

SEVERANCE PACKAGE = EMPLOYEE BENEFITS PLAN: WHY YOUR COMPANY'S SEVERANCE PLAN MAY CONSTITUTE A BENEFIT PLAN, AND WHY YOU SHOULD CARE

By Brent Klein

What is a Severance Plan?

As most people know, a severance allowance includes the payment of money, or the provision of benefits, to employees when they depart a company. It is often paid in recognition of the years of service and effort the departing employees have put into the company. There is no law however, that requires that a severance allowance be paid to departing employees.

Not all severance plans are subject to the federal law requirements. In the U.S. Supreme Court case of *Fort Halifax Packing Co. v. Coyne*, 482 U.S. 1 (1987), the Court held that a severance plan is subject to federal benefits law requirements only if the plan requires an "ongoing administrative scheme." Since 1987, the federal courts have applied this *Fort Halifax* analysis to numerous factual scenarios to determine if a severance plan is subject to federal benefits law. To distill the logic of those cases down to a simple general rule, it could be said that a severance plan that makes payments over time is deemed to be a plan subject to federal benefits law, whereas a plan that makes lump-sum payments of all benefits upon the occurrence of a single event is not subject to federal benefits law. But there are always exceptions, so severance plans must be considered on a case-by-case basis.

What is ERISA?

If a severance plan is subject to federal benefits law, then it is subject to the Employee Retirement Income Security Act of 1974 (ERISA). ERISA applies to two separate classes of employee benefit plans: (1) welfare benefit plans and (2) pension plans. Whether a severance plan constitutes a welfare benefit plan or a pension plan may be a difficult determination, but one with important consequences because welfare benefit plans and pension plans are subject to different requirements. Pension plans are subject to more burdensome funding and vesting requirements.

Under regulations of the Department of Labor, a severance plan will be considered a welfare benefit plan provided that:

- The severance payments are not contingent upon the employee's retirement;
- The total amount of severance payments does not exceed twice the employee's annual compensation paid in the year preceding the termination of service; and

- All payments to the departing employee are completed within 24 months after the termination of the employee's service (except for a certain limited program of terminations).

Why should you care if ERISA applies to your company's severance plan?

If your severance plan is subject to ERISA, then a number of requirements may apply. For example, unless your severance plan falls within certain limited exceptions, your company's plan may be subject to the following requirements:

- A written plan that sets forth the claims procedures mandated by ERISA;
- An annual report (Form 5500) filed with the Department of Labor; and
- Providing certain specified information to participants with a summary plan description and summary annual reports.

If the plan is deemed a pension plan, then additional requirements may apply. There are also consequences if these requirements are not met. For example, civil penalties may be assessed for each day the severance plan is not compliant, or in the most egregious cases, even criminal penalties may be applied. And the penalties are not limited to your company. The fiduciaries of the severance plan (e.g. the business owner) may also be personally subject to penalties.

It is essential to review your company's severance policies to determine if they may be subject to ERISA. If you believe they might be, or you are not sure, you should speak with your corporate law attorney immediately.

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