Audio Conference Course Material

Buying Peace: What HR Needs to Know About Separation Agreements

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I. SEPARATION AGREEMENTS AND WAIVERS

As you know, employees who have been terminated occasionally assert legal challenges to their terminations. For this reason, when terminating an employee, some employers offer some sort of severance or separation payments in exchange for the employee executing a separation agreement. These separation agreements should contain a provision whereby the exiting employee agrees to waive or release any claims he may have against the employer regarding his termination. This article will provide an overview of some practical considerations to consider in negotiating and drafting a separation agreement, the legal requirements for an effective waiver, and the tax implications of the payments made to the former employee and/or his attorney.

A. Practical Considerations

Separation or settlement agreements are essentially contracts between the employer and the employee in which the employee agrees to waive any claim or potential claim he may have against the employer in exchange for pay or benefits beyond that to which the employee is already entitled. A separation agreement “buys peace” for the employer in the sense that the employee agrees not to assert any legal claims against the employer. For the employee, a separation or settlement agreement can mean additional compensation, benefits or other valuable consideration – such as a neutral reference or outplacement assistance – that the employee otherwise had no right to demand. In addition, a separation agreement can set forth the terms by which the parties will conduct themselves in the future. For example, it may establish that neither party may disparage the other or that the employee will use his best efforts to assist the employer in future litigation or in the protection of intellectual property.

Drafting an enforceable separation or settlement agreement can be challenging. An employer must be aware of the constantly changing statutory requirements of a separation agreement and of the challenges an employee may assert to enforcement of such an agreement. Moreover, frequent changes as to how payments under a settlement agreement are treated under the Internal Revenue Code can have a significant impact on the dynamics of negotiating these agreements. Because there is no one form that fits the varied circumstances of each termination, employers are encouraged to consult counsel with questions in individuals cases.

1. When Is An Employment Separation Agreement Desirable?

There are several situations in which an employment separation agreement may be desirable:

• a termination in which the employee has already asserted a claim against the employer;
• a termination in which the employer is concerned that the employee will likely assert a claim; and
• a termination in which the employer is willing to provide extra pay or benefits above and beyond what the employee would normally be entitled to under the circumstances of her separation, but only in return for a waiver of claims.

Additionally, an employer may want to offer severance to an employee, prior to a discharge, such as when the employee is in performance counseling, has been passed over for promotion, is on a leave of absence, or is otherwise unproductive or unhappy with the company. Such an approach may be particularly appealing when the employee has a severance pay plan and it appears that the employee is headed for a discharge that may be severance-eligible under the plan. Under those circumstances, an early offer of severance (coupled with a release) may bring a quicker end to an employment relationship that is no longer working for either the employer or the employee.

Depending on the situation, the employer must examine carefully the consequences of asking for a waiver of claims. While releases in separation agreements are desirable to compromise and end disputes existing at the time of termination or likely to be raised by the employee in the future, caution is advisable when the dispute is only potential and has not been raised by the employee. By asking for a waiver, the employer may inadvertently suggest to the employee that he or she has a claim against the employer. Moreover, when no actual dispute has been raised by the employee at or before her termination, and the employer requests a release to cover claims that are only potential, there is danger that, if the employee refuses to execute the release, the request for the release may be admissible as evidence to raise an inference that the employer committed misconduct in connection with the termination.1

Finally, many companies have a standard practice of offering severance agreements to departing employees, or maintain an ERISA-governed severance pay plan. In the latter situation, of course, the terms of the plan govern, and failure to adhere to plan terms will likely constitute a breach of fiduciary duty. 29 U.S.C. § 1109(a)(1)(D). Aggrieved employees can bring suit to enforce the administration of ERISA-governed plans in accordance with their terms. 29 U.S.C. § 502(a)(1)(B). Of course, employers may also offer non-ERISA-governed severance plans in the absence of or in addition to an ERISA-governed plan. In such cases, employers must still be careful to apply such plans and their terms consistently (or be able to explain deviations from past practice or differences between seemingly similar employees) to avoid claims that disparate severance offerings are due to a protected status.2

1 See Cassino v. Reichhold Chem., 817 F.2d 1338 (9th Cir. 1987), cert. denied, 484 U.S. 1047 (1988); but see Fed. R. Evid. 408; see also, Pierce v. F.R. Tripler & Co., 955 F.2d 820, 827 (2d Cir. 1992).

2. **Effective Techniques in Negotiating An Employment Separation or Settlement Agreement**

- Be aware of company practice/policy with respect to similar situations.
- Follow any company policy, including any ERISA-covered severance pay plan.
- Be very cautious about offering severance to a current employee; let that person raise the issue first.
- In the event of a termination where no severance plan or company practice is implicated, conduct an exit interview when an employee is terminated and invite the employee to speak freely. From the substance of this interview and a review of the surrounding circumstances, gauge whether: (a) the employee is asserting a claim; and (b) the employer faces possible exposure. Consultation with an attorney can be essential to make this evaluation.
- If you are interested in “buying peace” from the employee, indicate that you are willing to enter into a comprehensive separation agreement, probably best characterized initially as “a means for us to part ways amicably and without any future disputes.”
- If the employee expresses an interest in an amicable separation with some type of enhancement, then present (or prepare) an appropriate agreement.
- Be prepared to negotiate. In individual terminations, the employee almost always seeks to negotiate the consideration and the terms of the agreement. Beware of using the last “form” that was heavily negotiated since negotiations always begin from what you offer in the first draft of the agreement. Moreover, the fact that the agreement was negotiated will help if challenges to its enforceability are thereafter made.
- Draft the agreement in as simple and comprehensible language as possible.
- If a waiver of an ADEA claim is sought, comply with all OWBPA requirements.
- Even if the OWBPA requirements do not apply, allow the employee a reasonable period of time to think over the matter, taking the proposed agreement with him if desired, and afford the employee the opportunity to consult counsel of his choice.

3. **Necessary Terms in a Separation/Settlement Agreement**

- For separation agreements in particular, a statement of the last date of employment, the last date on active payroll, and the last day of company provided benefits eligibility;
• an acknowledgment by the employee that he or she has received all wages, bonuses, vacation pay and other benefits and compensation due the employee by virtue of his or her employment;

• acknowledgment of payment by the employer of consideration to which the employee is not otherwise entitled;

• the employee’s general release of all claims, known and unknown, that the employee has or could have against the employer, including but not limited to specified statutory employment claims as well as a promise not to file any claims in the future arising out of the employment relationship;

• that it is a compromise and in full settlement of disputed claims between the parties;

• a statement that the employee is responsible for his/her own attorneys’ fees and costs;

• a statement that none of the benefits being given to the employee have been assigned or are not subject to alienation (i.e., personal bankruptcy);

• an acknowledgment by the employee that he or she understands the agreement fully, has had sufficient opportunity to review it (21 or 45 days in the case of ADEA claims) with counsel of his or her choice (and has been advised to review it with counsel in the case of ADEA claims), and executes it knowingly and voluntarily;

• an express denial by the company of the validity of the employee’s disputed claims and a statement that nothing contained in the agreement may be used or viewed as an admission of liability;

• an allocation of the consideration between taxable and non-taxable payment, if appropriate, and the employee’s indemnity of the employer against any liability arising from the allocation;

• an exclusion from the release of benefits in which the employee is vested by contract or law; and

• the employee’s ongoing duty to maintain the employer’s trade secrets.

4. Optional Terms in a Separation/Settlement Agreement

• continuation of salary and certain benefits in lieu of a lump sum payment, and what happens in the event of death prior to payment of all salary continuation;

• outplacement counseling;
the employee’s agreement not to apply for reemployment and waiver of any rights
to be recalled to employment in the future;

maintenance of the confidentiality of the agreement and the details of the
separation by both the employee and his or her attorney;

how the employer will respond if the employee files for unemployment insurance;

a statement that any ambiguity in the agreement will not be construed
presumptively against any party;

no-solicitation or non-compete provision, where and to the extent lawful;

the purging of objectionable materials from the employee’s personnel file;

an agreed-upon (but truthful!) letter of recommendation or some other limitation
on future references;

a provision requiring the employee to cooperate in connection with any
investigation, regulatory matter, lawsuit or arbitration in which the employee has
pertinent information and whether or not the employee will be reimbursed for
expenses or otherwise compensated for her cooperation;

at the employer’s option, return of the consideration or payment of liquidated
damages if the employee breaches any provision in the agreement;

arbitration of any future disputes concerning the agreement;

an award of attorneys’ fees to the prevailing party in any action to challenge,
enforce or interpret the separation agreement (this must be mutual);

if a lawsuit or an administrative charge has already been filed, a stipulation of
dismissal or withdrawal with prejudice should be appended to the separation
agreement;

a provision prohibiting the employee from encouraging or co-operating in the
prosecution of actions by other employees, unless required to do so by legal
process or other requirement and requiring notice when such process is served on
the employee;

execution by the employee’s attorney, if any; and

customary legal requisites (e.g., notice provisions, integration, severability,
governing law, execution in counterparts).
5. Must the Agreement Be Drawn Up in a Formal, Lengthy Manner?

No. Especially in the case where the employee has not retained counsel, oftentimes a letter agreement, which is equally valid, will make the process less imposing and decrease the prospect that there will be any issues enforcing the agreement.3

B. REQUIREMENTS OF AN EFFECTIVE WAIVER

In addition to the practical considerations a company should consider with regard to any separation agreement or waiver it requests from an employee, there are many legal considerations that must be taken into account in order to have a valid and effective waiver.

1. Waivable vs. Non-Waivable Claims

As a general matter, both federal and state laws encourage the settlement and waiver of claims.4 However, not all claims may be waived. There are federal and state claims that specifically prohibit waiver and others that only permit waiver under certain circumstances.

a. What Can be Waived

Claims arising under federal law are generally waivable. This includes claims arising under Title VII, the ADA, and ERISA. For example, in the context of Title VII, the Supreme Court has declared that “in enacting Title VII, Congress expressed a strong preference for encouraging voluntary settlement of employment discrimination claims.” Claims arising under the ADEA are also waivable, although employers must follow certain guidelines set out in the OWBPA, as described infra.5 Also, like federal claims, claims arising under state law are generally waivable. Of course, state law controls in determining which state law claims are waivable.

