INDEMNIFICATION AND RELEASES[1]
Employment Roundtable

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June 21, 2007

I. INTRODUCTION

Litigation and related activities are an expensive part of doing business. The financial burdens associated with these activities are significant, not only for employers, but also for employees, contractors, directors, and officers. Both indemnification and release agreements are important tools for minimizing financial liability and allocating risk. Such agreements are contracts to which basic contract rules generally apply, as discussed in our previous Employment Roundtable memorandum entitled: EMPLOYMENT CONTRACTS 101 (April 19, 2007).[2]

II. INDEMNIFICATION

Indemnification is the payment of expenses and other costs incurred by another party. Indemnification provisions are often included in business contracts as a means of protecting one party against damages and expenses caused the other party's malfeasance or failure to perform. An indemnification agreement may provide for the payment of expenses (*e.g.,* the cost of obtaining substitute performance or repairing damage to property), as well as judgments, settlements, attorney fees, costs, penalties, and other amounts incurred in connection with pending or threatened civil, criminal, administrative, investigative, or alternative dispute resolution proceedings. Indemnification may be required by statute, imposed by common law, or agreed to by contract.

"The law long has recognized that litigation can be expensive and that it could prove difficult to obtain the services of competent employees unless they are protected against the cost of lawsuits that arise out of the employers' business."[3] As a result, most state corporation and partnership laws either allow or require companies to indemnify directors, officers, and/or employees for defense costs arising out of their service to the entity.[4]

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[1] This memorandum contains a summary of information obtained from laws, regulations, court cases, administrative rulings, and legal publications and should not be viewed or relied upon as legal advice. Ater Wynne LLP urges readers of this memorandum to consult legal counsel regarding specific legal issues and factual circumstances.
[2] http://www.aterwynne.com/Employment+Roundtable.aspx?id=9.
[3] *U.S. v. Stein,* 435 F Supp2d 330, 335 (SDNY 2006).
[4] *Id. at n.4* (recognizing that indemnification "is very much a part of American life. Persons in jobs big and small, private and public, rely on it every day. Bus drivers sue for accidents, cops sued for allegedly

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Some indemnification agreements include a further obligation to advance legal fees and costs while an investigation is pending. This affords the indemnitee a source for payment of legal defense costs up front, rather than having to personally fund the expense and seek reimbursement as fees are paid or after the proceeding is over. Such a provision may be critical to an individual who is otherwise unable to pay for a defense.

Individuals who receive advanced expenses are sometimes required to repay such funds if they fail to meet certain tests establishing their eligibility for indemnification (*e.g.,* the individual is ultimately found guilty in a criminal proceeding, liable in a civil proceeding, or to have acted against the corporation's interest).[5] To insure that the repayment obligation will be met, some corporations that advance expenses require the indemnitee to post a bond, provide collateral, or prove the ability to repay the advance (often referred to as an "undertaking").[6]

Indemnification provisions are not failsafe for either side. Due to the significant expense to the party required to provide indemnity, such agreements often wind up in litigation. An employer-indemnitor may be reluctant to pay the legal costs of a director, officer, or employee believed guilty of malfeasance, especially when the company is being sued and facing exposure to significant damages, fines, penalties, or other consequences for the employee's conduct. Moreover, even when a party is ordered to provide indemnification, it may not have sufficiently deep pockets to fulfill its obligation, leaving the individual financially exposed. Such concerns should be considered and evaluated prior to entering into indemnification agreements.

A. Corporate Officers and Directors

Indemnification of corporate officers and directors is a common practice that is typically permitted, and sometimes mandated by statute. Both Oregon and Washington laws provide for mandatory indemnification of a director who successfully defends, on the merits or otherwise, against any proceeding in which the director was made a party due to his or her position as a director with the company, unless the articles of incorporation provide otherwise.[7] Delaware, the chosen state of incorporation by many companies due to its highly-developed body of corporate law, is even more supportive of indemnification.[8] Indemnification is mandatory in Delaware for

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wrongful arrests, nurses named in malpractice cases, news reporters sued in libel cases, and corporate chieftains embroiled in securities litigation generally have similar rights to have their employers pay their legal expenses if they are sued a s a result of doing their jobs. This right is as much a part of the bargain between the employer and employee as salary or wages.").

[5] *See generally* Kenneth Breen, *Issues in the Advancement of Legal Expenses,* 31-FEB Champion 54 (Jan./Feb. 2007). "With the high cost of litigation defense and the potentially long duration of even a trivial action, failure of a corporation to advance litigation expenses would likely harm the director's ability to defend himself or herself and personal financial condition." Stephen Sonne and Gene Levoff, *Indemnification Agreements: Why Every Director Needs One, 12*(5), The Corporate Governance Advisor 20 (2004).

