Financial and Economic Crisis – Law Firms

Navigating A Minefield Through Reductions In Force

*The Editor interviews **Robert M. Projansky,** Partner, and **Marc Mandelman**, Senior Counsel, who are Co-chairs of Proskauer Rose LLP's Managing Change/Reductions in Force Practice Group.*

Editor: Would each of you describe your practice?

Mandelman: As an employment lawyer in the Labor and Employment practice group, my practice is wide-ranging, including counseling, training and employment litigation with respect to all aspects of the employment relationship, and with a particular specialty in advising clients on managing employee separations. I am co-chair of our Managing Change/Reductions in Force (RIF) practice group, which is a practice group centralizing a base of knowledge and expertise in providing clients with a comprehensive multidisciplinary approach to preparing for, designing and implementing changes in the workforce.

Projansky: I am co-chair of the Managing Change/Reductions in Force practice group and a partner in the Employee Benefits and Executive Compensation Law group at Proskauer. I advise clients on the full spectrum of employee benefit issues but I have developed a particular focus on tax qualified plans, plan investment issues, and reductions in force. Marc and I have been working together with our practice group since we began at Proskauer to partner with our clients to address all of the legal aspects of the planning and implementation of workforce change in connection with job restructurings, reductions in force and corporate transactions. As Marc mentioned, our multidisciplinary approach allows us to focus on both the benefits and employment law components of these events.

Editor: We're seeing a number of RIFs as a result of the current economic crisis. Section 409A of the IRS Code has various proscriptive measures regarding severance. How are employers able to sidestep the requirements of Section 409A of the IRS code when structuring a RIF?

Projansky: Section 409A places significant restrictions on deferred compensation arrangements for employees, which has been interpreted by the IRS to include severance arrangements. Section 409A requires, for example, that severance arrangements specify a time and form of payment. It also requires a six-month delay in termination payments of certain key employees of public companies. The good news is that IRS guidance contains a number of exclusions from 409A coverage for certain types of severance pay. For example, we often structure severance plans to fit within the definition of a short-term deferral. To do that, all payments need to be made out of the plan by March 15 of the following year. Another way we avoid 409A coverage in voluntary plans or window programs is by limiting the post-termination payout to two times the individual's compensation (or, if a lesser amount, two times the IRS compensation limit), and restricting the payout period to the next two calendar years.

These exceptions are important because Section 409A's rules often conflict with terms that are typically found in broad-based severance arrangements. Thus, whether employers are designing ongoing severance arrangements, one-time arrangements, or individual one-off agreements, it is important that they seek legal advice, as there are significant complications to applying even these relatively simple-sounding exceptions.

Editor: How does the Worker Adjustment and Retraining Notification Act (WARN) influence the way a RIF is structured?

Mandelman: It is essential that employers take WARN and parallel state mini-WARN notification laws into account early on in the process. One of the first considerations for a client looking for guidance in a restructuring is to ascertain from a timing perspective whether or not WARN applies. Because WARN and its state law parallels require 60 and/or 90 days advance notice to individual employees of the specific date of their termination, the planning and vetting of the selections for a reduction in staffing need to occur sometime prior to that 60- or 90-day period. When only federal law applies or when the state law has only a 60-day notification requirement, the planning for the reduction in force needs to take place three or more months in advance of the planned action to timely meet the advance notification requirements without incurring the liability of additional pay and benefits to the employees after the expected termination date. The recent New York WARN Act, which now has the longest (90 days) advance notification requirement in the nation, may require employers who are conducting staffing reductions in New York to plan for a layoff four or five months in advance of the layoff. That's difficult for employers to do so we are routinely working with clients to address how to structure and implement RIFs to account for WARN timing and other requirements. Also, because the state notification laws all have somewhat different approaches to the obligation to provide advance notice to employees and to the government, the more restrictive laws may control the planning in multi-state reductions in force.

Projansky: WARN can often influence the amount of severance we might provide under a severance program. In other words, if we know that WARN might apply, we might draft a severance plan to reduce severance benefits by the amount of the WARN obligation. In so doing, we are making sure that people who happen to be entitled to WARN benefits do not get more than someone who is not at a WARN-affected site. It ensures consistency, particularly in a multi-jurisdictional reduction.

Editor: What are the safe harbor rules that allow notice of a large-scale RIF to occur in a time period shorter than the 60 days normally required?

Mandelman: The federal and most parallel state laws requiring advanced notification of mass layoffs or plant closings have certain exceptions to the timing of the advanced notification requirement, the most common of which are referred to as "the faltering company exception," "the unforeseen business circumstance exception," and "the natural disaster exception." The truth is that they really aren't exceptions per se. All they do is allow less time in those circumstances for notice to be provided, but notice must still be provided. They're not very effective for providing employer relief from the advance notification requirement. The courts have interpreted these exceptions very narrowly which places a high standard to meet with the burden generally on the employer to demonstrate that the exception applies. What will usually happen in these situations is that when the notice period is shortened, the employer's action is often challenged in court by employees. These kinds of cases are typically brought as a class action, so the question of whether these exceptions apply is usually decided in litigation. Most clients planning a reduction in force are seeking to reduce costs, and not incur additional expense in litigation.

Editor: In conducting a RIF, what selection criteria must an employer use?

