BRYAN CAVE
A Broader Perspective

Alert

Labor and Employment Client Service Group

To: Our Clients and Friends May 2009

Caution Should be Exercised Before Adjusting the Hours (and/or Pay) of Exempt Employees

To carry themselves through the current economic downturn, employers continue to apply various cost-cutting measures to their workplaces. While layoffs have taken place in certain sectors, many employers have managed to avoid layoffs by implementing certain intermediate measures, such as reducing employees' pay and/or reducing employees' work hours.

As explained below, while such cost-cutting measures generally are permissible from a wage-and-hour perspective, the manner in which such measures are carried out as to *salaried, exempt employees* in particular is key. Careful consideration must be given before any such measures are implemented as to salaried, exempt employees, to ensure the exemption from overtime that would otherwise apply to such employees is not lost.

First, some background. Under the Fair Labor Standards Act (FLSA), employees who are classified as exempt under either the administrative, executive, or professional exemption must satisfy not only a "duties" test, but also must be paid on a "salary basis." An employee who is paid on a "salary basis" must receive a predetermined amount of pay on a regular basis (at least $455 per week), which is not subject to reduction based upon the employee's quality or quantity of work.

Although employers are not required to pay exempt employees when they perform no work during an entire workweek, 29 C.F.R. § 541.602(a), they are required to pay an exempt employee's full salary in workweeks during which any work is performed. 29 C.F.R. § 541.118(a). Thus, the U.S. Department of Labor's (DOL) regulations construing the FLSA caution: "An employee is not paid 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." 29 C.F.R. § 541.602(a).

Recent case law and administrative guidance from the DOL clarify when an employer may reduce the hours (and pay) of an exempt employee during workweeks in which they will otherwise be performing work, without running afoul of the foregoing restrictions on "deductions" from exempt employees' wages.

In *Archuleta v. Wal-Mart Stores, Inc.*, 543 F.3d 1226 (10th Cir., Oct. 6, 2008), the appellate court concluded that the FLSA allows employers to make occasional changes to exempt employees' salaries without threatening their exempt status, but that employers may not constantly adjust exempt employees' salaries based upon ever-evolving work needs. Thus, the *Archuleta* court allowed exempt employees to proceed to trial with their claims for unpaid overtime, based on its concerns that the employer had changed the affected employees' salaries as many as 17 times over a nine-month period, equating to nearly weekly changes in their wages – similar to what an hourly employee might experience.

Havey v. Homebound Mortgage, Inc., 547 F.3d 158 (2d Cir., Oct. 22, 2008) presented a different set of circumstances than *Archuleta*, in that the employer in *Havey* prospectively changed a mortgage underwriter's salary on a quarterly basis. The Court of Appeals affirmed the dismissal of the employee's unpaid overtime claim, finding that an employer may occasionally change an exempt employee's salary so long as it does not do so in an attempt to evade the FLSA's overtime provisions. In *Havey*, the quarterly adjustments were prescheduled, and not initiated based upon constantly-changing business circumstances, and thus the court found there was no attempt to circumvent the FLSA's overtime requirements.

Most recently, in a letter published on March 16, 2009, the DOL confirmed that "a reduction in [an exempt employee's] salary corresponding to a reduction in hours in the normal scheduled work week . . . is permissible if it is a bona fide reduction not designed to circumvent the salary basis requirement, and does not bring the salary below the applicable minimum salary." FLSA2009-14. This opinion is consistent with earlier DOL interpretive policy. *See*, *e.g.*, DOL W.H. Op. Letter (Nov. 13, 1970) (concluding that an employer may, without losing the exemption, prospectively: (1) reduce its current fifty-two workweeks per year down to forty-seven; and (2) require employees to work five four-day workweeks at the end of each year); DOL W.H. Op. Letter (Feb. 23, 1998) (concluding that an employer may reduce its salaried employees' workweek due to a temporary work shortage without defeating the FLSA's professional exemption); DOL W.H. Op. Letter (Mar. 4, 1997) (concluding that an employer could reduce its workweek by eight hours per week, with a commensurate salary reduction, to accommodate a cut in state funding).

The central theme underlying each of these authorities is that when prescheduled (and infrequent) adjustments are made to exempt employees' hours and pay, the "salary basis" test is still met, as there has been no "deduction" from the employee's salary. But when hours and wages are adjusted so frequently and haphazardly as to make the employee's salary more akin to an hourly wage, the "salary basis" requirement is not met, and the exemption likely will be lost.

Although the above authorities provide helpful guideposts within which to operate, ultimately the question whether an employer has changed an exempt employee's hours or pay too frequently will lend itself to different answers by different triers of fact. Given the spectrum of different answers that different courts could provide on this subject, employers may want to consider any of the following alternative cost-cutting measures, which under current FLSA standards do not constitute improper salary deductions as a matter of law:

- **Reduce Pay Without Any Reduction in the Workweek.** Employers have wide latitude in setting employee compensation (including reducing pay). Thus, an employer faced with difficult economic conditions may implement pay reductions (e.g., an across-the-board 10% pay reduction) as to both exempt and non-exempt employees, without reducing their hours, without violating the "salary basis" test.

- **Require Employees to Use Vacation Time and Paid Time Off.** In FLSA 2009-14, the DOL confirmed that because employers are not required by the FLSA to provide any vacation time to employees, there is no prohibition on an employer who voluntarily offers a vacation benefit to require employees who are told not to come to work during a shutdown to use their accrued vacation benefits.

- **Full Week Shutdowns.** As noted above, exempt employees do not have to be paid their salary for any workweek in which they do not perform any work. 29 C.F.R. § 541.118(a). Hence, shutting all operations down for a full workweek (e.g., during the holidays or during a slow period) eliminates the risk of improper salary deductions.

This Client Alert interprets only federal wage and hour law as it applies to the foregoing situations. Employers should take care to ensure compliance with individual state wage and hour laws, some of which sometimes impose different and more restrictive requirements. Prior to implementing any payroll reduction measures, employers should consult with counsel to ensure compliance with all applicable state laws.

* * * * * * *

For information about anything contained in this Labor and Employment Bulletin, please speak with your regular Bryan Cave LLP contact.