[6] *See* Breen, *Issues in the Advancement of Legal Expenses*, at n.5.

[7] *See, e.g.,* ORS 60.394 and RCW 23B.08.520. Oregon law provides for indemnification of officers to the same extent as directors. ORS 60.407(1). Many states' corporate indemnification laws are based upon one or more versions of the Model Business Corporation Act. *See generally* James J. Hanks, Jr. and Larry P. Scriggins, *Protecting Directors and Officers from Liability – The Influence of the Model Business Corporation Act*, 56 Bus Law 3 (2000).

[8] *See* Delaware General Corporation Law §145; *see also* Stephen Sonne and Gene Levoff,

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actual and reasonable expenses incurred in the successful defense of actions threatened or brought against a director because of his or her position. A Delaware company cannot avoid this obligation by providing otherwise in its articles of incorporation.[9]

Oregon law allows corporations to indemnify directors, officers and employees.[10] Most corporations provide through their bylaws for indemnification of directors and officers for legal costs arising from their employment. However, corporations may also act by contract and/or resolution, bylaw, or charter provision.

Indemnification agreements are generally more comprehensive than indemnification provided in bylaws. In addition, such contracts cannot be changed without the indemnitee's consent.[11]

Indemnification agreements frequently make the news in Securities and Exchange Commission (SEC) cases against officers and directors. In *Happ v. Corning, Inc.,*[12] for example, the SEC sued board member Robert Happ for illegal trading. Happ had an indemnification agreement that provided for indemnification for legal expenses as long as he "acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the company."[13] Corning agreed to pay only if Happ signed an undertaking promising to repay defense costs if it were determined that he wrongfully used the company's material non-public information for personal gain. Despite allegations of duress,[14] the court upheld the undertaking and ordered Happ to repay the nearly $900,000 in legal fees incurred on his behalf after he was found guilty by a jury and ordered to pay a fine of $70,000.

Two Oregon cases demonstrate how indemnity provisions have come back to bite corporations that agreed to provide indemnification. In both *Damerow Ford Co. v. Bradshaw*[15] and *Sabre Farms, Inc. v. Kurth,*[16] the plaintiff corporations sued former officers and directors for various claims relating to their alleged breaches of fiduciary duty. Although the officers and directors were not exonerated of wrongdoing, the corporations' claims were dismissed, entitling the officers and directors to indemnification for attorney fees and expenses incurred in defending against the corporations' claims. As noted by the court in *Damerow,* no determination of "innocence" is necessary for recovery under the Oregon statute; as long as the officer or director

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Indemnification Agreements: Why Every Director Needs One, 12(5) The Corporate Governance Advisor 19 (2004) ("This policy enhances the ability of corporations to function as risk-taking enterprises and recognizes that, without giving corporate directors sufficient protection from liability, corporations would have difficulty finding qualified persons to serve").

[9] Delaware General Corporation Law §145.

[10] *See* ORS 60.387-60.414.

[11] *See generally* Sonne and Levoff, *Indemnification Agreements: Why Every Director Needs One, supra,* at n.8.

[12] 466 F3d 41 (1st Cir 2006).

[13] This language is from the Delaware statute.

[14] Happ argued that he signed the undertaking under financial pressure. Although he could have brought a declaratory judgment action asking the court to uphold the indemnification agreement to avoid the undertaking agreement, the court stated that his claim for indemnification would fail under general Delaware corporate law because he could not show that his conduct was (1) in good faith and (2) not opposed to the best interest of the company. 466 F3d at 46.

[15] 128 Or App 606, 876 P2d 788 (1994).

[16] 78 Or App 323, 717 P2d 156 (1986).

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is successful in the lawsuit, whether based on a technicality or otherwise, the directors or officers may recover fees and costs incurred.[17]

1. D&O Insurance

Corporate entities may decide to purchase Directors and Officers (D&O) insurance to either supplement or provide an alternative to indemnification. Indemnity agreements often require the purchase of such insurance.[18]

> [D&O insurance] is the subject of increasing importance in corporate America as a result of the proliferation of shareholder, class action, derivative action, and regulatory agency proceedings and investigations targeting companies and their directors and officers. In this era of public and government scrutiny of the actions of directors and officers in the wake of corporate financial scandals, D&O insurance has become a crucial asset to protect directors and officers from what could be devastating personal financial loss. It should come as no surprise, however, that D&O policies are not all created equally. As corporations and their directors and officers attempt to acquire D&O insurance as a means of protection from personal loss, careful attention to the terms, conditions, provisions and exclusions of the coverage to be purchased is necessary to avoid the placement of coverage that may be virtually worthless when directors and officers need it most.[19]