There is some disagreement on the question of whether claims arising under the FMLA may be waived in a release. The regulations enacted pursuant to the statute indicate that “employees cannot waive, nor may employers induce employees to waive, their rights under the FMLA.” See 29 C.F.R. 825.220(d). This provision has been interpreted by a number of courts to mean that employees cannot waive their rights under the FMLA prospectively.6 This position is accurately described as the majority view. However, not all courts concur in this assessment of employees’ ability to waive FMLA claims. In Taylor v. Progress Energy, Inc., 415 F.3d 364

3 Compare Dillard v. Starcon Int’l Inc., No. 05-470 (7th Cir. April 18, 2001) (enforcing oral settlement to settle employment dispute).
4 See, e.g., Williams, 23 F.3d at 935 (stating that “public policy favors voluntary settlement of claims and enforcement of releases”).
5 Although individual employees, union and non-union, may waive rights under the ADEA or Title VII, unions may not waive an employee’s ADEA or Title VII rights through collective bargaining. See EEOC v. Bd. of Governors of State Colleges and Univs., 957 F.2d 424 (7th Cir. 1992) (holding that “it is well established that unions cannot waive employees’ ADEA or Title VII rights through collective bargaining”).
6 See, e.g., Faris v. Williams WPC-I, Inc., 332 F.3d 316, 321 (5th Cir. 2003) (“A plain reading of the regulation is that it prohibits prospective waiver of rights, not the post-dispute settlement of claims.”)
(4th Cir. 2005), the Fourth Circuit ruled that the regulation did, in fact, invalidate post-dispute waivers of FMLA claims by employees. In other words, it invalidated both prospective and retrospective waiver of FMLA claims. On rehearing this judgment was vacated by the Fourth Circuit, but other courts have cited this opinion favorably in reaching an identical conclusion.²

Lastly, with the exceptions noted below, employees can waive claims that they are unaware of at the time they sign a release.³

b. What Cannot be Waived

Although public policy favors the voluntary settlement of claims, there are some claims that cannot be waived. First, employees cannot waive prospective claims, that is, claims arising after the date of a release. This is true for nearly all claims. For example, in the Title VII context, the Supreme Court has determined that “there can be no prospective waiver of an employee’s rights under Title VII.”⁹ The same holds true for ADEA and ADA cases.¹⁰

Second, claims under the Fair Labor Standards Act generally cannot be waived absent consent from a court or the U.S. Department of Labor.¹¹ This prohibition is found in 29 U.S.C. 216(c), which bestows authority solely on the Secretary of Labor to supervise any waiver. Authority for court supervised waiver for FLSA claims stems from the Supreme Court’s holding in D.A. Schulte, Inc. v. Gangi, 328 U.S. 108 (1946).

Third, under certain circumstances, employees cannot waive claims arising under the False Claims Act (FCA). This federal law allows whistleblowers to file lawsuits against individuals or companies that are defrauding the government. The FCA itself stipulates, in 31 U.S.C. § 3730(b)(1), that once a lawsuit has been filed, the action cannot be dismissed unless the court and the Attorney General give their written consent. Although the statute does not address releases entered into before the filing of a lawsuit, courts have ruled on public policy grounds that, in most instances, employees cannot waive their right to bring a claim prior to actually filing a lawsuit.¹²

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² See Dougherty v. Teva Pharm. USA, Civ. Action No. 05-2336, 2006 WL 2529632, at *7 (E.D.Pa. Aug. 30, 2006) (“Based on the language of the regulation, we find that § 825.220(d) prohibits an employee from waiving the right to sue for FMLA violations through a severance agreement.”)

³ See, e.g., Bickings v. Bethlehem Lukens Plate, 82 F. Supp. 2d 402, 406 (E.D. Pa. 2000) (holding that “a release that bars unknown claims will be enforced, even if a party claims that it was unaware of the matter at the time the release was executed”); Wagner v. NutraSweet Co., 95 F.3d 527, 533 (7th Cir. 1996) (enforcing release that applied to both “known and unknown” claims).


¹¹ See Lynn’s Food Stores, Inc. v. United States Dept. of Labor, 679 F.2d 1350, 1352-53 (11th Cir. 1982).

¹² See United States ex rel. Green v. Northrop Corp., 59 F.3d 953, 962-969 (9th Cir. 1995); but see United States ex rel. Hall v. Teledyne Wah Change Albany, 104 F.3d 230, 233 (9th Cir. 1997) (holding that a release entered into prior to the filing of a lawsuit was enforceable because the United States already had knowledge of the potential
Fourth, the EEOC has taken the position that employees cannot waive their right to file charges with the EEOC. The EEOC itself announced this policy in an enforcement guidance document. According to this document, any attempt to restrict an employee’s ability to file a charge though a release would be null and void. Recently, some courts have taken this a step further and characterized an employer’s attempt to prevent an employee from filing a charge as retaliatory. However, other courts have ruled that such attempts, while null and void, do not rise to the level of retaliation. Regardless of whether such a provision constitutes retaliation, it is clear that an employee can agree to waive his right to recover in any lawsuit brought by himself or by the EEOC on his behalf.

Fifth, employers also need to be aware of some potential pitfalls regarding waiver of claims under WARN. A number of circuits have indicated that employees can waive claims arising under WARN and that waiver of these claims need not be express. However, general releases, for example, those typically included in severance agreements, may not apply to WARN in some circumstances.

Finally, at the state level, worker’s compensation claims and unemployment compensation claims are typically not waivable, although this varies by state. In a number of states, before an employee can agree to waive claims under the worker’s compensation statute, the waiver must be approved by a board or other governmental entity. Likewise, most states do not allows employees to waive their statutory right to file a claim for unemployment compensation benefits.

In limited circumstances, an employer may elect to move forward with a settlement, even though aspects of the release may be invalid. For example, an employer may

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13 See EEOC Notice No. 915.002 (Apr. 10, 1997).
15 See E.E.O.C. v. Sundance Rehabilitation Corp., 466 F.3d 490, 500-01 (6th Cir. 2006); see also, Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 28 (1991) (an individual who signs an agreement to submit an employment discrimination claim to arbitration remains free to file a charge with the EEOC); EEOC v. Cosmair, Inc., 821 F.2d 1085, 1090 (5th Cir. 1987) (invalidating former employee’s promise not to file a charge with EEOC because it could impede EEOC enforcement of the civil rights laws and is void as against public policy); EEOC v. U.S. Steel Corp., 671 F. Supp. 351, 357-59 (W.D. Pa. 1987) (invalidating as contrary to public policy retirement plan provision that conditioned higher benefits on retiree’s promise not to file charges with the EEOC).
16 See Wastak v. Lehigh Valley Health Network, 342 F.3d 281, 291-92 (3d Cir. 2003) (declaring that “[a]n employee may validly waive the right to recover in his own lawsuit as well as the right to recover in a suit brought by the Commission on his own behalf”).
18 See, e.g., Allen v. Sybase, Inc., 468 F.3d 642, 655 (10th Cir. 2006) (general release signed prior to “Mass layoff” did not release other WARN claims).
elect to resolve a wage claim without getting approval from a court or the department of labor. Among other reasons, an employee who is satisfied with the resolution of a matter is not likely to initiate litigation, even though the release signed is not formally binding. Furthermore, it may be possible to draft an agreement to include factual statements that could make it difficult to assert a claim later. Such an approach involves calculated risk and the employer may wish to consult with counsel regarding how to draft the agreement.

2. Enforceability

In order to effectuate a waiver, an employer must demonstrate there was adequate consideration and that the employee waived their claims knowingly and voluntarily. Once an employer has established this, an employee can only challenge a waiver on the grounds that it was given under duress or because of fraud or mistake.

One requirement for a valid and enforceable waiver is adequate consideration. Adequate consideration will be sufficient to uphold a release or waiver. Assuming there is adequate consideration, courts then turn to the question of whether the release or waiver was entered into knowingly and voluntarily.

Courts addressing the issue of whether an employee entered into a waiver knowingly and voluntarily have utilized two separate approaches in order to reach an answer. The majority of courts apply a “totality of the circumstances” test. Under this analysis, the court examines a number of factors, including:

(1) the employee’s education and business experience;
(2) the employee’s input in negotiating the terms of the settlement;
(3) the clarity of the agreement;
(4) the amount of time the employee had for deliberation before signing the release;
(5) whether the employee actually read the release and considered its terms before signing it;
(6) whether the employee was represented by counsel or consulted with an attorney;

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19 See Forsythe v. BancBoston Mortg. Co., 135 F.3d 1069 (6th Cir. 1997) (dismissing forfeiture action was adequate consideration for release).

20 The First, Second, Third, Fifth, Seventh, Tenth, and Eleventh Circuits apply this totality of the circumstances approach. See Pierce, 65 F.3d at 570 (providing list of circuits); Rivera-Flores v. Bristol-Myers Squibb Caribbean, 112 F.3d 9, 10 (1st Cir. 1997).
(7) whether the consideration given in exchange for the release and accepted by the employee was greater than the benefits to which the employee was already entitled under contract or by law; and

(8) whether the employee’s release was induced by improper conduct on the defendant’s part.21

Essentially, this approach requires the court to look at the circumstances surrounding the release or waiver in addition to examining it under basic contract law.

Other circuit courts do not utilize a totality of the circumstances approach, but instead analyze a waiver or release under state law contract principles.22 This approach simply evaluates whether the release or waiver passes muster under the relevant state’s contract law. This is a less rigorous analysis than the totality of the circumstances approach.

