Lowenstein Sandler's Executive Compensation and Employee Benefits Podcast: Just Compensation

Episode 53:
Avoiding the Bad Breakup: Employee Termination Considerations

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Megan Monson: Welcome to the Lowenstein Sandler Podcast Series. Before we begin, please take a moment to subscribe to our podcast series at lowenstein.com/podcast or find us on Amazon Music, Apple Podcast, Audible, iHeart Radio, Spotify, SoundCloud, or YouTube. Now let's take a listen.

Jessica Stewart: Welcome to the latest episode of *Just Compensation*. My name is Jessica Stewart and I'm an associate in Lowenstein Sandler's Executive Compensation Employment and Benefits Practice Group. I'm joined today by Megan Monson, a partner in the same group, and Amy Schwind, counsel in the Employment Group.

Megan Monson: Hi, I'm Megan Monson. Pleasure to be here, Jessica.

Amy Schwind: Thanks for having me.

Jessica Stewart: Today's episode we'll dive into a topic that many employers find both sensitive and complex, involuntary employee terminations. We are going to discuss key considerations for employers during involuntary terminations, including legal obligations for employers, required and optional benefits for terminated employees, Section 409A issues, and implications for outstanding equity to the extent applicable. To start off, when an employer is considering terminating an employee, what are some practical considerations for employers to think about?

Amy Schwind: First, when we're talking about individual terminations and we'll address some group and reduction in force considerations later. In the individual context, an employer should assess the nature of the employment relationship. First, does the employee have an employment contract or any type of offer letter? If there's an employment contract like an employment agreement, the employer would want to look and see does it have a fixed term of employment? Are they required to give notice to

terminate? Is cause defined? Does the conduct at issue constitute cause? That typically has different implications than a not-for-cause termination.

Next, is there an obligation either in an employment agreement or an offer letter to pay severance or other post-employment benefits? If so, is the severance conditioned upon the employee signing a release and it should be. We'll talk about release requirements in more detail later in this episode. If an employee is at will, that means it is not for a fixed term and the employee can be terminated any time for any reason with or without notice.

But even if the employer is not legally required to have a reason to terminate, a jury, for example, would still be expecting a good one and you may want to consider the benefit of offering something in exchange for a release of claims. An employer would also want to consider the timing of terminations. Essentially, what is the straw that broke the camel's back? What happened today that makes today the day you or your management team have decided you can't have this person in your workplace any longer. You'll want to see if you have written documentation of the performance deficiencies. What do the performance reviews look like? When counseling clients, I often get asked, "Do I have to put the person on a PIP?" And that means a performance improvement plan. You don't have to put the person on a PIP, but it is all fact sensitive.

Is the person going to be surprised? Was the person getting glowing reviews and this comes out of left field? What does the documentary record look like? Was all feedback verbal? That is not necessarily going to be helpful if the person claims your legitimate nondiscriminatory reason is a pretext. You want to have enough there that it demonstrates and supports why you made the decision you made, particularly when it comes to performance.

You'll also want to consider legal requirements. Is the employee in a protected class? Is the employee on a leave of absence or has the employee announced an intention to do so? Some leaves are what are called job protected leaves, meaning there is a legal requirement to restore the employee to their original job or an equivalent one upon their return, but in some instances, if the employee would've lost their job anyway, it is legally permissible.

Employers really need to tread carefully and assess the risk. The burden is on the employer to demonstrate the employee was not retaliated against for taking the leave or requesting the leave. Also, you'll want to consider has the employee made any complaints of harassment, discrimination, financial impropriety or other wrongdoing? This is important to consider again from a retaliation standpoint or a whistleblower standpoint. If they made a complaint, did you investigate how much time has gone by? What is the reasoning for the termination? It can't be because they made a protected complaint. You'll also want to consider how the employee's performance compares to his or her peers.

Megan Monson: So it sounds like, Amy, based on everything that you've said, it really should not be an impulsive, rash decision to terminate somebody. A company should really be thoughtful and think through all of the

implications to be best suited to kind of defend against any sort of claims of violating any sort of legal issue.

Amy Schwind: Absolutely. The employer really needs to step back and look and see what does the documentary record, and hopefully there is one, what does that look like?

Jessica Stewart: So once an employer has decided to terminate an individual's employment, what are some considerations for the actual termination?

Amy Schwind: I often get asked how to have the conversation. It's okay and often makes sense to have a script of bullet points you will follow during that conversation. It is best to have the conversation in person, and by in person, I mean whatever a natural way of communicating verbally with the employee is whether in person or by Zoom, particularly if the person is remote. The termination conversation itself should be respectful, direct, and brief. Employers should have a witness in the termination meeting, so for example, HR and a supervisor, and should avoid engaging in debate with the terminated employee.

