How to Develop More Options For Employment Mediation

BY JEFFREY KRIVIS

When Congress decided to include, as gross income, settlements made for “nonphysical” injury torts, it reduced the value of such settlements by up to 45%. This has been particularly devastating in employment cases, where emotional-distress recoveries often helped the employee transition into a new work situation. Now that those recoveries are taxable, it has been difficult for alternative dispute resolution practitioners to find ways to create more value out of a settlement, aside from getting the defendant to pay more money.

There are several ways to create more value to the employee when dealing with limited settlement dollars:

Structured settlement. Perhaps the least used but most potent source of assistance to the employee is the structured settlement. This basically is an annuity that is purchased by the employer and is designed to pay the employee over the course of months or years a certain sum. That sum grows depending upon the annuity’s length.

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For example, if an employee who alleged sex discrimination in the workplace settled a case for $100,000, the numbers would be something like the following: Attorneys fees at 40% would equal $40,000; federal income tax at 27% would equal $27,000; and the net to the plaintiff would be something like the following: Attorneys fees at 40% would equal $40,000; federal income tax at 27% would equal $27,000; and the net to the plaintiff would be $33,000.

If part of the settlement were structured over a 10-year period, then the tax to the employee would be $15,000, which is based on 15% of the value of the total settlement over 10 years. The plaintiff would then make periodic payments to the plaintiff based on the settlement amount.

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ANNEX G
Sovereign Debt Restructuring

1. No claim that a restructuring of a debt instrument issued by Uruguay breaches an obligation under Articles 5 through 10 may be submitted to, or if already submitted continue in, arbitration under Section B, if the restructuring is a negotiated restructuring at the time of submission, or becomes a negotiated restructuring after such submission.

2. (a) For purposes of this Annex, “negotiated restructuring” means the restructuring or rescheduling of a debt instrument that has been effected through:
   
   (i) a modification of the key payment terms of such debt instrument, as provided for under the terms of such debt instrument; or
   
   (ii) a debt exchange or other process in which the holders of no less than the percentage of debt specified in subparagraph (b) have consented to such debt exchange or other process.

   (b) The percentage referred to in subparagraph (a)(ii) shall be the percentage required to modify the key payment terms of a single series of bonds in the most recent widely-distributed issue of external sovereign bonds that:

   (i) were issued by Uruguay prior to the alleged breach;
   
   (ii) are governed by New York law; and
   
   (iii) permit the modification of the key payment terms by holders of less than 100 percent of the aggregate principal amount of the debt outstanding.

3. Notwithstanding Article 26(1) and subject to paragraph 1 of this Annex, an investor of the United States may not submit a claim under Section B that a restructuring of debt issued by Uruguay breaches an obligation under Articles 5 through 10 unless 270 days have elapsed from the date of the events giving rise to the claim.

PROTOCOL

2. The Parties confirm their shared understanding that, consistent with general principles of law applicable to international arbitration, when a claimant submits a claim to arbitration under Section B, it has the burden of proving all elements of its claim, including the damages that it alleges were sustained by reason of, or arising out of, the alleged breach. Accordingly, the Parties further share the understanding that, where a claimant has met its burden of proving that the respondent has breached an obligation under Section A with respect to an attempt to make an investment, the only damages that may be awarded are those that the claimant has proven were sustained in the attempt to make the investment, provided that the claimant also proves that the breach was the proximate cause of those damages.

3. For greater certainty, the Parties confirm that the list of “legitimate public welfare objectives” in paragraph 4(b) of Annex B on Expropriation is not exhaustive.

More Options for Employment Mediation (continued from front page)

pay tax only based on the amount that he or she received each year.

Since the plaintiff’s taxable income likely would be significantly more during the year that the settlement was reached, by spreading that out over a period of time, the tax rate also is reduced because the income is significantly less. The employee would realize about 45% of the settlement, or $45,000. The employee defers the income tax at a lower rate, while creating a secure stream of income that assists with other financial needs.

