

Is Breaking Up Really Hard to Do? *Settlement Agreements and Potential Challenges Involving Employee Claims*

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Overview

- Basics of a settlement “deal.”
- Where the impediments to a deal often lie:
 - Monetary consideration (how much);
 - Scope of release (who is released and to what extent);
 - Confidentiality/Non-Disparagement (scope, mutual or unilateral; consequences for breach);
 - Taxes; and
 - Additional terms (mechanisms for dispute resolution, venue, etc.).



Challenges Specific to Employment-Related Disputes

1. The EEOC Issue – individual rights to agency participation that survive settlement.
2. Updates on confidentiality provisions.
3. Releasing age-related claims under federal law.
4. Wage and Hour issues in settlements.
5. Taxation and related issues.
6. Multi-state considerations.



The EEOC Issue

- The EEOC's restrictions on releases:
 - Cannot “release” a charge that has been filed;
 - Cannot prohibit filing a new/additional charge; and
 - Cannot bar participation in an EEOC investigation or lawsuit.
- Language violating restrictions is null and void.
- Other governmental agencies have similar mandates.



The EEOC Issue – How did we get here?

- *EEOC v. CVS Pharmacy, Inc.*, No. 1:14-cv-00863 (N.D. Ill. 2014):
 - Dispute over whether CVS’s “form” separation agreement was unlawful.
 - Employee, fired from CVS, files a charge of discrimination. EEOC contends that CVS’s use of its form separation agreement with numerous employees amounts to a pattern and practice of “resisting” Title VII rights.
 - Case was dismissed because the EEOC failed to attempt conciliation before suit. The dismissal was affirmed by the appellate court.
- Notable because the EEOC challenged settlement agreement terms that many viewed as “standard.”



The EEOC Issue

- The EEOC objected to the following provisions:
 - **Cooperation** clause requiring employee to call General Counsel regarding any contacts from administrative agencies or related to their investigations.
 - **Non-disparagement** clause prohibiting employee from disparaging the company, directors, officers, or employees.
 - **Non-disclosure** clause – need approval from HR before disclosing any company-internal information.



The EEOC Issue

- The EEOC objected to the following provisions:
 - **General release** of claims including release of “charges” and claims of “discrimination of any kind.”
 - **Liquidated damages** clause disgorging whatever severance the employee received if he/she breached any of the foregoing covenants.
 - **Attorneys’ fee** clause that employee must pay CVS’s attorneys’ fees if it sued him/her for breach of any of the foregoing covenants.



The EEOC Issue

- The CVS Agreement also contained this “savings” clause language:
“Nothing in this paragraph is intended to or shall interfere with Employee’s right to participate in a proceeding with any appropriate federal, state or local government agency enforcing discrimination laws, nor shall this Agreement prohibit Employee from cooperating with any such agency in its investigation.”



The EEOC Issue

- The EEOC's Position:
 - Settlement agreements must not chill protected activity.
 - Broad confidentiality provisions and non-disparagement clauses must be scrutinized closely.
 - Apply the objective standard: “reactions of a reasonable employee.” *See Burlington Northern & Santa Fe Ry. Co. v. White*, 548 U.S. 53, 68 (2006).



The EEOC Issue – Post-*CVS*

- *EEOC v. Montrose Mem'l Hosp.*, 264 F. Supp. 3d 1102 (D. Colo. 2017):
 - Per agreement of the parties, striking entire provisions about: confidentiality, remedies for breach, and attorneys' fees (which stated that none would be owed to the employee in connection with employment or the agreement).
 - Struck language waiving employee's right to recover damages in any suit brought by the EEOC and seeking a dismissal of charges.
 - Adding language to the notice provision that carves out the employee's obligation to notify the employer of a charged filed with the EEOC.
 - Declining to strike a mutual non-disparagement, because, after the other changes to the agreement, the language was not overbroad.



The EEOC Issue - Now

- The EEOC continues to attack release agreements:
 - Feb. 2018 – EEOC press release announces settlement with an employer based upon an allegedly overbroad settlement release agreement.
 - As in *Montrose*, the EEOC took issue with language waiving an employee's right to recover in an action by the EEOC.



