

# **NEGOTIATING SEPARATION AGREEMENTS IN DIFFICULT SITUATIONS**

January 2008

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### **1. INTRODUCTION**

Employers find it necessary to terminate employees for a number of reasons. Sometimes the action is necessary because the employee is performing poorly. Sometimes it is necessary because an employee who otherwise performs adequately nevertheless has a negative impact on other employees, such as by gossip or negativity. Sometimes termination is necessary simply because of a lack of work or job elimination. Each of these situations can be difficult for the employer as well as the employee. To make an employee's separation less difficult and more orderly, employers sometime offer departing employees separation agreements. Separation Agreements also are useful in resolving most employment-related claims by employees, through waivers of those claims given in exchange for a benefit to which the employee otherwise would not be entitled.

This paper discusses some of the issues which most often arise in negotiating severance agreements. Because most topics of negotiation which have been discussed between the parties should be reflected in their separation agreement, this paper focuses on those issues in the context of a written separations agreement.

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purposes of illustration, and should not be used in any legal document without the prior review and approval of the reader's legal counsel.

**2. SHOULD YOU OFFER A SEPARATION AGREEMENT?**

The first question is whether a separation agreement should be offered.

There are many circumstance in which it makes sense to offer an employee a reasonable separation agreement. For example, if the employer has inadvertently violated employment-related laws in connection with the employee's employment and the employee is willing to resolve the violations on reasonable terms through a separation agreement, then entering into a separation agreement disposing of those claims normally will be in the best interests of the employer and the employee, because the expense and uncertainty of litigation, which likely would result in a decision against the employer, will be avoided. If the employer finds it necessary to eliminate the job of a long-term employee who has performed well, and their are no other jobs into which the employee can transfer, then offering a reasonable separation agreement to that employee may be appropriate to avoid dissention and bad moral among the remaining employees. If an employee is expected to be terminated for inadequate performance, then allowing the employee to resign and agreeing to an orderly exit strategy through a separation agreement will enable the employee to avoid the embarrassment of being fired and will

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help the employer ensure that important matters do not fall through the cracks due to the employee's absence.

In other circumstances, however, entering into a separation agreement may not be the best course of action. If, for example, a white employee is fired for gross insubordination and then demands severance pay, that request probably should not be granted unless the employer is prepared to do the same for Black, Hispanic and Asian employees who are fired under similar circumstances.

A difficult situation faced by many employers arises when an employee is terminated, or resigns, and then demands the employer pay him money in settlement of a frivolous legal claim against the employer. The employer is likely to be able to dispose of the demand by paying significantly less money than it would cost the employer to defend the claim, and for that reason it is tempting for the employer to pay the claim. Some employers, however, will refuse to pay such a claim, and instead will defend against the claim vigorously, despite the cost, because they recognize the possibility that paying one frivolous claim will encourage other employees and former employees to assert frivolous claims of their own, resulting in the company paying more in the long run than it would have cost the company to defending the first claim. Employers also deny payment of frivolous claims because of a concern that payment of such a claim (the fact of which almost certainly will become known, regardless of how many confidentiality agreements are signed by the employee) will be interpreted by employees as a sign of weakness in

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leadership or lack of resolve by the company, and will lead to a general deterioration in employee performance and discipline. In these situations, management must determine its priorities, and must make decisions about separation agreements based upon those priorities.

**3. IMPORTANT PROVISIONS TO NEGOTIATE IN SEPARATION AGREEMENTS**

**a. Recitals**

Many contracts begin with statements, known as “recitals,” describing the factual background leading up to formation of the agreement and the basis intentions of the parties in entering into the agreement. For example, a simple separation agreement might contain recitals such as the following:

This Separation Agreement is made by and between ABC Company, Inc. (hereinafter “ABC”) and John Doe (hereinafter “Doe”) this 1st day of December, 2007.

*RECITALS*

*WHEREAS Doe is employed on an at-will basis by ABC as a commissioned sales representative; and*

*WHEREAS Doe desires to pursue full time employment outside ABC; and*

*WHEREAS ABC desires to enter into this Separation Agreement to ensure the departure of Doe from ABC is orderly; and*

*WHEREAS Doe desires to enter into this Separation Agreement in order to receive certain benefits provided hereunder, to which Doe otherwise would not be entitled;*

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NOW, THEREFORE, in consideration of the preceding recitals, the mutual promises and acknowledgments set forth below, and other valuable consideration, the adequacy and receipt of which hereby is acknowledged, the parties agree as follows:

Recitals are useful because they make the intention of the parties clear on the face of the agreement, and because they make it difficult for the employee to later assert facts conflicting with those set forth in the recitals.

**b. Confidentiality**

All separation agreements should contain a confidentiality covenant, requiring the employee to keep the terms, and sometimes even the existence, of the separation agreement confidential. The following is an example of a confidentiality provision:

Confidentiality. Employee shall treat this Agreement as CONFIDENTIAL and SHALL NOT DISCLOSE its terms and conditions to any person other than Employee's spouse, attorney or tax consultant, as applicable, unless specifically authorized or required by law, or by Employer in writing, to make such disclosure. Employee personally guarantees that any such spouse, attorney or tax consultant shall treat this Agreement as confidential, and any breach of confidentiality by Employee or such spouse, attorney or tax consultant shall constitute a material breach of this Agreement by Employee. In the event Employee breaches this confidentiality covenant, the employee shall pay to employee, as liquidated damages for such breach, the full amount of the Severance Payment paid to Employee under this Agreement.

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**c. Basis for Separation from Employment**

An employee often will find it preferable to resign or retire rather than be fired. Therefore, one of the benefits an employer can offer to an employee facing termination for cause is the option of resigning or retiring. If an agreement is reached regarding the basis for separation from employment, a provision establishing the agreed upon basis should be included in the separation agreement. Even if the employer is not willing to negotiate the basis for the separation, or is unable to reach agreement on that issue, the separation agreement should recite the position of the parties on that issue. The following is an example of such a clause:

Voluntary Resignation. Employee shall, and hereby does, voluntarily resign from the employment of Employer, which resignation Employer accepts, effective as of the date of the date of this Agreement.

**d. Date of Separation from Employment**

The separation agreement should state the date which was or will be the employee's final day of employment. If the employee went or will go on leave between his last day of active employment and the date on which his employment ended or will end, the separation agreement should state each of those date, and should specify the nature of the leave the employee took or will be taking.

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**e. Final Wage Payment**

A separation agreement should state the gross and net amount of the final payment of wages to the employee for work performed by the employee, and the date on which that payment was or will be made.

**f. Unused Leave**

If the employee has or will have unused accrued paid leave upon separation from employment, the separation agreement should contain a provision stating whether the employee will be paid for that leave or whether it will be forfeited. If the employer has an employee handbook, it should contain a policy addressing this issue, and therefore should be consulted in negotiating and drafting the separation agreement.

