

State of the Law on Settlement Agreements ...
and Tips to Make Them Stick

by Richard M. Freeman and Carole M. Ross

Sheppard, Mullin, Richter & Hampton LLP
12275 El Camino Real, Suite 200
San Diego, CA 92130-2006
Telephone: 858.720.8900
Facsimile: 858.509.3691
www.sheppardmullin.com

SheppardMullin

THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA

Quality People. Quality Projects



This paper is not intended as legal advice and cannot be relied upon for any purpose without the services of a qualified professional.

State of the Law on Settlement Agreements...and Tips to Make them Stick

by Richard M. Freeman and Carole M. Ross

Attorneys must remain knowledgeable regarding settlement agreements in order to protect their clients' interests, give their clients reasonable expectations, and protect themselves against malpractice claims. This program will address some of the most common issues that arise under federal law while drafting settlement agreements between employers and employees.

I. Discrimination Claims under Title VII of the Civil Rights Act of 1964

A. Validity of Waiver

There are specific requirements for a valid waiver of claims under Title VII of the Civil Rights Act of 1964 ("Title VII"). In order to be effective, waiver of federal discrimination claims under Title VII must be: (1) knowingly and voluntarily signed; (2) offer consideration, such as additional compensation, in exchange for the waiver of the right to sue; and (3) not require the employee to waive future rights.

The first requirement, that the waiver is knowing and voluntary, is where many settlement agreements fail. Most courts look beyond the literal contract language and consider the totality of the circumstances to determine whether an employee knowingly and voluntarily waived the right to sue. *Stroman v. West Coast Grocery Company*, 884 F.2d 458, 461 (9th Cir., 1989); *Wastak v. Lehigh Health Network*, 342 F.3d 281 (3rd Cir. 2003); *Smith v. Amedisys, Inc.*, 298 F.3d 434 (5th Cir. 2002). While the precise factors applied in the totality of the circumstances test depends upon the particular circuit, courts tend to look to the following factors:

- The clarity and lack of ambiguity of the agreement;
- The employee's education and business experience;
- Whether the employee had sufficient time to consider the advantages and disadvantages of the agreement before signing;
- The presence of a non-coercive atmosphere for the execution of the release;
- Whether the employee had input into the terms of the agreement;
- Whether the employee consulted with legal counsel, was encouraged to consult with legal counsel or was discouraged from doing so; and
- Whether the consideration given in exchange for the waiver exceeded the benefits to which the employee was already entitled by contract or law.

Smith v. Amedisys, Inc. 298 F.3d 434, 441 (5th Cir. 2002); *Stroman*, 884 F.2d at 462; *see Coventry v. United States Steel Corp.*, 856 F.2d 514, 522 (3rd Cir. 1988).

A review of the case law demonstrates that the first factor listed is often the key to determining whether a release was "knowingly" made. *Coventry*, 856 F.2d at 522. However, at least one circuit, the Ninth Circuit, has held that clear and unambiguous does not necessarily mean that each claim released must be listed. *Stroman*, 884 F.2d at 461. According to the Ninth Circuit, a release of Title VII claims need not be explicit if the facts surrounding the agreement demonstrate that the employee knew that such rights were being released. *Id.* Despite this helpful precedent, listing Title VII within the laundry list of claims released is probably the best way to ensure that the agreement is intended to waive those claims.

B. Nonwaivable Employee Rights

Even if the waiver within a settlement agreement is knowing and voluntary, the agreement may not purport to release certain nonwaivable rights. The Equal Employment Opportunity Commission ("EEOC") takes the position that employers may not interfere with the rights of employees to file a charge or participate in any manner in an investigation, hearing or proceeding under the laws enforced by the EEOC, including Title VII, the Americans with Disabilities Act, the Age Discrimination of Employment Act, and the Equal Pay Act. Enforcement Guidance on Non-Waivable Employee Rights Under EEOC Enforced Statutes (April 1997) ("EEOC Enforcement Guidance"). Agreements that purport to prohibit employees from cooperating with the EEOC have the effect of interfering with the EEOC's enforcement activities by depriving the EEOC of testimony and evidence needed to determine whether discrimination has occurred. Agreements that incorporate an employee's promise not to file a charge or assist with an investigation also constitutes unlawful retaliation. EEOC Enforcement Guidance; *see also* 29 C.F.R. §1625.22(i)(2).

