

SEPARATION PAY: TIMING ALTERNATIVES AND STACKING OPTIONS

NOTE: This chart relates solely to cash severance pay under a separation pay plan as defined in the regulations under Code Section 409A. It does not discuss reimbursement arrangements or provision of in-kind benefits that are sometimes provided in a negotiated departure or as part of a severance arrangement.

SCENARIO	TIMING ALTERNATIVES AND STACKING OPTIONS
A. Separation agreement executed in connection with a departure—not substitution for any prior severance commitment	<p>The “vesting” date will not occur prior to the execution of the separation agreement. The vesting date will either be the execution of the agreement or the termination of employment (if further service or other performance conditions exist prior to the effective date of termination of employment). <i>Note: This assumes that there is no other substantial risk of forfeiture in the agreement that would further delay the vesting date.</i></p> <p>Timing Options</p> <p>The available timing options are:</p> <ul style="list-style-type: none">• The short-term deferral exception is available—payment must be made within same year as vesting date, or within 2½ months into the next year. There is no limitation as to the amount that can be paid as a short-term deferral; such amounts are not deferred compensation subject to Section 409A.• The separation pay safe-harbor is available if payments are triggered from separation from service rather than execution of the agreement. The separation pay safe-harbor can be used to provide for severance payments in a stream beginning promptly following the date a separation from service* has occurred. (See limitations in accompanying article.)• Severance amounts can be treated as deferred compensation in compliance with Section 409A:<ul style="list-style-type: none">– The agreement can provide for payments to be made at a specified time or on a fixed schedule as determined and set forth in the agreement, without regard to the six-month delay for specified employees. This approach is compliant with Section 409A as providing for deferred compensation at a specified time or on a fixed schedule determined at the time the arrangement is entered into.– If payment is triggered from termination of employment, then payments must be made at a specified time or on a fixed schedule determinable from the date of termination, and, in the

case of specified employees, payments must be delayed for at least six months following separation from service.*

Stacking Options

Any combination of the timing options may be used, but the structure must not provide offsets from one category to another.

Example: A fixed amount can be paid within 2½ months after termination of employment (assuming that is the vesting event). Additional amounts above the short-term deferral amount can be paid pursuant to the separation pay safe-harbor, if clearly designated under such safe-harbor and as separate from the short-term deferral amount. Further additional amounts can be paid as deferred compensation if paid at a specified time or schedule set forth in the agreement. Finally, amounts can be paid six months following the date the separation from service occurs (though this may be unnecessary if the severance vests upon execution of the agreement). The plan or agreement cannot provide for offset of amounts between categories.

Caution: Any offsets or substitutions of one form of severance pay for another (e.g., between a severance plan and an employment agreement, or calculations offsetting one category of payments from another) can pose problems under Section 409A and must be carefully coordinated.

* “Separation from service” may be different than termination of employment, and separation from service standard must be used consistent with Section 409A.

B. Severance plan or agreement creating enforceable rights—severance payable upon termination by the company without cause or resignation by employee for good reason—good reason definition satisfies Section 409A

The “vesting” date is the termination of employment date. *Note: This assumes that there is no other substantial risk of forfeiture in the agreement that would further delay the vesting date.*

The regulations under Section 409A have certain safe-harbor definitions of “good reason” which, if used, will allow for the termination date to be treated as the vesting date. The regulations have more general standards that, if satisfied, also will allow for the termination date to be treated as the vesting date. However, because such standards do not create a safe-harbor, an element of risk necessarily exists with the use of the general standard, with the risk generally increasing as the definitions used diverge from the safe-harbor. Having the termination date as the vesting date is essential to the treatment described in this section. *Note: A full discussion of this issue is beyond the scope of this chart and the accompanying article.*

Timing Options

The available timing options are:

- The **short-term deferral exception** is available—payment must be made within same year as vesting date, or within 2½ months into the next year. There is **no limitation** as to the amount that can be paid as a short-term deferral; such amounts are not deferred compensation subject to Section 409A.
- The **separation pay safe-harbor** is available—this exception can be used to provide for severance payments in a stream beginning promptly following the date a separation from service* has occurred. (See limitations in accompanying article.)
- Severance amounts can be **treated as deferred compensation** in compliance with Section 409A—payments must be made at a specified time or on a fixed schedule, and, in the case of specified employees, payments must be delayed for at least six months following separation from service.*

Stacking Options

Any combination of the timing options may be used, but the structure must not provide offsets from one category to another.

Example: The Example in Scenario A above is instructive, but in this scenario the employer cannot usually rely on a “specified time or schedule” for compliance with Section 409A, since the parties do not know when separation from service will occur and no fixed time or schedule is certain. All other options noted above, however, can be used—short-term deferral, separation pay safe-harbor, and deferred compensation with the six-month delay following separation from service for specified employees. The plan or agreement cannot provide for offset of amounts between categories.

Drafting Note: If any specified employee is likely to be near the maximum limitation on amounts payable under a separation pay safe-harbor, the arrangement can provide for severance in a fixed dollar amount below the limit to be paid during the initial six-month period. Thereafter, additional amounts can be paid as deferred compensation compliant with Section 409A.

Caution: Any offsets or substitutions of one form of severance pay for another (e.g., between a severance plan and an employment agreement, or calculations offsetting one category of payments from another) can pose problems under Section 409A and must be carefully coordinated.

*“Separation from service” may be different than termination of

C. Severance plan or agreement creating enforceable rights—severance payable upon termination by the company without cause or resignation by employee for good reason—good reason definition does not satisfy Section 409A

employment, and separation from service standard must be used consistent with Section 409A.

The “vesting” date is the date on which the employee becomes covered under the agreement. *Note: This assumes that there is no other substantial risk of forfeiture in the agreement that would further delay the vesting date.*

Timing Options

Neither the short-term deferral exception nor the separation pay safe-harbor is available. Rather, all severance amounts must be **treated as deferred compensation** in compliance with Section 409A—payments must be made at a specified time or on a fixed schedule, and, in the case of specified employees, payments must be delayed for at least six months following separation from service.*

Stacking Options

Not applicable.

* “Separation from service” may be different than termination of employment, and separation from service standard must be used consistent with Section 409A.

D. Severance plan or agreement not creating enforceable rights until termination of employment. For example, plan or agreement allows employer to terminate severance arrangement at will prior to termination of employment.

The “vesting” date is the termination of employment date. *Note: This assumes that there is no other substantial risk of forfeiture in the agreement that would further delay the vesting date.*

Timing Options

Same as Scenario B above.

Stacking Options

Same as Scenario B above.