

THE BUSINESS OF BUILDING REDEFINED

builder news

® JUNE 2010
\$4.95
BNmag.com



**CASH FOR
CLUNKERS**

SEVERANCE AGREEMENTS FOR UNDERPERFORMERS

D. MICHAEL REILLY, LANE POWELL PC

Cash for clunkers

Severance agreements for underperformers

D. MICHAEL REILLY

A framed quote in my office reads, “Irish Diplomacy: The ability to tell someone to go to hell in such a way that they look forward to making the trip.”

How do you terminate underperforming employees so that they look forward to making the trip? It’s not easy. Employers generally have no obligation to offer severance. But, if you are offering a severance package, you may be missing opportunities and creating unanticipated risks. Here are some things to think about:

1. NO SURPRISES. Employees surprised by termination are more likely to sue you. No big secret there. Underperformers should know they are not performing. Tell them, e-mail them and make sure it’s in performance reviews. This will be important when it comes to termination time.

2. JURORS THINK MANAGERS LIE: Documentation Is Key. Anecdotal jury research confirms that more than 60% of potential jurors believe, even before hearing any evidence, that managers will lie for the company. To combat this preconceived notion, employers should document poor performance along with its company’s efforts encouraging improved employee performance.

3. REVIEW YOUR SEVERANCE POLICIES. Many employers do not have severance policies. They deal with severance on an ad hoc basis. But some employers adopt severance policies (in handbooks or formalized plans) that can present several tricky compliance issues involving the Employee Retirement Income Security Act (ERISA). While single lump sum severance payments generally will not invoke ERISA, other arrangements may. There are advantages and disadvantages to having a severance plan governed by ERISA. Claimants typically are not entitled to jury trials, there is greater flexibility to amend or terminate the

arrangement, and state law claims are pre-empted, including state wage-payment claims that allow for double damages. In order to comply with ERISA, employers have extra administrative duties, like submitting Form 5500, issuing a “Summary Plan Description,” and creating an internal appeal process. (Note: Form 5500 is not needed for unfunded severance plans with less than 100 employees potentially eligible on a qualifying termination.)

4. AVOID THE DE FACTO PENSION PLAN. If severance payments (a) are contingent on retirement, (b) total more than twice the employee’s annual compensation, and (c) are not completed within 24 months, then the severance arrangement may be deemed a “pension plan” under ERISA. A severance plan deemed a pension plan will require additional administrative work involving funding, vesting and trust requirements, which are likely to be prohibitively expensive. Certain severance arrangements may also be deemed deferred compensation, which requires compliance with Section 409A of the Internal Revenue Code. Failure to comply with Section 409A may require immediate payment of income taxes on the severance benefit (even before the severance is paid) plus interest and an additional 20 percent tax hit.

5. UPDATE SEVERANCE AGREEMENTS AND RELEASES. If you are still using that old severance agreement form saved on your computer last year, you’re probably creating risks that could invalidate the agreement. Some former employees and the Equal Employment Opportunity Commission (EEOC) have successfully challenged the validity of severance agreements. In some cases they have successfully argued that the release itself violated anti-retaliation provisions of federal law. In July 2009, the EEOC issued a checklist for release agreements. Go to the EEOC.gov

website to review the Technical Advisory. Have your attorney review it for legal compliance.

- The agreement must be in plain language. It must be “geared to the level of understanding” of the employee. Some releases were viewed as too complicated to understand and were deemed unenforceable.

- Disclosures must be made to the employee. EEOC regulations establish a guidance on what information should be provided to the employee as part of an exit incentive or termination program. Failure to comply may create an argument that the release was not “knowing and voluntary.”

- The employee cannot be required to waive certain rights. The EEOC contends that employees possess a non-waivable right to file charges with the EEOC. No waiver may require that the employee give up the ability to file a charge or participate in an investigation by the EEOC. Federal law prohibits releases affecting the EEOC’s rights to enforce federal law.

- Older workers get time to think about it. Federal law imposes additional requirements on severance agreements waiving legal rights of employees over 40. The agreement must specifically reference the Age Discrimination and Employment Act, advise the employee in writing to consult an attorney, and give the employee at least 21 days to consider the offer. The waiver also must give the employee seven days to revoke his signature.

Severance agreements are not for every employer or for every employee. But strategic use of them can eliminate potential risks and provide new opportunities for terminated employees. **LD**



D. MICHAEL REILLY, shareholder and director of Lane Powell’s Labor and Employment and Employee Benefits Practice Group, concentrates his

practice representing small and large employers on employment litigation and advice. His experience includes claims involving discrimination, wrongful discharge, ERISA, race, sex, religion, retaliation and disability claims.

REILLYM@LANEPOWELL.COM
206-223-7051