In order for an employee to contest the enforceability of a waiver, the employee must demonstrate that the waiver was the product of duress, fraud, or a mutual mistake. In some instances, courts have accepted an insufficient amount of time to consider the terms of a waiver to constitute duress.23

As for proving fraud as a defense to signing a waiver, an employee must generally show that the employer affirmatively misrepresented a material element and that the employee relied on this misrepresentation to his detriment. If the employee can demonstrate that fraud was involved in the waiver, then the waiver was not made knowingly and voluntarily and is therefore unenforceable. Similarly, if both the employee and the employer signed a waiver based on a mutual mistake, then the waiver will not be enforceable. However, if only one party was mistaken, courts will enforce the waiver, absent an additional showing of fraud or duress.

3. Older Workers Benefits Protection Act

In 1990, Congress passed the Older Workers Benefits Protection Act (“OWBPA”), as an amendment to the ADEA. The OWBPA created substantive and procedural requirements that must be met in order to have a valid and enforceable waiver or release of an ADEA claim.24

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21 Pierce, 65 F.3d at 571.

22 The circuits subscribing to this approach are the Fourth, Sixth, and Eight Circuits. See Pierce, 65 F.3d at 570.

23 See, e.g., Puentes v. United Parcel Serv., Inc., 86 F.3d 196, 198-200 (11th Cir. 1996) (holding that there is no bright line regarding how much time an employee must have to consider a release, but that “absent some reason for urgency, twenty four hours is too short a period”); Paolillo, 821 F.2d at 81 (holding that the district court erred in determining that employees’ waiver was voluntary when the employees were only provided a few days to determine whether to sign the waiver and retire).

24 The minimum requirements for a valid waiver set forth in the OWBPA only apply to ADEA claims, not other federal claims such as those arising under Title VII or ERISA. Madrid v. Phelps Dodge Corporation, No. 06-2106, 2006 WL 3423474 (10th Cir., Nov. 29, 2006).
a. **Requirements of the OWBPA**

Unless the statutory requirements of the OWBPA are met, a release of an ADEA claim is not knowing and voluntary and is, therefore, invalid. Pursuant to the OWBPA, in order to be knowing and voluntary, and thus valid, a waiver of an ADEA claim must:

1. be part of a written agreement that is reasonably calculated to be understood by the employee;
2. refer specifically to rights or claims arising under the ADEA (referencing the ADEA by name);
3. not encompass future ADEA claims (rights or claims arising after the date of the waiver);
4. be given in exchange of consideration that is over and beyond any benefit to which the employee is already entitled;
5. advise the employee, in writing, to consult with an attorney prior to signing the waiver;
6. give the employee adequate time to consider the waiver prior to signing it.

For an individual termination, the employee must be given 21 days to consider the waiver. For an exit-incentive or other employment termination program offered to a group of employees, the employees must be given at least 45 days. However, in settlement of a pending EEOC charge or court case, only a “reasonable period of time” is required.

In addition, the EEOC passed additional regulations in 2000 that provide that in order to be effective, a waiver cannot impose any conditions precedent, penalties, or other limitations (such as a covenant not to challenge the waiver) that adversely affect an employees right to challenge the waiver, including provisions requiring the employee to tender back consideration received and provisions allowing employers to recover attorneys’ fees and/or damages because of the filing of an ADEA claim.

Furthermore, in the case of a group-incentive program, the employer must also disclose in writing at the commencement of the 45-day time period: (1) the groups of employees

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25 29 U.S.C. § 626(f); 29 C.F.R. § 1625.22(a). See also, Thomforde v. IBM, 406 F.3d 500, 503 (8th Cir. 2005) (“The statutory requirements for waiver of ADEA claims are strict and unqualified; if an employer fails to meet any of the statutory requirements, the waiver is ineffective as a matter of law.”), citing Oubre v. Entergy Operations, Inc., 522 U.S. 422 (1998).

26 See EEOC v. Johnson & Higgins, 5 F. Supp. 2d 181 (S.D.N.Y. 1998)(finding that an employers post-judgment settlement offer of $1000 in exchange for ADEA release did not constitute adequate consideration as the employees were already entitled to the award of back pay and damages.


28 29 C.F.R. § 1625.23(b).
eligible for the program; (2) the program requirements; (3) any time limitations under the program; and (4) the job titles and ages of all employees eligible or selected for the program and the ages of all individuals in the same job classification or organizational unit who are not selected or eligible. This information must also be provided in writing in a manner calculated to be understood by the average person eligible to participate in the program.

b. Clarification of Requirements

While some of the requirements for valid waivers of ADEA rights and claims are self-explanatory, such as the need to reference the ADEA by name, others require a little more guidance from the regulations and subsequent case law.

i. Knowing and Voluntary

In addition to the requirements outlined in the statute and regulations, if there is a material mistake, omission, or misstatement in the content of the waiver, the waiver may be considered to not have been given voluntarily and knowingly. However, this material error need not be intentional or actually relied upon by the employee to invalidate the waiver agreement.

Furthermore, the statutory requirements of the OWBPA are the minimum standards for creating a voluntary and knowing waiver. Common law “circumstances such as fraud, duress, or coercion in connection with the execution of the waiver may render an ADEA waiver not ‘knowing or voluntary.’” As in other circumstances, courts have utilized the “totality of the circumstances” standard to determine whether a waiver is knowing and voluntary once it has been determined that the requirements of the OWBPA have been met. “Examples of additional, non-statutory factors that may be considered under the ‘totality of the circumstances’ test are whether the employee was subject to fraud, duress, coercion, or mistake of material fact, the employee’s education and business experience, the clarity of the agreement, and the employee’s access to counsel.”

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29 29 U.S.C. § 626(f)(1)(H). See also, Currier v. United Techs. Corp., 393 F.3d 246, 251 (1st Cir. 2004)(the OWBPA protects older workers “who are terminated as part of a group, providing them access to information that might assist them in legal challenges to their layoffs.”).


31 29 C.F.R. § 1625.22(a)(3).

32 Parsons v. Pioneer Seed Hi-Bred Intern., Inc., 447 F.3d 1102, 1105 (8th Cir. 2006).


34 Wells v. Xpedx, a Division of International Paper Co., No. 8:05-cv-2193-T-EAJ, 2006 WL 3133984 (M.D. Fla. Oct. 31, 2006)(recognizing that the 11th Circuit has adopted the totality of the circumstances test if the OWBPA requirements have been met); Wastak, 342 F.3d at 281; Bennett v. Coors Brewing Co., 189 F.3d 1221 (10th Cir. 1999); Griffith v. Novation, LLC, Civil Action No. 3:04-cv-2059-D, 2006 WL 1374017 (N.D.Tex. May 18, 2006)(applying the totality of the circumstances in Texas, which is in the 5th Circuit).

Suspicious or absurd facts surrounding the execution of the waiver can also give rise to the finding that it was not entered into knowing and voluntary. For instance, in *Johnson & Higgins*, the court found that there was a question of material fact regarding the knowingly and voluntarily standard based, in part, on the fact that liability had already been established and the employees accepted $1000 as consideration even though the EEOC had valued their claims at between $3 and $10 million each.36

ii. Wording of the Agreement

The OWBPA provides that a waiver must be written in a manner calculated to be understood by the individual, or by the average individual eligible to participate in an exit-incentive program.37 In clarifying this standard, the regulations provide that:

1. the entire agreement must be in writing;

2. to make the waiver agreement comprehensible, an employer must consider the comprehensive abilities and education level of the individual party to agreement, or of the average individual eligible to participate. Technical jargon and long, complex sentences should be avoided; and

3. the waiver must clearly and accurately describe the advantages and disadvantages without exaggerating either. It cannot be misleading or misinforming to participants.38

When drafting the waiver, the employer should be sure that the waiver does not contain language that is ambiguous or contradictory. In *Thomforde v. IBM*, the Court invalidated a waiver on the basis that it was not drafted in manner calculated to be understood by the intended recipients.39 In *Thomforde*, the waiver in question contained language releasing IBM from all claims, including under ADEA, but also contained a covenant not to sue which specifically excluded ADEA claims.40 The court found this language to be ambiguous, and therefore not written in a manner calculated to be understood by the employee, because the subtle difference between a release and a covenant not to sue are not apparent to the lay person.41

iii. Required Time Periods

As established by the OWBPA, employees are either entitled to at least 21 or 45 days to review the waiver before agreeing to sign it.42 However, the clock does not start to run

36 *Johnson & Higgins*, 5 F. Supp. 2d 181.
38 29 C.F.R. § 1625.22(b).
39 *Thomforde v. IBM*, 406 F.3d 500 (8th Cir. 2005)
40 *Id.*
41 *Id.* at 504 – 505.
until the employer has made its final offer. A material change in the offer restarts the clock, while a non-material change does not. Importantly, employees and employers can agree that changes, regardless of materiality, will not restart the review time period.

An employee, while entitled to the 21 or 45-day time period, may sign the agreement before such time has expired, so long as the employees choice to do so is made voluntarily and knowingly and is not induced by the employer through fraud, misrepresentation, or threat to withdraw or alter the offer prior to the expiration of the applicable time period. If the employee does sign the waiver prior to the expiration of the applicable time period, the employer may expedite the processing of the agreed-upon consideration.

Furthermore, the applicable time period only applies to the decision to sign the waiver, not to the decision whether to accept a termination program. The fact that an employee is given less time to decide whether to quit or transfer to a new position does not shorten the statutory review period, nor does it violate the OWBPA so long as the statutory period is given to review the waiver.

Although the OWBPA gives the employee either 21 or 45 days to consider the waiver, the employer may revoke the agreement during that time. The requisite time period is only relevant to the issue of whether the employee’s waiver was voluntary and knowing, it does not constitute an irrevocable power of acceptance.

The OWBPA also requires the employee be given 7 days after executing the release in which to revoke his waiver. The waiver shall not become effective before this revocation period has expired. Furthermore, the employee and the employer cannot shorten this revocation period by agreement.

