

## OAJ Business Torts Section Article January 2015

### Fraud in Settlements: A Singular and Difficult Road to Recovery in Ohio

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In general, a party who has been induced to enter a contract through fraud has a choice of remedies, to either (A) affirm the contract and demand monetary damages, or (B) rescind the contract and restore the parties to their *status quo ante*.<sup>i</sup> In light of the alternative pleading standards of Civ.R. 8(A), the defrauded party could demand one or both remedies and then elect his preferred remedy at the appropriate time. Should the plaintiff seek to rescind the contract, then the party was first required to “return or tender” the money or other consideration he had received from it.<sup>ii</sup>

Since 2010, however, Ohio has quietly but significantly changed these rules in the context of settlement agreements.

#### **A. In Ohio, a party fraudulently induced into settlement has only one remedy - - rescinding the settlement agreement.**

In *Berry v. Javitch, Block & Rathbone, L.L.P.*, the Ohio Supreme Court held that parties fraudulently induced into a settlement agreement do not have an election of remedies.<sup>iii</sup> Rather, the Court held that in order to proceed on claim for fraudulent inducement in a settlement agreement, the party has only one option: the party must rescind the release and seek relief under Civ.R. 60(B)(3).<sup>iv</sup>

The facts of *Berry* are worth noting. The plaintiffs alleged that a law firm had fraudulently induced them to settle a legal malpractice claim for less than its fair compromise value, based on a representation that the firm lacked insurance coverage when in fact coverage existed.<sup>v</sup> Because the plaintiffs did not discover the misrepresentation for three years after the legal malpractice claim was released, the plaintiffs were effectively prevented from seeking relief from judgment by the one-year time limitation period of Civ.R. 60(B).<sup>vi</sup> Unsurprisingly, the plaintiffs elected to recover their damages for fraud.

In a 5 to 2 decision, the Ohio Supreme Court held the plaintiff could not make that election. Instead, the majority broadly held, “an action for fraud in the inducement of a settlement of a tort claim is prohibited unless the plaintiff tenders back the consideration received and rescinds the release.”<sup>vii</sup> In addition, the majority implied that “tender back” was synonymous with “return,” such that a plaintiff “cannot retain the benefit of a settlement agreement and at the same time attack the validity of that agreement.”<sup>viii</sup>

Although the majority in *Berry* repeatedly emphasized that its conclusion was supported by “long-standing precedent,”<sup>ix</sup> the dissent accurately noted that prior Ohio precedents had never determined that rescission was the sole remedy for fraud in settlements.<sup>x</sup> Indeed, it had been accepted by the lower court of appeals and most jurisdictions outside Ohio that a party fraudulently induced to enter a settlement could elect to pursue *either* rescission *or* fraud damages.<sup>xi</sup> The dissent cautioned: “If the only remedy for a fraudulent settlement is paying or receiving back the funds and starting over, there is actually an incentive, and no downside, for an unscrupulous party to engage in fraud and concealment.”<sup>xii</sup>

#### **B. To rescind the agreement, the party must affirmatively demonstrate that the consideration has been made available for return.**

Beyond eliminating the election of remedies in the context of settlement agreements, the scope and lasting effect of *Berry* remains unclear. And due to *Berry*'s confusing recitation of the "tender back" rule, a party who seeks rescission now needs to do more than simply pray for rescission in the initial pleadings.

For example, on August 29, 2014, the Seventh District noted in *Yoskey v. Eric Petroleum Corp.* that *Berry* was "not limited to settlement of tort claims," and that settlement agreements should not be treated any differently than other contracts.<sup>xiii</sup> Yet the question in *Yoskey* was a narrow one: whether or not a plaintiff who sought to rescind a lease agreement was required by the "tender back" rule to physically return the consideration received. The Seventh District determined that "return or tender" were still alternatives, not synonyms, and held that "[t]ender, in this context, refers to an offer, not a completed transaction."<sup>xiv</sup> The Seventh District found that the plaintiff satisfied the "tender back" precondition as to his lease agreement by (1) specifically demanding in his complaint an order to return to the status quo ante, and (2) filing an affidavit that he was "ready, willing, and able to return" his contractual benefits.<sup>xv</sup>

