New Jersey Law Journal

VOL. CLXXXIV– NO. 1 – INDEX 42 MAY 1, 2006 ESTABLISHED 1878

IN PRACTICE

EMPLOYMENT LAW

BY STEVEN KLEPPER AND JASON MELZER

Layoffs for Economic Reasons Justified

Adverse economic conditions may constitute 'just cause' to terminate an employee

Paulie Coconuts is a highly compensated captain with Sobrano's Waste Management Company. Paulie's employment contract with Sobrano's provides that he cannot be terminated without just cause. "Just cause" is specifically defined in the agreement as follows: (a) failing to earn the minimum quota; (b) failing to kick up to the boss, Tony Sobrano; (c) having difficulty working with others; or (d) refusing to carry out Tony Sobrano's instructions.

A few months after Paulie signs his contract with Sobrano's, Carmine's Sanitation Company begins to muscle its way into some of Sobrano's most lucrative routes, which leads to severe financial difficulties for Sobrano's. Unless Sobrano's reduces its costs by a significant margin, Sobrano's will be faced with financial ruin. The most cost-efficient way to reduce its costs is for Tony Sobrano to terminate several highly compensated employees, including Paulie Coconuts. Tony Sobrano, however, faces a dilemma because during the course of Coconuts' employment with Sobrano's, none of the factors defined in his employment contract as constituting just cause has occurred. Sobrano's cannot afford to keep Coconuts, but also cannot afford to terminate him and face a wrongful termination charge. What can Tony do?

Fortunately, the courts have come to the rescue of employers who find themselves in the same predicament as Tony Sobrano. In situations where just cause is required for termination of employment, courts have consistently concluded that layoffs resulting from adverse economic conditions constitute "just cause" or, alternatively, that such conditions relieve a company from having to satisfy a "just cause" requirement. This is true even if, as in Paulie Coconuts' case, the employer did not expressly define "just cause" to include adverse economic conditions. Once an employer determines that adverse economic conditions require a reduction in the work force, courts will generally refrain from substituting their judgment for that of the employer as to the manner in which that decision is effectuated. *See Primer on Individual Employee Rights*, Felix Alfred G., 2nd Ed., July 2000, BNA Books.

Courts have held unanimously that, absent an express agreement to the contrary, a cause of action for wrongful termination based on an alleged absence of just cause will not lie when the employer's decision to terminate the employee is based on bona fide adverse economic conditions. While New Jersey courts have not addressed this issue as frequently or in as much depth as some other jurisdictions, the Appellate Division, in the case of *Linn v. Beneficial Commercial Corp.*, 226 N.J. Super. 74 (App. Div. 1988), clearly affirmed a corporation's right to make reductions in its workforce when faced with adverse economic conditions. In *Linn*, the plaintiff employee had an employment contract with the defendant corporation which provided that the contract could only be terminated for "good cause." Defendant corporation conceded that plaintiff consistently received excellent job performance reviews. Defendant corporation later decided to eliminate the plaintiff's position as part of a general reorganization of the company, which was designed to combat severe financial difficulties.

Citing the New Jersey Supreme Court's decision in *Pierce v. Ortho Pharmaceutical Corp.*, 84 N.J. 58 (1980), the *Linn* court held that employers have an interest in knowing that they can run their businesses as they see fit so long as their conduct is consistent with public policy. The Appellate Division in *Linn* further ruled that absent an express or implied promise to the contrary, a court should not compel a business to operate at a loss and risk insolvency in the interest of job security —"clearly, such a policy would be self-defeating." The Appellate Division further held that an action for wrongful discharge "does not generally lie for one whose loss of work is actuated by elimination of the job itself due to legitimate economic or business reasons…." Accordingly, the Appellate Division affirmed the trial court's grant of summary judgment dismissing plaintiff's

Klepper is a member and Melzer is an associate in the litigation department of Cole, Schotz, Meisel, Forman & Leonard of Hackensack.

This article is reprinted with permission from the MAY 1, 2006 issue of the *New Jersey Law Journal*. ©2006 ALM Properties, Inc. Further duplication without permission is prohibited. All rights reserved.

claim for wrongful discharge.