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43 29 C.F.R. § 1625.22(e)(4).
44 Id. Employers should look to existing law to determine whether a change is material.
45 29 C.F.R. § 1625.22(e)(4).
46 29 C.F.R. § 1625.22(e)(6).
47 Id.
48 Blackwell v. Cole Taylor Bank, 152 F.3d 666, 670 (7th Cir. 1998).
49 Id.
50 Ellison v. Premier Salons Int’l., Inc., 164 F.3d 1111 (8th Cir. 1999).
51 Id. at 1115; Marks v. New York Univ., 61 F. Supp. 2d 81, 89 (S.D.N.Y. 1999).
53 Id.
54 29 C.F.R. § 1625.22(e)(5).
c. Disclosures Required for Exit Programs

Pursuant to the OWBPA, if the employer is conducting a group exit-incentive program, the employer is required to provide employees, in writing, with any class, unit, or group of individuals covered by such program (the “decisional unit”), any eligibility factors for such program, and any time limits applicable to such program, as well as the job titles and ages of all individuals in the decisional unit who are eligible or selected for the program and those who are not. Failure to comply with these requirements will render any waiver of claims in connection with the program invalid.

i. Exit Incentive Programs

Pursuant to the OWBPA, “if a waiver is requested in connection with an exit incentive or other employment termination program offered to a group or class of employees,” each employee must be “given a period of at least 45 days within which to consider the agreement” and also given detailed information concerning the group of individuals covered by the program (the “decisional unit”), program eligibility, and other factors enabling the employee to make an informed choice whether to participate in it.

The terms “exit incentive [program]” and “employment termination program” are not statutorily defined. However, Department of Labor regulations state that “exit incentive programs” are usually voluntary programs offered to a group or class of employees where the employees receive adequate consideration in exchange for their voluntary resignation and execution of a waiver. “Other employment termination programs” involve an involuntary termination of a group or class of two or more employees (i.e. a RIF) who are offered additional consideration in return for an executed a waiver. Typically, an involuntary termination program contains a standardized formula or package of benefits available to affected employees whereas an “other” program consists of such a package “designed to induce employees to sever their employment voluntarily.” The Seventh Circuit has commented in the group reduction context that “outright termination is merely the extreme case of creating an exit incentive . . .

57 29 U.S.C. §§ 626(f)(1)(F)(ii), (H); 29 C.F.R. § 1625.22(f)(1). On the other hand, if the waiver is not requested in connection with an exit incentive or other employment termination program, the employer need give only 21 days notice and need not give information about eligibility or other factors relevant to the employee’s decision. Id. § 626(f)(1)(F)(i). Regardless, the waiver must be supported by consideration. Id. § 626(f)(1)(D).
employers] will often couple the termination of a group of employees with a severance offer conditioned on a waiver of rights, and in such a case there is both offer and choice, though not a choice of whether to stay or leave. 61 At bottom, “if the program creates an incentive to leave, it is within the statute, even if it is not described in those terms.” 62 For example, a group termination program was found where an employer eliminated five of ten quality control inspectors during a department restructuring without any indication that the terminations were done on the basis of individual work performance and waivers were included in a standardized package of benefits offered to each. 63

ii. Decisional Units

The decisional unit is the portion of the employer’s organizational structure from which the employer chose the persons who would be offered consideration for the signing of the waiver and those who would not. 64 Although the decisional unit is typically no broader than the facility, whether the decisional unit is a subgroup within a facility, the facility, or several facilities depends on the particular facts of each situation. 65

The following are some examples provided by the regulations in determining the appropriate decisional unit:

a. An employer is attempting to reduce its workforce at a particular facility in an effort to eliminate excessive overhead, expenses, or costs from its organization at that facility. If the employer’s goal is the reduction of its workforce at a particular facility and the employer undertakes a decision-making process by which certain employees of the facility are selected for the program and others are not selected for a program, then that facility generally will be the decisional unit. 66

b. If the employer seeks to terminate employees by exclusively considering a particular portion or subgroup of its operations at a specific facility, then that subgroup or portion of the workforce at that facility will be considered the decisional unit. 67

61 Blackwell, 152 F.3d at 669. See also, Burch v. Fluor Corp., 867 F. Supp. 873, 877-78 (E.D. Mo. 1994) (‘juxtaposition of the terms ‘exit incentive’ program and ‘other employment termination program’ indicates that the universe of other programs includes non-incentive programs).

62 Id.


c. If the employer analyzes, considers, and compares its operations at several facilities and determines to focus its workforce reduction at a particular facility, then by the nature of the employer’s decision-making process the, decisional unit would include all considered facilities and not just the facilities selected for the reductions.68

d. An employer decides that ten percent of the employees in the Springfield facility will be terminated within the next ten days. In this situation, the decisional unit is the Springfield facility.69

e. If the employer decides that fifteen of the employees in the Computer Division will be terminated in December, then the decisional unit is the Computer Division.70

f. If the employer decides that one-half of the workers in the Keyboard Department of the Computer Division will be terminated in December, then the decisional unit is the Keyboard Department.71

g. If the employer decides that ten percent of the employees who report to the Vice President for Sales, wherever they are located, will be terminated immediately, then the decisional unit is all employees reporting to the Vice President for Sales.72

h. If the employer decides that ten percent of all accountants, wherever they are located, will be terminated next week, then the decisional unit is all accountants.73

i. A number of small facilities with interrelated functions and employees in a specific geographic area may comprise a single decisional unit.74

j. If the employer utilizes personnel for a common function at more than one facility, the decisional unit for that function (e.g., accounting) may be broader than the one facility.75

70 Id.
71 Id.
72 Id.
73 Id.
k. A large facility with several distinct functions may comprise a number of decisional units. If a single facility has distinct internal functions with no employee overlap (e.g., manufacturing, accounting, human resources), and the program is confined to a distinct function, a smaller decisional unit may be appropriate.  

It is important to remember that the decisional unit may encompass more than one plant or facility. For instance, when a company considers several plants producing similar products for closure, and employees at the non-closed plants may assume the work of the closed plant, the decisional unit could encompass the employees at the plants that were not closed.

On the other hand, if an employer does not consider employees at other locations, the decisions unit is properly limited to the local or regional plants under consideration. In *Burison v. McDonald’s Corp.*, 455 F.3d 1242, 1245 (11th Cir. 2006), the employer reduced its domestic business divisions from five to three and its domestic business regions from thirty-eight to twenty-one. Specifically, McDonald’s “former Atlanta region merged with the former Nashville and Greenville regions to form a new Atlanta region.” *Id.* Employees terminated as a result of the merger brought suit under the ADEA, arguing that the releases they executed upon termination were unenforceable because McDonald’s included in them information solely from the three merged regions as opposed to nationwide age and position data. *Id.* at 1248. However, relying on EEOC regulations, the court found that the evidence demonstrated that the 208 employees chosen for termination all came from the Atlanta, Nashville, and Greenville regions and were considered for employment only in the new Atlanta region. *Id.* at 1248–49. “Given that the relevant regulations define the appropriate decisional unit as those who were considered for jobs in the same process as the terminated employees,” McDonald’s properly limited its provision of data to that regarding the 208 employees. *Id.* at 1249. Consequently, the releases signed by plaintiff’s based thereon were valid and their suit was barred. *Id.* at 1243, 1249. See also, *Adams v. Moore Bus. Forms, Inc.*, 224 F.3d 324, 330 (4th Cir. 2000) (finding that decisional unit did not include other plants where there was no evidence that the company actually considered employees at other plans for lay-off).

### iii. Information Required

In addition to disclosing the decisional unit, the employer must disclose any eligibility factors, applicable time limits, and job titles and ages of all individuals in the decisional unit who are eligible or selected for the program and those who are not. In a termination of persons in several established grade levels and/or other established subcategories within a job category or job title, the information must be broken down by grade level or other subcategory. The use of age bands broader than one year (e.g., “age 20-30”) is not acceptable. If an employer combines information concerning both voluntary and involuntary

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77 *Griffin*, 62 F.3d at 368.
78 29 C.F.R. § 1625.22(f)(4)(iii).
terminations, it must present the information in a manner that distinguishes between voluntary and involuntary terminations. 80

If an involuntary termination program in a decisional unit takes place incrementally over time, information supplied should be cumulative, so that employees terminated later are provided ages and job titles or job categories, as appropriate, for all persons in the decisional unit at the beginning of the program and all persons terminated to date. However, there is no duty to supplement the information given to employees terminated earlier so long as the disclosure, at the time it is given, conforms to legal requirements. 81

In disclosing the “eligibility factors,” recent case law has indicated that this includes more than merely defining the pool of employees examined; rather, employers must disclose the actual factors used to analyze the individual employees in determining which employees to retain and terminate. 82

As with all of the requirements of the OWBPA, the information must be presented in a manner understandable to the average worker. The determination of whether a particular disclosure satisfies this requirement must be made on a case-by-case basis. 83

1. whether the company used the proffered titles and classifications in its work processes prior to the RIF;
2. whether the titles and classifications were used in assessing or choosing workers to be included in the RIF; and
3. whether the titles and classifications were meaningful to the average worker in their understanding of the workplace and the RIF procedures. 84

The employer must also provide the age information in such a manner that is understandable. 85

In addition to providing the information in a understandable way, the employer must also ensure that the employees are able to use the information to determine the ages of the

81 29 C.F.R. § 1625.22(f)(4)(vi).
82 Id.
84 Raczak v. Ameritech Corp., 103 F.3d 1257, 1263 (6th Cir. 1997).
85 Id. at 1264.
86 Branker v. Pfizer, Inc., 981 F. Supp. 862, 867 n.3 (S.D.N.Y. 1997)(stating that giving the ages of individuals not offered the separation package as 23 – 67, excluding ages 40, 50, 55, 59, 60, 63, 64, 66 was an obscure method of providing the information and thus not satisfactory).
excluded workers and whether they were in the same job classification or organizational unit as the included employees. As such, by not matching job titles with ages or work units, and not specifying the number of terminated employees in each work unit, an employer fails to satisfy the requirements of the OWBPA. Moreover, employers must ensure that the information provided to the employees is accurate.

Furthermore, employers must remember that even when the people terminated are selected only from a subset of a decisional unit, the employer must still disclose information for the entire population of the decisional unit. For instance, if the employer decides that a ten percent RIF in the Accounting Department will come from the accountants whose performance is in the bottom one-third, the employer must still disclose information for all employees in the Accounting Department, even those who are the highest rated.

