WHEN DIFFICULT TIMES CALL FOR DRASTIC MEASURES – REDUCING YOUR WORKFORCE WHILE MINIMIZING RISK

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In difficult economic times, employers find themselves facing pressure to reduce costs and, in particular, overhead expenses. Often, employers look to reduce headcount as a cost-cutting measure. While workforce reductions may be an effective means to reduce overhead, employers should be aware of other options for cost savings, and consider the legal requirements and risks of reductions.

I. ALTERNATIVES TO LAYOFFS

Today’s employers are seeking alternatives that may allow them to maintain the current workforce while reducing costs. While these options may not work for your company, they are worth considering before undertaking a workforce reduction. In addition to delivering financial relief, the alternatives outlined below may allow the employer to retain its talent pool, thereby reducing future hiring and training costs. Additionally, suitable alternatives may permit employers to avoid the blows to employee morale and negative publicity that reductions often bring. As with any employment decision, these changes should be implemented consistently and without unlawful discrimination.
A. Hiring and Pay Freezes or Reductions in Benefits

Hiring freezes and wage freezes have been common cost-saving tactics in recent months.\(^1\) Often, employers see maintaining the status quo – by not filling vacancies created by natural attrition or not offering annual or merit-based raises – as a gentler alternative to reducing headcount. In some cases, these alternatives may result in savings sufficient to avoid the need for layoffs. Wage cuts, either across the board or within certain job categories, or elimination of annual bonuses also may be a viable option, although employers should take care to reduce wages only prospectively and not deny compensation that is already earned.\(^2\) Reduction or elimination of employee benefits, such as 401K matches, likewise presents an opportunity for cost savings. However, employers should consult legal counsel before making significant changes to established benefit programs that are subject to the Employee Retirement Income Security Act (“ERISA”).

B. Reduced Work Schedules or Forced Closures

Many employers are considering or implementing work furloughs as a means to reduce costs. These may take the form of reduced workweek (i.e., a Monday through Thursday schedule) or a forced shutdown of operations for some time. However, before instituting any plan involving reduced hours, employers should consider the requirements of federal and state wage laws. For instance, the federal Fair Labor Standards Act (“FLSA”) requires that exempt employees (those who are salaried and exempt from overtime requirements) earn at least $455


per week and receive a regular, predetermined amount constituting all or part of their compensation. Further, the FLSA prohibits most deductions from an exempt employee’s pay for a week in which any work is performed, including deductions for time not worked at the employer’s request.

The FLSA permits an employer to temporarily or permanently reduce work schedules, with a corresponding decrease in pay, without jeopardizing the exempt status of its employees in limited circumstances. Specifically, the cuts must be prospective and the result of a bona fide reduction. Reductions made in response to industry-wide layoffs, decreased funding, decreased demand or to enhance job security have been found to be bona fide.

Likewise, forced closures may reduce overhead costs while maintaining the current workforce. However, forced closures must last one or more full workweeks for exempt employees – partial-week shutdowns will jeopardize an employee’s exempt status. To avoid running astray of the FLSA, these decisions should be undertaken carefully with the assistance of legal counsel. If an exempt employee’s hours and corresponding pay are improperly altered, it may convert the employee into a non-exempt employee. In addition, where an employer has entered into a contract governing the terms and conditions of work, either with the individual employee or through collective bargaining, the employer should consult the agreement before making unilateral changes to employee hours or pay.

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3 29 C.F.R. § 541.602(a).

4 29 C.F.R. § 541.602(a).

5 Department of Labor Wage and Hour Field Guide § 22b00.

C. Unemployment Work-Sharing Plans

State unemployment work-sharing programs, currently available in Arizona and many other states,\(^7\) also allow employers to maintain their investment in a trained workforce while simultaneously cutting labor costs. These programs provide partial unemployment benefits when an employer enters into an agreement with the state in advance and subsequently reduces employee work hours. A potential drawback to such a plan may be the loss of employees who find full-time employment elsewhere. However, that concern is minimized in industries that suffer widespread hiring freezes.

The details of these unemployment programs vary from state to state. For example, Arizona’s work-share program allows employees to collect partial unemployment benefits for up to one year when they experience a reduction in work hours of ten to forty percent.\(^8\) To take advantage of the Arizona program, an employer must certify that the reduction in work hours is in lieu of a layoff. California’s program permits employers to apply for a work-share plan if a reduction in work hours will affect at least two employees amounting to at least ten percent of the employer’s total workforce.\(^9\) Additionally, under the California plan, each affected employee must experience at least a 10% reduction in hours to qualify. While these programs may provide some benefit for employees, the amount of the benefit is limited and may result in compensation that is significantly less than employees’ prior salaries. In addition, employers are still required to contribute to the costs of the unemployment benefits.

