THOMSON REUTERS
PRACTICAL LAW™

SETTLEMENT (CIVIL LITIGATION) Q&A: US (NEW YORK)

by Carolyn M. Branthoover and Eric M. Matava, K&L Gates LLP

This document is published by Practical Law and can be found at: **uk.practicallaw.com/W-006-5994**
To learn more about legal solutions from Thomson Reuters, go to **legal-solutions.co.uk**

United States of America - specific information on all aspects of settling a dispute by negotiation, mediation and other alternative dispute resolution mechanisms, including the statutory obligations to attempt settlement, form and formalities of settlement, how to ensure confidentiality of the settlement terms, the without prejudice status of negotiations, the law on third party rights, enforcement of the settlement terms and how to set aside a settlement.

This Q&A provides country-specific commentary on *Practice note, Settlement: Cross-border* and forms part of *Cross-border dispute resolution.*

RESOURCE INFORMATION

RESOURCE ID

W-006-5994

RESOURCE TYPE

Country Q&A

STATUS

Law stated as at 31-Mar-2017

JURISDICTION

United States

STATUTORY OBLIGATIONS

1. Do courts in your jurisdiction encourage settlement between parties? If so, by what means? Are there any implications for the parties that refuse to participate in settlement negotiations?

Courts in New York and throughout the United States of America (US), both at the federal and the state court level, use several methods to encourage settlement between parties. The Federal Rules of Civil Procedure (FRCP), applicable in all federal courts across the US, establish a process for scheduling one or more pre-trial conferences that typically have as one of their specific purposes "facilitating settlement" (*Fed. R. Civ. P. 16(a)(5)*). Matters that may be considered at a pre-trial conference include "settling the case and using special procedures to assist in resolving the dispute when authorized by statute or local rule" (*Fed. R. Civ. P. 16(c)(I)*).

Federal courts across the US have adopted Local Rules that supplement the FRCP. These Local Rules also typically encourage and/or require parties to engage in settlement discussions. For example, the Local Rules of the United States District Courts for the Southern and Eastern Districts of New York, which is one such set of Local Rules, provides that "[a]ll counsel in civil cases shall seriously discuss the possibility of settlement a reasonable time prior to trial" (*Local Civil Rule 47.1*). These New York District Courts are also empowered to impose on the parties or their counsel the cost of one day's attendance by jurors at the trial of a case if the case is settled after the jury has been seated or during trial. In this way, the New York Federal Courts have imposed upon parties, through their counsel, a positive obligation to engage in settlement discussions.

Also, the Southern and Eastern US District Courts of New York, like the majority of federal courts, have established a mediation process (*Local Civil Rule 83.11*) for cases that the court considers suitable for mediation. If the court deems a case suitable for participation in a mediation programme, the parties must attend at least one mediation session (*Local Civil Rule 83.11(c)(1)*). Failure to participate in a court-ordered mediation, like a breach of any other court order, subjects a party to potential sanctions (*In re A.T. Reynolds & Sons, Inc., 452 B.R. 374, 381–85 (S.D.N.Y. 2011)*. No sanctions were appropriate, but it acknowledged the court's power to sanction parties who fail to participate in good-faith mediation).

The procedural rules governing suits filed in New York state courts similarly encourage, if not require, parties to engage in good faith settlement negotiations throughout the case. For example, the Uniform Rules for New York State Trial Courts (Uniform Rules for Trial Courts) provide that "[t]he matters to be considered at the preliminary conference shall include: ... settlement of the action" (*Uniform Rules for Trial Courts, rule 202.12(c)(5)*; see also the reference to "facilitating settlement" during the pre-trial conference in federal court cases (*Fed. R. Civ. P. 16(a)(5)*).

New York law also prohibits a non-settling defendant from seeking contribution against a defendant that has settled (*New York General Obligations Law § 15-108(b)*). This statute was specifically designed to encourage parties to settle and was a response to the decision of the New York Court of Appeals in *Dole v. Dow Chemical Co., 282 N.E.2d 288 (N.Y. 1972)*, which held that, when only one of two defendants is sued, the defendant can take legal action against the other defendant for an equitable apportionment of liability. The *Dole* decision was interpreted by later courts to mean that a non-settling defendant could cross-claim for contribution from a settling defendant, which had the effect of discouraging defendants from engaging in settlement discussions. New York General Obligations § 15-108(b) was enacted to restore faith in the settlement process.

FORM OF SETTLEMENT

2. What are the different ways in which parties to a dispute can record a settlement between them (for example, a settlement agreement, deed or court order)? Are settlements agreed verbally or through emails or letters exchanged between the parties required to be recorded in separate agreement or court order to be considered valid?

