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By-Lined Article

SLIMMING SALARIES

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Employers sometimes cannot afford to cut any more jobs but still need to cut more costs—and fast. Looking for savings, they consider not just freezing salaries but slashing them.

This strategy isn't for the faint of heart. Without considering the legal minefields, cutting salaries may increase legal costs and jeopardize more jobs. This risk can be exacerbated by the urgency of reducing costs; in the rush, employers may overlook obligations to provide employees with advance notice of reduced salaries.

Time is precisely what is needed to thoroughly review individual and collective bargaining agreements (CBAs) and carefully coordinate pay reductions with requirements of the Fair Labor Standards Act (FLSA), wage payment and other laws.

There are other business risks to this strategy as well, such as the possibility that unhappy employees will leave—if not now, then when business improves.

Under most state wage payment and collection laws, employers must provide employees with notice of their rates of pay or salaries and, if salaried, the number of hours the salaries cover. Accordingly, if an employer intends to change an employee's rate of pay or salary, or the hours the salary covers, the employer ordinarily must provide the employee with reasonable advance notice. Generally speaking, state wage payment and collection laws do not include a specific amount of advance notice required before a change. In the absence of clear guidance, an employer should try to provide as much advance notice as practical.

At a minimum, employers must provide employees with notice before the change goes into effect. Employers may wish to go further and provide advance notice equal to at least one pay period.

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Individual Agreement

If an employee has an individual employment agreement or offer letter, the document needs to be reviewed by the employer to determine whether the contemplated reduction in compensation, workdays or hours can be implemented without breaching a contract.

If an employee's agreement to a change is required and the employee does not agree, this does not necessarily mean an employer is without recourse. There may be times when an employer has the right to end the employment relationship completely but not to change adversely the terms of employment.

Some offer letters expressly reserve the right to terminate employment at will but do not reserve the right to reduce compensation at will. Reserving the more significant right to terminate at will does not automatically translate into the less significant right to make compensation reductions.

Collective Bargaining

If employees are represented by unions and covered by a CBA, any reductions in compensation or hours ordinarily must be negotiated with the union, unless the right to make such reductions is already reserved in the CBA. Even with a strong management rights clause, these changes almost never can be made without a union's agreement.

As a practical matter, union employers often have greater flexibility in reducing headcount than they do in reducing compensation. Most CBAs do not prohibit employers from laying off employees. Rather, they simply set forth the criteria for who gets the ax first.

As part of negotiations, employers may wish to make clear to union officials that the concessions sought are an alternative to layoffs. Don't be surprised, however, if they prefer layoffs. Having a small number of unhappy former employees who bear all of the pain may be seen as preferable by union officials to a large number of current but unhappy union members who share the pain.

This reality needs to be considered for nonunion employees, too.

Sharing the pain across the board, while well-intended, sometimes creates a disgruntled workforce ripe for union organizing or high turnover.

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Equal Employment Criteria

Employers that decide to reduce pay need to determine how they will go about it.

Legally, an across-the-board reduction in pay is the safest. Where everyone is treated the same, it is hard for anyone to argue credibly that he or she was treated more harshly because of membership in a protected group or because that person engaged in protected activity.

However, across-the-board reductions may not be practical or desirable for business reasons. In these circumstances, employers should consider using the same kind of process for reducing compensation or hours as they do for reducing the workforce. To the extent that particular positions are selected for pay reductions or are exempt from reductions, criteria for selection or exemption must be as objective as possible and documented appropriately.

Even if everyone in a particular position is treated the same, there still is the potential for adverse impact claims. For example, assume an employer only reduces the compensation of its administrative employees. Even though administrative support is gender neutral on its face, in most workplaces there still are more women than men who perform this function.

The legal risk is even greater if the employer does not reduce the pay or hours of all employees in a particular position but rather selects for reduction only certain employees in a particular job. In these circumstances, employers need to protect against adverse impact and disparate treatment claims.