**g. Severance Pay**

Most separation agreements provide for a lump sum payment to the employee, over and above anything the employee already is owed for work performed or for any other reason. The amount of the severance payment is often the most contentious issue negotiated. The amount which may be appropriate in a given situation depends on numerous considerations, including the amount typically paid to comparable employees under similar circumstances by employers in the employer's particular industry and of the employer's size. While a clerical worker in a small company may be fortunate to receive



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two weeks of severance pay, an executive in a large corporation may have reason to expect no less than three to six months of severance pay.

Executives and professionals, especially in the medical field, often have written employment contracts which specify an amount to be paid as severance under qualifying circumstances. Such provisions can be good for the employer because they arguably establish, in advance, the maximum amount of severance pay the employer should have to pay the employee. They can be problematic for the employer, however, to the extent they arguably set a floor, not a ceiling, on the appropriate amount of severance pay.

The separation agreement should recite the fact that the severance pay is over and above anything to which the employee otherwise is entitled. This is desirable in general to establish the separation agreement is supported by adequate consideration, and is especially important in satisfying the requirements of the Older Worker Benefit Protection Act (discussed below) where the employee is 40 years old or older.

In negotiations, it usually is helpful to express the amount of severance pay in terms of weeks or months of the employee's regular pay. Once the parties have agreed upon the amount of severance pay, it should be stated clearly in the separation agreement. It should be expressed in dollars rather than in weeks or months, to avoid disagreement regarding the dollar amount of the payment. It should be stated as a "gross" amount, to reflect the fact that the amount received by the employee will be a lower net amount reflecting payroll tax withholding.

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**h. Tax Withholding**

Employees almost always want to receive their severance without withholding of payroll taxes. Employers normally should decline to do so, because the Internal Revenue Service and most courts regard severance payments, back pay, front pay, and almost all other such payments as constituting taxable income subject to withholding. *See* IRS Revenue Ruling 2004-10 (reversing previous IRS position and holding that amounts paid to employee in consideration of cancellation of employment contract and relinquishing contract rights are wages subject to Social Security, Medicare, federal unemployment and income tax withholding); *Commissioner of Internal Revenue v. Schleier*, 515 U.S. 323 (1995) (proceeds from settlement of Age Discrimination in Employment Act claim held not excludable from gross income under 26 USCS 104(a)(2) as to either backpay half or liquidated-damages half of settlement). Liquidated damages paid by an employer in settlement of a Fair Labor Standards Act claim, however, are not considered wages and are not subject to withholding. IRS Revenue Ruling 72-268. Payments of damages for physical injuries or illness, of for emotional distress resulting from physical injury or illness, generally are not subject to withholding; however, before agreeing to allocate any portion of a severance payment as a payment for injury, illness or emotional distress, employers should carefully consider whether such an allocation would stand up under IRS scrutiny.

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Employees sometimes ask the employer to pay the employee's attorney fees, which typically is a contingent fee calculated as percentage of the total recovery, directly to the attorney and issue the attorney a 1099, so the attorney fee portion of the severance will not be subject to withholding and will not be included in the employee's gross income for purposes of income taxes. Employers should refuse to do so, because the gross amount of the settlement constitutes taxable income to the employee, regardless of whatever fee the employee may have to pay his attorney. *See Commissioner of Internal Revenue v. Banks*, 543 U.S. 426 (2005) (as general rule for federal income tax purposes, when litigant's recovery of money judgment or settlement constituted gross income under § 61(a) of Internal Revenue Code (26 USCS § 61(a)), gross income held to include portion of recovery paid to litigant's attorney as contingent fee); *Young v. Commissioner of Revenue*, 240 F.3d 369 (4th Cir. 1001) (employee must include contingent attorney fees in gross income and then deduct them as a miscellaneous itemized deduction). (Note: Attorney's fees paid pursuant to a court order are not considered wages. IRS Revenue Ruling 80-364.)

If the employer and employee have reached agreement on the amount of a severance, but cannot reach agreement regarding withholding, an employer may "gross up" the gross severance amount in an amount sufficient to effectively shift the tax burden from the employee to the employer. This, of course, means that the employer is paying

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more than originally agreed, which the employer may or may not determine is justified under the circumstances.

If the employer agrees not to withhold some or all of the severance payment for taxes, or agrees to a gross up, the separation agreement should recite the justification for that decision and should explain the calculations in reasonable detail.

The rulings of the Internal Revenue Service and the courts are not completely consistent on these issues, and have changed over time. Therefore, an employer should consult a certified public accountant or tax attorney before agreeing not to withhold taxes from a severance payment.

**i. Other Deductions**

If the employee owes money to the employer, due to a draw, a loan, or for any other reason, the separation agreement should recite that fact and should address how that debt is to be discharged. In some circumstances, the debt can be repaid immediately through an authorized deduction from the severance payment. In other circumstances, such as where the debt is too large to be repaid immediately, the parties may wish to include a provision in the separation agreement requiring the repayment of the debt with interest under a promissory note which is attached to and made part of the separation agreement.

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**j. Employee Benefits**

Employee benefits should be addressed in the separation agreement, at least in a general way. In most cases, the normal operation of the employee benefit plans should be able to handle all issues that arise involving benefits. In those cases, the separation agreement simply can recite that the employee benefits plans will govern all such matters. If particular matters involving employee benefits are in dispute, or may become a source of controversy, then it may be best to address those matters through specific provisions in the separation agreement.

**k. COBRA**

Because health care continuation coverage often is an important issue to a departing employee, it should be addressed in the separation agreement. If the employer has close to 20 employees, the separation agreement should recite whether the employer is subject to COBRA and, if it is, it can be a good idea for the separation agreement to specify the duration of COBRA coverage, the qualified beneficiaries, and the employer contributions to be made, if any. In a state mandating COBRA-like continuation coverage, the same issues should be addressed under the applicable state law.

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**l. Letters of Reference**

Employees often seek a positive letter of reference as part of their separation agreement. For an employee who is departing on good terms, such a letter may not be problematic. The opposite is true, however, for an employee who is departing under less than good terms. Employers may be reluctant to endorse the employee to future employers, out of concern for the employer's credibility and because of the possibility of legal liability if a future employer or individual suffers harm because the employee was hired based upon the letter of reference. In any event, if the employer and the employee agree that a letter of reference is to be given, they should agree to the complete wording of the letter before signing the separation agreement, rather than signing the agreement and hoping they will be able to reach agreement on its contents at a later time. The following is a sample provision:

Letter of Reference. Employer shall provide Employee with a reference letter on its letterhead the text of which shall be identical to the text set forth in Schedule A, attached hereto. Employer shall respond to all requests by potential employers of Employee for references or other information solely by providing the potential employer with a copy of said reference letter.

