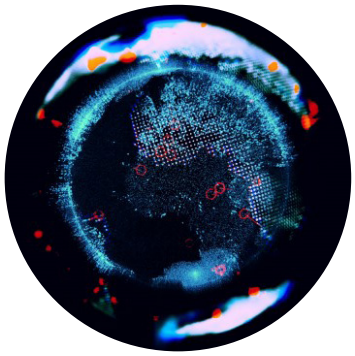
COVINGTON

COVID-19 and Workforce Reorganizations
Global Reductions in Force

Overview



As large companies across the globe continue to navigate the ongoing COVID-19 pandemic, many are considering workforce reorganizations as a way to reduce costs in light of geopolitical and economic uncertainties, flagging demand, and a rapidly changing outlook for recovery.

Workforce reorganizations can take many forms; however, many companies will consider global involuntary separation programs or reductions in force ("RIFs") / redundancies if initial job retention efforts or cost-saving measures such as voluntary separation programs have not proved sufficient to protect or re-size the business for anticipated future needs (for more on this topic, please see our prior alert: **COVID-19 and Workforce Reorganizations – Voluntary Separation Programs**).

Covington's **Global Workforce Solutions** team is well-suited to assist companies in designing and implementing RIFs, and handling the related complex benefits, tax, and employment issues.

Individual and collective statutory employment rights, particularly outside the U.S., and statutory regulation of pension and other employee benefits, means that large RIFs need extensive planning. Collective consultation requirements and consents can create timing issues, and severance pay and benefits can be significantly higher in more socially protective countries. A global RIF simultaneously covering multiple countries needs to account for such local differences in order to be effective.

The alert below focuses mainly on these issues, highlighting some critical distinctions between international and U.S. requirements.

Key Legal Issues Implementing RIFs

Below, we outline six key legal considerations for companies that may be exploring such a program.

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1. Employee Consultation, Consents, and Timing Issues

In many countries outside the U.S., particularly in Europe and LATAM, proposing to lay off multiple employees will likely trigger collective consultation requirements, often with established employee representatives bodies such as works councils or trade unions. These processes usually prescribe a minimum time period during which consultation must take place and during which dismissals cannot occur. In some jurisdictions, consent to proceed may be needed from a works council, a labor authority or a court. Employees and their representatives can use these mechanisms to extend consultation periods, and delay dismissals–often for many months–as part of negotiations over severance terms. As such, when planning a global RIF, each country's collective consultation and dismissal regime needs to be assessed in advance to identify any obvious blockers, particularly where the RIF is time-critical or has a hard stop date.

In the U.S., employee notification tends to be less complicated, but still important. In large RIFs, employees are likely entitled to 60 days' advance warning of layoffs under the federal Worker Adjustment and Retraining Notification Act ("WARN"). However, employers should also be mindful of state-level WARN equivalents (e.g., those in high-population U.S. states like New York and California), which sometimes impose additional obligations. Employers should be mindful of their WARN obligations when planning a RIF in the U.S., and carefully consider whether an alternative strategy (e.g., the so-called 'pay in lieu of notice' approach) may be palatable under the circumstances. In addition to WARN obligations, U.S. employers should be mindful of any consultation or notice obligations that may apply under collective-bargaining agreements with unions representing employees who may be affected by the RIF.

2. Termination Rights

Employee rights on termination in most jurisdictions are more protective than the 'at will' employment model prevalent in the U.S. Employees generally have notice periods, which have to be paid out if they are not to become a timing issue. In addition, many countries have a concept of an 'unfair dismissal' i.e., the dismissal must be for a fair reason (often requiring a significant business justification), and only confirmed following a 'fair' process. Without this fairness, the employee may claim additional damages for an unlawful dismissal. In some cases, reinstatement can be a remedy, undermining the effort to terminate employment for economic reasons.

