xxii According to these studies, the effect of employees’ dissatisfaction may pose a greater threat to the bottom-line than continuing their rate

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xvii *Havey*, 547 F.3d 158, 161-162  
xviii *Id.* at 165-167.  
of pay. Despite this, reduced wages may represent a useful tool for some employers to save costs while avoiding more drastic measures such as a RIF. And, although reduced wages and salary may cause bad will towards the employer, it is also true that some employees prefer a pay cut to having no job at all and may accept such cuts if the only alternative is to lay off employees.

For non-exempt employees, a reduction in wages is implemented just as with furloughs and with reduced workweeks; that is, following one fundamental rule: the non-exempt employees must be paid at least the minimum regular rate of pay under the applicable federal, state, and local minimum wage. The current federal minimum wage is $7.25/hour. Employers need to be aware that some states have legislated higher minimum wages.

Under the Fair Labor Standards Act, as stated above, exempt employees’ salaries cannot be reduced to less than $455 per week. Additionally, as discussed in the previous section, if reductions in exempt employees’ salaries accompany a reduction in hours or days worked, the employer should be aware that the exemption may be lost.

V. Implications of Implementing Cost-Saving Measures

A. Notice Requirements

Employers that do business in several states across the country should be careful to provide sufficient notice before implementing mandatory as opposed to an optional cost-saving measures such as furloughs, reduced workweeks and/or reduced wages or salaries. While all states require some form of advance notice before implementing a mandatory furlough, some states require a specific notice period, and some require written notice. It is important to know the notice requirements for each state in which the employer has employees.

Many states, for example, simply require employers to provide unequivocal notice and obtain acceptance of any changes in pay rate for at-will employees. Under Texas law, for example, an employer’s unequivocal notice of a change in the terms of employment combined with the employee’s continued employment are sufficient to satisfy the notice requirements. Texas law does not demand a specific period of notice in advance of implementation.

In order to avoid disgruntled employees and their lawsuits, however, all employers should consider giving written notice of at least one pay period before implementation where more is not required.

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xxii See 29 C.F.R. § 541.600.
xxiii See, e.g., Hathaway v. General Mills, 711 S.W.2d 227 (Tex. 1986).
xxiv In re Dillard Dep’t Stores, Inc., 198 S.W.3d 778, 780 (Tex. 2006).
B. WARN Act

Reducing the workweek may also have implications under the Worker Adjustment and Retraining Notification Act ("WARN Act"). The WARN Act requires employers, as defined under the Act, to provide sixty days’ advance notice of a “plant closing” or “mass layoff.”

- A plant closing is defined as the permanent or temporary shutdown of a “single site of employment,” or one or more “facilities or operating units” within a single site of employment, if the shutdown results in an “employment loss” during any 30 day period at the single site of employment for 50 or more employees, excluding any part-time employees.xxv

- A mass layoff is defined as “a reduction in force which (1) is not the result of a plant closing, and (2) results in an employment loss at the single site of employment during any 30 day period for (i) at least 33 percent of the active employees, excluding part-time employees, and (ii) at least 50 employees, excluding part-time employees.”xxvi

- An "employment loss" is defined to include "a reduction in hours of work of more than 50 percent during each month of any 6-month period."xxvii

An employer who reduces a sufficient number of employees’ working hours at a single location may need to comply with the WARN Act’s notice provisions.

Generally, an employer subject to WARN must provide the sixty days’ advance notice to (1) each representative of the affected employees; (2) each affected employee not represented by a union; (3) the State dislocated worker unit or office or the State or entity designated to by the State to carry out rapid response activities; and (4) the chief elected official of the unit of local government within which such closing or layoff is to occur. Under the Act, the notices should contain:

1. The name and address of the employment site where the plant closing or mass layoff will occur, and the name and telephone number of a company official to contact for further information;

2. A statement as to whether the planned action is expected to be permanent or temporary and, if the entire plant is to be closed, a statement to that effect;

(3) The expected date of the first separation and the anticipated schedule for making separations; and

(4) The job titles of positions to be affected and the names of the workers currently holding affected jobs.\textsuperscript{xxviii}

