masuda funai

News & Types: Employment, Labor & Benefits Update

Are You Using the Correct Severance Agreements?

7/8/2019

Practices: Employment, Labor & Benefits

EXECUTIVE SUMMARY

Severance agreements are a vital part of every company's Employment Law Toolkit. Executives should not download templates or use previous agreements without understanding the legal requirements and the company's goals. The agreement has to effectively release claims which a former employee may assert against the company. In addition, the agreement should address a number of other issues the company may want to resolve. Without addressing these issues and having an employee sign an effective release of claims, the agreement is "not worth the paper it's written on."

It's easy to draft a severance agreement. Just use the one your lawyer sent you last year and change the name and amount of severance. Or, Google "severance agreement" and use the template on the Internet.

The question is not whether and how quickly a human resource professional, CFO or CEO is able to prepare the agreement. The question is whether the agreement is enforceable, avoids litigation and fulfills the company's goals. If not, the company just gave the former employee just enough money to engage an attorney on retainer and fund a lawsuit. A former employee might well sign the unenforceable agreement and turn around and file suit.

What are the challenges, the company's goals, and the language that will protect the company?

- **What are the employee's protected characteristics?** Is the employee age 40 and over or not yet 40? What are the other protected characteristics – national origin, race, gender identity? In what protected activities did the employee engage – whistleblower activities, safety complaints, concerted protected activities? An effective release of age discrimination claims must comply with the Older Workers' Benefit Protection Act ("OWBPA"). Attorneys recommend listing specific statutes and common law rights for a knowing release of statutory and common law claims, including the specific state and local statutes. For example, an employee in Davenport, Iowa is protected by the federal Title VII of the Civil Rights Act, the Iowa Civil Rights Act and the City of Davenport Civil Rights Ordinance.
- **What other language is required for a knowing release of claims?** Some states, including California, require special language that references one of its state statutes. The OWBPA requires language about talking with an attorney prior to signing the agreement. Is the language used mandatory or permissive? In addition, the OWBPA requires information about the "decisional unit" analyzed by the company when

deciding whom to terminate, the job titles and ages of those in the unit and information showing whom the company selected and did not select for termination.

- **Are employees entitled to a period of time to consider signing an agreement?** Under the OWBPA, an employee who is 40 years of age and older who is not terminated as part of a group is entitled to 21 days to sign the agreement and 7 days to revoke the agreement. For a group termination, the employees are entitled to 45 days to sign the agreement and 7 days to revoke the agreement. May employees sign the agreement in less than 21 or 45 days? May an employee waive the 7-day revocation period. Is the language about an attorney mandatory or permissive? Should an employee not yet 40 years of age receive time to consider signing the agreement and additional time to revoke the agreement?
- **What happens if the employee and company renegotiate the terms of the agreement and the company drafts a revised agreement?** If the changes are material and the employee does not agree to continue with the original time period, the employee is entitled to a new 21- or 45-day period of time.
- **Must the agreement include a disclaimer of rights?** Yes. Employees may not release certain rights. For example, the U.S. Supreme Court stated that employees may not waive the right to file a charge of discrimination with the federal Equal Employment Opportunity Commission. Employees may not waive rights under a state's workers' compensation law or to enforce the provisions of the severance agreement.
- **Is the company protecting its intellectual property in the agreement?** Most templates include a standard provision stating that the agreement is the "entire agreement between the parties." Using this language – alone – may end the company's right to enforce a confidentiality, trade secrets, inventions, non-compete, non-solicitation and/or non-raiding agreement the employee signed when employment began. Therefore, besides determining the employee's protected characteristics and activities, companies need to determine the employee's contractual obligations and ensure that these obligations continue after termination.
- **What if there is no prior confidentiality or non-compete agreement?** The severance agreement may contain language to protect the company's intellectual property. However, for non-competition and non-solicitation provisions, the agreement needs to contain sufficient consideration. Six months' severance payments for a one-year non-competition provision may not be sufficient consideration. More importantly, a growing number of states, including California, Illinois, Massachusetts and even Georgia are limiting the scope of the non-competition and non-solicitation provisions.
- **Does the company and/or the employee have contractual obligations?** As part of the process of conducting due diligence for a termination, a company needs to review every agreement between the employee and company. There may be contractual language in an offer letter, for example. The company may have agreed to give the employee two weeks' notice of a termination or pay in lieu of the notice. Or, the employee may have agreed to reimburse the company for the cost of relocation or training. The company needs to comply with its contractual obligations, and the severance agreement should address and resolve the employee's contractual obligations.
- **What if the company wants the employee to release claims of sexual harassment?** When an employee agrees to release a claim of sexual harassment, a company must comply with laws of both the United States and Individual states. First, a company has to comply with the Internal Revenue Code. Under the Code, a company may not be able to deduct as a business deduction from the company's taxes the

