

Stack-Ranking–The Legal Risks & How to Manage Them



✘ Although Microsoft recently ditched it, many other employers still use stack-ranking to evaluate employees and winnow out poor performers. While the management and morale implications of stack-ranking have gotten tons of press, much less attention has been paid to the practice's *legal* ramifications. Here's what HR managers need to know if their organizations use or are even considering the use of stack-ranking.

What Is Stack-Ranking?

Stack-ranking, aka forced ranking, requires managers to rank all employees on a bell curve. The practice essentially pits one employee against another.

Example: At Microsoft, each employee was assigned a performance grade between 1 and 5. To generate the required bell curve, only about 10% of employees could get a 5; another 10% had to get a 1; the other 80% had to fall in the middle ranges of 2 to 4.

Stack-ranking became popular in the 1980s, especially with U.S. corporations seeking to identify employees for layoffs. But in recent years, it has become almost universally loathed for its supposedly debilitating effects on morale.

Yet, while its popularity has significantly waned, stack-ranking is still very much practiced.

Exhibit A: Even as Microsoft announced retirement of its stack-ranking system, Yahoo! let it be known that it was moving to a stack-ranking system of its own.

The Legal Risks of Stack-Ranking

Love it or hate it, stack-ranking remains very much in play, including at some of North America's leading companies. But if it's something you're using or considering using, you need to think long and hard not only about the impact on employee relations but the legal risks you're incurring. There are 2 major legal pitfalls you need to be aware of.

1. The Risk of Wrongful Termination

Stack-ranking is typically used not just to reward the good performers but identify

and straighten out the bad ones. Explanation: Being assigned the lowest grade a la a "1" under the old Microsoft system, typically results in an employee's being put on performance probation, loss of prospects for advancement and pay raises and even, in some cases, termination. (That's why stack-ranking has been derisively nicknamed "rank and yank".)

Is this legal?

Failure to perform up to standard *is* just cause for termination, at least in theory. But in the real world, you face the formidable task of persuading a sceptical judge that you were justified to fire (or accord other negative employment consequences to) one of your own employees for poor performance.

A 2001 Manitoba case called *Boulet v. Federated Co-operatives* ([2001] M.J. 306), establishes the 4 things you must prove to show poor performance as just cause to terminate for poor performance (whether under stack-ranking or any other system):

- You established a reasonable and objective performance standard and clearly communicated it to the employee;
- You gave the employee a fair chance to meet the standard;
- The employee was incapable of meeting the standard; and
- You provided clear warning that failure to meet the standard would result in dismissal.

The *Boulet* standard is still used across Canada to judge the legality of termination for poor performance and determine whether employees are entitled to notice and damages for wrongful dismissal.

2. The Risk of Discrimination

The other major liability issue posed by stack-ranking is the risk of discrimination lawsuits by minority employees who receive low grades under the system. Over the years, there have been dozens of such lawsuits contending that stack-ranking was discriminatory, especially in the U.S., including claims by:

- African-American employees against Microsoft for allegedly applying its stack-ranking system in a subjective way to discriminate on the basis of age and race;
- A female Microsoft employee who claimed the system was biased toward white males;
- Ford employees in 2 different class action lawsuits claiming the company's stack-ranking system was a fig leaf to get rid of older, white employees; and
- Employees of Capital One who claimed that stack-ranking had the effect of discriminating against older employees.

5 Ways to Protect Yourself

1. Establish Objective Performance Criteria

Termination, performance probation, salary cuts and other adverse treatment of employees for poor performance is legally indefensible unless you establish and clearly communicate objective and reasonable performance standards.

Strategy: Make sure your stack-ranking program sets out a grading system that is clear, reasonable and measurable.

2. Apply Your Criteria Consistently

One of the most common ways to incur liability for stack-ranking is to apply your performance criteria inconsistently.

Example: No just cause to fire an accountant for performance where the decision was made before her highly negative performance review. Suggesting that performance was a pretext, the court noted that it was the accountant's first review in 13 years on the job and took place just before a scheduled salary raise was about to kick in [*Black v. Robinson Group Ltd.*, [2002] O.J. No. 4011, Oct. 18, 2002].

Example: By contrast, denying promotion to border guard with excellent performance reviews was legit because the agency followed a consistent and transparent process of filling positions based on merit via open competition where internal performance reviews weren't considered so as not to give agency employees an unfair advantage over outside applicants [*Hughes v. Canada (Attorney General)*, [2009] F.C.J. No. 765, June 8, 2009].

3. Let Employees Appeal their Grades

The problem with stack-ranking isn't just the ethic of pitting one employee against another but the perception that the system is arbitrary and subjective.

Strategy: Provide a mechanism and set of appeals procedures enabling employees to challenge their grades. In addition to making the process feel more objective, appeals provide an opportunity to unearth new evidence that was overlooked before or reconsider evidence that the grading manager didn't properly consider.

4. Clearly Describe the Negative Consequences of a Bad Grade

Remember that under *Boulet*, you can't fire for poor performance unless you give the employee clear warning.

Example: Negative performance review telling collection agent to be careful and that company will be watching him wasn't fair warning because it didn't expressly say his job was in jeopardy and that he'd be fired immediately if he didn't improve [*Fanous v. Total Credit Recovery Ltd.*, [2006] O.J. No. 3036, April 11, 2006]

Strategy: Recognize that being graded a 1 isn't enough. To establish fair warning, you need to spell out in your stack-ranking policy or procedure that termination will be the consequence of getting a 1.

5. Audit How the System Is Working

Using stack-ranking as a fig leaf to get rid of employees based on their age, sex, race, etc. is a direct and intentional form of discrimination. But stack-ranking may also be illegal even if it's not *intended* to discriminate. To put it in legal language, a stack-ranking policy that is non-discriminatory on its face is still illegal if it has the *effect of* discriminating on the basis of age, sex, race, etc.

Strategy: Periodically step back and audit your system to see who's getting good and bad grades. For example, your system may have the effect of discriminating on the basis of age if the data shows that 5's are consistently awarded to employees 40 and younger and 1's to employees 50 and older.