

L a b o r & E m p l o y m e n t  
A L E R TJULY  
2006BEWARE: INFORMAL SEVERANCE POLICIES  
COULD BE BINDING ERISA PLANS

Many employers have “standard” severance pay policies that provide departing employees with a severance benefit based on the employee's salary and years of service. What you may not realize is that your severance policies, which do not appear “formal” enough to be called a “plan,” could obligate you or your successors to pay severance – even if you modify or revoke your policies.

For example, in July a New Jersey federal judge examined an employee's claim for severance pay against an employer that purchased the employee's original employer. The first employer had circulated a memo describing a generous severance policy it was adopting. Before selling the company, the first employer revoked its severance pay policy, but it did so only after the employee had accrued six months of severance benefits. Despite the informality of the severance memo, and although the policy it described was terminated and the company was sold twice, the court found that the policy established a welfare benefit plan under the Employee Retirement Income Security Act (“ERISA”), and that the employee had a vested right to the severance pay that had accrued before the plan was terminated. The Court reasoned that there was a promise of severance pay by the first employer that could not be extinguished merely because the new employer later revoked it. The Court observed that the severance policy contained no language reserving the employer's right to cancel the severance benefits earned under the policy retroactively. The

unwitting present employer, as successor, was left holding the bag.

This case teaches several points. Initially, your informally disseminated severance policy can create an enforceable plan under ERISA. If it is distributed and regularly followed, the fact that it lacks the formal appearance of a customary ERISA plan is immaterial. Second, if your company has a severance pay policy, then it should be reviewed to determine whether it continues to serve the purpose that prompted its adoption, and if not, it should be amended or terminated where possible. Third, any new severance pay policy should expressly reserve the right to modify or revoke regardless of the effect on severance pay already accrued. Fourth, include severance pay policies, both current and revoked, on your company's due diligence list before purchasing another employer whose employees might have a similar hidden vested right to severance pay.

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