



# JUSTIFIED ECONOMIC REASON FOR DISMISSAL: A LAW & ECONOMICS APPROACH



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# Note about methods

**Law & Economics** has **two sides**:

→ **economists'** L&E is focused on the consequences of the application of statutory provisions from an economic standpoint (jurists' role being limited, here)

→ whilst **jurists'** L&E uses the results found by economists in those cases in which a **consequential argument** becomes relevant for the interpretation/application of a statutory provision

(especially in the relations among provisions from different authority level)





# Why economists and jurists need to cooperate

- **Economists need jurists' help** in their L&E approach since there is no coincidence of *law in the code* with *law in action* (only jurists have knowledge of the latter)
- **Jurists need economists' help** in their L&E approach to become aware of the findings of the latter relative to the consequences of statutory provisions, and of the cognitional limits affecting any adopted model
- However, on both sides the **risk must be prevented that L&E be taken as a free area** where either of them can take the liberty to speak about topics they are not competent about



# In this talk

- I will make a critical review of some maxims, taken from the most recurrent Cassation case-law, relative to **justified economic reason for dismissal (JER)**
- My thesis is that these maxims do not correspond to the reasoning actually followed by the Courts to reach their decisions...
- ... which are mostly based on a (non declared) **case-by-case assessment** of the **expected loss** deriving from the continuation of the relationship, compared with a (non declared) **threshold** considered applicable by each Court
  - I'll mention a significant **inconsistency** between the old substantive law and the procedural law, regarding JER...
  - ... to which **the Italian recent labour law reforms** remedy



# The wording of the provision: an extremely generic notion

(Statute no. 604/1966, article 3)

- **justified economic reason** - *“reasons related to production activity, work organization and its regular functioning”*
- **justified subjective or disciplinary reason** - *“a significant unfulfillment of the obligations arising from the contract”*

1 – A maxim based on **the performance of the company's budget**, which prevailed (in IT and FR jurisprudence) until 2015

*«A dismissal is lawful if its purpose is that of reducing company **losses**, **not that of increasing profit**»*

If only **one business unit or department**, thus, has significant losses, is it right that it cannot be closed down only because some others compensate its losses?

Excluding j.e.r. in all cases in which the company financial results are positive, means a remedy can be taken only on **the verge of going bankrupt!**



Actually, a j.e.r. is relative to an appraisal of the single job position involved (in particular to the **expected loss if the employment relation continues**)

## 2 – The difference between **suppressing** the job and **replacing** the employee

«*The **elimination** of a job position is lawful, the **replacement** of the person is not*»

Let's take two examples:

- Terminating a telephonist who speaks one language only and recruiting a polyglot ...
- ... same regarding a delivery man without driver's licence vs. a car driver

Is it a new job **creation**, or an employee's **replacement**?



Actually, the decisive (yet non explicit) factor in Courts' judgments in these cases is the **opportunity cost**

# 3 – The *Repêchage*

«A dismissal is lawful only providing the employee cannot be usefully assigned elsewhere in the company»

The company is obliged to keep the worker even just to make photocopies? Or to manage stationery purchases? Or to prevent electric power waste?

What does «usefully» mean?

**Actually, a Court orders a *repêchage* only provided that in the new position the **expected loss remains within a certain threshold****



## 4 – Interchangeable employees

*«When there are some interchangeable employees and one has to be selected to be dismissed, objective criteria must be applied, related to seniority and family loads»*

If among the telephonists some speak one language and some many, in which case are they deemed to be «interchangeable»?

When a Court determines fungibility or not, the evaluation is always based on the **expected loss amount**, in the given circumstances, also in terms of **opportunity cost**, exactly as in the case of *repêchage*



## 5 – Management's choices are really unquestionable?

*«Freedom in running a business (sect. 41 of the Italian Constitution) entails that the choices made by those who run the business are not questionable by a Court»*

Actually, though, **there is always some overlapping of the evaluation made by the Court and the one made by the employer** whether concerning *repêchage*, or interchangeability of employees, or the extent of the expected loss



## 6 - «Courts can only check on the effectiveness of the management choice»

*«The choice by those running the business is not questionable; however, the Court shall ascertain: a) that it has really been made, and b) the causal link between it and the dismissal»*

If we think back to the case of the bicycle delivery man or of *repêchage*, we see that, actually, the action by the Court is not limited to checking whether a choice has been made in truth: there is always an **overlap between the Court's assessment and that of the employer**

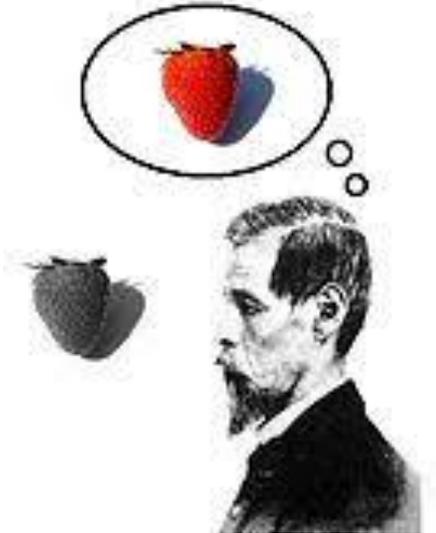
# Opaque decisions

**The actual Courts' reasoning in all the cases just examined**

- the **intuition about the expected loss** from the continuation of the employment relationship...
- ... is compared with the **maximum loss which the Court itself deemed** that could be foisted on the company

