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Reducing Personnel Expenses in an Uncertain Economy

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In light of the COVID-19 public health emergency and the uncertainty over its scope and lasting impact on the economy, companies are now considering options to ensure continued viability of their business, including labor cost savings. While layoffs are one option for short-term cost savings, there are a variety of other measures that employers may consider, with benefits and pitfalls to each.

- **Freezes in hiring, promotions and transfers**. Initial consideration should be given to freezes on hiring, promotions and transfers. These can generate short-term labor cost savings and avoid the economic and morale costs of a layoff. Of course, freezes alone may be insufficient to address cash-flow and resource shortages, and delaying promotions may result in morale issues. This issue may be addressed in part by offering high-performing or valuable employees additional equity awards and/or a retention bonus. Employers should seek counsel in crafting such arrangements to avoid running afoul of deferred compensation tax rules.
- **Reduction of working hours.** Employers may consider reducing employee work hours to reduce labor costs. This approach is well suited to employers with a large workforce of hourly, non-exempt employees because it can be quickly and efficiently implemented by simply scheduling fewer hours upfront. Due to wage and hour requirements unique to exempt employees, reducing work hours does not automatically create a commensurate reduction in pay, however there are lawful ways to reduce exempt employee working hours in connection with a salary reduction (see below). Employers must understand that reducing employees' hours of work or the amount of required work does not excuse compliance with the federal or any applicable state wage and hour laws. Employers should also consider the impact of reduced working hours on employees' eligibility under certain benefits plans. Depending on the terms of the plan, a reduction in hours may result in a loss of eligibility and create a COBRA qualifying event.
- **Reductions in pay.** Employers generally have the discretion to lawfully lower employee pay. However, such reductions must not reduce pay below the required minimum wage (for non-exempt employees) or the required minimum salary threshold (for exempt employees). The current federal minimum exempt salary is $35,568, whereas the California minimum exempt salary is $54,080 (or $1,040 per week) for large employers (26+ employees), and $49,920 (or $960 per week) for smaller employers (25 or fewer employees). If an exempt employee's salary is reduced below the applicable minimum exempt salary threshold, that employee will be converted to a non-exempt employee, and must receive all associated benefits and protections. For example, the employer will need to track the non-exempt employee's hours of work and pay applicable overtime. In certain states, any newly non-exempt employees will also need to receive other types of benefits (e.g., meal and rest breaks in California) and to receive certain notices about overtime eligibility. Note that employees may not agree to "defer" wages or suspend salaries; all employees performing work must be paid at least the applicable minimum wage for all time worked.
    - The FLSA generally prohibits partial day deductions from exempt employees' salaries, and improperly deducting pay from an exempt employee's salary can have serious consequences. For exempt employees, the reductions should not fluctuate day-to-day or even week-to-week, which could result in the loss of exempt status. Rather, the reductions should be instituted prospectively for a defined period of time, with the ability to be extended as circumstances continue to evolve.
    - When circumstances improve, employers may increase compensation again to retain employees, but should be careful not to make any promises now that such reductions will be "made up" to employees in the future.
    - If the reductions are taken as to only some, but not all employees, consider if protected classes are disproportionately impacted and could lead to discrimination claims. Decisions as to which employees will be impacted (and to what extent) must be supported by legitimate business reasons.

- Employers will need to memorialize any reduction in pay in writing, and certain states require a specific form to be timely provided (e.g., California employers must provide non-exempt employees with a notice that complies with California Labor Code section 2810.5).
- For exempt employees, a salary reduction may be paired with a change to part-time status – e.g., 60% pay for 60% work. This may be done on a temporary basis due to economic conditions, provided the minimum exempt salary threshold is met. Employees would potentially be eligible for some unemployment insurance benefits under this scenario.
- For employees who have severance and/or change in control entitlements, consider if the reduction in pay could reasonably trigger the "Good Reason" right to such entitlements. As it is likely that employees with such severance rights are executives or other higher-ranking employees, considering asking these individuals to (temporarily) waive their entitlements.