D&O insurance may cover situations in which the director or officer is not entitled to indemnification, and/or allow the corporate entity to satisfy its indemnification obligations while incurring less financial risk. As with other types of insurance, such policies differ significantly as to scope, coverage limits, deductibles, and other clauses. Directors and officers may also obtain their own supplemental D&O insurance policies.[20]

2. The SEC and the U.S. Justice Department's Public Policy Concerns

The SEC (and other government agencies) historically disfavor indemnification with respect to agency-related litigation.[21] For example, in 2004 the SEC brought an action against Lucent Technologies, Inc., for securities violations. After reaching a settlement in principle, Lucent, without any legal obligation to do so, expanded the scope of employees eligible for

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[17] 128 Or App at 622-623 (discussing application of ORS 60.394).

[18] *See generally* Sonne and Levoff, *Indemnification Agreements: Why Every Director Needs One, supra*, at n.8.

[19] Matthew L. Jacobs, Julie S. Greenberg, *Basic Principles of D&O Coverage and Recent Developments*, 741 PLI/Lit 29, *35 (2006).

[20] This may be especially important if the corporation later files for bankruptcy, leaving the officer or director potentially without access to the corporation's D&O insurance assets. *See id.* at *40-41.

[21] *See, e.g.,* 17 CFR §229.510, which provides in relevant part:

> Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers or persons controlling the registrant pursuant to the foregoing provisions, the registrant has been informed that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is therefore unenforceable.

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indemnification against the consequences of the SEC enforcement action. This conduct contributed to the SEC's imposition of a $25 million penalty.[22] The SEC's action was consistent with the U.S. Department of Justice's adoption of the "Principles of Federal Prosecution of Business Organizations" (aka, the "Thompson Memo"), which required federal prosecutors deciding whether to bring criminal charges against a corporation to consider whether the corporation appeared to be protecting culpable employees. According to the DOJ, this consideration could include advancement of legal fees and costs to its employees.[23]

Courts have shown some willingness to moderate the federal government's aggressive stance on indemnification, most notably in *U.S. v. Stein,*[24] considered "the largest criminal tax case in American history."[25] The case, which is ongoing as of this writing, involves allegations that KPMG employees devised and implemented fraudulent tax shelters that cost the U.S. Treasury more than $2 billion. In connection with the government's investigation, KPMG entered into a deferred prosecution agreement with the government, under which it agreed to cooperate fully with the government and pay $456 million in fines and penalties. The agreement required KPMG, among other things, to depart from its prior policy of routinely advancing attorney fees to employees under investigation in connection with their employment.[26] Instead, KPMG adopted a new policy under which it partially paid the fees of employees who "cooperated" with the government and opted not to invoke their privilege against self-incrimination under the Fifth Amendment. Payment of fees and costs ceased if the employee was charged with any criminal wrongdoing.[27] The court held that the U.S. Attorney's pressure[28] on the corporation to stop paying 19 employees' legal defense costs violated the employees' constitutional rights to counsel and a fair trial, and ultimately stayed the trial indefinitely until it is determined whether KPMG must pay the employees' attorney fees.[29] Sixteen of the employees are currently continuing separate proceedings against KPMG to determine whether or not KPMG is legally obligated to pay their fees.[30]

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[22] "Lucent Settles SEC Enforcement Action Charging the Company with $1.1 Billion Accounting Fraud" (May 17, 2004), http://www.sec.gov/news/press/2004-67.htm; *see also* John F. Savarese, David B. Anders and Carol Miller, *Directors' Fiduciary Duty of Care: SEC and Judicial Expectations, Risks and Protections: Developments in Indemnification and Advancement of Fees* (2006 NYU Directors' Institute).

[23] *See generally* the court's discussion and criticism of the "Thompson Memo" in *U.S. v. Stein,* 435 F Supp2d 330, 338 (SDNY 2006).

[24] 435 F Supp2d 330 (SDNY 2006); *see also* 461 F Supp2d 201 (SDNY 2006) (indictment trial adjourned indefinitely (*sine die*).

[25] *Stein v. KPMG, LLP,* 2007 WL 1487822 *1 (2nd Cir 2007).

[26] 435 F Supp2d at 340. The court noted that KPMG recently paid over $20 million to defend four partners in SEC-related litigation.

[27] *Id.* at 345-346.

[28] The court concluded that "KPMG refused to pay because the government held the proverbial gun to its head. Had that pressure not be brought to bear, KPMG would have paid these defendants' legal expenses." 435 F Supp2d at 336.

[29] *U.S. v. Stein,* 461 F Supp2d 201 (SDNY 2006) (estimating that the cost of a "basic defense" for an employee would be between $500,000 to $1 million or more).

