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SVB FALLOUT: How VC-backed Startups May Extend Payroll & Avoid Furloughs

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In light of the FDIC takeover of Silicon Valley Bank (SVB), many of our startup, growth company, and fund clients have asked about how to manage their obligations to pay their team members during a period when the company's bank accounts may be frozen. This article also addresses whether to furlough employees and whether employers may have criminal liability for retaining employees on payroll when the employer already may know that it will not make payroll. We are drawing upon our collective experiences working with startups and venture/growth funds, as an employment lawyer, a former Assistant U.S. Attorney (S.D.N.Y), a VC/emerging companies lawyer/Adjunct Professor of Venture Capital, and a prosecutor of employment matters for the D.C. Attorney General's Office.

Of course, we strongly urge employers to pay all employees their wages for hours already worked and for which payment is due. Companies should work with their board members and investors to find bridge loans and other resources to make timely payment. That said, the timing of when wages are due will vary depending upon **applicable state law** and upon whether the worker is an independent contractor, or *non-exempt* or *exempt* employee. State laws provide less protection to independent contractors than to employees so, if someone is genuinely an independent contractor, then payment is due in accordance with the terms of the contract between the company and that independent contractor. Try to work with these individuals in good faith to negotiate new pay dates, if possible.

Exempt and Non-Exempt Employees: Timing Payments & Notice of Changes to Pay Dates

Federal Requirements

The federal Fair Labor Standards Act ("FLSA") requires employers to pay their employees for all hours worked and to keep accurate information regarding hours worked. Employers must determine whether a given employee is "*exempt*" or "*non-exempt*" from the FLSA's coverage. Generally, an employer may properly classify as "exempt" from the FLSA those employees who (1) are paid a flat weekly salary above a certain threshold level that does not fluctuate from week to week, and (2) work in an administrative, professional, executive, computer, or outside sales role. While most states follow the FLSA thresholds regarding whether an employee is exempt or non-exempt, California and New York law have made it harder to qualify as an exempt employee. Put another way, the FLSA's level of protection for employees is a baseline, but California and New York are two of the states that have chosen to be more expansive.

State Requirements

As noted, state law governs wage frequency and payment dates. For example, New York's Labor Law Section 191 requires employers to pay non-exempt clerical workers at least semi-monthly. These New York State FAQs detail the timing requirements employers must meet to pay non-exempt workers, including weekly pay for manual workers. Importantly, New York law does not impose these timing obligations on employers as to their exempt employees who (1) meet the professional, administrative, or executive duties

test, and (2) who are paid at least $1,125 per week. While New York law requires employers to pay semi-monthly or even weekly, employers only are required to pay exempt employees at least monthly. **The New York Wage Theft Prevention Act requires an employer to provide 7 days advance notice of changes to the timing of wage payments for both exempt and non-exempt employees; if that is not possible, then employers should provide as much advance notice as they can, as there may be financial penalties for a breach.**

Takeaway for New York Employers:

This creates an opportunity to split payroll so that an employer with a New York employee base who cannot pay full payroll on this coming Monday/Tuesday, but can pay *all* non-exempt employees, might make that payment solely to the non-exempt employees, while notifying the exempt employees that they will be paid at the end of the month. For some, this will bridge the gap and enable substantial compliance with the law.

California Labor Code Section 204 requires employers to pay non-exempt employees at least twice per calendar month on days designated in advance by the employer as the regular pay date. California law also requires employers to provide prior notice for changes to pay dates. **For instance, if pay is due on March 15, California employers should provide immediate notice to employees if the employer will have difficulty meeting that date, noting that California Labor Code Section 2810.5(b) requires 7 days advance notice for non-exempt employees.** California law is very precise, requiring employers to pay (1) between the 16th and 26th of the month for work performed between the 1st and 15th day of the month, and (2) between the 1st and 10th day of the following month for work performed between the 16th and the last day of any calendar month. The California law also clarifies that the salaries of executive, administrative, and professional employees of FLSA-covered employers may be paid once a month on or before the 26th day of the month in which the work was performed if the employer pays salary for the entire month at that time (*i.e.*, including the unearned portion covering the period between the date of payment and the last day of the month).

Takeaway for California Employers:

While not ideal, employers at risk of missing payroll for California employees may consider notifying their California employees of a change in pay date to March 26. In that notice, the employer should state that the company is making substantial efforts to access liquidity in light of the SVB cash freeze but that the employees' March pay will be delayed until March 26, when they will be paid through March 31. (This assumes the employer already paid the non-exempt employees once during March because, as stated above, employers must pay non-exempt employees twice per month.)

Employers are not only responsible for determining and tracking which employees are exempt and which are non-exempt, but also the state from which employees work, including remote workers, as the laws of each state will govern when and how the employer is required to compensate those employees.

