



Severance Agreements

Overview

When ending the employment relationship, employers may consider whether to offer a severance agreement and release of legal claims. Often, the primary purpose of a severance agreement is to limit an employer's liability – the employer offers the employee a sum of money in exchange of the employee releasing potential claims against the employer. Sometimes, even when the employer is not concerned about liability, it may be their practice to offer severance in good faith to recognize years of service or following layoffs.

Notably, a severance agreement is not considered an “admission of guilt” by the employer or evidence that the employer did anything wrong. Additionally, a severance agreement is always voluntary by both parties; you cannot force an employee to sign one.

Perhaps most important, a severance agreement is a *legal document*, that must include specific language to be effective. It is never recommended to use a template from another employer or to download one off the internet. Many factors, such as the employee's age and the number of terminations being conducted at once, will dictate specific verbiage and rules. We always recommend that you have legal counsel draft or review the severance agreement in each case. Remember, the employee also has the right to review the document with their legal counsel. For a list of CEA's attorney partners [refer here](#). When determining if a severance agreement is the right approach for your business, there are different factors to consider, as outlined below.

Is Severance Pay Required?

Neither California nor federal law requires employers to provide severance pay or severance packages. However, like other optional benefits in the Golden State, if an employer chooses to provide a severance package, there are specific requirements. In California, for a severance agreement to be enforceable, the employee must receive something of value beyond what they are already entitled to receive. When deciding whether to provide an offer of severance to a terminated individual, employers should consider the following:

- (1) Is it our practice to provide it to long-term employees retiring in good standing or in conjunction with a position elimination?
- (2) Is severance pay being provided in exchange for a release of claims?
- (3) Is it recommended to minimize the organization's exposure to potential claims and lawsuits?
- (4) Is it part of an employment agreement (e.g., often included in executive contracts)?
- (5) Does the organization have a policy regarding severance?



Typical Severance Packages

Since severance pay is not required by law, the packages can vary based on the organization and the circumstances surrounding the employment. Typically, the package includes some form of financial compensation, often as a lump sum payment. For companies that have a general policy or practice of offering severance, employers may consider the employee's length of service, job title and salary, and create a non-discriminatory formula to determine the amount.

Severance pay is considered taxable income and subject to both federal and state income taxes. The EDD does not consider severance pay as a form of wages for unemployment eligibility purposes, meaning that receiving severance payments does not preclude a former employee from applying for or affect their eligibility for unemployment benefits.

Severance packages can also include other benefits beyond wages. It is important to check any employment contracts (particularly for executives) and consult legal counsel.

Reasons for a Severance Agreement

The simplest way to define a severance agreement is as a contract between an employer and their soon to be ex-employee, which sets terms for the separation and limits liability.

From an employee's perspective, a severance agreement can include some kind of compensation which helps ease the separation. As far as the employer is concerned, the primary benefit of the agreement is to reduce or eliminate the risk of legal claims against them. In essence, they are "buying" a release from the employee being terminated. For this reason, there is not a specific amount that must be offered. It is a negotiation between the parties and again, it is best to consult legal counsel experienced with these agreements. Employers can also use a severance agreement to protect the organization's reputation, protect trade secrets, or limit the release of leaking proprietary information, as well as provide a good will gesture for employees whose positions are being eliminated.

Limitations on Severance Agreements

Current and former employees in California have many legal rights that cannot be waived. These protections extend to severance agreements. For instance, a severance agreement cannot include language that:

- Waives their right to pursue wages owed to them.
- Prohibits an employee from reporting any crimes committed by their former employer.
- Prohibits an employee from filing a charge of discrimination with the Equal Employment Opportunity Commission or the Civil Rights Department.
- Prohibits reporting violations to the Securities and Exchanges Commission
- Releases liability for a Worker's Compensation claim



Be sure to discuss limitations and the specific language that needs to be included with your legal counsel.

Final Pay, Timelines, and Age Restrictions

Upon termination, all of an employee's wages, included earned and unused vacation, are due to them regardless of what is offered and accepted in a severance agreement.

There may be additional requirements that need to be included in regards to age such as:

- Under the Age Discrimination in Employment Act (ADEA) if the employee is 40 years of age or over, they must be given a minimum of 21 days (or 45 days if 2 or more employees are being terminated) to review and consider the severance agreement.
- The agreement to waive any age-related claims must also be in writing and refer to ADEA by name. The agreement should also advise employees of their right to consult legal counsel.
- The employer is required to disclose additional information when terminating two or more employees. Consult with counsel on what specific information to include.
- Under the Older Workers Benefit Protection Act (OWBPA), the employer must give employees seven days to revoke their waivers of age-related claims after signing the severance agreement. This right to revoke applies to both individual and group terminations.

Although not required, it is still recommended to give employees who are under 40 time to consider executing the agreement. The recommendation stems from employers proving that employees are waiving certain rights "knowingly and voluntarily." The more time an employer offers, the stronger their position becomes.

At any point, all employees can voluntarily sign earlier than the timeframe given by the Company.

Creating a Severance Agreement

As you can see, there is no such thing as a "One Size Fits All" severance agreement. Taking into account an employee's position, tenure, age protected classes and other liability risks are all important factors to consider.

Employers should also be prepared for negotiations – in many cases, employees may negotiate the compensation, benefits or certain clauses of the agreement with the same tenacity as a job offer. Employers should also take into account the fact that offering an employee a severance package could set a precedent for other employees. Consistency is crucial to ensuring a fair and compliant policy.



Consult Legal Counsel

Due to the complexity of California law and the importance of reducing exposure for the company and management, employers should always consult legal counsel when creating a severance agreement. The inclusion or exclusion of certain elements could even invalidate an entire severance agreement.

On the flip side, a well-crafted legal agreement can protect your business and go a long way in maintaining goodwill, mitigating risk and reducing the risk of litigation.