\(^7\) Work-share programs currently are available in Arizona, Arkansas, California, Florida, Iowa, Kansas, Louisiana, Maryland, Massachusetts, Minnesota, Missouri, New York, Oregon, Rhode Island, Texas, Vermont and Washington.


II. ASSESSING THE RISK

Workforce reductions often present many risks – some obvious and others less so. Such risks include potentially costly litigation, including discriminatory discharge claims based on race, gender, age, or disability. Additionally, unanticipated layoffs may prompt disgruntled employees to raise other unrelated claims, such as pay discrimination or sexual harassment, that they would not have raised otherwise. However, the risks of liability often may be assessed and managed with careful consideration and planning.

A. Understanding the Demographic Impact of Layoff Decisions

One of the most effective, and highly contested, tools in discrimination litigation is the use of statistical evidence to gauge the discriminatory impact of challenged decisions, policies, or practices. With this in mind, employers often conduct simple statistical analyses to understand the impact of the reduction decisions on the workforce by race, gender, age, or disability. While this analysis can be very informative and helpful, employers should proceed cautiously because the tool intended to assist in avoiding litigation may become a plaintiff’s most prized exhibit at trial. Employers should ensure that any statistical analysis is done correctly, and that the data analysis and subsequent evaluation are protected to the greatest extent possible by attorney-client privilege.

A proper statistical analysis will evaluate workers selected for reduction in protected categories, including gender, race, age, and disability, compared to those remaining in the same positions. Age, in particular, must be examined closely and may be considered within bands or age ranges. Even age ranges over 40 often should be broken out, as courts have recognized

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10 The Ledbetter Fair Pay Act was signed into law on January 28, 2009. The Act amends federal discrimination laws to clarify that a discriminatory compensation decision or other act occurs each time compensation is paid pursuant to the discriminatory compensation decision or other practice.
discrimination claims based on retention of a significantly younger employee who is over 40.11 Moreover, where the employer continues to hire during workforce reductions, statistical analysis should be expanded to include incoming employees. Employers should recognize that any new hires will serve as “comparators” in a discrimination action.

After conducting an analysis, employers should assess the results to determine whether reduction decisions will have a disproportionate impact on members of a protected class, such as older employees. The Supreme Court has upheld claims on a disparate impact theory under the Age Discrimination in Employment Act (“ADEA”), meaning even seemingly facially neutral employment practices can give rise to an ADEA claim if the practices impact an older age group more than a younger one. 12 Employers should take particular care with age comparisons, as ADEA claims often lead to high-dollar jury verdicts. 13

In the end, courts will look to statistical evidence to assist in determining whether there has been a disparate impact. 14 However, statistics, without more, often will not establish a discrimination claim. 15 Accordingly, up front statistical analysis can be a useful tool to identify discrepancies and consider ways to avoid those types of claims.

11 Douglas v. Anderson, 656 F.2d 528, 533 (9th Cir. 1981) (replacement by a person over 40, who is five years younger, sufficient to establish a prima facie case of age discrimination).


13 Cancellier v. Federated Department Stores, 672 F.2d 1312 (9th Cir. 1982) (affirming a $1.9 million jury verdict based on ADEA claims from three plaintiffs).

14 Diaz v. Eagle Produce Ltd. P’ship, 521 F.3d 1201, 1209 (9th Cir. 2008) (court considered statistical evidence, noted that many of the plaintiff employees were hired after their fortieth birthday, and observed “that the average age of the workers hired . . . is approximately nine and a half years younger than the average age of those laid off . . . fails to justify an inference of discrimination”).

15 Pottenger v. Potlatch Corp., 329 F.3d 740, 748 (9th Cir. 2003) (“to raise a triable issue of fact regarding pretext based solely on statistics the statistics ‘must show a stark pattern of discrimination unexplainable on grounds other than age;’” “plaintiff’s statistical evidence must focus on eliminating non-discriminatory explanations for the disparate treatment between comparable individuals.”).
B. Choosing Criteria to Select Employees for Reduction

While selection criteria obviously must be tailored to the specific needs of the organization, potential risks can be minimized by establishing uniform criteria for reduction decisions. Where possible, objective reduction criteria, such as elimination of an entire business unit, operation or department, or seniority-based decisions, provide sound and often defensible methods for reduction determinations.

