

## Effect of Paying Severance Pay in Installments and Related Cases

### I. Introduction

Recently, a client entrusted us with a case involving a claim that severance pay had not been paid due to the signing of an agreement to receive severance pay in installments. I would like to review the relevant regulations and judgment criteria in detail. In this case, our client had worked as an employee at a firefighting equipment company (“the Company”) from October 2019 to April 2021. When he requested severance pay upon resigning, the Company told him that it had no obligation to pay it as 10% of his monthly salary was an additional payment in lieu of severance pay, in accordance with the severance installment agreement he had signed along with the employment contract the Company had offered him. One of the documents in question was an application for payment of severance pay in monthly installments, while the other was a pledge that included a request for prepayment of the severance allowance equivalent to the employee's service year, and an agreement on the employee's part to repay any overpayment. All employees were required to sign these documents during the hiring process.

The following questions in this case had to be answered: ① Can the amount received in the form of preliminary payments be offset against the owed severance pay? ② Can the employee receive a separate severance pay amount if he submits a petition to the Employment and Labor Administration Office that he has not received severance pay? ③ Does the prepayment received monthly from the company in accordance with the agreement to receive severance pay installments amount to unfair gains received by the Company or ordinary wage as he received the prepayments on a regular and fixed basis?

In this article, I will look at the relevant court rulings and identify answers to these questions.

### II. Classification of Agreements to Receive Severance Pay by Installment and Interim Settlements of Severance Pay

#### 1. Agreements to receive severance pay in installments

An agreement to receive severance pay in installments is an agreement between employer and employee for the employer to pay a certain amount as severance pay in advance, along with monthly wages or daily wages. It is similar to an interim settlement of severance pay in that severance pay is received in advance. However, the fundamental difference is that severance pay installments amount to payments of severance pay for an unknown length of employment in the future so that severance pay will not be paid at the time of resignation.<sup>1</sup> On the other hand, interim settlements of severance pay amount to payment of severance pay that has already accrued, but paid before the time of resignation has been decided, meaning the remaining severance pay will still be paid upon resignation.

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<sup>1</sup> Lim, Jongryul, 「Labor Law」, 18<sup>th</sup> ed., Parkyoungsa, 2020, p. 589.

## 2. Interim settlements of severance pay

In principle, severance pay is a wage paid after the fact when an employee resigns from a job according to Article 8 (Severance Pay System) and Article 9 (Payment of Severance Pay) of the Workers' Retirement Benefit Guarantee Act (hereinafter referred to as the "Retirement Benefit Act"). Even in precedents, severance pay is a deferred payment that occurs only when an employee resigns, and is guaranteed by law. It is a right that cannot be given up.<sup>2</sup>

Severance pay is accrued to be paid upon resignation, not before. It amounts to 30 days of the employee's average wages for every full year of continuing work, is paid to a resigning employee, and is a statutory wage (Article 8 (1) of the Retirement Benefit Act). Therefore, severance pay cannot be replaced by an agreement to receive it in installments. What has thus far been accrued can be paid upon request of an employee before resignation, while the employee's working period continues after the interim payment and severance pay continues to accrue for work performed in the future (Article 8, Article 2 of the Retirement Benefit Act).

## III. Criteria for Judgment on an Agreement to Receive Severance Pay in Installments

### 1. Supreme Court decision (May 20, 2010: 2007da90760)

#### (1) Facts and progress of the lawsuits

The defendant was a business management consulting company, and the plaintiffs were the defendant's former employees, who did not receive severance pay due to the company's requirement to sign agreements to receive severance pay in installments. The company determined annual salary and severance pay through an annual salary contract, divided it into one-twelfth, and paid monthly salary and severance pay separately. In this annual salary contract, it was stated that "the employee hereby voluntarily requests to receive severance pay on a monthly basis, and on the regular pay day."

During the first trial, the court ruled that the base benefit paid to the employees through the installment agreement amounted to ordinary wage and that the agreement to receive severance pay in installments was invalid. During the second trial, the High Court ruled that the contract for division of severance pay was invalid, but the amount termed "severance pay" received by employees each month was an unfair benefit and should be returned. In response, the Supreme Court kept the ruling of the High Court, but limited the scope of the claim for severance pay under Article 246 (1) 5 of the Civil Execution Act to one-half of the severance pay received through the agreement to receive severance pay in installments.