**m. Employment Verification**

The issue of employment verification also should be addressed in most separation agreements. Normally, the agreement should indicate the employer will follow its regular

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policies and procedures. The following is an example of a separation provision on employment verification:

Employment Verification. Upon written request of Employee, Employer may provide to any third party a written employment verification consisting of the following information: (1) confirmation of employment, (2) position held, (3) date employment began, (4) date employment ended. If asked for additional information, Employer will advise such third party that releasing additional information is not permitted under Employer's policies. Additional information may be disclosed by Employer if required or permitted by law.

**n. Nondisparagement**

In some instances the employer may be concerned that the employee will make disparaging remarks about the employer, or vice versa. In such instances, the parties should consider including a nondisparagement provision in the separation agreement.

**o. Future Employment**

An employer may be very surprised when an employee who alleged sexual harassment by company officials and resigned under a generous separation agreement reapplies for employment a month after receiving her severance check. The employer, of course is not going to rehire the employee, and tells the employee so. The employee then files a charge of discrimination with the Equal Employment Opportunity Commission, alleging the company violated Title VII of the Civil Rights Act of 1964 by refusing to consider her application in retaliation for her earlier complaints of sexual harassment.

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Because the employee never agreed not to reapply for employment, the company must convince the EEOC that it had a legitimate business justification for rejecting the employee's application. The employer has allowed itself to be set up by a very clever former employee.

This situation can be avoided by including in the separation agreement a provision under which the employee agrees never to reapply for employment. The following is an example of such a provision:

Future Employment. Employee understands and agrees that Employee is not and shall not be entitled to any future employment with Employer, and hereby disclaims any entitlement to such employment. Employee covenants and agrees not to apply for or otherwise seek employment with Employer at any time now or in the future.

**p. Unemployment Compensation**

The employer normally should seek an agreement with the employee that the employee will not seek unemployment compensation or, if the employee is already receiving unemployment compensation, will disclaim further unemployment compensation. The parties also should agree that the employer will report the severance payment to the Virginia Employment Commission.



**q. Cooperation and Assistance**

The employer should consider whether it may need the cooperation of the employee in the future in regard to legal matters. For example, if the employer is being sued by a worker for disability discrimination alleged to have been committed by the departing employee, the employer probably will need the cooperation and assistance of the departing employee in defense of an EEOC charge of discrimination and in defense of subsequent Title VII litigation. If so, the employer should seek agreement to a provision in the separation agreement such as the following:

Cooperation and Assistance. Employee hereby covenants and agrees that, upon request by Employer, Employee shall fully and diligently assist and cooperate with Employer in any and all investigations or proceedings, whether criminal or administrative, instituted by Employer or in which Employer is a party or a participant. Said cooperation and assistance may include, but not be limited to, answering questions, providing statements, and testifying truthfully. All such cooperation and assistance shall be without pay or other compensation.

**r. Employer Property**

Departing employees often have company property which has been entrusted to them, or which they otherwise have obtained, during their employment. Such property may include, for example, keys, documents, and computer data. The employer should include in the separation agreement a provision requiring the prompt return of all such property, such as the following:

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Employer Property. Employee agrees to return to Employer, within three (3) calendar days of the date this Agreement becomes effective, any and all Employer property in Employee's possession, custody or control, if any, including Employer records, whether in tangible or electronic form, and whether originals or copies. Employee's failure to do so shall constitute a representation and warranty by Employee that Employee is not in possession, custody and control of any such items. Any computer data files or other electronic records stored on computer devices in Employee's possession, custody or control shall be delivered to Employer by appropriate and reliable means and, after Employer has acknowledged receipt of same in writing, Employee shall cause those files and records to be irrevocably deleted from said device(s) unless said devices have been delivered over to Employer. Within ten (10) calendar days of the date of this Agreement, Employee shall provide employer with an affidavit, attested by a qualified notary public, under which Employee affirms under oath that Employee has fully performed all of the preceding obligations.

**s. Ownership Interests**

If the departing employee has expressed some claim to ownership of the employer or any of its assets, the separation agreement should contain a provision resolving all ownership issues. The following is an example of such a provision:

Ownership. Employee hereby acknowledges and confirms that Employee does not have and will not have any ownership interest in Employer, or in the assets or property of Employer, whether real or intangible, and hereby disclaims any and all such ownership interest. Employee covenants and agrees to execute any documents and take any other actions reasonably requested by the Employer now or in the future for the purpose of resolving issues of title and ownership.

**t. Protection of Confidential Information**

Some departing employees will have had access to confidential and proprietary information and trade secrets of the employer, the disclosure of which, or the use of which in competition with the employer, would be detrimental to the employer. A separation agreements for such a employee should have provisions under which the employee acknowledges the fact that he has received such information, and under which he promises not to disclose or use it. The following is an example of such a provision:

Fiduciary Duties. Employee acknowledges that, during Employee's employment by Employer, Employee has been privy to confidential and proprietary information and trade secrets ("Confidential Information") which Employee has a fiduciary duty to hold in confidence and not use for any purpose other than for the benefit of Employer. Employee therefore covenants and agrees that Employee, while Employee is employed by Employer or at any time thereafter, shall not disclose to third parties, or use other than for the benefit of Employer, any such Confidential Information, unless authorized to do so by Employer in writing or unless required to do so by order of a court of competent jurisdiction. Employee acknowledges and agrees that these restrictions are reasonable and appropriate to protect the legitimate business interests of Employer.

**u. Noncompetition**

In exchange for severance benefits, and employee may be willing to agree not to compete with the employer for a specific period of time. Such agreements can be beneficial for the employer, particularly if the departing employee is in a position to effectively engage in competition against the employer. Such agreements, however, are unenforceable unless drafted precisely, and therefore should be drafted with great care.

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**v. Waiver and Release of Claims**

Every separation agreement should contain a general waiver and release of all claims the employee has or may have against the employer arising up to the time the separation agreement is executed. The release should apply to not just the employer, but also to the employer's parent or subsidiary entities, if any, and against the officers, directors, members, managers, employees, agents, representatives, attorneys, heirs, executors, administrators, successors and assigns of each. Inclusion of a general release in a separation agreement usually is not a sticking point in negotiations, since most employees (or their legal counsel) will expect to have to release any claims they may have in exchange for receiving severance benefits. The release should be drafted with care, since it is normally one of the most valuable, if not the most valuable, benefits the employer gains by entering into the separation agreement.