Under New York law, and in other US jurisdictions, settlement agreements are treated like any other contract. Accordingly to establish the existence of a settlement agreement, "a plaintiff must establish an offer, acceptance of the offer, consideration, mutual assent and an intent to be bound" (*Kowalchuk v. Stroup, 61 A.D.3d 118, 121 (N.Y. App. Div. 2009)*). However, there is some inconsistency in the courts' approaches to the enforcement of oral settlement agreements. There are many states where oral settlement agreements are enforceable so long as they do not violate breach the statute of frauds (see, for example, *Mastroni-Mucker v. Allstate Ins. Co., 976 A.2d 510, 518 (Pa. Super. Ct. 2009)* (applying Pennsylvania law)). New York and a number of other states, however, take the opposite view. New York law requires that, to be enforceable, a settlement agreement must be in writing.

This requirement is reflected in rule 2104 of the New York Civil Practice Law and Rules (NY CPLR), which provides that: "An agreement between parties or their attorneys relating to any matter in an action, other than one made between counsel in open court, is not binding upon a party unless it is in a writing subscribed by him or his attorney or reduced to the form of an order and entered. With respect to stipulations of settlement and notwithstanding the form of the stipulation of settlement, the terms of such stipulation shall be filed by the defendant with the county clerk." New York courts have referred to rule 2104 as "a statute of frauds" that governs the enforceability of a settlement agreement (*Sears, Roebuck and Co. v. Sears Realty Co., Inc. 932 F. Supp. 392, 401¬–03 (N.D.N.Y. 1996)*); and the requirement of "a writing" has been consistently applied (see *Apple Corp. Ltd. v. Sony Music Entm't, Inc., No. 91 Civ. 7465, 1993 WL 267362 (S.D.N.Y. July 14, 1993); In re Lady Madonna Indus. Inc., 76 B.R. 281 (S.D.N.Y. 1987); Klein v. Mount Sinai Hospital, 462 N.E.2d 1180 (N.Y. 1984); Greenidge v. City of New York, 179 A.D.2d 386 (N.Y. Sup. Ct.1992)*).

The second part of rule 2104 provides that stipulations of settlement filed with the court must include the terms of the parties' agreement. In practice, this requirement is not strictly observed. What usually happens in New York state courts is that the parties jointly file a stipulation of discontinuance, which brings the legal proceedings to an end. The stipulation of discontinuance may refer to the settlement agreement without including the terms of the settlement or a copy of the agreement.

Out of respect for the legitimate interest of parties to maintain the confidentiality of their settlement agreements, there has been almost no litigation regarding the stipulation requirements of rule 2104. Court clerks routinely accept non-complying stipulations of settlement so long as the required US$35 filing fee is paid (see *NY CPLR 8020* for further details on filing fees).

However, a court may in some circumstances refuse to enforce the settlement agreement if the parties have not complied fully with rule 2104 (see, for example, *Velazquez v. St. Barnabas Hosp., 13 N.Y.3d 894 (N.Y. 2009)* –).

Although New York law insists that settlement agreements must be in writing, the law is less strict regarding the degree of formality of the writing. Settlement agreements reflected in the exchange of letters or emails are enforceable provided that the letters or e-mails contain all the essential elements of a legally binding contract: an offer, an acceptance, an intention to create a legal relationship, and some form of consideration. Therefore, a further formal written agreement is not required for a settlement to be enforceable (see, for example, *Hostcentric Techs., Inc. v. Republic Thunderbolt, LLC, No. 04 CIV. 1621 (KMW), 2005 WL 1377853 (S.D.N.Y. June 9, 2005)* The court found that two e-mails between parties constituted a valid, binding settlement agreement; *Denburg v. Parker Chapin Flattau & Klimpl, 624 N.E.2d 995, 1000 (N.Y. 1993)* –).

FORMALITIES

3. What formal requirements exist for executing a valid settlement? Is it possible to use counterparts to complete the process of executing a settlement agreement?

There are usually no formal requirements regarding the contents of a written settlement agreement. However, the agreement must contain all the essential elements of a legally binding contract (see *Question 2*). Similarly, there are no formal requirements regarding the manner in which a settlement agreement is executed. The use of counterparts signature pages is common and acceptable.

TERMS OF SETTLEMENT SUBJECT TO COURT RATIFICATION

4. Do the terms of settlement require court approval? Does the settlement agreement need to be filed with the court? If so, are (i) the fact of settlement and (ii) the settlement terms, a matter of public record?

In most cases, the terms of a settlement agreement do not require court approval and the agreement does not need to be filed with the court. However, in certain classes of claims where the parties are acting, in whole

or in part, as representatives of others, court approval is required. Cases brought or defended in a representative capacity, and where court approval of a settlement agreement is required, include:

- Class actions.
- Shareholder derivative actions.
- Bankruptcy court claims.
- Cases involving minors or incompetents.
- Claims under the Fair Labor Standards Act.

Class actions

Rule 23 of the Federal Rules of Civil Procedure provides that "[t]he claims, issues, or defenses of a certified class may be settled, voluntarily dismissed, or compromised only with the court's approval." Rule 23 also sets out the specific procedures to be followed to secure the court's approval (*Fed. R. Civ. P. 23(e)). These procedures include (Fed. R. Civ. P. 23(e)(1)–(5)*):

- Reasonable notice to all class members.
- An opportunity for class members to object.
- A determination by the court that the proposed settlement is "fair, reasonable, and adequate."

