

THE DAILY RECORDER

September 15, 2006

Avoiding Litigation Over Releases of Employment Claims

by Jennifer Brown Shaw

Employers have several reasons for entering into settlement or separation agreements with employees. A release is used when an employee has filed a formal action against an employer and both sides decide to resolve the matter pre-trial. An employer may wish to resolve all differences with an employee before a dispute is filed in court. Employers and employees also use separation agreements in the context of layoffs, when severance pay is often exchanged for the employee's promise not to sue.

Whatever the reason for entering into a release, employers should be aware of the many legal requirements that must be observed to ensure the release is effective. Some recent court decisions provide guidance as to a few of the recurring issues.

Releases of Age Discrimination Claims Must Be Knowing and Voluntary

When an employer seeks to obtain a release of claims under the Age Discrimination in Employment Act (ADEA) from an employee who is 40 years old or more, the Older Workers Benefits Protection Act (OWBPA) comes into play. The OWBPA and its implementing regulations contain both procedural and substantive protections for employees.

Agreements that contain releases of claims under the ADEA must, among other things, be written in clear language (the "knowing and voluntary" requirement), advise the employee to seek an attorney, provide up to 21 days (45 days in the case of a layoff of two or more employees) for the employee to consider the release, and a seven-day revocation period. Under the OWBPA, if a release

does not comply with these requirements, the employee may keep the consideration for the release and sue under the ADEA.

The OWBPA requirements have been litigated in several cases where employees have sought to invalidate releases as not complying with the law's requirements. Two recent cases demonstrate some of the pitfalls facing employers seeking to comply with the OWBPA.

The plaintiffs in *Syverson v. IBM Corp.* were laid off as part of a 2001 reduction-in-force at IBM. Each of the employees signed a "General Release and Covenant Not to Sue" in return for receiving severance pay and benefits. The employees nevertheless filed charges of age discrimination with the Equal Employment Opportunity Commission (EEOC). The EEOC dismissed the charges, explaining the agreement signed by the employees satisfied the OWBPA's minimum requirements for a "knowing and voluntary" waiver of ADEA rights and therefore the employees could not pursue their age discrimination claims.

Undeterred, the employees filed a class action in federal court alleging that the agreement violated the "knowing and voluntary" requirement of the OWBPA because it was not clearly written. Specifically, the employees complained that the agreement contained a release of all claims (including ADEA claims), but also contained a "covenant not to sue" that excluded ADEA claims. A "release" extinguishes a claim; a "covenant not to sue" is a promise not to assert a right in court.

According to the employees, this contradictory language left them with the impression that they could bring a lawsuit under the ADEA even after signing the release. IBM argued that it carved out the ADEA from the covenant not to sue in an effort to comply with the EEOC's rule that a covenant not to sue cannot be used to preclude employees from challenging the validity of an ADEA release in court.

The Ninth Circuit Court of Appeals ruled in favor of the employees. The court held the agreement signed by the employees was not sufficiently clear to meet the "knowing and voluntary" requirement of the OWBPA. According to the court, the tension between the release language and the ADEA carve-out in the covenant not to sue created confusion for the employees and therefore the ADEA release was invalid. The court's decision was consistent with the ruling of the Eighth Circuit Court of Appeals in another case analyzing the same agreement.

The Ninth Circuit emphasized that releases must be written in a manner calculated to be understood by an "average individual." Excessive "legalese" will not meet this standard. In addition, instructing an employee to consult with an attorney prior to signing a separation or settlement agreement will not automatically render the agreement comprehensible. Rather, in the court's view, the agreement must be written plainly and in language that is easily understandable by a lay person.

Releases of Age Discrimination Claims in the Context of Group Layoffs

The OWBPA imposes additional requirements on employers when a release is prepared in the context of a “group” layoff (i.e., where two or more employees will be separated). The release must contain the “eligibility factors” regarding the employees selected, and lists of the ages and titles of employees selected and not selected for the layoff within the same “decisional unit.” This is sometimes called a “birthday list.” There has been a fair bit of litigation over whether the employer properly described the eligibility factors and “decisional unit.”

In 2005, the Tenth Circuit Court of Appeals issued a controversial opinion regarding the information that must be provided to employees about the decisional unit. In *Kruchowski v. Weyerhaeuser*, the court ruled that employers must clearly explain not only who has been selected for layoff, but *why* the selections were made. In other words, the court held, Weyerhaeuser was required to describe in detail why each employee was selected for layoff so the affected employees could more intelligently consider whether to waive their rights under the ADEA.

The *Kruchowski* decision caused significant concern for employers throughout the country contemplating layoffs because of the obvious challenges posed by describing the individual decision-making process in a written document given to each affected employee. Fortunately for employers, in May 2006, the court issued a revised opinion omitting any discussion of the “eligibility factors.” So, for now at least, a more generic description of “eligibility factors” should be sufficient to comply with the OWBPA. However, employers contemplating group layoffs should always consult with counsel regarding the drafting of the layoff documents and related issues.