The consequences of failing to identify the appropriate decisional unit are severe: invalidation of the waiver. In *Kruchowski*, the employer’s Group Termination Notice provided to employees stated that the decisional unit was “all salaried employees of defendant employed at the Valliant Containerboard Mill.” *Kruchowski*, 446 F.3d at 1094. In a group of terminated employees’ subsequently-filed lawsuit, the employer stated in interrogatory responses that the decisional unit “actually consisted of those salaried employees reporting to the Mill manager.” *Id.* This second explanation excluded fifteen employees (over ten percent of the employees at the Mill) from the actual decisional unit, though the notice indicated that they were included. *Id.* The employer tried to avoid liability by arguing that OWBPA regulations require the employer’s organizational structure to be considered in formulating and evaluating the organizational unit and that the fifteen employees excluded by virtue of its conflicting explanations were not part of its organizational reporting hierarchy. *Id.* at 1094-95. The Tenth Circuit rejected this argument, stating that it was the employer’s responsibility to consider its structure at the time it identified its decisional unit. *Id.* at 1095. Likewise, the fact that the employer attached a list of job titles and ages to the notice encompassing the actual decisional unit did not cure the notice’s failure to itself accurately describe the decisional unit as those are two separate requirements under the OWBPA. *Id.* Consequently, the releases signed as part of the employer’s group termination were invalid, and all sixteen plaintiffs were allowed to proceed with their age discrimination claims. *Id.* at 1095-96.

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87 *Id.* at 867.
88 *Kruchowski*, 446 F.3d at 1090 (finding waiver did not meet OWBPA standards where employer’s disclosed decisional unit was different from the actual decisional unit).
89 29 C.F.R. § 1625.22(f)(4)(v).
90 *Id.*
d. Other Considerations

i. Burden of Proof

Under the OWBPA, the waiver is an affirmative defense; thus the burden of proof is on the employer to prove the validity of the waiver.\(^{91}\)

ii. Tender Back and Ratification

Under basic contract principals, an employee may be required to tender back any payments made in exchange for a waiver prior to challenging the validity of the waiver; failure to do so could result in a finding that the employee has ratified the waiver by keeping the benefits thereof. However, the Supreme Court, and the EEOC regulations, have abandoned these principals with respect to waivers of ADEA claims under the OWBPA.\(^ {92}\) In *Oubre*, the Supreme Court rejected the defendant’s argument that the plaintiff was required by general contract principals to tender back the benefits of a waiver prior to instituting suit challenging the validity of the waiver and failure to do so constituted a ratification of the waiver.\(^ {93}\) In rejecting this argument as it applies to ADEA waivers, the Supreme Court reasoned that such a requirement would prevent older workers from challenging waivers under the OWBPA as many such workers would not have the resources to repay the severance they had spent on living expenses.\(^ {94}\)

Following the Supreme Court’s lead, the EEOC adopted regulations in 2000 that state that no employee challenging the validity of an ADEA waiver is required to tender back the consideration given in exchange for the waiver prior to filing a lawsuit or charge of discrimination.\(^ {95}\) In addition, the regulation provides that the employee’s retention of such consideration does not foreclose a challenge to the waiver, nor does it act as a ratification of the waiver.\(^ {96}\)

iii. Return of Consideration for Waiver

If an employee is successful in challenging a waiver, and subsequently prevails on an ADEA claim, the court has the discretion to determine whether the employer is entitled to restitution, recoupment, or set-off (collectively, “reduction”), against the amount of the

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\(^{92}\) *Oubre*, 522 U.S. at 422; 29 C.F.R. § 1625.23(a).

\(^{93}\) *Id.* at 425-426.

\(^{94}\) *Id.* at 426 – 427.

\(^{95}\) 29 C.F.R. § 1625.23(a).

\(^{96}\) *Id.* As discussed previously, the EEOC regulations also prohibit a waiver from including a provision that requires an employee to tender back consideration as a result of filing an ADEA claim.
employee’s award.\textsuperscript{97} However, this reduction is limited to the lesser of the amount recovered by the employee and the amount of consideration paid in exchange for the waiver.\textsuperscript{98}

Also, if there is more than one plaintiff, the reduction must be applied on a plaintiff-by-plaintiff basis and no individual’s award can be reduced based upon the consideration received by another.\textsuperscript{99}

\textbf{iv. Abrogation}

The EEOC regulations also provide that an employer may not abrogate or avoid the duties to which it agreed under a waiver agreement, even if the waiver is ultimately found invalid under the ADEA.\textsuperscript{100} As a result, an employer remains legally obligated to continue to make any retirement, severance, or other payments to which it agreed to the older worker, even after a suit has been initiated.\textsuperscript{101}

\textbf{v. Invalidity of Waiver Not a Cause of Action}

In general, the mere violation of the OWBPA’s waiver requirements does not constitute age discrimination under the ADEA.\textsuperscript{102} In addition, most courts have found that there is no separate cause of action based solely on an employer’s alleged violations of the waiver requirements under the OWBPA.\textsuperscript{103}

\section*{C. Tax Issues Connected With Employment Separation and Settlement Agreements}

The tax characterization of settlement payments can significantly affect the dynamics of negotiating settlement agreements. What follows is a summary of the highlights of the current tax consequences of payments under a separation or settlement agreement. In any

\begin{itemize}
\item \textsuperscript{97} 29 C.F.R. § 1625.23(b).
\item \textsuperscript{98} \textit{Id}.
\item \textsuperscript{99} \textit{Id}.
\item \textsuperscript{100} 29 C.F.R. § 1625.23(d).
\item \textsuperscript{101} \textit{Id.}  See also, \textit{Butcher}, 8 F. Supp. 2d at 317 (finding that employer could not cut off severance benefits or demand repayment as a result of an employee filing a lawsuit in breach of the employee’s release).
\end{itemize}
particular situation, the advice of counsel should be obtained, as the proper tax treatment of these payments depends greatly on the facts and circumstances of each situation.

1. **Income Tax**

Salary continuation and other severance payments, as well as back pay, are taxable as wages for federal and state income tax and social security (FICA) tax purposes when the payments are received, and withholding obligations will apply in some form.

   a. **Exclusion for Payments Received “On Account of Personal Injury or Sickness”**

   Until the mid-1990’s, I.R.C. § 104(a)(2) excluded damages or settlements received (whether by suit or agreement, and whether as lump sums or as periodic payments) “on account of personal injury or sickness” from a taxpayer’s gross income. When interpreting this provision, courts generally held that damages received for emotional distress, defamation, and other tort actions were excludable from gross income. However, case law was not similarly settled when courts addressed the taxability of damages received under Title VII, the ADEA, and other statutory discrimination claims. In these cases, taxability usually turned on whether the plaintiff’s statutory discrimination claim was based on “tort or tort type rights.” Accordingly, parties to a settlement in a statutory discrimination claim often characterized damages payments as compensation for settlement of an emotional distress claim and thereby avoided federal tax on the settlement amount.

   In *Comm'r of Internal Revenue v. Schleier*, 515 U.S. 323 (1995), the Supreme Court held that the tax excludability of a settlement proceeds of an employment discrimination claim required not only an underlying claim that gave rise to tort or tort-type rights, but also an additional showing that the damages were “received on account of personal injuries or sickness.” Thus, the amounts received by the plaintiff taxpayer in settlement of his ADEA claim were not within exclusion to gross income under Internal Revenue Code.

   Congress subsequently passed the “Small Business Job Protection Act of 1996,” which amended Section 104(a)(2) to provide that the exclusion from income tax applies only to damages received on “account of personal physical injury or physical sickness.” Thus, absent a claim of physical injury or physical sickness, damages claimed and settlement amounts received in employment-related cases are clearly taxable as gross income to the taxpayer.

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104 See, e.g., *Threlkeld v. Comm’r Internal Revenue*, 848 F.2d 81, 84 (6th Cir. 1988) (in a defamation suit alleging injury to reputation, “[a]ll income in compensation of that injury is excludable under § 104(a)(2)”; *Roemer v. Comm’r Internal Revenue*, 716 F.2d 693, 700 (9th Cir. 1983) (holding that punitive damages award under California defamation statute was excludable from gross income under section 104(a)(2)).

105 See, e.g., *U.S. v. Benson*, 67 F.3d 641, 645 (7th Cir. 1995); *Johnston v. Harris County Flood Control Dist.*, 869 F.2d 1565, 1579 (5th Cir. 1989); *Bent v. Comm’r Internal Revenue*, 835 F.2d 67, 69 (3d Cir. 1987) (holding that damages must have been received through prosecution of legal action based on tort or tort-type rights and also must have been received on account of personal injury in order for such damages to be excludible from gross income for tax purposes).

b. Allocation of Settlement Proceeds

Quite often, separation and settlement agreements encompass the employee’s release of more than one claim. In light of the tax law discussed above, the allocation of a settlement payment among a plaintiff’s claims in an employment case will not usually be of critical importance. The presence of multiple claims may provide the plaintiff some latitude to allocate the settlement on a tax-favored basis, however, if a claim alleging physical injury or physical sickness is present. In these cases if the allocation is reasonable, it likely will be upheld.\textsuperscript{107}

The IRS, however, is not bound by any such allocation and is more apt to challenge the allocation if it is purely for the plaintiff’s tax advantage.\textsuperscript{108} Additionally, when a settlement agreement does not allocate payment among multiple claims, the taxpayer is required to allocate. The basis for such allocation is the origin of the claim, or the nature of the injury which was the actual basis of the settlement.\textsuperscript{109} Failure to allocate may result in treatment of the entire payment on the basis of the most highly-taxed element included therein.\textsuperscript{110}

In \textit{Taggi v. U.S.}, 35 F.3d 93 (2d Cir. 1994), the Second Circuit held that where a general separation agreement fails to allocate the portion of the settlement payment excludable from income, \textit{all} compensation received under the agreement is taxable. The \textit{Taggi} court explained that “since the release was all-encompassing, including both contract and tort claims, the [district] court was not in a position to apportion the payment among the various possible claims.”\textsuperscript{111}

Because there may be some uncertainty over the IRS’s treatment of allocation in any particular case, any separation agreement should include: (a) an agreement that any taxes, interest, and penalties that may later be imposed by the IRS or court of competent jurisdiction are the employee’s sole responsibility; and (b) an agreement by the employee to indemnify the employer against and hold it harmless from any such assessments.

