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Putting teeth into your settlement agreement

If you're not settling with an insurer, focus on getting paid without further litigation

By David Cook

Parties settle cases because they strike a deal at agreed terms, they tire of the litigation, they run out of money to pay the attorneys, or they conclude that their strategy is flawed. Parties settle cases because they agree to settle. Settlements should end the conflict and bring peace to each side which is, at least, the object of the exercise.

Settlement agreements with an insurance company on behalf of its insured, as in the case of an automobile accident, can be relatively straight forward. The parties agree on a cash or structured settlement and, upon payment by the insurance carrier, the insurer and its insured are released from all claims arising out of the accident.

But when the settlement is with an uninsured, under-insured or partially-insured defendant – typically over matters such as employment, fraud, or sexual wrongdoing that are not covered by insurance – the settlement agreement can offer a grab bag of continuing, and sometimes contentious, obligations: long-term covenants, warranties and promises to each other. These near-endless terms include promises of confidentiality, duties to report of legal process, non-disparagement, payment of money at a specific date, place or time or in installments, warranties of title or condition if products, or property, are part of the deal, promise to deliver title to personal or real property by a certain date, promises to leave a certain market, and a myriad of other complex terms. Suffice to say, if the parties engaged in high-wire litigation prior to the settlement, further fracas litigation should exit stage right upon the settlement, and enforcement should take center stage if a party were to breach the settlement agreement.

A settlement agreement should incorporate remedies to compel the parties to perform their respective covenants, warranties and promises that should ameliorate the risk that the settlement continues the litigation by other means.

Below are some of the key risks.

Getting paid

The settlement of claims against an insured defendant bears only a marginal

risk of nonpayment. When the defendant is uninsured, settlement of claims against individuals or small, medium or even large businesses accrues risk. If the claim is typically insurable, but the defendant is uninsured, the risk of non-payment metastasizes if the uninsured defendant seeks a payment program that spans months or years. No cautionary letter to the client could adequately explain the risks of non-payment.

What are these risks? The primary risk is payment fatigue which is bankruptcy lingo to describe the weariness of a Chapter 13 debtor who embarks on a 60-month payment plan. By the time the debtor reaches the 30-month payment milestone, payment fatigue bashes down the door and the debtor stops paying.

The next risk is that the debtor runs into financial distress by a changing marketplace that topples the defendant's business. Try mismanagement, embezzlement, failure to pay taxes, or a divorce that craters the business, all of which can result in a defendant becoming unable to make payments under a settlement agreement.

The most dangerous risk is that the defendant lacks the intention of payment and exploits the time offered in the payment agreement as an opportunity to fraudulently convey or cash out assets. In some cases, the defendant, if a corporation without the burden of a personal guaranty or security, might liquidate its assets, distribute the proceeds and leave the plaintiff high and dry.

There are the standard remedies to assure payment:

Judgment upon settlement and not upon default

Don't expect the opposing counsel to bound over the net and shake your hand when you make this proposal. Judgment upon settlement, and not judgment upon the default, enables the plaintiff to secure the judgment with judgment liens, such as JL-1 filed with the Secretary of State (lien on personal property), and abstract of judgment recorded with the County Recorder (lien on real property). While not all-encompassing like some other remedies, something is better than nothing. Paramount in enforcement is to incorporate an acceleration clause in the settlement agreement: "In the event of default of payment when due and payable, or default of any other covenant herein, without notice or grace, plaintiff may accelerate all of the remaining installments, and each of them, and declare the entire unpaid balance immediately due and payable, and proceed to enforce all rights and remedies under law or equity under this agreement or any collateral agreement referenced herein. The late or non-conforming tender of any installment shall not act to revive, or reinstate, the right to make periodic installments, or to defer payment of the total, and any payments received after the default shall be applied on account of the accrued interest and the balance to principal and without a waiver of the default herein or the right to collect the accelerated balance." Don't surrender these demands. They are your [malpractice] insurance.

Perfected security interest

This settlement agreement should incorporate a perfected security interest in the *now owned and hereinafter acquired* personal property of the defendant, which would include fixtures, deposits, all intellectual property, and commercial tort claims. Don't forget that a copyright is subject to registration of a lien thereon with the United States Copyright Office, and not a UCC filing with the Secretary of State. Liens would provide some solace in the event the defendant sells the business, because the buyer, absent the bizarre, would otherwise acquire assets free and clear of liens. These liens, if older than 90 days, will emerge intact from a bankruptcy, which is the front-and-center risk in any payment agreement. Seek a control agreement to reach the bank accounts. The lien, by virtue of the settlement agreement, might well provide for priority over subsequent liens. A personal property lien also trumps subsequent attachment and judgment liens, thereby enabling the secured creditor to file a third-party claim and wrestle back any property seized by way of execution or attachment.