The scope of the “decisional unit” also is important. The Eleventh Circuit Court of Appeals in *Burlison v. McDonald’s Corporation* issued a decision in July 2006 regarding

who should to be included on the “birthday list.” There, a group of employees sued McDonald’s for age discrimination, despite their having previously signed ADEA releases. They argued the release failed to comply with the OWBPA because it did not contain the job titles and ages of *all* employees nationwide who were laid off and retained.

McDonald’s argued that the “decisional unit” properly was defined as 208 employees who worked in the Atlanta region, not employees in the entire country. Therefore, only information about those 208 employees was required to be included on the birthday list. The court agreed with McDonald’s, finding that the 208 employees constituted the appropriate decisional unit, and the release therefore complied with the OWBPA and precluded the employees from pursuing their ADEA claims.

Scope of the Release

Under California Civil Code section 1542, a general release does not include unknown claims if the person releasing them can show she would not have entered into the release if she has known about such claims. Employers seeking to obtain a full, final, and comprehensive release must ensure the employee “waives” his or her rights under section 1542. Otherwise, the employee may be able to sue based on “unknown” claims despite the fact that he or she signed a general release.

Employers typically quote verbatim section 1542 in securing the waiver. The Legislature amended that section in 2004 so it is “gender neutral.” The statute now reads: “[a] general release does not extend to claims which the creditor does not know or suspect to exist in his or her favor at the time of executing the release, which if known by him or her must have materially affected his or her settlement with the debtor.”

The drafter of a release agreement must be sure to explain the scope of the release. In a 2006 decision, *Butler v. Vons Companies*, a California court of appeal held that a

release entered into between an employer and a union was ambiguous as to whether it covered claims against the employer not covered by the collective bargaining agreement. The release contained a section 1542 waiver, but the court ruled that the scope of the waiver depended on the scope of the released claims themselves. Similarly, in *Claxton v. Waters*, the California Supreme Court held that general release language in a pre-printed form release used in Workers’ Compensation Appeals Board matters covered only workers’ compensation issues, not civil claims.

Finally, the scope of a release should not include claims that cannot be released. For example, the EEOC takes the position that an employee cannot waive the right to file a discrimination charge. The U.S. Department of Labor’s regulations prohibit releases of wage claims without the agency’s approval. Similarly, the Fourth Circuit Court of Appeals, in *Taylor v. Progress Energy, Inc.*, held that claims under the federal Family and Medical Leave Act also cannot be released with Department of Labor or court approval.

Taxability of Settlement Sums

The taxability of settlement sums in employment-related cases may consume more time than any other term of a settlement. Parties to a settlement must allocate settlement values between lost wages, benefits, compensatory damages such as emotional distress, costs and attorneys’ fees.

In a startling recent development, the U.S. Court of Appeals for the D.C. Circuit in *Murphy v. IRS* decided that taxation of damages for emotional harm is unconstitutional. The plaintiff in *Murphy* filed a complaint with the federal Department of Labor alleging that her former employer, the New York Air National Guard (NYANG), “blacklisted” her after she complained to state authorities about environmental hazards on an airbase. Ultimately, the court awarded her compensatory damages of \$45,000 for “emotional distress or mental anguish” and \$25,000 for “injury to professional reputation.” She

did not receive any award for lost wages or reduced earning capacity.

Murphy argued the payments were not taxable, and the D.C. Circuit agreed, ruling the award was not “income” under Sixteenth Amendment of the United States Constitution and therefore Congress had no power to tax it. According to the court, the Sixteenth Amendment does not differentiate between damages received for a physical personal injury and damages received for a non-physical injury unrelated to lost wages or earning capacity—neither one may constitute “income” under IRS Code section 104(a)(2).

Until the issue is addressed by Congress or the U.S. Supreme Court (which is likely, because there is now a conflict among the circuits on the issue), plaintiffs in employment cases will push even harder to characterize their settlement payments as compensation for “emotional distress,” “injury to personal reputation” and/or some other personal injury (whether physical or nonphysical). Under the *Murphy* decision, such an approach could result in the settlement payment not being treated as a taxable event at all. Of course, the decision is not binding on the Ninth Circuit, so employers must analyze the risk of agreeing to the personal injury characterization.

Conclusion

Employers cannot afford to take a casual approach to settlement agreements and releases. As the cases discussed above demonstrate, using a “form” agreement, whether for individual separation agreements, group layoffs or to resolve a litigation matter, can backfire. Employers should consult with experienced counsel to obtain guidance in drafting such agreements, including the characterization of any payments made under the agreements.

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