

Severance Plans and ERISA

Legal Alert

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The severe economic downturn has resulted in many employers implementing or considering the adoption of severance plans as part of a restructuring of their workforce. This article addresses when a severance plan will be subject to the Employee Retirement Income Security Act ("ERISA") and summarizes the legal requirements that an ERISA-covered plan must satisfy.

ERISA-Covered Plans

Most severance plans are subject to ERISA - and this is, in fact, a good thing for employers. Because ERISA plans are subject to federal and not state law, employers will not need to contend with multiple jurisdictions when formulating and implementing a plan. In addition, the standard of review in the federal court for an ERISA-covered plan is much more employer-oriented than in state court. Unlike state courts, the federal courts generally show a substantial degree of deference to the employer's decisions and will uphold such decisions unless the employer acted in an arbitrary or capricious manner. Another benefit is that ERISA plans require an aggrieved employee to exhaust administrative remedies provided by the plan before filing a lawsuit challenging the employer's decision. Thus, employers may avoid the expense of costly litigation by addressing employee challenges in an administrative framework.

ERISA Requirements

The basic ERISA requirement for a severance plan is that there be a written plan document that describes the program, defines the eligible employees and the benefit payable, and addresses the method of payments (e.g., installments or a lump sum). A written plan document also serves as an administrative guide to the employer in making decisions relative to severance and will allow the employer to consider other design advantages beyond the basic terms.

For instance, it is important for the employer to include the employer's right to amend or terminate the plan and possibly provide for offsets when there are other sources of funds for an employee (such as Social Security or pension benefits). An employer can also require the employee to sign a release as part of the severance arrangement so as to prevent an employee from collecting severance and then claiming other benefits. Another design feature, anticipating a future economic recovery would require participants to repay all or a portion of the severance if the employee is ever rehired by the employer.

Not a Pension Plan

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A severance plan should be designed as a welfare benefit plan and not a pension plan. This characterization avoids more onerous requirements of ERISA such as vesting and funding. To qualify as a welfare benefit plan, the severance payments must not be contingent on retirement, the total payments must not exceed two times an employee's annual salary, and the payment(s) must be made in a lump sum or over a period that does not exceed 24 months. Unlike a pension plan, a welfare plan has very limited ERISA requirements that involve reporting and disclosure, certain fiduciary provisions and an enforcement scheme. For example, if designed as a welfare benefit plan, a severance plan that covers fewer than 100 employees (including former employees collecting benefits from the plan) and directs that benefits be paid from the company's general assets requires no annual report to be filed with the IRS. Even if the plan covers over 100 employees the reporting and disclosure requirements continue to be less difficult to satisfy. Accordingly, there are benefits of planning for severance and subjecting severance arrangements to ERISA. Most important, clients should seek professional advice at the design stage, and certainly before announcing any force reductions in order to ensure the program is properly designed to conform to ERISA.

ATTORNEYS MENTIONED

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