To effect a fair dismissal in a RIF an employer might have to consider factors such as the method of selection for dismissal, redeployment within the group of companies, and individual consultation (in addition to any mandatory collective consultation). Selection, in particular, can be a complex area where discrimination protections are very strong (e.g., for pregnant women, disabled employees, those with family responsibilities, or older individuals). Successfully conducting a global RIF without significant employee termination claims requires understanding where local processes must be followed, and where there are opportunities to negotiate shorter or simpler outcomes without breaching local laws. Finally, in the current climate employers will need to check if any local anti-dismissal laws implemented in response to the pandemic might apply to prohibit or delay dismissals.

In the U.S., any RIF must be designed to ensure that there is no violation of federal and state discrimination statutes, in particular in relation to age discrimination. Most companies do not design RIF programs in a way that is facially discriminatory. However, these programs carry a significant risk of being discriminatory in operation (in other words, indirectly). For example, many companies are inclined to seek the greatest amount of cost savings with the least reduction in employee headcount. However, the employees with the highest salaries tend to be the older employees in the workforce. Relying too heavily on salary as the determinative factor in RIF selections can thus result in a disparate impact on older workers, which may create de facto age discrimination. Companies must take great care in designing the selection criteria for any RIF.

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3. Severance Payments

Internationally, local rules need to be considered to maximize the tax-efficiency of severance, as there are often special tax breaks or other support for terminating employees (particularly in response to the pandemic). In addition, in most countries outside the U.S. employees are entitled to notice payments, and often to statutory severance payments (which may include variable compensation within those formulae); it is important to check that a global severance formula actually meets the minimum contractual and statutory entitlements which employees are subject to locally. Some European countries require a 'social plan' to be negotiated with works councils, within which severance terms fall, and which can lead to such sums being negotiated upwards significantly (along with the implementation of a range of other supportive social measures, such as paid leaves of absence, re-training and unemployment benefits). In some jurisdictions, the 'reason' for termination can also impact both the taxation of severance payments, and the ability of employees to access state-funded benefits following termination.

In the U.S., employers also face challenges with respect to the legal and tax implications of cash severance payments. U.S. companies with ERISA-covered severance plans will need to consider the impact of the existing severance plan on the cash severance to be offered under the RIF. U.S. companies without ERISA severance plans should consider whether to establish such a plan to pay cash severance offered under the RIF. In addition, cash severance paid in the U.S. should be carefully structured to comply with or be exempt from treatment as nonqualified deferred compensation under Code § 409A. Care must also be taken to avoid adverse tax consequences when structuring company-subsidized continued medical coverage and/or providing additional cash payments in lieu of such coverage.

4. Employee Benefits

Pension Enhancements. Companies that sponsor defined benefit pension plans can often incorporate pension enhancements to provide additional value for employees in a global RIF. These enhancements could be additional benefit accruals or early retirement subsidies, or perhaps new forms of benefit that were not previously available.

Outside the U.S., enhancements to defined benefit pension plans face complex legal, regulatory, and governance issues, particularly as many such plans are already under-funded. Employee consultation requirements may also be triggered. In practice, most employers have closed down defined benefit plans and moved to defined contribution pension plans, so the proportion of the workforce that might benefit from an enhancement is relatively small. In addition, many European countries rely mainly on state pension provision, paid for via higher social security contributions, which limits the availability of pension enhancements.

In the U.S., companies considering offering these enhancements should seek advice early due to complex legal issues arising under ERISA. For example, new benefits, rights, or features, could overly favor highly-compensated employees in a way that creates nondiscrimination problems for the plan. In addition, under ERISA's 'serious consideration' doctrine, plan fiduciaries could be obligated to tell plan participants about a contemplated RIF with pension enhancements, even if the RIF has not yet received final approval and has not yet been formally announced by the company.

Stock Plans and Share Schemes. There are often stock plan enhancements for employees who are terminated in a RIF, built into plan rules or via an exercise of employer discretion. These can take the form of accelerated or continued vesting, extended post-termination exercise periods for stock options or stock appreciation rights, or accelerated settlement. In the U.S., care must be taken to ensure that any enhancement or modification to a stock award does not violate the nonqualified deferred compensation rules of Code § 409A. Changes to stock plans and awards could also require filings or disclosures with securities regulators.

