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## CIVIL PROCEDURE

### New Incentive for Reasonableness in Settlement Negotiations

BY DANIEL C. RITSON

In a decision sure to play an immediate role in litigation strategy, the U.S. Court of Appeals for the Third Circuit recently held in *Lohman v. Duryea Borough*, 574 F.3d 163 (3<sup>rd</sup> Cir. 2009), that a court may consider evidence of settlement negotiations between the parties in making a determination on an application for counsel fees. In doing so, the court effectively has taken the “rose-colored glasses” from attorneys and litigants in the Third Circuit. Reasonableness is the new order of the day.

In *Lohman*, Nicholas Lohman obtained a jury verdict in his favor in an action premised on an alleged wrongful discharge. The jury found defendants liable to Lohman in the amount of \$12,500 dollars in lost wages and nominal damages, and Lohman moved for attorney’s fees and costs in the amount of \$112,883.73. The district court awarded him only \$30,000 in attorney’s fees and \$4,251.77 in costs. Lohman, who had rejected a settlement offer of \$75,000 dollars during trial, appealed from the fee award, contending that the district

*Ritson is an associate and practices in the areas of labor and employment law with Herten, Burstein, Sheridan, Cevasco, Bottinelli, Litt & Harz in Hackensack.*

court erred in considering the settlement negotiations between the parties in fashioning the award. The district court had ruled that the consideration of settlement negotiations did not violate Rule 408 of the Federal Rules of Evidence. In a case of first impression, the Third Circuit wholeheartedly agreed.

Lohman premised his argument before the district court on *Alphonso v. Pitney Bowes*, 356 F.Supp.2d. 442 (D.N.J. 2005), in which the plaintiff failed to prove his claims of employment retaliation at trial. The defendants in that matter moved post-trial for sanctions, on the theory that the plaintiff’s claims were frivolous. The court found that the consideration of the plaintiff’s counterargument, that his claims could not have been frivolous because the defendants made a settlement offer on the eve of trial would have violated Rule 408. However, the district court in *Lohman* found an out-of-circuit case, *EMI Catalogue Partnership v. CBS/Fox Co.*, 1996 WL 280813 (S.D.N.Y. 1996), to be far more relevant and persuasive than *Alphonso*.

The court in *EMI Catalogue Partnership* drew a critical distinction that was relied upon by the district court in *Lohman*. Specifically, the district court noted that the “validity” of a claim is separate and distinct from its “objective reasonableness.” Rule 408 prohibits

consideration of settlement negotiations with regard to the former, but not the latter. As such, the court held that evidence of settlement negotiations is not precluded where that evidence is probative of a claim’s objective reasonableness for purposes of ruling on a fee application.

The district court in *Lohman* began its analysis by citing the proposition that the most critical factor in determining a reasonable fee is the degree of success obtained. Then, following the logic of *EMI Catalogue Partnership*, the district court noted that, like a determination of objective reasonableness, a consideration of the degree of success obtained by a plaintiff’s counsel is separate and distinct from the validity of a claim. Therefore, the district court held that evidence of settlement negotiations may be considered in determining the degree of success obtained by a plaintiff’s counsel and, as such, may further be considered in the context of an application for attorney’s fees.

The Third Circuit gave a plenary review to the district court’s ruling, noting that the question was one of law, centering on the standards to be applied in ruling on fee applications. The court then stated its agreement with the district court that a court’s consideration of evidence of settlement negotiations in determining a reasonable fee does not offend Rule 408’s “clear terms.” The court rejected Lohman’s citation to *Alphonso* as being inapplicable, due to the fact that, in that case, evidence of settlement negotiations was proffered specifically to support the argument that the plaintiff’s claims had validity. To

the contrary, the Third Circuit explained that such evidence may be relevant to a comparison between “what a plaintiff ‘requested’ to what the plaintiff was ultimately ‘awarded.’”

