A Settlement Gone Wrong:
Practice Pointers to Avoid Every Lawyer's Nightmare

Lee Hollis, Esq.
Mary M. Drake, Esq.
Lightfoot, Franklin & White, LLC
Birmingham, AL

It finally happened. You settled the nightmare case. The case that kept you low on sleep and high on anxiety, not to mention in constant trouble with your significant other. So you're quick to catch up on sleep and move on to the cases that you neglected while you were otherwise occupied. You forget about those discovery responses that you never finalized and the documents you never produced, the documents that were made available to but were never inspected by the other side, and the discovery requests that you never supplemented—because why should they matter now? You quickly complete the settlement paperwork and put the nightmare to bed. You got a good result for your client, and everyone is satisfied.

But you can never be too sure. This paper gives a real-life example of what could happen if you fail to pay attention to detail during the pendency of a case or during settlement, and it explains how to avoid these potential pitfalls.

What, exactly, are these potential pitfalls, you wonder? How bad could it possibly be? Aside from the obvious threat of having a malpractice action filed against you, you could face (1) a potential Rule 60(b) motion, where the court retains jurisdiction, the settlement monies are returned, and the case is reopened; (2) a motion to reopen based on fraud on the court, which likewise reopens the action and could subject you to sanctions; or (3) a potential independent cause of action for fraud in the settlement where the plaintiff keeps the settlement proceeds and sues for the difference in the settlement value—i.e., what the case would have settled for had the true facts been known.

I. The Example Nightmare.

Imagine that you are involved in a series of securities class actions. You know from experience that the majority of class actions settle, and the focus of the case for your purposes is limiting damages and getting the best settlement possible. And, like every case, you try to be strategic. You wait for the other side to ask the right questions and discover the underlying facts. After all, litigation is an adversarial system, and you aren't going to do their job for them. But they never do any formal discovery. Instead, they review public filings, get some information informally, and want to settle quickly. A settlement is negotiated. Your client is happy to be done with the case, and the plaintiffs' attorneys are happy because they have achieved a nearly record-breaking settlement.

So, the plaintiffs' attorneys prepare a Stipulation of Settlement to present to the Court and do all the talking at the fairness hearings. At this point, it is over as far as you are concerned, and

you leave it up to them to push the ball across the goal line, get the settlement approved, distribute the settlement funds and collect their fee. All that happens, the judge approves the settlement as fair and reasonable based on what is presented to him, and you move on to your next case. Or so you think.

But years later, the other side claims to discover that it had been operating under a misapprehension about some of the facts that it deemed material to the settlement. For example, plaintiffs' attorneys might discover documents from another source that should have been produced in the prior case. They might discover that discovery responses or sworn testimony given in the prior case was inaccurate. Or they might discover that more assets or insurance proceeds were available for settlement than they thought. That is when things get interesting.

The plaintiffs' attorneys (sometimes an entirely new set of attorneys seeking to benefit where others already have) file suit in a new action against the former defendants, alleging suppression and misrepresentation in connection with the settlement. They claim that they would have demanded millions more in settlement if they had known the true facts and seek compensatory and punitive damages running into the 9-figures.

The case can become a perfect storm. The plaintiffs' attorneys get to re-litigate the issues. Lawyers are witnesses. Their files are subpoenaed, and their time records are scoured with a fine-toothed comb. Witnesses are dead or in jail. The conduct of all of the lawyers is second-guessed. The court is outraged that it was "duped" into approving a settlement based on inaccurate information and feels like it has a duty to the class members to ensure that they are made whole. And even though the plaintiffs' attorneys didn't do their job in the initial lawsuit, the defendants are the ones being blamed for it.

We explain below the mechanisms through which a party can challenge a settlement and how to avoid this happening to you.

II. <u>The Legal Mechanisms Available to Challenge a Settlement.</u>

1. Rule 60(b).

The rules of procedure—in federal court and in most state courts—provide a specific method for setting aside a prior order or judgment. The federal rule, for example, permits a court to "relieve a party from a final judgment" for reasons such as mistake, newly discovered evidence, fraud, misrepresentation, a void judgment, release, "or any other reason that justifies relief." Fed. R. Civ. P. 60(b); *see also e.g.*, Ala. R. Civ. P. 60(b); N.Y. C.P.L.R. 5015. But, importantly, these rules also set particular time frames in which a Rule 60 motion must be brought. The federal rule states that such a motion must be brought within a reasonable time, and for fraud, newly discovered evidence, and mistake/excusable neglect, no later than one year after the entry of judgment or order. By contrast, the Alabama Rule states that these motions must be made no later than four months after the judgment or order, but that the Rule "does not limit the power of the court to entertain an independent action within a reasonable time and not to exceed three (3) years after the entry of the judgment." Ala. R. Civ. P. 60(b). And the New

