

Reducing Staff in a Down Economy: Handling Terminations and Using Separation Agreements

Staff reductions and terminations have been an unfortunate result of the current economic downturn. So far this year, U.S. employers, seeking to cut costs, have eliminated more than a quarter million jobs. In addition to employees laid off due to economic considerations, underperforming employees and those that violate Company policies are less likely to be retained in tough financial times when the Company's bottom-line is under scrutiny by corporate officers, boards of directors, and shareholders. However, employers must keep in mind that terminations cause more lawsuits than any other employment action, and anticipated cost savings can be negated by legal defense costs.

Despite the general rule that the employment relationship is "at-will" and can be terminated at any time, with or without notice, reason or cause, there are many exceptions to the at-will rule, making each termination open to potential legal challenge. Moreover, when the job market is difficult and terminated employees have a hard time finding work, they are more likely to pursue litigation against their former employer. In our practice, we are witnessing first-hand both the increase in terminations and the corresponding increase in lawsuits by terminated employees. This edition of the Employment Law Advisor focuses on handling terminations, using separation agreements, and the steps employers can take to reduce the risk of legal claims and liability in this challenging economic environment.

- ✓ Is the economic environment forcing you to consider staff reductions?
- ✓ Are you concerned about exposure to liability when terminating employees?
- ✓ Do you need to review best practices for handling terminations and using separation agreements?

Read on to learn about best practices when reducing staff in a down economy...

Terminations: The Legal Landscape

There are three categories of restrictions on employers' ability to discharge employees: statutory, contractual and common law. Each restriction is a source of potential liability for employers. Statutory restrictions are those imposed by federal, state and local laws, such as laws prohibiting employment discrimination and retaliation. For example, it is unlawful under federal law to make a termination decision based upon an employee's age, race, national origin, sex, religion or disability. In addition, Massachusetts also prohibits termination decisions based upon sexual orientation, ancestry, genetics or military service. Unlawful retaliation includes discharging an employee because the employee (i) participated in an activity protected by an employment statute (e.g., filing a complaint, testifying, assisting or participating in an investigation, proceeding or hearing) or (ii) opposed an employment practice prohibited by the statute (e.g., objecting to discriminatory hiring practices).

Contractual restrictions are those agreed to (or self-imposed) by the employer, including restrictions contained in employment agreements (e.g., employment for a one-year term). Contractual restrictions may also arise from statements made in offer letters or through other written or oral promises of continued employment for a specified period of time or unless discharged for "cause." In some instances, an employee handbook or particular personnel policies may create explicit or implicit restrictions on the employer's right to discharge employees "at-will."

Common law restrictions are those created by the courts to protect employees from some types of employer conduct not prohibited by statutes. Such restrictions include prohibitions on discharges that violate "public policy," such as firing an employee for refusing to engage

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in unlawful behavior on behalf of the employer. Massachusetts courts also hold that there exists in every at-will employment relationship a “covenant of good faith and fair dealing” that is violated when an employer discharges an employee in bad faith in order to avoid payment to the employee of earned compensation. There are also other common law claims that can arise from the manner in which a discharge is handled, including claims of defamation, false imprisonment and intentional or negligent infliction of emotional distress.

Steps Employers Can Take to Reduce the Risk of Claims and Liability Due to Terminations

Employers should recognize that an employee termination may some day be judged by a third party (e.g., a jury) who may base its decision on the perceived “fairness” of the employer’s actions. Although legal challenges are sometimes unavoidable, there are steps employers can take to reduce their risks and to ensure that the termination process itself does not lead to additional employee claims.

1. Determine/clarify the precise reason(s) why the employee is being discharged. When a termination decision is challenged as discriminatory or retaliatory the claim usually turns on the employee’s ability to show that the reason given by the employer is untrue. When an employer says one thing at the time of termination (sometimes to spare the employee’s feelings) and something else later to the court or investigating agency, the employer’s ability to defend the case may be severely impaired.

2. If discharging for misconduct, be certain that there was a thorough and objective investigation of the employee’s conduct. Was the employee given an opportunity to explain his or her side of the story? Have any admissions by the employee been documented? If dis-

charging for poor performance, determine whether the performance problem is well-documented and demonstrable.

3. Avoid surprise. Determine whether the employee was given prior notice that his or her misconduct or continuing poor performance would result in discharge. While not legally required, notice generally is expected by courts and investigating agencies, and the failure to provide notice is viewed with great suspicion (except in those situations involving egregious employee misconduct).