The United States Congress enacted the Class Action Fairness Act of 2005, 28 U.S.C. §§ 1711–1715 (CAFA) in response to abuses of the class action procedure. Some of these abuses "harmed class members with legitimate claims" (*section 2, CAFA*). To protect class members and defendants, CAFA expanded the jurisdiction of federal courts to preside over class actions (section 4). The Act also provided further guidance on the circumstances under which a court may or may not approve the settlement of a class action, including additional notification requirements (*section 1715, CAFA*).

Therefore, class action settlements are regularly subjected to close examination by the federal courts and approval of a jointly proposed settlement is not automatically granted. For example, in one particularly high profile and complex antitrust case brought by millions of retailers against the Visa and MasterCard payment networks, the parties have spent several years trying to reach agreement without being able to secure the final approval of the court (*In re: Payment Card Interchange Fee and Merchant Discount Antitrust Litigation, No. 12-4671-cv(L) (2d Cir. June 30, 2016)*;).

New York state law is similar to federal law and requires that "[a] class action shall not be dismissed, discontinued, or compromised without the approval of the court. Notice of the proposed dismissal, discontinuance, or compromise shall be given to all members of the class in such manner as the court directs" (*NY CPLR 908)*.

New York courts impose a level of scrutiny similar to federal courts when reviewing a proposed settlement for approval. For example, in *Fiala, et al. v. Metropolitan Life Ins. Co., 899 N.Y.S.2d 531 (2010)* (*Fiala)*, the court approved a US$50 million settlement of the claims of a class of more than 10 million life insurance policyholders of MetLife. In doing so, the court undertook a careful assessment of the "fairness of the settlement, its adequacy, its reasonableness and the best interests of the class members" (*Fiala at 537*). More specifically, the court took into account *(Fiala at 538–39)*:

- The duration of the litigation.
- The experience and skill of counsel.
- The complexity of the legal issues.
- The relative strength of the parties' positions.
- The challenges associated with the proof of damages.

The court also assessed and found reasonable the portion of the settlement identified for the payment of counsels' fees (*Fiala at 540–41*).

Shareholder derivative actions

Shareholder derivative actions are brought by individual shareholders as fiduciaries on behalf of the corporation. Like class actions, shareholder derivative actions receive the close attention of the federal courts. The Federal Rules of Civil Procedure provide that "A derivative action may be settled, voluntarily dismissed, or compromised only with the court's approval. Notice of a proposed settlement, voluntary dismissal, or compromise must be given to shareholders or members in the manner that the court orders" (*Fed. R. Civ. P. 23.1(c)*). New York Business Corporation Law is similar and provides that a shareholder derivative action "shall not be discontinued, compromised or settled without the approval of the court having jurisdiction of the action" (*N.Y. Bus. Corp. L. § 626(d)*). The court's involvement in the approval of settlement agreements ensures that the interests of the corporation and its shareholders are protected.

The law of Delaware, and in particular the common law of the state, is particularly important in the context of shareholder derivative actions. This is because Delaware courts play a unique role in shareholder litigation. The majority of US corporations are incorporated in Delaware, which means that most shareholder disputes are litigated in Delaware courts. Delaware Chancery Court rule 23.1(c) is almost identical to the corresponding Federal rule and provides that a derivative action "shall not be dismissed or compromised without the approval of the Court, and notice by mail, publication or otherwise of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the Court directs" (*Del. Ch. Ct. R. 23.1(c)*).

The great majority of derivative actions are resolved by settlement, and such settlements are particularly favoured by the courts because derivative actions are "notoriously difficult and unpredictable" (*Maher v. Zapata Corp., 714 F.2d 436, 455 (5th Cir. 1983), citing Schimmel v. Goldman, 57 F.R.D. 481, 487 (S.D.N.Y. 1973)*). The standard of review used by a court when considering approval of the settlement of a derivative action is similar to that used by courts when approving class action settlements: "In reviewing the settlement of a derivative suit, the Court must assess, using its business judgment, whether the settlement terms are fair, reasonable, and adequate" (*Ryan ex rel. Maxim Integrated Prods. v. Gifford, No. 2213-CC, 2009 Del. Ch. LEXIS 1, at *16 (Del. Ch. Jan. 2, 2009)*). In making this assessment in *Stepak v. Ross, 11 Del. J. Corp. L. 1011 (Del. Ch. 1985)* (*Stepak*), the Delaware Court of Chancery took into account "the nature of the claim, possible defenses and the legal and factual obstacles facing plaintiffs in the event of trial" and concluded that the proposed settlement of the derivative shareholder claims in several consolidated actions was "fair to all concerned" (*Stepak at 1017–19*).

