Settling Wrongful Termination Actions: A Practical Approach

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Wrongful termination suits are expensive to litigate and fraught with uncertainty for both sides. Therefore, settlement is often in both parties' interest. How to obtain a settlement is, of course, at least as important as developing the proper settlement agreement. Generally, there are distinct advantages to getting involved in the case before the actual termination. There are also advantages to using means other than the typical settlement process. This Article discusses what steps should be taken before termination, alternative means of obtaining settlement, settling in general, settling specific claims, and tax consequences of settlement.

I

GETTING INVOLVED EARLY: THE CONSULTING ARRANGEMENT

Client are frequently best served by using a consulting arrangement instead of a termination, unless, of course, an immediate termination is clearly warranted. There is such a psychological difference between the two that everything is easier with the consulting agreement. Termination can be devastating. One day the employee is an important executive with an office and something to do. The next day, the employee is at home telling his family and spouse that he has been terminated. He has nothing to do and nowhere to go.

The consulting agreement changes the entire dynamic. Faced with a conflict that cannot be resolved, a consulting agreement eases the transi-

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tion between jobs. A consulting agreement allows the employee to say that he chose to be a consultant so that he could find a more interesting or more profitable position. Thus, a consulting agreement helps preserve the employee's dignity. The employer, offering a specific sum of money, can extend to the employee the choice of taking it over several months, all up front, or accelerated once he finds a job. Once the employee begins to think about how to collect the money, he has begun to accept the fact that a separation is inevitable.¹

II

MEDIATION

If for some reason a consulting agreement will not work, or if it is too late to propose one, but counsel and client have decided to settle, the next question is what is the best way to settle. While the attorney-to-attorney settlement process is the standard method, it is not always the best way. Frequently an attorney-to-attorney settlement will not be easy to achieve. Relations might be strained. Even if the plaintiff's lawyer has not caused the plaintiff to have unrealistic expectations, the plaintiff undoubtedly will have heard stories of discharged employees who have received awards in the millions of dollars. If the plaintiff's lawyer leans too hard on the plaintiff to be realistic, the plaintiff might begin to doubt the lawyer, and the lawyer might lose control of the process. Unrealistic expectations and hard feelings can make the job of both lawyers difficult.

Mediation might well be the best way to settle.² Furthermore, it improves the quality of the settlement by allowing the parties to deal with issues other than money. Although the plaintiff does not get his day in court, mediation does provide the plaintiff an opportunity to present his problem, face to face with his employer and the employer's counsel. By contrast, when two attorneys are discussing settlement, generally the only topic that matters is money.

Many of these cases, however, do not start out as money cases, but as respect cases. When the employee's dignity has been insulted, the mediation process can help restore that dignity. Treating an employee throughout the process with respect greatly facilitates settlement.

Finally, mediation can often facilitate concluding a settlement even

¹ The employer can also use to great advantage the Comprehensive Omnibus Budget Reconciliation Act ("COBRA"), I.R.C. § 162(k) (1982). Continued medical care is usually very important to the employee. Before COBRA, the employer could have offered to pay the employee's premium, but the premiums were high, and the insurance normally had to be converted to a less desirable individual policy because most group policies cover only full-time employees. With COBRA, the employer can have the employee elect his COBRA rights. He gets the same insurance for 18 months and the premium is a modest 102% of the group rate. Paying that premium is often a small price for having a settlement go down easily.

² Many mediation services will, upon referral by either party, attempt to secure an agreement from both parties to mediate.
where the clients and lawyers remain angry. Where both parties and
their lawyers meet with an experienced mediator, everyone has to come
together with a common goal of settling. There is an “ownership” inter-
est in the settlement process. At the end of the process everyone knows
exactly what decisions were made, why they were made, and why each
party ended up where they did.

Attorneys should consider matching the mediator to the particular
case. There are generally two kinds of mediators. One is the judge-per-
spective mediator who advises the parties what they ought to do. This
mediator tells a party to settle in light of what is “going to happen” in
court. This kind of mediator can be effective for a bull-headed client.
Some clients need to be told the grim realities of the case by someone
other than their attorneys.

