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Workforce Readjustment & Employee Benefit Plans

Maintaining Excellence in Human Capital While Minimizing Legal Risks During the Economic Downturn

Marcia Goodman, Mayer Brown LLP
Maritoni Kane, Mayer Brown LLP
Edward Pionke, Mayer Brown LLP

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Human capital is key for the knowledge economy, but cost control is now!

- In the current economic downturn, every day brings more reports of layoffs, shutdowns and other workforce adjustments
- Microsoft plans to layoff almost 10% of its workforce in its first mass layoffs ever
- The decline in the stock market and shareholder demands challenge employers in maintaining benefits
- How will you maintain excellence and minimize legal risks while addressing these challenges?

Common Corporate Survival and Cost-Cutting Strategies in the Current Economy

- Reductions in Force
- Workforce Restructuring – often global
- Sales, Mergers, Acquisitions
- Pressure on Executive Compensation
- Pressure on Traditional Defined Benefit Pension Plans

Overview of Today's Presentation

- Key Areas of Legal Risk in RIF's, Restructuring and Sales/Mergers affecting All Employees
- Special Risks in Reducing and Redeploying Executives
- "Clawbacks" in Executive Compensation
- Issues Confronting Pension Plan Sponsors During the Economic Downturn

Key Areas of Legal Risk in RIF's, Restructuring and Sales/Mergers affecting All Employees

Key Areas of Legal Risk in RIF's, Restructuring and Sales/Mergers affecting All Employees

- Advance notice obligations under WARN and similar state laws
- Discrimination laws and class actions – limiting risk in selecting employees for reduction
- Releases – Making yours enforceable
- Obligation to reinstate employees on leave of absence under laws such as FMLA and USERRA

WARN Act & Similar State Laws

- What is the WARN Act?
- Why Do You Need to Know About the WARN Act?
- When does the WARN Act Apply and What Does it Require?
- What are “Baby-WARN” Laws and how do they differ from the WARN Act?
- What Do You Do When You are Uncertain About Your Company’s Plan?

What is the WARN Act?

- WARN = Worker Adjustment and Retraining Notification Act, 29 U.S.C. § 2101 et seq.
- Federal Law
- Purpose of WARN

Why Do You Need to Know About the Federal WARN Act?

- Recent WARN litigation
  - *Werth, et al. v. Heller, Erhrman, White & McAuliffe LLP* (California, October 2008)
  - *Berenshteyn et al. v. Lehman Brothers* (New York, October 2008)
  - *Batman et al. v. ATA Airlines, Inc. et al.* (Indiana, April 2008)
  - *Jevic Transportation, Inc.* (Delaware), *Adam Aircraft Industries Inc.* (Colorado), *Southern Star Mortgage Corp.* (New York), *Protected Vehicles Inc.* (S. Carolina), *First NLC Financial Services, LLC* (Florida), *First Magnus* (Arizona), *Kitty Hawk* (Texas), *Bill Heard Enterprises, Inc.* (Alabama)
- Liability
  - Damages claimed by plaintiffs in *Lehman* case - $5 million

When does the federal WARN Act apply and what are your obligations?

- Covered Employer-100 or more employees, 20 CFR 639.3
- Triggers
  - Plant Closings, 20 CFR 239.3(b)
  - Mass Layoffs, 20 CFR 239.3(c)
  - Time frame for calculation, 20 CFR 639.5(a)(i)-(a)(ii)
- Basic Notice Requirements
  - 60 days advance notice, 20 CFR 639.5 & 20 CFR 639.5
  - Parties who must receive notice 20 CFR 639.6
  - Content elements, 20 CFR 639.7

When does the federal WARN Act apply and what are your obligations? (cont'd)

- Penalties
  - Back pay and benefits, up to 60 days
  - Civil penalties
  - Attorney fees and costs in civil cases
- Enforcement
- Exceptions, Exemptions

Is your company subject to Individual State “Baby-WARN” Laws and how to they differ from the federal WARN Act?

- Examples of states which do not have their own Baby-WARN laws and adopt the federal WARN Act
  - E.g., Florida, Ohio, Pennsylvania, Texas

Is your company subject to Individual State "Baby-WARN" Laws and how to they differ from the federal WARN Act?

