The Accidental ERISA Plan: Unintended Results of Severance Pay

By Alison McCalla

With recent and anticipated layoffs on the rise, severance benefits are currently receiving increased attention from employers hoping to ease the burden experienced by terminated employees. Even with increased attention, some employers continue to overlook one critical question in establishing severance arrangements: is this arrangement a "plan" subject to ERISA?

The Employee Retirement Income Security Act of 1974 (ERISA) generally governs employee benefit plans that provide pension or welfare benefits to employees, including to the surprise of many employers, severance benefits. Severance programs governed by ERISA are subject to increased administrative burdens, including, but not limited to: maintaining a written plan document, establishing a detailed claims procedure, filing Form 5500 with the Department of Labor unless considered an exempt small welfare plan, and providing eligible employees with a summary plan description.

However, severance benefits can be structured in a manner that successfully avoids the creation of a "plan" subject to ERISA. Despite this option, employers are often unaware that ERISA's reach can extend as far as an employment or severance contract with a single employee or an informal severance policy in an employee handbook, and therefore, inadvertently structure severance arrangements subject to ERISA.

This is not to say that severance arrangements need to or should be structured to avoid ERISA. In fact, there are several advantages to ERISA coverage, including its preemption of state laws that are often more onerous on the employer in the event of litigation. However, to the extent that an employer does not wish to comply with the reporting and disclosure requirements of ERISA (and potentially, funding and vesting requirements), it is important to understand what causes a severance arrangement to be considered an ERISA plan.

Based on a United States Supreme Court decision and subsequent case law, the central question in deciding if severance benefits constitute an ERISA plan is whether it requires an employer to maintain an "ongoing administrative program" to satisfy its obligations. A definite standard does not exist for purposes of answering this question, and courts addressing this issue are somewhat inconsistent in their holdings.

Courts have consistently held, however, that a program providing for a one-time, lump sum payment following the occurrence of a single event requires little to no employer discretion or continuing obligation, and therefore, is not an ERISA plan. Oftentimes, though, a severance arrangement does not fit neatly into this description.

For instance, an employer may prefer to provide salary continuation to employees terminated without cause for a stated period beginning on the employee's termination date. Because this approach provides for ongoing periodic payments at different intervals for affected employees and requires employer discretion in determining if "cause" exists, it is difficult to predict how a court would rule in this instance.

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Consequently, employers wishing to avoid the application of ERISA should proceed with caution in veering too far from the one-time lump sum payment on the occurrence of a single event. Otherwise, an employer and related fiduciaries could be exposed to unexpected per-day penalties if the severance arrangement is later determined to be subject to ERISA and the employer failed to comply with ERISA's requirements.

Employers should contact their benefits counsel for additional assistance in determining whether an existing or planned severance program is subject to ERISA.

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