Bankruptcy court claims

Matters brought before federal bankruptcy courts are governed by the Federal Rules of Bankruptcy Procedure. Rule 9019(a) gives federal bankruptcy courts the authority to approve settlements. The rule provides that "[o]n motion by the trustee and after notice and a hearing, the court may approve a compromise or settlement" (*Fed. R. Bankr. P. 9019(a)*). Although a bankruptcy court is required to hold a hearing, it is not required to conduct an independent investigation or a mini trial on the merits (*In re Drexel Burnham Lambert Group, Inc., 134 B.R. 493, 496 (S.D.N.Y. 1991)* (*Drexel*)). Instead, the court must "make an informed, independent judgment as to whether a settlement is 'fair and equitable' and 'in the best interests of the estate'" (*Drexel at 496*, quoting *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414 (1968), reh. denied, Protective Committee for Independent Stockholders etc. v. Anderson, 391 U.S. 909 (1968), on remand, TMT Trailer Ferry, Inc. v. Kirkland, 471 F.2d 10 (5th Cir. 1972)*).

Factors that bankruptcy courts take into consideration when determining the reasonableness of a proposed settlement include (*Drexel at 497*):

- The probability of success compared to the present and future benefits of the proposed settlement.
- The probability of complex and lengthy litigation if the proposed settlement is not approved.
- The extent to which represented parties object to or support the proposed settlement.
- The competency and experience of counsel supporting settlement.
- The relative benefits to be received by all members and groups within the class.
- The nature and scale of releases obtained by directors and officers.
- The extent to which the proposed settlement resulted from arm's length negotiations.

The bankruptcy courts are not required to resolve all of the legal and factual issues presented by the dispute but should "canvas the issues and see whether the settlement 'fall[s] below the lowest point in the range of reasonableness'" (*In re W.T. Grant Co., 699 F.2d 599, 608 (2d Cir. 1983)*, quoting *Newman v. Stein, 464 F.2d 689, 693 (2d Cir. 1972)*).

Cases involving minors or incompetents

Another class of plaintiffs who are protected by rules requiring court approval of settlements are minors and individuals who lack legal ability to stand trial, who are considered wards of the state (*Valdimer v. Mount Vernon Hebrew Camps, Inc., 172 N.E.2d 283, 284–85 (N.Y. 1961)* (*Valdimer*)), and whose interests in disputed matters are usually represented by parents or court-appointed guardians or conservators. This requirement is codified in the New York Civil Practice Law and Rules, which provide: "Upon motion of a guardian of the property or guardian ad litem of an infant of, if there is no such guardian, then of a parent having legal custody of an infant, or if there is no such parent, by another person having legal custody ... or of the conservator of the property of a conservatee, the court may order settlement of any action commenced by or on behalf of the infant, incompetent or conservatee" (*NY CPLR 1207*). The court must assess the fairness and reasonableness of the settlement when considering the best interests of the minor or incompetent (*Valdimer at 284*).

Claims under the Federal Fair Labor Standards Act

Rule 41 of the Federal Rules of Civil Procedure provides for the voluntary dismissal of an action without court order or approval. However, voluntary dismissal under rule 41 is only available to the parties so long as another federal rule or "any applicable federal statute" does not provide otherwise (*Fed. R. Civ. P. 41(a)(1)(A)*). An example of a federal law claim requiring court approval of a dismissal with prejudice is a claim brought under the Fair Labor Standards Act (FLSA).

In *Cheeks v. Freeport Pancake House, Inc.*, 796 F.3d 199 (2d Cir. 2015) (*Cheeks*), the United States Court of Appeals for the Second Circuit concluded that "in light of the unique policy considerations underlying the FLSA", the FLSA is an "applicable federal statute" under rule 41 such that settlements involving stipulated dismissal of FLSA claims *with prejudice* must be approved by the district court or the US Department of Labor (*Cheeks at 206*). Characteristics of FLSA claim settlements unlikely to secure court approval include (*Cheeks at 206*):

- Highly restrictive confidentiality provisions.
- Excessively broad releases.
- Provisions setting attorneys' fee awards at inordinate amounts not supported by adequate documentation.

CONFIDENTIALITY

5. Are settlements in your jurisdiction automatically confidential? If not, what steps can parties take to seek to keep the settlement confidential?

In New York, settlement agreements are not automatically treated as confidential. If parties wish to keep their settlement confidential, they usually include a confidentiality provision in the agreement. Also, the parties must file a motion with the court to allow the filing of their stipulation of settlement and dismissal under seal. However, placing a settlement agreement under seal is an awkward process. Another option, not tested in the courts, is to describe the settlement terms in the stipulation generally and not specifically.

POWERS OF THE PARTIES TO COMPROMISE

6. Are there any restrictions on parties' power to compromise their disputes? Are there rules on who may sign a settlement, especially on behalf of a company?

There are restrictions on parties' power to compromise their disputes if the dispute requires court approval (see *Question 4*). The types of disputes requiring court approval include class action settlements and shareholder derivative actions (see *Question 4*). The court will review the fairness of the proposed settlement in accordance with applicable law and either approve or reject the proposed settlement.