[30] *See Stein v. KPMG, LLP,* 2007 WL 1487822 (2nd Cir 2007).

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Subsequent to the opinion in *U.S. v. Stein*, the U.S. Department of Justice largely reversed its enforcement policy on advances via the recently released and superseding "McNulty Memo":[31]

> The new memorandum also instructs prosecutors that they cannot consider a corporation's advancement of attorneys' fees to employees when making a charging decision. A rare exception is created for those extraordinary instances where the advancement of fees, combined with other significant facts, shows that it was intended to impede the government's investigation. In those limited circumstances, fee advancement may be considered only if it is authorized by the Deputy Attorney General.[32]

This turnabout in policy means that corporate employers can breathe a little easier about advancing legal fees to employees in compliance with their charters, bylaws, and agreements without fear of being labeled as "uncooperative" in a federal investigation.

B. Private Employees

Some states, such as California, expressly require indemnification of private employees by statute. California Labor Code § 2802 requires employers to provide indemnification for expenses directly incurred by an employee "in the discharge of his or her duties."[33] The statute does not require the employer to provide a defense.[34] Although the scope of the employer's obligation has not been clearly defined by the courts, it will apply if the employee is "required to defend the action solely because of acts which he performed within the scope and course of his

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[31] http://www.usdoj.gov/dag/speech/2006/mcnulty_memo.pdf, pp. 11-12:

> Prosecutors generally should not take into account whether a corporation is advancing attorneys' fees to employees or agents under investigation and indictment. Many state indemnification statutes grant corporations the power to advance the legal fees of officers under investigation prior to a formal determination of guilt. As a consequence, many corporations enter into contractual obligations to advance attorneys' fees through provisions contained in their corporate charters, bylaws or employment agreements. Therefore, a corporation's compliance with governing state law and its contractual obligations cannot be considered a failure to cooperate. This prohibition is not meant to prevent a prosecutor from asking questions about an attorney's representation of a corporation or its employees.

[32] http://www.usdoj.gov/opa/pr/2006/December/06_odag_828.html.

[33] Cal Lab Code §2802 provides in relevant part:

> (a) An employer shall indemnify his or her employee for all necessary expenditures or losses incurred by the employee in direct consequence of the discharge of his or her duties, or of his or her obedience to the directions of the employer, even though unlawful, unless the employee, at the time of obeying such directions, believed them to be unlawful.
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> (c) For purposes of this section, the term "necessary expenditures or losses" shall include all reasonable costs, including, but not limited to, attorney's fees incurred by the employee enforcing the rights granted by this section.

See also Cal Corp Code § 317.

[34] *Grissom v. Vons Companies*, 1 Cal App 4th 52, 557-58 (1991).

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employment."[35] The cases are in disagreement as to whether the action against the employee must also be "unfounded."[36]

California employers that are corporations also have indemnity obligations under California Corporations Code § 317, which requires indemnification of corporate officers, directors, employees, and other agents when the individual: (1) was sued or threatened with suit because he/she is or was an agent of the corporation, (2) acted in good faith and in a manner believed to be in the best interests of the corporation in the conduct giving rise to the suit (and, if the action is a criminal matter, had no reasonable cause to believe his or her conduct was unlawful), and (3) was successful on the merits in the proceeding. An indemnity obligation also exists toward partners who incur expenses in connection with partnership business or the preservation of its property.[37]

Oregon imposes no statutory obligations on employers to indemnify employees other than those who serve as directors and/or officers of a corporation.[38] However, a party can bring a common law indemnity claim based on an implied contract theory of liability.[39] To be eligible for common law indemnity, the plaintiff must allege and prove that (1) he or she discharged a legal obligation owed to a third party; (2) the defendant was also liable to the third party; and (3) as between the plaintiff and the defendant, the obligation should be discharged by the latter.[40]

With respect to the second prong of the test, the liability to the third party must rest on a common duty, as opposed to one assumed by contract.[41] Although employers rarely invoke the right,

