Cost-Saving Measures that Could End Up Costing More

Strategies Employers Should Consider Before Implementing a Force Reduction

By Danielle C. Beasley

Introduction

Virtually every aspect of the American economy has felt the impact of the recession. The unemployment rate in the state of Michigan reached a staggering 15 percent in 2009 and remains at high levels. The foreclosure rate for homes continues to rise. Financial markets remain volatile, sales are down, and the American government has bailed out major banks, Chrysler, and General Motors.

In light of these conditions, many businesses have had to find ways to cut costs, and a reduction in force (RIF) is just one of many programs that businesses have used amidst this economic climate. In a RIF, the employer selects certain employees to be involuntarily terminated while retaining others. Accordingly, force reductions can provide an opportunity for employees to file discrimination claims based on protected characteristics such as race, gender, age, disability, etc. That is, disgruntled employees may turn to filing lawsuits as a means to oppose the implementation of the force reduction.

To minimize exposure to subsequent legal challenges, the employer must carefully plan before implementing a RIF. The United States Court of Appeals for the Sixth Circuit explained the importance of proper planning in *Godfredson v Hess & Clark, Inc* by stating that "a lack of evidence regarding a company's objective plan to carry out a reduction in force" is a factor that might indicate that an alleged reduction in force is a pretext for age discrimination.[1] This article assists employers in preparing a RIF plan by offering guidelines to consider before implementing a force reduction.

Creating an Effective Plan

Deciding to use a force reduction can be one of the most difficult decisions that an employer will ever make. However, a properly executed RIF can have a significant effect on the organization's sustainability, as well as prevent costly litigation. Advance planning and careful consideration of each step of the force reduction can help employers avoid mistakes. This section outlines the step-by-step analytical framework that employers should think about *before* using a force reduction.

Step 1: Recognize Possible Alternatives

Not only can force reductions foster an environment for legal challenges, they also can significantly affect the morale of the remaining employees, thus hampering productivity. Consequently, before conducting a RIF, a company should consider alternatives:

- **Hiring Freeze:** An employer can elect not to hire any new personnel, even choosing not to replace those individuals who leave by natural attrition. However, using this strategy may not provide the company with enough economic relief and, as a result, the company may want to move forward with the force reduction. If a company does employ a RIF, though, it is good business practice to combine a hiring freeze with the RIF to avoid sending the message that the RIF was not really needed.

Fast Facts:

Given our current economic climate, employers are consistently looking for ways to cut costs through the use of, inter alia, force reductions. However, if employers do not use certain strategies before implementing a reduction in force, they could end up paying a lot more to defend costly litigation if employees (or former employees) contest the validity of the measure. This article considers this paradigm and sets forth the major practical and legal issues that an employer must be aware of before using a force reduction.

- **Reduced Work Hours and Pay Reductions:** An employer may decide to reduce employees' work hours and related pay in an effort to reduce costs. The advantage of this alternative is that an employer can keep its existing workforce. Further, employees will generally find that a pay reduction is a better alternative to a layoff or termination, especially when market conditions make it difficult for them to find new jobs elsewhere. However, before employing this strategy, employers should consult with labor and employment counsel to avoid violating the Fair Labor Standards Act (discussed in Step 2) and other employment laws.
- **Exit Incentive Programs:** An exit incentive program involves enhancements to pension eligibility or cash incentives to encourage employees to accept severance benefits now rather than await possible termination with reduced severance benefits later. Thus, because exit incentive programs are voluntary in nature, employees generally welcome the use of such programs over the use of an involuntary RIF. Additionally, in an exit incentive program, an employer can require that, in exchange for the pension eligibility or severance pay, employees sign a waiver releasing the employer from liability for statutory claims that an employee could assert. Courts will generally uphold the validity of a release, thereby insulating the employer from liability, provided that employees knowingly and voluntarily signed the release.

  However, whenever an employer offers severance benefits coupled with a release of age discrimination claims (which could be provided in a general release) to employees aged 40 years or older, the Older Workers Benefit Protection Act[2] requires that these employees be given additional information that includes (1) directing the employees to seek the advice of counsel before signing the release, (2) giving employees 45 days to consider the waiver, (3) allowing employees 7 days in which to revoke a signed release, and (4) providing employees with information detailing the program eligibility factors (i.e., showing the names, ages, and job titles of employees eligible for the severance benefit and those who are not).[3]
- **Temporary Shutdowns:** A temporary shutdown can be an effective solution when a company's inventory is up, but its sales are down. In that situation, an employer may opt to close one or more facilities until the inventory levels necessitate additional production. Any shutdown, however, should be reviewed by labor and employment counsel for compliance with the applicable wage and hour laws, as well as to ensure that the Worker Adjustment and Retraining Notification Act (discussed in Step 2) does not apply to the shutdown.

