

Client Alert **Employment & Labor**

Severance: To Pay or Not To Pay

As the economic downturn from the COVID-19 pandemic continues to impact businesses throughout the United States, many employers face the prospect of implementing reductions in force or other employee terminations. Common questions include whether employers are legally obligated to pay severance, whether offering severance is advisable in the absence of a requirement to do so, and how much to offer. As explained below, severance payments are generally optional and can be used by employers to achieve a number of important goals, including risk mitigation and litigation avoidance.

Are Employers Required to Pay Severance?

As of this writing, no federal or state law obligates employers to pay severance to employees upon termination. Under the federal Worker Adjustment and Retraining Notification (“WARN”) Act and some state equivalents, employers may be required to pay terminated employees wages and benefits for a certain period if they fail to provide adequate notice to those employees as part of a qualifying mass layoff or plant closing. However, these payments under the WARN Act are penalties for non-compliance with the notice requirement rather than true severance and, moreover, can easily be avoided by providing the required notice.

New Jersey will become the first state in the nation to require employers to pay severance in certain circumstances when amendments to its WARN Act equivalent become effective. As part of a [series of employer-unfriendly laws enacted in January 2020](#), New Jersey will require large employers—even those who comply with WARN notice requirements—to pay one week of severance for each full year of service to employees who are terminated as part of a qualifying mass layoff or plant closing. Employers who fail to provide adequate notice must pay an additional four weeks as a penalty. Fortunately, New Jersey has delayed the effective date of this new severance requirement to 90 days after termination of the COVID-19-related state of emergency.

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Although no law currently requires the payment of severance, an employer may legally obligate itself to provide severance in a number of scenarios, including:

- An employment agreement, especially for an executive, may guarantee some amount of severance in the event of a termination without cause.
- A company policy, whether contained in an employee handbook or not, may provide for severance for employees who are terminated through no fault of their own.
- A collective bargaining agreement may contain a severance guarantee.
- Federal, state, and local anti-discrimination laws may compel an employer to offer severance to similarly situated employees in order to avoid a disparate treatment claim.
- A practice of paying severance may be viewed under some circumstances to create a plan under the federal Employee Retirement Income Security Act (“ERISA”), with attendant requirements.

Should an Employer Offer Severance?

Absent a requirement or obligation to pay severance, an employer may nonetheless choose to offer severance in order to avoid claims or litigation, to obtain other benefits, or as a matter of goodwill. Indeed, whenever an employer offers severance, the offer should be conditioned upon the employee’s signing a general release of claims against the employer, affiliated entities, and associated personnel. This is true whether there is a specific concern about a claim or lawsuit—for example, where the terminated employee has previously complained about alleged discrimination—or not. Note that certain claims and rights cannot be released by an employee even in exchange for severance, such as claims for unemployment and worker’s compensation and the right to file a discrimination charge with a government enforcement agency.

Employers can also use severance to obtain strategic benefits from terminated employees beyond the release of claims, including confidentiality and restrictive covenants such as non-competition, non-solicitation, and non-disparagement provisions. In some situations, employers may wish to include other provisions as part of the exchange, such as a requirement that terminated employees cooperate with post-termination transition work or be available as a witness for pending or anticipated litigation.

How Much Severance to Offer?

Unless there is a preexisting requirement, policy, or plan to pay severance in a specified amount, the amount of severance to offer is entirely up to the employer. The amount should be sufficient “consideration” to support the employee’s release of valuable rights/claims; however, there is no minimum threshold or magic number. Ultimately, the right amount of severance is a function of how much the employer is willing to pay and how little the terminated employee is willing to accept in exchange for signing an agreement containing a general release and any other provisions desired by the employer.

A good starting point—though by no means a requirement or standard—is one week of base salary for every year of service. Using a formula to determine severance amounts based on tenure or some other objective criteria helps insulate an employer from allegations of discrimination or unfairness, especially in the context of a group termination. Still, an employer is generally free to adjust the amount of severance to address individual situations.

Severance can be paid in a single lump sum or in installments over time, within certain limitations under the tax code. Employers should note that severance pay will likely be deemed to be W-2 wages by the IRS and state tax authorities, thus requiring employers to withhold employee payroll taxes and to pay employer payroll taxes. In addition, receipt of severance may impact a terminated employee's eligibility for unemployment insurance benefits.

There are also a variety of other items that can supplement severance pay and may help achieve the employer's ultimate goal—getting an employee to give a general release or agree to other conditions. Perhaps the most common is subsidized health insurance continuation coverage, in which the employer makes up the difference between the cost for the terminated employee under COBRA and the rate paid by active employees. Other, non-monetary supplements include job placement assistance, reference letters and more.

Takeaways for Employers

Severance is a powerful tool that employers can use to protect against lawsuits, legal fees, unfair competition, and a host of other undesirable situations. It is critical that any offer of severance, whether contained in an agreement/policy or made in conjunction with a termination, include, at a minimum, a requirement that the terminated employee provide a general release of claims. Finally, severance agreements and policies require the input of experienced legal counsel. There are many procedural requirements to ensure that releases and related agreements are fully enforceable, and these requirements continue to evolve.

We are available to advise employers on using severance for their maximum benefit and to draft enforceable severance agreements.

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