Some employees will demand the release be mutual, i.e., that the employer waive any claims it may have against the employee. Before agreeing to do so, an employer should carefully consider whether it may have a legal claim against the employee which it will wish to assert in the future. For example, if the employer has any reason to believe the employee may have been stealing customer lists, computer data or trade secrets, the employer may have causes of action against the employee for breach of fiduciary duty and breach of contract, which would be lost if the employer executed a general waiver and release of all claims as part of the separation agreement. An employer also should

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carefully consider whether entering into a general release with an employee may violate the terms of an insurance policy or other third party contract. For example, a medical practice employing physicians will have a medical malpractice policy covering its physician employees, which may contain a provision under which the carrier can seek contribution or indemnity from a physician whose negligence results in payment of a claim. If the medical practice grants a general release to the physician, that release will prejudice the rights of the carrier and give the carrier grounds to refuse to defend or pay the claim. If this becomes a sticking point in negotiation of the separation agreement, the employer may wish to agree to the general release, with certain rights, such as those of insurance carriers, expressly reserved.

Statutes, such as Title VII of the Civil Rights Act of 1964, upon which employee claims may be based, should be specifically named in the release to prevent the employee from later arguing that he did not understand he was releasing claims under those statutes. Other causes of action frequently asserted by employees, such as breach of contract, wrongful discharge, assault, battery, libel, slander, intentional or negligent infliction of emotional distress, also should be specifically named as being released.

Claims under some statutes cannot be released under a separation agreement unless the release is approved in advance by a government authority or court. This is true, for example, of claims under the Fair Labor Standards Act. *See Taylor v. Progress Energy, Inc.*, 493 F.3d 454 (4th Cir. 2007), *petition for certiorari filed*, No.07-739 (Oct.

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22, 2007). This does not mean that the employer and the employee cannot reach an agreement which includes a resolution of any FLSA issues; its does mean, however, that an unsupervised waiver of FLSA claims in the separation agreement will not serves as a defense in the event the employee, after signing the release and accepting the severance payment, chooses to file a FLSA lawsuit.

The law is unsettled in regard to the validity of a waiver of FMLA claims in a separation agreement that has not been approved in advance by the U.S. Department of Labor or by a court. The Fourth Circuit has held that such waivers are invalid. *See Taylor v. Progress Energy, Inc.*, 493 F.3d 454 (4th Cir. 2007), *petition for certiorari filed*, No.07-739 (Oct. 22, 2007) (“without prior DOL or court approval, 29 C.F.R. § 825.220(d) bars the prospective and retrospective waiver or release of rights under the FMLA, including the right to bring an action or claim for a violation of the Act”). Other federal circuits, however, have ruled that such waivers are valid. *See, e.g., Dougherty v. TEVA Pharmaceuticals, USA, Inc.*, 2007 U.S. Dist. LEXIS 27200, 12 Wage & Hour Cases 2d (BNA) 1252 (E.D. Pa. 2007) (29 C.F.R. § 825.220(d) “does not prohibit an employee from waiving past FMLA claims as part of a severance agreement or settlement”). It seems likely that the United States Supreme Court will rule in the issue eventually, but it is impossible to know when. Until then, employers in the Fourth Circuit should be aware that unsupervised FMLA releases in separation agreements are invalid in this federal circuit, at least for now.

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**w. Covenant Not To Sue**

A separation agreement which contains a release normally also should contain a provision under which the employee agrees not to institute legal proceedings asserting any cause of action which has been released. Having such a covenant will provide the employer with a clear cause of action against the employee for breach of contract in many circumstances in which the employee attempts to bring a legal action asserting a released claim, the damages for which will be, among other things, the cost and expenses, including attorney's fees, paid by the employer to defend the lawsuit.

**x. Remedies for Breach**

Depending on the other terms of a separation agreement, it may be desirable for the employer to include in the agreement a provision granting the employer the right to preliminary, temporary and permanent injunctive relief in the event of breach or threatened breach of the separation agreement by the employee. This can be important where, for example, the separation agreement contains a nondisclosure provision or a noncompete provision.

**y. Cost of Enforcement**

A separation agreement normally should contain a provision requiring the employee to reimburse the employer for all costs and expenses, including reasonable

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attorney's fees, incurred by the employer is obtaining a remedy for any breach of the agreement by the employee. The obligation can be made mutual as part of negotiations, if necessary.

**z. No Admission**

The separation agreement should state that nothing in it should be construed as an admission of any wrongdoing. The following provision is provided as an example:

No Admission. Nothing contained in this Agreement shall be construed as an admission, agreement, consent, statement, acquiescence or declaration on the part of either party as to any wrongdoing, breach of contract, violation of any law, or legal liability.

**aa. No Policy, Plan or Precedent**

The separation agreement should state that nothing in it should be construed as establishing any policy, plan or precedent applicable to other employees.

**bb. Compulsory Legal Obligations**

It can be useful to include in a separation agreement an provision such as the following, to prevent any other provision from being construed as being inconsistent with an employee complying with legal obligations:

Compulsory Legal Obligations. Nothing in this Agreement shall be construed as prohibiting any party to this Agreement, or any officers, employees, agent or representative of any such party, from complying



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with compulsory legal obligations including but not limited to providing documents or information in response to any lawful subpoena, Court order, or other legal process, or as prohibiting any party to this agreement, or any officers, employees, agent or representative of any such party, from testifying truthfully if compelled under legal process or otherwise required by law to do so.

**cc. Total Integration Clause**

Most separation agreements should contain a “total integration” clause, such as the following:

Entire Agreement. Except to the extent expressly stated herein, if any, this Agreement constitutes the entire agreement between Employer and Employee, and supersedes any and all prior agreements and understandings between them, except to the extent, if any, expressly provided herein.

The proviso “except to the extent, if any, expressly provided herein” can be very important where, for example, the employee has previously signed a noncompete agreement which the employee does not wish for the separation agreement to supersede. In such a situation, it is best to expressly acknowledge, in the separation agreement, the existence of the prior agreement, the fact that it remains valid and enforceable, and the fact that the separation agreement does not supersede it.

**dd. Interpretation**

Under a general rule of contract interpretation, a contract is construed against the party who drafted it. While no clause in a contract can guarantee the contract will not be

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construed against the employer, a clause such as the following may be helpful in some circumstances:

Interpretation. This Agreement is the product of and reflects actual negotiations between the parties in regard to its term and conditions. Therefore, the parties agree that no rule of contract interpretation based upon authorship shall be applied in interpretation of this Agreement.

**ee. Voluntariness**

In order for a separation agreement to be enforceable by the employer, it is usually important for the employer to be able to establish that the employee entered into the agreement voluntarily and not as a result of duress. This is particularly true in regard to waivers and releases of statutory claims. To help demonstrate voluntariness, it can be helpful to include a clause such as the following in a separation agreement:

Voluntary Agreement. The Employee acknowledges, represents and warrants that the Employee has read this Agreement completely; that the Employee understands the words used in this Agreement, that this Agreement reflects the desires and understanding of the Employee; that the Employee has been advised in writing to consult with legal counsel of the Employee's choosing prior to signing this Agreement, and either has done so or has had an adequate opportunity to do so and has elected to proceed without the benefit of such legal counsel; and that the Employee is entering into this Agreement voluntarily, without coercion or duress, intending to be legally bound.