Reduce the risks of claims due to terminations by:

1. Clarifying the business reasons justifying the termination.

2. Paying all wages due in a timely manner.

3. Planning the termination meeting.

4. Documenting the process appropriately.

4. Consider the appearance of unfairness, given the potential that the employer’s actions will be judged by a third party. Is discharge clearly warranted for the employee’s misconduct or poor performance? Are there any mitigating circumstances? How have other employees been treated in similar situations? These considerations are of particular importance when a potential discrimination or retaliation claim exists.

5. Review the employee’s personnel records and any documentation relating to the discharge: (i) to get an accurate picture of his or her work record; (ii) to make certain the documentation is com-

plete; and (iii) to remove any materials that do not belong in the file.

6. Review any employment agreements, offer letters, and pertinent personnel policies to determine whether the employer has complied with all requirements, including any notice prerequisites.

7. Assess whether there is any particular vulnerability to legal challenge. Is the employee a member of a protected group (e.g., age 40 or older)? Has he or she exercised a legally protected right recently (e.g., taken Family and Medical Act leave, requested reasonable accommodation of a disability, filed a complaint of discrimination or harassment)? Are there any contractual restrictions to discharge? Are any public policy issues involved (e.g., the employee objected to doing something because of legal or ethical concerns)? Will the employer arguably be in any way unjustly enriched by the discharge (e.g., the employee loses a bonus or commission due to the timing of the discharge)?

8. Plan the termination meeting carefully, taking into consideration the dynamics of the situation. Who will be present? (More than one employer representative should attend.) Where and when will it be conducted? Be discreet. Avoid a “termination march” past co-workers. Avoid causing unnecessary embarrassment or emotional distress to the employee.

9. Be truthful and accurate in telling the employee the reason(s) for the discharge, in a direct but respectful manner. Present the decision as definite and final (assuming it is). Offer support, but not in terms of reversing the discharge decision. Be knowledgeable and prepared to discuss the employee’s termination benefits, including any severance pay, any accrued vacation pay, group insurance continuation, the form of reference the employee will receive,

and the employer's position on unemployment benefits. Also be prepared to discuss any transition matters and any continuing employee obligations (e.g., non-disclosure and/or non-competition restrictions). Prepare a memorandum documenting what was said in the meeting.

10. Provide the employee with a final paycheck. The Massachusetts Payment of Wages Act, M.G.L. c.149, §148, requires that discharged employees be paid their full and final wages on the date of discharge, and the Act provides substantial remedies to employees for violations. Final wages include pay for all accrued and unused vacation time as well as commissions or potentially bonuses earned but not yet paid. Employers should not make any irregular deductions (e.g., for equipment not returned, property damage or outstanding loans) without careful consideration of the potential legal ramifications.

11. Provide notice of the employee's (and other beneficiaries') rights regarding health insurance continuation under federal law (COBRA) or state law.

12. Massachusetts law requires that employers provide terminated employees with a notice from the Division of Unemployment Assistance ("DUA") concerning how to file for unemployment benefits. The DUA's notification pamphlet can be printed from: http://www.detma.org/pdf/0590A_0504.pdf

13. Take all appropriate security measures to protect co-workers (if there are safety concerns) and to protect the employer's business interests (e.g., obtain employee's laptop, cell phone, keys, pass cards, employer credit cards, terminate access to computer system, prevent the removal of confidential documents and materials).

14. Take appropriate steps to keep confidential matters surrounding the discharge (including any investigation

leading up to it). Generally, when the discharge is for misconduct, a strict "need-to-know" rule should be followed to reduce the risk of a defamation claim.

15. As discussed below, in appropriate circumstances, consider presenting the employee with the option of receiving additional termination benefits in exchange for a legal release of all claims the employee may have against the employer.

Our experience in defending hundreds of claims by discharged employees tells us that what is said at the time of termination, and how the termination process is handled by the employer, often determines whether an employee will subsequently file a legal claim. When an employee does file a claim, an employer's contradictory statements, insensitive conduct or other missteps at the time of termination almost always adversely impact the employer's defense of the claim and increase its exposure to damages. We believe that taking the steps outlined above will help employers manage employee terminations more effectively and avoid the mistakes that so often lead to employee claims.

Using Separation Agreements to End the Employment Relationship

For many employers, an employee termination triggers an almost knee jerk reaction: offer the employee severance pay and a separation agreement with a release of claims to avoid a potential employee lawsuit. Although there are advantages to the use of separation agreements to prevent prospective legal headaches, such agreements may not be appropriate in all instances. Moreover, a form of separation agreement is often used with little thought regarding whether it is suitable under the circumstances or has been updated. In light of recent legal trends, that form could be found unenforceable by a court, which could result in the former employee get-

ting to keep the severance pay but also having the right to sue the company for employment claims.

