

## **FIVE KEY CONSIDERATIONS WHEN DRAFTING A RELEASE**

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Separation agreements almost always contain release provisions whereby one or both parties agree to waive claims that they may have against the other party; when the employee releases claims, he or she typically gains compensation or a benefit that he or she is not already entitled to receive. In a world in which every terminated employee is a potential plaintiff, employers should have a good grasp on how to draft a valid and enforceable release in a separation agreement. Here are five tips every employer should consider when drafting this type of a release.

### **Tip No. 1: Offer Valid Consideration**

In order to have a valid and enforceable release agreement, the employer must provide the employee with payments or benefits the employee is otherwise not entitled to receive. Therefore, payments or benefits the terminated employee is otherwise entitled to receive either by law or pursuant to an employment agreement generally do not satisfy the consideration requirement. For example, conditioning the employee's release on the receipt of his final paycheck, earned commissions or vacation pay specified by an employee handbook or other policy will not constitute valid consideration. While severance pay is the most common type of consideration, it is not the employer's only option. Valid consideration can also include notice pay (i.e., pay in lieu of notice), continuation of health benefits at the employer's expense (note, there are tax issues associated with this approach), bonuses, unearned vacation pay, outplacement services or use of office services (e.g., secretarial, computer access, etc.), or relocation expenses reimbursement, among others..

Again, the most common type of consideration offered in exchange for an employee release is severance pay. However, as mentioned above, this severance pay has to be something other than what the employee is already entitled to receive. For example, if the employer has a severance plan written into an employee handbook in which the employee is entitled to receive one week of severance for each year of service and the payment is not conditioned on a release of claims, the severance payment offered in exchange for a release must exceed what the employee is already entitled to receive. However, there is a simple way around this issue - the written severance plan can expressly condition the receipt of severance upon the employee executing a release. This is discussed in more detail in Tip 2.

In sum, when drafting a release, the employer should always ask: Is this benefit or payment something the employee is already entitled to receive? If it is, then it is not valid consideration and the release will be unenforceable.

### **Tip No. 2: Condition Severance on the Execution of a General Release and Compliance With Other Contractual Provisions**

If the employer negotiates the payment of severance in an employment agreement, it should *always* require the employee to execute a release as a condition of receiving severance (note the timing rules for this requirement discussed in Tip 3). By failing to include this provision, the employee could collect severance and still sue the employer for breach of the agreement, discrimination, or other claims under the employment relationship. Besides conditioning the payment of severance on signing a release, the employer should also condition payment of severance on compliance with other contractual provisions of the agreement such as provisions relating to the return of the employer's documents and property, non-disparagement, noncompetition, nondisclosure of confidential information, and nonsolicitation of customers and employees. Not only does this approach incentivize employees to honor their post-employment contractual obligations, but it also potentially avoids litigation by giving the employer the option to simply discontinue severance payments if the employee breaches the agreement.

### **Tip No. 3: Comply with Section 409A of the Internal Revenue Code**

So far it seems simple—condition receipt of severance payments upon the execution of a release waiving employment claims such as disability discrimination, age discrimination, etc. It seems fair to say that severance payments don't begin until the employee returns the release agreement. However, this type of arrangement creates potential issues under 409A of the Internal Revenue Code ("Section 409A"). Under Section 409A, the concern is that the employee could wait to execute the release until the year following his or her termination in order to control the year in which he or she receives (and is taxed on) the severance payments. Because the severance is taxable when actually paid, the employee could hold on to a release and defer taxation in a manner the IRS deems abusive. The penalties for failure to comply with 409A are harsh (including a 20% excise tax). Although it is the employee who is ultimately penalized, these issues are typically brought up by employee's counsel during negotiations.

There are two common solutions for addressing the problem raised above. First, payment could begin upon a fixed cut-off date following termination of employment so long as the release becomes effective before that date. While this solution is relatively easy to implement, employees may not get their payments as quickly as they would like. Alternatively, the separation agreement could call for severance to begin upon return of the signed release within a fixed window (90 days maximum) following termination of the employment. To avoid the problem of the employee holding on to the release to affect the year the severance is taxable, the agreement would need to provide that if the release consideration period spans two calendar years, then the severance

payments will be made (or commence, as applicable) no earlier than the first day of the second calendar year. While this approach is potentially more desirable for the employee, it can be harder for the employer to administer.

Legal counsel experienced with drafting 409A separation agreements can avoid potential liability by including “safe harbor” provisions or restructuring the agreement. Accordingly, employers should always consult counsel with Section 409A expertise when an employment agreement or separation agreement provides for any form of severance.

#### **Tip No. 4: Use Clear Language in the Release**

To the extent possible, draft an agreement that is simple and comprehensible. The agreement does not need to be a formal, lengthy agreement. Generally for claims to be effectively waived by agreement, the release must be “knowing and voluntary.” To avoid a potential challenge from an employee that their release was not “knowing and voluntary,” an employer should use clear language in the release. Furthermore, an employer should give an employee a reasonable amount of time to consider the release and afford the employee the opportunity to consult separate counsel. Note that the time period for considering and revoking a release might be governed by statute, and many states have specific statutory requirements that must be met in order to obtain an enforceable release.

#### **Tip No. 5: Be as Specific as Possible, but Consider the Requirements of Each Waived Claim**

Depending on the jurisdiction, a court may construe employee releases narrowly, limiting them to claims explicitly released. To avoid the potential challenge of the agreement being overbroad, employers should, if possible, include a release of specific claims (e.g., ADEA, ERISA, Title VII, etc.).

As a result, employers should consider the requirements implicated by each released claim. For instance, a waiver of Age Discrimination in Employment Act (ADEA) claims must comply with the requirements of the Older Workers Benefit Protection Act, 29 U.S.C. §§621 et sq. (“OWBPA”). Under OWBPA, the waiver must be “knowing and voluntary”, as described in the statute. While courts have not traditionally applied the OWBPA requirements to non-ADEA claims, given the particular requirements of the OWBPA, it may be beneficial for an employer who is asking for a release of ADEA and non-ADEA claims to draft a release that complies with the OWBPA requirements.

#### **Concluding Thoughts**

While this list is not by any means exhaustive, it highlights some of the most important considerations in drafting a valid and enforceable release in a separation agreement. As a concluding thought, while obtaining a release can be very desirable, an employer should be tactful in asking for a waiver of claims. Asking for a waiver in a separation agreement could inadvertently suggest that the employer believes that employee has a claim against it. To avoid any unnecessary

litigation, an employer should be thoughtful in its approach to negotiating a release and always consult counsel with expertise in employment law.

## MEET THE TEAM



### **William J. Wortel**

Chicago

[bill.wortel@bclplaw.com](mailto:bill.wortel@bclplaw.com)

+1 312 602 5105

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