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**ff. Choice of Law**

The separation agreement should specify the state whose law will govern the separation agreement. This can be important where, for example, the employee resides outside the state in which the employer is located, or a noncompete provision in the separation agreement is to be enforced outside the employer's home state. The following is an example of such a provision for a Virginia employer:

Choice of Law. This Agreement shall be governed by the law of the Commonwealth of Virginia, without regard to conflict of law principles.

**gg. Other Clauses**

Depending on the circumstances, it may be appropriate to include other provisions in a separation agreement. In deciding what provisions should be included, the guiding principle is that the agreement should address every issue which is important, or which may reasonably be expected to become important, between the employer and the employee.

**4 AGE DISCRIMINATION CONSIDERATIONS**

**a. Nature of Considerations**

An employee who is offered a separation agreement may claim that the employer, by asking him to accept it or by taking some other related action, such as deciding to terminate him, is discriminating against him because of his age. He also may claim age

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discrimination on the grounds that the benefits offered to him under his separation agreement are less generous than those offered to younger employees. In addition to such “disparate treatment” claims, an employee may assert “disparate impact” claims where, for example, an early retirement plan allegedly treats older employees less favorably than younger employees. *See generally Smith v. City of Jackson, Mississippi*, 544 U.S. 228 (2005) (holding that disparate impact cases are cognizable under Age Discrimination in Employment Act). In order to avoid liability for age discrimination in connection with separation agreements, employers need to ensure their separation agreements, and the process used in offering them, do not discriminate on the basis of age against employees protected by the Age Discrimination in Employment Act and other similar laws.

**b. Laws Prohibiting Age Discrimination**

The primary federal law prohibiting age discrimination in employment is the Age Discrimination in Employment Act of 1967, 29 U.S.C. § 621 *et seq.* (“ADEA”). It prohibits age-based discrimination “in any aspect of employment” against most individuals 40 years of age or older by private employers having 20 or more employees, by employment agencies, by most labor unions, by local governments, and by state governments (subject to certain immunities). *See generally* 29 CFR § 1625.2. Under the ADEA, covered employers are forbidden to fail or refuse to hire, to discharge, or

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otherwise discriminate against any person with respect to compensation, terms, conditions, or privileges of employment because of such person's age; limit, segregate, or classify an employee in any way that would deprive the employee of job opportunities or adversely affect employment status because of age; reduce the wage rate of an employee in order to comply with the act; indicate any “preference, limitation, specification, or discrimination” based on age in any notices or advertisements for employment; and operate a seniority system or employee benefit plan that requires or permits involuntary retirement. Covered employment agencies are forbidden to fail or refuse to refer for employment, or otherwise to discriminate against, any individual because of the individual's age, or to classify or refer for employment any individual on the basis of the individual's age. Covered labor unions are forbidden to exclude or to expel from its membership, or otherwise to discriminate against, any individual because of his age; to limit, segregate, or classify its membership, or to classify or fail or refuse to refer for employment any individual, in any way which would deprive or tend to deprive any individual of employment opportunities, or would limit such employment opportunities or otherwise adversely affect his status as an employee or as an applicant for employment, because of the individual's age; and to cause or attempt to cause an employer to discriminate against an individual in violation of the ADEA.

The primary Virginia law prohibiting age discrimination is the Virginia Human Rights Act, Va. Code § 2.2-2900A *et seq.* It provides in part:

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Conduct that violates any Virginia or federal statute or regulation governing discrimination on the basis of ... age ... shall be an "unlawful discriminatory practice...."

The Virginia Human Rights Act is enforced by the Virginia Council on Human Rights.

The statutory provisions relating to the Virginia Council on Human Rights provides in part:

No employer employing more than five but less than 15 persons shall discharge any such employee on the basis of ... age if the employee is 40 years old or older.

Va. Code § 2.2-2639(B).

Most states have their own laws prohibiting age discrimination. Therefore, employers operating outside Virginia should make sure they are complying with the laws of each state in which they are operating.

The discussion of age discrimination below focuses on the ADEA, since it is the law most frequently used as the basis for litigation.

**c. Who are Employees Protected by the ADEA?**

**(1) Why It Is Important**

Any employee at least 40 years old may assert an age discrimination claim under the ADEA. Not everyone affiliated with an organization, however, is an employee within the meaning of the ADEA. Because the terms of a separation agreement should reflect all the particular risks associated with the departing individual and his separation from

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employment, it can be important to determine whether an individual is within or outside the protections of the ADEA.

**(2) General Rule**

In general, any employee 40 years of age or older is protected by the ADEA. This means that an employee at least 40 years old can base an ADEA claim upon alleged discrimination against him compared to employees under 40. In addition, the United States Supreme Court has ruled that an ADEA discrimination claim can be made by an employee within the protected class (employees age 40 or older) based upon allegedly preferential treatment of employees who are substantially younger but who are also within the protected class. *See O'Connor v. Consolidated Coin Caterers*, 517 U.S. 308 (1996).

**(3) Officers, Directors, Owners, Members and Partners**

Officers, directors, and shareholders in a corporation generally are not considered employees protected by the ADEA, but can be employees depending on individual circumstances, such as where they act as an employee as well as acting as an officer, director or shareholder. *See, e.g., EEOC v. First Catholic Slovak Ladies Association*, 694 F.2d 1068 (6th Cir. 1982) (officers of a nonprofit corporation who performed traditional employee duties were employees protected by the ADEA even though they were elected

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by the organization's board of directors). A partner in a partnership or a member in a limited liability company may or may not be an employee for purposes of the ADEA, depending on the legal relationship of the partner to the employing entity. *See, e.g., Fountain v. Metcalf, Zima & Co.*, 925 F.2d 1398 (11th Cir. 1991) (discharged member of a four-person accounting firm was a “partner” and not an employee under the ADEA because he shared in the firm's profits, losses, and expenses; he was liable for certain debts, obligations, and liabilities of the firm; he had a right to vote on member amendments to the membership agreement, on the admission of new members, on draws, and on distribution of profits and income).

**Suggestions for Employers:** In any **separation agreement** with such individuals, it is desirable to recite that the individual is an officer, director, owner, etc., and not an employee, if the facts support such a characterization. Non-employee characterization also should be considered before having such an individual enter an **“employment agreement,”** such entering such an agreement (as opposed to, for example, a **compensation agreement** for a director or a **partnership agreement** for a partner) may be interpreted as clear proof of employee status.