York C.P.L.R. provides a specific limitation only if relief is sought on the basis of "excusable neglect; otherwise a motion need only be brought in a "reasonable time." N.Y. C.P.L.R. C5015:3. *See also, e.g.*, Fla. R. Civ. P. 1.540(b) (permitting relief from a judgment, decree, or order in the event of "Mistakes; Inadvertence; Excusable Neglect; Newly Discovered Evidence; Fraud; etc." and stating that "[t]he motion shall be filed within a reasonable time, and for [mistake, inadvertence, surprise, excusable neglect; newly discovered evidence, fraud, misrepresentation, or other misconduct of an adverse party] not more than 1 year after the judgment, decree, order, or proceeding was entered or taken"); Mass. R. Civ. P. 60(b) (same); N.J. Ct. R. R. 4:50-1 & 4:50-2 (same),

Regardless of the jurisdiction, this mechanism for relief is ordinarily limited. The upshot of Rule 60(b) is generally that it "is available . . . only to set aside the prior order or judgment. It cannot be used to impose additional affirmative relief." *United States v. One Hundred Nineteen Thousand Nine Hundred Eighty Dollars*, 680 F.2d 106, 107 (11th Cir. 1982) (citation omitted); *see also Adduono v. World Hockey Ass'n*, 824 F.2d 617, 619-20 (8th Cir. 1987) (reversing district court for imposing sanctions and fees under a Rule 60 motion because it was limited under Rule 60 to setting aside its order of dismissal). Thus, while Rule 60 can be used to reopen an action, it has only the effect of unraveling the prior resolution and continuing the prior action. *But see* Fed. R. Civ. P. 60(d)(1) (noting that Rule 60 "does not limit a court's power to . . . entertain an independent action to relieve a party from a judgment, order, or proceeding."). And in that sense, it is perhaps the lesser of two (or more) potential evils because an independent action like our above example could have potentially far worse repercussions, particularly where fraud is allegedly involved. Moreover, in a Rule 60(b) action, the parties have the benefit of a judge already familiar with the case, which may not be the case with our other options.

Because of its limitations, plaintiffs and plaintiffs' attorneys often prefer not to choose this option if possible. Specifically, this method of undoing a settlement ordinarily has fairly strict time limitations across jurisdictions to promote finality in judgments, which means the window of time may have already passed by the time plaintiffs' attorneys decide to take action. *See, e.g.*, *AAA Nevada Ins. Co. v. Buenaventura*, No. 13-17664, 2016 WL 1019269, at *2 (9th Cir. Mar. 15, 2016) ("What constitutes 'reasonable time' [under Federal Rule of Civil Procedure 60(b)] depends upon the facts of each case, taking into consideration the interest in finality, the reason for delay, the practical ability of the litigant to learn earlier of the grounds relied upon, and prejudice to other parties." quoting *Ashford v. Steuart*, 657 F.2d 1053, 1055 (9th Cir. 1981) (per curiam))); *Giroux v. Fed. Nat. Mortgage Ass'n*, 810 F.3d 103, 108 (1st Cir. 2016) ("The high threshold required by Rule 60(b)(6) reflects the need to balance finality of judgments with the need to examine possible flaws in the judgments." *quoting Bouret-Echevarria v. Caribbean Aviation Maint. Corp.*, 784 F.3d 37, 42 (1st Cir. 2015)); *see also, e.g.*, *United States v. Philip Morris USA Inc.*, 686 F.3d 839, 843 (D.C. Cir. 2012) ("As to Rule 60, Relief From a Final Judgment or Order, that rule sets forth a litany of grounds establishing a high bar for modification.").

But more importantly, plaintiffs' attorneys may prefer not to choose this option because it also involves giving the settlement money back and re-opening the case. And in some cases, such as the class action context like our example case, this route is simply not a viable option because it would be virtually impossible to refund the settlement proceeds after they have been

distributed. And if a Rule 60(b) motion is not a realistic option in a particular case, plaintiffs' attorneys may resort to one of the next two options. *But see Roger Edwards, LLC v. Fiddes & Son Ltd.*, 427 F.3d 129, 134 (1st Cir. 2005) (explaining that a Rule 60(b)(3) motion alleging fraud during the course of litigation can be easier to prove because one must prove "merely" that the fraud "substantially interfered with the movant's ability fully and fairly to prepare for, and proceed at, trial" and that "[t]his is a far less demanding burden than showing that a different result would probably have ensued" (internal quotation marks and citations omitted)).

