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Does Your Company's Employment Release Cover All The Bases?

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Corporate Counsel and Human Resources Managers are frequently called upon to prepare separation agreements for departing employees. As with any form of agreement, separation agreements can address a wide range of issues including releases of actual or potential claims to covenants not to compete. While many have their favorite "form" from which to work, a periodic review is critical to ensure that any changes in applicable law – or the interpretation of applicable law – are properly integrated into the document.

Obviously, a detailed review of all issues that could be addressed in a separation agreement is beyond the scope of anything other than a law review article or treatise. However, the subject thumbnails set forth below will allow professionals who deal with these forms of agreement to approach them with additional insight.

Releasing Age Claims: The Older Workers' Benefit Protection Act ("OWBPA") establishes certain, irreducible standards for enforceability of a release of a claim under the Age Discrimination in Employment Act (the "ADEA"). While simply meeting the minimum statutory requirements does not satisfy the burden of proving that the release is knowing and voluntary, failure to do so can be fatal to the enforceability of the release.

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The OWBPA requires, at a minimum, that the waiver agreement between the individual and the employer:

- be written in language easily understood by the average employee;
- specifically refer to rights or claims arising under the ADEA;
- not waive rights or claims that may arise after the date of the waiver is executed;
- provide for consideration which is in addition to anything of value to which the individual already is entitled;
- advise the individual in writing to consult with an attorney prior to executing the agreement;
- give the individual at least 21 days within which to consider the agreement;
- provide for a seven-day revocation period.[1]

Moreover, if the employer requests the release in connection with a group or class termination, the employer must provide the employee with at least 45 days to consider the release and provide the employee with detailed information concerning those eligible and ineligible for the separation package.

Child Support Judgments: Some states have taken steps to recover child support judgments with the assistance of employers and their attorneys. Under New Jersey law, judgments for child support docketed with the Clerk of the Superior Court are liens against the net proceeds of settlements negotiated prior or subsequent to the filing of a lawsuit, civil judgments, civil arbitration awards, inheritances or workers' compensation awards. The law defines "net proceeds" as any amount of money in excess of $2,000 payable to the prevailing party or beneficiary after all costs relating to the lawsuit (attorneys' fees, etc.) are deducted from the award. Before an attorney distributes any net proceeds of settlements, judgments, inheritances, or awards to the prevailing party or beneficiary, that attorney must initiate a search of child support judgments to check if the recipient is a child support debtor. If a judgment is found, the attorney must provide the Probation Division with a copy of the settlement within thirty (30) days of identification of the judgment. An attorney who abides by the law will not be liable to the prevailing party, beneficiary, or that person's creditors. Impliedly, an attorney who does not abide by the law could be liable to the child support creditor.

Filing of Administrative Charges: Many separation agreements include broad release language requiring employees to agree not to institute any "proceeding, action, complaint, charge or grievance" against the former employer "in any administrative, judicial, or other forum" with respect to any acts occurring before the date of the agreement. Some courts, such as the United States Court of Appeals for the Third Cir-

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cuit, which has jurisdiction over Delaware, Pennsylvania, New Jersey and the Virgin Islands, have held that a separation agreement including the foregoing language constitute a *per se* violation of the anti-retaliation provisions of the named employment statutes (ADEA, Title VII, the Equal Pay Act, and the ADA) because the purpose of filing an agency charge is not to seek recovery from the employer but to inform the administrative agency, such as the Equal Employment Opportunity Commission ("EEOC"), of possible discrimination. Based on this precedent, employers should be wary of using overly broad releases which waive an individual's right to file an administrative charge.

Agreements Not to Reapply: Employers also should consider including a provision providing that the employee agrees not to seek reemployment. In the absence of such an agreement, should the employer later refuse to rehire the person, it could face a retaliation claim under the applicable federal or state anti-discrimination laws.

Covenants Not to Compete: Often employers wish to include some restriction on an employee's ability to compete or seek to enforce an existing restriction from an employment agreement. Whether or not such restrictive covenants are enforceable depends on state law. In general, courts in New York, New Jersey and Pennsylvania will enforce covenants not to compete to the extent that they are geographically and temporally reasonable and protect certain interests of the employer (such as trade secrets or confidential information). What is reasonable and what constitutes a protectable interest are determined on a case-by-case basis. In addition, each state has certain idiosyncrasies in the manner in which it will enforce such covenants. For example, courts in New York and Pennsylvania have refused to enforce such restrictions where the employer terminates the employment relationship unless the termination is "for cause." Accordingly, employers should not assume that the existence of the covenant will guarantee them the protection that they seek.