As a result, settlement agreements should not include a covenant not to file a charge with the EEOC or provide information to the EEOC in connection with an investigation. An agreement may, however, incorporate a waiver of an employee's right to recover money in a lawsuit initiated by the employee or the EEOC. See EEOC Enforcement Guidance.

II. Age Discrimination in Employment Act of 1967

The Age Discrimination in Employment Act of 1967 ("ADEA"), as amended by the Older Workers' Benefits Protection Act ("OWBPA"), protects employees who are 40 years of age or older.¹ Congress has established specific criteria for a knowing and voluntary waiver of the federal age discrimination claim. If these requirements are not met, a release is ineffective as a waiver of federal age discrimination claims, even if it effectively waives other types of claims. The precise requirements depend upon whether the employer is a single or isolated employee to sign a waiver or the employer is presenting the waiver in connection with a group termination or exit incentive program.

¹ The ADEA and the OWBPA are collectively referenced as "ADEA."

A. Single Employee

The following are the requirements for a knowing and voluntary waiver under the ADEA where an individual employee is being offered consideration in exchange for a waiver of age discrimination claims under the ADEA:

- Form: The waiver must be in writing and geared to the level of understanding of the employee. The waiver must expressly refer to rights or claims under the ADEA;
- Consideration: The waiver must be supported by something of value to which the employee is not already entitled;
- Advise to consult attorney: The employee must be advised in writing to consult with an attorney prior to executing the agreement;
- No return of severance pay: The waiver cannot require return of severance pay or other consideration in order to sue the employer;
- No prospective waiver: The waiver cannot waive future rights or claims arising after it is executed;
- Review and revocation: The employee must have 21 days to review the agreement before he or she is required to sign. After signing, the employee must be permitted 7 days to revoke the agreement; and
- No fraud: The waiver is unenforceable if an employer used fraud, undue influence or improper conduct to coerce the employee to sign or if the agreement contains a material mistake, omission or misstatement.

29 C.F.R. §1625.22(b).

B. Group Termination

Different and additional requirements apply where an employer seeks a release in connection with an “exit incentive program” or “other termination program.” An “exit incentive program” is a voluntary program where an employer offers two or more employees additional consideration to persuade them to voluntarily resign and sign a waiver. 29 C.F.R. §1625.22(f)(1)(III). An “other employment termination program” generally refers to a program where two or more employees are involuntarily terminated and are offered additional consideration in return for their decision to sign a waiver. 29 C.F.R. §1625.22(f)(1)(III).

Whether a “program” exists depends on the facts and circumstances of each case. The general rule is that a “program” exists if an employer offers additional consideration – or an incentive to leave – in exchange for signing a waiver to more than one employee. 29 C.F.R. §1625.22(f)(1)(III)(B). There are exceptions to that general rule such as when a large employer terminates multiple employees in different units for cause (*e.g.*, poor performance) over the course of several days or months.

The following are the requirements for a knowing and voluntary waiver under the ADEA where an individual employee is offered consideration in exchange for a waiver of age discrimination claims under the ADEA in connection with an exit incentive program or other termination program:

- Form: The waiver must be in writing and geared to the level of understanding of the employees. The waiver must expressly refer to rights or claims under the ADEA;
- Consideration: The waiver must be supported by something of value to which the employee is not already entitled;
- Advise to consult attorney: The employee must be advised in writing to consult with an attorney prior to executing the agreement;
- No return of severance pay: The waiver cannot require return of severance pay or other consideration in order to sue the employer;
- No prospective waiver: The waiver cannot waive future rights or claims arising after it is executed;
- Review and revocation: The employee must have 45 days to review the agreement before he or she is required to sign. After signing, the employee must be permitted 7 days to revoke the agreement;
- No fraud: The waiver is unenforceable if an employer used fraud, undue influence or improper conduct to coerce the employee to sign or if the agreement contains a material mistake, omission or misstatement; and
- Age disclosures in group layoffs: Where the waiver is negotiated as part of an exit incentive or other termination program for a group of employees, each individual must be provided written information as to the job titles and ages for both the individuals selected for termination and those retained in the same job classification.