2. Fraud on the Court.

A second, potentially worse option than your typical Rule 60(b) motion, is an allegation of fraud on the court. A subset of Rule 60 in federal court is an action for "fraud on the court," which falls under the "other powers to grant relief" provision of Rule 60(d). In federal court, actions for fraud on the court can come in many different forms, there is no time limit on them, and it is within the inherent power of the court to vacate a judgment that was obtained by fraud. *See Drobny v. C .I.R.*, 113 F.3d 670, 677 (7th Cir. 1997) ("A] decision produced by fraud on the court is not in essence a decision at all, and never becomes final."); *see also* Wright & Miller,11 Federal Practice & Procedure § 2870 (3d ed.); *see also, e.g.*, Ala. R. Civ. P. 60(b) (stating the rule "does not limit the power of a court to . . . set aside a judgment for fraud upon the court"); Fla. R. Civ. P. 1.540 ("This rule does not limit the power of a court to entertain an independent action to relieve a party from a judgment, decree, order, or proceeding or to set aside a judgment or decree for fraud upon the court."); N.J. Ct. R. R. 4:50-3 (same). *But see Matthews, Wilson & Matthews, Inc. v. Capital City Bank*, 614 F. App'x 969, 971 (11th Cir. 2015) (noting that the equitable doctrine of laches "does apply"); N.Y. C.P.L.R. 5015 (treating fraud upon the court under the same provision as regular fraud); Va. Code § 8.01-428 (stating that a "motion on the ground of fraud on the court shall be made within two years from the date of the judgment or decree").

Given the general flexibility in federal court and in many states regarding time limits on bringing such actions along with the offensive nature of such an action—if legitimate—to a court, these allegations can be far more worrisome than an average Rule 60(b) motion. The remedy if such fraud has indeed occurred is ordinarily to vacate the judgment and deny "the guilty party [of] all relief." *Boyer v. GT Acquisition LLC*, No. 106-CV-90-TS, 2007 WL 2316520, at *4 (N.D. Ind. Aug. 9, 2007). Sanctions may be imposed, and the entire cost of the proceedings, including attorneys' fees, may be assessed against that party who perpetrated the fraud. *See* Wright & Miller, 11 Federal Practice & Procedure § 2870 (3d ed.).

In general, "[f]raud on the court which justifies vacating a judgment is narrowly defined as fraud which is directed to the judicial machinery itself and is not fraud between the parties or fraudulent documents, false statements or perjury." *United States v. Smiley*, 553 F.3d 1137, 1144 (8th Cir. 2009) (internal quotation marks and citations omitted). Examples of fraud on the court in a settlement context can be seen most clearly in the class action or pro ami context, where court approval is required—as a fiduciary for the class or the minor—to settle the action. *See, e.g., In re Tremont Sec. Law, State Law, Ins. Litig.*, No. 08 CIV. 11117, 2013 WL 795974, at *2 (S.D.N.Y. Mar. 1, 2013) (arguing fraud on the court after approval of settlement through fairness

hearing); *CA, Inc. v. Wang*, No. 04-CV-2697 TCP, 2011 WL 5401324, at *15 (E.D.N.Y. Nov. 4, 2011) (same). But while those are the most obvious, fraud on the court can stretch much farther than just those scenarios in a settlement context. *See Burlington N. R. Co. v. Warren*, 574 So. 2d 758, 764 (Ala. 1990) (holding a consent judgment was fraud on the court and stating, "where fraud is practiced upon a party to induce the party to enter into an agreement, and the wrongdoer intends that the court adopt that fraudulent agreement as part of a judgment, then there is fraud upon the court."); *id.* ("[O]nly that species of fraud which does or attempts to, defile the court itself, or is a fraud perpetrated by officers of the court so that the judicial machinery can not perform in the usual manner its impartial task of adjudging cases that are presented for adjudication."); *R.C. by Alabama Disabilities Advocacy Program v. Nachman*, 969 F. Supp. 682, 690-91 (M.D. Ala. 1997), *aff'd sub nom. R.C. v. Nachman*, 145 F.3d 363 (11th Cir. 1998) ("Fraud upon the court is . . . typically confined to the most egregious cases, such as bribery of a judge or juror, or improper influence exerted on the court by an attorney, in which the integrity of the court and its ability to function impartially is directly impinged."). Luckily, because fraud on the court is so difficult to establish, very few of these actions are successful. *See, e.g.*, *In re Sealed Case (Bowles)*, 624 F.3d 482, 489 n.4 (D.C. Cir. 2010) ("Appellant's allegations of fraud do not meet the high threshold for showing a fraud on the court."); *Dempsey v. Arco Oil & Gas Co.*, 25 F.3d 1043 (5th Cir. 1994) (reviewing district court ruling for abuse of discretion and stating that a " reversal will be granted only upon a showing of extraordinary circumstances that create a substantial danger that the underlying judgment was unjust" (internal quotation marks and citation omitted)); *see also, e.g.*, *Pizzuto v. Ramirez*, 783 F.3d 1171, 1180 (9th Cir. 2015) ("[A] party bears a high burden in seeking to prove fraud on the court, which must involve an unconscionable plan or scheme which is designed to improperly influence the court in its decision." (internal quotation marks and citations omitted)); *Matthews, Wilson & Matthews, Inc. v. Capital City Bank*, 614 F. App'x 969, 971 (11th Cir. 2015) ("Less egregious misconduct, such as nondisclosure to the court of facts allegedly pertinent to the matter before it, will not ordinarily rise to the level of fraud on the court." (internal quotation marks and citation omitted)).

