SEVERANCE AGREEMENTS: WHAT ARE THEY GOOD FOR?

By: Rachelle E. Hill

Employers frequently use a severance agreement when terminating an employee or when an employee resigns with the hopes of reducing potential liability. In our practice we often advise employers to offer severance pay that is memorialized in an agreement that contains a general release, covenant not to sue and often indicates the employee is resigning. Since an employee has no legal entitlement to severance pay, the majority of times, he or she accepts the offer and typically the employer does not hear anything else from the employee. However, this is not the case with all employees and therefore, it is imperative that employers understand the benefits and downsides to severance agreements and how the EEOC and state unemployment offices view these agreements.

In practice, severance agreements significantly reduce a company's liability exposure by minimizing the risk of litigation and administrative proceedings. Additionally, offering pay that an employee is not already entitled to will often placate an otherwise disgruntled employee by providing additional financial assistance. Typically a severance agreement will offer severance pay and include a confidentiality and non-disparagement clause, a general release by the employee of all claims, and will often indicate that the employee is resigning from his or her employment. However, what if an employee refuses to agree to language indicating he or she resigned or counters with a demand for significantly more pay? In reality, what an employer bargains for is not always what it receives.

Mutual Releases and Covenant Not to Sue. Severance agreements typically require the employee to release the employer from any claims he or she has through the date of the agreement and an express agreement not to sue the employer. Employers are most often concerned about discrimination claims filed with the EEOC or under state law and offer severance in hopes of avoiding any potential claim, which, even if frivolous, can cause a company to incur substantial costs defending the action.

In the EEOC guidelines, it concludes that while a signed release and waiver may be enforceable where it is knowingly and voluntarily consented to, it cannot be used to limit an employee's right to testify or assist in any investigation conducted by the EEOC or prevent an employee from filing a charge of discrimination with the agency (http://www.eeoc.gov/policy/docs/qanda_severance-agreements.html). Additionally, EEOC regulations indicate an employer cannot require an employee to return severance pay prior to filing an age discrimination claim. For other types of claims, the courts vary on whether an employer can require an employee to return the severance pay prior to filing an EEOC charge.

In addition to EEOC guidelines, each state has its own body of law regarding which claims can and cannot be released. In California, an employee can release most state and common law claims by agreement including breach of contract and defamation. (*Skrbina v. Fleming Cos., Inc.,* 53 Cal. Rptr. 2d 481 (Cal. Ct. App. 1996). However, a release will not be effective for claims for disputed wages (Cal. Lab. Code § 206.5), unemployment benefits (discussed below) or the ability to file a charge with the EEOC.

Requiring Employee to Resign. Typically a severance agreement will include language indicating the employee is resigning instead of being terminated. Employers often request this language based on the belief that such language will cut off any claim for unemployment because in states such as California, New York, Maryland and Virginia, an employee that quits his or her job is not eligible for unemployment compensation. However, how should an employer respond when an employee refuses to agree to such language? Is there any real benefit to an employer to mandate such language? The answer in most, if not all, states is that employers should not let this one issue be a sticking point for finalizing a severance agreement.

The Virginia Unemployment Commission has determined that voluntarily leaving, which would disqualify an employee for benefits, does not include situations where an employee quits in lieu of discharge. Specifically, where the only alternative to resigning is that the employee will be discharged, the Virginia Unemployment Commission concludes that this is not a voluntary act and the employee will not be disqualified from receiving benefits.

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In New York, as in Virginia, indicating an employee is resigning instead of being terminated in a severance agreement may not make a difference in the effect on unemployment benefits. Whether the employee is terminated or resigns, they can still be eligible for unemployment benefits. See N.Y. Lab. Law § 593(3). Similar to Virginia, the New York Unemployment Insurance Board has found that "if an employer gives the claimant the choice of leaving or being discharged and the claimant resigns in order to avoid discharge, it is generally held that he does not leave voluntarily." A.B. Case 8936-43 (N.Y. Unemployment Ins. Appeal Bd. 1943); see also In Re Jimenez, 20 N.Y.S.2d 803 (N.Y. App. Div. 2005).

Maryland holds a similar position on resignation in lieu of termination. Maryland's Department of Labor, Licensing and Regulation ("DLLR") focuses on the plain meaning of "leaving work voluntarily," stating that the evidence must show that the claimant intentionally and of his own free will and choice terminated the employment. Further, the DLLR's Division of Unemployment Insurance says that an employee that resigns in lieu of discharge "does not show the requisite intent to quit," however, an employee who resigns instead of facing charges that may lead to discharge is considered to have voluntarily quit.

Similarly, in California, an individual is disqualified for unemployment benefits if they have left their work voluntarily without good cause. However, the Employment Development Department has stated that resignations in lieu of termination or discharge are not voluntary, because the claimant has no choice relative to remaining employed. This is codified in the California Code of Regulations: "An employee who leaves work when asked by the employer to either resign or be fired, or an employee who resigns rather than agree to a forced leave of absence, has not left work of his or her own free will. In these situations, since the employee did not choose to quit, the employer is the moving party in the separation and the employee becomes involuntarily unemployed." Cal. Code Regs. tit. 22, § 1256-1(d). Cases from the California Unemployment Insurance Appeals Board affirm this. *See In Re Pierce*, P-B-218 (Ca. Unemployment Ins. Appeals Bd. 1952) ("[T]he claimant's forced resignation was in no sense voluntary. If he had not resigned, he would have been discharged. Having no real voluntary choice in the matter of continuing his employment, we hold that he was discharged by his employer.").

In Texas, an employee who resigns in lieu of discharge will also be treated as discharged involuntarily. According to the Texas Workforce Commission, separation is involuntary if "initiated by the employer." Thus, the employee would still be eligible for unemployment benefits.

Generally in most states, an employer will still be able to allocate severance payments for any period following separation so that those amounts will be counted as wages in the event the employee later files a lawsuit, EEOC charge, or seeks unemployment compensation. The EEOC follows the "tender back" requirement that any "renege" of promises under a release will invalidate the release, but that severance pay can offset or eliminate subsequent recovery. This generally decreases an employer's overall exposure and reduces any disincentive to offering severance payment.

This article only provides a survey of state opinions on this issue and touches on the issues an employer should be aware of when offering severance. In most cases, it is still highly recommended for an employer to offer severance payment, as it can be an effective way to reduce future liability. But like many issues in law, this is not black and white.

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