\textsuperscript{107} See Hubbard v. Yardage Town, Inc., No. 05 CV 0104, 2005 WL 3388146 (S.D.Cal. Dec. 2, 2005) (“Neither the courts nor the Commissioner are bound by the terms of a settlement agreement between third parties that is not the result of good faith, adversarial, arms-length negotiations”); McKay v. Comm’r Internal Revenue, 102 T.C. 465 (1994) (upholding parties’ settlement allocation where settlement was reached as result of bona fide, arms-length negotiations in adversarial setting), vacated on other grounds, 84 F.3d 433 (5th Cir. 1996). \textit{But see Bagley v. Comm’r Internal Revenue}, 105 T.C. 396 (1995) (refusing to honor settlement which was not adversarial because neither party wanted to characterize amounts as punitive despite inherent punitive element). \textit{See also Robinson v. Comm’r Internal Revenue}, 102 T.C. 116 (1994) (Tax Court rejected state trial judge’s approval of allocation of damages in final judgment and allocated damages instead according to jury’s original calculations).

\textsuperscript{108} Mitchell, 992 F.2d at 1219.

\textsuperscript{109} Seay v. Comm’r Internal Revenue, 58 T.C. 32 (1972).

\textsuperscript{110} Whitehead v. Comm’r Internal Revenue, 41 T.C.M. (CCH) 365, 369 (1980); Hodge v. Comm’r Internal Revenue, 64 T.C. 616 (1975).

\textsuperscript{111} Id. at 96. \textit{See also, Reisman v. Comm’r Internal Revenue}, 79 T.C.M. (CCH) 2075 (2000) (“When a settlement agreement includes both contract and tort claims, and the claims are not specifically apportioned, the courts may not be in a position to apportion the settlement payment among the various possible claims”).
c. Reporting and Withholding Obligations For Employers\textsuperscript{112}

Physical Injury Damages. Under 26 U.S.C.A. § 104(a)(2), if an action has its origin in a physical injury or physical sickness, then all damages, other than punitive damages, that flow from the injury or sickness are treated as payments received on account of physical injury or physical sickness and are excluded from gross income for federal income tax purposes, whether or not the recipient of the damages is the injured party. Therefore, under federal law, employers do not have any reporting or withholding requirements for damages attributable to physical injury, including related emotional distress, lost wages, and medical costs.

The IRS’ only guidance in this area has been in Priv. Ltr. Rul. 200041022 (July 7, 2000). This ruling chronicles a “slow progression” of affronts and injuries suffered by the plaintiff. The plaintiff’s relationship with her employer had at first been friendly. Then, however, it came to include lewd remarks and unwanted attempts to make sexual contact and progressed to unwanted physical touching without “observable bodily harm.” The employer also “assaulted” the plaintiff, causing “what [she] represent[ed] was extreme pain,” but her doctors found nothing to be “physically wrong” with her. Subsequently, the employer assaulted the plaintiff again, “cutting her and biting her.” Later assaults resulted in “skin discoloration and swelling.” The I.R.S. ruled that the employer’s assaults produced physical injury only when they reached the cutting and biting stage. The ruling describes the standard for “physical” injury as “uninvited physical contacts resulting in observable bodily harm such as bruises, cuts, swelling, and bleeding.”

Emotional Distress Damages (Not Related to Physical Injury). Section 104(a)(2) specifically states that emotional distress is not considered a physical injury or physical sickness, and, consequently, damages received on emotional distress claims are taxable (although reimbursement for medical care attributable to emotional distress would be excludable from gross income).\textsuperscript{113} Employers are required to report such payments but are not required to withhold taxes from these payments, and should use Form 1099-MISC for federal income tax purposes.

Plaintiffs in employment cases may claim that any emotional or reputational damages should not be taxable, and may therefore oppose an employer’s issuance of Form 1099s in connection with settlement payments that represent such damages. However, unless the I.R.S. amends its current guidance, employers may continue to issue 1099s for amounts paid for non-physical emotional injuries. Additionally, when negotiating settlement agreements, employers should seek tax indemnification clauses, given the likelihood that individuals will claim that emotional distress recoveries should be treated as non-taxable income.

\textsuperscript{112} This article does not address reporting or withholding requirements under state law. However, many state anti-discrimination statutes provide for a broad range of remedies, which include compensatory damages. See, e.g., N.Y. Exec. Law § 296a.7-10(2) (authorizing the award of compensatory damages). Thus, it appears that the tax consequences for awards or settlements under these statutes would be analogous to the tax consequences of awards or settlements under Title VII.

\textsuperscript{113} See also, Polone v. Comm’r Internal Revenue, No. 12665-00, 2003 WL 22953162 (Tax Ct. Dec. 16, 2003).
Cash Payments to Compensate For Unpaid Life and Health Insurance Premiums. These payments are taxable if received in cash as part of a settlement award or judgment and must be reported. If the employer continues to make premium payments on a former employee’s life or health insurance plan pursuant to a settlement agreement or a judgment, these premium payments are excludable from income. If the employee elects to continue receiving health insurance under the employer’s health plan pursuant to COBRA and the employer pays the premiums, the payments also are excludable.

Compensatory and Liquidated Damages (Not Related to Physical Injury). Employers are required to report such payments but are not required to withhold taxes from these payments, and should use Form 1099-MISC for federal income tax purposes.

Punitive Damages. The Internal Revenue Code makes clear that all punitive damages (except for those awarded in certain wrongful death actions) are taxable, regardless of whether or not they are related to a claim of personal physical injury or physical sickness. Employers are required to report such payments but are not required to withhold taxes from these payments, and should use Form 1099-MISC for federal income tax purposes.

Front and Back Pay. To begin with, employers making payments of “wages” shall deduct and must withhold income and employment taxes. As used in the Internal Revenue Code, “wages” means “all remuneration for services performed by an employee for an employer.” Consistent with Supreme Court precedent, Section 104(a)(2) was amended to provide that back pay awards are not excludable from gross income. The I.R.S. and most courts have taken the position that back pay and front pay damages constitute wages for the purpose of federal income tax, FICA, and FUTA. Therefore, an employer must withhold on the portion of a settlement payment attributable to a claim for front or back pay.

Nevertheless, some courts have prohibited employers from withholding on such amounts. These courts have found payments not to be “wages” as defined by the I.R.S., because they are not “remuneration for services performed by an employer.” For example, in Newhouse v. McCormick & Co., 157 F.3d 582 (8th Cir. 1998), the plaintiff claimed an employer did not hire him because of his age. The court held that an employment relationship never existed here, and therefore the employer could not withhold taxes. Additionally, in Churchill v. Star Enter.,

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115 See Priv. Ltr. Rul. 96-12-008 (Dec. 18, 1995).
116 26 U.S.C.A. § 104(a)(2). See also, O’Gilvie v. United States, 519 U.S. 79 (1996) (holding that punitive damages are not awarded “on account of personal injuries or sickness” and therefore constitute gross income).
119 26 U.S.C. § 104(a)(2). See also, United States v. Burke, 504 U.S. 229, 241 (1992) (holding that back pay awards in settlement of Title VII claims are not excludable from gross income); Comm’r of Internal Revenue v. Schleier, 515 U.S. 323 (1995) (back pay and liquidated damages received in settlement of an ADEA claim are not excludable because neither are received “on account of personal injuries or sickness”). Ultimately, Section 104(a)(2) was amended to reflect this decision.
3 F. Supp. 2d 622 (E.D. Pa. 1998), the court held that an employer improperly withheld taxes on an award of front pay and back pay under the FMLA and required the defendant to pay the full amount of the judgment to plaintiff. In doing so, the court rejected I.R.S. Regulations which instructed that back pay awards to former employees on account of discrimination should be included as “wages” for withholding purposes, as contradictory to express statutory language. The court based this holding largely on the fact that an employer-employee relationship did not exist during the time period for which damages were awarded.\(^{120}\)

Accordingly, an employer faced with the question of whether to withhold in any particular case should consult with counsel or a tax advisor for guidance.

2. Payments of Attorneys’ Fees

a. Taxability

The determination of whether payments to a litigant for attorneys’ fees are considered taxable income is of great significance to the litigant, as it will significantly affect his or her tax liability. Up until 2005, there was a split among the Courts of Appeal as to whether attorneys’ fees in employment related cases are properly included in a successful plaintiff’s gross income.\(^{121}\) Then, the Supreme Court resolved this split in authority and considered whether the portion of a judgment or settlement paid to a plaintiff’s attorney under a contingent-fee arrangement is income to the plaintiff for tax purposes. In Comm’r of Internal Revenue v. Banks, 543 U.S. 426 (2005), the Court held: “as a general rule, when a litigant’s recovery constitutes income, the litigant’s income includes the portion of the recovery paid to the attorney as a

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\(^{120}\) See also, Longstreth v. Copple, 101 F. Supp. 2d 776 (N.D. Iowa 2000) (award in settlement of former employee’s action against employer and supervisor for violations of the FMLA did not necessarily represent award of wages, but could have represented damages payable by supervisor under FMLA, and thus employer could not withhold statutory deductions from award); Kim v. Monmouth College, 726 A.2d 1017 (N.J. Super. L. Div. 1998) (damages awarded to employee for lost past income in action for breach of employment contract were not “wages” that were subject to deduction of withholding taxes; damages were awarded for period of time during which employee was no longer employed, and employee had been terminated and had never been reinstated). Similarly, other courts have held that payment in satisfaction of a judgment in favor of a plaintiff and against an employer for breach of employment contract is not subject to withholding for federal and state income taxes and social security taxes. See Lisec v. United Airlines, Inc., 10 Cal. App. 4th 1500 (1992) (court reasoned that even though such an award is measured by lost wages and is normally taxable, when it is paid in satisfaction of a judgment obtained after the employment relationship has been terminated, then it is not subject to withholding); Kelly v. Hunton & Williams, No. 97-CV-5631JG, 1999 WL 759972 (E.D.N.Y. Sept. 21, 1999) (to the extent settlement represents lost wages, it relates to time when employment relationship was terminated and therefore does not constitute wages subject to withholding); Wilson v. A.M. General Corp., No. 3:95CV-125RM, 1999 WL 1746071 (N.D. Ind. Sept. 9, 1999) (same).

