The Nuts and Bolts of Severance Plans under ERISA

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In our topsy-turvy 21st century economy, it is often hard to tell who is up, and what is down. During the 2008 and 2009 financial crisis, companies in the financial and real estate sectors took a beating. Seven years later, those stocks are back. The sectors that did well during the financial crisis—like energy companies—have recently fallen out of favor. One common ERISA thread ties these disparate economic events together: severance pay plans. When companies experience economic problems,
they consistently use ERISA-regulated severance plans to ease the transition of their former employees to new jobs and to obtain a release of all employment-related claims. What follows is a brief review of the nuts and bolts of using ERISA-regulated severance plans during difficult times.

**Are Severance Pay Plans Regulated by ERISA?**

The short answer is “Yes.” Section 3(1) of ERISA, 29 U.S.C. 1002(1), defines the terms “employee welfare benefit plan” and “welfare plan” to include:

> [A]ny plan, fund, or program which was heretofore or is hereafter established or maintained by an employer or by an employee organization, or by both, to the extent that such plan, fund, or program was established or is maintained for the purpose of providing for its participants or their beneficiaries, through the purchase of insurance or otherwise, (A) medical, surgical, or hospital care or benefits, or benefits in the event of sickness, accident, disability, death or unemployment, or vacation benefits,… or

> (B) any benefit described in section 186(c) of this title (other than pensions on retirement or death, and insurance to provide such pensions).

Section 186(c), cited in subsection (B) of the foregoing definition, refers to Section 302(c) of the Labor Management Relations Act (LMRA),\(^1\) which concerns, in relevant part, money paid to trust funds “for the purpose of pooled vacation, holiday, severance or similar benefits…”\(^2\) According to the regulations promulgated by the Department of Labor pursuant to ERISA, the effect of citing Section 186(c) in the statutory definition of “employee welfare benefit plan” is “to include within [this] definition…those plans which provide holiday and severance benefits, and benefits which are similar….”\(^3\) In order to have the “establishment” of a plan, fund or program within the meaning of ERISA, “the surrounding circumstances must be such that a reasonable person can ascertain the intended benefits, a class of beneficiaries, the source of financing, and procedures for receiving benefits.”\(^4\) The absence of a formal written policy is not, in itself, determinative of whether an ERISA plan exists.\(^5\)

The consequences of unknowingly sponsoring an ERISA-regulated severance plan can be devastating. In *Blau v. Del Monte Corporation*,\(^6\) the Del Monte Corporation decided to sell off the Granny Goose Foods, Inc., potato chip business. A group of private investors purchased Granny Goose on December 15, 1980.\(^7\) Del Monte maintained a written but confidential “separation allowance policy” that was in
The undisputed facts show that defendants failed to comply with virtually every applicable mandate of ERISA. The [Severance Agreement] Policy was "confidential," i.e., secret, in contravention of ERISA’s reporting and disclosure provisions. The policy was subject to no claims procedure. ERISA mandates a reasonable claims procedure. Here, there was no summary plan description, no claims procedure, and no provision to inform participants in writing of anything. Del Monte’s claims procedure fails simply because there was none.

The Ninth Circuit concluded:

Del Monte claims that the secret purpose behind its secret severance benefit policy was to benefit only those employees who were without a job of any kind after termination. We decline to refer to the secret intent behind a secret plan to determine whether the denial of severance benefits in this case was not arbitrary and capricious. Allowing reference to this factor would only encourage violation of ERISA’s reporting and disclosure requirements, in the hope of later being able to interpret the policy through cost-benefit analysis of hindsight.

Blau v. Del Monte Corporation makes clear that failing to formalize an ongoing separation pay arrangement can be at the plan sponsor’s economic peril.

Advantages of a Formal Severance Plan

There are numerous advantages to using an ERISA-regulated severance plan. If a severance pay plan is properly structured to comply with
ERISA, only federal judges (and not juries) decide disputes. The types of claims permitted are limited to claims for benefits and breach of fiduciary duty claims. State law claims are not permitted. The damages available for a severance benefit claim are the benefits that the plan promised. Claims for extra contractual or punitive damages are not allowed.

In the context of an ERISA plan, all disputed claims for benefits must first be presented to the plan administrator for review. If the plan administrator's denial of the claim has an irrational basis in the facts, a court reviewing that denial will do so under the arbitrary and capricious standard of review.