The individual who signs a settlement agreement must have the authority to bind the settling party in order for the settlement agreement to be enforceable against that party (see *Question 16*). This rule also applies to attorneys: "[W]ithout a grant of authority from the client, an attorney cannot compromise or settle a claim" (*Hallock v. State of New York, 474 N.E.2d 1178, 1178 (N.Y. 1984)* (*Hallock*)). Settlement authority, however, may be either express or implied (see *Hallock at 1178* where a settlement agreement agreed to by counsel was found binding on plaintiff because plaintiff's counsel had apparent authority to bind him).

TIMING OF SETTLEMENT

7. Can settlement discussions be conducted at any time during litigation proceedings? Are there any advantages, in terms of costs or otherwise, to entering into settlement negotiations sooner rather than later during litigation proceedings?

In New York, as well as generally within the US, there are no court-imposed limitations on the timing of settlement discussions. Civil procedure rules applicable in federal and state courts encourage settlement discussions from the earliest days and throughout the duration of an ongoing action. In New York, the Local Rules require parties to discuss settlement before the trial begins (*Local Civil Rule 47.1*; see *Question 1*). The Local Rules also provide for costs to be imposed on parties if the case is settled after the jury has been seated or during trial (*Local Civil Rule 47.1*; see *Question 1*).

WITHOUT PREJUDICE RULE

8. Does the 'without prejudice' rule apply to settlement negotiations in your jurisdiction? Are there any exceptions to the applicability of the rule? Can it be waived with the consent of the parties?

The "without prejudice" rule applies in New York in the form of NY CPLR 4547. Evidence that a party either offered, promised to offer, accepted, or promised to accept any valuable consideration to satisfy a claim which is disputed as to either validity or amount of damages, is inadmissible as proof of liability for or invalidity of the claim or the amount of damages (*82 Retail LLC v. Eighty Two Condo., 117 A.D.3d 587, 589 (N.Y. App. Div. 2014)*). New York Rule 4547 provides for two exceptions that mirror those provided in Federal Rule of Civil Procedure 408:

- Evidence that is otherwise discoverable.
- Evidence that is offered:
  - to prove the bias or prejudice of a witness;
  - to reject a contention of undue delay; or
  - as proof of an effort to obstruct a criminal investigation or prosecution (*Arben Corp. v. New York State Thruway Auth., 859 N.Y.S.2d 892 (N.Y. Ct. Cl. 2008)*).

Additionally, evidence of any conduct or statement made during settlement negotiations is also inadmissible. The New York legislature added this provision in 1998 to conform to Federal Rule of Civil Procedure 408, and this addition represented a major shift in New York law.

Before, it had been the rule in New York that unqualified statements of fact made during settlement negotiations were admissible against the party who made the statements (*Miller v. Sanchez, 789 N.Y.S.2d 850 (N.Y. Civ. Ct. 2004)*). So, to avoid the admissibility of their comments, negotiators had to enter into stipulations or preface their discussions with technical or protective phrases such as "This is without prejudice," or "Let's assume, hypothetically." The traditional rule prevented open, informal communication and often created a trap for individuals who did not understand the complex legal principles and language. The expansion of the exclusionary rule to include statements of fact made in the course of negotiations was adopted in line with public policy aimed at encouraging settlements (Vincent C Alexander, *Practice Commentaries on the New York Civil Practice Law and Rules, in McKinney's Consolidated Laws of New York* (Thomson/West) (*McKinney's CPLR*); *McKinney's CPLR 4547*).

TERMS OF SETTLEMENT

9. Are there any limitations on the scope of release clauses that parties may agree with respect to existing and future claims? Please cite any relevant statutory provisions and case law.

In general, no particular form of words is required to make a written release of claims effective. All that is necessary is that the words show an intention to discharge. The scope and meaning of a release will be determined by the clearly expressed intention of the parties using principles of general contract interpretation (*Gordon v. Vincent Youmans, Inc., 358 F.2d 261, 263 (2d Cir. 1965)*).

Releases are often referred to as either general or specific in nature. A general release covers any and all claims that are in existence between the parties and that they have in mind when the release is executed (*Peterson v. Regina, 935 F. Supp. 2d 628, 636 (S.D.N.Y. 2013)* (*Peterson*)). By contrast, a specific release is one that is restricted by its terms to claims or actions arising from specified events, transactions or injuries (*Peterson*; see also *19A N.Y.Jur.2d Compromise, Accord*, and *Release § 105*).

Neither form of release is more enforceable than the other. However, the restricted nature of specific releases means that they are likely to generate fewer disputes regarding their scope, which may make them easier to enforce.

The law is not uniform across the US regarding the enforceability of releases of future claims. California statutory law provides that: "A general release does not extend to claims which the creditor does not know or suspect to exist in his or her favor at the time of executing the release, which if known by him or her must have materially affected his or her settlement with the debtor" (*Cal. Civ. Code § 1542;*). Specific releases, however, are not covered by section 152 of the California Civil Code and may therefore serve to discharge claims that the creditor does not know or suspect to exist at the time of executing the release (*Larsen v. Johannes, 7 Cal. App. 3d 491 (Cal. Dist. Ct. App. 1979)*).