Personal property liens make payment a personal priority. Don't forget to run a UCC search to determine the status of prior liens and encumbrances as soon as possible. Don't forget to confirm the legal name of the potential debtor. Spelling counts. Don't forget to file the UCC Financing Statement in the right place (i.e., the state of the defendant's legal domicile) and record the trade fixture and lease (if collateral) UCC Financing Statements with the correct county recorder. Run a UCC search to confirm the correct and timely filing and recording, and moreover, that the debtor did not interpose any late-filed liens to subvert the settlement liens. Use a commercial service to ensure proper filings. UCC Article 9 sweats the details.

Personal guaranty

A personal guaranty spools up another live body to sue in the event of a default by a corporate debtor. Aside from providing another pot of assets, a personal guaranty compels the guarantor to prioritize payment of the debt because the guarantor benefits with each payment by reduction of the liability under the guaranty. The personal guaranty offers a personal incentive to the guarantor in the form of debt relief, better known as the "settlement helper." "The enemy of my enemy is my friend" is a recognized settlement strategy. Witness the signature and take away the defense of forgery.

Non-economic covenants of reporting, providing access to books and records, and providing notice of liens

Covenants of reporting, providing access to books and record, and providing notice of liens can serve as early warning tripwires of a financial default by the defendant. Failure to pay another liability

suggests that the defendant's financial condition rests on the chopping block. If the defendant complies and reports on other suits and claims, decreased revenues or any other information that constitutes a breach, the plaintiff may proceed with immediate enforcement under the settlement agreement. If the defendant fails to issue the periodic report, likewise the defendant would be in breach. Either way, non-economic covenants are the harbingers of default.

Overly broad releases

Expect releases that come in two flavors. The first is a release that is limited to the transaction and guards the parties against related claims lurking around the corner. The second is a global release that releases the parties and their insiders of liability for all claims. What other claims did the plaintiff hide behind the sofa? The answer may be a previous or current fraudulent conveyances perpetrated by the corporate insiders: Contemporaneous with the release, insiders may have transferred the defendant's assets to a new entity or to themselves, or shipped assets (money) out of state or offshore, or diverted the defendant's receivables to different entities. Expect the first settlement check and maybe the second, but forget about the third payment. Then, upon default, the plaintiff ascertains that the corporate defendant has been looted, and the assets sit in a successor entity (or with the insiders themselves) that is controlled by the corporate insiders of the defendant. The global release might discharge the fraudulent conveyance claims against the insiders and the successor entity. Maybe, maybe not, but why take the risk?

Giving pause to gonzo litigation

Settlements should wind down the litigation and not recycle one lawsuit for another. The advance sheets regale the readers with stories of suits born of defaults in settlement agreements. Why?

The answer to that question is often an attorneys' fees clause embedded in most settlement agreements. Civil Code section 1717 shifts the risk of litigation to the loser. Given the "winner takes all" mantra, the fee clause encourages parties (and their attorneys) to prosecute litigation to the bitter end (i.e., trial at all costs) and the Holy Grail of the fee motion. Embrace the *zeitgeist* that attorneys' fees energize litigation. Revenge is a dish best served at the fee motion, and litigators chant "Hara Krishna" while taking the podium. If the parties have infused in their settlement a complex formula of contractual terms, long-term commitments, or terms that are fuzzy or subject to legitimate dispute, litigation looms over the horizon at any time. Complex terms are the gala ticket to the courtroom. Some contract terms bearing the language "reasonable," or "to the satisfaction of," nestle under the neon sign of "*SUE ME*."

What can be done to ameliorate the risk of facing the adverse party in the OK Corral over a contract glitch? Answer: Incorporate a pre-filing notice of claims and opportunity to cure as the poor man's Code of Civil Procedure version of section 998. Let's try this:

> **Enforcement of Agreement and Pre-Filing Covenant.** If any party to this Agreement brings an action to enforce her, his or its rights hereunder, the prevailing party shall be entitled to recover her, his or its costs and expenses, including court costs and attorney's fees, if any, incurred in connection with such action. No action shall be filed unless and until each party at least 30 days prior to the filing of any action, or any amended or supplemental cause of action therein, notifies in writing the other party of the claims, and the facts and basis supporting the same, therein and provides the other party an opportunity to cure, correct, remedy or resolve such claims. Notice shall be forwarded to the current email addresses of each party, and current attorneys, with the subject line of "PREFILING NOTICE OF CLAIMS." In the event the plaintiff in such an action fails to recover judgment in excess of the pre-suit offer by which to cure, correct, remedy or resolve the claim, the plaintiff shall not recover attorney's fees and cost and shall be liable to the defendant for attorney's fees and costs. The email addresses are the following:

This language is the tripwire to any litigation. This language also levels the playing field between litigants of unequal financial ability.

Avoid a forum-selection clause, mediation and arbitration

Forum selection clauses favor anyone with the superior bargaining position because the party can select an inconvenient forum-selection clause which warehouses the litigation out of county, out of state or even offshore.