A severance plan sponsor can dictate a reasonable statute of limitations for filing a lawsuit challenging the plan administrator's denial of a claim. Because severance plans are not subject to any nondiscrimination rules under ERISA, the plan sponsor can customize severance pay plans for different groups of employees and even offer the severance pay plan for short time periods. Due to the lack of any nondiscrimination rules under ERISA, employers have complete discretion in deciding who should participate. Employers can choose who can and who cannot participate and can establish different benefit formulas for employees in different job classes. That said, employers must be sure that they do not violate the other employment discrimination rules that prohibit employment discrimination based upon race, sex, national origin, and so on.

Typically, employers provide severance pay plans to broad classes of employees. These formal ERISA plans applying to large groups of employees usually act as a shield from employment discrimination claims. Individually negotiated severance can expose the company to potential liability for numerous types of employment discrimination. In order to qualify for treatment as an ERISA-regulated severance plan, plan benefits may not exceed twice the employee's annual compensation in the year before the employee terminates employment, and payments under the plan must be completed within 24 months of the date employment ends. An employer can also reduce its exposure to severance pay litigation by mandating arbitration of all severance pay disputes and by mandating that plan participants waive their right to pursue class action or collective action claims.

Disadvantages of a Formal Severance Plan

ERISA is not, however, all sunshine and lollipops. Without the constraint of a formal plan, an employer can choose who gets severance pay, what they get, and how much they get. Haphazard severance pay agreements can trigger a variety of discrimination lawsuits and even claims that a consistent offering of severance pay created an enforceable severance pay plan under ERISA.
If an employer chooses to offer severance in compliance with ERISA, the plan is subject to ERISA's fiduciary, claims procedure, and reporting and disclosure rules. First, a summary plan description must be prepared and distributed to eligible employees. A severance plan that benefits more than 100 participants is required to file an annual Form 5500. If the severance plan is unfunded and has fewer than 100 participants at the beginning of the plan year, a Form 5500 need not be filed. A failure to provide documents upon request to employees who are eligible for benefits could expose the plan administrator to a civil penalty of up to $110 per day for failing to provide the required documents upon request. Various monetary penalties can be applied to employers that fail to timely file a Form 5500 Annual Report. The severance plan sponsor can even select the forum for any federal court disputes.

One of the most important features in a severance pay plan is a requirement that an employee agree to release all employment-related claims in exchange for severance pay. For a number of years, this practice was a battleground among ERISA lawyers.

**US Supreme Court Approves Early Retirement Plans Requiring a Release of Claims**

The US Supreme Court, in *Lockheed Corp. v. Spink*, ruled that Lockheed Corporation did not violate ERISA when it amended its pension plan to provide early retirement benefits to employees in exchange for a complete release of any employment-related claims against the company. The court also held that the employer and its board of directors, as plan sponsors, were not acting as fiduciaries when they amended the plan. Under the plan provisions, eligible employees were offered increased pension benefits paid out of surplus plan assets. A class of retirees sued challenging the early retirement plans, particularly with regard to the feature that benefits were available only to employees who signed a complete release of all employment-related claims. They contended these acts to be breaches of ERISA's requirements that plan assets be used exclusively for the purpose of providing benefits and violated fiduciary obligations. In particular, the participants argued that the amendments, which offered increased benefits in exchange for a release of employment, constituted a use of plan assets to “purchase” a significant benefit for Lockheed and was not in the interests of participants and beneficiaries.

The Supreme Court disagreed, ruling that legitimate benefits that a plan sponsor may receive from the operation of a pension plan are attracting and retaining employees, paying deferred compensation, settling or avoiding strikes, providing increased compensation without increasing wages, decreasing employee turnover, and reducing the
likelihood of lawsuits by encouraging employees who would otherwise have been laid off to depart voluntarily. The court concluded that obtaining waivers of employment-related claims cannot be distinguished from these legitimate purposes because each involves, at bottom, a *quid pro quo* between the plan sponsor and the participant; that is, the employer promises to pay increased benefits in exchange for the performance of some condition by the employee. The participants admitted that the employer can ask the employee to continue to work for the employer, to cross a picket line, or to retire early. The execution of a release of claims against the employer is functionally no different; like these other conditions, it is an act that the employee performs for the employer in return for benefits.

**Truth or Consequences!**

ERISA’s fiduciary rules in the severance context have their own special protocols. The Supreme Court announced in *Varity Corporation v. Howe*, that an employer may be subject to breach of fiduciary duty claims under ERISA when it makes misleading statements about severance pay and retiree medical benefits. In *Varity*, the employer downsized by what football pundits would describe as a misdirection play—it pretended to do one thing when it was actually doing something entirely different.