29 C.F.R. §1625.22(b), (f).

III. Fair Labor Standards Act

The United States Supreme Court held that, absent a bona fide dispute as to liability, employees may not waive the substantive protections provided by the FLSA. *Brooklyn Savings Bank v. O'Neil*, 324 U.S. 697 (1945). In other words, without a true dispute over liability (*e.g.*, the number of hours worked), a settlement agreement in which an employee waives his or her claims is not valid. The Court reasoned that employees lacked the bargaining power of their employers and that allowing parties to contract around the FLSA's protections for employees against substandard wages and excessive hours. The Court, however, left open the question as to whether courts may enforce a settlement agreement where there is a bona fide dispute as to liability.

Only two circuit courts of appeal have ruled on the issue of whether private parties may settle an FLSA claim without DOL supervision or court approval. In *Lynn's Food Stores, Inc. v. U.S.*, 679 F.2d 1350 (11th Cir. 1982), the Eleventh Circuit concluded that FLSA claims may not be settled privately, without DOL supervision or court approval. In that case, however, there was no evidence the employees were represented by an attorney, some employees did not speak English, and some employees appeared unaware that the DOL had already determined that the employer owed back wages or that they had any rights under the FLSA.

More recently, in *Martin v. Spring Break '83 Productions, LLC*, 688 F.3d 247 (5th Cir. 2012), the Fifth Circuit enforced a settlement agreement where employees released claims under the FLSA. In *Martin*, the employees claimed that they had not been paid for all hours worked and that the settlement agreement did not effectively waive claims under the FLSA because the agreement was not approved by the court or supervised by the DOL. The employees were represented by an attorney and the agreement acknowledged that the parties disputed the amounts due to employees. There was also evidence in the record that the employees' representative who negotiated concluded that it was not possible to determine the number of hours the employees worked. The Fifth Circuit concluded that the agreement was a resolution of a bona fide dispute as to the number of hours worked, not at the rate which the employees would be paid.

To the extent attorneys settle claims under the FLSA without approval of the DOL or the courts, attorneys should strongly consider one of two options. The employer should pay all amounts owed in full and recite that fact in the settlement agreement. Alternatively, where it is not possible to determine the amounts owed, the settlement agreement should identify the bona fide dispute clearly in the agreement. Regardless of which option is selected, the agreement should also expressly reference the FLSA.

IV. Uniformed Services Employment and Reemployment Rights Act of 1994

The Uniformed Services Employment and Reemployment Rights Act of 1994 ("USERRA") protects employees' reemployment rights when returning from service in the uniformed services and prohibits employer discrimination based on military service or obligation. USERRA supersedes all contracts and agreements that restrict its rights." 38 U.S.C. § 4302(b). The question then arises whether a settlement agreement can effectively release USERRA claims.

USERRA's legislative history permits the inference that known USERRA rights already in existence may be settled privately between parties and without court or DOL approval. The House Report relating to 38 U.S.C. § 4302(b) states: "The Committee wishes to stress that rights under chapter 43 belong to the claimant, and he or she may waive those rights, either explicitly or impliedly, through conduct. Because of the remedial purposes of chapter 43, any waiver must, however, be clear, convincing, specific, unequivocal, and not under duress. Moreover, only known rights which are already in existence may be waived." H.R. Rep. No. 103-65 (1994), as reprinted in U.S.C.C.A.N. 2453 . Consistent with the House Report, courts have denied prospective waivers of USERRA rights. See *Perez v. Uline, Inc.*, 157 Cal. App. 4th 953, 957-58 (2007); see also *Brelectic v. CACI, Inc.-Fed.*, 413 F. Supp. 2d 1329, 1338 (agreement to arbitrate USERRA claims unenforceable because not "clear, convincing, specific, [and]

unequivocal"). Several published decisions reference such USERRA settlements without criticism or comment. *See, e.g., Pohl v. United Airlines, Inc.*, 213 F.3d 336, 339 (7th Cir. 2000) (holding district court did not abuse discretion in determining plaintiff's attorney had actual authority to settle USERRA claims; no mention of USERRA preemption).

