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# U.S. Court of Appeals for Fifth Circuit Bars Offset of Severance Payment Against Claim of Unpaid Overtime

By **Lionel M. Schooler**

INTRODUCTION. The United States Court of Appeals for the Fifth Circuit (the federal appeals court overseeing federal cases covering Texas, Louisiana and Mississippi) recently issued a decision that emphasizes the distinction between a severance payment and a claim for unpaid overtime. The Court ruled in *Martin v. PepsiAmericas, Inc*. that an employer could not attempt to offset an employee's claim for unpaid overtime by the amount of the severance payment.

SEVERANCE PAYMENTS AND RELEASES. For a variety of reasons, employers sometimes decide to pay a departing employee "severance pay," that is, "some additional amount of money or benefits to which the employee would not otherwise be entitled." Usually, this payment is made as consideration for obtaining a complete release from the employee, where the employee promises not to file any complaints, lawsuits or any other claims "arising out of or related in any manner to the employment relationship." Thus, by paying severance benefits, the employer seeks relief from any threat of post-employment litigation by the employee.

FAIR LABOR STANDARDS ACT. According to the Fair Labor Standards Act of 1938 (FLSA), any "non-exempt" employee working more than forty (40) hours in a calendar week has the right to be paid overtime of not less 1.5 times his/her base rate of pay. An employee is generally considered "non-exempt" if he or she is paid on an hourly basis or, even if paid on a salaried basis, is not employed in a bona fide executive, administrative, or professional capacity, or as an outside salesman, or as a computer systems analyst, computer programmer, or software engineer.

FACTS OF THE MARTIN CASE. Ms. Martin initially worked for Pepsi as a route settlement clerk for approximately five years in an hourly position, and was paid overtime wages for any time in excess of forty hours in a given week. She was then promoted to the position of route settlement supervisor, and was paid a salary rather than hourly wages. Two years later, Ms. Martin was laid off.

Ms. Martin signed a severance agreement when she left the company, and part of this agreement recited that she was agreeing not to file any lawsuits or any other claims against the company arising out of her employment relationship. In exchange for her agreement, the company provided her with a severance benefits package that included various benefits to which she was not otherwise entitled.

LAWSUIT FILED BY MS. MARTIN. Despite the existence of the severance agreement, Ms. Martin sued the company about two years after her termination of employment, claiming she was owed unpaid overtime, and also submitting certain state law claims.

There was a dispute whether her supervisory position caused Ms. Martin to become "exempt" from the right to be paid overtime wages under the FLSA if she worked more than forty hours in a workweek.

Ultimately, the company claimed a "setoff," that is, that the amount claimed by Ms. Martin for unpaid overtime did not exceed the amount of severance the company had paid her. The lower court agreed with this contention and dismissed Ms. Martin's claims.

DECISION BY FIFTH CIRCUIT. On appeal, the United States Court of Appeals for the Fifth Circuit disagreed with the company's position. It stated that in most situations, defending against a claim of unpaid overtime wages by asserting that severance pay should offset that claim fails under the FLSA.

The Court of Appeals first emphasized that the FLSA does not expand a federal court's jurisdiction to permit consideration of the kind of claim at issue here because "the federal courts are not designated by the FLSA to be either collection agents or arbitrators for an employee's creditors."

The Court then explained that the amount paid by the employer in this case was not for accrued wages already earned or claimed to have been earned by the employee, which might under certain circumstances qualify as a legitimate offset to a claim of unpaid overtime wages, but rather for a release of claims. Although the employee had no entitlement to this severance package, the severance payment was not gratuitous -- the company had received something in return.

Therefore, the Court emphasized that while the lawsuit filed by the employee might arguably be a "breach" of her severance agreement, this did nothing more than establish a claim of breach of contract for the employer, not a setoff of a federally mandated statutory claim. It held that the payment by the employer was not a wage payment at all and was, in fact, totally unrelated to any labors by the employee. It therefore ruled that while the employer could potentially sue the former employee to recover damages for breach of contract in state court, it could not leverage that potential claim into a total offset of an unpaid wage claim filed under the FLSA.

CONCLUSION. The decision in the *Martin* case reinforces the existence of potential limits to severance agreements. Indeed, the U.S. Department of Labor takes the position that no settlement seeking to deprive an employee of the rightful payment of wages can be enforced unless the Department itself approves such a settlement or a court does.

Therefore, when negotiating a severance package with a departing employee, an employer is well-advised, first, to ensure that it has classified an employee properly as "exempt" under the FLSA, and second, if not, to ensure that all potential overtime work has been properly accounted for and paid timely and in full as of the date of separation. Finally, the employer should consider including a clause in the severance agreement that will clearly set forth the consequences to the employee for breaching the agreement.

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