The other kind of mediator is the juror-perspective mediator, a
trained mediator who is a good listener. This mediator points out weak-
nesses and problems and asks the parties how they will deal with them.
This type of mediation is often more satisfactory, since it permits the
parties to retain greater control.

III
Settling

Counsel and client should discuss whether they want a settlement
agreement at all. If they do want to settle, they must consider what kind
of agreement they want, and, in particular, how unassailable they want to
try to make it.

First, it should be noted that a settlement agreement may turn out
to be unnecessary. One of our clients recently laid off a substantial
number of employees. Against the advice of the company’s general
counsel and local counsel, our client decided not to ask for settlement
agreements at all. The client thought that it was inappropriate to ask its
employees for a release, that the layoffs were lawful since they were eco-
nomically motivated, and that it was providing a generous, supplemental
severance pay package. The layoffs were completed without releases, ex-
cept for those people with written contracts. Despite the lack of re-
leases—or perhaps because of this—few problems have surfaced in the
year following the layoffs.

If client and counsel want a settlement agreement, they need to dis-
cuss how unassailable they want it to be. There can be tension between
securing a settlement and attempting to make it unassailable. The more
the employer tries to make a settlement agreement unassailable, the
greater the likelihood the employee will bring in counsel.

Proposing a release can pose other problems as well. In Cassino v.
Reichhold Chemicals, Inc., an employer proposed a release to an employee whom the employer was terminating. The employee refused the settlement and sued. At the trial, the employee sought to introduce the proposed settlement agreement, claiming that it was evidence that the employer was guilty of discrimination. The district court judge admitted the evidence. The Ninth Circuit affirmed, holding it was not inadmissible as a settlement agreement, on the grounds that, since the employee had not asserted any claim at the time the employer required the release, there had been no negotiation of a settlement. Thus, to propose safely a severance agreement that contains a release, negotiations must precede the proposal.

There is an outside limit, in any event, to making settlement agreements unassailable. Indeed, they probably cannot be made completely bulletproof. Courts are willing to examine the scope of a settlement agreement, and, in the absence of clear and explicit language, are willing to construe such an agreement to avoid a waiver. Courts are also willing to hold that the execution of an agreement was not voluntary and thus void if, among other things, the release was conditioned upon benefits to which the employee already was entitled, if there was an unduly short time to consider the settlement agreement, the employee was prevented from talking to or consulting with an attorney, there was grossly inadequate consideration, or the employee was told to sign an agreement without an opportunity for bargaining or adequate explanation. As a result, even with the most elaborate settlement agreements, it remains possible for the employee to come back at the employer at a later time.

In any case, the simplest agreements may be the best. A person who has settled is generally reluctant to reopen the issues. While a simple agreement may resolve the case, a complicated agreement may raise more problems and still not be bulletproof. Counsel should discuss these issues with the client and explain the advantages of the various types of settlement agreements and, to the greatest extent possible, allow the client to make the decision.

3. 817 F.2d 1338 (9th Cir. 1987), cert. denied, 108 S. Ct. 785 (1988).
4. Id. at 1342.
5. Id.
8. E.g., Boyd v. Adams, 513 F.2d 83 (7th Cir. 1975).
9. See, e.g., Coventry v. United States Steel Corp., 856 F.2d 514, 523 (3d Cir. 1988).
10. See, e.g., id.
IV
SETTLING SPECIFIC CLAIMS

The two parties to a typical settlement agreement may not be able to settle all claims without governmental supervision. For example, wage claims in California cannot be compromised.\(^\text{14}\)