If, after considering these alternatives, an employer still believes that a force reduction is necessary, the employer should adhere to the following guidelines.

Step 2: Understand the Governing Legal Framework for RIFs

By understanding the general legal framework applicable to force reductions, an employer can use strategies to address these issues, thereby reducing the legal risk. The law governing force reductions is not contained in any single statute; rather, it is governed by various federal, state, and local laws. Some of the most important federal laws are:

- **WARN Act:** The Worker Adjustment and Retraining Notification Act (WARN Act)[4] requires that covered employers (i.e., those with more than 100 employees) provide 60 days' advance notice of a plant closing or mass layoff.[5] Specifically, the act requires employers to give written notice to each affected employee (or employee representative for those represented by a union), the state agency concerned with displaced workers,[6] and the chief elected official of the local government within which the closing or layoff is to occur.

  Although the notice requirements can be partially waived under three exceptions,[7] the act still requires employers to give notice "as soon as practicable."[8] An employer that violates the WARN notice requirements can be liable for back

pay for each day of the violation up to a maximum of 60 days, lost benefits, civil penalties, and attorney fees.[9] Given these penalties, employers should be aware of the WARN Act's requirements and take steps to ensure compliance when considering a reduction in force that falls under the act's purview.

- **FLSA:** An employer considering a RIF must also heed the Fair Labor Standards Act (FLSA),[10] as it could be implicated in a variety of ways. For example, there may be FLSA consequences if a plant closure lasts for a short duration (e.g., less than a week) or if employees continue to work remotely (e.g., from home by e-mail or telephone) during the closure. To avoid such results, it is wise to seek advice on the FLSA from labor and employment counsel.
- **ERISA:** Some separation agreements used in connection with a RIF may be an employee welfare benefit plan governed by the Employee Retirement Income Security Act (ERISA).[11] To distinguish an agreement that is subject to ERISA from one that is not, federal courts examine whether the agreement requires "an ongoing administrative program to meet the employer's obligation."[12] The Sixth Circuit, in particular, focuses on two factors: (1) whether the employer has discretion over the distribution of benefits and (2) whether there are ongoing demands on an employer's assets.[13] If the answer to these questions is yes, the severance agreement is subject to ERISA.

  However, given ERISA's numerous requirements, obligations, and penalties for violation, employers may want their severance agreement to be treated as an individual agreement between an employee and an employer and not a welfare plan that is subject to ERISA's many requirements. This objective can be properly addressed through consultation with counsel and careful drafting of the agreement.

Step 3: Identify the Business Need for the Reduction

The most important step in planning a RIF is to identify the business purpose necessitating the reduction. Some legitimate reasons might include (1) an economic climate that has substantially interfered with projected sales, (2) cost savings that can be achieved through consolidation of functions, (3) technological advances that reduce the need for manual labor, (4) overcapacity, and (5) aligning the company's production levels with current market conditions.

By identifying and documenting the business reason and necessity for the RIF, the company can adequately defend its process should the RIF be challenged in litigation. Moreover, determining the business purpose for the reduction can assist employers in selecting the layoff criteria. For example, if a company has an overstock of inventory, eliminating the second shift of production might be an appropriate solution.

Step 4: Determine What Criteria Will Be Used to Reduce the Force

Perhaps the hardest step in planning a successful RIF is determining which positions will be eliminated. To avoid subsequent litigation, employers should carefully identify and document *objective* criteria to classify the jobs that will be affected by the RIF. Examples include documented performance, education level, salary, seniority, or necessity of job function.

Step 5: Prepare the Research

The possibility of litigation accompanies any force reduction because terminated or laid-off employees may file lawsuits alleging discrimination, retaliation, wrongful discharge, breach of contract, or failure to provide WARN notice. An employer should consult with counsel in a privileged communication to determine whether the proposed RIF will have a disproportionate effect on minorities, women, older workers, disabled employees, or other protected personnel. Counsel might even do a statistical analysis of the RIF. Additionally, the employer should consult its human resources department and review employment contracts, personnel records, and other potential sources that could refute a claim of breach of contract.