The notice to each affected employee who does not have a representative is to be written in language understandable to the employees, and also must contain the expected date when the plant closing or mass layoff will commence and the expected date when the individual employee will be separated. The notice provided to the State dislocated worker unit and to the chief elected official of the unit of local government also must contain the name of each union representing affected employees, and the name and address of the chief elected officer of each union.\textsuperscript{xxix}

C. Benefits Plans

Employee benefits plans should be evaluated to determine the effect, if any, of the reduced hours and compensation. This is true in the context of furloughs as well as with reduced workweeks and reduced wages or salaries. Under some health insurance plans, for example, a “covered employee” is defined by hours of work. If this is the case, the employer needs to decide whether an amendment to the plan may be necessary to ensure continued health care coverage if the hours are reduced.

The same may be true for disability plan coverage and for retirement benefits. A pay and/or work reduction may have an impact on the amount of any disability or life insurance benefits (calculated as a function of pre-event earnings) payable in the case of a covered event. Employers should be prepared to provide information to their employees regarding any such impact.

With particular respect to the continuation of health care coverage, in order to ensure compliance with the Consolidated Omnibus Budget Reconciliation Act of 1986, as amended ("COBRA"), employers should become familiar with the terms of their group health plans to determine whether a furlough (or a reduced workweek) will affect employees’ health care coverage. COBRA provides qualified individuals the option to continue group health benefits for a period of time after a “qualifying event.” One such event is a reduction of hours that results in the loss of health benefits.\textsuperscript{xxx}

Employers should analyze the effect on employee benefits and plans of a furlough or reduction in hours to ensure that the benefits of a protected group of employees are not disproportionately affected. For example, in a recent case in the

\textsuperscript{xxviii} 29 C.F.R. § 639.7.
\textsuperscript{xxix} 29 C.F.R. §§ 639.6, 639.7.
Western District of Pennsylvania, *Hayden v Freightcar America, Inc.*, the plaintiffs asserted that the employer violated the Employee Retirement Income Security Act ("ERISA") by purposefully including them in the employer’s mandatory furlough in order to prevent the plaintiffs from attaining the necessary amount of service time to be eligible for their pension and welfare plan benefits.³³¹ Pursuant to a collective bargaining agreement between the employer and the union, the employees’ rights to benefits, including the period of service for vesting, would still accrue during the mandatory furlough, but only for a duration up to two years, a period shorter than the period of the furlough imposed by the employer. The plaintiffs sought certification of a class of similarly-situated employees who were set to vest slightly more than two years following the date the employer implemented the furloughs. The court certified a class of similarly-situated employees and permitted the claim to proceed. In addition, the court granted the plaintiffs a preliminary injunction reinstating two sub-classes of the affected employees to work so that their furlough would not extend beyond the two-year time period.

As demonstrated by *Hayden*, employers should be aware of the effect that a furlough or reduction in pay/workweek will have on its employees’ benefits and benefit plans to determine whether the cost-saving measure will have a disproportionate impact.

D. Effect on Unemployment Benefits

A reduction in hours may entitle employees to unemployment benefits under the applicable state unemployment compensation statute. This is governed by local law and will differ from state to state. If claims are payable, a furlough or reduced workweek may affect the employer’s experience rating and could lead to higher premiums for unemployment insurance.

The employer may consider establishing a Supplemental Unemployment Benefit ("SUB") Plan (and a corresponding trust) under Section 501(c)(17) of the Internal Revenue Code.³³² These types of plans are subject to a number of requirements, including that benefits be limited to participants who are eligible for unemployment benefits, and that benefits not be paid in a lump sum. Despite these obligations, where well-designed, benefits paid to the participants are not considered wages for purposes of the Federal Insurance Contributions Act ("FICA") and Federal Unemployment Tax Act ("FUTA"), although they are wages for purposes of federal withholding requirements.³³³

³³² 26 U.S.C. § 501(c)(17)
³³³ See Rev. Rul. 90-72, 1990-2 CB 211.
E. Contractual Limitations

Because most states maintain at-will employment laws, there are typically not employment agreements forming the basis of the employment relationship. In other states, however, some form of an employment agreement is typical if not required by state law. Employers should determine whether the terms or conditions of individual employment agreements or other obligations might affect the implementation of furlough, reduced work week schedules or a reduction in pay.