Unlike California, New York does not have a statute prohibiting releases of future unknown claims as part of a general release. On the contrary, New York courts have held that a release may include unknown claims if the parties so intend and the agreement is fairly and knowingly entered into (*Centro Empresarial Cempresa S.A. v. Am. Movil, S.A.B. de C.V., 952 N.E.2d 995, 1000 (N.Y. 2011)*, which enforced the terms of a specific release that extended to unknown future claims). On the other hand, if a release does not extend to future claims, the release would be effective only to bar or discharge any claims in existence up to the date of the execution of the release (*Id.*; see also *19A N.Y. Jur. 2d Compromise, Accord, and Release § 108*).

TAXES ON SETTLEMENTS

10. Are taxes (such as income tax, capital gains tax or corporation tax) payable in relation to settlements involving payment of money?

Whether taxes are potentially payable on a settlement payment depends on the circumstances and requires specialist advice.

SEVERABILITY

11. Are severability clauses commonly incorporated within settlement agreements to avoid the entire agreement being held void or unenforceable due to the illegality, invalidity or unenforceability of a part of the agreement?

Yes, severability clauses are commonly incorporated into settlement agreements.

THIRD PARTY RIGHTS

12. Can third parties enforce their rights under the terms of the settlement? If so, can parties exclude the application of third party rights in the agreement?

The ability of third parties to bring a claim as a third-party beneficiary under a contract that was made for his or her benefit is well-established in New York (*Port Chester Elec. Const. Co. v. Atlas, 357 N.E.2d 983, 985 (N.Y. 1976)*). If a person wishes to bring a third-party beneficiary claim, he or she must establish that (*Mandarin Trading Ltd. v. Wildenstein, 944 N.E.2d 1104, 1110 (N.Y. 2011)*, citing *Mendel v. Henry Phipps Plaza W., Inc., 844 N.E.2d 748, 748 (N.Y. 2006)*):

- A valid and binding contract exists between other parties.
- The contract is for his or her benefit.
- The contracting parties have a duty to compensate him or her if the benefit is lost.

It is very common for parties to include a clause in a settlement agreement that positively denies any third party rights in the agreement. These types of provisions are almost always given effect, even when the contract is intended to benefit a third party. For example, the US District Court for the Southern District of New York recently noted that "courts applying New York law have consistently found that, even where a contract expressly sets forth obligations to specific individuals or categories of individuals, those individuals do not have standing to enforce those obligations by suing as third-party beneficiaries when the contract contains a negating clause" (*In re Lehman Bros. Holdings Inc., No. 11-CIV-2792 JGK, 2012 WL 3047175, at *6 (S.D.N.Y. July 26, 2012);* see also *28 N.Y. Prac., Contract Law § 8:9.10*).

The parties to the settlement agreement should make sure that the clauses denying third party rights are precisely worded. Vague or uncertain language should be avoided (*Greenfield v. Phillies Record, Inc., 98 N.Y.2d 562, 569 (N.Y. 2002)*). For example, any intended and exclusive beneficiaries should be clearly identified. The exclusion of any other intended beneficiaries should be clearly stated (*India.Com, Inc. v. Dalal, 412 F.3d 315 (2d Cir. 2005)*).

Also, parties should be careful when using the word "herein" or the phrase "except as otherwise provided herein" when referring to third parties in negating clauses. The parties should clearly identify whether the word or phrase refers to the clause only or to the agreement as a whole (see *Bayerische Landesbank v. Aladdin Capital Mgmt. LLC, 692 F.3d 42 (2d Cir. 2012)* (*Bayerische*); *Morse/Diesel, Inc. v. Trinity Indus., Inc., 859 F.2d 242 (2d Cir. 1988)* (*Morse/Diesel*)). If the court finds the word or phrase to be uncertain or vague, it may look to the document as a whole for guidance on how to interpret the clause, and this may interfere with the parties' intentions (*Bayerische*; *Morse/Diesel*).

DISPOSAL OF LEGAL PROCEEDINGS

13. What are the formalities to dispose of court or litigation proceedings once the dispute has been settled?

The Federal Rules of Civil Procedure allow a plaintiff to voluntarily dismiss an action without court approval or order. Assuming that the defendant has already filed an answer and no summary judgment motion is pending, the plaintiff may secure the voluntary dismissal of any action (for example, following a settlement) simply by filing a stipulation for dismissal signed by all the parties (*Fed. R. Civ. P. 41(1)(A)*).

The corresponding rule in New York state courts provides for voluntary discontinuance by filing a stipulation of dismissal signed by counsel for all of the parties (*McKinney's CPLR 3217*). The New York Civil Practice Law and Rules also provide for the prompt payment of agreed settlement amounts. The defendant must pay the settlement amount within 21 days of an executed release and stipulation of discontinuance by the plaintiff (*NY CPLR 5003-a(a)*).

BREACH OF SETTLEMENT TERMS

14. What are the remedies available for breach of the settlement terms? Is it possible to revive the original claim, or is it necessary to bring a fresh claim for breach of the settlement agreement?