- Examples of states with Baby-WARN laws with terms differing from the federal WARN Act
  - California, Cal. Lab. Code §§ 1400 to 1406, as enacted by Cal. Stat. 780
    - Covered Employer-75 or more employees
  - Illinois, 820 Ill. Comp. Stat. 65/1 to 65/99, as enacted by 2004 Ill. Laws 93-915
    - Covered Employer-75 or more employees
    - Penalties-the cost of any medical expenses incurred by the employee that would have been covered under a benefit plan
  - New York, N.Y. Lab. Law §§ 860 to 860-I, as enacted by 2008 N.Y. Laws 475 (*effective February 1, 2009)
    - Covered Employer-50 or more employees
    - 90 day notice

Federal & State WARN Laws: What to do if Your Company's Plans are Uncertain?

- Conditional notice based on the occurrence or non-occurrence of a definite event is allowed
- Identification of a 2 week period, extensions of notice, 20 CFR 639.10

Federal & State WARN Laws: What to do if Your Company's Plans are Uncertain?

- Consider pay in lieu of notice
  - Offsets: Voluntary and unconditional payments versus severance pay required by contract, including policies and handbooks
  - Case law
    - *Castro v. Chicago Housing Authority*, 360 F.3d 721 (7th Cir. 2004)(reduction in damages was not warranted by severance payments)
    - *Washington v. Aircap Industries, Inc.*,860 F.Supp. 307 (D.S.C. 1994)(employer could reduce liability by amount of wages and severance it paid)
    - *Tobin v. Ravenswood Aluminum Corp.*, 838 F.Supp. 262 (S.D.W.V. 1993)(employer not entitled to offset right to backpay with severance payment)
- Plan ahead, plan ahead, plan ahead.

Discrimination laws and class actions – limiting risk in selecting employees for reduction

- Communication
- Neutral Business-Related Criteria for Selection
- Process and Documentation
- Adverse Impact Analysis
- Releases

Discrimination laws and class actions – limiting risk in selecting employees for reduction

Communication

- Communication is a legal issue – not only HR and PR
- Public statements can and will be used in litigation
- For a clear message, coordination among communicators is key
- Understand the business message before the selection process is put in place
- The business message and the selection process must match

Discrimination laws and class actions – limiting risk in selecting employees for reduction

Neutral Business-Related Criteria for Selection

- McDonnell Douglas method of proof requires the employer to articulate a legitimate business reason for selecting an employee for termination, even in a reduction or restructuring
- In post-restructuring litigation, the criteria for selection are subject to attack as pretext
- Example: Meacham v. Knolls Atomic Power Laboratory, 461 F.3d 134 (2d Cir. 2006): KAPL needed to perform same work with fewer employees, so they used criteria of “criticality” and “flexibility” of skills. Plaintiff employees claimed this was too subjective and age-discriminatory.

Discrimination laws and class actions – limiting risk in selecting employees for reduction

Process and Documentation

- Plan the selection criteria, the selection process, who will make the selections, and how the selections will be documented and reviewed
- Measure twice, cut once – once again, make sure the selection criteria and the business message match
- Example of effective documentation and review process:
  - *Mynatt v. Lockheed Martin Energy Systems, Inc.*, 271 Fed.Appx. 470 (6th Cir. 2008): Lockheed's RIF process included 5 objective criteria, charts and review by a supervisor, a written explanation of the reason for selection, and "an 'adverse impact' analysis of proposed terminations by the company's Workforce Diversity Office. Then, after selections are approved by the [RIF Review] Board, the selections are reviewed by the human resources and legal departments." (affirming summary judgment for employer on employee's Title VII claim)

Discrimination laws and class actions – limiting risk in selecting employees for reduction