While the most conservative route to effectively waiving USERRA claims would be through court approval, it is likely that that a private settlement agreement is also effective to waive known USERRA claims. The key to drafting the settlement agreement is to ensure that the waiver language is "clear, convincing, and specific." The best way to do so is typically to expressly reference the facts that could potentially support a USERRA claim and clearly state that the employee is releasing all claims under USERRA. Keep in mind that the waiver is only effective as to known USERRA claims.

V. Whistleblower Claims

Settlement agreements should include a release as to "all state and federal whistleblower claims to the maximum extent permitted by law." Certain types of claims, however, cannot be released for public policy reasons. In other words, an employee can sign a release of all claims, accept money, and still sue under one of these laws. This section will address two common types of whistleblower claims that arguably cannot be released without court approval or governmental insight and some strategies to try to limit employees' success in later asserting these claims.

A. Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") authorizes the Securities and Exchange Commission ("SEC") to pay awards to whistleblowers who provide the SEC with information about violations of federal securities laws under certain circumstances. 15 U.S.C. § 78u-6. The Dodd-Frank Act prohibits employers from discharging or discriminating against an employee for engaging in protected conduct. 15 U.S.C. §78u-6 (h)(1)(A). The Dodd-Frank Act provides that "the rights and remedies provided for in this section may not be waived by any agreement, policy form, or condition of employment, including by a predispute arbitration agreement." It is, therefore, questionable as to whether a general release effectively waives such claims.

Where an employer is concerned about a former employee signing a settlement agreement and later suing claiming that he was terminated in violation of the Dodd-Frank Act, the employer may want to take the extra step of having the employee forth in the settlement agreement all legal and regulatory compliance issues about which he or she complained or the employee never complained about any such issues. While the agreement is not necessarily effective to release these claims, it may be useful to contradict any subsequent assertions that the employee submitted these types of complaints.

B. False Claims Act

The False Claims Act prohibits an employer from retaliating against an employee for attempting to uncover or report fraud on the federal government. 31 U.S.C. § 3730(h). The False Claims Act provides that once an action has been filed, the individual may not settle (or at

least may not voluntarily dismiss) the action. 31 U.S.C. § 3730(b)(1). In general, courts hold that settlement agreements executed prior to the filing of a claim under the False Claims Act are not effective to bar a claim under the False Claims Act. *United States ex rel. Green v. Northrop Corp.*, 59 F.3d 953, 963 (9th Cir.1995). The rationale is that enforcement of such releases would thwart public interest in learning about claims of fraud. Some circuits, however, have held that a general release is effective as to a False Claims Act claim if the government had knowledge of the claims prior to filing of the release. *United States ex rel. Hall v. Teledyne Wah Chang Albany*, 104 F.3d 230, 233 (9th Cir. 1997); *U.S. v. Pursue Pharma L.P.*, 600 F.3d 319 (4th Cir. 2010).

As with claims under the Dodd-Frank Act, where an employee is likely to later claim a termination in violation of the False Claims Act, the attorney should consider whether to take extra precautions. For example, the agreement may require the employee to either identify any complaints that would fall under the False Claims Act or state that the employee has never submitted any such complaints and has never been discouraged or prevented from doing so. If the employee lists claims and the government has already has knowledge of those allegations, courts in some jurisdiction will enforce the release. If the employee represents that he or she never made any such complaints, the employee's credibility may be called into question if he later contradicts the information provided in connection with the separation agreement.

