Shifting Sands in a Downsized Economy: Public Employers and RIFs, Furloughs, and Reductions in Salaries

by Jerry L. Deloach



In local governments throughout the country, the following scene is being played out almost daily: The Chief Finance Officer calls the Mayor, Chief Operating Officer, Chief Administrative Officer, City Manager, County Manager, or some other high ranking official, to discuss the budget situation because of dwindling revenue. The call is to place the official on notice that there is a widening gap between the revenues projected and the revenues collected, as a direct result of the worsening economic situation.[1] The local government entity cannot, by law, run a deficit: its budget must be balanced.

A public-sector employer is limited in the choices it can exercise when the financial resources are insufficient to cover expenses. First and foremost, the governmental entity should move to cut discretionary expenses (such as supplies, commodities, and the like); in addition, it should place a hiring freeze on non-essential hiring. Finally, because personnel expenses are more likely than not the greatest line item in the budget, at some point, the question that must be answered is the impact of the budget on active personnel.

Of course, the options are limited as to what can be done without impacting the delivery of services. While there may be others, three of the options available to a public employer when budget considerations impact staffing and personnel are furloughs, reductions in force (RIFs), and reductions in salaries. An employer will want to implement a plan that is the least disruptive for staff, as well one that minimizes the impact on the delivery of services. Depending on the severity of the budget gap, it is possible to implement one or several plans, in one action or in stages.

Regardless of which option is selected, an employer should ensure that implementation is planned appropriately – for example, by forming a committee of stakeholders to make sure that all necessary steps have been taken for a smooth transition. The stakeholders will vary depending on which plan is implemented, but it should include representatives from the human resources, legal, finance (payroll and pension) and IT departments, as the government will need to answer questions such as the impact of the various options on pension plans, the accrual of vacation and other leave, and the distinction between exempt and non-exempt employees. Further, it is very important to have a communication plan to minimize rumors and to provide accurate information.

Furloughs

Under a furlough, employees are not paid for a designated number of days in the fiscal year. The authority to implement a furlough plan is normally vested in the appointing authority or the legislative body. This is the least disruptive option because it keeps the staff in place and at work for a regular (albeit shortened) workweek, while providing some relief to the cash-strapped governmental entity. Employees may beg to differ on the "least disruptive" description because, at the end of the day, they are taking less money home; however, *all* employees are sharing in the pain of the financially strapped entity.

The City of Atlanta implemented a furlough plan in December 2008 for 2009 (a four-day, 36 hour work-week for all general fund employees).[2] However, the planning commenced in early October 2008, three months into the 2009 financial year. A task force was created which included representatives from the law department, human resources, payroll, pension, and other departments. The goal was to ensure a smooth transition for employees. For example, since the annual salary of employees was to be reduced based on the number of furlough days, pension and leave accrual rates would also be affected.[3] Unless these issues were addressed at the onset, they would resurface years later, when the employees retired.

Furloughs and FLSA

One consideration is the distinction between exempt and non-exempt employees insofar as the Fair Labor Standards Act (FLSA) is concerned. In general, non-exempt employees are only paid for the hours worked; therefore, a

reduction in their hours of work has little implications under the FLSA. However, when a furlough requires exempt employees to participate, there may be additional challenges (a reduction in pay or hours may result in the loss of their exempt status) and it might be necessary to look to another option for exempt employees, depending on the severity of the particular budget situation.[4]

For example, in Atlanta, the City's furlough was based on a 36-hour work-week. While salaried executive employees were normally exempt from the overtime provisions of the FLSA, because of the City's furlough plan there were two situations which could arise and obligate the City to pay compensation for overtime.[5] First, where an exempt employee had worked between 37 and 40 hours in a week, the City was required to provide "comp time" to the employee for each hour worked over 36 hours in a week, up to 40 hours. If an exempt employee left the City and there were accrued "comp hours" earned during the furlough, the City was required to pay the employee for this time. Second, if an exempt employee worked more than 40 hours in a week, the City was to pay cash compensation for the first four hours after 36 at the regular rate and provide "comp time" for time worked beyond 40 hours. The comp time for hours in excess of 40 was at the rate of time and half of the normal rate. Paying the employees in cash allowed the City to give them "comp time" for the hours worked above 40. If an exempt employee leaves the City with accrued comp time earned during the furlough, the City will be required to pay this in cash.[6]

Court Challenges

Furlough plans are being legally challenged in a number of states or local jurisdictions. In Prince George's County, Maryland, a federal district court declared that the County's plan violated the Contract Clause of the United States Constitution by unilaterally cutting wages guaranteed through collective bargaining.[7] Similarly, when furloughs were ordered without first negotiating with public employee unions in Hawaii, a state judge there ruled that the furlough plan violated the state constitution.[8] A review of the Maryland case shows why it is crucial that you review your state and federal laws regarding collective bargaining agreements before you consider a furlough plan, as union officials are mobilizing based on their limited success in these two cases.