Here’s what happened: Varity transferred all of its poorly performing businesses into a newly formed subsidiary (Newco). One of the company’s primary objectives in forming Newco was to rid itself of costly employee benefit obligations. Varity persuaded employees to transfer to the new subsidiary by making overly optimistic observations about the new subsidiary’s business outlook, its likely financial liability, and the security of the employee benefit program. The thrust of Varity’s remarks was that the employees’ benefits would remain secure if they voluntarily transferred to the new subsidiary. Varity made these representations, even though it intended to reduce the employee benefits at Newco in the near future. Moreover, Varity knew that the representations it had made to the employees were untrue at the time they were made. At the time the new subsidiary was formed, it was insolvent (it had a $46 million negative net worth). The new subsidiary ended its first year of operation with an $88 million loss. It ended its second year of operation in receivership. After the new subsidiary failed and went into receivership, the new subsidiary’s employees stopped receiving certain welfare benefits, including their rights to the retiree medical benefits they would have had, had they remained employed at Varity.

The Supreme Court held that *Varity* was acting in both its capacity as an employer and as a plan fiduciary when it intentionally made misrepresentations to its employees about the security of their
employee benefits. The Supreme Court explained, “reasonable employees…could have thought that Varity was communicating with them both in its capacity as employer and in its capacity as plan administrator.” Obviously, the Court’s use of the subjective “reasonable belief” standard in evaluating Varity’s actions blurs the distinction between when an employer is acting as an employer and when an employer is acting as a plan fiduciary.

Company officers who are also fiduciaries to employee benefit plans must be careful to identify when representations are being made as corporate officers and when their representations are being made as plan fiduciaries. In light of the Supreme Court’s holding in Varity, it may also be advisable for employers to not name the company as the plan administrator or as a fiduciary of its employee benefit plans in order to minimize the risk that company communications about business activities or proposed benefit changes may be characterized as misleading fiduciary communications.

Get Serious!

A series of recent ERISA federal courts of appeal decisions also have placed employers that are considering subcontracting or downsizing in an extremely awkward position. When an employer is acting as a plan fiduciary it must answer a participant’s questions truthfully. Does a fiduciary have a duty to volunteer information about the adoption of a severance pay plan or early retirement incentive plan before the plan is adopted and before a participant has asked a question about them?

In Pocchia v. Nynex Corp., the US Court of Appeals for the Second Circuit answered no and explained:

[A] fiduciary is not required to voluntarily disclose changes in a benefit plan before they are adopted…Until a plan is adopted, there is no plan, simply the possibility of one. Insisting on voluntary disclosure during the formulation of a plan and prior to its adoption would…increase the likelihood of confusion on the part of the beneficiaries and, at the same time, unduly burden management, which would be faced with continuing uncertainty as to what to disclose and when to disclose it. Moreover, any requirement of pre-adoption disclosure could impair the achievement of legitimate business goals.

The courts of appeal are divided on this issue. A number of courts of appeal, however, have taken the opposite view. These courts require a plan fiduciary to disclose to the plan’s participants plan changes that are under “serious consideration.” In Fischer v. Philadelphia Electric Co., employees who had retired prior to the
company’s announcement of an early retirement incentive plan sued to receive the plan’s enhanced retirement benefits. According to the US Court of Appeals for the Third Circuit:

“Serious consideration” of a change in plan benefits exists when (1) a specific proposal (2) is being discussed for purposes of implementation (3) by senior management with the authority to implement the change.41

According to this theory, whether a plan change is under “serious consideration” is driven by each situation’s facts. Thus, an employer that is downsizing would, according to this theory, be required to tell the plan’s participants of the proposal when it is “sufficiently concrete to support consideration by senior management for the purpose of implementation.”42 The “serious consideration” doctrine has been adopted by a number of appellate courts.43

**Severance Plan and Waivers of Age Discrimination Claims**

In 1990, Congress passed the Older Workers Benefit Protection Act (OWBPA),44 amending the Age Discrimination in Employment Act (ADEA)45, which addressed the procedures for obtaining a valid waiver of age discrimination claims. The OWBPA sets forth seven factors that must be satisfied in order for a waiver of age discrimination claims to be considered “knowing and voluntary.”

1. A waiver must be written in plain language geared to the level of comprehension and education of the average individual eligible to participate.

2. A waiver must specifically refer to rights or claims arising under the ADEA.

3. A waiver must tell the employee in writing that he or she should consult with an attorney before accepting the agreement.

4. A waiver must provide an individual employee with at least 21 days to consider the offer. In the case of “group terminations” (involving two or more individuals) then a 45-day time period is required to be extended to the employees.