VI. General Waivers and Release of Claims and Covenants Not To Sue

A. Waiver v. Covenant Not To Sue

It is important to understand the difference between a covenant not to sue and a covenant to release past claims (*i.e.*, a waiver). The common law of contracts recognizes that the difference between a covenant not to sue and a waiver is in the remedies afforded to the beneficiaries of these bargains. 29 Williston on Contracts § 73:5 (4th ed.). The beneficiary of a covenant not to sue has purchased the right to be free from suit for the indefinite future, a breach of which entitles him to damages, most often in the form of attorneys' fees and costs in defending the breach action. The beneficiary of a release has been relieved of a debt, and the release acts as a bar to an action on such debt in the future.

In *Isbell v. Allstate Insurance Company*, 418 F.3d 788 (7th Cir. 2005), the court vacated an award of attorneys' fees and costs made to Allstate, the prevailing party in an ADEA case brought in derogation of a general release executed by the plaintiff which otherwise satisfied the waiver requirements of the OWBPA. However, Allstate's agreement failed to contain a separate and distinct covenant not to sue. The Seventh Circuit held that the release **merely provided Allstate with an affirmative defense to an ADEA claim**; because the release language failed to extract a promise not to sue in the future on the released claims subject to a claim of damages for breach, and therefore Allstate was not entitled to recover its attorneys' fees. In a footnote, the court noted that the beneficiary of a bare waiver of claims might be able to recover fees if it were able to show that the action was brought in bad faith. *Id.*, 418 F.3d at 797.

The Second, Sixth and Eighth Circuits have also recognized the distinction between a covenant not to sue to and a general release of claims. *See Astor v. Int'l Business Machs. Corp.*, 7 F.3d 533, 540 (6th Cir. 1993)(ERISA); *Artvale, Inc. v. Rugby Fabrics Corp.*, 363

F.2d 1002, 1008 (2nd Cir. 1966); *Thomforde v. Int'l Business Machs. Corp.*, 406 F.3d 500 (8th Cir. 2005)(ADEA). It is, therefore, generally recommended that attorneys include a covenant not to sue, along with an attorneys' fees provision, in releases if the client wishes to preserve its right to recover fees when past employees dishonor their releases.

B. ADEA Claims

Special care should be taken when a settlement agreement includes a waiver of claims under the ADEA. In *Oubre v. Entergy Operations, Inc.*, 522 U.S. 422 (1998), the Supreme Court held that an individual was not required to tender back consideration for a waiver in order to allege a violation of the ADEA. The Court reasoned that retention of the consideration did not constitute a ratification that made the release valid.

Following the *Oubre* decision, the EEOC issued regulations, codifying *Oubre* and extending its reasoning to apply to other aspects of a release, in conflict with the requirements of the OWBPA. The EEOC took the position that a covenant not to sue or any other condition precedent, penalty, or other limitation adversely affecting any individual's right to challenge a waiver agreement is invalid under the ADEA. 29 C.F.R. § 1625.22(g). This creates a problem in drafting general releases which include ADEA claims, necessitating carve out language that can be readily understood by affected individuals without appearing to be inconsistent with the purpose of a general release.

The Eighth and Ninth Circuits have held that confusion created by an ADEA carve-out provision contained in the covenant not to sue invalidated the release as a whole. See *Thomforde v. Int'l Business Machs. Corp.*, 406 F.3d 500 (8th Cir. 2005)(ADEA); and *Syverson v. Int'l Business Machs. Corp.*, 472 F.3d 1072 (9th Cir. 2007). In one decision the Ninth Circuit specifically disapproved the following language contained in the covenant not to sue paragraph of the IBM Release:

... This covenant not to sue does not apply to actions based solely under the [ADEA], as amended. That means that if you were to sue IBM ... only under the [ADEA], as amended, you would not be liable under the terms of this Release for their attorneys' fees and other costs and expenses of defending against the suit.

The Ninth Circuit concluded that the language quoted above appeared to contradict the language of the general release appearing in an earlier paragraph of the agreement. The court concluded therefore that the agreement failed to satisfy the first among eight enumerated ADEA waiver requirements set out in 29 U.S.C. § 626(f), namely, that the waiver between an individual and an employer be written in a manner calculated to be understood by such individual, or by the average individual eligible to participate in the severance program offered in exchange for the waiver. By contrast, the *Syverson* court expressly approved the following language within the covenant not to sue provision of the IBM Release as consistent with the requirements of the ADEA:

... This Release does not preclude filing a charge with the U.S. Equal Employment Opportunity Commission.