Mandelman: In a nutshell, any well-documented, nondiscriminatory criterion that is consistent with achieving very clearly defined business objectives that underlie the need to reduce staff. The law doesn't specify any particular criteria that an employer must use in selecting employees in a reduction in force, and there are many different criteria that are commonly used. However, once you move away from truly objective criteria, such as straight seniority, and attempt to use more subjective criteria, such as relative job performance, that increases the justification burden on the employer to demonstrate a nondiscriminatory reason for the selection. We often see companies running into difficulty when they are using the legitimate need to reduce staff as an opportunity to make up for weak performance management systems by selecting all the subjectively weaker performers when there hasn't been a well-documented record of poor performance.

Editor: What protected classes have to be considered as excluded?

Mandelman: The law doesn't require any particular or protected category to be excluded from the selection process of a reduction in force, but selection criteria must be neutral as to all protected classes. In other words, the selection process should not be based on any protected class or status. There should be an objective business rationale as to how people are being selected. Nevertheless, it is important to analyze any potential adverse impact on all protected classes to assess the potential litigation risk that a neutral selection criteria might inadvertently adversely impact a protect class.

It is worth noting that insofar as particular protected classes are concerned, one area of difficultly for many employers is understanding how to manage the selection for layoff of employees who are on Family Medical Leave Act or disability leave. Whether or not dismissal is appropriate in these circumstances may depend on whether other similarly situated employees who are not on leave are selected.

Editor: Do you foresee increased union activity as a result of RIFs and reduction of employee benefits?

Projansky: Given the difficult economy and the large number of layoffs, increased job security and severance benefit protections will probably be important selling points for unions that can secure them. We expect that employee concerns about this issue will bolster union organizing activity, particularly when combined with proposed new legislation such as the Employer Free Choice Act. In terms of how union relationships affect RIFs themselves, most collective bargaining agreements do not restrict an employer's ability to reduce staff for business needs. However, communication with the union in addressing the effects of a layoff on represented employees is required. In addition, it can be an important tool in getting the union's buy-in to a particular approach, which is effective in maintaining strong employer-employee relations in an already difficult environment.

Editor: Do you get called on more often in states that have their own WARN statutes that are more stringent than the federal law?

Mandelman: Many states have what we refer to as mini-WARN statutes, and each state law has its own unique approach to the advance notification requirements. It is usually not just a lower threshold than the federal law since each one has its own unique requirements. So yes, in states with WARN statutes, knowledgeable legal guidance in navigating these arcane variations is particularly needed to avoid what can be a costly mistake.

Editor: Is the current economic environment likely to produce more litigation regarding wage-and-hour disputes than in previous years?

Mandelman: We're definitely seeing an uptick in employees arguing that their selection for a reduction in force is unfair or unlawful. Given the current economic environment, employees are acutely aware that the loss of their jobs can mean a longer-term of unemployment than in years past. We're starting to see more of these kinds of claims being filed or threatened. As far as wage and hour liability is concerned, which is generally brought as a class action and has always been a minefield for employers, although we haven't specifically seen a large number of laid-off employees asserting misclassification or overtime claims as a result of being selected in a layoff, we are seeing many compensation claims and disputes arising out of incentive, bonus, and commission arrangements by laid-off employees, as there seems to be a lot of misunderstanding between employers and employees' as to rights to these kinds of compensation upon termination. As it relates to wage-hour claims specifically, these issues are rising to the surface when employers attempt to avoid layoffs by using what I would refer to as layoff alternatives, such as reducing employees regularly scheduled work hours – that kind of situation may present enhanced risks for exposing undiscovered misclassification issues.

Editor: When conducting a layoff, is it sufficient for an employer to rely on an unwritten severance policy or a description of the firm's policy in the employee handbook?

Projansky: There are practical and legal considerations that might lead an employer to consider more formally documenting severance arrangements. From a practical perspective, documentation leads to more certainty in what is inherently a traumatic process for employees and for employers alike. From a legal perspective, employers need to be aware that ERISA might apply to their severance plans even if they are not written. This will most likely be the case where there is some reasonable consistency in an employer's practices and there is some level of ongoing administration to the severance program. Where ERISA does govern an employer's arrangements with its work force, compliance obligations typically would not be satisfied by a short statement in an employee handbook — and certainly not by an unwritten policy. An ERISA plan is required to be documented and disseminated to employees.

However, not all is lost. While there are burdens to complying with ERISA, there are also significant legal advantages such that employers might be well-advised to document their programs in a manner that both enhances the likelihood of ERISA coverage and takes advantage of the benefits of ERISA. Examples of those benefits include the fact that ERISA preempts state laws, meaning punitive damages are not an available remedy. In addition, claims for benefits can be heard in federal court, which in general is more employer-favorable. Also, plan fiduciaries can reserve discretion, so their determinations are only overturned if they are arbitrary or capricious.

ERISA compliant plan documents are neither complicated nor expensive for experienced legal counsel to draft, as groups like ours have a comprehensive understanding of the various permutations that are available in plan design. For that reason, we believe that employers should consult their legal counsel to determine whether there are advantages to doing something more than simply relying on an unwritten policy in a handbook.

Please email the interviewees at rprojansky@proskauer.com or mmandelman@proskauer.com with questions about this interview.