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COVENANTS NOT TO SUE: MAKING EXECUTIVES GAMBLE

by
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Companies often require executives to waive and release claims as a condition of receiving severance pay. Sometimes they do so under the terms of a previously established severance program, and other times in connection with ad hoc payments made upon termination. The inclusion of a carefully tailored covenant not to sue in such a release can serve as a powerful deterrent to an executive later claiming that she or he did not receive all amounts to which the executive was entitled, including amounts unrelated to the severance pay itself. This is well illustrated by a recent federal trial court decision, *Rosser v. Raytheon Excess Pension Plan*, 2008 U.S. Dist. LEXIS 89595 (N.D. Tex. 2008).

In *Rosser*, an employee was, upon his retirement, entitled to receive a "reduction-in-force benefit," as well as a "leave of absence payment." The reduction-in-force benefit entitled the employee to collect his salary for 60 days. The leave of absence payment entitled the employee to receive an amount equal to one week's worth of salary for every year he was employed. The employee was entitled to elect to receive both the 60-day reduction-in-force benefit and the leave of absence payment in a single lump sum, and the employee chose to do so. The amount of the executive's reduction-in-force benefit was almost $26,000, and his leave of absence was a bit over $116,000, for a total of about $142,000.

The employee's lawsuit did not involve these payments, though. It instead concerned a dispute over the amount to which the employee was entitled under a nonqualified deferred compensation plan, apparently a defined benefit SERP. The employee argued that he was entitled to count the 60-day reduction-in-force lump sum payment as compensation in calculating his benefit under the SERP. The plan's appeals committee disagreed. That committee concluded that although the employee would have been entitled to count the 60-day payment if he had received it as salary over a period of 60 days, the employee's election to instead receive the payment in a lump sum prevented the payment from being counted as compensation under the plan. The committee's reasoning was as follows: The SERP defined the term "compensation" as including "total earnings" (which included base pay, overtime pay, sales bonuses, and "performances premiums"), but expressly excluded severance pay. The committee focused on the severance pay exclusion. Consistent with materials provided to employees, the committee concluded that under the reduction-in-force benefit employees were eligible to remain employed during the 60-day period and receive full pay and benefits during that period. The employees would simply receive their normal paychecks. The plaintiff acknowledged, however, that by taking the 60-day payment in a lump sum he gave up his opportunity to remain an employee, with associated benefits, for the 60-day period. Because he was not employed

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during the 60-day period, the court sustained the committee's decision that the reduction-in-force benefit was a severance payment and therefore not pensionable compensation under the SERP.

This was bad news for the employee, but the news got considerably worse. The employer made a counterclaim for breach of a waiver and release agreement the employee had signed. The employee had agreed to release any "claims of any nature whether now known or later becoming known from my employment or termination of employment with the [employer]." The agreement included an obligation never to file a lawsuit based on the released claims. Importantly, the release provided that if the employee breached the agreement – and the court concluded that he did so by filing the lawsuit – the employer was entitled to recover all benefits mentioned in the agreement, as well as attorneys' fees and costs incurred in the defense of the lawsuit. In particular, the release stated: "Should I breach my promise set forth in this agreement and file a lawsuit or accept recoveries or benefits based on claims that I have released, as a condition precedent to maintaining litigation, I will immediately reimburse [the employer] those . . . benefits described . . . in . . . this Agreement . . . ."

Despite the employee's argument that the release did not apply to ERISA claims, the court concluded that the release was valid and did apply to ERISA claims. In particular, the court, citing earlier precedent from the Fifth Circuit Court of Appeals, found that the language of the release was unambiguous and evinced an intent to release "every imaginable cause of action," including ERISA claims. The court quoted the Fifth Circuit Court of Appeals, as follows: "a general release of 'any and all' claims applies to all possible causes of action, unless a statute specifically and expressly requires a release to mention the statute for the release to bar a cause of action under the statute. ERISA contains no such requirements. The releases therefore cover plaintiff's claims for ERISA benefits."

The court found that the employee had received consideration for his release in the form of the $142,000 he was paid in reduction-in-force and leave of absence benefits. The court, therefore, not only denied the employee's claim for additional SERP benefits, it also required that he return to the employer the $142,000 in unrelated benefits he had received.

Lesson. Employers that provide executives with additional compensation upon termination of employment may wish to consider including in any release a covenant not to sue, together with an obligation to return all consideration paid to the executive should she or he violate the covenant not to sue. Where the additional payments that serve as consideration for the release are substantial, such as was the case in *Rosser*, such a covenant may provide a substantial disincentive to an executive who is considering filing a lawsuit about which the executive is not fully confident.

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