Age cases may not require supervision, however. The Federal Age Discrimination in Employment Act ("ADEA")\(^\text{15}\) incorporates by reference the enforcement mechanism of the Fair Labor Standards Act ("FLSA").\(^\text{16}\) FLSA case settlements require federal supervision,\(^\text{17}\) which is understandable in a typical FLSA-overtime case. There the employee is still employed, and the employer has enormous leverage. The employer could be in a position to force a settlement. In an ADEA-wrongful termination case, however, the situation is totally different. There the person is no longer employed, and the employer cannot exert undue pressure. Thus, in Runyan v. National Cash Register Corp.,\(^\text{18}\) the Sixth Circuit decided en banc that age discrimination settlements did not require the supervision of the Department of Labor or the Equal Employment Opportunity Commission ("EEOC"). The EEOC has issued guidelines to that effect,\(^\text{19}\) but their operation has been suspended.\(^\text{20}\)

Claims that lie within the exclusive jurisdiction of the California workers' compensation system represent a class of claims that do require supervision to settle. Thus, parties can settle these claims only with a compromise and release approved by the Workers' Compensation Appeals Board ("WCAB").\(^\text{21}\)

These principles have great importance if the California Supreme Court's decision in Cole v. Fair Oaks Fire Protection District\(^\text{22}\) applies to termination cases, for the workers' compensation scheme preempts intentional infliction of emotional distress, negligent infliction of emotional distress, and breach of the implied covenant of good faith and fair dealing, to the extent it is a tort. In Cole, the plaintiff alleged that the employer had harassed him, publicly stripped him of his captain's rank, and

\(^\text{17}\) E.g., Tony & Susan Alamo Found. v. Secretary of Labor, 471 U.S. 290, 302 (1985).
\(^\text{18}\) 787 F.2d 1039 (6th Cir.) (en banc), cert. denied, 479 U.S. 850 (1986).
\(^\text{19}\) 29 C.F.R. § 1627 (1988).
\(^\text{22}\) 43 Cal. 3d 148, 729 P.2d 743, 233 Cal. Rptr. 308 (1987). Decided on the last day of the "Bird Court," the six to one decision was surprisingly pro-employer.
subjected him to a kangaroo court. These acts were alleged to have caused illness and an affliction which left him unable to communicate except by blinking his eyes.\(^{23}\) The plaintiff filed suit against his employer and a fellow employee for intentional infliction of emotional distress that left him totally, permanently, physically and mentally disabled.

The court of appeals, in an unpublished decision, affirmed the trial court’s ruling that the plaintiff’s claim came within the exclusive jurisdiction of the WCAB, and thus that workers’ compensation provided his exclusive remedy.\(^{24}\) The California Supreme Court held that workers’ compensation provides the exclusive remedy with regard to intentional infliction of emotional distress and employer misconduct arising out of conduct normally occurring in the workplace.\(^{25}\) Further, a plaintiff may not escape the exclusivity of workers’ compensation simply by characterizing the employer’s conduct as “manifestly unfair, outrageous, harassment, or intending to cause emotional disturbance.”\(^{26}\)

Cole should also apply in termination cases. Even though it did not deal with an actual termination, it did deal with what could be characterized as a constructive discharge. Hence, recovery for tortious damages due to an act of wrongful termination—arguably the last act of employment—should be restricted by workers’ compensation.\(^{27}\)

As a result, if the employer does not secure a compromise and release approved by the WCAB when settling a case, the claimant might still, despite the settlement, have a workers’ compensation claim. Compensation might include lifetime medical benefits for the particular type of injury suffered by the claimant. It might also include retraining, which can be very expensive.

When settling these cases, counsel and client should ask whether they should require a workers’ compensation settlement as part of an overall settlement. When they ask this question frequently there will be no workers’ compensation claim pending, although the employer may have made an affirmative defense based upon workers’ compensation being the exclusive remedy, and might even have based a motion for summary judgment on such a theory. At the time the case is settled, the plaintiff’s lawyer may be unfamiliar with workers’ compensation and may not give this aspect of the case careful thought. But the question

\(^{23}\) Since the case was decided on demurrer, the facts of the complaint were accepted as true. Id. at 151-53 & n.1, 729 P.2d at 744-45 & n.1, 233 Cal. Rptr. at 309-10 & n.1.