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[35] *Douglas v. Los Angeles Herald-Examiner*, 50 Cal App 3d 449, 463, 123 Cal Rptr 683, 691 (1975).
[36] *Compare Douglas, id. at n.34* (finding no duty to indemnify until determination is made that establishes employee acted within scope of employment); *Mallari v. Home Depot, Inc.*, 1996 WL 130935 (ND Cal 1996), *aff'd*, 108 F3d 338, 1997 WL 66251 (9th Cir 1997) (opinion designated not appropriate for publication) (finding, as a matter of law, that allegations of sexual harassment were outside scope of employment where employer had policy against sexual harassment, it never directed employee to harass the plaintiff, and allegations described conduct outside the scope of employment); *Jacobus v. Krambo Corp.*, 78 Cal App 4th 1096, 93 Cal Rptr 2d 425 (2000) (indemnification required where employee prevailed in co-worker's sexual harassment action against him and jury found that no harassment occurred); *Devereaux v. Latham & Watkins*, 32 Cal App 4th 1571 (1995) (indemnification disallowed).
[37] Cal Corp Code § 16401(c) ("A partnership shall reimburse a partner for payments made and indemnify a partner for liabilities incurred by the partner in the ordinary course of the business of the partnership or for the preservation of its business or property.").
[38] *See* footnote 7, *supra;* under ORS 60.407(2), a corporation "may" indemnify and advance expenses to an employee or agent of the corporation.
[39] *See generally,* 1 Torts §16.1 (Oregon CLE 2006) (citing *Owings v. Rosé,* 262 Or 247, 262, 497 P2d 1183 (1972)).
[40] *Fulton Ins. v. White Motor Corp.*, 261 Or 206, 210, 493 P2d 138 (1972) (relying on rule stated in Restatement of the Law of Restitution § 76 at 331 (1937)). An example would be a retailer and a manufacturer who are sued for injuries to a consumer caused by a defective product produced exclusively by the manufacturer. In such circumstances, the retailer who settles with the consumer may have a right of indemnity against the manufacturer.
[41] *Safeco Ins. Co. of America v. Russell*, 170 Or App 636, 13 P3d 519 (2000) (*citing Citizens Ins. v. Signal Ins. Co*., 261 Or 294, 297-98, 493 P2d 46 (1972) and Restatement of Restitution § 76, comment b). The court in *Safeco* rejected an insurer's claim for indemnity against a driver that negligently caused damage to its insured. The court reasoned that the insurer already had the right of subrogation, affording it the same rights its insured had against the tortfeasor:

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those found vicariously liable for the negligent acts of their employees may have a right of indemnity against them.

C. Public Employees

Public employees are generally entitled to indemnification when they are sued for acts or conduct related to their employment. Oregon requires public employers to defend and indemnify public employees "against any tort claim or demand, whether groundless or otherwise, arising out of an alleged act or omission occurring in the performance of duty," unless the employee engaged in "malfeasance in office or willful or wanton neglect of duty."[42] For state employees, the Attorney General must provide a defense unless he or she finds, after investigation, "that the claim or demand does not arise out of an alleged act or omission occurring in the performance of duty, or that the act or omission complained of amounted to malfeasance in office or willful or wanton neglect of duty."[43] A parallel obligation exists for local public bodies, except that they must engage private counsel to defend the employee.[44]

A public employer violates its duty by failing to conduct an investigation before refusing to defend the employee.[45] The requirement of an investigation cannot be satisfied by merely reviewing the allegations against the employee who tenders a defense.[46] However, once a thorough investigation has been conducted, the government may be relieved of its duty to indemnify.[47]

D. Indemnification Agreements

Employers may wish to require contractors, vendors, and others who perform services for the company to assume the risk of damages in the event the contractor's performance is defective or the contractor otherwise causes harm to the company. To make sure the contractor can fulfill its indemnity obligation, it may be desirable to require the contactor to obtain and provide proof of insurance to cover any potential losses. The following is a typical indemnification provision:

> To add a right of indemnity to its arsenal of claims actually would improve the insurer's position over that of its insured. It would afford the insurer a longer statute of limitations than the insured had on an underlying tort claim. In addition, it would insulate the insurer from other defenses, such as comparative negligence, that the alleged tortfeasor might have asserted against the insured. Insurers such as plaintiff are in the business of assuming risks for compensation. There is no reason why the law should, in fairness, imply a remedy in plaintiff's favor that would surpass any remedy that its insured may have had against defendant.

170 Or App at 643.

[42] ORS 30.285(1) and (2).

[43] ORS 30.285(3).

[44] ORS 30.287(1).

[45] *Pomplin v. Emerald People's Utility District* , 102 Or App 403, 407, 794 P2d 816 (1990).

[46] *Genesis Indemnity Ins. Co. v. Deschutes County*, 194 Or App 446, 452 n.4, 95 P3d 748 (2004).

[47] *See, e.g., Hallberg v. City of Portland,* 2006 WL 1642349 (D Or 2006) (city housing inspector who violated city rule by purchasing house after posting violations which resulted in homeowner's loss of the property through foreclosure was not entitled to statutory defense in homeowner's suit against him).

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> Contractor agrees to defend, indemnify and hold harmless Company for any and all claims, demands, actions, damages, losses and expenses, including attorney fees and costs of litigation, arising out of or relating to Contractor's performance under this Agreement. Contractor shall maintain and provide Company with proof of liability insurance in the minimum amount of $________ which covers the services to be performed under this Agreement.