The EEOC Issue – Not Just at the EEOC

- Security and Exchange Commission:
 - Severance agreements may not require employees to waive potential whistleblower awards.
 - *In the Matter of HomeStreet, Inc. and Darrell Van Amen*, No. 3-17801, Order Instituting Cease-and-Desist Proceedings (SEC January 19, 2017).
 - \$500,000 penalty (for improper hedge accounting and impeding whistleblowers).
 - *In the Matter of Health Net, Inc.*, No. 3-17396, Order Instituting Cease-and-Desist Proceedings (SEC January 19, 2017).
 - \$340,000 penalty (for settlement agreements that restricted employees from obtaining financial incentives from the SEC).
 - Requiring employee to first notify company before communicating with agency considered unlawful.
 - *In the Matter of Blue Linx Holdings, Inc.*, No. 3-17371, Order Instituting Cease-and-Desist Proceedings (SEC Aug. 10, 2016).
 - \$265,000 penalty (for agreements requiring notification to the company for communication with SEC and restricting monetary awards).



The EEOC Issue – Not Just at the EEOC

- Financial Industry Regulatory Authority, Inc. (FINRA) – self-regulatory agency that regulates brokerage firms/exchange markets:
 - Reg. Notice 14-40: a model confidentiality provision will not restrict a party from initiating communications with a regulatory organization.
- National Labor Relations Board:
 - Confidentiality provisions in settlement agreements have been found permissible but only where narrowly tailored to the facts giving rise to the settlement.
 - *S. Freedman & Sons, Inc. & Drivers, Chauffeurs & Helpers Local Union No. 639, a/w Int'l Bhd. of Teamsters*, 364 NLRB No. 82 (N.L.R.B. Aug. 25, 2016), *review denied, enforcement granted sub nom. S. Freedman & Sons, Inc. v. Nat'l Labor Relations Bd.*, 713 Fed. Appx. 152 (4th Cir. 2017).
 - “It is incumbent upon employers to use language that is not reasonably subject to an interpretation that would unlawfully affect the exercise of Section 7 rights.”
 - *Brandeis Mach. & Supply Co. v. NLRB*, 412 F.3d 822, 831 (7th Cir. 2005)(internal citation and quotation marks omitted).



The EEOC Issue

- Takeaways:
 - Consider the terms of the agreement collectively to see whether they potentially chill protected activity.
 - Include a savings clause, but don't rely on it alone – as appropriate, carve out protected rights in others terms (confidentiality, notice, non-disparagement, attorneys' fees, etc.).
 - Waiver of recovery language.
 - Although the EEOC has taken issue with it recently, courts and the EEOC itself have taken contrary positions.



Confidentiality Concerns - Update

- Two types of confidentiality terms:
 - Keeping the agreement itself confidential.
 - Protecting the employer's confidential information generally.
- Recent Developments:
 - Federal Defend Trade Secrets Act.
 - Tax treatment of confidential harassment settlements.



Confidentiality Concerns - Update

- Federal Defend Trade Secrets Act:
 - Enacted in May 2016.
 - Provides federal cause of action for theft and misuse of proprietary information.
 - An employer can recover punitive damages and attorneys' fees, but *only if* it advises employees about whistleblower immunity in employee agreements or policies
 - Whistleblower Immunity.
 - Generally, no violation of DTSA if disclosure of a trade secret is to an attorney or the government, is in connection with reporting a violation of law, or in filing a lawsuit under seal.



Confidentiality Concerns - Update

- **Federal Defend Trade Secrets Act:**
 - Sample whistleblower immunity language to include in agreements:
 - Notwithstanding anything in this Agreement to the contrary, Employee is advised that, pursuant to 18 U.S.C. § 1833(b): “An individual shall not be held criminally or civilly liable under any Federal or State trade secret law for the disclosure of a trade secret that—(A) is made—(i) in confidence to a Federal, State, or local government official, either directly or indirectly, or to an attorney; and (ii) solely for the purpose of reporting or investigating a suspected violation of law; or (B) is made in a complaint or other document filed in a lawsuit or other proceeding, if such filing is made under seal.” Nothing in this Agreement is intended to conflict with 18 U.S.C. § 1833(b) or create liability for disclosures of trade secrets that are expressly allowed by 18 U.S.C. § 1833(b).