**and the post-hoc justification**

- then the motives of the decision are given by appealing the most suitable among well-established maxims, and **hiding both the expected loss and the maximum**



# A problem of coherence of the law system

- We have seen that JER consists in an **expected loss** from the continuation of the employment relationship, **beyond the threshold** the Court deems can be foisted on the entrepreneur
- If so, JER refers to something **occurring in the future**
- As such, JER **may be conjectured, not proved** (by documentary evidence, nor by witness), except in some very rare cases
- But Italian procedural law **prohibits interrogating witnesses on future events**



# Two arguments in comparison on the expected loss amount justifying dismissal

- M.T. Carinci's view, according to which **any** reasonably expected loss is sufficient
- My view, according to which **not any whatever reasonably expected loss is sufficient**: it has to be **beyond** a determined threshold



M.T. Carinci

- This view entails an **insurance-type content underlying the employment relationship**: the j.e.r. coincides with the limit of the amount of risk covered for by the employer



# How justified economic reason actually works: an emblematic case

Normally, chambermaids working in a big hotel can tidy up 30 rooms each per day. A chambermaid becomes able to tidy up only 15 due to an intervened permanent disability.

Is this sufficient to justify her dismissal?

Let's represent by

$v$  the number of rooms tidied up per day

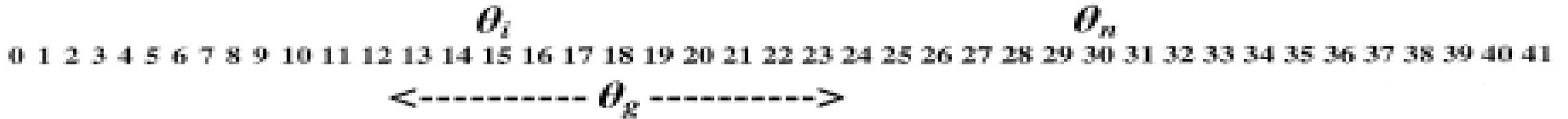
$v_n$  the no. of rooms *normally* tidied up (normal performance)

$v_i$  the no. of rooms tidied up by the *inefficient* chambermaid

$v_g$  the threshold beyond which a dismissal is deemed acceptable by the Court



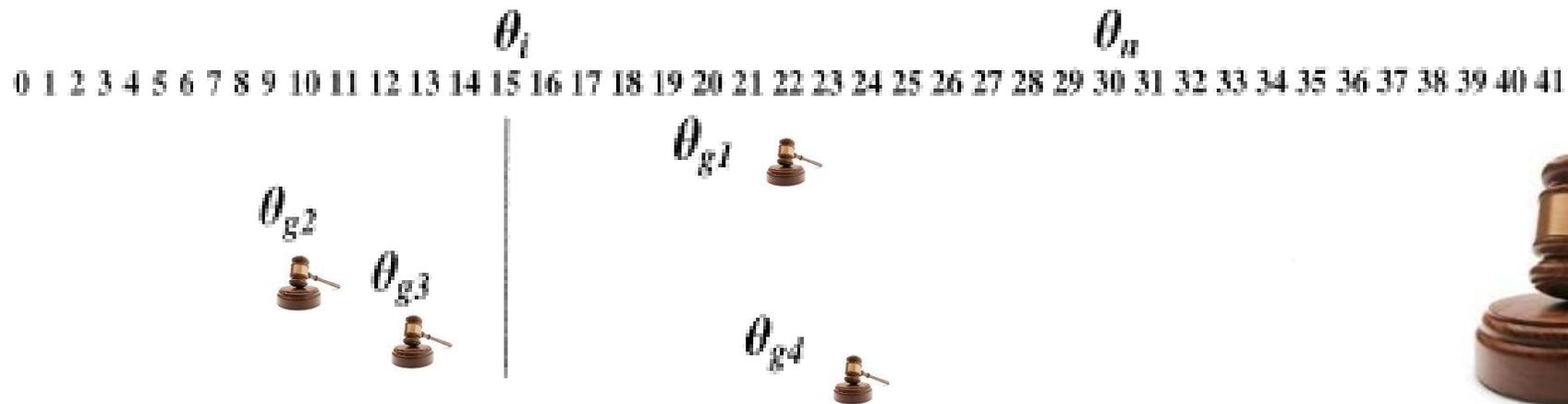
# Where is the threshold?