Another form of indemnity that employers may find desirable is for the payment of taxes. This may come up in circumstances where the company is hiring an individual as an independent contractor. A typical provision might be as follows:

> Contractor shall be responsible for all self-employment, social security and other taxes, fines, penalties or other liability to the State of Oregon or to the Internal Revenue Service of the United States or to any other entity with taxing jurisdiction. Contractor agrees to indemnify and hold harmless Company from any claim of liability of any kind by any taxing authority as a result of the payments made under this Agreement.

There are limits to the scope of conduct that may be covered by contractual indemnity. In general, while "a party may obtain indemnity protection against liabilities from its own negligent conduct if its conduct is not 'wanton or criminal' in nature,"[48] that intention must be clearly and unequivocally expressed, and ambiguities will be construed against the party who drafted the contract.[49]

III. RELEASES

A release is an agreement to abandon claims or rights.[50] Releases are often used in the context of settling a lawsuit, for example, where one party pays a settlement in exchange for the other party's agreement to permanently dismiss the lawsuit and bring no future actions based on the same claim. Releases are extremely useful in the employment context to manage exposure to claims arising from employment terminations and other high-risk situations.

Like all contracts, a release must be supported by consideration.[51] This may be in the form of additional compensation, benefits, or other promise of "value" (*e.g.,* an agreement to provide

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[48] 1 Torts §16.3 (Oregon CLE 2006) (citing *Waggoner v. Oregon Auto Ins Co.,* 270 Or 93, 97, 526 P2d 578 (1974)).

[49] *Estey v. MacKenzie Engineering Inc.*, 324 Or 372, 376, 927 P2d 86 (1996); *Blanchfill v. Better Builds, Inc.,* 160 Or App 527, 534, 982 P2d 53 (1999) (finding that if the contract is clear and unequivocal, the inquiry ends, but if the contract language is broad and indefinite with respect to negligence, referring to "any and all claims" or "any and all liability," the court determines the scope and enforceability of the indemnity provision). In the context of construction agreements, this general rule has been modified by statute in Oregon. *See* ORS 30.140; *see also* 1 Torts §16.4 (Oregon CLE 2006).

[50] *Maier v. Pacific Heritage Homes, Inc.*, 72 F Supp 1184 (D Or 1999). "An agreement to waive legal claims under Oregon law is subject to construction and interpretation like any other contract." *Eldridge v. Pollin Hotels II*, LLC, 2005 WL 1838958 (D Or 2005).

[51] Consideration is the inducement to enter into a contract or the promise that is exchanged; *i.e.,* "[s]ome right, interest, profit or benefit accruing to one party, or some forbearance, detriment, loss, or responsibility, given suffered, or undertaken by the other." BLACK'S LAW DICTIONARY (6th ed.); *see also*

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neutral references or not to contest unemployment) to which the individual is not already entitled. This means that payment of a final paycheck, commission, or other benefit already owing to the employee will not be sufficient to support the release.

To be enforceable, a release in the employment context must be entered into "knowingly and voluntarily."[52] A number of considerations are relevant in this inquiry, including: (1) the employee's experience, background, and education; (2) the amount of time the employee had to consider whether to sign the waiver, including whether the employee had an opportunity to consult with a lawyer; (3) the clarity of the waiver; (4) the consideration provided in exchange for the waiver; as well as (5) the totality of the circumstances.[53]

Employees who are not given adequate time to consider a release may later challenge it claiming they signed under duress, so the release was not truly signed voluntarily.[54] To avoid allegations of duress, it is recommended that the employer:

- Encourage the employee, both in person and in writing, to have an attorney review the document, and allow the employee a reasonable time to do so;
- Do not imply that any rights or benefits to which the employee is already entitled may be withheld or delayed until the document is signed or a decision is made (*e.g.,* follow normal procedures for final pay regardless of the status of the release);
- Be courteous and respectful when presenting an employee with a release and avoid an oppressive atmosphere.[55]

The use of fraud or other bad acts may invalidate an otherwise valid release. For example, in *Bennett v. Coors Brewing Co.*,[56] the employer allegedly announced that it intended to eliminate jobs as part of a reduction in force in order to encourage employees to accept severance packages when, in fact, Coors hired new employees to replace the old ones. Most of the new employees were younger. The circumstances allowed the court to consider whether or not the release was induced by fraud, in which case it would not be valid. Therefore, avoiding the appearance of fraud, duress, and/or other improprieties is important to the validity of the release.

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generally, CONTRACT LAW IN OREGON (Oregon CLE 2003) §6.17.

[52] This standard originated in the Age Discrimination in Employment Act (ADEA) and EEOC regulations applicable to the waiver of an age claim. *See* 29 USC § 626(f); 29 CFR 1625.22.