Confidentiality Concerns - Update

- Tax treatment of confidential harassment settlements:
 - Included in Dec. 2017 tax bill.
 - Disqualifies confidential harassment settlement from tax deductions.
 - "No deduction shall be allowed under this chapter for—(1) any settlement or payment related to sexual harassment or sexual abuses if such settlement or payment is subject to a nondisclosure agreement, or (2) attorneys' fees related to such a settlement or payment."
 - Unclear how this affects settlement of multiple claims.



Release of Federal Age Discrimination Claims

- Federal age discrimination claims are treated differently than most other claims.
- Intention is to guard against unscrupulous employers taking advantage of older workers.
- Older workers = 40 years and up!
- Defined specifically by the federal statute – the Older Workers Benefit Protection Act (“OWBPA”). 29 U.S.C. §626(f).



Release of Federal Age Discrimination Claims

- OWBPA Requirements:

- A release must be “knowing and voluntary.”
- Clear language.
- Expressly name *Age Discrimination in Employment Act* claims being released.
- States it does not release claims that may arise later.
- Consideration *above and beyond* what worker is otherwise entitled.
- Written *direction* to consult attorney *prior* to signing.
- 21/45 days to consider.
- 7 days to revoke/rescind after signing.



Release of Federal Age Discrimination Claims

- Failing to comply with OWBPA does not invalidate the settlement agreement, but permits the employee to pursue his ADEA claim.
 - Employer bears the burden to prove strict compliance.
- OWBPA requirements do not apply to other claims.
 - Consider whether a valid age release is desired/necessary in all instances or whether it can/should be segregated.
- Consider timing and re-acknowledgment when an employee will separate employment in the future.



Settling FLSA Claims

- The Fair Labor Standards Act (FLSA) was enacted in the 1930's to protect employees from employers with disproportionate bargaining power.
- Court or DOL approval is required to fully resolve wage and hour claims under the FLSA.
- Challenge for employers: How to settle a claim for overtime and secure peace of mind?



Settling FLSA Claims

- Different jurisdictions use different standards.
- Circuit split on the issue:
 - Fifth Circuit (Texas, Louisiana, and Mississippi): Bona Fide Dispute Rule.
 - Other Circuits: Court or DOL supervision or approval.



Settling FLSA Claims

- Fifth Circuit Bona Fide Dispute Rule – Parties may settle “bona fide” wage and hour disputes privately:
 - *Martin v. Spring Break '83 Productions, L.L.C.*, 688 F.3d 247 (5th Cir. 2012) (employer and employee may settle FLSA claims without court or DOL approval as long as the settlement resolves a bona fide dispute re hours/pay).
 - Case centered on a claim for unpaid wages.
 - *Bodle v. TXL Mortgage Corp.*, No. 14-20224 (5th Cir., June 1, 2015).
 - After settling a non-compete dispute, plaintiff executed a generic release of all claims
 - That did not bar him from suing for overtime.
 - The generic release settling the non-compete dispute did not resolve a bona fide dispute as to overtime.



Settling FLSA Claims

- Resolving FLSA Matters Outside the Fifth Circuit:
 - No private settlements of FLSA claims or, stated differently, the release may not be effectual.
 - Need Court or DOL supervision and approval.
 - Followed in many other jurisdictions (*e.g.*, 2d, 4th, 6th, 8th, & 11th Circuits).



Settling FLSA Claims

- Takeaways:
 - In Texas, parties can privately settle a wage and hour dispute, if the settlement agreement is to resolve *that dispute*.
 - General releases, without more, will not bar FLSA claims.
 - In Texas and elsewhere, evaluate whether representations from employee about wage hour matters will help secure peace of mind when settling employment matters.
 - Example: Employee represents in the agreement that he/she has reported all hours and been paid for all hours worked, etc.



Tax Considerations

- Tax considerations – often one of the last consideration.
- Three main issues:
 - Whether payment is “wages” subject to withholding of payroll taxes.
 - Whether payment is taxable.
 - Whether payment is structured to be exempt from 409A.