For the purposes of determining an appropriate remedy, courts will treat a breach of settlement agreement claim much like a simple breach of contract claim. So, courts may award compensatory, liquidated, and punitive damages when appropriate (*SMD Capital Grp. LLC v. Reichenbaum, 867 N.Y.S.2d 21 (N.Y. Sup. Ct. 2008)*). The most common remedy sought for breach of a settlement agreement, however, is the equitable remedy of specific performance. Given the courts' strong preference for the resolution of disputes by settlements, a party usually will not be required to show that remedies at law are inadequate in order to obtain specific performance of a settlement agreement (*Specific Performance of Settlement Agreements, 2 N.Y. Prac., Com. Litig. in New York State Courts § 10:11 (2015)*).

In limited circumstances, courts may consider rescission of the settlement agreement an appropriate remedy. Rescission, however, is "'an extraordinary remedy' rooted in equity" *(Krumme v. WestPoint Stevens Inc., 238 F.3d 133, 143 (2d Cir. 2000),* internal citations omitted) In *Krumme*, the court refused to rescind the settlement agreement where one of the parties acted in good faith. Therefore, rescission is generally limited to cases where a party's breach is "material and willful, or, if not willful, so substantial and fundamental as to strongly tend to defeat the object of the parties in making the contract" (*Krumme*).

Whether or not rescission of a settlement agreement is appropriate will also depend on whether the agreement is classified as an "executory accord" or a "substitute agreement".

An executor accord extinguishes a claimant's prior claims upon performance of the accord. A substitute agreement extinguishes a claimant's prior claims upon execution of the agreement. In *C3 Media & Mktg. Grp., LLC v. Firstgate Internet, Inc., 419 F. Supp. 2d 419, 434 (S.D.N.Y. 2005)* (*C3 Media*) the court found a substitute agreement where a separation agreement contained language indicating that it was intended to replace the previous agreement. When a material breach of a substitute agreement occurs, the non-breaching party may sue on the underlying obligations only if the court orders rescission (*C3 Media*). By contrast, when a party

materially breaches an executor agreement, the non-breaching party may sue on the pre-existing obligations without first obtaining rescission of the agreement (*C3 Media*). .The United States Supreme Court has conclusively ruled that a motion to enforce a settlement agreement is essentially a claim for breach of a contract, part of the consideration for which was dismissal of an earlier federal suit, and therefore requires an independent basis for the court to re-exert jurisdiction (*Kokkonen v. Guardian Life Ins. Co. of Am., 511 U.S. 375, 378 (1994)* (*Kokkonen*)). In some cases, the basis for jurisdiction may be found in the doctrine of ancillary jurisdiction. This doctrine allows a district court to decide matters that are "factually interdependent" with another matter before the court; or to take actions necessary "to manage its proceedings, vindicate its authority, and effectuate its decrees" (*Kokkonen at 378–79*). However, to ensure that the federal court retains ancillary jurisdiction over enforcement of a settlement agreement, it is best practice to provide that a district court's order of dismissal either:

- Expressly retains jurisdiction over the settlement agreement.
- Incorporates the terms of the settlement agreement in the order itself (*Hendrickson v. United States, 791 F.3d 354, 358 (2d Cir. 2015)* – holding that unexpressed intent or merely acknowledging the existence of a settlement agreement would not be sufficient to retain jurisdiction; *StreetEasy, Inc. v. Chertok, 752 F.3d 298, 305 (2d Cir. 2014)* – holding that after-the-fact statements and actions of the parties, and even of the court, are not enough to retain jurisdiction).

ENFORCEMENT PROCEEDINGS

15. What are the procedures to enforce a settlement contained in a:

- **Settlement deed/agreement?**
- **Court order?**

The method for enforcing a stipulation of settlement will depend on the terms of the settlement and the procedural status of the relevant litigation (*Oppenheim v. Ultimate Servs. for You, Inc., 958 N.Y.S.2d 647, 647 n.1 (N.Y. Sup. Ct. 2011) (Oppenheim)*). Whether the agreement is recorded in a court order or a separate agreement, the party seeking enforcement must file a motion to enforce the settlement agreement *(Oppenheim*). In most cases, the motion may be brought in the same action that was settled, as long as the parties have not ended the lawsuit. If the original action was brought in federal court, the motion may be filed in federal court if the court retained jurisdiction over the settlement agreement (see *Question 14)*. If the federal court did not retain jurisdiction, and starting a new federal action is not a realistic option, then the only option available to the party seeking enforcement would be to commence an action in state court to enforce the settlement agreement.