Given the EEOC's regulations and the case law within the Eighth and Ninth Circuits, attorneys may want to include in any settlement agreement waiving rights under the ADEA a statement that the agreement does not preclude (1) filing suit to challenge the Employer's compliance with the waiver requirements of the ADEA as amended by the Older Worker Benefit Protection Act; and/or (2) filing a charge with the Equal Employment Opportunity Commission.

VII. Taxation Issues

An analysis of the rules regarding taxation of settlement proceeds is beyond the scope of this program. Nevertheless, some basic points regarding when and how to address tax issues are in order.

A. General Issues

Taxation of settlement proceeds is often one of the last issues discussed by the parties and their attorneys in an employment case. Sometimes the issue is not discussed until after one party forwards the first draft of the settlement agreement. By that time, the employer is often set on how much it is willing to pay to resolve the matter and the employee is set on how much he or she needs to recover in order to be whole. Rather than waiting until after the draft settlement agreement has circulated, the issue should be addressed early on during negotiations.

There is financial incentive for the employer and employee to characterize settlement proceeds as something other than wages so that the amounts are excludable from gross income. The parties' desires and even the settlement agreement itself do not determine whether and how much of the settlement proceeds are taxable. In most employment disputes, at least some portion of the settlement must be treated as wages. This means that the employer must withhold Federal Insurance Contributions Act ("FICA") deductions, income tax and other standard payroll deductions.

In order to determine whether any portion of damages are excludable from gross income, the Internal Revenue Service ("IRS") will look to the nature of the claim that was the basis for the settlement. According to the IRS, characterization of the settlement must be consistent with the relief that would have been available if the claims had not been settled. Office of Chief Counsel, I.R.S. Memorandum, Income and Employment Tax Consequences and Proper Reporting of Employment-Related Judgments and Settlements, PMTA2009-025 (October 22, 2008).² In general, in order to be excluded from income, the amounts received must be due to personal physical injuries or physical sickness, or must be reimbursed expenses for medical treatment for emotional distress. 26 U.S.C. §104(a)(2); *see Commissioner v. Schleier*, 515 U.S. 323, 336-337 (1995). Emotional distress alone is not considered a physical injury or physical sickness that may be excluded from gross income. 26 U.S.C. §104(a)(2). For example, in the case of a recent wrongful termination settlement, the IRS concluded that the former employee's

² This IRS memorandum may not be used or cited as precedent. The memorandum is a reference tool designed to outline the income and employment tax consequences as well as the appropriate reporting of employment-related judgments and settlement payments.

depression and physical symptoms of insomnia, migraines, nausea, vomiting, weight gain, acne, and back pain did not qualify as physical injuries or sickness. *M. Blackwood and J. Blackwood v. IRS*, T.C. Memo 2012-190 (July 11, 2012). However, once a true physical injury or sickness has been established, proceeds allocated to related emotional distress may be excludible.

Once the parties determine how the settlement proceeds should be taxed, the settlement agreement should clearly state how the amounts will be characterized for tax purposes. Including this information in the settlement agreement has at least two benefits. First, the tax treatment will not come as a surprise and prompt one of the parties (usually the employee) to try to rescind the agreement. Second, if the IRS challenges the tax treatment, the agreement itself may provide some background and support as to how that decision was made.

B. Payments as Wages

Assuming that all or a portion of the settlement proceeds must be included in the gross income of the plaintiff, the next consideration is whether the payments constitute “wages” for purposes of federal and state withholding tax purposes. This is not always an easy determination – for example, where a portion of the proceeds are for so-called “front pay.”

Further, what if the settlement agreement calls for payments of back wages and also payment of the plaintiff’s legal fees – would the legal fees be subject to withholding? Although in almost all cases, the attorneys’ fees constitute income to the plaintiff (a narrow exception applies where the attorneys’ fees are associated with the recovery of physical injury payments that are non-taxable to the employee), there is some uncertainty as to whether the payments to the attorney constitute wages. As a practical matter, the risk to the employer that it under-withheld may be low in comparison to the risk that the employee will not settle if the attorneys’ fees are subject to withholding.