Tax Treatment of Payments: Employers and employees are always looking for advantageous ways to structure payments to eliminate or reduce the amount of federal, state and even local taxes on severance payments. While the general rule of thumb should be that all such payments are taxable and, in some instances, also subject to income tax withholding, there may be certain circumstances whereby all or a portion of a payment can be made on a non-taxable basis (*e.g.*, where there are physical manifestations of emotional distress or a physical injury). Where employees are represented by counsel, aggressive attorneys have sought to minimize tax consequences by making part of the payment directly to the employee's attorney for his or her "attorney fee" component of the payment amount. In the past, the IRS has taken the position that the payment to the employee's attorney was "constructively received" by the employee and, therefore, taxable to the employee as well as to his or her attorney as well. The result was, among other things, double taxation. The Civil Rights Tax Relief Act provisions of the American Job Creation Act of 2004 (signed by President Bush on October 22, 2004) creates a special deduction for taxpayers that eliminates this double taxation. Depending upon the amount of money in question and the increased financial burden of income tax obligations of the employer, it may be justified for an employer to look more closely into the set of circumstances to determine if there is a means of characterizing all or a portion of the payment as non-taxable to the employee including, but not limited to, making an appropriate portion of the payment directly to the employee's attorney.

Tender Back of Payments: Severance agreements sometimes require a former employee to repay (a/k/a tender back) to the employer the monies under the agreement in the event the employee violates the terms of the agreement – for example, by filing a complaint in court or breaching the confidentiality of non-compete provisions. Within the context of the ADEA, the EEOC has promulgated regulations that prohibit the enforcement of tender back rules with respect to the filing of administrative charges. Outside of the ADEA context, courts have frequently relied upon general contract principles to find that tender back provisions are appropriate and enforceable if properly drafted. As a result, care must be taken to draft any tender back provision with an eye toward not offending the EEOC's rule while providing the greatest protection for the employer based upon the law of the applicable jurisdiction.

Unemployment Compensation: Upon termination of employment, many employees apply for unemployment compensation benefits, even in those instances where the same employees will be receiving some form of severance payment. The question then becomes whether the severance payment is true "severance" or "payment in lieu of notice." The distinction may be significant depending upon the jurisdiction. For example, under New Jersey law, traditional severance does not affect an applicant's ability to apply for and obtain unemployment compensation; however, "pay in lieu of notice" prohibits an employee from receiving unemployment compensation during the same period they are receiving severance that has been so characterized. When preparing severance agreements, consideration should be made as to how such payments are characterized. Alternatively, some employers factor the amount of unemployment compensation anticipated to be received by the former employee into their determination of the amount of severance to be made to the employee.

Employee Benefits Post Termination: Employers may want to provide group health insurance to employees post-termination. While nothing prohibits such action, care should be taken to make sure the provision of the benefit is done properly and effectively. While many group health insurance contracts permit "active" employees to participate in the benefit plan, most contracts do not cover terminated employees within the definition of eligible participants. As a result, the most effective and ultimately proper way to provide group health insurance to a terminated employee would be to have the employee exercise his or her right to COBRA continuation coverage and for the employer to then make the appropriate monthly premium payment on behalf of the employee (and his or her covered beneficiaries). The structure of this arrangement in any severance or settlement agreement should be very specific and cover various issues including, but not limited to, changes in benefit plans and premiums, the length of time of the employer's obligation to make the premium payment and any conditions precedent to the employer's obligations.

Assignment: Severance agreements usually bind the employer. It is important, however, for the employer to reserve the right to assign its rights and obligations under the agreement. This assignment right should be set forth in the agreement itself as some states do not recognize a general right of assignment without language to that effect in the agreement. While this may not appear to be an important issue, it may rise to that level especially with respect to enforcement of covenants not to compete and confidentiality provisions. In certain cases, it may even be beneficial for the employer to assign its obligations – for example the obligation to provide group health insurance or make periodic payments – to another entity.

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[1] *These requirements do not need to be met where an employee is not releasing a claim under the ADEA. Thus, where the employee is under age 40, the employer does not need to give the employee 21 days in which to consider the agreement (although the employee should have a reasonable period of time in which to do so) and the employer does not have to permit the employee any revocation period.*