However, in many instances, employers must make more employee-specific subjective determinations to meet specific financial goals. In those cases, employers may choose to use performance-based selection criteria. While some aspects of performance may be objective, such as sales dollars, many will require the personal opinion or assessment of management. Such personal assessments may be subject to scrutiny and challenge in subsequent legal actions.

Mindful employers will consider whether using objective criteria will achieve the necessary reductions before moving to more subjective grounds. For example, seniority-based determinations or those geared toward eliminating the highest wage earners are generally considered to be lawful, and not discriminatory under the ADEA, even though they may affect certain age groups more than others.\textsuperscript{16} However, employers need to be aware that, when selecting criteria, even if facially objective, upon which to make these broad-based determinations, these decisions are subject to challenge. For example, in age discrimination

\textsuperscript{16} See e.g. Allen v. Highlands Hospital Corp., 545 F.3d 387, 404 (6th Cir. 2008) (hospital’s desire to “reduce costs associated with its highly paid workforce, including those costs associated with employees with greater seniority,” did not constitute “an identifiable practice that disproportionately harms workers who are at least 40 years old”). See also Turney v. Beltservice Corp., 92 F.3d 1194 (9th Cir. 1996) (terminating employees based on high salary is not an improper motive).
cases, employers will bear the burden of demonstrating that their decisions based on these facially neutral criteria were based on proper reasons other than age.17

Regardless of the selection criteria utilized, employers should take care to ensure the process is uniform and fair, particularly within departments. Employers also should be careful to maintain documentation throughout the process, particularly explaining any deviations from the established process.

Finally, employers should identify any “wild card” employees up front. These are the employees who are not bringing value to the organization, but do not fit into the established criteria for reduction. While it may be appropriate to include them in the reduction in force, again, it is important to carefully document the basis for decisions that vary from the otherwise uniform selection process.

C. Maintaining Confidentiality

We recommend that employers, where possible, protect discussions, correspondence and documents relating to a headcount reduction with attorney-client privilege. In particular, employers conducting internal analyses regarding potential layoffs should undertake every effort to ensure that any results and discussions retain the protection of attorney-client privilege. Courts have recognized that the attorney-client privilege will apply if the risk assessment is conducted to develop a defense to potential litigation or to obtain legal advice.18 To maintain

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17 Meacham v. Knolls Atomic Power Lab., 128 S. Ct. 2395 (2008) (holding that employers have the burden of demonstrating that terminations are based on reasonable factors other than age in ADEA cases).

confidentiality, companies should be sure that counsel is included in layoff discussions, and that individuals outside the company are not included.

III. NOTICE REQUIREMENTS

Both federal and state laws require employers to provide notice to employees, their representatives, and the state and local government of the state in which the reductions are to occur under certain circumstances. Because the penalties for failing to give appropriate notice can be onerous, employers should be aware of and comply with applicable notice laws.

A. WARN: Worker Adjustment and Retraining Notification ("WARN") Act.

The federal WARN Act, enacted in 1988, applies to any business employing 100 or more full-time employees, or 100 or more employees who, in the aggregate, work at least 4000 hours per week. The WARN Act’s definition of an “employee” extends to employees who are not currently working for the employer, if there is a reasonable likelihood that they will return to work. In addition, employees of related companies, independent contractors and leased employees may be considered “employees” under the Act. For employers covered by WARN, the Act mandates 60 days’ notice in advance of a plant closing or mass layoff.

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19 See Castro v. Chicago Hous. Auth., 360 F.3d 721 (7th Cir. 2004) (holding that the federal WARN act applies to quasi-government agencies, housing authority).

20 20 C.F.R. § 639.3(a)(1).

21 Childress v. Darby Lumber, Inc., 357 F.3d 1000 (9th Cir. 2004) (parent and subsidiary were a single employer where they had common ownership and subsidiary derived 90% of income from parent).

22 Administaff Comps. v. New York Joint Bd., 337 F.3d 454 (5th Cir. 2003) (leasing company was not considered a joint employer with client despite “co-employer” relationship upon finding that, among other things, the companies did not share administrative services, there was no interchange of equipment or commingled finances, and client’s employees did not perform any work for the leasing company, i.e., no interchange of employees).