There may also be limitations on reductions in pay and/or working hours in place in a collective bargaining agreement where the employer’s workplace is organized by a union or other labor-organizing body. A prudent employer should evaluate its obligations under any CBA before structuring and planning the implementation of any cost-saving measure.

VI. Worksharing

Several states, including Texas, California, and New York, offer employers the option of participating in worksharing programs in order to avoid RIFs, furloughs, or wage or hours reductions. Below is a description of the Texas Worksharing program as an example. Employers should investigate whether the state in which they are implementing the cost-sharing measure offers worksharing programs in order to analyze whether this option might be advantageous.

A. Texas Workforce Commission Sharing Work Compensation

The Texas Workforce Commission offers employers the opportunity to participate in a worksharing program called Shared Work Compensation whereby employers facing a RIF, instead of laying off employees, may reduce the hours of work each week among a specific group of employees. Wages lost to the employee as a result of reduced hours are supplemented by a partial unemployment benefit amount provided through the Texas Workforce Commission.

Employers can use worksharing in one or more departments, shifts or work units. The program gives an employer the flexibility to specify the affected areas and employees. In addition, different employees can have differing percentages of reduced hours as long as the reduction is between 10% to 40% each week depending on the specifications of the plan.

When the employee no longer needs to participate in the shared work program, replacing individuals or groups back to work full-time for a week or more is encouraged and facilitated by the Texas Workforce Commission. The plan is structured such that

xxxiv The information in this section was obtained from the Texas Workforce Commission’s website: http://www.twc.state.tx.us/ui/bnfts/sharedworkfaq.html, last accessed March 1, 2010.
employers should not confront any serious inconveniences in returning to a regular work arrangement.

Employers participating in the shared work program do not have to report any wages their employees may earn from outside part-time employment. It’s important to note, however, that once an individual files under the regular unemployment insurance program, that individual is required to report any earnings (full-time or part-time) on that individual’s claim certification.

An interested employer submits to the Commission an application to participate in the program. The Commission then approves or denies a shared work plan no later than 30 days after the plan is received. The plan becomes effective on the date it is approved by the Commission, and the plan expires on the last day of the 12th full calendar month after the effective date of the plan. The Commission recommends that employers request a starting date that will coincide with his payroll date to simplify the time keeping procedures.

As stated above, if the plan is approved, workers who qualify for unemployment benefits will receive both wages and Shared Work benefits. The workers will receive the percentage of their regular benefits that matches the percentage of reduction in the employer’s plan. Benefits paid under shared work plans are charged back against employers’ unemployment compensation accounts for use in computing general (experience) tax rates. Thus, shared work benefits affect the employer’s tax rate in the same manner and to the same extent as other chargebacks of benefits.

VII. Modified Bonus/Incentive Programs

Another way for employers to avoid costs is to modify or curtail bonus or incentive programs. Bonus and incentive programs are supplemental compensation schemes that intend to reward certain employees, typically high-level or professional employees for good job performance. Whatever advantages exist to instituting these programs, the programs can represent drains on an employer’s resources in times of economic crisis.

Employers seeking to avoid this drain can explore the option of modifying, delaying or curtailing bonus/incentive programs during periods of fiscal retraction. Much has been made of the executive bonuses paid to the Wall Street financial firms like Goldman Sachs that many connect to the current recession.xxxv Taking this measure especially in conjunction with reduction in pay or working hours for non-exempt or mid-to-low level employees may increase employee morale and loyalty as well as save the company some resources.

As is the case with many of the so-called Wall Street bonuses mentioned above, before implementing any modifications to bonus or incentive programs, employers must take caution in determining and complying with any contractual obligations it may have with respect to bonus payments. Obviously, to the extent that existing contracts and CBAs permit employers to modify their incentive or bonus programs, employers normally must limit their modifications to prospective changes only.

