

Employee Furlough Considerations in the Time of COVID-19

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Enhanced Unemployment Insurance

Employees who are furloughed, meet state-specific eligibility requirements, and timely apply for unemployment benefits will be entitled to unemployment insurance benefits. In addition, the Coronavirus Aid, Relief, and Economic Security Act of 2020 (CARES Act), established federal funding for, among other things, additional unemployment insurance benefits for covered individuals in the form of up to 39 weeks of regular state unemployment insurance benefits through December 31, 2020, and an additional \$600 weekly benefit through July 31, 2020. See Unemployment Insurance Program Letters 14-20, 15-20, 16-20, and 17-20. In order to provide the supplemental funded \$600 benefit under the CARES Act, individual states must enter into an

This article discusses key considerations for employers and boards that are contemplating furloughing employees due to the coronavirus pandemic. In the wake of the market disruption caused by the COVID-19 outbreak, many employers are considering employee furloughs as an alternative to layoffs. Furloughs generally refer to a mandatory, but temporary, cessation from work without pay, with the expectation that the impacted workforce would return to work with the employer in the future.

agreement with the Department of Labor. As of the date of this publication, all states have entered into this agreement, and nearly all have begun to process the additional \$600 payments. Employees who are furloughed due to COVID-19 should consult their state's unemployment website for more information on how to apply for unemployment and eligibility requirements.

Impact of Furloughing to Employee Plan Participation

Health Benefits and COBRA

Employers that sponsor group health plans should consider whether a furlough would allow employees to continue to participate in employer-provided health benefit plans as "active" participants without requiring participants to elect benefits pursuant to the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA). The determination will depend on the terms of the applicable plan and the underlying insurance policies. In particular, consider how eligibility is defined in the plan document. The definition often focuses on whether employees are continuing to receive pay or perform services. If any plan amendments are required in order to provide active coverage rather than continuation coverage under COBRA, and if it is possible under the circumstances to adopt such amendments, employers must ensure they properly document the changes, including updating the summary plan description.

If furloughed employees do not qualify for active coverage, employers that employed at least 20 employees (whether full or part time) on more than half of its typical business days in 2019 must provide furloughed employees with notice of their right to elect COBRA coverage. Failure to timely provide a COBRA notice to terminated employees can subject employers to significant penalties. That penalty includes an excise tax of \$100 per qualified beneficiary receiving late notice, but not more than \$200 per family, for each day the employer is in violation.

COBRA requires that continuation coverage for covered employees and their eligible beneficiaries extend for 18 months from the date of a "qualifying event" (extensions are mandatory in certain states; e.g., up to an additional 18 months (or 36 in total) of coverage is required for health insurance policies subject to New York law after such event).

Whether furloughed employees receive healthcare coverage through continued active participation or as a result of electing COBRA, employers may want to consider subsidizing the cost of healthcare premiums for some period of time.

Qualified Defined Contribution Retirement Plans

A furloughed employee generally will be considered an active participant in a retirement plan and would not be considered to have experienced a "severance of employment." As such, the employee would not qualify to take a termination distribution from a retirement plan, such as a 401(k) plan. See I.R.C. § 401(k)(2)(B)(i)(I); Treas. Reg. § 1.401(k)-1(d)(2). Further, furloughed employees would not be counted toward any partial plan termination assessment. Furloughed employees who are considered active participants may, subject to applicable plan terms, receive plan loans (or have existing loans remain outstanding) or in-service distributions.

Determining whether a furloughed employee has experienced a "severance of employment" is based on facts and circumstances, and may change during the furlough, particularly if (1) the employer no longer expects the employee to return to work or (2) the employer ceases operations. Changes to an employee's annual salary due to the furlough can impact the employee's 401(k) contribution levels and employer matching and profit-sharing contribution calculations. Notify furloughed employees of these effects and of how they can alter their deferral elections due to the expected change in their income.

Equity Plans

Employers should review their equity plans to determine whether a furlough would be treated as a termination of employment. This determination is likely to fall to the plan administrator, which may be the board, a committee of the board, or an officer in the case of grants beyond the C-suite. If that furlough is treated as a termination of employment, awards will be treated in accordance with the termination provisions of the plan or award agreement. However, typically, equity plans or the related award agreements provide for awards to remain outstanding and for continued vesting during an approved leave of absence (in some cases through an express leave of absence provision).

It is also possible that a plan will provide that vesting be tolled during certain leaves of absence. Plan administrators should review plan provisions, including whether the plan documents limit the duration of an approved leave of absence to a set period (such as 90 days). If the existing plan terms are not in line with employer expectations, or the needs of the employer, the employer may wish to consider whether to amend awards to reach the desired outcome (and the accounting consequences of any change).

Employers should remain aware that changing circumstances may impact this assessment mid-furlough and separately

assess whether the furlough has resulted in a “separation from service” under I.R.C. § 409A (Section 409A), which is discussed further below, or, in the case of incentive stock options (ISOs), a termination of employment under the regulations governing ISOs.

Section 409A

Employers should consider whether an employee furlough results in a separation from service under its non-qualified deferred compensation plans covered by Section 409A. See I.R.C. § 409A. Under Section 409A, an employee furlough is not a separation from service, so long as it qualifies as a bona fide leave of absence. A “bona fide” leave of absence is one where there is a reasonable expectation that the employee will return to perform services for the employer, and where either:

- The leave is less than six months.–or–
- The leave of absence exceeds six months but the employee has either a contractual or a statutory right to reemployment.