Tax Considerations

Type of Recovery	Taxable as Plaintiff's Income?	Authorities
Compensatory , actual damages, including lost wages (front or back pay)	Yes	26 U.S.C. §104(a)(2); <i>Commissioner v. Schleier</i> , 515 U.S. 323 (1995)
Compensatory damages for emotional distress, pain & suffering (NOT associated with personal physical injury and NOT including mental expenses from emotional distress)	Yes	26 U.S.C. §104(a)(2)
Compensatory damages for emotional distress, pain & suffering associated with personal physical injury	No	<i>Id.</i>
Medical expenses associated with emotional distress	No	<i>Id.</i>
Punitive damages EVEN IF ASSOCIATED WITH PHYSICAL INJURY	Yes	<i>Id.</i>
Liquidated damages (such as FLSA, FMLA, ADEA)	No	<i>Id.</i> ; Rev. Rul. 72-268.
Costs & attorney fees	Yes	<i>Commissioner v. Banks</i> , 543 US 426 (2005)



Tax Considerations

- Expressly allocate settlement proceeds up front.
 - After-the-fact allocation is more susceptible to attack by the IRS.
- When a settlement agreement expressly allocates the settlement proceeds among various types of damages, the allocation is generally binding for tax purposes, as long as the agreement is entered into by the parties in an adversarial context, at arm's length, and in good faith. *See e.g., Bagley v. Commissioner*, 105 T.C. 396, 406 (1995), *aff'd* 121 F.3d 393 (8th Cir. 1997).
 - If examined by the IRS, it will consider the reason for making the payment and can reject a settlement allocation by the parties to an agreement.



Tax Considerations

- Step 1: Wages?
 - Standard FICA and income tax deductions apply.
- Step 2: Otherwise Taxable?
 - 26 U.S.C. §104(a)(2) is the only way payment might not be taxable: physical injury; emotional distress is taxable, even with physical manifestations
 - IRS: Most employment settlements do not meet this standard; physical injury = observable or documented bodily harm (bruising, bleeding, etc.) *See* IRS Chief Counsel Memorandum (October 22, 2008), *available at* <http://www.irs.gov/pub/irsoia/pmta2009-035.pdf>.
- Step 3: Allocate Costs and Attorney Fees?



Tax Considerations

- IRS Section 409A – Deferred Compensation:
 - Imposes a tax on certain deferred compensation.
 - Timing of payments should be defined in the agreement.
 - Employees should not be able to determine timing of payments.
 - If payments will extend into another tax year, consider whether language regarding 409A compliance or exemption should be added to the agreement.
 - Employee will bear the tax liability.



Tax Considerations

- Takeaways:
 - Consult tax counsel/CPA.
 - Include an indemnity from the employee for tax consequences of settlement.



Multi-State Considerations

- State-Law Specific Non-Waivable Claims.
 - Unemployment Claims:
 - Cannot require employees to waive rights to unemployment in Texas.
 - Wages in lieu of notice v. severance.
 - Workers' Compensation Claims:
 - In Texas, employees can only waive workers' compensation claims in specific circumstances.
 - Be aware that releases may not extend to these claims.



Multi-State Considerations

- California
 - No-rehire covenants:
 - No-rehire covenants can be subject to higher scrutiny in California.
 - As with non-compete and other agreements, be cautious in drafting “one size fits all agreements” when representing multi-state employers.
 - Bigger concern when dealing with multi-state organizations.
 - Choice of law:
 - Must be California for employees in California.
 - Extra release language required by statute:
 - Statutory language must be included.



Other Potential Provisions

- **Dispute Resolution:**
 - Mediation/Arbitration.
 - Jury Waiver.
- **Liquidated Damages:**
 - For non-disparagement or confidentiality.
 - Cannot be a penalty.
- **Return of Property**
- **No rehire**



Other Potential Provisions

- Medicare Secondary Payer Act:
 - Requires reporting of settlement information to Medicare beneficiaries where medical expenses are claimed or released.
 - Medicare covers certain disabled individuals and those over age 65.
 - Where insurance is involved and if it pays the settlement, it is likely responsible for reporting.
 - Consider adding a representation that the individual is not a Medicare beneficiary in the settlement agreement.
 - Likely rare that this is needed.



Resources

- A Model Settlement Agreement from the EEOC:
 - <https://www.eeoc.gov/federal/adr/fsms-settlement.cfm>
- Texas Workforce Commission Recommendations:
 - http://www.twc.state.tx.us/news/efte/release_waiver_agreements.html



Questions?

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