$\theta_n - \theta_g = \text{limite minimo della perdita attesa che può giustificare il licenziamento}$

- \* the threshold actually depends on the extent of the expected loss that the Court considers sufficient to justify the dismissal
- \* the higher is the **insurance content** underlying the employment relationship, the higher is  $\theta_n - \theta_g$ , i.e., the reduction of efficiency allowed for by a Court

# Four judgements, four different $\theta$ values



- $\theta_{g1}$  = esito del giud. cautelare (impugnazione respinta)
- $\theta_{g2}$  = esito del giud. di 1° grado (licenziamento annullato)
- $\theta_{g3}$  = esito del giud. di appello (licenziamento annullato)
- $\theta_{g4}$  = esito del giud. di rinvio (licenziamento convalidato)

# The rationale of 2012-2015 reforms

## *The severance cost as a «safety valve»*

- If a j.e.r. is nothing more than an expected loss (opportunity cost included) beyond a certain threshold ...
- ... a indemnification equal to the threshold value can be taken as an «**automatic filter**», if it is charged on the entrepreneur *in any case* (according to the **Blanchard and Tirole** proposal of **2003**)
- ... it may constitute a «**safety valve**», instead, if ordered as a penalty in the event of a negative judgment: when a nullity case is excluded , whatever the Court deems, if the employer prefers to pay a compensation, this means that **the expected loss would be higher**



Lorenzo Sacconi

# Lorenzo's first objection

- **OBJECTION**: the entrepreneur is interested in expropriating the worker of the investment she has made on her human capital, firing her to avoid having to pay more

- **MY REPLY** :

- a. most Courts would still consider such misconduct as an illicit reason, would declare the **dismissal null and void**, hence would **reinstate the worker**
- b. also an **adequate indemnification** could effectively fight this unfair behavior
- c. however, the law must also take into account **all other possible reasons** for dismissal, many of which serious and not easy to prove at Court
- d. anyway, this misconduct is **intrinsically detrimental to the company**:
  - its other **employees** would lose every incentive to invest in their human capital
  - except in the case of monopsony, in the future **good workers** would refuse to be hired in that company; and **trade unions** not only oppose a behaviour like this, but they also provide workers with its historical memory

# A more radical argument

- **OBJECTION**: In reality, employers' behaviours do not abide by a model based on the rationality of human beings
- **MY REPLY** :
  - a. no model can ever fully grasp the rich complexity of human society and behavior: the function of a model is to **shed light on some aspects of reality**
  - b. however, to comprehend such society and behavior, we always need to assume **some logic underlying** them (however such logic is modelled)
  - c. and when it comes to the domain of **corporate governance**, we've got some solid ground to think that **models based on rational behaviors are more accurate** than models based on irrational ones



Lorenzo Sacconi

# An example of employers' and workers' rational behaviour

- The 2015 reform uses the indemnification as a «safety valve», i.e. as a threshold of the expected loss that can be placed on the company, so subtracting it from the discretion of the Court and drastically **reducing the judicial alea** ...
- ... quite rationally, employers and employees have correspondingly **drastically reduced judicial litigation**, confirming the provisions of the self-selection theory of litigating parties...
- ... the **dismissal frequency remaining unchanged**



After the 2012-2015 reform:

no appreciable increase in the frequency of dismissals (1,4%),

but

a dramatic reduction of litigation at Court concerning dismissals and fixed-term contracts



## Le cause di lavoro

In Italia nel settore privato

PROCEDIMENTI ISCRITTI A RUOLO IN MATERIA DI LAVORO

	2012	2013	2014	2015	2016	Var. % nei 5 anni
Categoria e qualifica	1.627	1.508	1.520	1.486	1.307	-19
Mansioni	1.346	1.326	1.222	1.062	1.248	-7
Retribuzione	52.644	51.923	47.131	41.368	39.293	-25
Sanz. discipl. minori	1.440	1.184	1.237	1.229	1.364	-5
Trasferimento	472	498	514	540	668	41
Trasfer. azienda	470	407	444	360	324	-31
Dimissioni	389	387	424	331	295	-24
<b>Tot. Parziale</b>	<b>58.388</b>	<b>57.233</b>	<b>52.492</b>	<b>46.376</b>	<b>44.499</b>	<b>-23</b>
Contratto a termine	8.019	4.363	2.867	1.789	1.246	-84
Lavoro interinale	1.376	633	430	251	280	-79
Licenziam. collettivo	901	552	462	403	279	-69
Lic. g.m.o.*	7.535	5.952	4.615	3.493	3.298	-56
Lic. disciplinare	3.665	2.432	1.494	1.050	1.040	-71
Lic. giusta causa	5.641	3.522	2.492	1.966	2.151	-61
Licenz. Dirigente	455	506	338	295	286	-37
<b>Tot. Parziale</b>	<b>27.592</b>	<b>17.960</b>	<b>12.698</b>	<b>9.247</b>	<b>8.580</b>	<b>-69</b>
<b>TOTALE</b>	<b>123.156</b>	<b>110.259</b>	<b>98.016</b>	<b>85.460</b>	<b>82.514</b>	<b>-33</b>

(source: Ministry of Justice)

# Thank you for your attention

for further insight into material written by me, see  
*Last labor reforms in Italy* (2016)  
*Job security and the value of equality* (2004)  
on the page **Archivio** of my website  
***[www.pietroichino.it](http://www.pietroichino.it)***