Treas. Reg. § 1.409A-1(h)(1). Furloughs related to business disruption due to COVID-19 likely will be treated as bona fide leaves of absence under Section 409A, and therefore will not result in an immediate “separation from service” if the employer reasonably expects to recall the furloughed employees within six months. If the leave exceeds six months and the individual does not have a contractual right to reemployment, the employment relationship would be deemed terminated on the first date following the six-month period.

Benefit Plan Elections

Employers should also carefully review and assess the impact of furloughs on employee participation in, and elections made under other benefit plans, including flexible spending accounts. A furlough may be considered a qualifying event triggering an employee’s ability to make mid-year election changes under a flexible spending account or cafeteria plan. Employers should notify furloughed employees of the impact of the furlough on the plans in which they participate and of their ability to make changes in plan elections such as transit benefits and employee stock purchase plans.

Labor Law and Contract Considerations

Employers considering furloughing employees must consider and comply with applicable federal, state and local wage and labor laws, as well as any individual contracts and employer policies.

The Fair Labor Standards Act and similar state wage and hour laws require among other things, an employer to compensate employees for any work performed. As such, employers should take steps when furloughing employees to ensure that furloughed employees do not perform any work on behalf of the employer during the furlough period. These steps may include preventing employees from receiving or accessing their work emails, preventing access to employer facilities and ensuring that employees who are still actively working and may try to contact furloughed employees are made aware that they should not contact furloughed employees concerning work-related matters.

Further, when determining which employees to furlough, it is important for employers to use objectively defined categories of employees, to mitigate arguments of disparate impact and retaliation.

Prior to placing any employees on furlough, employers should review all contracts and policies covering such employees, including employment contracts, employee handbooks and with respect to unionized employees, collective bargaining agreements. These documents may contain specific terms regarding furloughs and employers should ensure that any employee furlough complies with the terms of its policies and agreements. Further, contracts may contain guarantees regarding annual compensation or terms of employment, and a furlough may give rise to a contract breach or trigger a right for the employee to terminate the employment relationship for “good reason.” Employers should also assess confidentiality and restrictive covenant agreements, and how the employer intends to interpret and enforce these provisions, keeping in mind that furloughed employees remain common-law employees.

WARN Act

Under the federal Worker Adjustment and Retraining Notification Act of 1988 (WARN Act), employers with 100 or more employees are required to provide 60 days’ advance written notice to terminated employees in the event of a plant closing or mass layoff.

Under the federal WARN Act, notice obligations are not triggered if employees will be furloughed for fewer than six months. However, a furlough that exceeds six months or a reduction of hours by 50% for six months or more will constitute an “employment loss” and trigger WARN’s notice obligations. An employer implementing a furlough on account of COVID-19 may believe that the furlough is short-term, but if conditions persist longer than expected, WARN requirements may apply.

The WARN Act does include an exception to the standard notice requirement for extensions of furloughs beyond six months resulting from business circumstances that were “not reasonably foreseeable” at the time of the original furlough event. To determine if the business circumstances were “not reasonably foreseeable,” “[t]he employer must exercise such commercially reasonable business judgment as would a similarly situated employer in predicting the demands of its particular market. The employer is not required, however, to accurately predict general economic conditions that also may affect demand for its products or services.” In this case, the employer must provide notice “when it becomes reasonably foreseeable that the extension is required.” The employer bears the burden of proving that it appropriately relied on this exemption. If this exemption is not met, an extension of a furlough beyond six months may result in the original furlough event being treated as the event for which advanced notice was required, retroactively triggering the violation.

Several states that have adopted “mini-WARN” laws have similar exceptions for unforeseeable business circumstances to the WARN Act, such as New York. Conversely, California’s “mini-WARN” law does not have such an exception, and courts have generally interpreted California’s “mini-WARN” law to require employers to provide 60 days’ advance notice, even for furloughs lasting less than six months. The Governor of California added some relief on March 17, 2020 through an [Executive Order](#), providing that the 60-day advanced notice requirement was suspended if certain conditions are met. That Executive Order requires that:

- The employer provides “as much notice as is practicable.”
- The written notice includes certain language including with respect to eligibility for unemployment insurance.–and–
- The qualifying event “is caused by COVID-19 related business circumstances that were not reasonably foreseeable as of the time that notice would have been required.”

Accordingly, it’s advised that employers (or their counsel) review the applicable local, state and federal notice requirements before furloughing any employees.

Families First Act (Expanded Employee Leave)

The Families First Coronavirus Response Act (the Families First Act) became effective on April 1, 2020 and requires employers with fewer than 500 employees to provide employees two weeks of paid sick leave and additional benefits for family leave due to the COVID-19 outbreak

(the FFA Benefits). The Wage and Hour Division of the Department of Labor issued [temporary rules](#) that expanded upon a previously published series of [Q&As](#). These temporary rules provide that, among other things, employees who are furloughed would not be entitled to the FFA Benefits as of the date of the furlough. In addition, if an employer closes the worksite of an employee who is already receiving FFA Benefits, the employer would not be required to provide any further FFA Benefits following the closure. In these circumstances, the employee would be able to apply for unemployment benefits.

Other Furlough Implementation Tips

Reducing or eliminating employee benefits and compensation is never easy. Implementing a large-scale furlough of employees may be a new experience for many employers. To make this action most effective, use thoughtful employee messaging, follow best practices, and ensure compliance with applicable legal requirements. If properly implemented, furloughs can serve as an alternative to layoffs, helping to keep employers financially stable, while retaining employees expected to be part of the business for the longer-term.

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