[53] *Id.* Many of these factors have been applied by courts when evaluating the enforceability of releases of employment claims generally, even when no age claim was at issue. *See, e.g., Adams v. Philip Morris,* 67 F3d 580 (6th Cir 1996).

[54] *See generally* Jay M. Zitter, *What Constitutes Duress by Employer or Former Employer Vitiating Employee's Release of Employer from Claims Arising Out of Employment*, 30 ALR 4th 294.

[55] *See generally* Adria Martinelli, *Too Bad, So Sad: Employee Stuck with Release, and Lawsuit Dismissed*, 9 (10) Del Emp L Letter 1 (Oct. 2004).

[56] 189 F3d 1221 (10th Cir 1999).

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A. Limitations on Releases

1. Release of Prospective Rights and Claims

In general, releases are only valid as to claims existing as of the date the release is signed. An existing claim is one that was or could have been asserted based on events that have already occurred, as opposed to a prospective claim that is based on events that occur after the release is signed. The distinction between the two is not always clear. In *Adams v. Philip Morris, Inc.,*[57] for example, an employee who signed a general release during a layoff saw an advertisement for what appeared to be his former position a year later. Although he applied for the position, a younger applicant got the job. When the employee sued for age discrimination, the court noted that it was unclear whether the claims at issue were based on the continuing effect of past discrimination, which would make the release effective, or conduct that had not occurred at the time the release was signed.

2. Statutory Limitations

a. ADEA

Under the Age Discrimination in Employment Act, as amended by the Older Worker Benefit Protection Act (OWBPA), "[a]n individual may not waive any right or claim under this chapter unless the waiver is knowing and voluntary."[58] To satisfy the EEOC's "knowing and voluntary" standard, the waiver must: (1) be in writing; (2) written in plain language geared to the level of understanding of the intended recipient; (3) not be misleading; (4) specifically refer to ADEA rights or claims; (5) not waive future rights or claims; (6) be in exchange for valuable consideration; (7) advise the individual in writing to consult an attorney before signing; and (8) provide the individual 21 days to consider the agreement (45 days in layoffs involving two or more employees) and at least 7 days to revoke the agreement after signing it. In layoffs affecting two or more employees, the employer must provide employees 40 and over with specific information about the ages of employees selected for layoff versus those who were retained.[59]

A release that fails to meet the EEOC requirements for "knowing and voluntary" execution is unenforceable as to ADEA claims.[60] Moreover, when these standards are not met, the employee may pursue an age claim without returning the compensation he or she received in exchange for the ineffective release.[61]

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[57] 67 F3d 580 (6th Cir 1995).
[58] 29 USC §626(f).
[59] *See generally* EEOC's Facts About Age Discrimination at www.eeoc.gov/facts/age.html.
[60] *See, e.g., Eldridge v. Pollin Hotels II*, LLC, 2005 WL 1838958 (D Or 2005) (court refused to enforce release where employee given only a few minutes to consider release despite request for more time and had concerns about a negative recommendation and forfeiture of accrued wages if she failed to sign); *Syverson v. International Business Machines Corporation*, 461 F3d 1147 (9th Cir 2006) (covenant "[to] never institute a claim of any kind against [the employer]" that also said it "does not apply to actions based solely under the Age Discrimination in Employment Act" held confusing and unenforceable).
[61] *Oubre v. Entergy Operations, Inc.*, 522 US 422 (1998).

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b. FMLA

FMLA regulations provide that "employees cannot waive, nor may employers induce employees to waive, their rights under FMLA."[62] At least two courts have interpreted this regulation as invalidating a release of claims to the extent it purported to waive the employee's right to assert a claim for a FMLA violation.[63]

c. Waiver of EEOC Charges

While it is permissible to require an employee to waive the right to file a lawsuit or collect monetary damages as a condition of receiving severance or other benefits under a release, the EEOC's position is that it is impermissible to condition benefits upon the waiver of the right to file an EEOC charge.[64]

A release that prohibits an employee from asserting *any* type of action or proceeding against the employer (*e.g.*, a broad covenant not to sue) is not enforceable to the extent it purports to prohibit employees from filing charges with the EEOC. [65] The release itself also may constitute actionable retaliation by the employer.[66]

d. Oregon Wage and Hour Claims

For a release of wage claims to be valid under Oregon law, the release must pertain to a "known and identified claim." [67] The statute does not address what makes a claim "known and identified," but a conservative approach would require the existence of a dispute over wages that is identified in the release agreement. A general release of "all claims for unpaid wages" would probably not be effective.[68] In addition, the release cannot require the employee to relinquish a claim for additional or future violations.[69]

e. Personal Injury Claims

Oregon law prohibits employers from settling personal injury claims with employees within fifteen days after the injury occurs.[70] An employee who signs a release in violation of the statute

