WHITE & CASE

Global HR Hot Topic

September 2011

Employment Termination and Reductions-in-Force Outside the United States, part 1

Challenge:

Overseas, terminating an individual employee or doing a reduction-in-force is far more complex and heavily regulated than in the employment-at-will US.

Against the backdrop of bad economic news, turbulent world economic markets and talk of a "double dip" recession, multinationals are assessing budgets for the coming fiscal year. Inevitably some will face tough decisions about reduced staffing across worldwide workforces.

Firings are always difficult. Group layoffs outside the US can be particularly troublesome for US-based multinationals, because outside of employment-at-will, employment termination is much more heavily regulated.

This is a primer on the challenging topic of how to approach both individual employee firings and group layoffs outside the US. Our discussion breaks into four parts: terminating staff outside an employment-at-will environment; individual dismissals outside the US; employee settlements/releases abroad; and reductions-in-force outside the US.

1. Terminating staff outside an employment-at-will environment

"Employment-at-will" means the right to end employment (for an employee to quit and for an employer to fire) for any reason or no reason, except that an employer cannot legally dismiss an employee for a discriminatory, retaliatory or statutorily prohibited reason. The US—including some of its territories and excluding only Montana—is the world's only major employment-at-will jurisdiction. "American exceptionalism" in this particular regard of employment termination law means that, from the point of view of a US-headquartered multinational, firing employees gets stricter, more complex and more expensive upon stepping outside the US.

- **Erosion.** American employment law mavens make the case that the US employment-at-will doctrine has eroded over the years. Speaking historically, this is a fair point. But speaking *geographically*, America's employment-at-will rule remains robust. Other

Pointer:

Account for all levels of termination laws before dismissing an overseas employee. Project-manage outside-US layoffs to account for local laws. In a cross-border downsizing, use tailored local-country "field guides" to catch all the legal issues.

Each monthly issue of *Global HR Hot Topic* focuses on a specific challenge to globalizing HR and offers state-of-the-art ideas for ensuring best practices in international HR management and compliance. White & Case's International Labor and Employment Law practice helps multinationals globalize business operations, monitor employment law compliance across borders and resolve international labor and employment issues.

For further information, contact:

Donald C. Dowling, Jr.
International Employment Partner
New York
+ 1 212 819 8665
ddowling@whitecase.com

White & Case LLP
1155 Avenue of the Americas
New York, NY 10036
United States
+ 1 212 819 8200

countries—even other common law jurisdictions with legal systems descended from England's like Australia, Canada, Hong Kong, Ireland, Jamaica, Malawi, New Zealand and South Africa—impose significant restrictions on unilateral firings even in the absence of any allegation of discrimination. "Despite dire predictions of the demise of [US] at-will employment in the early years of the 21st century, it appears that 'funeral arrangements' may still be a bit premature." (P.J. Strelitz *et al.*, "Employment-at-Will," *International HR Journal* Thomson West, Summer 2008, at 16.)

Americans refer to employment-at-will as a "doctrine" or "rule," but actually it is the opposite—it is a mere label for the *absence* of any affirmative rule. Actual legal rules (for example, the US Fair Labor Standards Act and US Title VII) grant enforceable legal rights (for example, the FLSA right to overtime pay and the Title VII right to a nondiscriminatory workplace). "Employment-at-will," on the other hand, just describes a legal vacuum—the *absence* of affirmative rights, the negative concept that the law, in the absence of some express agreement providing otherwise, does not grant either party to an employment relationship any right to continue the relationship, any right to pre-termination notice, any right to access an in-house claims procedure or any right to termination pay.