Following that statement of its ruling, the Third Circuit addressed (and dismissed) two additional arguments offered by *Lohman*. *Lohman* first argued that a court’s consideration of evidence of settlement negotiations to reduce a fee award would violate public policy because it would have a detrimental effect on civil rights attorneys who “achieve only partial success,” and would discourage settlement negotiations between parties. The Third Circuit first noted that the concept of reducing a fee award where only partial success is achieved is “well-settled.” Citing to *Hensley*, the court implied that such concept is implicit in the Supreme Court’s direction that the most critical factor to be considered in determining a fee award is the degree of success obtained. The Third Circuit also explained that its ruling, contrary to discouraging settlement discussions, would in fact lead to more “reasonable and realistic” negotiations.

*Lohman*’s final argument was that evidence of settlement negotiations should not be considered in the absence of a formal offer of judgment by the defendants pursuant to Rule 68. The court summarily rejected that contention, noting that the existence of a means of formal negotiation has no bearing on a court’s ability to consider informal discussions.

Finally, the Third Circuit clarified its ruling, reaffirming that while evidence of settlement negotiations may be considered in determining a fee award, such evidence is only one factor to be considered by a court. The court noted that, in some circumstances, settlement discussions may not be a fair gauge of what a plaintiff is seeking in damages. However, the court pointed out that *Lohman*

had rejected a substantial offer of settlement during trial.

For litigators, there is much to take from the Third Circuit’s opinion in *Lohman*. *Lohman* forces a plaintiff’s attorney to take a long, hard look at what his or her case may really be worth and to negotiate accordingly. A plaintiff can literally no longer afford to “take a shot” at trial when a case appears to be lacking in real merit and a reasonable offer has been made by the defense to resolve the matter.

It should be noted, though, that it is not just the plaintiff’s response to a defendant’s offer that may play a role in a subsequent ruling on a fee application. Rather, a plaintiff’s initial demand may play an important part in that determination as well. The Third Circuit emphasized in *Lohman* that the consideration is between what a plaintiff requests and what he or she is actually awarded. As such, plaintiffs must now take caution before making outlandish demands that may be lacking in any evidentiary support. Such demands, if made too vociferously or too deep into litigation, may have significant consequences if and when damages are actually awarded. In the civil rights context, plaintiffs with very little compensatory damages should think twice before banking on substantial punitive damages in lieu of accepting a reasonable offer of resolution.

Defense attorneys, too, should take note that the timing of settlement negotiations may be quite important. Based on the Third Circuit’s note that early discussions may not be as pertinent to a determination of the plaintiff’s success, defense counsel should keep in mind that it is never too late to make a reasonable offer to resolve a matter.

It should be noted that defense counsel who find *Lohman* to be an additional incentive to come to the bargaining table should also take care to exercise restraint in settlement negotiations. Inter-

estingly, the Third Circuit’s ruling does not, at first glance, appear to provide as much of an incentive of reasonableness for the defense as it does for plaintiffs’ counsel. As explained above, the consideration in *Lohman* was of the comparison between what a plaintiff requests in damages and what that plaintiff is ultimately awarded. The court did not address whether a comparison between what the defense offers and what the plaintiff is ultimately awarded would be accorded the same weight. However, the rationale behind the opinion appears to indicate that the latter comparison could in fact be accorded at least some weight.

As explained above, the Third Circuit relied in part on the plain language of Rule 408 in holding that evidence of settlement negotiations may generally be considered in the context of an application for attorney’s fees. Therefore, it seems that the latter comparison above could in fact be considered in determining the degree of a plaintiff’s success. Certainly, the clear terms of Rule 408 do not preclude such a consideration. That being the case, defense counsel ought to exercise some caution in low-balling a case based on an unrealistic view of the merits of the claims, or merely to take stock of a plaintiff’s position.

As the *Lohman* holding is put into practice by district courts in the Third Circuit, it will surely be interesting to see what weight, if any, is actually given to evidence of settlement negotiations between the parties in the consideration of fee applications. Due to the fact that the plaintiff’s degree of success has been held to be the most critical factor in that consideration, it appears that evidence of settlement discussions may play a prominent role in determining such applications. Until further guidance is provided, though, counsel on both sides of the table can best protect the financial interests of their clients by doing what they ought to be in any event: acting reasonably. ■