**(4) Bona Fide Executives and High Policymakers.**

The ADEA excludes from its coverage certain bona fide executives and high policymakers. 29 USC section 631(c) provides:



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(1) Nothing in this Act shall be construed to prohibit compulsory retirement of any employee who has attained 65 years of age and who, for the 2-year period immediately before retirement, is employed in a bona fide executive or a high policymaking position, if such employee is entitled to an immediate nonforfeitable annual retirement benefit from a pension, profit-sharing savings, or deferred compensation plan, or any combination of such plans, of the employer of such employee, which equals, in the aggregate, at least \$ 44,000.

(2) In applying the retirement benefit test of paragraph (1) of this subsection, if any such retirement benefit is in a form other than a straight life annuity (with no ancillary benefits), or if employees contribute to any such plan or make rollover contributions, such benefit shall be adjusted in accordance with regulations prescribed by the Secretary, after consultation with the Secretary of the Treasury, so that the benefit is the equivalent of a straight life annuity (with no ancillary benefits) under a plan to which employees do not contribute and under which no rollover contributions are made.

The EEOC regulations published at 29 CFR section 1625.12 provide interpretive guidance regarding this exemption.

In determining whether an employee is a “bona fide executive” for purposes of this ADEA exemption, the EEOC requires that the employee meet the requirements of the regulations of the United States Department of Labor under the Fair Labor Standards Act defining employees employed in a bona fide executive capacity. The EEOC’s regulations state:

In order for an employee to qualify as a “bona fide executive,” the employer must initially show that the employee satisfies the definition of a bona fide executive set forth in Sec. 541.1 of this chapter. Each of the requirements in paragraphs (a) through (e) of Sec. 541.1 must be satisfied, regardless of the level of the employee's salary or compensation.

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29 CFR 1625.12(d)(1). In addition, the EEOC requires the employee meet the following criteria:

Even if an employee qualifies as an executive under the definition in Sec. 541.1 of this chapter, the exemption from the ADEA may not be claimed unless the employee also meets the further criteria specified in the Conference Committee Report in the form of examples (see H.R. Rept. No. 95-950, p. 9). The examples are intended to make clear that the exemption does not apply to middle-management employees, no matter how great their retirement income, but only to a very few top level employees who exercise substantial executive authority over a significant number of employees and a large volume of business. As stated in the Conference Report (H.R. Rept. No. 95-950, p. 9):

Typically the head of a significant and substantial local or regional operation of a corporation [or other business organization], such as a major production facility or retail establishment, but not the head of a minor branch, warehouse or retail store, would be covered by the term “bona fide executive.” Individuals at higher levels in the corporate organizational structure who possess comparable or greater levels of responsibility and authority as measured by established and recognized criteria would also be covered.

The heads of major departments or divisions of corporations (or other business organizations) are usually located at corporate or regional headquarters. With respect to employees whose duties are associated with corporate headquarters operations, such as finance, marketing, legal, production and manufacturing (or in a corporation organized on a product line basis, the management of product lines), the definition would cover employees who head those divisions.

In a large organization the immediate subordinates of the heads of these divisions sometimes also exercise executive authority, within the meaning of this exemption. The conferees intend the definition to cover such employees if they possess responsibility which is comparable to or greater than that possessed by the head of a significant and substantial local operation who meets the definition

29 CFR 1625.12(d)(2). The EEOC holds that

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The EEOC explains the meaning of “high policymaking position,” for purposes of this ADEA exemption, as follows:

The phrase “high policymaking position,” according to the Conference Report (H.R. Rept. No. 95-950, p. 10), is limited to “\* \* \* certain top level employees who are not ‘bona fide executives’ \* \* \*.” Specifically, these are “individuals who have little or no line authority but whose position and responsibility are such that they play a significant role in the development of corporate policy and effectively recommend the implementation thereof.”

For example, the chief economist or the chief research scientist of a corporation typically has little line authority. His duties would be primarily intellectual as opposed to executive or managerial. His responsibility would be to evaluate significant economic or scientific trends and issues, to develop and recommend policy direction to the top executive officers of the corporation, and he would have a significant impact on the ultimate decision on such policies by virtue of his expertise and direct access to the decisionmakers. Such an employee would meet the definition of a “high policymaking” employee.

On the other hand, as this description makes clear, the support personnel of a “high policymaking” employee would not be subject to the exemption even if they supervise the development, and draft the recommendation, of various policies submitted by their supervisors.

29 CFR 1625.12(e).

This exemption can apply to a particular employee only if the employee was in a bona fide executive or high policymaking position for the two-year period immediately before retirement. An employee who holds two or more different positions during the two-year period is subject to the exemption only if each such job is an executive or high policymaking position. 29 CFR 1625.12(f).

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This exemption applies not only to retirement, but also to demotions. According to the EEOC regulations, “An employee within the exemption can lawfully be forced to retire on account of age at age 65 or above. In addition, the employer is free to retain such employees, either in the same position or status or in a different position or status. For example, an employee who falls within the exemption may be offered a position of lesser status or a part-time position. An employee who accepts such a new status or position, however, may not be treated any less favorably, on account of age, than any similarly situated younger employee.” 29 CFR 1625.12(c).

This exemption should be relied upon by an employee only if the employer has a high degree of certainty it can establish the exemption applies. The EEOC regulations state, “Since this provision is an exemption from the non-discrimination requirements of the Act, the burden is on the one seeking to invoke the exemption to show that every element has been clearly and unmistakably met. Moreover, as with other exemptions from the Act, this exemption must be narrowly construed.” 29 CFR 1625.12(b).

For examples of court decisions regarding this exemption, see *Morrissey v. Boston Five Cents Savings Bank*, 54 F.3d 27 (1st Cir. 1995) (employer did not violate ADEA by forcing retirement of employee who had direct access to decisionmakers and recommended policy on areas of importance because statutory exception for high policymaking employee applied); *Passer v. American Chemical Society*, 935 F.2d 322 (D.C. Cir. 1991) (district court's disposition of employee's ADEA claim was improperly