SETTING ASIDE A SETTLEMENT

16. On what grounds can a settlement be varied or set aside? Please outline the procedure to be followed.

If a party wishes to set aside a settlement agreement, he or she must file a motion to set aside the settlement, setting out the reasons for the relief sought. Similar to a standard contract, settlement agreements will typically only be set aside where there is sufficient evidence of fraud, collusion, mistake, accident or duress. Courts are reluctant to set aside settlement agreements lacking one of these circumstances (see, for example, *Saviano v. Estate of Saviano, 836 N.Y.S.2d 489 (N.Y. Sur. Ct. 2006),* which expressed reluctance to vacate settlement agreement based on insufficient consideration). However, certain procedural defects, such as failing to notify or obtain the consent of necessary parties, may also invalidate an otherwise valid settlement agreement In *In re Estate of Drake, 278 A.D.2d 929, 930 (N.Y. App. Div. 2000)* the court held that the settlement agreement was properly vacated where the parties failed to obtain necessary releases from the other heirs.

A settlement agreement may also be set aside on the ground that the attorney who agreed to the settlement lacked the authority to stipulate on behalf of the client (*Hallock v. State of New York, 474 N.E.2d 1178, 1178 (N.Y. 1984)* (*Hallock*)). In *Hallock*, the plaintiffs sought to vacate a settlement agreement more than two months after it had been agreed to in court with one of two plaintiffs present (*Hallock at 1180*). The court denied the motion to vacate, citing the fact that the attorney had represented both plaintiffs throughout the case and participated in prior settlement negotiations (*Hallock at 1182*). The court also reasoned that the parties' conduct gave their counsel implied authority to enter into a binding settlement (*Hallock at 1181*). By contrast, a court will probably grant a motion to vacate provided that (see *Koss Co-Graphics, Inc. v. Cohen, 166 A.D.2d 649, 650 (N.Y. Sup. Ct. 1990)*):

- No previous settlement negotiations have taken place.
- The defendant has strongly defended the proceeding on the merits from the beginning.
- The defendant immediately files a motion to vacate upon learning of the agreement.

LEGAL COSTS

17. Would you expect to see a clause dealing with legal costs in the settlement agreement? Are parties free to agree on arrangements regarding payment of legal costs? What is the position if the parties do not include a separate clause dealing with legal costs?

Settlements that do not require court approval generally have a clause dealing with legal costs.

The clause will say something to the effect that each party will be responsible for paying its own legal costs. This is consistent with the 'American rule' regarding the recovery of legal costs. For settlements requiring court approval, such as class actions and shareholder derivative actions, the payment of the legal fees of plaintiffs' counsel usually forms part of the settlement eventually approved by the court. This was the case, for example, in *Fiala, et al. v. Metropolitan Life Ins. Co., 899 N.Y.S.2d 531 (N.Y. Sup. Ct. 2010)* (*Fiala*), where up to US$15 million of a US$50 million settlement agreement was set aside by the parties and approved by the court for the payment of counsel fees and reimbursements (*Fiala at 611*).

If parties to a written settlement agreement do not incorporate terms related to the payment of legal costs, it is presumed that they reached no agreement and are bearing their own costs. Under both New York law and federal law, a successful party cannot recover its attorneys' fees from the losing party unless such recovery is authorised by statute, agreement or court rule (*U.S. Underwriters Ins. Co. v. City Club Hotel, LLC, 822 N.E.2d 777, 777 (N.Y. 2004); Gotham Partners, L.P. v. High River Ltd. P'ship, 76 A.D.3d 203, 204 (N.Y. Sup. Ct. 2010)*).

SETTLEMENT AGREEMENTS

18. Are there any other clauses that would be usual to see in a settlement agreement and/or that are standard practice in your jurisdiction which do not appear in the *Standard document, Settlement agreement (civil litigation): Cross-border?*

The clauses included in the *Standard document, Settlement agreement (civil litigation): Cross-border* are commonly found in settlement agreements used in New York and throughout the US. Additional clauses that are commonly found in settlement agreements executed in the US include the following:

- "Equitable Relief" clauses. These clauses provide for court-ordered relief where no adequate remedy at law is available to the injured party.
- "Accord and Satisfaction" clauses. These clauses establish that the settlement agreement is a substitute agreement as opposed to an executory agreement (see *Question 14*).
- "Jointly Drafted" clauses. These clauses deal with the consequences of ambiguous contract provisions. The common law rule of contract construction interprets ambiguous provisions against the party that drafted them. However, if the parties were to introduce a clause affirming that neither party was the main drafter of the settlement agreement (the jointly drafted clause) the common law rule would not apply.
- "Representation by Counsel" clauses. These clauses declare that:
  - each party has sought legal advice regarding the signing of the agreement and the meaning of its provisions;
  - each party is signing the agreement voluntarily and with the intention to be legally bound; and
  - each party has undertaken an independent investigation and assessment and is not relying on the advice, representations or information provided by any other party.

This clause reduces the possibility of either party later complaining that he or she was induced to enter the agreement on the basis of fraud, coercion or duress.

CONTRIBUTOR DETAILS

Carolyn M. Branthoover, Practice area leader - litigation and dispute resolution

K&L Gates LLP

T +1.412.355.8902

E *carolyn.branthoover@klgates.com*

Eric M. Matava

K&L Gates

T +1.412.355.7445

E *eric.matava@klgates.com*

W *www.klgates.com*

Area of practice: Litigation and dispute resolution.