Prince George's County was, like other jurisdictions in the country, feeling a substantial economic crunch. The budget process for the 2009 financial year projected a significant budget deficit (approximately $80.1 million) that needed to be addressed. A proposed operating budget (POB) was submitted, representing the continued funding of the administration's priorities. A few weeks afterwards, the County entered into collective bargaining agreements (CBAs) with the American Federation of State and Municipal Employees and affiliated unions. The County also maintained "reserve funds," as required by law.[9] The FY 2009 budget was enacted without substantial changes, and the CBAs with the public safety unions were fully and finally approved. The County's budget office did not revise the projected revenue amounts while the POB was before the County Council, but, after the budget was passed, that office "re-projected" the revenues to show a greater deficit. Immediately thereafter, the County called the unions and their representatives to a meeting. It announced that a revenue shortfall was expected, and asked each labor organization to give up their merit "step increases" or cost of living adjustments. The unions refused, indicating this was "not possible unless and until the County could demonstrate that there were no reasonable alternatives."[10] The County agreed to provide all of the negotiated wage increases, and the County Council subsequently approved a furlough, the Employee Furlough Plan (EFP). The EFP essentially cut the work hours of all covered employees by 80 hours, resulting in salary reductions of 3.85%.[11] At the time the EFP was enacted, the County had approximately $230 million in its three reserve funds, but officials explained that it was against the County's policy to use the funds to pay for ongoing expenditures.[12] The unions filed suit a few days later, claiming that the EFP violated the County's personnel law (in that it was not required, reasonable or necessary) as well as the Contract Clause of the United States Constitution.[13] The County moved to dismiss the claims.

The federal district court held that, while the EFP did not violate the personnel law, it did violate the Contract Clause, recognizing that the County enjoyed more discretion under the Personnel Code than it did under the Contract Clause.[14] A court's analysis under the Contract Clause required a three-part inquiry: first, whether the legislation in fact impaired a contract; second, if so, whether it constituted a "substantial impairment of a contractual relationship;" and, third, assuming that the impairment was substantial, the court was to determine whether the impairment was, nonetheless, permissible as a legitimate exercise of the County's sovereign powers by being "reasonable and necessary" to serve an important public purpose.[15] The court answered these questions by finding that the EFP did impair the CBAs, as the salary and hours of work reductions impaired the extant contractual relationship, and the contracts were not subject to unilateral amendment by the County;[16] the impairment was substantial;[17] and the "EFP was not reasonable in light of the surrounding circumstances, because it was not a narrowly tailored response

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Jerry L. Deloach has been Deputy City Attorney with the City of Atlanta Department of Law since 2003. Prior to joining the City's legal department, he was an assistant city attorney with Memphis, Tennessee, where he handled litigation involving federal issues, like Section 1983 actions and employment-related matters. He has worked previously as an assistant dean at the University of Mississippi; as an assistant public defender for Shelby County, Tennessee; and as an assistant city attorney for the City of Memphis. He has been an adjunct faculty member at Clark Atlanta University; taught in summer law programs at the University of Mississippi, University of Memphis, and Southern University at Baton Rouge.

to a real problem and …the Court ha[d] reservations about whether the shortfalls were 'unforeseen.'"[18] Referring to the reserve funds, the court explained that, although the County suggested that it faced dire circumstances and had no other reasonable alternatives, "the record suggest[ed] otherwise and the County's actions resemble trappings of doing that which was 'politically expedient.'"[19]

Importantly, however, the court stated "…furloughs have occurred nationally in both the public and private sector, and in light of the economic forecast, furloughs are likely to continue. This court's holding is not a pronouncement regarding furloughs in general, but rather applies to the narrow issue of the legality of EFP as proposed by Prince George's County executive and approved by the County Council on September 16, 2008."[20]