\(^{24}\) Id. at 151, 729 P.2d at 744, 233 Cal. Rptr. at 309.

\(^{25}\) Id. at 151 & 160, 729 P.2d 744 & 750, 233 Cal. Rptr. at 309 & 315.

\(^{26}\) Id. at 160, 729 P.2d at 750, 233 Cal. Rptr. at 315.

\(^{27}\) Compare, e.g., Mitchell v. Hizer, 73 Cal. App. 3d 499, 140 Cal. Rptr. 790 (1977) (if a terminated employee is injured when he comes back the next day to pick up his tools, not only does he have a workers’ compensation claim, but that claim provides his exclusive remedy against his employer).
remains whether to require that the settlement go through the workers' compensation system.

On the one hand, if the settlement involves any significant amount of money, it is generally wise to require approval by the WCAB. Approval by the WCAB does not require a pending workers' compensation case. Indeed, a compromise and release can be the first and only document filed before the WCAB. If done properly, the employer can settle the lifetime medical benefits issue and can often preclude a retraining obligation. But this type of settlement does require the advice of competent workers' compensation counsel.

On the other hand, if the settlement is inexpensive, the employer may not want to go through the WCAB process. The allegations may be such that a workers' compensation judge would consider the settlement inadequate. Moreover, if there is no indication that the plaintiff is concerned about workers' compensation, or if the case is four or five years old, the employer might not choose to put it through the WCAB. This decision should also be made carefully.

V

TAX CONSEQUENCES

The decision whether to seek WCAB approval can affect the tax consequences of the settlement. It is relatively clear that, to the extent a claim is a workers' compensation claim, it is not taxable. Obviously, the employer's goal is to pay as little as possible, while the employee's goal is to collect as much money after taxes as possible. Consequently, the employer needs to pay less if the employee receives a settlement that is nontaxable.

In almost every case, the tax consequences of a settlement will need to be faced. Indeed, there may well be a switch once the parties have agreed to a monetary settlement. Typically during negotiations, employer's counsel argues that there is no case, and the plaintiff's lawyer emphasizes back pay, actual damages, and the time the employee has been out of work and all his efforts at finding work. But at the settlement stage, the plaintiff's lawyer states that his client has practically no contract or back pay damages, and that all damages are from personal injury or emotional distress. While I am aware of no cases where an employer has been prosecuted for tax fraud in these circumstances, I am not com-

28. See I.R.C. § 104(a)(1) (1982); Treas. Reg. § 1.104-1(b) (as amended in 1970). Subsequent to the Symposium, the Tax Court ruled that the portion of an employee's settlement allocable to his alleged right to be free of age discrimination was excludable from gross income as a claim for personal injury. Rickel v. Commissioner, 92 T.C. No. 32 (1989).

fortable participating in an allocation that has no basis in reality and that serves only to minimize the plaintiff’s taxes.

The plaintiff, however, wants an allocation to avoid an uphill battle with her taxes, as evidenced by an older Tax Court case. More recent Tax Court decisions, however, have indicated that, although the plaintiff must still produce evidence to support it, there can be an after-the-fact allocation by the plaintiff. Thus, it is preferable from the employee’s perspective to list the claims that are being settled and let the plaintiff make his own allocation. Alternatively, if there are reasons, such as an economic study, to believe that back pay damages are low, this may provide a satisfactory basis for making an allocation beneficial to the plaintiff.

30. Knuckles v. Commissioner, 23 T.C.M. (CCH) 182 (1964) (plaintiff unable to meet burden of proof that payments did not represent compensation).

31. See, e.g., Byrne v. Commissioner, 90 T.C. 1000 (1988) (relying on settlement agreement language that lump sum payment made “in compromise of disputed claims,” court made allocation between includable and excludable portions of settlement payment); Metzger v. Commissioner, 88 T.C. 834 (1987) (court approved taxpayer’s 50-50 allocation of payment where agreement designated allocation “for tax purposes only”).