5. The waiver must notify the employee that he or she has seven days to revoke his or her signature of the waiver.

6. A waiver cannot release rights and claims that arise after the date on which the waiver is executed.
(7) A waiver must be supported by consideration in addition to that to which the employee already is entitled. This means that an OWBPA waiver cannot be purchased with wages or benefits already earned by the employee. For example, an OWBPA waiver cannot be purchased with vacation or sick pay owed to the employee. Severance plans can be written in advance to require the signing of an OWBPA waiver as a condition for receipt of the promised severance benefits; the “additional consideration” requirement merely means that the employer cannot require an OWBPD waiver for a benefit that was already promised upon severance without a waiver condition.

Group Layoffs under the OWBPA

OWBPA waivers sought in connection with group layoffs or “voluntary termination incentive programs,” requires an employer to provide enough information about the factors used in selecting individuals for the program so as to allow terminating employees the ability to determine whether the group layoff program was age discriminatory. The OWBPA requires the employer to provide a written notice to all affected employees of the program with the program’s particulars. The employees must have a period of at least 45 days to consider whether to sign the OWBPA waiver. Equal Employment Opportunity Commission (EEOC) guidance requires an employer to inform employees in writing, about the following:

(1) Who is in and who is out—the employer must describe the class, occupational unit, or group of employees who were chosen for the program as well as the employees who were not selected for the program. For example, the unit of employees could be all salaried employees, all hourly employees or all employees in the accounting department.

(2) Eligibility factors for the occupational unit affected.

(3) The time limits that apply to the program.

(4) The job titles and ages of all individuals who are eligible or who were selected for the program and the ages of all individuals in the same job class or organizational unit who are not eligible or who were not selected for the program.

Severance Pay and the WARN Act

The US Department of Labor provides the following advice about severance pay and notices under the Worker Adjustment and Retraining Notification Act (WARN Act).
Can My Employer Provide a Severance Package Instead of Notice?

It is possible for an employer to provide a severance package instead of notice in two situations. First, the severance package may be conditioned on waiving any claims under WARN. The conditions for waiver are discussed in the next question. Second, the severance package may offset WARN, thus effectively providing pay in lieu of notice. There are certain circumstances under which WARN allows “voluntary and unconditional” payments that are not required by a legal obligation or collective bargaining agreement to be offset against an employer's back pay obligation. However, payments that are required by a contract, such as an employer's personnel policies (or much less likely, state law), would not offset WARN damages and, thus, would not serve to reduce the employer's liability.

Can I Waive My WARN Rights?

There are circumstances in which your employer may ask you to waive your rights to WARN notice in return for a severance package. If you agree to such a waiver voluntarily and knowingly, with an opportunity to think about it and consult with a lawyer if you wish to, and if there is consideration, that is, if you get something of reasonable value in exchange for the waiver, then the waiver will be effective to eliminate your rights under WARN.

Two cases dealing with the question of whether WARN Act payments can be integrated into severance plan payments have reached opposite conclusions.47

Notes

1. Id. § 186(c).
2. Id. § 186(c)(6).
3. 29 C.F.R. § 2510.3-1(a)(3).
7. Id. at 1351.
8. Id. at 1352.
9. Id. at 1353.
12. Id.
13. Id. at 1355.
15. ERISA § 502(a)(1)(b) and 502(a)(2) and (3).
21. 29 C.F.R. § 2510.3-2(b)(1)(ii).
22. See Am. Express Co. v. Italian Colors Rest., 570 U.S. ___, 133 S. Ct. 2304 (2013) (ruling that an express waiver of class action claims in written arbitration agreements are enforceable under the Federal Arbitration Act).
23. Blau, supra, n.6 at 1353.
30. Id. at 1068.
31. Id. at 1069.
32. Id. at 1071.
33. Id. at 1072.
34. Id. at 1069.
35. Id. at 1071–74.
36. Id. at 1073.
39. Id. at 278. See Stanton v. Gulf Oil Corp, 792 F.2d 432 (4th Cir. 1986); see also Bettis v. Thompson, 932 F. Supp. 173 (S.D. Tex. 1996).
41. Id. at 1539.

42. Id. 1540.

43. See, e.g., Vartanian v. Monsanto Co., 14 F.3d 697 (1st Cir. 1994); Wilson v. Southwestern Bell Tel. Co., 55 F.3d 399 (8th Cir. 1995); Maex v. Mountain States Tel. & Tel., Inc., 54 F.3d 1488 (10th Cir. 1995); Barnes v. Lacy, 927 F.2d 539 (11th Cir. 1991), cert. denied, 502 U.S. 938 (1991); and Berlin, supra n.36

44. 29 U.S.C. §§ 623, 626, and 630.

45. 29 U.S.C. §§ 621 et seq.