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Step 6: Plan the Delivery of the Message

The final step in RIF planning is to determine how managers, affected employees, and others will be informed about the force reduction.

- **Communication to Management:** Communication to management personnel is an essential part of any successful RIF plan. Managers and supervisors need to clearly understand the business reasons necessitating the RIF, the criteria used to eliminate positions, and what their role will be in the entire process. If managers are not fully informed about these issues, they may say or do something during the process that could expose the company to subsequent legal challenges. In preparing management for a force reduction, it may be helpful to ask counsel to prepare written documentation that will be distributed to management detailing how they should respond to frequently asked questions, setting forth the parameters of what they can and cannot say, and explaining what level of confidentiality must be maintained during the process.
- **Communication to Affected Employees:** The manner in which terminated or laid-off employees are notified of the RIF can have a significant effect on whether they will file lawsuits against the company. If employees believe that they are being treated equally and with respect, an employer can substantially reduce its litigation exposure. As a result, employers should establish written exit procedures to ensure that employees are given a clear, consistent, and compassionate message about the force reduction. Moreover, employers should work with human resources to create an exit package that includes (1) written notice of the layoff and the business reasons for the reduction; (2) information about 401(k), pension, stock, bonus, COBRA, health, and other related benefits; (3) information about severance agreements and releases (if applicable); and (4) information about outplacement services (if applicable).
- **Communication to Others:** An employer should also think about what communications it will have with employees who are not selected for the RIF. Specifically, these employees should be notified of the business need for the RIF, as well as the effect that the RIF may have on their jobs (e.g., expanded duties or different reporting requirements). Moreover, employers should think about how they will notify the public at large about the force reduction, as well as when the notification should occur.

Advance planning of these issues *before* implementing a force reduction can help the company avoid making costly mistakes.

Conclusion

Conducting a force reduction is not an easy task. However, by planning *before* implementing a RIF, an employer will both increase the likelihood of successful execution and reduce the risk of exposure to costly litigation. To implement a RIF effectively, the employer should recognize the possible alternatives to a RIF, understand the governing legal framework for RIFs, identify the business purpose for the reduction, determine what criteria will be used to eliminate positions, prepare the necessary research, and plan the delivery of the message. Given the nature of legal issues addressed by force reductions, employers may find it advantageous to consult labor and employment law attorneys before implementing a RIF. ■

Danielle C. Beasley practices in the areas of labor and employment law at Vercruysse Murray & Calzone, P.C. in Bingham Farms. She received her JD from the University of Maryland School of Law and her BA, with distinction, from the University of Michigan. She can be reached at (248) 901-0301 or dbeasley@vmclaw.com.

FOOTNOTES

1. *Godfredson v Hess & Clark, Inc,* 173 F3d 365, 374 (CA 6, 1999), citing *Hillebrand v M-Tron Industries Inc,* 827 F2d 363, 367–368 (CA 8, 1987).
2. 29 USC 621 *et seq.*
3. 29 USC 626(f).
4. 29 USC 2101 *et seq.*
5. 29 USC 2102(a).
6. The Rapid Response Section of the Department of Energy, Labor & Economic Growth is the applicable Michigan agency.
7. 29 USC 2102(b)(1) (faltering company exception); 29 USC 2102(b)(2)(A) (unforeseen business circumstances exception); 29 USC 2102(b)(2)(B) (natural disaster exception).
8. 29 USC 2102(b)(3).
9. 29 USC 2104(a).
10. 29 USC 201 *et seq.*
11. ERISA defines an employee welfare benefit plan as including any plan established or maintained by an employer for the purpose of providing for the plan's participants "benefits in the event of…unemployment" or any benefit described in 29 USC 186(c). 29 USC 1002(1)(A) and (B). Since severance plans are included in the latter part of this definition, they may be considered ERISA benefit plans. See *Cassidy v Akzo Nobel Salt, Inc,* 308 F3d 613, 615 (CA 6, 2002).
12. *Fort Halifax Packing Co, Inc v Coyne,* 482 US 1, 11; 107 S Ct 2211; 96 L Ed 2d 1 (1987).
13. *Kolkowski v Goodrich Corp,* 448 F3d 843, 848 (CA 6, 2006).