23 29 U.S.C. § 2102(a); 20 C.F.R. § 639.7(a)(2).
1. **Plant Closing**

Covered employers must give required notice if an employment site (or one or more facilities or operating units within an employment site) will be shut down, and the shutdown will result in an employment loss for 50 or more employees during any 30-day period.\(^{24}\) The employee threshold however does not count employees who have worked less than 6 months in the last 12 months or employees who work an average of less than 20 hours a week.\(^{25}\) Importantly, while these groups are not counted to determine if notice is required, they are entitled to notice if WARN does apply to a reduction in force.\(^{26}\) The term “plant closing” is somewhat misleading, as the notice requirements will apply to the shutdown of a smaller piece of the operation, such as a department.\(^{27}\)

2. **Mass Layoff**

Notice also is required in advance of a mass layoff that does not result from a plant closing, but which will result in an employment loss at a single site during any 30-day period for 500 or more employees, or for 50-499 employees if they make up at least 33% of the employer’s active workforce.\(^{28}\) Again, this threshold does not count employees who have worked less than 6 months in the last 12 months or employees who work an average of less than 20 hours a week for the employer.\(^{29}\) These groups, however, are entitled to notice if WARN applies.\(^{30}\)


\(^{26}\) 29 U.S.C. § 2101(a)(5).


\(^{29}\) 29 U.S.C. § 2101(a)(8).
3. The Aggregate Rule

An often unnoticed provision of WARN requires that an employer give notice if the number of “employment losses” for two or more groups of workers reaches the threshold number of a plant closing or mass layoff during any 90-day period. Job losses within any 90-day period will count together toward WARN threshold levels, unless the employer demonstrates that the employment losses during the 90-day period are the result of separate and distinct actions and causes.\(^{31}\) Accordingly, employers should be mindful of the timing and cumulative effect of their planned reduction decisions.

4. Employment Loss

The term “employment loss” refers to (1) any employment termination other than a discharge for cause, voluntary departure or retirement, (2) a layoff exceeding six months, or (3) a reduction in an employee’s work hours of more than 50% in each month of any six-month period.\(^{32}\) Therefore, broad work schedule reductions may trigger WARN Act obligations.

However, there are some exceptions to this general definition of employment loss. For example, where a new employer hires the employees in the sale of a business, an employment loss has not occurred under the Act.\(^{33}\) Also, an employee who refuses a transfer to a different employment site within reasonable commuting distance does not experience an employment loss.\(^{34}\) What constitutes a reasonable distance varies, depending on the industry, “the geographic


\(^{31}\) Hollowell v. Orleans Reg’l Hosp. LLC, 217 F.3d 379 (5th Cir. 2000) (the burden is on the employer to prove that losses within a 90-day period are for distinct causes; “[l]ayoffs that are occasioned by a continuing and accelerating economic demise are not the result of separate and distinct causes.”)

\(^{32}\) 20 C.F.R. § 639.3(f).

\(^{33}\) 20 C.F.R. § 639.6(a).

accessibility of the place of work, the quality of the roads, customarily available transportation, and the usual travel time.\textsuperscript{35} An employee who accepts a transfer outside a reasonable commuting distance within 30 days after it is offered or within 30 days after the plant closing or mass layoff, whichever is later, does not experience an employment loss.\textsuperscript{36} In both transfer exceptions, the transfer offer must be made before the closing or layoff, there must be no more than a six-month break in employment, and the new job must not be deemed a constructive discharge.\textsuperscript{37} In addition, these transfer exceptions apply only if the closing or layoff results from the relocation or consolidation of part or all of the employer’s business.\textsuperscript{38}

5. Employment Site

An employment location constitutes a “single site of employment” under the WARN Act if it is a single geographic location or a grouping of contiguous locations forming a “campus” or “park.”\textsuperscript{39} Both the WARN regulations and courts recognize a multi-factor test to determine whether two facilities would be considered a “single site” under the Act.\textsuperscript{40} Separate buildings in the same geographic area also may also constitute a “single site” if an employer regularly rotates the same employees to the different locations.\textsuperscript{41} Employees who regularly travel for business

\textsuperscript{35} 20 C.F.R. § 639.5(b)(2).
\textsuperscript{36} 29 U.S.C. § 2102(b)(2).
\textsuperscript{37} 29 U.S.C. § 2102(b)(2).
\textsuperscript{38} 29 U.S.C. § 2102(b)(2).
\textsuperscript{39} See 20 C.F.R. § 639.3(i).
\textsuperscript{40} 20 C.F.R. § 639.3(i); \textit{Frymire v. Ampex Corp.}, 61 F.3d 757, 766 (10th Cir. 1995) (The most important factors in determining whether a facility constitutes a single site are “proximity and contiguity.” Once a court determines whether a site is contiguous, the analysis turns to managerial and operational variables within that facility.).
purposes are assigned to a single site of employment for WARN purposes based on their home office or the office from which their work is assigned.\(^{42}\) Additionally, the WARN Act does not apply to foreign employment sites.\(^{43}\)