#### (2) Details of the Supreme Court decision

Since the judgments were different regarding the agreement to receive severance pay in installments, the principle was established through this Supreme Court decision in 2010. The Supreme Court deliberated on ① whether severance received in prepaid installments can be valid as severance pay, ② whether the payments amounted to a wage or unfair gain, ③ if the payments were unfair gain, could the company offset it with other wages, and ④

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<sup>2</sup> Supreme Court ruling on Aug. 23, 2007: 2007do4171.

the scope of the amount of prepaid severance pay that could replace the mandatory severance pay at resignation.<sup>3</sup>

- ① Validity as severance pay: “The agreement to receive severance pay in installments is a waiver of the right to claim severance pay that occurs when resigning, and is invalid because it violates law. It has no effect as severance pay.”
- ② Determination as wage or unfair gain: “If the payment of severance pay is not effective, the employer was not obligated to pay the amount corresponding to the original severance pay. Therefore, the amount prepaid as severance pay under the above agreement is not wage to be paid as compensation for work. These payments then amount to losses without legal cause, with the employees thereby gaining an uncalled-for benefit. It is therefore reasonable from the standpoint of fairness that it should be returned to the employer.”
- ③ Replacement by the employer in the event the prepayments amount to unfair gain: “In the case of overpayment of wages due to an error in calculation, etc., the employer may replace the claim for return of the overpaid wages with the wage to be paid or severance pay of the employee. This also applies when the amount the employer has already paid as severance pay to the employee is ruled as not severance pay. The employer has a claim against the employees to return the unfair benefit they received, which is balanced against the employee's claim for unpaid severance pay.”
- ④ When replacing, the employer needs to pay an additional amount equivalent only to one-half of the severance pay: “Under the Civil Execution Act, the amount equivalent to half of the severance pay and other benefit bonds with similar properties is stipulated as a non-seizure bond (Article 246 (1) 5). When replacing the unfair gain equivalent to the amount paid by the employer as prepaid severance pay with the employee's severance pay, it is allowed only for the amount equivalent to no more than one-half of the severance pay bond.

## 2. Critiques within the Supreme Court ruling

- ① Validity as severance pay: If the right to claim severance pay is waived in advance, this is a violation of law. It can be argued that the employer has paid severance pay already through the installment agreement to comply with the labor-management agreement as a way to reduce the burden on the company of paying a certain amount of money upon resignation or employee retirement. However, since the retirement pension system was introduced in December 2005, the defined contribution retirement pension system has also been introduced.<sup>4</sup> By this DC retirement pension plan, it is possible to prevent future payments by depositing a certain amount of severance pay each month into financial facilities. Therefore, it is not justifiable for an employer to use his/her superior position to require employees to sign an agreement to receive severance pay in installments when signing an employment contract.

<sup>3</sup> Kim, Hongyoung, “Effect of the Agreement to Receive Severance Pay in Installments”, Labor Law (35), Korean Labor Law Association, Sept. 2010, p. 387.

<sup>4</sup> Article 2 of the Retirement Benefits Act. 9. “Defined contribution retirement pension system” refers to a retirement pension system in which the level of contributions to be borne by the employer for payment of benefits is determined in advance.

② Determination as wage or unfair gain: In judging whether the amount prepaid in lieu of severance pay is wages or not, the Supreme Court regarded it as unfair gain. Here, if the amount that is not recognized as severance pay is paid regularly and in a fixed amount to employees, it can be regarded as ordinary wage. In December 2013, the Supreme Court's decision on ordinary wage was that if a fixed monthly wage was paid to all employees, it should be regarded as ordinary wage, regardless of the name it was called.<sup>5</sup> Therefore, the argument that the amount paid in advance as severance pay is not wages (compensation for work), but is other money and goods that amount to unfair gains, is weak. The fixed amount paid monthly in lieu of severance pay should be regarded as a regular wage because it was a regular and fixed amount of money paid only to employees who have worked.

③ Replacement by the employer in the event the prepayments amount to unfair gain: The Supreme Court ruled that even though the agreement to receive severance pay in installments was invalid, it was done in good faith. The Court ruled that it could be replaced with the employee's severance pay. However, it can be seen that the agreement to receive severance pay in installments amounted to a way to avoid paying the amount of severance pay employees were entitled to. Since the retirement pension system was introduced, severance pay can be deposited into the retirement account on a monthly basis, to be paid out upon resignation. Therefore, receiving severance pay in installments through monthly wages cannot be recognized as severance pay. Therefore, I do not believe that the amount paid under the agreement to receive severance pay in installments can replace the obligation to pay severance pay upon resignation/retirement.