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rendered in employer's favor because the district court erred in determining whether former employee's forced retirement was lawful under ADEA's bona fide executive exemption); *Wendt v. New York Life Ins. Co.*, 1998 U.S. Dist. LEXIS 3139, 76 Fair Empl. Prac. Cas. (BNA) 1500 (S.D.N.Y. 1998) (because an employee fell within bona fide executive exemption under the ADEA, summary judgment was granted in favor of the employer and employee could not maintain his claim that he was subjected to mandatory retirement in violation of ADEA); *Morrissey v. Boston Five Cents Savings Bank FSB*, 866 F. Supp. 643 (D. Mass. 1994) (summary judgment regarding ADEA claim was proper as employee had served in a high policymaker position two years prior to his retirement, and he was entitled to nonforfeitable pension benefits of \$ 44,000, so he was exempt from coverage under ADEA); *Priester v. Amoco Corp.*, 1990 U.S. Dist. LEXIS 6123; 60 Fair Empl. Prac. Cas. (BNA) 1083 (N.D. Ill. 1990) (employer was not entitled to summary judgment in the employee's age discrimination action, because the employer failed to show the employee came within the bona fide executive exception to the ADEA); *Hysell v. Mercantile Stores Co.*, 736 F. Supp. 457 (S.D.N.Y. 1989) (where employer relied on the advice of outside counsel that the forced retirement of an employee fell within an exception to the ADEA for executives, the employee could not show a willful violation of the Act); *Hysell v. Mercantile Stores Co.*, 1989 U.S. Dist. LEXIS 1315; 49 Fair Empl. Prac. Cas. (BNA) 770; 49 Empl. Prac. Dec. (CCH) P38,802 (S.D.N.Y. 1989) (former employer failed to demonstrate that the former employer was a

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bona fide executive who was subject to exemption from the ADEA that would allow forced retirement at age 65); *Tatarian V. Oneida, Ltd.*, 1985 U.S. Dist. LEXIS 13564 (D. Mass 1985) (defendants could not use the exemption for the retirement of bona fide executives under the ADEA because the president was not entitled to an immediate nonforfeitable benefit from a retirement plan).

***Suggestions for Employers:*** If an employee is bona fide executives or a high policymaker, it may be wise to recite that fact in any **separation agreement** with that employee. Doing so confirms the inapplicability of the ADEA to that employee, in case the employee later decides to assert an ADEA claim. Because of the linkage of the ADEA exemption to the Fair Labor Standards Act executive exemption, such a recitation also may be valuable if the employee asserts an FLSA claim for overtime compensation in which he argues he was not properly classified as an exempt executive. Employees to whom this exemption applies almost always should be employed under a written **employment agreement**, and it can be very helpful for that agreement to clearly state all the facts necessary to establish the exemption.

**(5) Elected Public Officials and Appointees**

The ADEA does not apply to elected public officials and their personal staff, appointees on the policy-making level, and immediate advisers, if they are not subject to civil service laws. 29 U.S.C. § 630(f).

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**d Age Discrimination Waivers**

**(1) ADEA Waivers After the Older Workers Benefit Protection Act**

In 1990, Congress enacted the Older Workers Benefit Protection Act (“OWBPA”), which amended the ADEA. (29 U.S.C. § 626(f)). The OWBPA provides that employees may waive rights and claims under the ADEA if, but only if, the waiver is “knowing and voluntary.” The OWBPA established the following requirements which must be met in order for a waiver to be knowing and voluntary:

- A. the waiver be part of a written, clearly understood agreement between the employee and the employer;
- B. the waiver specifically refer to rights or claims arising under the ADEA;
- C. rights and claims arising after the date of the waiver may not be waived;
- D. rights and claims be waived only in exchange for consideration in addition to anything of value to which the employee is already entitled;
- E. written advice to consult with an attorney be given;
- F. a period of 21 days be given for the employee to consider the agreement or, if a waiver is in connection with an exit incentive or other employment termination program offered to a group or class, at least 45 days be given to consider the agreement; and
- G. the waiver provide for at least 7 days during which the employee can revoke the agreement.

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- H. If a waiver is executed in connection with an exit incentive or other employment termination program offered to a group of employees, the employer must inform the employees in writing about the group covered by the program, any eligibility factors for the program, and any applicable time limits. The employer must also make clear the job titles and ages of all people eligible or selected for the program and the ages of all people in the same job classification or organizational unit who are not eligible or selected for the program.

In a dispute concerning the validity of an ADEA waiver, the employer bears the burden of proving the waiver was knowing and voluntary.

An ADEA waiver cannot affect the EEOC's right to enforce the ADEA. *See* 29 U.S.C. § 626(f)(4); EEOC Guidance on Waivers Under Civil Rights Laws.

**Suggestions for Employers:** Any **separation agreement** with an employee who is 40 years old or older should contain a release of ADEA claims that complies with all the requirements of the Older Workers Benefit Protection Act, and which is administered in accordance with the OWBPA.

**(2) Tender Back**

In *Oubre v. Entergy Operations*, 522 U.S. 422 (1998), the United States Supreme Court held that if an ADEA waiver does not comply with the OWBPA then an employee



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may pursue an ADEA lawsuit without first tendering back payments made under the waiver. Effective January 10, 2001, the EEOC issued 29 CFR section 1625.23, Sec. 1625.23 (“waivers of rights and claims: tender back of consideration”), which states:

(a) An individual alleging that a waiver agreement, covenant not to sue, or other equivalent arrangement was not knowing and voluntary under the ADEA is not required to tender back the consideration given for that agreement before filing either a lawsuit or a charge of discrimination with EEOC or any state or local fair employment practices agency acting as an EEOC referral agency for purposes of filing the charge with EEOC. Retention of consideration does not foreclose a challenge to any waiver agreement, covenant not to sue, or other equivalent arrangement; nor does the retention constitute the ratification of any waiver agreement, covenant not to sue, or other equivalent arrangement.

(b) 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. This rule is not intended to preclude employers from recovering attorneys' fees or costs specifically authorized under federal law.

(c) Restitution, recoupment, or setoff. (1) Where an employee successfully challenges a waiver agreement, covenant not to sue, or other equivalent arrangement, and prevails on the merits of an ADEA claim, courts have the discretion to determine whether an employer is entitled to restitution, recoupment or setoff (hereinafter, “reduction”) against the employee's monetary award. A reduction never can exceed the amount recovered by the employee, or the consideration the employee received for signing the waiver agreement, covenant not to sue, or other equivalent arrangement, whichever is less.

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(2) In a case involving more than one plaintiff, any reduction must be applied on a plaintiff-by-plaintiff basis. No individual's award can be reduced based on the consideration received by any other person.

(d) No employer may abrogate its duties to any signatory under a waiver agreement, covenant not to sue, or other equivalent arrangement, even if one or more of the signatories or the EEOC successfully challenges the validity of that agreement under the ADEA.