Employers should anticipate any security risks and implement appropriate security measures. Employers should disable the employee's access to the employer's systems upon termination. Don't leave time for something to go awry. You'll want to cut the access. Employers should inform staff and clients of the employee's departure without oversharing and consider the messaging. Employers should also manage the employee's expectations by informing the employee of any payments or benefits that the employee may be entitled to receive. And if the employer is going to send a separation and general release agreement, the employer should tell the departing employee to expect it.

Jessica Stewart: Let's talk about these separation and release agreements. At a high level, what are these and who should be asked to sign them?

Amy Schwind: Release agreements ask employees to waive their right to sue an employer in exchange for some form of consideration, typically severance. We'll discuss different benefits that can be offered to terminated employees later in this episode. Employers should consider asking all involuntarily terminated employees to sign release agreements, in particular, the following circumstances may weigh in favor: recent employee complaints, recent protected leaves of absence, tumultuous history, or a bad breakup severance policy that requires an employer to do so.

If the person departing is a particularly litigious person, they've sued prior employers, and also beware that they may try to negotiate. Also consider the benefits of getting a release for a future sale or investment. Typically, our release agreement includes the separation date. That's very important to include, an employee's release of all waivable claims and a covenant not to sue. The employee can only waive claims arising on or before the date the employee signs the agreement, which is why it is important that an employee doesn't sign the release before the last day of employment.

An employee can't lawfully waive wage claims under federal law and certain state laws without court or agency approval and they also can't release their right to file a charge of discrimination with the EEOC or similar state agencies, but you can limit recovery if they do file a charge. There are also certain SEC-related whistleblower actions that need to be permitted, and regulated entities need to be particularly mindful of that. Release agreement must include consideration, and we will talk more about that. It should include cooperation with investigations and litigation, a non-disparagement provision. As far as non-disparagement and confidentiality of the terms of the agreement go, employers should tread carefully. There are state laws that place limitations on both. For instance, there are specific requirements and hoops you have to jump through to include a confidentiality provision for New York if a claim of harassment or discrimination has been asserted.

There is also certain language that needs to be carved out in non-disparagement language for California.

In recent years, the NLRB had taken a stance that rendered non-disparagement and confidentiality provisions in severance agreements potentially unlawful. That guidance was rescinded earlier in 2025. As of now, it's unclear the exact stance the NLRB will take on this for non-supervisory employees covered by the National Labor Relations Act, but it suggests a more employer-favorable one.

It should include an acknowledgement, the agreement is knowing and voluntary, and you also need to give sufficient time for it to be reviewed. Even if 21 or 45 days is not required by law, you need to give a reasonable period of time. It should include the due date to return it and sometimes where transition period is included prior to termination, it would be appropriate to include a reaffirmation of the release.

There are two key considerations to think about when it comes to preparing a release agreement. First, how old the employee is upon termination and also what state the employee is located in. For employers with 20 or more employees, for release agreements, for employees that are 40 years old and older at the time of termination, they must comply with certain requirements based on federal age discrimination law. The release needs to have specifics not required for those employees under 40, including, among other things, a minimum period of 21 days for consideration, and that is increased to 45 days in the context of a group layoff and also a seven-day revocation period after signing the agreement. It's important not to obligate yourself as the employer in the agreement to pay severance until that revocation period expires.

For group terminations, the employer must also provide a statistical analysis and that's often referred to as an Older Worker Benefit Protection Act chart. That chart shows the decisional unit, the titles and ages of those in the decisional unit eligible and ineligible for severance, and failing to comply means age discrimination claims won't be waived. Various states have nuances for release agreements too, so it's important to keep that in mind.

It's also important to tailor the release to the terminated employee rather than just using a generic form. You don't want to use the wrong thing and

it's not one-size-fits-all. If there are mistakes, it could compromise the actual release of claims.

Jessica Stewart: Megan, Amy mentioned that employees must receive consideration in exchange for signing a release agreement. What can serve as consideration?

Megan Monson: So, in general, some form of consideration is going to be required in exchange to have a valid release of claims, and this could be either pre-negotiated in an offer letter or an employment agreement or a severance plan. If there's something that already promises somebody something that they'll get on the way out the door, it may be otherwise specified and that they'll only get it if they sign a release of claims. But consideration is really a broad term. It really means any payment or benefit to which the employee is not otherwise entitled to without signing the release. And as an employer you want to think about, it must be something valuable enough to show that the employee is voluntarily releasing his or her rights and you want to offer something sufficient enough to incentivize the employee to sign the release, whatever that may look like.