- **State work sharing programs.** A number of states offer work sharing programs that provide an alternative to layoffs. For example, in California, employers who need to reduce hours and wages by 10% to 60%, and who meet other specific requirements, may apply to California's Work Sharing program. Under this program, affected employees may receive a percentage of their weekly unemployment insurance benefit in an amount equal to the reduction in normal hours and wages for that week. However, employers must apply and be approved to participate in such plans, and not all employers may be eligible depending on the circumstances. Moreover, during economic downturns, state governmental authorities may face a significant backlog of requests from employers and may not provide timely approvals to employers seeking immediate relief.
- **Voluntary termination programs.** Employers might also consider a voluntary termination program, whereby employees can voluntarily agree to a termination in exchange for severance pay. Severance is frequently a cash payment, but can also take the form of such things as equity-related incentives or health benefits continuation. This approach reduces potential conflict because it allows employees to evaluate their current needs and future plans, and be part of the decision. A potential drawback is that more high-performing employees may accept the severance offer, while underperforming employees choose to remain.
- **Furloughs.** A furlough involves stopping employees from working for a specified timeframe, with the intent to later reactivate their employment. A furlough offers some advantages over a layoff by providing short-term labor cost savings without having to terminate employees. This effectively spreads the cost reductions over the larger workforce and ideally minimizes attrition and the loss of key talent. Furloughs may slow, but not halt, attrition, as employees may ultimately be forced to seek other employment. In addition, certain employees facing financial difficulties may in fact prefer to be terminated in order to receive a payout of accrued vacation and/or severance pay.
  - While employers who temporarily suspend or reduce operations will only have to pay non-exempt employees for hours in which they actually perform work, exempt employees are generally entitled to payment of their full salary in any week in which they perform any work. As such, exempt employees should be furloughed in full week increments, whereas a furlough for non-exempt employees can be for a partial week.
  - All employees who are on furlough should also be expressly prohibited from performing any work for the employer, otherwise the employer may open itself up to potential off-the-clock wage claims and associated damages and penalties. For this reason, employers may wish to implement protocols to address furloughed employee activity, such as restricting or limiting IT access. These protocols also guard against any attempts to steal company property or trade secrets.
  - Furloughs and temporary shutdowns that last for six months or more can implicate the federal WARN Act notice requirements, which entitle employees to 60 days' advance notification (or pay in lieu of such notice). In addition, states may treat temporary layoffs differently. Notably, in California, even a temporary furlough of less than six months may trigger the California WARN Act (Cal-WARN); however, California's governor recently offered some relief to employers by enacting an **executive order that suspends certain notice requirements under Cal-WARN under specific conditions**. The federal and state WARN Acts are highly technical and their specific application is beyond the scope of this alert – any employer conducting furloughs or layoffs should navigate these complex requirements with the assistance of counsel *before* moving forward.
  - Employees who are unable to work because of a shelter in place order can apply any accrued paid sick leave to their time off at home. Employees can also voluntarily use their accrued vacation or paid time off during an unpaid shutdown, though employers with "unlimited" or "non-accrual" vacation policies face unique issues that should be navigated with the assistance of counsel.

- In addition, the newly enacted federal Families First Coronavirus Response Act (FFCRA) (expected to go into effect on April 1) provides certain employees affected by COVID-19 circumstances with emergency family and medical leave and/or emergency paid sick leave. Please see **our alert** regarding these new laws. Contact counsel for assistance navigating these benefits with existing employer-provided leave benefits and other cost-cutting measures.
- Employees who are furloughed are likely to be eligible for unemployment insurance benefits, though specific eligibility requirements vary depending on jurisdiction. For example, the California Employment Development Department has stated that employees who have had their hours reduced due to circumstances related to COVID-19 may apply for unemployment benefits.
- Furloughs may trigger a COBRA-qualifying event. Employers should consult with their carriers concerning benefits eligibility during the furlough.
- Vesting of equity awards may or may not automatically continue during a furlough, and employers should carefully review applicable equity plans.

- **Layoffs.** For employers who face severe declines in business due to the impacts of COVID-19 and government shelter-in-place orders, a permanent layoff or business closure may be inevitable. Layoffs allow for immediate reduction of short-term labor costs and eliminate redundancies in the most streamlined manner. Layoffs can also offer additional cost savings in certain states where accrued and unused vacation or paid time off may be forfeited upon employment termination. However, large layoffs may require the employer to provide notice under the federal WARN Act and/or similar state laws. Again, the federal and state WARN Acts are highly technical and their specific application is beyond the scope of this alert – any employer conducting furloughs or layoffs should navigate these complex requirements with the assistance of counsel *before* moving forward.

Prior to implementing any of the above measures, employers should check applicable state, federal and local law, take into account the impact of any shelter-in-place orders and compliance with the new and developing COVID-19-related regulations, and consult with counsel.

For additional information and guidance, please refer to Cooley's **coronavirus resources hub**. Cooley's employment team continues to monitor developments stemming from COVID-19 that affect employers and will issue updates as they are available.

Coronavirus resource hub

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