Adverse Impact Analysis

- Consider "proactive" adverse impact analysis, conducted in advance of workforce readjustment –
  - *Mynatt v. Lockheed Martin Energy Systems, Inc.*, 271 Fed.Appx. 470 (6th Cir. 2008): Lockheed's RIF process included "an 'adverse impact' analysis of all proposed terminations is conducted by the Workforce Diversity Office. Once a selection is approved by the [RIF Review] Board, the selections are reviewed by the human resources and legal departments." (affirming summary judgment for employer on employee's Title VII claim)
  - *Meacham v. Knolls Atomic Power Laboratory*, 461 F.3d 134 (2d Cir. 2006): employer's RIF process included "adverse impact analysis to determine whether the layoffs 'might have a disparate impact on a protected class of employees'" (remanding for judgment for employer on employees' ADEA claim)

Discrimination laws and class actions – limiting risk in selecting employees for reduction

Adverse Impact Analysis

- Consider "proactive" adverse impact analysis, conducted in advance of workforce readjustment –
  - *Soliday v. Fluor Fernald, Inc.*, 2006 WL 143381 (S.D. Ohio 2006): plaintiff pointed to employer's June 2003 adverse impact analysis that preceded its July 2003 RIF; because the list of employees who were actually selected for the RIF were different than those involved in the earlier adverse impact analysis, the evidence was unhelpful to plaintiff. (granting summary judgment for employer on employee's age and sex discrimination claims)
  - *Salvato v. Illinois Dept. of Human Rights*, 155 F.3d 922 (7th Cir. 1998): "[a]n important part of the [employer's] review process was to conduct an 'adverse impact analysis' to ensure that the layoff plan would not have a proportionate effect on any legally protected group." (affirming judgments for employer on employees' age discrimination and retaliation claims)

Discrimination laws and class actions – limiting risk in selecting employees for reduction

Releases

- What are Releases and Why are They Useful?
- What are the Basic Elements of Releases?
- What Laws, Regulations & Guidance Impact Releases?

Releases: What are they and why use them?

- What are they?
- Benefits
  - to Companies
    - cuts off exposure to liability
    - peace of mind
    - good will
  - to Employees
    - morale
    - productivity for remaining employees
    - economic assistance with transition

Releases: What are the Basic Elements of Releases?

- Consideration
- Waiver of claims
- Confidentiality

Releases: What Laws, Regulations & Guidance Impact Releases?

- The Older Workers Benefits Protection Act (OWBPA)
- The Family and Medical Leave Act (FMLA)
- Equal Employment Opportunity Commission (EEOC) Enforcement Guidance
- Department of Labor (DOL) eLaws Advisory

Releases: What Laws, Regulations & Guidance Impact Releases?

- Older Workers Benefit Protection Act (OWBPA), amendment to the Age Discrimination in Employment Act of 1967, 29 U.S.C. 621 et seq.
  - Designed to protect older workers entering into agreements promising economic benefits in exchange for waiving their ADEA rights
  - For a waiver to be considered knowing and voluntary, the waiver must meet certain criteria and contain certain language
  - Differing treatment of individual separations and separations made in connection with an exit incentive or other termination program offered to a group or class of employees

Releases: What Laws, Regulations & Guidance Impact Releases?

- The Family and Medical Leave Act of 1993 (FMLA), 29 CFR Part 625 (Final Rule, effective January 16, 2009)
  - Employees may voluntarily settle or release their FMLA claims without Court or Department of Labor approval
- EEOC Enforcement Guidance re: Waiver of the Right to File An EEOC Charge
  - An employee's right to file a charge is non-waivable
- Department of Labor eLaws Advisory re: WARN Waivers
  - Employees may not be required to waive their rights to advance notice under WARN, but employers may ask them to do so knowingly and voluntarily

Obligation to reinstate employees on leave of absence: Family/Medical Leave

- § 104 Employment and Benefits Protection
  - Generally, employees who take FMLA leave must “be restored to an equivalent position with equivalent employment benefits”
  - However, FMLA does not entitle such an employee to “any right, benefit or position of employment other than any right, benefit or position to which the employee would have been entitled had the employee not taken the leave”