In contrast, the First District apparently requires the consideration to be physically returned. In the unreported decision of *Brautigam v. Hackett*, the First District cited to *Berry* to hold that "because Brautigam has not returned the \$5,000 that he received as consideration," his claim for coercion to enter a settlement agreement was properly dismissed.<sup>xvi</sup>

**C. The party fraudulently induced into settlement has no right to a jury trial and must prove the fraud by clear and convincing evidence.**

*Berry* has other implications of which attorneys should be aware. First, a party who is fraudulently induced into settling a lawsuit must bring the claim within one year of settlement, regardless of when the fraud was actually discovered.<sup>xvii</sup> Second, the party duped into settling no longer has the right to let a jury decide whether fraud occurred, because the only remedy available - - rescission - - is an equitable remedy for which no jury trial is required.<sup>xviii</sup> Third, the burden of proving the fraud is higher, because while an entitlement to fraud damages can be proven by a preponderance, the right to rescind a contract must be proven by clear and convincing evidence.<sup>xix</sup>

In sum, parties and practitioners should be cautious before entering a settlement or release agreement in Ohio. If there is any doubt of the material facts or of the veracity of the other party, consider adding a choice of law provision to have to agreement governed by another State that still recognizes a choice of remedies. For if Ohio law applies, then the party fraudulently induced into releasing his or her claim is likely to have to live with the injustice.<sup>xx</sup>

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<sup>i</sup> *Frederickson v. Nye*, 110 Ohio St.459, 467-468, 114 N.E.299 (1924).

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- ii *See Cross v. Ledford*, 161 Ohio St.469, 475, 120 N.E.2d 118 (1954); *Picklesimer v. Baltimor & O.R.Co.*, 151 Ohio St.1, 84, N.E.2d 214 (1949).
- iii 127 Ohio St.3d 480, 940 N.E.2d 1265, 2010-Ohio-5772.
- iv *Id.* at ¶1.
- v *Id.* at ¶11.
- vi *Id.* at 12.
- vii *Id.*
- viii *Id.* at ¶30 (emphasis added). Notably, the case on which *Berry* relied to make this declaration held that “a releaser may not attack the validity of a release for fraud in the inducement unless he first tenders back the consideration he received for making the release.” *Haller v. Borrer*, 50 Ohio St.3d 10, 552 N.E.2d 207 at ¶2 (emphasis added).
- ix *Id.* at ¶¶21, 30, 31.
- x *Id.* at ¶¶45-50.
- xi *Id.* at ¶¶ 53-66; *see also Mettke v. Hewelett Packard Co.*, S.D. Ohio No. 2:11-CV-00410, 2012 WL 1158629 at \*7 (Apr. 6, 2012).
- xii *Id.* at ¶68.
- xiii 7th Dist. Columbiana No. 13 CO 42, 2014-Ohio-3790, ¶¶18, 21.
- xiv *Id.* at ¶29.
- xv *Id.* at ¶30.
- xvi 1st Dist. Hamilton No. C-110412, unreported (Feb. 15, 2012) at p.3 (emphasis added).
- xvii *See Berry*, 2010-Ohio-5772, ¶69 (Froelich, J., dissenting) (citing Civ.R. 60(B)).
- xviii *See Wannemacher v. Cavalier*, 3rd Dist. Hardin No. 6-03-12, 2004-Ohio-4020, ¶59 (citing *Cross*, 161 Ohio St. at 475).
- xix *See Berry*, 2010-Ohio-5772, ¶¶60-61 (Froelich, J., dissenting); *see also Household Finance Corp v. Altenberg*, 5 Ohio St.2d 190, 129-193, 214 N.E.2d 667 (1966).
- xx *See Mettke*, 2012 WL 1158629 at \*7 (finding that, in light of *Berry*, the likelihood of injustice resulting from the application of Ohio law to a settlement agreement based on fraud is greater than if other state law is applied).