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Publications

Seventh Circuit Affirms Plan Sponsor's Discretion for Severance Benefits

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A recent opinion out of the U.S. Court of Appeals for the Seventh Circuit provides additional support for ERISA-governed severance plans to incorporate a "discretionary component" as a factor in determining eligibility for benefits.

The severance plan at issue in *Carlson v. Northrop Grumman Severance Plan* (2023 Westlaw 3299703, May 8, 2023) provided severance benefits to laid-off employees regularly scheduled to work at least 20 hours a week, but only if that employee "received a cover memo, signed by a Vice President of Human Resources (or his/her designee)" designating the employee as eligible for severance benefits. The employer laid off a number of workers in 2012, some of whom did not receive a memo designating them as eligible for severance benefits. These workers sued, claiming they were entitled to severance benefits because they regularly worked the requisite number of hours needed to be eligible, and the cover memo referenced in the plan was simply a "ministerial document."

The Seventh Circuit affirmed the ruling of the United States District Court for the Northern District of Illinois, stating that the terms of the severance plan allocate discretion regarding eligibility for benefits to a non-fiduciary, the employer's human resources department, that is entitled to exercise that discretion in the employer's interest. The court further noted that, even assuming *arguendo* that the employer had historically provided an eligibility memo to all laid-off employees who had worked enough hours prior to the 2012 layoffs, this would not prevent it from changing that approach, as "a person possessing discretion may change the way that discretion is exercised."

The following excerpt from the Seventh Circuit opinion provides a succinct summary of the applicable law:

Welfare-benefit plans under ERISA – unlike retirement plans – need not provide for vesting, and the terms of welfare-benefit plans are entirely in the control of entities that establish them. When making design decisions, employers may act in their interests.

One of the choices that employers may make when designing welfare-benefit plans is to include a discretionary component. A plan's administrator act in a fiduciary capacity when exercising discretion, but the firm's management does not. The Northrop Grumman Plan allocates discretion to the Human Resources Department, a non-fiduciary that is entitled to exercise that discretion in Northrop Grumman's interest.

The plaintiffs have filed a petition for a rehearing *en banc,* which is yet to be ruled on.

The decision affirms that, if the plan so provides, discretionary eligibility criteria for severance benefits is permissible under ERISA. However, plan sponsors should be aware that the exercise of discretion in certain ways can cause issues under other federal laws intended to protect against discrimination (e.g., the Age Discrimination in Employment Act). In addition, in the context of a voluntary severance plan, the exercise of discretion with respect to eligibility could negate the voluntary nature of the plan.

If you have questions, please reach out to your Groom attorney.