amount of money the company gives to the employee in exchange for the release. Second, some state laws do not allow an agreement to include a section in which the employee promises to keep the agreement confidential, if the agreement is a settlement of claims of sexual harassment.

- **But, what if the company wants to keep the fact and amounts of the severance confidential?** Except where there is a restrictions, companies may include language in which the employee warrants that the fact and amount of severance was not shared with co-workers. In addition, the former employee may promise not to disclose the fact and amount of severance, except, for example, with immediately family members, tax preparers, and in response to court proceedings.
- **What about references and the company's obligation to maintain the confidentiality of the termination and severance?** Agreements may provide for a written letter of reference attached to the agreement, or the language to be used when co-workers, vendors and suppliers inquire about the employee and prospective employers ask for a reference. References may be neutral, positive or what some human resource professional refer to as "neutral plus." These are references in which the company lists the job duties and, in some cases, the successes of the former employee without using adjectives. The type of reference depends upon the circumstances, including whether the termination was the result of a reorganization or a reduction-in-force, depends upon the terminated employee's position within the company, or as part of negotiating a settlement of potential litigation with a former employee.
- **How does the company and employee want to refer to the termination?** Most importantly, the language in the agreement needs to be consistent with all of the other language used during a termination. At government agencies and in court, different reasons are a "shifting defense" which may result in the agency, the court or a jury deciding that the company is hiding the real reason for the termination. Nevertheless, the word "termination" has a connotation that the ending of the employee was "for cause." Unless an employment agreement or union contract states that employees may be terminated "for cause," all employees in every state are "at-will." Using the word "termination" or "resignation" may also impact the former employee's ability to receive unemployment compensation or when applying for a new job. Therefore, depending upon the circumstances, an agreement may state that employment "ended." Using a neutral word such as "ended" may meet all of the company's goals.
- **What is sufficient consideration for a release of claims and what types of consideration do companies include in a severance agreement?** Most all agreements provide for the payment of money to a former employee as consideration for the release. Payments may be made as a lump sum or over a period of time. If, for example, a former employee is contractually bound to a confidentiality or non-compete agreement, a company may prefer to make payments over a period of time. If the company discovers that the employee is violating the contractual obligations, the company may cease the periodic payments. The employee has to file suit to prove that the contractual obligations were not violated and payments should continue.
- **May the agreement promise to continue health insurance coverage after employment ends?** No. By continuing coverage, the employee may be liable for the medical costs, if the insurance company discovers that the employee was not eligible when the insurance company paid those costs. Instead, a termination is a qualifying event under COBRA. A company may agree to pay the COBRA premiums, or the company

may agree to reimburse the COBRA premiums paid by the employee. But, the company must notify the former employee of COBRA rights, and the employee must elect COBRA coverage.

- **Should the agreement include outplacement services?** The answer depends upon the circumstances, the company's culture and the company's reputation in the marketplace. For example, by offering outplacement services as a condition of releasing claims, the company may avoid litigation for an amount that may equal one or two months' wages. Thus, rather than providing three months' wages as severance, an agreement may provide for two months' wages and a three-month outplacement program. Importantly, the agreement should state that the company – and not the former employee – chooses the outplacement company and that the company pays the outplacement company only when the former employee uses the outplacement company's services. Agreements should not provide for the payment to the employee of outplacement services which the employee may – or may not – choose.

Downloading a template for the Internet is not the answer. Instead, by understanding and applying the correct language, the agreement will effectively release claims and avoid litigation. Just as importantly, the correct language will meet the company's myriad goals.