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Labor Letter

Pros and Cons of Severance Agreements

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Employers who pay out severance to their employees run certain risks that need to be considered beforehand. Some employers have learned the hard way that severance agreements aren't always the best course of action. Last year, the University of Oregon received bad press when it was discovered that former head coach Mike Bellotti received a substantial payout upon his departure.

More recently, the mayor of Cornelius, Oregon, was recalled by voters who were upset that his firing of a City Manager cost the city over $100,000 in severance payouts. Although these examples come from public employers who need to report their actions, private employers can still run into hot water when trying to sever employment relationships.

What's Involved?

Before we look at the risks, let's define what we're looking at. Broadly, a severance agreement is any contract that is entered into between an employer and a departing employee, usually providing some form of compensation to the departing worker in exchange for something.

Some employers pay employees a lump sum at the end of their tenure in order to tide them over until they find a new job, and never enter into a contractual agreement with them. This is perfectly legal, but it should be seen as a gift and nothing more. That employee is free to sue the employer for any reason and the severance payout has no legal significance at all. There are some employers that choose to make the "gift" payout because they believe it is the right thing to do, or because it is a standard practice. Some of these employers also hope that this will help convince the employee that the company is a good and professional employer, less likely to be the target of a lawsuit by that employee.

But most employers who use severance payouts ask their employees to sign a document essentially releasing the company from any and all legal liability upon acceptance. This way, the relationship can be considered to be completely and forever severed, each party moving on in the world, never again to have to deal with each other.

What are the pros and cons to entering into such an agreement? The pros are fairly obvious. For a simple payout and a signature, the employer avoids possible messy legal action in the future. It can get rid of the headache by buying some freedom, or at least buy some certainty that a lawsuit will not follow. A good night's sleep, free from the worry of a threatened lawsuit, is the clear upside of such agreements.

But severance agreements are not right for every employer and every situation, and the following considerations should be taken into account. First off, how much is enough to induce the employee to sign? This is one of the most common questions we receive from clients. Unfortunately, there is no local standard, and most industries have no such standard either. It is a case-by-case situation, usually tied to either some round figure that sounds enticing enough for the employee to sign, or sometimes tied to a number of weeks or months of the employee's pay.

Second, will the employee sign the document? This is the big question. Many times, if the employment relationship is rocky, and the employee is fearful, and possibly litigious, offering them a severance agreement could be a bad step. The employee might start to think that "where there's smoke, there's fire," and begin believing a conspiracy theory exists where you must be trying to hide something by buying them off. Sometimes we recommend that you simply terminate the employee and cross your fingers, for fear that handing them a severance agreement will plant ideas in their head that you must be covering up something.

Third, what happens if they don't sign the document? The employee might take the unsigned document and try to use it as evidence in a legal proceeding later on. You can imagine an employee arguing to a jury, "Hey look – if they didn't have anything to hide, why were they trying to shut me up and keep me out of court?" For these reasons, employers must be cautious in using a severance agreement.

The final consideration to take into account is the age of the employee. If departing employees are age 40 or above, they receive special legal protections when it comes to severance agreements under a law called the Older Worker Benefit Protection Act (OWBPA). The severance document must contain certain language advising the employees of their rights under federal law, and must advise them to take the document to a lawyer to have it reviewed.

Also, the OWBPA provides for a mandatory waiting period of at least seven days between the time you originally enter into the agreement and the time when the agreement can be countersigned and the severance paid. This cooling-off period could be used for the employee to go to a lawyer, who might advise them of their opportunity to file a legal claim or threaten a lawsuit instead, when the payout might be much higher. In any event, employers should talk to their employment lawyer to make sure you are jumping through all of the necessary hoops with these agreements.

With all of these warnings, many employers might be skittish about severance agreements, and rightfully so. They are not a one-size-fits-all tool, and they should be used only after great deliberation and consideration. When used effectively, however, they can be a great way to save money and spare your company from legal headaches.

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