C. Update Regarding Certain Severance Payments

For quite some time the IRS takes the position that severance payments are wages for FICA tax purposes and, therefore, subject to FICA withholding. In *CSX Corp. v. United States*, 518 F.3d 1328, 1344 (Fed. Cir. 2008), the federal circuit confirmed the IRS’s position when it held that supplemental unemployment compensation benefits (“SUB”) payments to employees in connection with a reduction in force were subject to FICA withholding.

Last year, however, the Sixth Circuit created a split among the circuits when it held that an employer’s payments to employees in connection with a reduction in workforce were not subject to FICA withholding. *United States v. Quality Stores*, 693 F.3d 605 (6TH Cir. 2012). While the holding in *Quality Stores* decision is currently good law in the Sixth Circuit, the Supreme Court has granted the government’s request for a one-month extension to file a petition for certiorari. The petition is currently due on May 3, 2013. Employers and employees might not have a definitive answer to this issue for quite some time. Employers may wish to file protective refund claims for FICA withheld in these circumstances, at least until the issue has been resolved.

D. Reporting

Employers are often confused about their obligations to report settlement proceeds to the employee and the IRS. Unless the payments are excludible from the gross income of the employee (due to physical injury or sickness), all payments must be reported, whether on a Form W-2 as “wages” or on Form 1099 as “non-wage employee income.” Further, payments made to the employee’s attorney must also be reported on a Form 1099, even if that means reporting the same payment twice – both as made to the attorney and as made to the employee. The reporting rules can be very complicated.

This paper is not intended as legal advice and cannot be relied upon for any purpose without the services of a qualified professional.

Appendices to EEOC Publication

“Understanding Waivers of Discrimination Claims in Employee Severance Agreements”

APPENDIX A

Employee Checklist: What to Do When Your Employer Offers You a Severance Agreement:

- **Make sure that you understand the agreement**
 - Read the agreement to see if it is clear and specific, or if it is confusing because it contains terms you do not understand.
 - If you are 40 or older, inform your employer that the law requires your agreement to be written in a manner that makes it easy to understand. Usually this means that your agreement should not contain technical jargon or long, complex sentences.
- **Check for deadlines and act promptly**
 - The moment you are given a severance agreement, check to see if your employer gave you a deadline for accepting, or declining, the agreement. If you are 40 years old or older, federal law requires the employer to give you at least 21 days to review the agreement and make up your mind.
 - If your employer has not given you a reasonable amount of time, or rushes your decision, this is a red flag. An employer who is fair will understand that you cannot review or make decisions about an important document on a moment’s notice.
 - If you are being rushed, ask for more time. Put your request in writing. If you are 40 or older and your employer is asking you for a decision in fewer than 21 days, remind the employer that the law requires you to be provided at least 21 days. (If you and at least one other person are being laid off in a reduction in force (RIF) at the same time, you must be given 45 days to consider the agreement.)
- **Consider having an attorney review the severance agreement**
 - Even if you are parting amicably with your employer, you may want to ask for advice about whether you should sign it, whether the terms are reasonable, and whether you should ask your employer to change any of the terms.
 - If you decide that you want an attorney to review the agreement, promptly make an appointment. Do not wait until the last day before the deadline to review the severance agreement.

- If you are at least 40 years old, the agreement must advise you to consult with an attorney.
- **Make sure you understand what you are giving up in exchange for severance pay or benefits**
 - The main benefit to signing an agreement is that you will receive a cash payment or benefits in exchange for signing away your right to bring certain legal claims against your employer.
 - Make sure that the agreement offers you something of value to which you are not already entitled.
 - If you think you have been wrongfully terminated because of age, race, sex, religion, or some other discriminatory reason, you may want to think twice about signing. The benefits of signing a severance agreement should be carefully weighed against claims you might have against your employer, the likelihood of winning a court case or settlement, and the probable costs.
- **Review the agreement to ensure that it does not ask you to release nonwaivable rights**
 - Confirm that your employer is not asking you to waive your right to file a charge, testify, assist, or cooperate with the EEOC.
 - Make certain that the agreement is not asking you to waive rights or claims that may arise after the date you sign the waiver.
 - Make sure that your employer is not asking you to release your claims for unemployment compensation benefits, workers compensation benefits, claims under the Fair Labor Standards Act, health insurance benefits under the Consolidated Omnibus Budget Reconciliation Act (COBRA), or claims with regard to vested benefits under a retirement plan governed by the Employee Retirement Income Security Act (ERISA).