\(^{121}\) Compare Banks v. Comm’r of Internal Revenue, 345 F.3d 373 (6th Cir. 2003); Young v. Comm’r of Internal Revenue, 240 F.3d 369 (4th Cir. 2001); Srivastava v. Comm’r of Internal Revenue, 220 F.3d 353 (5th Cir. 2000); Davis v. Comm’r of Internal Revenue, 210 F.3d 1346 (11th Cir. 2000) (contingent attorneys’ fees excludable); with Raymond v. U.S., No. 03-6037, 2004 WL 51836, (2d Cir. Jan. 13, 2004); Alexander v. Comm’r of Internal Revenue, 72 F.3d 938 (1st Cir. 1995); Kenseth v. Comm’r of Internal Revenue, 259 F.3d 881 (7th Cir. 2001); Sinyard v. Comm’r of Internal Revenue, 268 F.3d 756 (9th Cir. 2001); Baylin v. U.S., 43 F.3d 1451 (Fed. Cir. 1995) (contingent attorneys’ fees paid directly out of reward must be included in plaintiff’s gross income).
contingent fee.” Thus, an employer’s payment of attorney’s fees in the settlement of an employment discrimination case is considered income to the plaintiff/employee.

Ultimately, however, this decision does not mean that all plaintiffs in employment-related cases will pay federal income tax on the amounts paid to his or her attorney. On October 22, 2004, President Bush signed the American Jobs Creation Act of 2004 into law. This Act made attorneys’ fees payable in connection with a claim of “unlawful discrimination” fully deductible for both regular and alternative minimum tax purposes.122 Accordingly, Section 62(a) of the Internal Revenue Code now allows a deduction from gross income for amounts a taxpayer pays for attorney’s fees and court costs in connection with a discrimination action. This change is effective for fees and costs paid after the date of enactment with respect to any judgment or settlement that occurs after the enactment date.123

However, with respect to the few employment-related actions to which the above-the-line deduction doesn’t apply, Banks has on-going significance.124 That is, in cases where the above-the-line deduction doesn’t apply, and the judgment or settlement is non-business income or relates to a taxpayer’s trade or business of being an employee, the contingent attorney’s fees will be includible in income but only deductible as miscellaneous itemized deductions—which are subject to the 2%-of-adjusted-gross-income (AGI) floor, and the overall limitation on itemized deductions, and aren’t deductible for AMT purposes.125 Thus, taxpayers will be subject to tax with respect to the portion of any such contingent attorney’s fees for which they can’t claim a deduction.

122 26 U.S.C.A. § 62(a)(20). This rule applies to claims brought under the following statutes: (1) Section 302 of the Civil Rights Act of 1991; (2) Section 201, 202, 203, 204, 205, 206, or 207 of the Congressional Accountability Act of 1995; (3) The National Labor Relations Act; (4) The Fair Labor Standards Act of 1938; (5) Section 4 or 15 of the Age Discrimination in Employment Act of 1967; (6) Section 501 or 504 of the Rehabilitation Act of 1973; (7) Section 510 of the Employee Retirement Income Security Act of 1974; (8) Title IX of the Education Amendments of 1972; (9) The Employee Polygraph Protection Act of 1988; (10) The Worker Adjustment and Retraining Notification Act; (11) Section 105 of the Family and Medical Leave Act of 1993; (12) Chapter 43 of title 38, United States Code (relating to employment and reemployment rights of members of the uniformed services); (13) Section 1977, 1979, or 1980 of the Revised Statutes; (14) Section 703, 704, or 717 of the Civil Rights Act of 1964; (15) Section 804, 805, 806, 808, or 818 of the Fair Housing Act; (16) Section 102, 202, 302, or 503 of the Americans with Disabilities Act of 1990; (17) Any provision of Federal law (popularly known as whistleblower protection provisions) prohibiting the discharge of an employee, the discrimination against an employee, or any other form of retaliation or reprisal against an employee for asserting rights or taking other actions permitted under Federal law; (18) Any provision of Federal, State, or local law, or common law claims permitted under Federal, State, or local law—(i) providing for the enforcement of civil rights, or (ii) regulating any aspect of the employment relationship, including claims for wages, compensation, or benefits, or prohibiting the discharge of an employee, the discrimination against an employee, or any other form of retaliation or reprisal against an employee for asserting rights or taking other actions permitted by law. 26 U.S.C.A. § 62(e).

123 This provision, however, does not exempt these costs and fees from a taxpayer’s. It merely allows the taxpayer to take an “above the line” deduction in the amount of costs and fees paid.

124 For instance, Banks applies to breach of contract claims or ERISA claims for benefits (as the Section 62(a)(20) only includes the ERISA retaliation provisions).

125 See, e.g., Porter v. U.S. Agency for Int’l Dev., 293 F. Supp. 2d 152, 155 (D.D.C. 2003) (“The portion of an award that goes to pay attorney’s fees may be partially deductible, but the deduction will not be available if the Alternative Minimum Tax (“AMT”) is triggered. The unhappy result is (or theoretically can be) that the tax consequences of an award of compensatory damages can seriously diminish or even exceed the award”).
b. Withholding and Reporting Obligations

Generally speaking, IRS regulations require that defendants report payments made to plaintiffs for attorneys’ fees.\textsuperscript{126} Such payments are to be reflected, reported, and withheld differently, however, depending on how the defendant issues the payment that involves attorneys’ fees.

If the defendant issues a settlement check payable only to the plaintiff, then it has an obligation to file a Form 1099-MISC for the plaintiff reporting the full amount paid less any amount that is non-taxable or subject to reporting on a Form W-2, but has no reporting obligation with respect to the plaintiff’s attorney.\textsuperscript{127}

If the defendant issues a settlement check for the full settlement amount payable only to the plaintiff’s attorney, then it is obliged to file a Form 1099-MISC for the full amount for the plaintiff, less any amount that is non-taxable or subject to reporting on a Form W-2. The defendant must also issue a Form 1099-MISC to the plaintiff’s attorney in the full amount of the payment, if the plaintiff’s attorneys’ fees are taxable income to the plaintiff.\textsuperscript{128}

If the defendant issues separate settlement checks to the plaintiff and the plaintiff’s attorney, it should report the actual amount paid to the plaintiff on a Form 1099-MISC, less any amount that is non-taxable or subject to a reporting on a Form W-2, and should report the amount paid to the attorney on a Form 1099-MISC, provided that the plaintiff’s attorneys’ fees are not taxable to the plaintiff. If the attorneys’ fees are taxable to the plaintiff, the defendant must report the full settlement amount to the plaintiff.

D. Drafting the Agreement

1. Waivers of Claims

Waivers of claims should be broadly drafted. Courts tend to construe releases narrowly, limiting them to claims explicitly released. Accordingly, each and every statutory claim encompassed by the release should be explicitly stated in the release.\textsuperscript{129}

\textsuperscript{126} 26 C.F.R. § 1.6041-1(f)(2).
\textsuperscript{127} See 26 U.S.C.A. § 6045(f); 26 U.S.C.A. § 6041(a).
\textsuperscript{128} Id.
\textsuperscript{129} However, courts have held that properly-drafted general release language may constitute a valid waiver. See, e.g., Smith v. Amedisys Inc., 298 F.3d 434, 443 (5th Cir. 2002) (“There is no obligation, however, under Title VII or federal common law, that a release must specify Title VII or federal causes of action to constitute a valid release of a Title VII claim”); Stroman v. West Coast Grocery Co., 884 F.2d 458, 461 (9th Cir. 1989) (language of agreement unambiguously stated that agreement would represent “full and final settlement of any and all claims” arising out of employment and fact that agreement did not specifically recite particular claims waived did not render it ineffective); Pilon v. Univ. of Minn., 710 F.2d 466, 467-68 (8th Cir. 1983) (holding that even though a general release of “any and all” claims did not specifically mention Title VII, “the wording of the release in the present case is clear and leaves no doubt that all claims potentially held by Pilon are waived”).
2. Dismissal of Complaints

The settlement agreement should require the claimant to dismiss all pending litigation with prejudice. A proposed Order should be drafted and agreed upon as part of the settlement. If charges are pending with the EEOC or some other administrative agency, the agreement may state that the employee waives any right to individual relief in his/her claim before the EEOC. As noted above, cases are split on whether a requirement to waive the right to file or pursue a charge is retaliatory.

3. Covenant Not To Sue

In a non-ADEA or non-OWBPA context, covenants not to sue are enforceable. However, under the OWBPA, the covenant must be carefully drafted to make clear that the employee retains the right to challenge in court the validity of the agreement. Otherwise, the EEOC may consider it to be unlawful.

4. Consideration

The settlement agreement should clearly provide that the employee or former employee will receive something of value beyond that which he or she is already entitled, and explicitly detail the consideration given in exchange for the release. If the consideration consists solely of a monetary payment, the agreement should state when the payment will be made, whether taxes will be withheld from any of the payments, to whom the checks will be issued, and where the checks will be sent.


Confidentiality provisions allow employers to avoid possible negative publicity and prevent other employees from learning about the settlement. Although standard in most settlement agreements, an employer desiring a confidentiality provision is advised to state as much at the beginning of negotiations. This puts the employee on notice of the provision early

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130 29 C.F.R. § 1625.22(d)(2) (for waivers of ADEA claims, consideration “ means anything of value in addition to that to which the individual is already entitled in the absence of a waiver”).

