

## SEVERANCE ARRANGEMENT: ERISA PLAN OR NOT?

### The Problem

If severance payments to a terminated employee rise to the level of a "plan," the payments will be subject to the Employee Retirement Income Security Act ("ERISA"). ERISA requires that the terms of the plan must be in writing, a summary plan description must be distributed to eligible participants, and Form 5500 reports must be filed with the Department of Labor every year (exceptions apply for certain small welfare plans). Significant "per-day" penalties may be imposed for failing to comply. The funding status of the arrangement is irrelevant, because even an unfunded severance pay plan arrangement may be an ERISA plan. An arrangement can be a "plan" even if it's unwritten – the lack of documentation is simply a violation of ERISA's plan document requirements.

When offering severance benefits to terminated employees, can the arrangement be designed so that it is not covered by ERISA?

### The Solution

Generally, an ERISA "plan" exists if a reasonable person could ascertain: (1) the benefits intended to be provided; (2) the class of intended beneficiaries; (3) the source of financing; and (4) the procedure for receiving benefits. The case-law test is whether the severance arrangement requires an "ongoing administrative scheme." For example, a one-time, lump-sum severance payment triggered by a single event, such as a plant closing, does not usually have an administrative scheme. Therefore, that severance arrangement would not be covered by ERISA.

This contrasts with the situation where several factors over time must be evaluated to determine an employee's severance benefit. That constitutes an administrative scheme. For example, an administrative scheme was found where an employee received a multiyear distribution of benefits tied to premiums on a specific "book of business." To determine the employee's severance, the employer had to keep a separate book of accounts coded to the former employee, manage those accounts, and then distribute the benefits. These actions amount to more than a one-time obligation and involve more discretion than simply writing a check. In another case, an employer promised to provide medical benefits to an employee and spouse until age 65, special coverage after they reach 65, and lifetime prescription drug benefits. Unlike a simple severance payment, these benefits imposed a long-term obligation on the employer and required an administrative structure to ensure benefits were provided.

Employers should make the payment of severance as simple as possible to avoid creating an "ongoing administrative scheme." A one-time, lump-sum payment based on a single, non-discriminatory and readily-ascertainable factor is the preferred route.

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