So often the consideration takes the form of a severance payment but there's no bright line rule in terms of what is sufficient consideration for a valid release. So, it's going to be based on facts and circumstances and we would encourage you to consult with your legal counsel in terms of what would be appropriate given termination situation. In general, no amount of severance is required by law unless it's either promised in an employee's contract or in certain group termination situations that Amy will talk about a little bit later on.

But employers should also consider offering severance that's consistent with an informal severance policy or their past practices to reduce any risk of litigation or have a smooth separation. Often employers have guideposts or baselines based on seniority or tenure and employees talk, so they may be aware of historically what the company has done in certain termination situations, and again, if the goal is to have a smooth separation and have a release signed without a lot of back and forth, those are all just things to be mindful of.

Severance can take the form of a lump sum payment or it can be paid over time equivalent to salary continuation. The latter is more employer favorable and it's also not uncommon to have it stop if the former employee breaches any sort of restrictive covenant obligations with the company. If an employee is enrolled in active healthcare coverage, it's important to understand when that coverage would terminate. Often it is the last day of the month in which the termination occurs, but sometimes it may be on the last day of employment, so that's just something to be mindful of for purposes of a separation and release agreement and communicating that to the departing employee.

Employers with 20 or more employees must also allow employees to elect COBRA continuation coverage to the extent that they were enrolled in active healthcare and maintain their current employer sponsored health

coverage for a limited time after certain termination events, but typically it's 18 months.

COBRA coverage provides the same health insurance benefits that they had while they were employed, but unless there's an agreement with the company, the individual must pay both the employer and employee portion of the premiums, plus an administrative charge. As consideration for a release, an employer could offer to pay a portion of the COBRA premiums for a period of time after terminations and if they do so, often employers will have that either align with the term of any sort of severance or salary continuation payments, and it may cease if the individual is eligible for medical insurance through a new provider.

I will also add that certain individual states have different COBRA rules, called mini COBRA, so similar to as Amy mentioned in the general release concept, you want to be aware of any sort of state law implications.

Amy Schwind: I know Megan is going to address consideration for a release in the form of equity momentarily, but just to mention some other possibilities for consideration, particularly if an employer is cash-strapped or for whatever reason prefers not to offer more typical monetary consideration. If an employee has an enforceable post-employment non-compete obligation, the employer could choose to waive its right to enforce the covenant not to compete as consideration.

Also, an employer could consider a mutual release if it is really looking for something to offer that's not money or if it's negotiated in a settlement. This is something to carefully consider as an employer because you would be waiving the right to pursue claims against the employee, which you perhaps are unaware of at the time signing the agreement, but it is an option. I'd also like to provide some examples of inadequate consideration that would include payment of salary already earned by the employee, payment of a bonus or commission already earned by the employee, equity benefits already owed to the employee under an equity plan or payout of vacation, or PTO already owed under policy are required to be paid by applicable law.

If the consideration for the release is something the employee is already entitled to receive, that lack of consideration generally would invalidate the release if it's challenged.

Jessica Stewart: You mentioned that employers generally have discretion when determining the amount of severance to award terminated employees. What are some tax-related considerations to be mindful of when determining severance amounts?

Megan Monson: Yeah, so that's a great question, Jessica, and I'll preface this with another plug of, another reason why it's very important to involve your counsel even if you have a form that you're starting with beyond the various state and federal considerations that Amy mentioned is compliance with tax law, issues that could arise related to severance. Section 409A of the Internal Revenue Code governs non-qualified deferred compensation,

meaning compensation that's paid in a different tax year than the year in which it's earned. Payments that are made in a tax year other than the year that they are earned must either be structured to be exempt from or compliant with Section 409A. 409A is a very complex provision in the tax code, but if it's violated it can result in excise taxes on the employees and a loss of a tax deduction on the employer. I'm not going to get into all of the specifics because we discuss 409A in more granular detail in other episodes, in particular, stock options in section 409A. What you need to know and why is a 409A evaluation important. But section 409A also applies to severance payments. Severance can typically be exempt from 409A under a couple of different scenarios. The first being if it's paid by March 15th of the year following the year in which the termination occurred.

It can also be exempt from 409A under what they call the severance exception, and that would require that severance is paid solely due to an involuntary termination, the payments are under two times the employee's annual pay, up to a statutory cap, and the severance is fully paid within two years. It's common for severance to be structured to fit in this 409A exemption and if not in its deferred compensation, there needs to be careful thought in terms of how the document is drafted because the severance must meet 409A's rather stringent timing and distribution rules. And there is also ERISA related considerations as well. As a best practice, most employers are going to stick to severance being no more than two times over two years to be exempt from 409A.