Outside the US, laws regulate how, when and why an employer can end an indefinite-term employment relationship. Many foreign employment termination laws impose steep notice/severance pay costs and cumbersome pre-firing procedural steps. Unfortunately we have no commonly accepted term for discussing these laws, no widely used label for the *opposite* of employment-at-will. Some refer to "indefinite employment" regimes while others (particularly in the Philippines) call this the "security of tenure" doctrine. But whenever we discuss all the world's termination laws outside employment-at-will, we necessarily talk in generalizations. For example, Canada, Japan, the Netherlands and Nigeria regulate no-cause firings, but each does so in its own unique way. We might call all four countries "indefinite employment" or "security of tenure" jurisdictions, but Japan and the Netherlands are closer to a "lifetime employment" model than are Canada and Nigeria.

Employment-at-will and indefinite employment/security-of-tenure are so different because they evolved in two different environments—two divergent ways of understanding what an employment relationship is. Employment-at-will reflects the *contract metaphor* view while indefinite employment/security-of-tenure reflects the *paternal metaphor* view. The employment-at-will contract metaphor sees employer and employee as equals who freely enter a two-way business agreement to provide services (even if it is just an oral agreement terminable at will). If an employment contract expressly includes some special termination provision, then that provision controls. Otherwise, the default understanding is that one party, the employee, can end the employment relationship at any time without penalty by quitting, and so the other party, the employer, can also end the relationship at any time without penalty, by dismissing. After all, a bilateral agreement runs in two directions.

By contrast, the indefinite employment/security-of-tenure paternal metaphor sees bosses as accountable to their staff by virtue of an inherently unequal relationship—bosses hold the economic bargaining power while employees are functionally dependant. As a *quid pro quo* to a boss's right to assign work and set the pay rate, the law attaches responsibilities. Just as we have laws that impose duties on parents and even pet owners not to commit neglect, and just as we have laws that impose a duty of support on spouses, the parental metaphor sees bosses as guardians who owe their employees certain duties. A boss who decides to enter an employment relationship locks himself into the relationship unless and until he complies with mandated termination procedures. If he later decides to end the relationship, he will have to get a legal separation analogous to divorce or emancipation proceedings, and he will have to pay mandated notice and severance pay analogous to alimony and child support.

Of course, each of these metaphors is a legal fiction. Getting a job is not really the same as entering a commercial contract, and employees are not really helpless dependants. The point is that these metaphors explain why, as contrasted with employment-at-will, indefinite employment/security-of-tenure jurisdictions impose strict employee protections.

2. Individual dismissals outside the US

The "American exceptionalism" of employment-at-will is the backdrop against which multinational employers ask a practical question: *What are the actual rules and obligations that jurisdictions outside the US impose on employers that need to fire an employee?*

- **Termination costs.** Actually, even before asking about rules and obligations, a multinational that needs to dismiss an overseas employee often asks first about termination *costs*. The notice/severance pay costs that virtually every country imposes tend to link to final pay rate, so the price in dollars to terminate a given overseas employee runs highest in economies where pay rates are highest. Within those jurisdictions, severance costs run higher where a terminated employee is long-tenured and high compensated. The other side of that coin is that short-tenured, nonexecutive employees in low-wage countries can be inexpensive to fire. But outside the US, most all terminations, even the inexpensive ones, are regulated and subject to rules and obligations.

To understand what rules and obligations jurisdictions outside the US impose on employers terminating individual staff, the first step to distinguish *good-cause* from *no-cause* firings. Most every jurisdiction offers employers broad freedom to fire staff, without penalty, for certain proven misconduct. But each jurisdiction has its own concept of what constitutes good enough cause to justify a summary dismissal. Many countries require that an employer prove a fired worker guilty of some specific misdeed that appears on the country's statutory list of terminable good-cause infractions. Accordingly, in "statutory list" jurisdictions (which include countries as far-flung as Costa Rica, Czech Republic, Indonesia, Malawi, Peru, Philippines, Russia, Ukraine, Vietnam), even an employee who breaches a posted company work rule might not be terminable for cause unless his particular misdeed happens to parallel an infraction specifically included in the jurisdiction's termination law.

