

Recession Risk and Workforce Reorganizations:

1. Voluntary Separation Programs

Overview

As concern over a possible global recession continues to grow, many companies will consider workforce reorganizations as a way to reduce costs in light of geopolitical and economic uncertainties, flagging demand, and an unclear outlook for recovery.

Workforce reorganizations can take many forms; however, many companies are exploring global voluntary separation programs (“VSPs”) as an initial way to achieve desired cost savings while providing a financial cushion for employees who elect to participate. If a voluntary program cannot provide the necessary economic results, then involuntary reductions in force will often need to be considered (for more on this topic, see our next alert: [Recession Risk and Workforce Reorganizations – Global Reductions in Force](#)).

Covington’s [Global Workforce Solutions](#) team is well-suited to assist companies in designing and implementing VSPs, and handling the related complex benefits, tax and employment issues. Some employers may feel that because these programs are voluntary they are generally without risk. However, this is often not the case, particularly outside the U.S., where greater statutory employment rights mean mandatory procedures that may limit the scope or effectiveness of VSPs.

In the alert below we focus mainly on issues arising from implementing a U.S. VSP, while highlighting some international similarities and differences.

Key Legal Issues Implementing VSPs

1. [Risks in Employee Selection](#)
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5. [Nonqualified Deferred Compensation](#)
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1. Risks in Employee Selection

In the U.S., any VSP must be designed to ensure that there is no violation of federal and state discrimination statutes, in particular in relation to age discrimination. Due to their voluntary nature, VSPs are often not designed in a way that would create overt age (or other) discrimination. However, these programs can risk being discriminatory in operation. For example, if a company retains the right to approve applications for the program, and company managers use this approval power to set criteria or make inherently biased decisions, companies could open themselves to claims of de facto age, gender, disability or racial discrimination.



Outside the U.S., employee selection is often bounded not just by discrimination issues but also by the need to avoid creating unfair dismissal risk or breaching collective redundancy consultation requirements. In some countries, a significant business justification is needed to even lawfully offer a VSP—and the very concept of a voluntary termination for redundancy may be unattractive to employees, making this fairly uncommon.

Careful planning is required as VSPs are often effectively an early stage of a wider reduction in force program which is regulated by local laws and may involve mandatory engagement with employee representative bodies such as works councils, and notifications to governmental agencies.

2. Severance Structure

The structure of cash severance payments can have legal and tax implications for companies and departing employees. Companies in the U.S. with ERISA-covered severance plans will need to consider the impact of the existing severance plan on the cash severance offered under the VSP. Companies in the U.S. without ERISA-covered severance plans should consider whether to establish such a plan to pay cash severance offered under the VSP. 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.



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. 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 the formulae); it is important to check that a U.S. severance formula actually meets the minimum contractual and statutory entitlements which employees are subject to locally. In addition, if the offered severance formula is not materially greater than any contractual or statutory entitlements, the VSP may not be attractive to these employees, and the purpose of the program may be frustrated.

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 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.

3. Pension Enhancement

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

3. Pension Enhancement (Continued)

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 VSP with pension enhancements, even if the VSP has not yet received final approval and has not yet been formally announced by the company.



Outside the U.S., enhancements to defined benefit pension plans face similarly 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 solely on state pension provision, paid for via higher social security contributions, which limits the availability of pension enhancements.

4. Stock Plans and Share Schemes



Employers often include stock plan enhancements for employees who participate in VSPs. These often 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.

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 the future ('acquired rights').

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5. 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 VSP. 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.

5. Nonqualified Deferred Compensation (Continued)

This means companies who separate significant numbers of employees with these types of benefits could experience unplanned additional cash flow drain due to these payouts. In addition, companies must be mindful of the Code § 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.

6. 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.



7. 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, will all be entitled to information about the program. 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 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 program is U.S.-based. This is particularly important if foreign employee representative bodies are entitled to be consulted in their country about the VSP and its terms.

Contact Us to Learn More

The areas highlighted above are the most critical for companies considering a VSP, 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 VSP 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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