Jessica Stewart: Can employers also offer consideration in the form of equity?

Megan Monson: Yeah, so that's a great question, Jessica, and that's something I get asked often. The answer is yes, but it's also where things can get complicated. So, employers should look at the terminated employee's outstanding equity agreements and their equity plan to understand what happens when employment ends. A common question is, somebody leaves and they want to accelerate vesting. It's really going to be important to see what the plan says because often an employee may forfeit unvested shares immediately upon termination, and so there's limited flexibility to do any sort of acceleration without careful fore planning before the termination occurred.

Another thing that comes up is understanding what the post-termination exercise period is for outstanding stock options under the governing documents because that's another area where employers may want to offer an extended post-termination exercise period in consideration for a release. So one of the key things to think about is that employers can offer these type of benefits to the extent permitted under their documents, but it also requires advanced planning, in particular those type of things that I mentioned, either accelerated vesting or extending a post-termination exercise period, would require board approval, and as I mentioned, some in the context of accelerating vesting may need to be done prior to the termination, so there's a lot of timing and drafting considerations.

For example, a release agreement could provide that the unvested equity will remain outstanding and eligible to vest over a period of time. It could accelerate vesting. As I mentioned, the post-termination exercise period for stock options could be extended. Often the default is 90 days post-termination but extending it beyond that could have some tax implications, converting incentive stock options to non-qualified stock options. But because of all these nuances in terms of how equity is treated upon termination and what changes can be done in all of the steps that need to be taken, it's imperative that employers seek the advice of counsel before any terminations of employment to understand any timing and approval of requirements.

Jessica Stewart: What are other considerations for employers to be mindful of in the context of involuntary employee terminations?

Amy Schwind: If an employer is terminating a group of employees, so a reduction in force, they'll want to consider both the Federal WARN Act and any state mini WARN acts. High-level federal and state WARN acts require certain additional requirements and consideration for certain mass layoffs, plant closings, relocations, and reductions in hours.

While these laws have been in effect for some time, this was really brought to the forefront quickly when employers were making mass layoffs during the pandemic. Whether terminations fall under a WARN Act requires some WARN math, which looks at the number of terminations and the timing of those terminations. WARN math varies based on federal law and by state, so it's important to be mindful of how many employees are involved and where they are located to see if WARN will be implicated. There are very limited exceptions to WARN acts. If a WARN Act is implicated, it requires advance written notice to employees and the government generally in the case of certain mass layoffs or terminations due to business closures.

Federally, this notice is a notice period of 60 days, and in some states, the notice period is 90 days. The Federal WARN Act does not require any sort of mandatory severance. But to note, the New Jersey WARN Act does require mandatory severance in certain situations if New Jersey WARN is triggered, which is very unique. I also want to mention, in any termination scenario whether group or individual, there is other termination documentation to be mindful of. If you work with a PEO, they may provide it, but ultimately it is your responsibility as an employer to ensure employees are getting what they're required to get. For example, New York requires that employees be provided a written notice of termination within five days after termination. California requires that employers provide a notice of change in relationship upon termination.

These notices typically require to set forth the date of termination and when benefits will end. This is separate and apart from a release if that is going to be provided. Also, COBRA notices are required often and notices of separation for unemployment purposes. So, some states like New York, California, and New Jersey require that employers provide an employee with the notice of the right to file for unemployment upon termination.

Other things that sometimes come up, “can I impose a restrictive covenant agreement at the end of the employment relationship if one wasn't in place from the start?” There can be, depending where the employee is located, some enforceability issues there. In some states, restrictive covenant agreements must be in place for a substantial amount of time prior to termination to be enforceable. Also, a final reminder to be aware of final pay laws. In most states, final paycheck must be issued on the next regular payday after termination, but in some states, the final paycheck must be issued sooner or immediately upon termination, and some of those states are California and Massachusetts, for example.

This can require a special payroll run to ensure compliance and often requires advanced planning with the payroll provider. If company policy requires payment for unused accrued vacation or PTO upon termination, then this payment must be included in the final paycheck. And in some states, employees can't forfeit unused vacation or PTO upon termination, like in California. Also determine whether under company policy or individual agreement or applicable law bonus payment or commission must be paid upon or after termination.

Jessica Stewart: Involuntary terminations aren't just difficult emotionally, they can be legally and administratively complex. Employers should ensure careful planning with respect to releases, severance and other post-termination benefits. Employers should also carefully review existing documentation and impose consistent practices for involuntary terminations. Thanks for joining us today. We look forward to having you back on the next episode of *Just Compensation*.

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