**(3) Recent Cases**

Recent cases involving ADEA waivers include *Thomford v. IBM*, 406 F.3d 500 (8th Cir. 2005) (ADEA waiver invalid because it was not written in a manner calculated to be understood by the employee); *Krane v. Capital One Services*, 314 F. Supp. 2d 589 (E.D. Va. 2004) (former employees could seek relief for alleged waiver violations, but threats in the waiver agreement did not constitute adverse employment action for purposes of a retaliation claim); *Cole v. Gaming Entertaining, LLC*, 199 F. Supp. 2d 208 (D. Del. 2002) (ADEA release that stated employee "had been advised" to consult with an attorney before signing the release was insufficient to meet the OWBPA requirement that the employer advised the employee in writing to consult with an attorney before signing the release); *Adams v. Moore Bus. Forms, Inc.*, 224 F.3d 324 (4th Cir. 2000) (ADEA releases of claims by employees in exchange for severance packages were valid); and

**e. Early Retirement Incentive Plans**

Voluntary early retirement incentive plans (ERIs) provide a means by which employers and employees can work together in connection with downsizings and reorganizations. In an ERI, the employer typically offers older employees a financial incentive to agree to retire early. An ERI can yield direct financial benefit to an employer because the older workers taking the early retirement usually have the greatest seniority and are at the upper end of the pay scale; in contrast, a reduction in force based upon seniority typically eliminate the least senior and lower-paid employees. An ERI can be beneficial to the employees as well, because it enables them to retire with larger benefits, received earlier, than otherwise would be the available.

The Equal Employment Opportunity Commission issued a “Guidance on Employee Benefits” on October 3, 2003, as section 3 of the EEOC Compliance Manual (“EEOC Guidance on Employee Benefits”). It states that, as long as an ERI is voluntary, an employer may set a minimum age, or a minimum number of years of service, at which employees will be eligible to participate; offer an ERI for a limited period of time ( e.g. , only to those who retire between January 1 and April 30); and/or offer an ERI only to a subset of a company (e.g., only to managers, only to a particular department, or only to employees at a single facility).

Voluntariness is often a key issue on any ERI. The EEOC Guidance on Employee Benefits states as follows regarding voluntariness:

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The determination of whether an ERI is voluntary will be based upon the facts and circumstances of a particular case. The employee has the burden of proving that an ERI is not voluntary. The test is whether, under those circumstances, a reasonable person would have concluded that there was no choice but to accept the offer. Among the considerations that can be relevant are:

- Was the employee given adequate time to make a decision?
- Was the employee given accurate and complete information about the plan?
- Was the employee subjected to any threats or coercion?
- Will older employees be subjected to negative consequences if they reject the offer?
- Did the employee receive advice of counsel while making his/her decision?

A plan will not be voluntary if an employee was given inadequate time or insufficient information to make an informed decision about whether to accept the employer's offer. Where an employee or group of employees is asked to sign a waiver of rights under the ADEA in exchange for the ERI, moreover, specific time limits apply; an individual must be given at least 21 days, and a group of employees at least 45 days, to consider the waiver. Employers must also meet various other criteria for a waiver to be valid. On the other hand, it is not coercion for an employer to notify its work force that layoffs will be necessary if insufficient numbers of employees retire voluntarily, unless older workers are the only ones threatened. It is also not coercion that an employer's offer was "too good to refuse."

For cases addressing voluntariness, *see, e.g., Auerbach v. Board of Education*, 136 F.3d 104, 113 (2d Cir. 1998) (plan voluntary where no coercion, employees got complete and accurate information, and employees had four months to make decision); *Anderson v. Montgomery Ward & Co., Inc.*, 650 F. Supp. 1480 (N.D. Ill. 1987) (factual issue about voluntariness precluded summary judgment where employer encouraged some employees to stay and threatened others that they would be terminated without separation benefits if they rejected the ERI).

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Example - Employer E offers an early retirement incentive to those employees who are 55 or older and who have at least 10 years of service. Employer E tells the employees that they have until the end of the business day to decide whether to accept the incentive. Employer E's supervisors also visit all eligible employees to advise them that the company president will be "very unhappy" and will be "forced to reconsider their standing in the company" if they decline the offer. This ERI is not voluntary.

Under the EEOC Guidance on Employee Benefits, an employer must provide the same level of ERI benefits to older and similarly situated younger employees, unless the employer can establish one of the following five justifications for giving older employees lower benefits (i.e., the ways specified in the ADEA an employer can justify providing lower benefits to older employees than younger employees in general):

(1) *Equal Cost Justification.*

The equal cost justification applies where the employer can show that it is spending an equal amount on benefits for each employee but that amount purchases less for older workers.

(2) *"Subsidized Portion" Offset Justification.*

The "subsidized portion" offset justification applies where the benefits are used to bring those who retire early up to the level of an unreduced pension, i.e., to the amount that those employees would receive at normal retirement age. This justification can be used only if the total annual pension does not exceed the pension of a similarly situated older employee who has reached normal retirement age; the ERI benefit is provided as

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part of a defined benefit pension plan; and the plan offers the same terms to older and younger employees eligible for the ERI.

(3) *Social Security Supplement Justification.*

For persons who are not yet eligible for Social Security retirement benefits, the ERI “bridges the gap” between early retirement and Social Security eligibility. This justification can be used only if the supplement terminates at the age of eligibility for reduced or unreduced Social Security benefits; the supplement is to be a defined benefit to be paid to the employee; and the amount of the supplement does not exceed the amount to which an employee would be entitled in Social Security payments at the date on which the supplement terminates.

(4) *Tenured Faculty Justification.*

Under recent ADEA amendments, an institution of higher education may make age-based reductions in ERI benefits offered to its tenured faculty without demonstrating that it meets one of the other justifications. This justification can be used only if the employer is an institution of higher education; the age-based reductions applies only to tenured faculty members; the employer does not reduce or eliminate any other benefits due to tenured faculty members unless the reduction is otherwise permitted by the ADEA; the employer does not repackage other benefits that have been offered to the employees eligible for the ERI within the preceding 365 days; and all tenured faculty have at least one chance to elect the benefit when they first become eligible for it (this is

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a grandfathering requirement to protect tenured faculty who are over the ages eligible for early retirement when the employer first institutes an ERI).

- (5) *Plans “Consistent With the Relevant Purpose or Purposes of” the ADEA Justification.*

Under this justification, the employer structures its ERI to give all employees above a certain age a flat dollar amount; additional service-based benefits (e.g., \$1,000 multiplied by the number of years of service); a percentage of salary; a flat dollar increases in pension benefits (e.g., \$200 per month); a percentage increases in pension benefits (e.g., 20%); imputed years of service and/or age.

***Suggestions for Employers:*** Early retirement incentive plans, if designed and administered properly, can be valuable tools for employers who need to downsize. However, an early retirement incentive plan can expose the employer to liability for age discrimination if not properly designed or if not properly administered. Therefore, employers wishing to use an early retirement incentive plan should engage legal counsel to design, or at least review, the plan for legal compliance, and should ensure that the persons administering it are familiar with the details of the plan and the applicable legal issues.

## **5. CONCLUSION**

Negotiating and drafting separation agreements involves numerous legal, business and practical issues. Separation agreements, however, provide employers with a valuable

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means of preventing disputes with employees from turning into investigative proceedings by government agencies or lawsuits in state or federal court. While separation agreements are not appropriate in every circumstance, their use should be considered in any situation in which an employee is departing amidst legal controversy.