The Financial Benefits of Avoiding Furloughs

Eerily reminiscent of COVID's early days, employers who fear missing payroll, even by month's end, may consider the need to terminate or furlough employees. Employees who are terminated **must** receive their final paychecks in accordance with applicable state law. New York, for example, requires the final paycheck to be issued on the next regular paydate after the separation date, while C**alifornia requires the final paycheck to be issued on the separation date. Unused accrued vacation may need to be paid as well. Accordingly, furloughing employees actually may cost the employer *more money sooner* because the employer has to pay its employees at termination including, possibly, for unused vacation). That employer would avoid that expense by simply waiting first to see what actions the FDIC Receiver takes over the next few days to try to unlock additional SVB funds. There are also ramifications regarding stock options.**

Employers who wish to place employees on unpaid furlough (pausing both all work and wages) should consult with their professional employer organizations (PEOs) or other health insurance providers to determine the impact and cost of maintaining an employee's health insurance coverage while on furlough. Typically, health insurance can continue for furloughed employees for 60-90 days, depending upon the terms of the health plan. Furloughed employees also may be eligible for unemployment, depending upon applicable state law.

For companies impacted by SVB, deciding whether to furlough may depend on factors including whether management and the board of

directors believe in good faith that they will make payroll by the actual (or legally-permissible, extended) due date. Assuming that the freeze of (at least a portion of) SVB-custodied cash will be short-lived, management and board members could, in good faith, reasonably determine that the funds will be available when needed to make payroll. This good faith belief could enable a company that otherwise was able to make payroll (but for the SVB shutdown) to avoid a furlough. Of course, it provides little or no help to a company that otherwise would have been unable to pay team members. Moreover, an employer making substantial efforts to work in good faith to access liquidity to make payroll in the face of the SVB cash freeze may also have a good argument that avoiding a furlough was a commercially reasonable and legitimate approach. The way management phrases specific language in state-mandated notice to employees regarding the timing of payment should, of course, comport with how management expects to justify the decision not to furlough. The specific verbiage will matter. This may mean, for instance, the difference between "we are working to ensure sufficient liquidity to make payroll, though we may change the pay date just in case our funds that had been custodied at SVB remain unavailable to us" as opposed to "we do not have funds to make payroll and therefore are moving the payroll date."

Criminal Liability

While fairly remote, companies should also be aware of the risk of criminal sanctions, which will vary depending both upon applicable state law and the specific facts. Many states have statutes that make it a crime to intentionally fail to pay wages to employees. Under these unique circumstances, criminal charges are unlikely to result when a company makes a good faith effort to pay employees on time and fails. Examples of good faith efforts include (but are not limited to) trying to secure financing through other financial institutions or communicating with payroll service providers about any processing delays. Management could also consider reducing their own pay pending their ability to pay their employees in full. Management should also continue to keep detailed records related to wages and maintain a reasonable level of transparency with employees as circumstances change so that employees are informed.
An example of steps that will be viewed as antithetical to good faith is employers who pay senior management but do not pay junior team (or non-exempt) employees, or employers who pay their employees but fail to pay withholding (which generally leads to personal liability for directors and officers).

Elected Officials

We have made outreach to various elected officials regarding the implications of the SVB takeover and understand that, from a policy perspective, layoffs and furloughs are to be avoided. One member of U.S. Congress with whom one of the authors was in touch spoke to the Governor of California to discuss suspending liability for SVB depositors who fail to make payroll on Monday (to avoid layoffs and furloughs). While there are no assurances, the Governor seemed favorably inclined. These are, of course, matters of prosecutorial discretion and that is where people working in good faith to unfreeze their accounts and secure other funding should, hopefully, be helpful.

Under the circumstances, employers should:

- Try to obtain capital in the short term from investors and other third-party lenders
- Consider the state in which each employee is based (employers need this for tax/withholding anyway) and that state's deadline to pay that employee if exempt and if non-exempt
- Determine whether the employee is exempt or non-exempt
- Check whether, if the employee is exempt, applicable state law will allow the employer to extend the pay date by a few days
- If an employer needs to bifurcate payroll into non-exempt employees who must be paid sooner and exempt employees who need not be paid (under applicable law) until month end, consider whether that split reduces the payroll burden enough to enable the employer to meet its obligations by only paying the non-exempt employees now and extending the payroll date for exempt employees
- For employers who choose to extend the paydate, determine the notice requirements for extending a paydate, and tailor the notice language to demonstrate you are acting in good faith to ensure sufficient liquidity for payment rather than making an unintended declaration of insolvency

Conclusion

Businesses are understandably uneasy about the implications of the SVB crisis on payroll. At least for the short term, officers and directors

of companies navigating how to make payroll and whether to furlough their employees as a means of trying to prevent legal exposure would be wise to consider where their employees are located, whether they are exempt or non-exempt, whether paydates can be extended (with notice), and the reasonable likelihood of obtaining funds from resources other than SVB—as well as the likelihood of accessing SVB funds in the near term. While placing employees on furlough initially may seem necessary, the long-term consequences may be more damaging both to the individuals and the employer.

To see our other material related to the collapse of Silicon Valley Bank, please visit our resource page by clicking here.

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