Obligation to reinstate employees on leave of absence: Family/Medical Leave

- If job is eliminated while employee is on leave, FMLA does not require reinstatement
  - *Batacan v. Reliant Pharm. Inc.*, 228 Fed.Appx. 702 (9th Cir. 2007) (holding "an employee taking FMLA leave may be terminated pursuant to a legitimate reduction in force") (affirming summary judgment for employer)
  - But *see* *Liu v. Amway Corp.*, 347 F.3d 1125 (9th Cir. 2003) ("Termination within the context of a reduction in force does not insulate the defendant from liability for violating FMLA. Where a plaintiff alleges that she was terminated for unlawful reasons, courts will not accept a reduction in force as the conclusory explanation for the employee's termination.") (reversing summary judgment for employer)
  - *Campbell v. Gambro Healthcare*, 478 F.3d 1282 (10th Cir. 2007) (employee must establish a causal connection between FMLA leave and termination) (affirming summary judgment for employer)

Obligation to reinstate employees on leave of absence: Military Leave (USERRA)

- USERRA provides reemployment rights for veterans and members of the National Guard and Reserve following qualifying military service
  - Following tour of duty, service member is entitled to all employment benefits s/he would have received if s/he had been continuously employed
- Military service cannot be a "motivating factor" in an employer's action (38 U.S.C. § 4311(c)(1))
- Courts have been "sympathetic to employers in genuine financial peril, notwithstanding the protections of USERRA." *Johnson v. Michigan Claim Service, Inc.*, 471 F.Supp.2d 967 (D. Minn. 2007) (denying summary judgment on employee's USERRA claim for both employer and employee)

Special Risks in Reducing and Redeploying Executives

Special Risks – Reducing and Redeploying Executives

- Special severance and other benefits in executive employment agreements
  - Typical Employment Agreement Provisions
    - "Good reason" triggers
    - Change in Control payments
    - Severance (extended or special condition)
    - Bonus, performance-based compensation guarantee
    - Stock Options and other benefits that vest over time (accelerated vesting)

Special Risks – Reducing and Redeploying Executives
Executive Compensation Considerations

- Good Reason Triggers – Change in organization through restructuring, sale, divestiture or merger may allow executive to resign and collect significant severance
- Change in Control Provisions
  - *Fix v. Quantum Industrial Partners LDC* (7th Cir. 2004): After employer declared bankruptcy, employee sought payment of $5 million under a "Change of Control" provisions of his employment contract. Court held that liquidation of corporate assets in bankruptcy was "change in control" of corporation and employee was entitled to payment.
- Severance – Executive severance plans may provide for severance if position or compensation changes, even if not terminated by company

Special Risks – Reducing and Redeploying Executives
Executive Compensation Considerations

- Bonus/Performance-Based Compensation – Contract/plan may provide guarantee when employment changes or is terminated during performance period
- Stock Options and Other Benefits that Vest over Time – Contract/plan may provide for accelerated vesting upon termination or other change in employment or compensation

“Clawbacks” in Executive Compensation Legal Issues

- Shareholders want companies to recapture huge severance, bonus and stock-based compensation for executives if financials are incorrect
- Many compensation committees are instituting “clawback” provisions that allow recapture
- There are questions of enforceability under state law, especially California

Issues Confronting Pension Plan Sponsors During the Economic Downturn

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- Restrictions on defined benefit plans under Code section 436
- Funding and notice requirements for defined benefit pension plans
- Restrictions on funding nonqualified deferred compensation plans
- Defined contribution plan issues

Restrictions on defined benefit plans under Code section 436

- Measuring a plan's "AFTAP"
- Limitations on funding shutdown benefits and other unpredictable contingent event benefits
- Limitations on plan amendments increasing liability for benefits
- Limitations on accelerated benefit distributions
- Limitations on benefit accruals for plans with severe funding shortfalls
- Ways to avoid benefit limitations

Measuring a Plan's AFTAP

- A Plan's funding target attainment percentage ("FTAP") is defined under Code section 430(d)(2)
- A plan's AFTAP is it's FTAP adjusted to take into account the aggregate amount of purchased annuities for employees other than HCEs during the preceding two plan years
- Special rule for plans which are fully funded without regard to reductions for funding balances
- Transition rules