Other jurisdictions have taken a similar approach in protecting a corporation's ability to make reductions in workforce when economic conditions make such terminations necessary. As the Michigan Court of Appeals emphasized, to hold otherwise would impose an unworkable economic burden on employers to stay in business to the point of bankruptcy to satisfy employment contracts and related agreements terminable only for good or sufficient cause. *Friske v. Jasinski Builders, Inc.*, 402 N.W. 2d 42 (Mich. Ct. App. 1986). In *McCart v. Thompson*, 469 N.W.2d 284 (Mich. 1991), the Michigan Supreme Court held that bona fide economic reasons for discharge constitute "just cause."

The plaintiff in *McCart* was a senior vice president who had been employed by the defendant company for over ten years. The defendant eliminated plaintiff's position as part of a work-force reduction to lower the company's costs. At the close of discovery, the defendant filed a summary judgment motion, wherein it conceded that plaintiff had an oral contract for permanent employment that was terminable only for good cause. The defendant corporation further acknowledged that plaintiff's performance was not at issue. The Michigan Supreme Court reinstated the trial court's grant of summary disposition for the defendant, holding that bona fide economic reasons for discharge constitute "just cause."

Similarly, the Vermont Supreme Court, in *Taylor v. National Life Ins. Co.*, 652 A.2d 466 (Vt. 1993), held that absent clear and specific language in an employment agreement to the contrary, economic difficulties will constitute "just cause" for an employee's termination. The Court in *Taylor* explained that an employer can bind itself to continue employment of an employee despite the fact that the employer is not making a profit, but, in light of the grave consequences of such a policy and the impossibility of compliance in serious economic difficulties, such a requirement will only be upheld if it is clearly and specifically set forth in the contract. *See Boynton v. TRW, Inc.*, 858 F.2d 1178, 1184 (6th Cir. 1988).

Courts further protect companies which are suffering economic difficulties by holding that courts may not substitute their business judgment for that of the company. An employee's discharge for economic reasons, as determined within the complete discretion of the company, will not be actionable based upon an allegation that the employee was to be terminated only on a showing of just cause. In *Boynton v. TRW, Inc.*, 858 F.2d 1178 (6th Cir. 1988), the Sixth Circuit Court of Appeals held that the termination of an otherwise competent employee due to the economically-motivated closing of a business is not grounds for a wrongful discharge claim. To hold otherwise would impose an unworkable economic burden on employers to stay in business to the point of bankruptcy in order to satisfy employment contracts and related agreements terminable only for good or sufficient cause.

Similarly, the Montana Supreme Court, in *Heltborg v. Modern Machinery*, 795 P.2d 954 (Mont. 1990), held that there is no justification for giving a jury the authority to review whether reasonable care was utilized in a reduction in force based on economic conditions. The *Heltborg* Court concluded that the employer was not under a duty to use reasonable care in decision-making. Therefore, management's decision to implement a reduction in force for economic reasons was not susceptible to a negligence analysis by a jury. The Montana Supreme Court further held that employers should not be foreclosed from engaging in legitimate reductions in force necessary to maintain the economic vitality of the company. An employer is entitled to be motivated by and serve its own legitimate business interest and must be given discretion as to whom it will employ and retain in employment. *See Cecil v. Cardinal Drilling Co.*, 797 P.2d 232 (Mont. 1990). Like the Sixth Circuit and other jurisdictions discussed above, the Ninth Circuit has held that a reduction in force based on economic necessity constitutes good cause for the elimination of a position and the termination of an employee. *See Deminico v. Monarch Wine*, 1986 WL 27578 (C.D. Cal. March 12, 1986).

In sum, courts have taken a real-world, business-minded approach when considering wrongful discharge claims based on an alleged absence of just cause. Courts have refused to substitute their judgment for that of a company when it comes to legitimate reduction in force decisions that do not violate public policy. Courts have consistently ruled that employees who can only be terminated for "just cause," whether by operation of statute or contract, can still be lawfully terminated if the termination is based on bona fide adverse economic conditions. As succinctly stated by the Appellate Division in *Linn*, courts "cannot and should not compel a business to operate at a loss and risk insolvency in the interest of job security." Thus, Sobrano's can terminate Paulie Coconuts without fear of retribution — at least in court. ■