

SEVERANCE PLANS

An Overview

Introduction

There is no law or other requirement stipulating that severance allowance must be paid to departing employees. Employers are free to pay or not pay severance, as they deem appropriate. However, if severance is paid, the Employee Retirement and Income Security Act (ERISA) requires that it be consistently applied for all employees. Furthermore, if a *plan* is established, it should be written and clearly communicated to all covered employees.

This is not to imply that if one employee is paid severance, all employees must be paid. To the contrary, there can be different severance policies applied for exempt, non-exempt, and hourly employees; for different position levels such as executive versus staff-level employees; for higher as against lower salary employees; and for longer service as opposed to shorter service employees. To be sure, most severance plans do differentiate using one or more of the above criteria for establishing policy. The overriding requirement, however, if a policy/plan is established, is that it be consistently applied and communicated to employees.

If an organization does not now have a severance plan established, and is faced with the need to implement a one-time severance payment, there is no need to write a plan for a single event, particularly if no future events are planned or foreseen. However, past practice can apply and the handling of subsequent events if they occur becomes important. Should the second event be handled as the first, and the third as the second, a *de facto* policy can be created whether or not it is intended to do so. At some point, it is good business to write the plan rather than leave the creation of one to practice...or worse, the courts.

Reasons for Paying/Eligibility

The most common reason for paying severance is position elimination followed closely by permanent layoff (cutback, downsizing, facility closing, etc.). Other events that trigger severance, though less frequently, include voluntary quit, poor performance, retirement, and temporary layoff. Issues involving termination for cause (theft, fighting, etc.) almost never merit payment of severance, though even in these situations there can be extenuating circumstances.

Amount Paid/Calculation

The overwhelming method for establishing the amount of severance to be paid is a formula-based method. The most common calculation is one week of pay for each year of service. Less common is two weeks per year with higher amounts (up to one month/year) in a very small minority. Generally, these formula-based calculations are about equally applicable to exempt and non-exempt employees alike.

Some organizations, in lieu of a formula-based arrangement, simply establish a single payout of one or two weeks of severance without regard to any criteria. Other organizations follow the “Notice Rule” giving employees notice (or payment-in-lieu of notice) equal to that which the organization expects from departing employees. The payment-in-lieu of notice may be particularly appropriate where an employee quits or is terminated for poor performance thus avoiding retaining, however briefly, an individual who may take retaliatory action or has the potential to damage employee morale.

Method of Payment

The plan for paying severance can be established by the organization with the decision between making one lump sum payment or periodic installment payments (e.g., regular paydays), or by providing the terminated employee a choice between those two methods. Lump sum payment offerings are often predicated on financial/cash flow considerations more than any other criteria. Payment of unused vacation, accrued sick leave, and other entitlements, are almost always paid in a lump sum at the time of termination. Note: Outplacement providers suggest lump sum payment of severance for “psychological” reasons; a candidate that sees his/her bank balance reducing week by week has more incentive to be an active job seeker than one who is receiving a paycheck on regular paydays and perceives layoff as a long vacation.

Unemployment Insurance Eligibility

In New York State an employee who is receiving severance allowance, and who will not be recalled, is almost always eligible to receive unemployment insurance benefits *concurrent* with the receipt of severance. There is usually a requirement that the employee also lose some benefit or benefits but even that is oftentimes waived. Unemployment insurance is presently \$405.00 per week for anyone earning more than \$28,000 annually and who has worked twenty-six of the last fifty-two weeks. The Department of Labor will normally disqualify an employee who is receiving *salary continuance*, as opposed to severance, and who has not lost any benefits.

Long-Term Disability

Prior to deciding to pay salary continuance, however, as a tactic for avoiding the concurrent UI/severance payments, an organization should evaluate their long-term disability plan. Most organizations will eliminate long-term disability on the day of termination because of the potential for protracted payments under LTD should the terminated employee become disabled while still covered. Many organizations consider the payment of unemployment insurance a small trade off to avoid the potential downside of continuing long-term disability.

In the final analysis, whether or not an employee receives unemployment insurance is the prerogative of the Department of Labor and no amount of planning by an organization will “guarantee” their determination in any particular situation.

Departure Agreements

Most organizations in today's litigious business environment require the departing employee to sign a letter waiving certain legal rights as a quid pro quo for receiving severance and other departure-related benefits. It is legal to ask that an employee sign such a document before payments of any kind begin. For any employee forty years of age or older, such a letter is not only advisable, it is necessary.

It is strongly advised that organizations not play armchair lawyer in this endeavor. Seek legal advice and counsel. Labor/employment law is a specialized area and an organization's business attorney may not be qualified; select wisely.

Tying outplacement services to the signing of a departure letter is *not* advisable. Providing outplacement services is a tangible expression of an organization's good will and oftentimes will represent an intangible encouragement to a departing employee to sign his/her departure letter. Furthermore, while ethical outplacement providers will not influence a candidate's decision to sign or not sign, they can answer questions objectively about the pros and cons of either decision. Finally, should a candidate ultimately decide not to sign the letter, so as to seek legal redress from a former employer, ethical outplacement firms will discuss the matter with the sponsoring organization to determine whether or not to continue the outplacement assignment.

One last word on Departure Agreements. Some organizations will give the affected employee the option of taking outplacement services or taking a larger severance amount; usually larger by the dollar amount that would have been paid for outplacement. This is tantamount to having the employee pay for the outplacement service. The employee will almost always select the increased pay because he/she does not understand the value of outplacement services to their future career. Outplacement is a benefit that the organization includes as part of the overall severance package. The employee either accepts it or not. If not, the sponsoring organization should save its money.

Closing

Losing a job is number three on the list of life's most stressful events. Providing a departure package that includes severance allowance, continuing health coverage, and outplacement services gives a former employee the necessary bridge to a new future and is evidence that you, as an employer, have valued them as an employee.... regardless of the circumstances (within limits) surrounding their departure. It is simply good business practice.

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