VIII. Potential Pitfalls

As with reductions-in-force, employers should become aware of the risks associated with utilizing these alternatives before implementing them. While the risks particular to specific measures have been addressed above, there are two risks that apply widely. They are the potential for increased discrimination and/or retaliation claims, and the possible alienation of employees.

A. Increased Discrimination and/or Retaliation Claims

When an employer takes actions that adversely affect a broad swath of its employees, the potential arises for increased discrimination and/or retaliation claims. There are multiple federal and state laws that protect employees who are the victims of discrimination in employment on the basis of their membership in a protected class, most notably, 42 U.S.C. § 1981, Title VII, the ADA, and the ADEA. These statutes also protect against an employee from retaliation for participating in an effort to assert rights under these statutes or for opposing unlawful conduct under these statutes.

Employers considering implementing any cost-saving measure should assess and protect against the possibility of increased discrimination claims coming in two forms: a disparate treatment claim and a disparate impact claim. Disparate treatment is the more common claim of discrimination in which an employee or a group of employees asserts that they have been treated differently and, in fact, adversely because of their membership in a protected class. With regards to disparate treatment claims, absent any direct evidence of discrimination, it is true that an employer who implements a cost-saving measure affecting a large number of employees has a ready legitimate, non-discriminatory reason – to save costs.

Especially in furloughs or reduced workweek measures affecting a smaller group of employees, employers should be aware of the potential for litigation. Koster v. Trans World Airlines is typical. In Koster, the First Circuit Court of Appeals upheld a jury verdict in favor of an employee who alleged he was chosen for furlough among a group of six employees because of his age.\textsuperscript{xxxvi} The employee-plaintiff did not attack the reason for the furlough – the employer's need to save costs – but rather asserted that

\textsuperscript{xxxvi} Koster v. Trans World Airlines, 181 F.3d 24 (1st Cir. 1999).
he was chosen over other younger employees because of his age. In upholding the verdict, the court relied on evidence that the plaintiff received only excellent markings and ratings on his performance evaluations, and that other younger employees who were not furloughed had received some negative comments. From this, the court reasoned that the jury could have concluded that the plaintiff’s age, not his performance, was the reason for his discharge.xxxvii

Similarly, the Third Circuit, in Risk v. Burgettstown Borough, PA, denied the employer’s appeal of the trial court’s denial of its motion for judgment as a matter of law after a jury verdict in favor of an ex-police officer who alleged he had been chosen for furlough because of his religion.xxxviii The plaintiff based his claim on evidence that, prior to the furlough, the police chief had asked the police officer a number of times to remove a pin in the symbol of a cross from his uniform. In addition, the supervisor had made negative comments regarding the public nature of the plaintiff’s religious beliefs. Finally there was evidence from which the jury could have concluded that the police department had ignored seniority furlough laws applicable to government employers in deciding that the plaintiff, despite his seniority, was to be included in the furlough. This evidence was sufficient to support the jury’s verdict that the plaintiff had been chosen for furlough because of his religion.

As opposed to disparate treatment claims, disparate impact claims rest on the statistical or actual fact that the majority of employees affected by an employer policy or action belong to a particular protected class. When implementing a cost-saving measure, employers should avoid using criteria for selecting those who will be affected that result in the selection of a disproportionate number of employees belonging to single protected class. Such a result would likely be prima facie evidence of disparate impact claim under the statutes referenced above.

In a 2007 case out of New York state, Velez v. Novartis Pharm. Corp., 19 women who worked at the employer’s company alleged that the company engaged in systemic gender discrimination in compensation, promotions and evaluations.xxxix The court certified a class of plaintiffs that consisted of thousands of female employees and former employees. In certifying this class, the court explained that the evidence was sufficient at that stage to demonstrate that the company relied on subjective assessments in conducting performance reviews and then utilized those subjective reviews in making decisions regarding compensation and promotions.

The court also relied on two expert reports offered by the employees that analyzed and attacked the effectiveness and meaning of the company’s performance reviews. The first report concluded that the performance ratings incorporated in the

xxxvii Id. at 32. It is important to note that under Massachusetts law at that time, the plaintiff need only prove that the employer’s proferred reason was pretextual, not that age was the actual reason.


reviews did not necessarily reflect the level of actual performance because the ratings could be modified by supervisors up the chain, and because the ratings had to be distributed according to a prescribed curve.