131 Confidentiality provisions in agreements in agreements involving the EEOC or public sector employers may not ensure confidentiality. First, settlements involving a public entity are often subject to disclosure under a state’s access to public records law. See, e.g., Newspaper Holdings, Inc. v. New Castle Area School Dist., 911 A.2d 644 (Pa. Cmwlth. 2006) (instructing school district to provide newspaper with copy of settlement agreement, pursuant to state’s right to know law); Pansy v. Borough of Stroudsburg, 23 F.3d 772, 784 (3d Cir. 1994) (settlement agreement entered into between township and private party was likely a “public record” subject to disclosure under the Pennsylvania Right to Know Act); Pengra v. State, 14 P.3d 499, 503 (Mont. 2000) (“On balance, we conclude that Pengra has not demonstrated that his and his daughter’s rights to privacy clearly outweigh the public’s right to know what cost they public has incurred in the settlement agreement”); Iowa Code § 22.13 (requiring that, whenever there has been a settlement of a claim against a governmental body or its employee by its insurer, a written summary of the agreement’s terms to be filed with the governmental body and made public); EEOC Regional Attorneys’ Manual, Section IV. A., “Settlement Standards and Procedures” (May 31, 1990) (“Once the Commission has filed suit, the agency will not enter into settlements that are subject to confidentiality provisions, it will require public disclosure of all settlement terms, and it will oppose the sealing of resolution documents”).
and may inhibit him or her from discussing the ongoing negotiations. You should also notify the employee or his counsel that the employee must represent that he or she has not discussed the terms or the proposed terms of the settlement, except to certain specified individuals, such as the employee’s tax advisors, attorneys, and spouse.

You should include the following information in a confidentiality provision:

- The employee has not disclosed and will not disclose the fact, terms, or proposed terms of the agreement.
- The employee is responsible for any breaches of confidentiality by any permitted confidants, such as the employee’s spouse or tax advisor.
- Liquidated damages will be imposed for breach of the confidentiality provisions.
- The employee agrees that the settlement agreement or its terms should not be admissible as evidence, or discoverable, in any judicial, administrative, or other proceeding, except in a legal proceeding concerning the enforceability of the settlement or any of its terms.
- If the employee is required to disclose the settlement agreement or its terms in connection with any judicial or administrative proceeding, the employee will immediately notify the employer of the request so the employer may object to the disclosure. The employee agrees that the employer has standing to appear on his or her behalf to contest the disclosure, and the employee agrees to await the final outcome of the objection before disclosing the agreement or its terms.

Employers should avoid committing to a “mutual” confidentiality agreement. The employer has no incentive to publicize a settlement and a promise of confidentiality by an employer is unmanageable, as the employer cannot bind every person working at the company.

6. Specific OWBPA Compliance Language

Employers must ensure that all bases are covered when the settlement agreement includes a release of an employee’s ADEA claims. To cover the obligations imposed by the OWBPA, include a separate provision where the employee expressly acknowledges the following information:

- The employee has been advised to consult with an attorney of his or her choosing considering the legal significance of the agreement.
- The agreement is written in a manner he or she understands.
- The consideration set out in the agreement is adequate and sufficient for entering into the agreement, and is consideration to which the employee is not otherwise entitled.
• The employee has been offered twenty-one (21) days to consider the agreement before signing.

• The employee has been afforded seven (7) days after signing the agreement to revoke the agreement. The agreement should state that notice of revocation should be given in writing via certified mail and directed to a specified employee. Also, it should state that the agreement will not take effect until after the revocation period expires.

7. Non-Disparagement Clause

This provision requires that the employee not engage in conduct that would tend to create a negative impression about the employer, its employees, or its business. Similar to a confidentiality provision, an employer should not agree to a mutual non-disparagement clause. The employer has no incentive to disparage the employee and this promise by an employer is unmanageable, as the employer cannot bind every person working at the company. If the employee insists on this provision, then you should agree only that certain identified persons (listed by name or job title) will not disparage the employee.

8. No Admission of Wrongdoing

It is essential that employers insist that the agreement clearly express that, by entering into the settlement, they are not admitting to having engaged in any wrongdoing or unlawful activity with respect to the employee or otherwise. In this provision, the employee should agree and acknowledge that the settlement is not to be construed as an admission by the employer of any violation of any law or wrongdoing.

9. Attorney’s Fees

The Supreme Court has held that, to be entitled to recover attorneys’ fees as a “prevailing party” under civil rights statutes, a party must have obtained some court-ordered relief. In many cases, settlements will take place in the absence of a court order. Nevertheless, it is crucial to make clear that any waiver specifically includes a waiver of claims for attorneys’ fees. This is particularly important when the settlement was achieved after a court has already ordered some form of relief, because the plaintiff is then a prevailing party.

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132 Buckhannon Bd. & Care Home, Inc. v. West Virginia Dept. of Health & Human Resources, 532 U.S. 598 (2001). See also, Lazarska v. County of Union, No. 04-02602, 2006 WL 2264455 (D.N.J. Aug. 8, 2006) (“anything less than a precise, unequivocal statement from the opposing party refusing to pay any attorney’s fees and costs will not suffice to waive a statutory right to such fees and costs”); Torres v. Metro. Life Insur. Co., 189 F.3d 331 (3d Cir. 1991) (plaintiff could seek fees despite signing release that “specifically releases all claims, charges, or demands asserted or assertable in Pending Lawsuit,” because attorneys’ fees were not mentioned and, therefore, the right to seek them was preserved).
10. **Disclaimers of Representations**

The agreement should state that no additional representations were made during settlement negotiations. This is important to make sure that one party cannot argue that the other made statements or commitments outside of, or inconsistent with, the written agreement.

11. **Right to Recover Fees in Case of Breach**

Employers must proceed with caution when drafting provisions in settlement agreements that permit either side to recover attorneys’ fees in the event of a breach by the other party. Under OWBPA and EEOC Guidance, the agreement must be clear that the employee may challenge the validity of the agreement without risking the harsh penalty of paying the employer’s attorneys’ fees in the event the challenge does not succeed. Nevertheless, courts have upheld these types of provisions.

12. **Revocation**

When the OWBPA is involved, the agreement must provide the employee with at least seven (7) days within which to revoke his or her waiver. The agreement should specify how notice of revocation will be provided and how the revocation period will be computed (e.g., effective as of the date of mailing, or date of receipt).

13. **No Reemployment**

If the employer retains an employee following settlement, then he or she is a likely source of claims in the future. Therefore, employers are well-advised to require no-reapplication and no-reemployment provisions in settlement agreements. However, employees have often argued that these provisions are unlawful as (1) attempts to waive future legal rights, or (2) retaliatory. Notwithstanding plaintiffs’ claims to the contrary, a properly worded covenant not to reapply or seek reemployment (i.e., a promise rather than a waiver) is most likely lawful.135

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133 See 29 C.F.R. § 1625.23 (“No ADEA waiver agreement, covenant not to sue, or other equivalent arrangement may impose any condition precedent, any penalty, or any other limitation adversely affecting any individual’s right to challenge the agreement. This prohibition includes, but is not limited to, provisions requiring employees to tender back consideration received, and provisions allowing employers to recover attorneys’ fees and/or damages because of the filing of an ADEA suit”).


135 See 29 C.F.R. § 1625.22(c)(2) (“the ADEA does not bar, in a waiver that otherwise is consistent with statutory requirements, the enforcement of agreements to perform future employment-related actions such as the employee’s agreement to retire or otherwise terminate employment at a future date”); Adams v. Philip Morris, Inc., 67 F.3d 580, 582 (6th Cir. 1995) (former employee executed a release and waiver of all claims against the employer in a termination agreement and court held that though an employee “may not prospectively waive his or her rights under either Title VII or the ADEA [in this circuit],” a settlement agreement that incorporates the “future effects of prior discrimination” is permissible and “effectively bars new discrimination claims based on post-settlement conduct that stems directly from, or is a continuing effect of, past discrimination”); Kendall v. Watkins, 998 F.2d 848, 851 (10th Cir. 1993) (“no rehire” clause was not an unlawful prospective waiver of Title
14. **Return of Company Property**

If relevant, an employer may want to include a provision in the agreement which requires the employee or former employee to return all “company property” by a certain date. Importantly, the agreement should broadly define what constitutes “company property,” such as, among other things, items owned by the company, information about the company (including all copies, no matter the form).

15. **Severability**

This clause provides that, in the event any provision of the agreement is declared to be unenforceable, invalid, or illegal for any reason, that provision should either be removed in its entirety or rewritten by a court so as not to affect the validity of the entire agreement.

16. **Tax Indemnification Issues**

An employer should include in an agreement an indemnification clause which states that the employee will pay in full all taxes due on the payments he receives and is solely liable for any improper allocation and resulting damages, on both his behalf and that of the employer. This is because, if the I.R.S. finds an improper allocation of settlement proceeds, employers are liability for the employee’s failure to pay social security and income taxes, unless the I.R.S. can recover the amounts owed from the employee.\(^{136}\)

17. **Binding Effect of Agreement on Others**

Other potential plaintiffs should also be covered by the agreement. Therefore, the agreement should provide that it binds plaintiff, his heirs, executors, administrators, personal or legal representatives, successors, and/or assigns.

18. **Choice of Law**

To exert control over potential legal disputes, the agreement should expressly identify the state law which will govern the terms, rights, and obligations of the agreement.

19. **Resolution of Breaches**

Many settlement agreements refer disputes over compliance and breach to arbitration, to hopefully result in a more expeditious and cost-effective resolution. However, an agreement may also provide that a specified court of competent jurisdiction should determine the enforceability of the agreement. Additionally, when the OWBPA is implicated, an employer should state in the agreement that any challenges to the validity of the agreement are to be made in a specified court.

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Brian R. Garrison has concentrated his law practice on counseling and representing management in labor and employment matters. Mr. Garrison is a frequent contributor to 'Indiana Employment Law Letter' and has researched and written about severance agreements. He is a graduate of the University of Illinois College of Law. Before joining Baker & Daniels, he served as a judicial extern for the Honorable Michael M. Mihm in the U.S. District Court for the Central District of Illinois.
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Participant Information

6. How many people listened at your site?
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