But if successful, a likely result is a reopening of the action and heavy sanctions (both monetary and non-monetary) against the party that committed the fraud. *See, e.g.*, *Haeger v. Goodyear Tire & Rubber Co.*, 813 F.3d 1233, 1237, 1254 (9th Cir. 2016) (affirming monetary and non-monetary sanctions by district court imposed under inherent power because of "deliberate decisions by [defendants] to delay the production of relevant information, make misleading and false in-court statements, and conceal relevant documents").

3. Independent Cause of Action for Fraud.

Finally, an opponent can attempt to affirm the settlement and sue for more money by way of an independent action for fraud, much like our example case. Although much more rare, this type of an action could be a tremendous threat, especially given the potential for punitive damages in fraud actions. Although many courts may not permit such an action and may conclude that Rule 60(b) is the only available remedy, some courts have held otherwise. *See, e.g., Ex parte Caremark RX, Inc.*, 956 So. 2d 1117, 1125 (Ala. 2006) ("As the complaint is now drafted, [the] only option is to proceed with [the] misrepresentation and suppression claims as a new action."). *But see, e.g.*, *Pondexter v. Pennsylvania Human Relations Comm'n*, 556 F. App'x

129, 131 (3d Cir. 2014) (dismissing new action with additional defendants); *Villarreal v. Brown Exp., Inc.*, 529 F.2d 1219, 1221 (5th Cir. 1976) (holding that new complaint filed regarding prior settlement in reality fell under Rule 60(b)); *Aldana v. Del Monte Fresh Produce N.A., Inc.*, 741 F.3d 1349, 1359 (11th Cir. 2014) (stating relief is available under this mechanism only to prevent a grave miscarriage of justice); *id.* ("The Supreme Court has made clear that such '[i]ndependent actions must, if Rule 60(b) is to be interpreted as a coherent whole, be reserved for those cases of injustices which, in certain instances, are deemed sufficiently gross to demand a departure from rigid adherence to the doctrine of res judicata." (internal quotation marks and citations omitted)). And of course, the worse the conduct appears, the more likely it becomes that a court will find a way to allow the action to proceed, regardless of any Rule 60(b) time limits. After all, as lawyers we have all heard the old adage that "bad facts made bad law," and it unfortunately turns out to be true more often than we would like.

Although "[p]roper resorts to independent actions are rare, *Matthews, Wilson & Matthews, Inc. v. Capital City Bank*, 614 F. App'x 969, 971 (11th Cir. 2015), if such an action is permitted to proceed, the potential damages could get worse than just sanctions by a court. Not only can the plaintiffs' recover the difference between what the settlement was and what it would have been had the suppressed or true facts been known, they can recover punitive damages to punish the defendants for the fraud and suppression. And in a case like our example case, where the members of the class are painted as innocent victims of a fraud, a high jury verdict becomes a very real risk.

III. A Malpractice Claim May Not Be a Viable Alternative.

The obvious alternative to a case like our example case is a malpractice action against the plaintiffs' attorneys who failed to conduct thorough discovery and do their jobs for the class members. And this may well be a potential alternative (that is of course better for you and your client) if the timing is right. But, like Rule 60, there are time limitations that could apply. Most if not all states have statutes of limitations on malpractice claims against lawyers, and some states even have statutes of repose, making recovery impossible after a certain number of years. *See, e.g.*, Ala. Code § 6-5-574 (Alabama); 735 ILCS 5/13-214.3 (Illinois); La. Stat. § 9:5605 (Louisiana); MCL 600.5838b (Michigan); N.C. Gen. Stat. § 1-15; Tenn. Code § 28-3-104 (Tennessee). For this reason, a malpractice claim may not be a viable alternative for unhappy plaintiffs.