Here is a partial solution. Aside from the very bizarre, the plaintiff seeks to enforce the settlement agreement because the defendant defaulted under the settlement agreement. The plaintiff can enforce the settlement through enforcement mechanisms that include a stipulation for entry of judgment or enforcing the judgment at hand. Some settlements require the parties to dismiss the case with prejudice, which compel the parties to file a new suit on the settlement agreement. Forum selection, mediation and arbitration terms impede access to the local civil courts that offer the most advantageous forum to prosecute an enforcement action. Assuming that the settlement provides a fixed amount, the plaintiff can proceed with a writ of attachment requiring that the amount be "fixed and readily ascertainable," based on commercial transaction and arises from a contract, express or implied (Code Civil Procedure section 483.010) Try this:

> **Forum Selection.** The parties agree that the judicial forum that shall hear and adjudicate and resolve all disputes by and among the parties arising interpretation or any breach of this Settlement Agreement shall be the trial courts of the state of California, which are located in San Francisco County, and that the laws of the State of

California shall constitute the sole body of law in the enforcement, interpretation or adjudication of any action. Notwithstanding the terms hereof, in the event that ABC [the creditor] is owed money, or any other obligation, arising from the breach of this Settlement Agreement, or any other obligation, ABC company may at its option file suit in any forum, select any venue in its discretion to enforce its rights and remedies herein and may select the law of the forum in the interpretation or enforcement of all rights and remedies herein.

Alternative dispute resolution exceptions to collection, breach, or enforcement claims in settlement agreement. Notwithstanding the agreement of the parties to mediate and, if necessary, arbitration of any dispute under the terms of the Settlement Agreement, ABC shall be excused and exempted from mediation or arbitration of any claims that arise from the breach of the Settlement Agreement, breach of term or condition (including the obligation to pay money), or the enforcement of any terms therein. ABC shall be entitled, without the necessity to mediate or arbitrate, to file suit and enforce all right and remedies that arise from the Settlement Agreement, including but not limited to any prejudgment remedies of any type or nature as allowed by the law of the forum state and in the forum of ABC's choosing.

This language relieves the parties from mediation and arbitration when the issue is nonpayment under the settlement agreement. Delay in the prosecution of the breach of the settlement enables the defendant to fraudulently convey or cash out assets that is probable when the defendant faces a financial apocalypse. Nothing stops the defendant from emptying the bank accounts and transferring the funds to accounts out of county, state or offshore.

Why trade a settlement agreement for a new lawsuit?

Accept the fact that sometimes the settlement offered by a defendant is in bad faith. The defendant has no intention of ever complying. The defendant will never pay the first installment, or any installment. This is a settled expectation. After default, the defendant offers to settle the obligation in the settlement agreement by paying a discounted sum. The disaster is accepting the discounted amount in full settlement of the debt without the funds in possession. If a default occurs, the defendant will argue, and maybe rightfully so, that the plaintiff agreed to accept a lesser sum, and that the putative deal constitutes a substitution and novation or written modification of the settlement contract. Getting stuck with a reformed contract that reduces payment to the plaintiff, but in which the plaintiff bargains for payment and not another promise to make payment, is an invitation to more litigation. Settlements which impose an inflated judgment invite trouble (*Sybron v. Clark Hospital Supply Corp*. (1978) 76 Cal.App.3d 896).

Most contracts structure acceptance as the offeree signing on the dotted line. The defendant has no intention of fulfilling the promise that is authenticated by the signature. Embrace the fact that the new promise is just as worthless as the old promise. The plaintiff wants cash.

This is the magic formula to ensure that the plaintiff gets cash, and not just hot air:

> Payment in full of the agreed amount is due on _____, which payment, and nothing less, constitutes acceptance of the offer to settle based on timely compliance. You can accept this offer solely and exclusively by due and timely performance and any type of non conforming tender shall be deemed a rejection of this offer without further notice to anyone. Time is of the essence. Strict compliance is required. You are not offered any extension of time, nor delay in responding to legal process, or waiver of any contractual covenant, warranty or promise unless and until you accept the offer according to its terms and without any default. You are not entitled to grace, notice, notice of default, or notice of any non conformity of any tender. All rights under California Code of Civil Procedure section 473 are waived. The sole means of payment is wire transfer per the attached instructions and no other means.

An important note on wire transfers: Never incorporate wire instructions in an email or letter. Embed wire instructions in paper which is provided to the offeree in an Adobe Acrobat File (PDF). This will avoid clerical errors that are catastrophic. This rule is inviolate.

Unlike most contracts that authorize acceptance with a signature, the offeree accepts this by payment and no other way. By requiring payment as acceptance, the plaintiff mitigates the risk of swapping out one agreement, presumably in default, with another agreement that is destined to default.

Walking back the legal analysis, and stepping forward the vernacular, spells it out: Money talks, and everyone else walks.


Cook

David Cook is the founding partner of Cook Collections Attorneys*, San Francisco. He wrote the Amicus brief in* Singer v. Malin for Survivors Network of those Abused by Priests, Kosnoff Fasy PLLC, Christine Lozier, Peace over Violence, Protect Mass Children, Law Firm, Charlie Stecker, Taylor & Ring, and the Zalkin Law Firm, P.C. *Cook is a prolific writer of magazine and journal articles, focusing on solvency, collection and enforcement. The ABA has offered to publish Cook's* The Debt Collector's CookBook *and it is due out the end of this year.*