6. Who is Entitled to What Notice and When?

Written notice stating whether the layoff or closing is temporary or permanent, the expected date of the layoff, and the contact information for a company official must be given 60 days prior to the action.\(^ {44}\) All employees or their representative, if they are covered by a collective bargaining agreement, as well as the state and local governments are entitled to WARN notice.\(^ {45}\) State and local governments generally specify the form and contact for such notice.

a. Required Notice to Employees

Employers must provide affected employees with a \textit{plain statement} detailing: (1) whether the layoffs are permanent or temporary, (2) whether the employer is closing a facility, (3) the expected date the layoffs will commence and when the employees will be let go, and (4) whether employee bumping rights apply. Additionally, employers must provide the name and contact information of a company official to affected employees.\(^ {46}\) While the Act does not

\(^{41}\) *But see Bader v. N. Line Layers, Inc.*, 503 F.3d 813 (9th Cir. 2007) (Construction sites in various locations across the country for same employer did not constitute a single site of employment although several of the construction employees reported to a single home base office via telephone. The home office did not constitute a single site of employment because the employees never physically reported there.)

\(^{42}\) 20 C.F.R. § 639.3(i)(6).

\(^{43}\) 20 C.F.R. § 639.3(i)(7).

\(^{44}\) 29 U.S.C. § 2102(a).

\(^{45}\) 29 U.S.C. §§ 2102(a)(1), (2).

\(^{46}\) 20 C.F.R. § 639.7(d)(4).
require employers to provide a separate notice to employees who are represented by a union, employers often opt to provide notice to both – and some state laws mandate notice to the employees regardless whether they are represented.

b. **Required Notice to the Union**

If employees are represented, employers must provide notice to union representatives, including (1) the name and address of the affected work site, (2) whether the layoffs are temporary or permanent, (3) whether or not the employer is closing a facility, (4) the expected date the layoff will commence and a schedule for affected employees, and (5) the job titles of affected positions and names of each employee in those positions.\(^47\)

c. **Required Notice to State and Local Government**

Employers also must provide notice to the state Dislocated Workers’ Unit and the local government head with information regarding (1) the name and address of the affected work site, (2) the name and contact information of a company official, (3) whether the layoffs are temporary or permanent, (4) the expected dates of the layoff, (5) whether bumping rights apply, and (6) the name and contact information of the union and its chief elected officer, if applicable.\(^48\)

7. **Penalties and Enforcement**

The WARN Act is enforced through the United States District Courts, and penalties for failing to give the required WARN notice can include back pay for the period during which

\(^{47}\) 20 C.F.R. § 639.7(c).

\(^{48}\) 20 C.F.R. § 639.7(e).
notice was required, up to 60 days, and benefits for those 60 days. Additionally, employers may be charged a civil penalty of up to $500 per day during the period when notice was required but not given, and the prevailing party is entitled to attorneys’ fees and costs. Failure to comply with WARN notice requirements also can result in costly class action litigation. Damages and attorneys’ fees in these types of suits can be substantial.

8. Exceptions to the Notice Requirement

The WARN Act does permit some limited exceptions to the notice requirement. Closing of a temporary facility or a layoff resulting from the completion of a temporary project does not require WARN notice. However, to avoid triggering the notice requirements, the employer must advise employees at the time of hire of their temporary status. Also, employees are not entitled to notice for closures resulting from a strike. Additionally, a faltering company (a business actively and in good faith seeking capital), a company facing unforeseeable business circumstances (such as the unanticipated cancellation of a major contract), or a company damaged by a natural disaster (such as a flood or earthquake) need not give WARN notice prior to laying off employees. Even in these exceptional situations, notice must be given as soon as possible.

