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Anatomy of a Settlement Agreement

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This is the time of year when the parties to a dispute have one last opportunity to resolve their cases before turning the page and moving on to 2020. From the Plaintiff’s standpoint, a year-end settlement can provide a much needed infusion of cash for the holidays. For the Defendant, it can free up time and resources to devote to other business in the New Year.

While most of the work during mediation entails negotiating over money, the parties should not overlook the drafting of the settlement agreement. In employment disputes, there are some unique issues that come up in settlement agreements that don’t apply in a typical business dispute or personal injury case.

Sure, many of us rely on our trusty set of templates when drafting a settlement agreement, but as they say, the devil is in the details, so it pays to review them periodically in light of new legal developments and tailor them carefully to the case at hand.

Here are a few common provisions for settlement agreements in employment disputes that may merit a second look as we close the book on 2019.

Wage Allocation in Employment Disputes

The taxation of settlements is a can of worms that no litigator wants to open, but it is a topic that must be addressed in settlement agreements, at the risk of exposing the parties to significant tax liability with the IRS and other tax authorities. The bottom line is that the IRS never turns down an opportunity to get paid, and there is no statute of limitations for unpaid

income taxes.

In an employment dispute, the primary tax issue is the appropriate allocation of the settlement amount to wage-based income versus non-wage income. The catch-22 for the parties is that increasing the allocation to wages increases the cost of the settlement to both sides in the form of payroll taxes. On the other hand, an unreasonably low allocation to wages (or none at all, as the case may be) may trigger an audit and assessment of back taxes.

The million dollar question is: How much of the settlement amount should the parties allocate to wages? There are no hard and fast rules here, so it really comes down to assessing the risk of an audit and the potential tax exposure.

Large, publicly-traded companies may be more prone to audits of their settlements, whereas a mom-and-pop business may be less likely to be audited. Defendants with active litigation dockets may be more prone to audits than those settling a one-off case. The amount of the settlement may also be a factor, with large settlements getting more attention from the government than a more modest settlement.

Also important is the nature of the claims at issue in the dispute. For example, the parties would be hard pressed to characterize the entire settlement as non-wage income on a claim seeking unpaid wages.

The caveat here is that most litigators are not tax law experts. At the same time, knowing enough to spot the issues and refer the parties to their CPAs can save the day.

Confidentiality Provisions

Most settlement agreements include a provision that requires the parties to keep the details of the settlement, including the settlement amount, confidential. This was standard, non-controversial language until the #MeToo era.

Earlier this year, the #MeToo movement resulted in the passage of the Stand Together Against Non-Disclosure (STAND) Act, which prohibits a blanket confidentiality provision in a settlement agreement involving claims of sexual harassment and other sexual offenses.

That said, the STAND Act has some carveouts. For one, the statutory language suggests that blanket confidentiality agreements are still permissible in cases where no lawsuit or administrative complaint has been filed. It also does not bar a confidentiality agreement when the alleged victim requests for it. Lastly, it does not prohibit a confidentiality provision as to the amount paid in a settlement.

In light of the STAND Act, the parties may have to devote more time than usual in drafting the confidentiality provision of a settlement agreement in a sexual harassment case.

Civil Code Section 1542 Waivers

A Civil Code Section 1542 waiver, whereby the waiving party agrees to release claims that are both known and unknown at the time of the agreement, has been a no-brainer in settlement agreements forever.

However, effective in January of this year, the language of Civil Code Section 1542 was amended in order to clarify that the releasing party agrees to release both monetary and non-monetary claims. While the substance of Section 1542 remains essentially the same, the parties and their attorneys should be sure to update their settlement agreement templates to reflect the new language.

Below is a redlined version of Section 1542 reflecting the changes.

A general release does not extend to claims ~~which~~ **that** the creditor **or releasing party** does not know or suspect to exist in his or her favor at the time of executing the release, ~~which and that~~ if known by him or her, ~~must~~ **would** have materially affected his or her settlement with the debtor **or released party**.

No-Rehire Provisions

Another standard provision in the settlement agreements for employment disputes is a no-rehire provision, whereby the Plaintiff/employee agrees not to seek employment with the Defendant/employer in the future. They even go so far as to prohibit the Plaintiff from working for affiliated entities such as parent companies and subsidiaries.

However, under Assembly Bill 749, another product of the #MeToo movement, no-rehire provisions will no longer be enforceable in California. Effective January 2020, settlement agreements can no longer contain any provision that prohibits, prevents or otherwise restricts a Plaintiff-employee from obtaining future employment with the Defendant-employer, including any parent companies, subsidiaries, divisions, affiliates or contractors.

In conclusion, year-end settlements are a great way to give the parties closure and financial relief before embarking on a new year. That said, attorneys must stay vigilant throughout the settlement negotiation process, including the drafting of the settlement agreement.

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Tis the season...for year-end settlements at mediation! To get you into the settlement spirit, check out my latest article on a few of key provisions in a settlement agreement for an employment dispute. [#mediation](#) [#adr](#) [#disputeresolution](#)

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