



Why Every Employer Should Implement an ERISA Severance Pay Plan

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The current economic crisis requires revisiting severance pay. The benefits to the employer of having a written ERISA severance pay plan are many and include being perceived as a humane employer who cares about the employees it terminates, giving its employees the comfort of knowing what the employer will do for them if they are terminated through no fault of their own, promoting the company's public image as a good "corporate citizen", being in compliance with the laws regarding severance pay, avoiding the associated noncompliance penalties and, most importantly, to limit litigation risks. It is not just an employee benefit program, but part of a company's overall risk management strategy.

A lot of employers may not realize it but severance pay benefits are covered by the Employee Retirement Income Security Act of 1974 (ERISA) if they are paid as part of a "plan." An employer in doubt could simply call IRS or the Department of Labor and ask, or examine page 3 of the 2008 Form 5500 Instructions (the required annual report for ERISA plans). So employers still employing an ostrich strategy towards severance should simply face it---severance pay is governed by ERISA (if paid under a "plan")

But when is it a "plan"? Since ERISA itself provides no definition of the term (even though it is used repeatedly throughout the law), the courts have set out to define it over the last 27 or so years. The general parameters have been fairly well settled since 1987, although still being tweaked and refined. But as a practical matter, the operating definition is generally something like this:

There must be an employer-created "ongoing administrative scheme." The factors for determining if such a scheme exists include: (1) whether the payments are one-time, lump sum payments (generally not a plan) or continuous, periodic payments (generally a plan); (2) whether the employer undertook any long-term obligation with respect to the payments (generally a plan); (3) whether the severance payments are triggered by a single event, such as a plant closing (generally not a plan), or are continuous payments to be made generally to terminated employees (generally a plan); and (4) whether the severance arrangement requires the employer to engage in a case-by-case review of employees to determine their particular eligibility based on the applicable criteria (generally a plan).

No one factor is necessarily determinative (at least in some courts), but courts in different parts of the country may require fewer of the factors to be present than others. However, it is fair to say that the more “(generally a plan)” factors are present, the more likely it will be found to be a plan by IRS, DOL and the courts.

Some employers think that if it is not in writing, it is not a “plan.” Unfortunately, they are living in a fool’s paradise. Most courts will not even consider that a factor in determining if a plan exists. To the contrary, if it is an ERISA “plan” it must be written.

Many employers think they are better off not putting their severance pay arrangements in writing. Bad assumption! Suppose the employer paid Charley \$10,000 in severance and paid nothing to Dave, who did the same exact job for the same exact pay for the same number of years? If Dave sues for the same benefits Charley got, how will the employer prove that Charley was eligible for severance but Dave was not? Answer: it cannot. It will write a \$10,000 check (plus attorney’s fees) to Dave.

Most severance pay plans are considered employee welfare plans rather than pension plans. This is good because welfare plans are subject to considerably less ERISA regulation and have much more design flexibility than pension plans. Department of Labor regulations save severance plans from pension treatment as long as benefits are limited to no more than two times the final rate of annual pay and are not paid over a period longer than 24 months. There are some exceptions for mass layoffs.

Employers are often surprised by all the legal benefits they get from putting in a formal, written severance pay plan. These include getting the benefit of ERISA “preemption” (avoiding state law liability theories), the right to remove any severance pay lawsuit brought in state courts to a more employer-friendly and ERISA knowledgeable federal court, discouraging suits for more than the plan expressly grants, and requiring former employees to exhaust all administrative remedies and claims procedures before the courts will entertain any suit. So there is nothing to fear; no need for the Pavlovian response of glazed eyes and sweaty palms at the thought of “good grief, not ERISA!”

Sure, there are a few disadvantages, but as Frank Sinatra once sang, “...too few to mention...” Mainly they are the cost of writing up a simple document, possibly filing a simple annual report, the obligation to exercise discretion in a manner that does not violate discrimination laws and making everything open instead of secret.

If an employer simply has not and will not ever pay severance to anybody, then it can stop reading here and forget this article. However, in our experience such employers are rare. The advantages already listed should be enough to cause an employer to implement an ERISA severance pay plan, but it may come as an even bigger surprise that these plans can be turned into a risk manager’s delight. How? Simple. The employer tacks on a requirement of signing a written release of all legal claims of any kind the employee may have against the employer in order to get the severance pay. This does several good things. First, you are not giving the terminated worker his or her lawyer’s retainer for suing you. Second, if you get a proper release, you can scratch that former employee off the potential nuisance suit list.

And third, if the employee refuses to sign the release and passes on the severance, you know a lawsuit is on the way. As they say, knowledge is power. Employers going into mass layoff mode are almost mad not to put in such a plan. Such layoffs are a minefield of potential wrongful discharge suits. Paying some severance is likely to be far cheaper in the long run.

Employers have exceptional design freedom with severance pay plans, from eligibility to size of payments to conditions under which benefits stop to the form of payment and much more. They can even be used to induce voluntary resignations. If your company would like to explore severance pay plans further, please contact us.

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