Actuarial Certification and Presumptions Regarding a Plan's AFTAP

- A Plan's AFTAP for a given plan year is generally established on the date the plan sponsor receives the enrolled actuary's certification of the AFTAP (the "valuation date")
- For the first four months of the plan year, the AFTAP is presumed to be the prior year AFTAP
- If the actuarial certification is not received by the first day of the 10th month of the plan year, the plan is presumed to have an AFTAP of less than 60%
- If there is no current year AFTAP certification as of April 1, and the prior year AFTAP is in the 60-70 percent or 80-90 percent ranges, the plan's AFTAP is presumed to be equal to 10 percentage points less than the prior year AFTAP as of April 1

Limitations on funding shutdown benefits and other unpredictable contingent event benefits

- An unpredictable contingent event benefit may not be provided with respect to an event occurring in a plan year if the plan's AFTAP for such plan year is:
  - Less than 60%; or
  - Would be less than 60% taking into account such event
- Definition of unpredictable contingent event
- When limitation ceases to apply

Limitations on plan amendments increasing liability for benefits

- Certain amendments which have the effect of increasing a plan's liability for benefits cannot take effect in a plan year if the plan's AFTAP for such plan year is:
- Less than 80%; or
- Would be less than 80% taking into account such amendment
- Types of amendments to which limitation applies
- Exception for certain benefit increases
- When limitation ceases to apply

Limitations on accelerated benefit distributions

- Definition of “prohibited payment”
- No prohibited payments may be made after the valuation date of a plan year if the AFTAP for such plan year is less than 60%
- Limited payment of a prohibited payment is permitted if the plan’s AFTAP is 60% or greater but less than 80%
- Exception

Restriction on benefit distributions for AFTAP between 60% and 80%

- Plan must allow the participant the option to either bifurcate the benefit into unrestricted and restricted portions or to defer payment of the benefit to a later date (to the extent permitted under applicable qualification requirements).
- Unrestricted portion of the benefit equals the lesser of:
  - 50% of the benefit; and
  - the portion of the benefit that has a present value equal to the PBGC guaranteed benefit
- If the participant elects to bifurcate the benefit:
  - the plan must permit the participant to elect to receive the restricted portion of the benefit in an optional form which would have been permitted with respect to the participant's entire benefit;
  - the plan may, but is not required, to permit a participant to defer payment of the restricted portion of the benefit.

Limitations on benefit accruals for plans with severe funding shortfalls

- Benefit accruals shall cease as of the valuation date of a plan year if the AFTAP for such plan year is less than 60%
- When limitation ceases.

Other Issues under Code Section 436

- Provision of security to avoid limitations and restrictions
- Special rule for new plans
- Special rules for collectively bargained plans
- Credit balance issues

Funding and notice requirements for defined benefit pension plans

- Annual Funding Notice
  - Model notice has not been published
- Notice to participants required if plan is subject to:
  - Limits on unpredictable contingent event benefits
  - Limits on accelerated benefit distributions
  - Limits on benefit accruals
- Timing issues

Restrictions on funding nonqualified deferred compensation plans

- Code section 409A(b)(3) provides, in part, that if assets are set aside or reserved (directly or indirectly) to pay nonqualified deferred compensation plan benefits to an applicable covered employee of an entity which is the sponsor or is in the controlled group of the sponsor of a single employer defined benefit plan which is in at-risk status, such assets shall be treated as property transferred in connection with the performance of services (for purposes of Code section 83)
- Definition of at-risk status
- Definition of applicable covered employee
- When restrictions cease

Defined Contribution Plan Issues

- Reducing or Eliminating Matching and Profit Sharing Contributions
- Plan amendment requirements
- Impact on nondiscrimination testing
- Linkage with nonqualified deferred compensation plans

Reducing or Suspending Safe Harbor Matching Contributions

- ADP and ACP tests will be satisfied if:
- Notice provided to eligible employees explaining:
  - consequences of reduction or suspension of matching contributions,
  - procedures for changing deferral election, and
  - amendment effective date;
- Reduction or suspension effective no earlier than later of date 30 days after notice provided and date amendment is adopted;
- Employees provided "reasonable opportunity" to change deferral elections;
- ADP and ACP tests use current year testing method; and
- Other 401(k) safe harbor regs are generally satisfied.

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