Sometimes an employer loses even when it proves an employee breached a statutory dismissal standard. For example, section 626 of the German Civil Code includes "theft" as grounds for dismissal, but Germany's highest labor court held otherwise in its widely publicized 2009 *Emmely* case involving petty theft of coupons worth €1.30. And having solid proof that an employee committed a terminable infraction does not necessarily excuse legal obligations to undergo pre-firing termination procedures, even if it does excuse the severance pay obligation. For example, in 2008, Parisian rogue trader Jérôme Kerviel singlehandedly lost his employer, Société Générale bank, US$7.2 billion in unauthorized trades—but French termination procedure laws blocked Société Générale from firing Kerviel for over a month. (See "French Twist," *Wall St. J.*, 2/1/08 at A-1.)

Termination laws outside the US tend to recognize only egregious misconduct as good enough cause to excuse an employer from termination payments. Even a demonstrable business reason to terminate is often insufficient. Few jurisdictions recognize substandard performance, imperfect attendance, bad attitude, mismatched skill set, or internal restructuring as good enough cause for termination to relieve notice and severance pay obligations. A rough analogy here is the willful misconduct standard under US state unemployment compensation law. If some employee outside the US commits an act of willful misconduct that, if committed stateside, would be egregious enough to defeat a US state unemployment benefits claim, then we might expect a foreign labor court to uphold a no-pay firing as for cause. But where an employer's alleged good cause for termination amounts to something less than willful misconduct that would bar US state unemployment compensation benefits, do not expect foreign law to justify the termination.

- **Economic dismissals.** This said, some jurisdictions credit employers that can justify a dismissal economically. These jurisdictions may not excuse an economic dismissal the way they excuse a termination for willful misconduct, but they credit economic dismissals by reducing severance pay awards. For example, courts in Argentina reduce severance pay where a dismissal is because of a *force majeure* that amounts to economic reason for layoff. In Spain, an employer that can clear the hurdle (which Spain lowered in 2010) defining a Spanish "economic dismissal" saves a lot of money in severance pay—liability drops from the usual Spanish severance award of 45 or 33 days' pay-per-year of service capped at 42 months' pay, down to 20 days' pay-per-year capped at 12 months' pay.

The far more common scenario is where an employer fires an outside-US employee under circumstances that the employer realizes will not likely amount to legally recognized good cause, and so must comply with local-law severance obligations for no-cause firings. As a starting point, the employer will have to cash out/pay out all vested/accrued benefits (like vacation and retirement commitments). Beyond that, the specific severance obligations differ widely from country to country. Find out what the applicable obligations are.

- **Rank and status.** When investigating severance obligations under foreign law, begin by accounting for the targeted employee's *rank and status*. Employees serving lawful probation periods are always easier to dismiss—although in countries like Japan they may not be terminable at will. Expatriates might have rights under both home- and host-country laws. Fixed-term employees enjoy special termination rights linked to the end date of their contracts. Many countries apply different termination rules to managing directors, directors, officers and locally defined categories like *cadres* in France and *dirigenti* in Italy. In Sweden, Spain and elsewhere a top executive is actually easier to fire than rank-and-file employees, because the law recognizes the need to staff leadership ranks as management deems necessary. Some countries boost severance pay for certain types of employees—Argentina, for example, gives fired pregnant/nursing women and the newly married an extra year's pay and traveling salesmen enhanced severance awards.

There are six categories of termination law obligations. In checking what applicable local rules control an overseas firing, find out what doctrines (if any) apply under each—the six categories are cumulative, not mutually exclusive:

1. **Notice pay:** Many legal systems (and employment agreements) require employers to give fired employees pre-termination notice or pay in lieu. Depending on the jurisdiction and on factors like service period that are specific to each employee, mandated pre-termination notice can be as short as a week or as long as several years. In some jurisdictions, notice periods tend to run fairly short; in Mexico, statutory notice runs one month; in South Africa, it runs up to four weeks; and in the UK,

it runs one week per year of service capped at twelve weeks. But other jurisdictions let notice run surprisingly long—long enough that notice almost universally gets paid out in lieu. In long-notice jurisdictions, actual notice periods can get hard to calculate, subject to complex formulae (such as the Clayes formula in Belgium) or to various tiers (such as statutory versus common law versus contractual notice in Canada).