Is a Separation Agreement Appropriate?

Whether to offer a terminated employee a severance package in return for a release of claims depends on a number of employer specific factors, such as employer policy, practice and employee relations philosophy. Generally, providing severance in exchange for a release can be a worthwhile investment, as the amount of severance is often insignificant when compared to the cost of defending an employee claim. Severance agreements are particularly useful when the termination is a difficult one or the separated employee is viewed as the type of person likely to assert a claim. Severance agreements are also effective tools to prevent litigation in the context of layoffs, where there are risks of multiple claims.

However, there are sometimes factors that militate against offering severance. For example, out of fear of litigation many employers offer severance to nearly all employees, regardless of the reason for termination, needlessly driving up the overall costs of employee terminations. Offering severance to an employee fired "for cause" may send the wrong message to other employees, i.e., that they will get severance no matter what the infraction.

Further, offering an employee a severance agreement, which by necessity will contain at least some "legalese,"



may unintentionally generate claims. When provided with an imposing legal document, a terminated employee may feel compelled to consult an attorney (indeed, the severance agreement may advise the employee to do so). Especially if the severance offered is relatively modest, the offer may do no more than cause the employee to consult counsel and consider asserting claims when he or she might otherwise not have done so.

Special Issues Relating the Older Workers' Benefit Protection Act.

Employers should ensure that any release of age claims under the federal Age Discrimination in Employment Act ("ADEA") complies with the Older Workers' Benefit Protection Act ("OWBPA"). A compliant agreement must include the following provisions (among others): (i) a 21 day consideration period; (ii) a 7 day revocation period; and (iii) advice to consult with an attorney prior to executing the agreement. Omitting these and other provisions will mean that the release will not waive age claims under federal law. Moreover, employers should be aware that in situations involving the termination of two or more employees special rules apply to release federal age claims, including additional time for consideration (45 days) and detailed informational disclosures.

Special Issues Relating to Reductions In Force

Reductions in force ("RIFs"), which often involve the termination of substantial numbers of employees, must be planned carefully given the potential cost of defending potential claims from large numbers of employees or a class-action lawsuit. Moreover, employers

conducting RIFs must consider the potential impact of laws concerning plant closings, such as the federal Workers Adjustment and Retraining Notification Act ("WARN") and Massachusetts plant closing law.

Generally, WARN requires employers with 100 or more employees to provide 60 days' notice prior to a plant closing or before laying off/terminating 50 or more employees. Compliance with WARN can be technical and missteps may subject an employer to substantial penalties, so counsel should be consulted well in advance of any planned RIF. Massachusetts also has a plant closing law that applies to any employer closing a facility that had 50 or more employees during the previous six-month period. Under state law, a "plant closing" is defined as a permanent cessation or reduction of business at a facility that results in the permanent separation of at least 90% of the employees within a 6 month period. Among other things, the law requires reporting to state agencies. If both WARN and Massachusetts law are triggered by the RIF, the employer must comply with both.

Additionally, if a reduction in force is challenged in court, the employer will want to have its selection and decision-making process well-documented so that it can show that layoff decisions were based on legitimate, non-discriminatory considerations. Employers should also consult with counsel to discuss conducting an analysis of the impact of the RIF on protected categories (i.e., age, race, sex, etc.) prior to implementing the layoff.

Conclusion

Handling terminations carefully is always important, but is even more so in an economic downturn due to the increased risk of former employees bringing legal claims. Each situation should be reviewed carefully to ensure that the risk of claims and the potential exposure to liability is minimized. Steps may need to be taken before the termination or layoff is implemented.

Whether it makes sense to offer a terminated employee a severance package in return for a release of claims depends on a number of employer specific factors, such as employer policy, practice and employee relations philosophy. Providing severance in exchange for a release can be a worthwhile investment, as the amount of severance is often insignificant compared to the cost of defending an employee claim. Severance agreements also can be effective tools to prevent litigation in the context of layoffs, where there are risks of multiple claims. Employers should revisit their separation agreements to ensure the agreements will be enforced. Employers should also make sure they are in compliance with the special requirements relating to reductions in force and plant closings.

The Morse, Barnes-Brown & Pendleton, PC, **Employment & Immigration Practice Group** provides sophisticated legal services and practical advice to employers of all sizes, ranging from technology start-ups to Fortune 1000 companies.

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