



News & Types:

Another Release Unsuccessfully Attacked by Releasing Party

2/19/2018

Practices: Commercial, Competition & Trade, Corporate, Finance & Acquisitions, Litigation

In our update of January 2, 2018, we reported on a 7th Circuit case in which the releasing party, ADM, unsuccessfully tried to overcome the release it had signed. ADM claimed that, after it had signed the release, it discovered that it had been defrauded by the other party to the release, SGA. ADM brought a fraud claim against SGA. But the trial court, affirmed by the 7th Circuit Court of Appeals, would not even consider the merits of the fraud claim, finding that ADM had released known and unknown claims and ADM's fraud claim, even if unknown at the time of the release and even if meritorious, could not withstand the broad release language. (*ADM Alliance Nutrition, Inc. v. SGA Pharm Lab, