pillsbury

Corporate Counsel May 2, 2012

FIVE TIPS FOR AVOIDING SETTLEMENT TRAPS

From the Experts

When a lawsuit is settled, the clients cut a deal, the legal gladiators lay down their briefs, and everyone breathes a sigh of relief. But is that sigh premature?

By

Bruce Ericson
Pillsbury Winthrop Shaw Pittman LLP
Four Embarcadero Center, 22nd Floor
San Francisco, CA 94111-5998
415-983-1560
bruce.ericson@pillsburylaw.com

Frederick Brodie
Pillsbury Winthrop Shaw Pittman LLP
1540 Broadway
New York, NY 10036-4039
212-858-1628
fab@pillsburylaw.com

The dynamics of settlement negotiations often invite parties and their counsel to cut corners—and to fall into traps when they wander off the path. Falling into a settlement trap may mean further litigation: a *Bloomberg Law* search reveals that more than 1,000 lawsuits have been brought in the past decade for breaches of settlement agreements.

To craft a settlement that has staying power, and to avoid buyer's remorse, both clients and their counsel should learn how to avoid the most common settlement traps.

1. Talk to Your Adversary

One of us clerked for a federal judge whose practice, when conducting settlement conferences, was to hand the lawyer for each side an index card. On the card, the judge instructed counsel to write down their "no-B.S. settlement number." For the defendant, this meant the highest number that would willingly be paid. For the plaintiff, it meant the lowest number that would willingly be accepted.

The judge would then compare the two cards. Usually, there was a gap between the numbers. Sometimes, however, that gap was small, and the numbers were very close. Once, the plaintiff's and defendant's numbers were *exactly the same*. Another time, the defendant's number was *larger* than the plaintiff's.

We're not advocating index cards as a new method of mediation. The moral we draw, instead, is that counsel should not be afraid to talk to each other about settlement early on. Particularly in the two cases noted, if counsel had communicated candidly about what their clients needed, expensive trial preparation could have been avoided. Even if it doesn't result in an immediate settlement, a constructive settlement discussion early in the process can educate the parties about their adversaries' positions and help them understand what is really at stake.

2. Put it in Writing

Settlements often will be struck after extended negotiations, perhaps at the end of a lengthy mediation. The hour may be late, and the clients' reserves of patience may long since have been depleted. There will be a figure circled on a legal pad, and then a handshake. Of course, it's all subject to documentation. And documenting the deal can wait until next week, right?

No, it shouldn't, unless you are sure both sides are immune from buyer's remorse. If you want to settle and have the settlement stick, seize the moment. Before the bleary-

eyed parties and advocates depart the arena, make sure the parties have at least signed a letter of intent. Otherwise, your deal could evaporate in the light of the next day.

We aren't suggesting that litigants should choose a quick-and-dirty term sheet over a carefully drafted formal settlement. The two can coexist. The initial written document should contain the parties' key points of agreement and at least the minimum terms for an enforceable contract. That document should state that it is intended to be enforceable. It should also make clear, however, that the parties intend to supersede it with an equally enforceable, formal, written settlement agreement. That way, the parties preserve the initial deal they struck while allowing their counsel to spend some additional time constructing a formal home for it.

3. Understand Your Release

The standard release is probably the hairiest run-on sentence in the history of the English language. Even the most determined proofreaders feel woozy after a few lines. Yet, an inadvertent omission could undermine your settlement.

A lengthy form release is just a combination of five key deal points:

1. The identity of the releasors (usually the plaintiff and related parties).
2. The nature of the legal act (a release? a waiver? a covenant not to sue? some or all of the above?).
3. The things released (is it a general release of all claims, or just certain causes of action?).
4. A description of the persons released (typically the defendant and related parties).
5. The time period covered (often, in general releases, described in that curious phrase "from the beginning of the world to the date of this release").

When preparing a release, make a checklist of those basic items. What do you want released? What do you *need* released? What can't you release? Then draft accordingly.

The form release can be simplified considerably by defining key terms elsewhere in the agreement. For example, instead of saying "the defendant and each of its past and present direct and indirect subsidiaries and parents, affiliates, divisions, business units, predecessors, successors, directors, officers, and agents," the agreement could use a single defined term. If the agreement separately defines the terms "Releasors,"

"Releasees," and "Released Claims," the run-on sentence in a form release may be reduced to something that's readily understandable.

4. Don't Forget About Taxes

We don't know anyone who has purchased a hall pass from the IRS and is thereby excused from paying taxes. Yet, in our experience, individual litigants may attempt to revoke a settlement after learning that taxes will be withheld from the resulting payment. Without any legal basis, they will insist that the settlement offer was net of taxes and will refuse to settle until they are "grossed up."

A defendant negotiating to pay a settlement is well advised to make clear—both in negotiations and in the documents—that the recipient will be responsible for any taxes. Further, if the defendant determines that tax withholding is required, then taxes must be withheld.

5. Drive a Stake Through its Heart

Finality is a key objective of defendants in settling disputes. Like the vampires and zombies that have become ubiquitous in recent films and novels, a lawsuit that rises from the grave is an unwelcome guest. Above all, a settlement agreement should not become the occasion for continued litigation between the parties.

In the midst of negotiations, it may seem easier to leave difficult issues unresolved. There's always the risk that one might "wake the sleeping tiger" by poking it with a release or covenant not to sue. Yet failing to address material issues in the settlement can give rise to future disputes that revivify the original lawsuit.

Are you expecting the other side to render assistance after the deal is done? Make sure the settlement agreement requires it. Are you expecting to be indemnified for third-party claims? Include an indemnity clause. Do you expect the other side not to bring another action? Obtain a covenant not to sue, in addition to the release. Do you hope the other side will not trumpet the settlement to the world in a press release? Add a confidentiality clause or a ban on press releases. Express contract clauses are stakes in the heart of a settled controversy that prevent its reanimation.