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Globally, companies should be aware of the impact of any accelerated vesting on tax withholding and reporting obligations, as these can be triggered in some jurisdictions even if settlement of the award is not accelerated. There is also the challenge of how to document such arrangements, given that the local employing entity is often not the grantor under the relevant stock plan or other equity incentivization scheme. This is compounded where the mechanics of the enhancement (which often factor in age and length of service) risk having a discriminatory effect under local law on the grounds of age. Finally, care must be taken to minimize the risk of stock plan enhancements in a particular set of circumstances creating a right for employees to demand the same or similar treatment in a different set of circumstances in future ('acquired rights').

Nonqualified Deferred Compensation. Nonqualified deferred compensation programs like supplemental executive retirement plans, elective deferral programs, and deferred stock programs, must be carefully reviewed when designing a RIF. In the U.S., many deferred compensation programs link payment of benefits to an employee's 'separation from service' as a way of complying with Code § 409A. This means companies who separate significant numbers of employees with these types of benefits could experience additional cash flow drain due to these payouts, which should be factored into the costs of the program. In addition, companies must be mindful of the § 409A six-month delay requirements for payouts to the most highly compensated key employees.

Outside of the U.S., such programs can have tax implications for employees, with the consequence that they do not appear as 'attractive'. Also, the same acquired rights considerations outlined above in relation to stock plan enhancements would apply.

Healthcare Plan/Coverage and Other Benefit Extensions. Both internationally and in the U.S., employees may seek to negotiate the extension of employer-provided medical insurance for a period after employment ends, particularly where the insurance also covers family members. Internationally, social plans agreed with works councils may make provision for some ongoing support from the employer after termination (e.g., re-training or contributions to unemployment payments), and sometimes such support is required by law. In the U.S., companies must be mindful of their obligations under COBRA to continue offering access to coverage at the employee's expense, and the potential tax and nondiscrimination issues that could arise if the employer subsidizes the COBRA coverage.

In addition to post-termination health benefits, employers often offer outplacement services, engaging a consultant firm to provide departed employees with ongoing assistance with locating new roles, drafting CVs, and preparing for job interviews.

5. Release Agreements and Waivers

In the U.S., releases of claims must be carefully drafted to ensure enforceability, particularly if the release is intended to apply to age discrimination claims. U.S. age discrimination statutes also require certain information to be provided to employees participating in separation programs, and prescribe notice and revocation periods that must be observed in order for a release to be effective. Companies must also be careful in the timing of a release, as releases generally apply only to claims that existed at the time the waiver is executed.

Similar considerations can apply outside the U.S. as well. In addition, there may be local legal requirements necessary to create a binding waiver of claims (such as the provision of legal advice to an employee, the need for additional consideration or to have the release translated). In some countries release agreements have to be approved by, or filed with, a local labor authority or court.

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6. Communications and Disclosures

The company must have a comprehensive, coordinated communication strategy to ensure that all interested stakeholders receive the appropriate communications at the appropriate time. Employees, shareholders, public markets, and other stakeholders, will all be entitled to information about the RIF. In some cases, the form and content of notices will be driven by local legal requirements and obligations. In other cases, the company will have flexibility in what the company says and how it is said. In both cases, the content will need to be coordinated to ensure consistent messaging to all stakeholders.

Internationally, critical legal issues can arise if global communications are made in advance of any mandatory local employee redundancy consultation. Close vetting of local communication and timing issues may need to be conducted prior to rolling out communications to U.S. employees, for instance, particularly where the first wave of a global RIF2 is U.S.-based. This is particularly important if foreign employee representative bodies are entitled to be consulted in their country.

Contact Us to Learn More

The areas highlighted above are the most critical for companies considering a RIF, but they are not exclusive. Even within each area, many issues will arise depending on the program design the company wishes to pursue. If your company is considering a RIF or other workforce reorganization in the U.S. or internationally, we encourage you to contact anyone in our **Global Workforce Solutions** practice.

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