The Basics of a RIF

The second option for local governments is a Reduction in Force (RIF) – essentially, a "lay off" of personnel. Other means – such as hiring freezes, furloughs, reduced workweeks, or reassignments – should be explored before implementing a RIF. It is important to remember that a RIF should not be used to dismiss or demote employees with performance issues, or to alter the racial or gender composition of a department or classification. Attorneys also need to work closely with the human resources department to ensure that the RIF is in conformance with the laws of their jurisdiction. This is particularly the case if the RIF policy is codified or statutory, since any deviation will serve as the basis for a legal challenge.[21]

In Atlanta, the RIF policy was only applied to classified employees; unclassified employees who served at the will and pleasure of the appointing authority were not subject to the policy. For the 2008 financial year, the City reduced in force 307 employees. Only 42 filed an appeal before the Civil Service Board and, of these, only 34 actually proceeded to a hearing, with all appeals being denied. In the next financial year, the City "RIFed" 327 employees, with 46 filing appeals. Of these, 38 went to a hearing, with three appeals being granted. Where an appeal was granted, it was based on miscalculation of employee points.[22] In other words, the RIF was conducted according to procedure. Accordingly, Atlanta has had tremendous success with its RIF policy based on the low number of appeals and further petitions for review. Primarily, this was due to the early involvement of, and consultation with, the law department.

Reductions in Salary

The third option that a public employer might implement is reductions in salary. This option addresses one of the concerns raised with the furloughs – the distinction between exempt and non-exempt employees and the FLSA, and the problem that exempt employees on a furlough may lose their exempt status in the week of the furlough. However, a salary reduction for exempt employees could be construed as the legal equivalent of a furlough, due to the highly structured nature of governmental pay plans. The essence of this approach is to get completely away from the idea of a "furlough" of exempt employees by simply instituting a reduction in pay of a specified percentage, while continuing to pay these employees on a guaranteed salary basis regardless of the number of hours worked in a work week.

The City of Atlanta, like other governmental bodies, has been forced to monitor and to re-anticipate revenues on a continual basis. The City's fiscal year runs from July 1 through June 30 and the budget adopted for fiscal year 2008-2009 anticipated revenues in the form of property taxes, sales taxes, and fees that simply were not realized due to the national economic crisis.

However, unlike many government agencies, the City of Atlanta has a pay and classification plan that is not stringently structured based upon pre-determined pay grades and steps through which an employee automatically progresses. Instead, the City's pay plan is defined by ordinance, providing that the mayor and council establish, by ordinance, a pay plan for all classes of positions. This plan is to consist of a series of pay grades with minimum, midpoint, and maximum salaries. The plan may be amended by ordinance, subject to the limitations in the City Charter relating to the period during which salary or wage increases may be granted.[23] Thus, any individual employee's salary is "guaranteed" only to the extent that, within a classification, the employee is entitled to a salary within the range of the classification. This concept is further explained by the a directive that pay and incentives be based on performance, with no employee being "guaranteed compensation just for adding another year to organizational service."[24]

Accordingly, at most, the pay plan provides for broad parameters for the executive branch of government to implement individual salary decisions that best suit the needs of a given department. Beyond that, however, the executive branch retains flexibility to adjust salaries as needed (with the noted exception, in the ordinance, of not being able to give raises after the time specified in the City Charter). The only other limitation is that "[f]unding for positions must be within the existing budget allocations of the department employing the individual."[25] Consistent with these provisions setting forth the City's pay plan is the City's procedure for RIFs, which also is included in the Code of Ordinances: "Prior to initiating a RIF, the mayor should consider using other means, such as hiring freezes, reduction through attrition, furloughs without pay, reduced workweeks, reassignments or other methods to lessen the negative impact of such an action."[26]

What the City proposed to do to address the fiscal crisis was to comply with the ordinance provisions that funding for positions be within the existing budget allocations of City departments, and to resort to means other than layoffs, where practicable, by reducing salaries for all covered exempt employees for an indefinite period to comport with the shortfall in revenue. Salaried exempt employees would continue to receive a guaranteed salary that was not tied to the number of hours worked in any given workweek. This would allow the City to address its fiscal downturn without forcing the City to separate any

additional exempt employees and without losing its overtime exemption for covered executive, professional and administrative employees.[27]

The City has moved forward with a reduction in salary for exempt employees and re-issued the administrative order which implemented the furlough plan. The reissued Administrative Order implemented a ten-percent salary reduction for exempt employees.