The second expert’s report also analyzed the performance ratings and concluded that the class members systematically received lower ratings than their male counterparts specifically on the subjective parts of the performance review. This evidence was sufficient to certify the class based on the employees’ claim that female employees were the victims of systemic discrimination. Although the plaintiff’s allegations were not made in the context of a RIF, a furlough, or any other such cost-saving measure, it is easy to see how this evidence and analysis could translate into such a context. Where decisions to include employees in these mandatory measures are made on the basis of performance or potential contribution to the future of the company, employers should base those decisions on objective, measurable factors to the extent that is possible, in order to minimize the risk of adverse litigation outcomes.

Increasingly frequent in relation to the implementation of cost-saving measures is the retaliation cause of action. Imagine that an employee complains of harassment, mistreatment or discrimination shortly, or even not so shortly, before he is negatively affected by a reduction in salary, for example. If the reduction in salary was not implemented broadly, the employee could have a viable claim that he was chosen for the reduction in salary because of his complaint despite the fact that the reduction was a cost-saving measure.

The Fifth Circuit addressed a plaintiff’s retaliation claim after her placement on furlough in *Staten v. New Palace Casino, LLC.*xl The plaintiff was a lead cook for the graveyard shift at the casino’s buffet. Prior to the furlough, the plaintiff had made several complaints and reports of race discrimination to management. In November 2001, the casino decided to close the buffet for a complete renovation. As a result, all the employees working in the buffet were furloughed except, as the evidence demonstrated, all the other leads working in the buffet were transferred to other positions at the casino pending the renovations. The plaintiff was taken off the work schedule. She then filed a charge of discrimination and retaliation with the EEOC.xli

Thereafter, when she attempted to re-obtain her position after the renovations were complete, she was not hired. In her lawsuit, she alleged that the employer discriminated against her because of her race and retaliated against her with respect to both the decision to furlough her and the decision not to re-hire her. The trial court granted the employer’s motion for summary judgment on all claims. The Fifth Circuit reversed the trial court’s dismissal of the plaintiff’s retaliation claim with respect to the furlough, holding that her previous complaints of discrimination coupled with evidence that other leads were transferred into other positions pending the renovations despite

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xli Id. at 352-353.
the employer's initial assertion that all buffet employees were furloughed, was sufficient to create a question of fact for the jury.\textsuperscript{xlii} The court upheld the summary dismissal of the plaintiff's retaliation claim with respect to the failure to re-hire because the employer produced evidence that the individual responsible for the hiring decision was not aware that the plaintiff had filed an EEOC charge.\textsuperscript{xliii}

To avoid the risk of increased discrimination and retaliation litigation altogether, employers may consider offering voluntary measures. That is to say, employers can design policies and offers that give their employees the option of participating instead of mandating participation. For example, if an employer offers two-week furlough, an employee who voluntarily chooses to participate would encounter a formidable obstacle in arguing that he was negatively affected in the terms and conditions of his employment a result of a discriminatory motivation. The employer should be careful to ensure that the choice is voluntary. In other words, if the choices presented to a particular employee are different than the choices presented to other employees, it will plant the seed of an argument supporting an employee's allegation that he was the victim of discrimination. Likewise, if the choices are so lopsided with one being clearly better than the other, it may appear that the employee had no choice and provide a basis upon which to argue that the decision was not solely motivated by the employer’s desire to cut costs.

This was precisely the case the Eleventh Circuit confronted in 2005 in \textit{Rowell v. BellSouth Corporation}. The employee-plaintiff alleged that the company unlawfully forced him to choose between voluntary separation and involuntary discharge during a RIF and therefore constructively discharged him because of his age.\textsuperscript{xliv} Seeing the need to cut costs, the employer informed its employees that it would be implementing a RIF of its management personnel in two phases. First, it would offer voluntary severance plans to willing management employees. If the need to reduce the workforce remained after this initial phase, it would implement mandatory reductions in force.