IV. How to Protect Yourself and Your Client.

1. Attention to Detail During the Case.

Often times it is easy to go through the motions of a case without thinking about strategy long term, particularly where settlement is on the table from the start, like in the case of a class action. But our example case illustrates that one can never be too careful in paying attention to the details and in thinking one step ahead. Below are just a few examples of ways in which you can protect yourself and your client during an action.

a. Discovery Responses. Discovery responses are something we often go through the motions of without truly thinking about the end game. It is dangerous to hide the ball or give evasive answers and rely on the plaintiffs' attorneys to be diligent and file motions to compel, particularly about "material" matters. If the plaintiffs' attorneys fail to push for all of the facts, any less than complete discovery responses could potentially be construed as suppression or misrepresentation in a later action for fraud. Moreover, Rule 26 in federal court and most if not all states imposes a duty to supplement discovery responses "in a timely manner if the party learns that in some material respect the disclosure or response is incomplete or incorrect, and if the additional or corrective information has not otherwise been made known to the other parties during the discovery process or in writing." Fed. R. Civ. P. 26(e)(1)(A). Therefore, the rules create a duty of full disclosure, which you must comply with, even if your opponent is lazy.

b. Statements in Court. As officers of the Court, certainly most lawyers strive to be honest, but mistakes happen, especially in the heat of the moment. Keep in mind that in some circumstances, such as a fairness hearing or a pro ami hearing, you may even have an arguable duty to speak to correct the other side's misstatement as potential joint proponents of the proposed settlement. The key is to be sure that the court is aware of and has considered all material facts; otherwise you may later face an action for fraud on the court, or worse. Likewise, should you or someone from your own side misspeak, it is prudent to correct that misstatement—however small—during the hearing, by subsequent letter, and/or in a subsequent hearing. Taking precautions such as this will protect both you and your client from later collateral attack on any settlement.

c. **Honesty to Opposing Counsel.** While we work in an adversarial system, honesty is still always the best practice. Obviously, you should not divulge case strategy or privileged information, and it can be difficult to determine where to draw the line at times. But certainly, honest discovery responses are the responsibility of the client and the lawyer. Where supplementation of discovery responses is required under the applicable rules of civil procedure for some material change—do it! Do not sit on your hands and wait for a motion to compel that may never come. Do not "whistle past the graveyard" and hope the case settles before you have to correct a prior discovery response. Because you have an affirmative duty to supplement your responses, pointing the finger at the other side for failure to do their own job later may not help you.

2. Proper Settlement Documents.

As already discussed, most lawyers' inclination once settlement is reached in principle is to move on and let someone else handle the details or to gloss over important details in an effort to get the case over the finish line. Don't fall into that trap. Making sure that the settlement documents are iron clad may help in a later action challenging the very same settlement. Some suggestions include the following:

- **a.** Be involved in the drafting of the documents so that you have control over the initial language, instead of simply revising the language that someone else chose.
- **b.** Fly speck anything drafted by opposing counsel, even the most routine clauses, and correct any even *arguable* misstatements or misrepresentations.
- **c.** Include the broadest release possible. Although this may not help in an action for fraud, including fraud in the release may convince some courts that the parties meant what they said.
- **d.** Include a "no reliance" clause that is as broad as possible and specifies that the plaintiffs' attorneys have done their own investigation into the merits of the case and that they rely on no representations by you or your client in entering into the settlement.
- **e.** Include language that all material information needed to evaluate the fairness of the settlement has been obtained and considered with advice of counsel before agreeing to the settlement.
- **f.** In the case of a class action that requires fairness hearings, set forth in the settlement documents that the parties are not joint proponents of the settlement and that any statements by the plaintiffs' attorneys are not to be imputed to the defendant(s).

V. Conclusion.

We like to think that when a case settles it won't come back to haunt us, but the reality is that many cases do, particularly when large sums of money are involved. The lesson from our example case is that even a series of small missteps could later be used against you and your client in an action for fraud in the settlement, fraud on the court, or in a Rule 60(b) motion. Don't ignore the details at the expense of your client. Make it a routine to strive for perfection all the way through the process, and you—and more importantly your clients—will never be disappointed.