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51 See Castro v. Chicago Housing Authority, 360 F.3d 721, 730 (7th Cir. 2004) (upholding a $1.2 million damages award plus costs and three years’ interest.); see also Hollowell v. Orleans Reg’l Hosp. LLC, 217 F.3d 379 (5th Cir. 2000) (upholding award of attorneys fees of $305,992.61.).
52 20 C.F.R. § 639.5(c).
53 20 C.F.R. § 639.5(d).
54 29 U.S.C. § 2102(b).
is practical and the notice must state the reason for reducing the notice period.\textsuperscript{55} In addition, the employer bears the burden of proving that the exception is met.\textsuperscript{56}

9. Proposed Amendments to the WARN Act

President Barack Obama has announced his support of proposed changes to the WARN Act, known as the FOREWARN Act.\textsuperscript{57} The new provisions would broaden the scope of the Act in a number of ways, including extending its reach to employers with 50 or more employees. The proposed changes also would expand the class of affected employees entitled to WARN notice. For example, under the FOREWARN provisions, a mass layoff is triggered if 25 or more employees are affected. Additionally, these employees will be entitled to 90 days’ notice, rather than the 60 days currently required, and notice also must be given to the Secretary of Labor. The new provisions also include a significant increase in penalties for violating the Act. Back-pay damages will be doubled and affected employees will be entitled to benefits for up to 90 days.

B. State WARN Acts

Many states have passed their versions of WARN, known as “baby WARN Acts,” which may have additional or different requirements than the federal Act. It is important to be familiar with the state requirements as they are often more favorable to the employee than the federal act. States such as New Jersey, Illinois, California and New York have implemented baby WARN Acts with significantly different employee thresholds and/or notice requirements than the federal law.

\textsuperscript{55} 29 U.S.C. § 2102(b)(3).

\textsuperscript{56} \textit{Alarcon v. Keller Indus.}, 27 F.3d 386, 389 (9th Cir. 1994) (employers must provide adequate reasons to support claims that they are excepted from providing WARN notice).

For example, the New Jersey WARN Act applies to any employer, regardless of the number of employees.\textsuperscript{58} The Illinois Act applies to employers with 75 or more employees and to layoffs of 25 or more employees, constituting 1/3 of the workforce.\textsuperscript{59} The California Act applies to employers with 75 or more employees, including part-time employees, and a mass layoff is triggered if 50 or more employees are affected. Additionally, the California Act does not require that the employment loss represent 1/3 of the workforce to trigger a mass layoff.\textsuperscript{60}

The New York WARN Act took effect February 1, 2009, and contains provisions similar to the proposed FOREWARN Act.\textsuperscript{61} The New York Act applies to employers with more than 50 employees, and a mass layoff is triggered by 25 or more affected employees. The New York Act also requires notice if a plant relocates to a new site more than 50 miles from previous site.

**IV. IMPLEMENTING THE REDUCTION**

Employers who take care in determining that a workforce reduction is necessary and identifying the appropriate cuts will gain some protection from legal liability, but the risks do not stop there. From laws that can punish an employer’s well-intended efforts or undo separation agreements, to clumsy procedures that can fuel a litigious fire under even the most loyal of employees, the process of conducting a layoff can be a minefield. Careful employers will review each step of the process with the following issues in mind.


\footnotesize\textsuperscript{59} 820 Ill. Comp. Stat. 65/5.

\footnotesize\textsuperscript{60} Cal. Lab. Code § 1400.

\footnotesize\textsuperscript{61} http://www.labor.state.ny.us/agencyinfo/warnact.shtm, last accessed February 24, 2009.
A. Payment of Wages and Benefits

1. Deadlines for Payment of Wages

State law governs the timing of payment of employee wages. Therefore, employers must review state law to ensure compliance in payment of wages upon discharge, as these requirements can vary considerably by state. For instance, Arizona law requires that discharged employees be paid all wages due within three working days, or at the end of the next pay period, whichever is sooner.\(^\text{62}\) “Wages” include all nondiscretionary compensation, so vacation pay, sick pay, severance pay, commissions, bonuses and other amounts promised are included if the employer has a policy or practice of making such payments.\(^\text{63}\) On the other hand, California law requires all wages, including accrued vacation pay, to be paid immediately at the time of discharge.\(^\text{64}\) In Connecticut, involuntarily discharged employees must be paid all wages, including vacation pay, the next business day after discharge.\(^\text{65}\) Importantly, even if an employee’s separation agreement provides for some payment at a later date, wages for time worked still must be paid according to state statute.

2. COBRA

In many cases, employers will be required to offer continuing benefits to affected employees. Under the Consolidated Omnibus Budget Reconciliation Act (COBRA), employers offering benefits under ERISA plans must offer certain employees the option to continue their


\(^{64}\) Cal. Lab. Code §§ 201; 227.3.

health coverage at group rates for at least 18 months after a qualifying event. Termination of employment, except on grounds of gross misconduct, and reductions in hours below the minimum required to be eligible for benefits are “qualifying events.”