2. **Severance pay:** Countries impose very different types of individual severance pay obligations. Spain, Mexico and many others impose mandated severance payouts pursuant to simple formulas based on final pay rate and tenure/years of service. Arab countries require so-called end-of-service "gratuities" also based on tenure and pay rate, and which may be due even if an employee quits. UK, Germany and other jurisdictions give terminated employees an unliquidated cause of action for wrongful dismissal; a labor tribunal awards a "severance indemnity" for a successful claim. In Brazil, severance pay runs through a mandated system of bank-administered employee unemployment compensation accounts called "FGTS."

3. **Due process and discrimination claims:** Many jurisdictions (for example, Indonesia, Italy, Japan, New Zealand, Peru, South Africa, UK) recognize an additional cause of action where an employer fires an employee in a way that denies due process/good faith. These legal systems see the due process/good faith deprivation as a separate injury meriting damages over and above severance pay for loss of the job. Along with these unfair/arbitrary dismissal claims, we can also include discriminatory dismissal claims that allege a firing was motivated by animus against an employee's protected status. Unfair/arbitrary dismissal and employment discrimination claims can entitle a successful claimant to enhanced remedies like greater or uncapped money judgments and reinstatement. For example, Sweden awards punitive damages when a dismissal is held procedurally unfair; South Africa raises the cap on a firing claim from 12 months' pay to 24 months' pay where a dismissal is deemed "automatically unfair"; in a highly publicized May 2010 labor arbitration in Toronto, a unionized Canadian worker won CDN 500,000 for "bad faith" firing.

4. **Procedural steps:** Many countries' laws require that employment terminations follow set procedures; in effect, these laws prohibit the direct "Donald Trump" approach *("You're fired!")*. Some countries' termination procedure requirements are simple, such as Czech and Nicaraguan mandates that termination notice be in writing. Others are much more complex, such as the French mandate of pre-firing steps beginning with the registered-mail transmission of a French-language letter summoning the would-be terminated employee to a discussion meeting followed by subsequent meetings and rights of internal appeals. The UK imposes a similar multistep procedure. Indonesia requires a negotiation session with would-be fired employees. Many countries grant *Weingarten*-like rights that let even nonunionized employees bring representatives to termination meetings.

5. **Government/court approval:** While the US is the world's only major employment-at-will jurisdiction, most countries do grant employers the right to decide, unilaterally, to fire individual employees even without cause. Yes, termination obligations abroad impose procedures and severance costs. But at the end of the day, in most countries an employer willing to follow mandated steps and willing to pay required costs is free to fire any individual employee. But not in all countries. In the Netherlands, a court or government agency must approve an individual termination. Indonesian firings need to be approved by the Industrial Relations Court. Japan in effect grants employees lifetime employment during good behavior, in that Japanese law flatly prohibits firing an employee other than for demonstrable misconduct—Japanese judges award winning employee plaintiffs reinstatement and back pay, not severance pay. Governments from Colombia and Venezuela to China, Korea and the Philippines can also block firings. And many countries protect *certain classes* of workers from firing. For example, South Africa and much of Europe in effect all but bans firing union officers, strikers and pregnant women—even when the employer harbors no discriminatory animus. Italy also insulates women within one year of marriage. Argentina imposes a pre-dismissal judicial approval procedure before firing a union official, even for good cause.

6. **Employment contracts and policies:** These five categories are severance restrictions imposed by legal mandate; our sixth category is severance restrictions undertaken by the employer itself, or its bargaining agents. Individual employment terminations must of course comply with termination-specific provisions in a targeted employee's employment contract and in any applicable collective agreement (including any industry-wide "sectoral agreement"), as well as with company-issued benefit plans, equity plans and severance policies.

This discussion concludes with our next Global HR Hot Topic, October 2011