Settlement of Commercial Litigation Matters: Approaches and Issues to Keep in Mind

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By **Christopher E. Ezold** | April 17, 2018

The themes of commercial disputes are often the same as those of personal disputes—someone feels a promise was broken, blames another for property loss, or believes a duty was shirked. Instead of divorce or personal injury claims, however, these themes play out within more complex structures, such as master services agreements, corporate operations and management or fiduciary relationships. Settling commercial disputes frequently implicates a wide range of issues than settling personal matters; in this article I will discuss approaches and issues to keep in mind in resolving commercial disputes.

This Is a Business Deal

When negotiating commercial disputes, it can be useful to frame communications to both clients and opposing parties as if the matter were a business deal, not a dispute. Decision-makers in commercial disputes are generally C-suite executives who are used to solving business problems. Framing the issue as a business deal for both the client and the opposing party helps to focus them on the bottom line, and not the principle or emotional issues involved. This also enables consideration of creative solutions. For instance, converting a noncompetition agreement to a nonsolicitation agreement allows an aggrieved party to obtain its primary goal of protecting its customer base, while allowing the former employee/new employer to move forward. Focusing on the numbers and facts as if it were a business deal (i.e., sales, identified clients, years of restriction, etc.) and avoiding the visceral issues of "my former employee is now on the other team" can allow for a resolution.

Issues of principle and emotion are normally not the benefits that shareholders want to obtain from the company they own. Executives and board members have a duty to maximize shareholder value. Asserting or defending a commercial dispute over principle, when it is not otherwise economically advantageous, implicates the fiduciary duties these decision-makers have to the company and its shareholders. I have found it productive to remind both clients and opposing counsel of this fact; not as a bludgeon to move settlement forward, but as a reason that the parties can use to 'save face' and justify to themselves and explain to others why they have decided to take a bottom-line settlement position.

Until It Isn't

Business owners and executives are still people. There are times that they cannot, and even should not, resolve a matter based solely on the bottom line. Abandoning principle can harm the company's brand or image, damage the confidence of their customer base, and raise issues of regulatory concern. Small to midsized business owners, especially founders, frequently are attached to their businesses almost as if they were their own children. A savvy lawyer will look for and understand whether and when their client and opposing parties will be unable to focus on a bottom-line resolution, and adjust the conceptual framework of the settlement communications as needed. If a party is focused on principle, and you are communicating from a bottom-line framework, you may as well be speaking different languages; you will not be effective in resolving the matter, and you risk unnecessarily alienating the client or opposing party. Adjusting your communications does not mean that you can ignore the bottom-line issues; frequently, parties who litigate on principle end up regretting their decision to do so. In order to protect yourself and to provide good counsel, ensure that you have put the bottom-line issues to your client in writing early on. I have found that a memo comparing and contrasting bottom-line issues and issues of principle can help a client focus on their long-term interests.

The Clockwork of a Settlement Deal

Regardless of the framework, there is a wide range of secondary legal issues frequently implicated by the settlement of commercial disputes; I list only a few below.

- Tax: Always ensure that you have a handle on the tax consequences of a commercial settlement. Payments to executives frequently can be deferred compensation or parachute payments under Sections 409A or 280G of the tax code. If so, they must be structured correctly in the agreement prior to signature, or both parties can end up with significant negative tax consequences that cannot be fixed after the fact. Transfers of property, returns of monies paid and forgiveness of debts are frequently part of the settlement of commercial disputes—and they can trigger taxes or create losses that need to be understood by the client before the deal is signed. Ensure that you loop in your client's accountant or tax attorney on the deal structure well in advance not only of signing, but of final negotiations. It is difficult to re-establish the trust a deal is based on when you have to pull out at the last moment. Know the tax consequences before you make or respond to a settlement offer.
- Corporate form: You must understand the requirements of the corporate form of both your client and an opposing party in any settlement. If you are negotiating an equity dispute, understand what formalities are required to issue or transfer an equity interest, and the effect the transaction will have on your client and on the terms of the deal. For instance, prior to any payment to a shareholder of a Subchapter S corporation, or even certain lenders or creditors, consider whether that payment might be considered a second class of stock under the tax code. If so, your settlement may likely destroy the company's Subchapter S election, exposing the company and its shareholders to significant tax liability.
- Impact on other contracts: If you are negotiating the settlement of a matter relating to a contract for the sale of goods, ensure that all formalities required by the Statute of Frauds are met. Also ensure that you include language requiring the parties to further execute such documents as are necessary to effectuate the intent of the parties, so that any errors in documentation can be cured without further dispute. Finally, if your negotiations result in a reduction in the cost of goods or services your client provides, ensure that your client does not have 'most favored nation' clauses with other customers that might be implicated—or your client may have to reduce pricing to its other customers.
- Pending written agreement: Dealmakers are familiar with the risks of letters of intent, and how to avoid accidentally turning them into contracts. The same risks occur in settlement negotiations, especially when such negotiations are complex and multiple interdependent terms are being addressed. Where parties have reached an agreement, the fact that they intend to reduce the agreement to a formal writing does not prevent enforcement of the agreement, as in *Kazanjian v. New England Petroleum,* 332 Pa. Super. 1, 480 A.2d 1153 (1984). If all material terms of the bargain are agreed upon, the courts will enforce the settlement. If parties agree upon essential terms and intend them to be binding, a contract is formed even though they intend to adopt a formal document with additional terms at a later date, as in *Mastroni-Mucker v. Allstate Insurance,* 2009 PA Super 101, 976 A.2d 510, 522 (2009). Ensure that your verbal communications are followed up by a writing confirming what was said in order to avoid dispute; furthermore, ensure your written communications create an enforceable settlement agreement only if that is what you intend.
- Public statements. Commercial disputes frequently have reputation and branding impact for your client. While you cannot control all gossip in an industry, it is important to ensure that the parties agree on a unified message regarding the resolution. Stereotypical

‘amicable resolution’ language is frequently expected after a settlement, and even if the industry might not fully believe such language, its absence can speak more loudly than your client would like.

- Indemnification and insurance. Indemnities are frequently provided in commercial settlement agreements. Ensure you have taken your client’s insurances into account, and worded the indemnities such that they do not vitiate coverage for your client. Further, ensure that your client is aware of any gap between their insurance coverage and the indemnity being negotiated.
- Collections and bankruptcy. Payments over time pose risk of nonpayment. Worse, payments made may be clawed back by a bankruptcy trustee if they were made within 90 days prior to the bankruptcy. Consider whether the settlement agreement creates a new obligation or resolves an antecedent debt, and whether you will require a representation that no bankruptcy petition will be filed within 90 days of any payment due or action required by the agreement.

Conclusion

Settlement is both an art and a science; commercial settlements require greater attention to detail in both aspects. Recognizing that the settlement of commercial disputes cannot be conducted in a vacuum, but that attention must be paid to their wider implications is at the root of being both a good attorney and counselor at law for commercial clients.

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