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INSIGHT: Getting Severance Right Through ERISA

BY MARK POERIO

In the midst of volatile times, the smartest employers position for uncertainty. From a workforce perspective, that should include consideration of a formal severance plan. Some employers think it is safest to follow informal, unwritten practices and to avoid the federal labor law known as ERISA. They should read on.

What could be wrong with an informal practice?

Just because an employer's practices are unwritten and informal doesn't mean that they are unenforceable; they can often create a legal obligation. The result could be an ERISA (Employee Retirement Income Security Act)-covered plan without many of the employer protections that a carefully crafted plan can provide.

An informal practice that results in what a court deems an ERISA plan exposes an employer to expensive but uncertain liabilities under ERISA. Employees can claim benefits at levels based on past, albeit random, employer practices, as well as win attorney fees and costs. The employer can be liable for penalties for failing to report an ERISA plan it didn't know it had. In such circumstances, ERISA becomes a sword for employees, when a proper plan would've enabled the employers to use ERISA as a time-tested shield.

What does it take to have ERISA control a severance plan?

In its seminal *Fort Halifax* decision, the Supreme Court held that ERISA generally applies to severance plans, programs, and practices that involve an ongoing administrative scheme. (*Fort Halifax Packing Co. v. Coyne* (a ''one-time, lump sum payment triggered by a single event requires no administrative scheme.'')) Employers may design a severance plan to fall within ERISA by hard-wiring, into the plan framework, the need for ongoing administration and discretion. For example, an ongoing scheme is indicated by benefit payouts over time, as well as by benefit forfeitures for not providing transition assistance or for violating post-employment trade secret obligations or restrictive covenants such as non-competition or non-solicitation requirements. Careful drafting is needed to minimize the risk that a court will not apply ERISA to a plan expressly intended to fall within ERISA.

Why could an ERISA-fied severance plan be better?

If an employer designs its severance plan to fall within ERISA, it opens the door for defusing future litigation risks through the following well-established mechanisms for expediting and efficiently resolving ERISA disputes:

- *Applicable Law:* ERISA plans are governed solely by ERISA; informal practices may be subject to dispute about whether and what state law applies, as well as whether ERISA is applicable. Uncertainty allows aggrieved employees to pick-and-choose their best remedy and forum.

- *Internal Deadline for Asserting Claims*. The claims provisions within an ERISA plan may impose a period after which benefit claims will be deemed untimely and automatically denied. For instance, a plan may limit claims to those raised within 60 or 90 days after an employee first becomes aware of actions by the employer giving rise to the claim, such as a denial of severance benefits at the time employment terminates. Such a limitation encourages the prompt assertion of claims.

■ *Exhaustion of Plan Remedies*. An ERISA claims procedure steers the initial processing of claims through an employer's claim resolution systems, thereby giving the employer an opportunity to address problems in an informal manner that avoids the time, publicity, and expense of a formal judicial or arbitration proceeding. (For supportive Supreme Court precedent, see *LaRue v. DeWolff, Boberg & Assocs. Inc.*)

■ *Shortened Statute of Limitations for Litigation*. In most cases, severance benefit litigation occurs under breach of contract principles that, depending on state law principles, may allow litigation to commence six years or more after a claim arises. ERISA case law supports the efficient resolution of claims through enforcement of shortened, uniform limitations periods, such as one year after the claim arises. (For supportive Supreme Court precedent, see *Heimeshoff v. Hartford Life & Accident Ins. Co.* (''a participant and a plan may agree by contract to a particular limitations period, even one that starts to run before the cause of action accrues, as long as the period is reasonable''). See, generally, a survey of cases within the article ''*Internal Statutes of Limitation under ERISA*'' (Barry L. Salkin, Benefits Law Journal, Vol. 31, No.2, at fn 46-47).)

■ *Arbitrary and Capricious Judicial Review*. Under ERISA, the employee must normally show the employer acted arbitrarily or capriciously to establish liability. Without ERISA, the review is *de novo*, which is more favorable to the employee.

■ *Forum Selection*. Plan provisions that require filing suit in a particular jurisdiction are commonly called *forum selection clauses*. A plan may impose such a requirement in order to localize any plan-related litigation to a forum convenient for the employer. Such a provision could discourage questionable claims, and make it more efficient for an employer to defend against claims. On the other hand, plan participants could consider a forum selection provision unfair (especially if they would have to litigate cross-country). Interestingly, although most but not all federal courts may enforce an ERISA plan's forum selection clause, the consequence of an unenforced clause is essentially the same as not having one in the first place. Overall, these provisions warrant careful examination before being instituted.

■ *Federal Judge rather than State Jury*. Federal judges handle ERISA cases based on a wealth of generally predictable ERISA case law. The alternative can be a state court jury, which tends to favor employees, with applicable law varying from state to state.

■ *Preemption of State Law and Remedies*. In an ERISA plan, claims exposure is limited to plan benefits. Under an informal practice, exposure can be based on the employer's past severance practices, and entail the full panoply of claims conceivable under state tort law. Those state law remedies open the door for the recovery of punitive and consequential damages, as well as damages for pain and suffering, none of which are recoverable under ERISA.

What are some other notable benefits of an ERISA severance plan?

First, under a written ERISA plan, benefits are easy to modify and customize provided the plan contains an express provision authorizing changes. By contrast, under an informal severance plan, an employer's past practices could lock in reasonable expectations that those severance practices will continue for the benefit of similarly-situated employees, because of the absence of written reservation of this authority to make changes.

Second, because ERISA preempts state law, an ERISA severance plan is better positioned to have courts enforce benefit forfeiture provisions if a former employee violates trade secret or other restrictive covenants.

Conclusion

There is nothing easy or painless about any severance program. Those who lose employment often feel wronged and mistreated, especially if an economic downturn makes it difficult for them to find new jobs. The best employers get out in front of the issues, by formalizing their severance plans and bringing them within the scope of ERISA, for the reasons described generally above.

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