In recent weeks, employers’ obligations under COBRA have changed significantly. Under The American Recovery and Reinvestment Act, signed by President Obama on February 17, 2009, the federal government will subsidize 65% of an eligible employee’s costs of COBRA coverage for a limited time. The employee pays only 35% of his COBRA premiums, and the employer, or in certain cases the insurer or multi-employer group plan, will be reimbursed the remaining 65% of the premiums, generally as a credit against payroll taxes. The Act also provides for a special election period, allowing eligible employees 60 days after notice of the new provisions to elect coverage. Additionally, if the employer permits it, eligible employees who would ordinarily be required to continue the health benefit option that they had at termination may choose a different option offered by the employer if the option they choose is less expensive than their current benefit.

The new provisions require immediate and continuing action by employers. Employers should begin immediately to identify employees who were “terminated involuntarily” on or after September 1, 2008. Plan administrators also should amend COBRA notice forms to alert employees to the availability of the subsidy and other provisions of the Act. Qualifying employees currently enrolled and paying full COBRA premiums will be eligible for a refund of their excess payments, and the plan administrator will be responsible for administering these refunds.

B. Severance Packages, Separation Agreements and Releases

1. The Application of ERISA to Severance Packages

To the extent that employers offer severance packages that go beyond the norm of a lump-sum payment, they should be cognizant that they may take on additional responsibilities and fiduciary duties. Specifically, depending how a severance plan or package is designed and administered, it may qualify as a welfare or pension plan under ERISA. Generally, a severance plan that requires a one-time, lump-sum payment will not be covered by ERISA.\(^\text{68}\) However, if the employer has discretion in the administration of the severance plan, or it requires ongoing administration, it may be subject to ERISA, including fiduciary duty requirements.\(^\text{69}\) In addition, for exiting employees for whom severance will be paid over some period of time, as opposed to a lump-sum provision, certain tax implications may apply.

2. Separation Agreements and Releases of Claims

a. Assessing the Need for and Crafting the Separation Agreement

Offering terminated employees separation agreements that include releases of potential claims can help an employer to avoid costly litigation. However, employers should consider that formal separation agreements may not be necessary or provide any benefit in situations where the risk of litigation is already low, for instance where few affected employees are in a protected class. If an employer does seek a release, they should be aware that a form release may not always meet the need. For example, employers may want to tailor the release to address unique

\(^{68}\) *Fort Halifax Packing Co., Inc. v. Coyne*, 482 U.S. 1, 12 (1987) (“[t]he requirement of a one-time, lump-sum payment triggered by a single event” does not implicate ERISA because “[t]o do little more than write a check hardly constitutes the operation of a benefit plan”).

\(^{69}\) *Cassidy v. Akzo Nobel Salt, Inc.*, 308 F.3d 613, 616 (6th Cir. 2002) (severance plan is governed by ERISA where some employees were permitted to choose lump-sum payments and others were given a two-year salary continuation).
issues relating to nondisclosure, cooperation or confidentiality. In addition, where an employee has an existing employment contract, the release should incorporate and continue the applicable provisions of that contract after the employee’s separation.

For releases to be enforceable, consideration – some benefit or right to which the employee is not otherwise entitled – must be given to employees in exchange for their release of claims against the company. The consideration can be monetary, although other items may be sufficient, such as a favorable recommendation, job search assistance or a waiver of a prior, continuing and enforceable non-compete agreement. However, while referrals can be valuable to a departing employee, it is important to carefully consider any deviation from established policy or practice. In addition, any unique circumstances may dictate special treatment in terms of release provisions or consideration to facilitate a smooth separation.

Employers should keep in mind that even the most carefully crafted release can be found invalid. To be enforceable, releases must comply with numerous statutory requirements, some of which are addressed below. Moreover, courts may invalidate agreements that are deemed too onerous. For example, common “tender back” agreements, in which an employee agrees to pay back any severance if she later files a claim, may be considered per se retaliatory and could invalidate a release altogether. Similarly, non-compete provisions are strictly limited in some states and may be nullified if they are found too constricting.