④ When replacing, only the portion that exceeds one-half of the severance pay is allowed: The Supreme Court considers the amount paid through the severance pay installment agreement as unfair gain, and based on the provisions of Article 246 (1) 5 of the Civil Execution Act, the employer stipulates that the amount equivalent to half of the benefit receivables can be replaced with the severance pay receivables. The above Civil Execution Act is a legislative consideration that protects the debtor from social policy considerations and maintains the standard of 1/2 of the severance pay to balance with the interests of the creditors.<sup>6</sup> However, since the principle of paying full wages under Article 43, (1) of the Labor Standards Act is a special law of the Civil Act and is a claim arising from the illegal but employer-required agreement to receive severance pay in installments, the amount seen as unfair gain cannot be the full amount paid through the illegal agreement.

#### **IV. Revision of Related Law and Changes in Major Precedents after Supreme Court Ruling**

##### **1. Legislation prohibiting abuse of the interim payment system for severance pay**

In many cases, the interim settlement system for severance pay was overused, threatening the livelihood of employees after retirement. Accordingly, on July 25, 2011, the Retirement Benefit Act was revised to place stricter requirements for interim settlement of severance pay. Employers shall not make interim severance payments outside of the following 7 reasons: ① the employee needs it to purchase a home, ② the employee needs it to

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<sup>5</sup> Supreme Court ruling on Dec. 18, 2013: 2012da94643 (Decision on ordinary wages)

<sup>6</sup> Yoo, Jaeshin, "Critical Review of the Legal Principles of the Severance Pay by Installment Agreement," Labor Law Forum (20), Labor Law Theory and Practice Society, Feb. 2017, p. 225.

provide key deposit money for leasing a home, ③ the employee needs it for medical care of an illness or condition that requires medical treatment of at least 6 months, ④ the employee declares bankruptcy or ⑤ individual rehabilitation procedures are initiated, ⑥ the employer introduces a wage peak system, or ⑦ the employee needs it to recover from a disaster. Therefore, requiring an employee to give up receiving severance pay upon resignation or retirement and to agree to receive it in advance instead violates the Labor Standards Act.<sup>7</sup>

## 2. Recent precedents related to paying severance pay in installments

(1) Daegu District Court ruling on October 26, 2012: 2012na11028 for a claim stating: “The company signed an annual salary contract with the employees and received a pre-payment agreement for severance pay from the employees. The company calculated the annual salary including severance pay, divided it by 12, and paid it to the employees every month. Since the company has already paid all severance pay owing, there is no obligation to pay severance pay to the employees again.”

2) Busan District Court ruling on October 16, 2012: 2012gadan28710 for a claim stating: “The employees signed an employment contract with the company at the beginning of each year, including the amount of severance pay for the next one year, and the company paid the amount of severance pay accordingly. If the above payment is not recognized as a payment of severance pay and is not effective as a wage payment prescribed by labor-related laws, employees must return the above amount to the company as an unfair benefit.”

Ruling on (1) and (2) above:

The court stated, “If the effect of the payment of severance pay is not recognized due to the violation of laws and compulsory regulations even though the employer has actually paid the employee the required amount of severance pay, the amount received as severance pay by the employee is an unfair benefit and must be returned to the employer.<sup>8</sup> However, in view of the legislative purpose of stipulating the severance pay system as mandatory, although the agreement concluded between the employer and the employee only sets wages, the employer required an installment agreement simply to avoid having to pay severance pay at resignation/retirement. In such case, the above rule cannot be applied.” Therefore, the ruling was against having to repay the severance pay received through the agreement to receive severance pay in installments.

3) Supreme Court ruling on October 11, 2012: 2010 da 95147: The agreement to receive severance pay in installments to avoid paying severance pay later means the payments are not severance pay, and the amount received as severance pay cannot be regarded as unfair gain. Therefore, return of the funds cannot be sought.

## V. Conclusion

In 2010, after the Supreme Court ruling that money received under agreements to receive severance pay in installments was unfair benefit and that 1/2 of the employer's severance pay obligation could be considered paid due to the unfair benefit claim, restrictions on interim severance pay were made stricter in 2011 in order to protect

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<sup>7</sup> Supreme Court ruling on Mar. 27, 1998: 97da39732.

<sup>8</sup> Supreme Court ruling on May 20, 2010: 2007 da 90760

the right to severance pay. Accordingly, receiving interim severance pay has become virtually impossible outside of the seven legal reasons. In December 2013, the Supreme Court ruled that certain allowances given a variety of names were actually ordinary wages as they were paid according to a fixed schedule. Due to such legislation and precedents, payments given to employees through an agreement to receive severance pay in installments is not recognized as severance pay or unfair benefit. It is also particularly important to recognize that such pre-payment of severance pay is no longer recognized as interim receipt of severance pay or an unfair employee benefit.