



Alternatives

TO THE HIGH COST OF LITIGATION

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DIGEST

SETTLEMENT AGREEMENTS

Creativity in mediation gets quite specific in employment matters. **Jeff Krivis**, of Los Angeles, writes about interesting options that can be used as part of the employee's package that can significantly increase the settlement value.Page 45

ADR RESOURCES

In this month's CPR News, *Alternatives* announces the publication of its first compilation book, as well as a new CPR book on patent mediation.Page 46

INTERNATIONAL ADR

Mark Kantor, of Washington, D.C., follows up on his *Alternatives'* analysis last year of the new arbitration-centric U.S. draft revised model bilateral investment treaty. The first fully negotiated treaty since the model was released has been signed with Uruguay, and changes some of the model's application.Page 47

ADR ETHICS

In an installment of highlights from CPR Meetings, a panel discusses the professional responsibility issues involved in drafting agreements with alternative dispute resolution provisions. Another segment features nationally known neutrals discussing hot topics.Page 51

ADR BRIEF

A California appellate court for the first time enforces against a defendant a standard form residential real estate contract provision that says a refusal to mediate means no attorneys fees for a winning party.Page 55

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.

The primary value in this approach is that the employee defers taxes on the settlement funds until they are actually received, as opposed to the year that the settlement takes place.

Before the employee receives the money, arrangements are made with a structured-settlement broker, who shops the life-insurance market in order to retain an annuity company to purchase an insurance product from a highly rated insurer.

Several companies now will allow a nonqualified assignment of ownership of the annuity. This means that the employer no longer has to own the annuity but simply has to pay the money to an insurance company, which then will make periodic payments to the plaintiff based on the settlement amount.

The value to the employees is that "they have the security of a guaranteed stream of payments backed by an annuity from a highly rated life insurance company," according to James J. Brady, of the Aliso Viejo, Calif., office of Ringle Associates, a firm that structures settlement annuities.

The employee may pay fewer taxes on periodic payments, as opposed to the taxes that they would owe on a lump-sum settlement. The rate of return is secured and no management fees are involved.

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 \$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



The author mediates complex employment, catastrophic injury, and insurance cases at his Los Angeles-based firm, First Mediation Corp. See www.firstmediation.com. An early version of this article first appeared at www.mediate.com. He teaches at the Pepperdine Law School/Straus Institute for Dispute Resolution and is a member of *Alternatives* editorial board. His most recent article in these pages was "Where Court-Annexed Mediation Fails: How to Avoid a Decline in the Practice," 22 *Alternatives* 185 (December 2004).

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ADR Counsel In Box

Nonparties in Arbitration


Document I

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. 

Document II

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

jump back into the workforce. This may result in an emotional downward spiral.

Many employers have relationships with outplacement service organizations that assist former employees in presenting a professional profile to prospective employers. Usually the cost of such services is between \$2,000 and \$5,000. When the employer pays for this as part of an overall settlement, it provides added value at minimal cost.

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-

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. ■

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A simple way to avoid a huge tax liability in one year on money from a received settlement is to ask the employer to pay it over two calendar years.

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 amount of the settlement funds being diverted through the workers' compensation system in order to have that claim resolved for good.

Stock options. Losing a job often means more to a senior-level person than losing a mere biweekly paycheck. The person's focus while employed is primarily profit driven, so that not only will the company have success, but the employee also will reap stock benefits. When this benefit is lost, it can cause an employee to feel as though his or her time with the company was wasted.

One easy way to encourage a former employee to fairly evaluate a case and negotiate a settlement is to offer stock options for an additional period of time past the employment. This allows the employee to control his or her own destiny as far as corporate profits are concerned.

Outplacement services. When employees are out of work based on an alleged discrimination or harassment issue, often they lack the focus or direction to

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

1996–2004
INDEXES



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