Conclusion

In the past, most employees thought that government employment was safe, stable, and secure. However, the unprecedented economic crisis, and the fiscal problems it has spawned, has dramatically changed the way the government employment is viewed.

Notes

1. *See*, e.g., Press Release, U.S. Conference of Mayors, *City Responses to Recession-Driven Budget Shortfalls* (June 12, 2009) at http://usmayors.org/pressreleases/uploads/report-200906-budgets.pdf, describing in detail, the critical budget situations in 94 individual cities across the Nation. In early 2009, more than 200,000 California state employees stayed away from work during a mandatory employee furlough aimed at reducing a $42 billion budget deficit.
2. Atlanta, Ga., Administrative Order No. 2008- _ (Dec. 2, 2008) at http://www.atlantaga.gov/client_resources/media/financial/admin%20orders.pdf.
3. Reductions in a standard workweek may also affect the amount of Family and Medical Leave Act leave to which employees are entitled.
4. Under the FLSA, an employer is obligated to pay exempt employees on a "salary basis" in order to preserve the exemption (for every work week in which the employee performs any work, he or she must receive a fixed, predetermined salary of at least $455 per week, and this salary may not be reduced "because of variations in the quality or quantity of work performed").
5. *See* 29 C.F.R. 541.710(b) (2009) ("Deductions from the pay of an employee of a public agency for absences due to a budget-required furlough shall not disqualify the employee from being paid on a salary basis except in the workweek in which the furlough occurs and for which the employee's pay is accordingly reduced").
6. *See* 29 C.F.R. 778.315 (2009) (payment for all hours worked in overtime workweek is required).
7. Fraternal Order of Police v. Prince George's County, 645 F. Supp.2d 492 (D. Md. 2009) (unions sued for declaratory, injunctive and monetary relief, challenging the validity of an employee furlough plan). This case has been appealed and IMLA has filed an *amicus* brief in this case. For a copy of the brief, please contact IMLA.
8. Hawaii State Teachers Ass'n v. Linda Lingle, Governor, State of Hawaii, No. 09-1-1372-06 KKS (Haw. Cir. Ct. July 29, 09) at http://publiclawgroup.com/test/pdf/HawaiiStateTeachers.pdf.
9. 645 F. Supp.2d at 500 (section 806 of the County Charter required the County to maintain the equivalent of 5% of the County's budget in a "General Fund Contingency Reserve" fund).
10. *Id.* at 500.
11. *Id.* at 501.
12. *Id.*
13. The Contract Clause states, "No State shall… pass any…Law impairing the Obligation of Contracts." U.S. CONST. art. I, § 10, cl. 1.
14. 645 F. Supp. 2d at 507-08 (the argument was whether the "required" standard in the County's personnel law mirrored the "reasonable and necessary" standard in the Contracts Clause).
15. *Id.* at 508.
16. *Id.* at 509-10.
17. *Id.* at 510 (the 3.85% reduction was more than the 0.95% that a court had previously held was "substantial" in *Baltimore Teachers Union v. Mayor and City Council of Baltimore*, 6 F.3d 1012, 1015 (4th Cir. 1993)).
18. *Id.* at 512.
19. *Id.* at 515.
20. *Id.* at 518.
21. Under the Atlanta City Code, an employee who is "RIFed" can file an appeal with the Civil Service Board for failure to follow procedures in the administration of the RIF, but has no right to appeal the reason for the reduction. ATLANTA, GA., CODE § 114-379(n) (2007).
22. Retention points were calculated for employees based on years of service and the most recent performance rating. From this calculation, a list is compiled based on total points awarded and in compliance with the RIF policy submitted and approved by the Commissioner of Human Resources.
23. ATLANTA, GA., CODE § 114-123(a) (2007).
24. *Id.* at § 114-121(f).
25. *Id.* at § 114-125(a).
26. *Id.* at §114-379(b) and (d).
27. Letter to Ms. Janet Campbell, U.S. DOL , from Bob Godfrey, Senior Ass't City Attorney, City of Atlanta, Jan. 27, 2009.