APPENDIX B

Sample Waiver and General Release: Group Layoffs of Employees Age 40 and Over

The following example illustrates one way in which the required OWBPA information could be presented to employees as part of a waiver agreement and is not intended to suggest that employers must follow this format. Rather, each waiver agreement should be individualized based on an employer's particular organizational structure and the average comprehension and education of the employees in the decisional unit subject to termination. For another example of how the required information might be presented, see 29 C.F.R. § 1625.22(f)(vii).

Although this sample addresses only OWBPA issues, most severance agreements also ask employees to waive all claims against the employer, including claims arising under any federal, state, and local laws. See paragraph 6 below.

Dear [Employee]:

This letter will constitute the agreement between you and [your employer] ("the Company") on the terms of your separation from the Company (hereinafter the "Agreement"). **The Agreement will be effective on the date specified in paragraph 7, below.**

1. Your employment will terminate on _____X_____ date.

or

You have agreed to resign on _____X_____ date. Your last day of work will be _____X_____ date.

2. In consideration of your acceptance of this Agreement, the Company will pay you an extra _____ [week's][month's] salary at your current rate of \$ _____ per [week][month], less customary payroll deductions, to be paid within five (5) business days after the effective date of this Agreement as defined in paragraph 7 below. This severance pay will be in addition to your earned salary and accrued vacation pay or leave to which you are entitled.

[Paragraphs 3, 4, and 5 may address benefits, unemployment compensation, references, return of property, confidentiality, etc.]

6. Except as to claims that cannot be released under applicable law, you waive and release any and all claims you have or might have against the Company. . . . These claims include, but are not limited to claims for discrimination arising under federal, state, and local statutory or common law, including Title VII of the Civil Rights Act, the Americans

with Disabilities Act, the Age Discrimination in Employment Act, the Genetic Information and Discrimination Act, and [state law].

7. The following information is required by OWBPA:

You acknowledge that on _____, you were given 45 days to consider and accept the terms of this Agreement and that you were advised to consult with an attorney about the Agreement before signing it. To accept the Agreement, please date and sign this letter and return it to me. Once you do so, you will still have seven (7) additional days from the date you sign to revoke your acceptance (“revocation period”). If you decide to revoke this Agreement after signing and returning it, you must give me a written statement of revocation or send it to me by fax, electronic mail, or registered mail. If you do not revoke during the seven-day revocation period, this Agreement will take effect on the eighth (8th) day after the date you the sign the Agreement.

The class, unit, or group of individuals covered by the program includes all employees in the ____ [plant, location, area, etc.] whose employment is being terminated in the reduction in force during the following period : _____. All employees in ____ [plant, location, area, etc.] whose employment is being terminated are eligible for the program.

The following is a listing of the ages and job titles of employees who were and were not selected for layoff [or termination] and offered consideration for signing the waiver. Except for those employees selected for layoff [or termination], no other employee is eligible or offered consideration in exchange for signing the waiver:

Job Title	Age	# Selected	# Not Selected
(1) Bookkeepers	25	2	4
	28	1	7
	45	6	2
(2) Accountants	63	1	0
	24	3	5
(3) Retail Sales Clerks	29	1	7
	40	2	1
(4) Wholesale Clerks	33	0	3
	51	2	1

Sincerely,

On Behalf [the Company]

By signing this letter, I acknowledge that I have had the opportunity to consult with an attorney of my choice; that I have carefully reviewed and considered this Agreement; that I understand the terms of the Agreement; and that I voluntarily agree to them.

Date:

[Employee]