Before either phase began, to implement the RIF, the company generated six competency factors that would be used to determine which employees were included in the mandatory measure. Those factors were: (1) demonstrates broad business knowledge and savvy; (2) achieves results through speed and decisiveness; (3) maintains a focus on customer satisfaction; (4) instills purpose and vision; (5) communicates openly and effectively; and (6) builds high performing teams and individual talent. The company divided the employees into “universes” in order to compare and rank their competency ratings. The plaintiff and one other employee received the two lowest ratings in their universe. When the plaintiff asked his supervisor whether he should be looking for other jobs, the supervisor responded that

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\textsuperscript{xlii} \textit{Id.} at 358-360.
\textsuperscript{xliii} \textit{Id.} at 362.
\textsuperscript{xliv} \textit{Rowell v. BellSouth Corp.}, 433 F.3d 794 (11th Cir. 2005).
\end{flushright}
he should. His supervisor's comment indicated to the plaintiff that he should take the voluntary severance package, and he did.

In ruling on the plaintiff's constructive discharge claim, the court reviewed case law regarding claims of constructive discharge in the context of an employer's offer of voluntary separation. Certain cases hold that plaintiffs can establish that working conditions were so intolerable that the employees were forced to leave by showing that they were presented with a take-it-or-leave-it choice between voluntary resignation and involuntary discharge. However, the court held that in the plaintiff's situation “the fact that one of the possible outcomes is that [the plaintiff] would lose his job alone is not sufficient to establish the intolerable conditions sufficient to justify a finding of constructive discharge because the possibility that a plaintiff may not remain employed is not by itself enough to place a reasonable person in the position of ‘quit or be fired.”xlv Because the plaintiff may have remained employed if he had refused the voluntary separation agreement, he could not establish the “intolerable condition” necessary to prove he was constructively discharged.

By way of mitigation against these risks, however, there are several protections for employers. When preparing to implement any action that may adversely affect a wide range of employees, an employer should have objective, business reasons for the implementation. These reasons should be manifested in documents such that, if the need arises, the employer can substantiate the need for the adverse action. As an example, if an employer determines it's necessary to implement a furlough in order to save costs, the employer should assess and document not only the financial reasons motivating the initial decision but also the practical reasons for furloughing specific job positions and/or individuals.

B. Employee Alienation

Although employers have a basic need to run a profitable business, actions that negatively affect employees often generate bad feelings, negative will and low morale. When implementing changes that will negatively affect employees, even if necessary to protect the health of the company, employers risk alienating their employees. As opposed to reductions-in-force, when utilizing the options described in this paper, employers are maintaining the employment relationship with the employees. Therefore, it is more important and central to the success of these measures to nurture good will amongst the employees.

Even though the employer may feel that it is taking all efforts to minimize the negative impact on the employees, any negative impact often harms employee morale and job satisfaction. Workplaces in which morale and satisfaction are low not only hinder productivity and efficiency, but also may become susceptible to union

xlv Id. at 806.
organization. The terms and conditions of employment, including compensation, job security, health insurance, are topics that unions use to engender support. Where employees are dissatisfied with their employers’ treatment of these topics, unions may find an entrance point.

The key to avoiding employee alienation is communication. Open and frequent communication between the employees and their employers dampens the complaints and reinforces the spirit of community in the workplace. In addition, employees who feel as if they are apprised of the company’s situation, even if it is a precarious one, are more likely to understand it, including why the employees are not able to work as much as they would like (furlough or reduced workweek) or why they are making less money than they were before business slowed down (furlough or reduced wages).

There are risks inherent in any broadly-implemented employer action that negatively affects employees. If an employer is aware of them and proactive in responding to them, these risks do not pose insurmountable obstacles to the implementation of the cost-saving measures described above.

**IX. Conclusion**

In challenging economic times, employers have options for cutting labor costs outside of the RIF. Furloughs, reduced work weeks, reduced wages or salaries, work sharing programs and modifying bonus or incentive programs represent valuable and effective tools for minimizing the dampening effect of these trying economic times.