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[62] 29 CFR 825.220(d).
[63] *Dierlam v. Wesley Jensen Corp*., 222 F Supp 2d 1052 (ND Ill 2002); *Dougherty v. Teva Pharmaceuticals USA,* 2006 WL 2529632 (ED Pa 2006).
[64] *See* Enforcement Guidance on non-waivable employee rights under Equal Employment Opportunity Commission (EEOC) enforced statutes: http://www.eeoc.gov/policy/docs/waiver.html; *see also EEOC v. SunDance Rehabilitation Corp.,* 328 F Supp 2d 826 (ND Ohio 2004).
[65] *EEOC v. Lockheed Martin Corporation*, 444 F Supp 2d 414 (D MD 2006).
[66] *Id.* (employer unlawfully retaliated against employee by requiring her to dismiss discrimination charge filed with EEOC as a condition of receiving severance and including in release a broad prohibition on pursuing any "charges" against employer).
[67] ORS 652.360.
[68] *See Vento v. Versatile Logic Systems Corp.,* 167 Or App 272, 3 P3d 176 (2000) (payment of $1,000 to terminated employee in exchange for general release of all claims was not effective as waiver of employee's state law claims for unpaid overtime, liquidated damages, and statutory penalty that exceeded $1,000).
[69] ORS 652.360.
[70] ORS 17.075 provides:

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may disavow it. However, any such disavowal must be clear, unequivocal, and notify the employer exactly what is being disavowed.[71] Settlements are allowed within the fifteen-day window "if at least five days prior to obtaining the settlement, compromise, release or statement, the injured employee has signified the willingness of the injured employee that a settlement, compromise, release or statement be given."[72] The settlements subject to ORS 17.075 do not include contract or wage claims.[73]

B. Things to Consider When Using a Release

1. Forms Should Be Current and Appropriate to the Circumstances

Release agreements can be an effective tool for managing risk. However, release forms are not "one size fits all." Many laws affect the validity of releases and, in a number of recent cases, courts have invalidated release forms under a variety of theories. Therefore, it is important to periodically consult counsel when release forms are used in new circumstances or when a lot of time has elapsed since the release form was last used.

2. Consider Policy Requiring Release as Condition of Severance

Many employers contractually agree to provide generous severance packages to executives upon separation and/or have policies to provide severance to employees in layoffs and other circumstances. When developing such contracts and policies, it is permissible--and prudent--to condition the severance on the execution of a general release. Employers who are bound by existing contracts or policies providing for severance may offer additional severance pay or other benefits in exchange for the release.

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(1) An employer whose interest is or may become adverse to that of an injured employee shall not, within 15 days from the date of the occurrence causing the employee's injury:
(a) Negotiate or attempt to negotiate a settlement or compromise with the injured employee;
(b) Obtain or attempt to obtain a general release of liability from the injured employee; or
(c) Obtain or attempt to obtain any statement, either written or oral from the injured employee.
(2) Subsection (1)(c) of this section does not apply to the extent that compliance with statutes or rules of federal or state agencies requiring reports of accidents and injuries necessitates obtaining an employee statement within the 15-day period following the date of the injury.
(3) Any settlement or compromise agreement entered into, any general release of liability or any written or oral statement made by any employee after the employee incurs a personal injury, that is not obtained in accordance with ORS 17.085, requiring notice, may be disavowed by the injured employee within 12 months following the date of the injury and such statement, release, compromise or settlement shall not be admissible evidence in any court action or administrative proceeding relating to the injury.

[71] *Knutson v. Yamhill County*, 130 Or App 173, 881 P2d 156 (1994).
[72] ORS 17.085.
[73] *Maier v. Pacific Heritage Homes, Inc.,* 72 F Supp 1184, 1193-1194 (D Or 1999).

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3. Be Creative

A release agreement does not have to be limited to a simple exchange of compensation for a release of claims. Employers may use releases to resolve many other issues specific to the particular circumstances. For example, a release can provide an opportunity to incorporate any of the following:

- An agreement not to disclose the fact or terms of the settlement
- A confidentiality, nonsolicitation, noncompete, and/or assignment of rights agreement
- A liquidated damages clause that provides for a payment to the employer in the event the employee breaches his or her obligations under the release
- An agreement to cooperate in the event the company is involved in litigation
- An agreement to transition customers or work to others
- An agreement to provide specific services to the company
- An agreement not to disparage the company
- A plan for resolving any open issues between the employee and the company, such as stock options and other benefits, the return of company property, payment of expenses, etc.

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