The considerations that would justify a structured settlement include whether the employee:

- Needs the cash up front or can afford to defer income.
- Might be interested in a retirement-type plan that can be set up at the time of the settlement.
- Has any other future needs, such as a college fund, mortgage or other long-term commitment that would benefit from a periodic payment plan.
- Has a “lottery ticket” mentality about the case.
- Has counsel that can craft a physical-injury component.
- Has long- and short-term goals that fit a structured settlement.
- Has workers’ compensation. Since the landmark decision in City of Moorpark v. Superior Court, 18 Cal.4th 1143 (1998), many employees are concurrently filing workers’ compensation claims while prosecuting discrimination actions. If the workers’ compensation claim is still open at the time of the mediation, counsel should consider running a portion of the settlement funds through the Workers’ Compensation Appeals Board.

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Often, the employer’s insurer will deny the claim automatically, yet the claim remains on the books. When finalizing the mediation in the civil action, the employee can negotiate a compromise and release of the workers’ compensation claim using some of the funds provided in the civil action. Since workers’ compensation settlements are tax free, the employee is able to maximize the settlement money in his or her pocket rather than give most of it to the government.

Some employers are skeptical of this approach because of the impact on their underwriting. Since workers’ compensation premiums are currently out of control, employers tend to shy away from having to pay out on another claim. On the other hand, some employers don’t mind a small pay out on another claim. On the other hand, some employers don’t mind a small pay out on another claim.

Bodily injury release. Some cases, such as sexual battery, are torts rooted in physical injury. As such, the law allows the physical injury to be viewed as a nontaxable event. Counsel can negotiate a bodily-injury-type release for a significant portion of the settlement in order to create a larger share of the proceeds for the employee.

But the tort must be a tort—and not an attempt to get around the tax code. In Emerson v. Commissioner of Internal Revenue, T.C. Memo 2003-82 (2003)(available at www.ustaxcourt.gov/InOpHistoric/Emerson5.TCM.WPD.pdf), a retired California judge acting as a mediator suggested to the parties that they should allow the plaintiff to amend his lengthy complaint about his research-and-development contract to include personal injury allegations. The case settled. And according to the opinion, only four minutes after the amended complaint was filed in court, the parties filed a dismissal request.

The tax opinion voided the plaintiff’s nearly $90,700 exclusion from income because the “record compels the conclusion that the reference to personal injuries in the settlement documents was an afterthought, solely in anticipation of tax benefits, and did not reflect the nature” of the claim.

Consultancy agreement. A consultancy agreement offers benefits to the employee and the employer. For example, an employer can use the strengths of a former employee in doing certain tasks while they are looking for a replacement employee. An employee has a transition income while seeking other employment.

Sometimes the parties simply enter into a consultancy agreement to defer some income or to allow the employee to represent to the rest of the world that he or she is still employed. Generally, it is easier to get another job while working for someone than it is while unemployed.

Cash now, part cash next year. A simple way to avoid a huge tax liability in one year on money received from a settlement is to ask the employer to pay it over two calendar years. This doesn’t mean over 24 months. If a settlement is concluded in September, then the first payment could be in October, while the second and final payment is in January of the next year. That way, the income-tax obligation is deferred a year.

Court determines legal fees. When the dispute turns on the amount of legal fees, counsel should consider reaching an agreement on the case’s value without attorney fees. Have the employee’s counsel submit a motion in court to have the trial judge determine a fair amount for fees.

Stock instead of cash. By offering stock instead of or in addition to cash, an employer gets to retain cash flow without discounting the case’s value. Sometimes a combination of stock and cash will help seal a deal.

Separate check for the lawyers. It is always preferable to have the employer make separate settlement checks out to the lawyer and employee for their respective shares, along with separate Form 1099s.

Letter of recommendation and/or apology. If all else fails, there always is the tried-and-true recommendation letter. If that fails, even a simple apology might make the difference.