Employers also should honestly assess their own limitations in complying with the terms of a separation agreement, and not enter into promises that may be violated. For example, a company may seek a confidentiality agreement regarding the contents of the settlement and release. However, the employee may request a reciprocal agreement, but the company cannot necessarily control the comments and conduct of all of its employees. Such considerations also
should weigh into any commitment to provide a neutral or positive reference for a former employee, unless the provision also specifies a contact person or other narrow process for requesting a reference.

b. **What Claims Can be Released?**

Generally, employees can waive their rights to most claims under federal, state and common law arising from their employment up to the date of the release. However, federal agencies and the courts have determined that certain claims cannot be waived. In addition, the ADEA requires that specific requirements be met, above and beyond the normal release requirements, before an individual can waive an age discrimination claim under the statute.

Prohibitions on waivers exist in various areas of potential liability. Generally, prospective claims – those based upon conduct that occurs after a separation agreement is signed – cannot be waived.70 Also, employees legally can waive their right to file a discrimination lawsuit under Title VII, but employees can not waive the right to file an EEOC claim.71 Moreover, courts have limited employees’ ability to waive minimum wage or overtime claims under the FLSA and some parallel state provisions.72 Similarly, state law often limits employees’ ability to waive rights under workers’ compensation laws.73 Care is required in both the construction and use of a separation agreement when a likely claim cannot be waived.

70 See, e.g., 29 C.F.R. § 825.220(d) (limiting waiver of rights under the federal Family and Medical Leave Act (FMLA)).


Although employees are able to waive age discrimination claims under federal law, special procedures must be followed to do so. The Older Workers Benefit Protection Act (OWBPA), which amended the ADEA in 1990, applies to any separation agreement in which an employee over the age of 40 purports to release ADEA claims against the company.74 To successfully waive an ADEA claim, a release must permit a 21-day consideration period if the release is offered to an individual, or 45 days if it is offered to a class of employees.75 The release also must provide a seven-day revocation period, and advise employees in writing to consult an attorney prior to signing the agreement.76 Additionally, any waiver of rights must be knowing and voluntary, meaning it be must “written in a manner calculated to be understood” by the average employee.77 The release must specifically state that the employee is waiving rights under the ADEA, and must state that the employee is not waiving rights or claims arising after the waiver is executed.78 It also must indicate that the employee is waiving her rights in exchange for specific consideration to which the employee is not already entitled.79

The OWBPA requires additional disclosures if the waiver is offered to a class of employees, rather than to individuals, as part of an exit incentive or other termination program.80 A class can include as few as two employees.81 The additional disclosure must provide

77 Syverson v. Int’l Bus. Machines Corp., 472 F.3d 1072, 1074 (9th Cir. 2007).
information relating to the group or class covered by the program, any factors determining eligibility for the program, time limits for taking advantage of the program, job titles and ages of all eligible employees, and the ages of individuals in the same job classification not eligible for the program.\textsuperscript{82} OWBPA requirements are strictly construed by courts and even a small deviation from requirements may invalidate the release and permit litigation.\textsuperscript{83}

c. **Consider Any Pre-existing Employment Contract**

Employers also should be cautious that any separation agreement does not supersede an employee’s continuing obligations under an existing employment contract, such as non-compete, non-disclosure and confidentiality provisions. A carefully crafted release can re-affirm relevant portions of existing agreements.

C. **Practical Suggestions for Handling the Reduction**

Layoffs are always a very emotional process, and adopting procedures that convey respect and dignity for impacted employees can make the difference between an amicable former worker and a disgruntled likely plaintiff. Offering to assist employees with job placement services, either as part of a separation package or independently, may help assuage negative emotions. Additionally, employers may offer not to contest an unemployment claim, should the employee pursue it. Employers also may consider offering counseling services for a time to assist employees in the transition.

While employers should give employees time to collect themselves and their belongings after they are notified of a layoff, companies also must be careful to protect their confidential


\textsuperscript{83} \textit{Oubre v. Entergy Operations, Inc.}, 522 U.S. 422 (1998) (release was invalid under OWBPA because employee was not given enough time to consider, release did not give seven days after signature to retract and made no specific reference to ADEA claims).
information. Often, employers put in place a computer policy to prevent data scraping, as well as requiring employees to return all company property. These policies should be implemented in advance of the separation and clearly communicated to all management and personnel.

V. CONCLUSION

Business decisions undertaken to reduce headcount often involve significant legal considerations. Particularly in a down economy, government agencies and plaintiffs’ attorneys are watchful for potential claims arising from termination or other reduction determinations. Therefore, employers that remain aware of the various legal and business implications in making reductions and proactively address potential issues will benefit from such foresight.

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