Disparate treatment claims are possible because an employee can claim that he or she was singled out for a pay reduction because of a protected category such as gender or race.

Employers need to define, apply and document the criteria carefully so that they can show individuals were selected for pay reductions—or not—for legitimate nondiscriminatory reasons.

Wage and Hour Considerations

Here are a few examples of how the FLSA, and often more-restrictive state law counterparts, may come into play with reductions in compensation or hours.

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If an employer wants to reduce the hourly rate of pay of certain employees, the employer cannot reduce the rate below the minimum wage under federal or state law, whichever is higher. Some localities have minimum wage ordinances, and employers must comply with these, too. Don't forget federal and state prevailing wage laws if your employees are working on contracts covered by them.

When a nonexempt employee is paid on a salaried rather than an hourly basis, his or her effective hourly rate cannot be reduced below the federal, state or local minimum wage, whichever is highest. Generally speaking, the employee's effective hourly rate is calculated by dividing the employee's weekly salary by 40 hours.

If a nonexempt employee is paid on the FLSA's fluctuating workweek basis—a measure not permitted in some states such as California—the employee's effective hourly rate is determined by dividing the employee's base salary by the number of hours the employee works in a given workweek. The more hours an employee works in a particular workweek, the lower his or her effective hourly rate, and this becomes the regular rate for overtime purposes as well.

For example, assume an employee is paid $500 per week. If he works 50 hours in a workweek, his effective hourly rate is $10. If he works 60 hours, his effective hourly rate is $8.33.

Any reduction in pay cannot bring the employee's effective hourly rate below the minimum wage in any given workweek as the employee's hours fluctuate.

If an employee is exempt, the employee's salary cannot be reduced below $455 per week or the employee no longer is exempt under the FLSA.

But what if the employee is working only three or four days per week? The U.S. Department of Labor has made clear that there is no proration of the $455 per week requirement because an employee works less than full time.

Of course, if the employee is working fewer than 40 hours per week, there won't be any overtime to pay under federal law. That does not mean that there is only a technical violation of the FLSA with no potential consequences. Remember, if improper deductions are taken from an exempt employee's pay, the exemption may be lost for that employee and for other employees in the same job classification who report to the same manager.

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Just as some states have higher minimum wages for nonexempt employees, some states have higher minimum salaries for exempt employees. For example, New York requires $536.10 per week for exempt status. An employer cannot reduce the salary of an exempt employee below the state's minimum salary or the exemption will be lost.

When an exempt employee's salary is reduced, the employer often reduces the hours expected of him or her, too. An employer can reduce the "regular" hours that an exempt employee is expected to work along with reducing his or her pay. For example, if an exempt employee's salary is cut by 20 percent, regular hours can be cut by 20 percent.

However, employers need to be careful about framing this reduction in hours. Otherwise, it may appear that the employee is being paid on an hourly rather than a salaried basis.

When reducing hours, employers should include "salary basis" language making clear that employees will receive lower but fixed salaries each workweek, regardless of the hours they work, subject only to deductions permitted by law.

The change in compensation and hours cannot fluctuate as business ebbs and flows. The change should be deemed as long term or indefinite as opposed to short term or for a defined period. Otherwise, reductions may appear to be a subterfuge around the salary basis requirement.

Unemployment Compensation

A reduction in compensation, with or without commensurate reduction in hours, also may entitle employees to partial unemployment compensation under applicable state laws. The concept is easy; however, as a practical matter, the determination and calculation can be painfully complicated.

Accordingly, an employer should tell employees that they may be eligible but that whether employees are eligible may turn on such factors as:

- Employees' "regular" compensation.
- The amount and duration of the reduction.
- Employees' employment history.

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Beware of the Quick Fix

Employers can and should do whatever they reasonably can to minimize the effects this and any future global economic malady has on employees while at the same time preserving their economic viability.

But quick fixes in terms of reduction in compensation that are not thought through carefully may serve only to expose employers to liabilities that they can afford to pay only by cutting jobs they were trying to protect.

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