AUGUST 08

Published by Proskauer Rose's multi-disciplinary Managing Change/Reductions in Force Practice Group, the "Managing Change/Reductions in Force Tip of the Month" is a periodic best practices alert for employers confronting workforce changes and job restructurings.

Severance pay arrangements have become a popular tool for employers to soften the economic effect of RIFs or other terminations of employment, help avoid employment-related litigation (by requiring exiting employees to sign a waiver of claims in consideration for severance pay benefits) and address potential morale issues. However, employers are often surprised to learn that there are a number of pitfalls that can put them at legal risk if these arrangements are not designed properly. Periodic "Tip of the Month" alerts will identify various pitfalls and assist employers in maximizing the return on, and reducing exposure related to, severance arrangements.

Law & The Workplace™

Managing Change/Reductions in Force Tip of the Month

Tip: Many severance pay plans, whether voluntary or involuntary, written or unwritten, will be subject to the Employee Retirement Income Security Act of 1974 ("ERISA"). Employers should be sure to design their plans not only to comply with the substantive and procedural requirements of ERISA, where applicable, but also to ensure that they are maximizing the likelihood that they are obtaining the benefits of ERISA coverage.

When is a severance pay arrangement considered an ERISA plan?

A severance pay arrangement is covered by ERISA only if it constitutes a "plan, fund, or program . . . established or maintained by an employer" for the purpose of providing severance benefits to employees. In contrast, if a severance pay arrangement requires no ongoing administrative program to meet the employer's obligation (*e.g.*, it provides an easily calculated one-time lump sum payment following a plant closing) or it does not have a determinable level of benefits and class of beneficiaries (*e.g.*, payments are entirely discretionary, ad hoc and unsystematic), it generally will not be considered a plan, fund or program under ERISA.

While a written plan that is operated in compliance with ERISA is sometimes used as evidence that the arrangement is ERISA-covered, an arrangement that satisfies the statutory definition will be considered an ERISA plan even if it is neither publicized nor formally documented. Whether a severance pay arrangement is actually governed by ERISA is a fact-intensive legal analysis wrought with significant nuances that are best pursued with the assistance of legal counsel.

What requirements do employers need to satisfy to comply with ERISA?

While there are some significant benefits to maintaining an ERISA-covered plan that often significantly outweigh the disadvantages (as discussed below), there are also some procedural and substantive requirements that create pitfalls for employers who are unaware of them.

A few examples:

- If a severance pay arrangement is governed by ERISA, a formal plan document must be drafted.
- ERISA contains certain reporting and disclosure requirements. Participants must receive summary plan descriptions and summaries of material modifications.
- ERISA-covered arrangements with more than 100 participants must also file annual reports (Form 5500) with the U.S. Department of Labor.
- Plan fiduciaries must act prudently and in the best interests of plan participants when administering the plan. This burden is significantly mitigated by the fact that plan design, modification and termination are typically considered a non-fiduciary (or "settler") functions that are not subject to these rules. Thus, for example, a properly designed ERISA plan could still require a release of all claims against the employer.
- The plan fiduciaries must follow the terms of the plan, which means that there is somewhat less flexibility to determine eligibility for, and the amount of, benefits.
- ERISA contains explicit procedures for addressing participant claims and appeals (although these requirements often work in the employer's favor).

How can an employer take advantage of some of the benefits of ERISA?

While the concept of ERISA is somewhat intimidating to those who are unfamiliar with it (and even to those who are familiar with it in other contexts), ERISA coverage of a severance pay arrangement carries with it some very significant advantages. Employers can take concrete steps to maximize the advantages that ERISA affords.

For example:

- Due to ERISA's preemption provisions, a plan that is subject to ERISA is generally not subject to state law, which can often be more onerous than ERISA. Thus, a former employee that wishes to bring a claim for severance benefits would be forced to do so under federal law and, typically, in federal court, where the environment may be significantly more favorable to an employer. In contrast to many state law claims that might otherwise apply, under ERISA, punitive damages are unavailable and attorney fees and court costs are only imposed at the discretion of the court. In addition, there are no jury trials in ERISA suits, resulting in more reasoned and predictable outcomes. To avail themselves of these benefits, employers may wish to take steps to maximize the likelihood that ERISA will apply.
- Fiduciaries of ERISA-covered plans can generally reserve very broad discretion with respect to determinations regarding benefits or plan interpretation. A reviewing court will not second-guess these determinations as long as the fiduciary was not acting in an arbitrary and capricious manner. (In contrast, decisions under a non-ERISA arrangement would typically be reviewed de novo, with a court attempting to determine whether the employer's decision was substantively correct.) In order to avail itself of

these benefits, however, employers must ensure that they have specific plan language reserving the appropriate discretion.

- Some of the "burdens" of ERISA actually represent opportunities for employers. For example, the requirement that an ERISA plan be written encourages employers to reduce to writing eligibility criteria, exclusions and benefit formulas. Employers that do so clearly are significantly less likely to face claims related to oral promises, patterns of past behavior and so forth.
- As noted above, ERISA-covered plans must have specific procedures for deciding claims and appeals by employees. A properly drafted plan will prevent an employee from bringing a lawsuit until these procedures are exhausted. This layer of pre-litigation burdens can serve to reduce the number of lawsuits an employer may face.

Conclusion

Employers should be cognizant of the possibility that ERISA will apply to their severance pay arrangements and the compliance issues attendant to its application. More importantly, employers would be well-advised to analyze with legal counsel the possible advantages of ERISA coverage and design their arrangements accordingly.

The Proskauer Rose Managing Change/Reductions in Force Practice Group has extensive experience in addressing these and related issues in connection with virtually every type of severance pay arrangement. We would be pleased to assist you in navigating through any reductions in force or work force restructurings in which you may be engaged.

If you have any questions, please feel free to contact the Chairpersons of Proskauer's Managing Change/Reductions in Force Practice Group, who are listed below.

Robert M. Projansky
212-969-3367 – rprojansky@proskauer.com

Marc A. Mandelman
212-969-3113 – mmandelman@proskauer.com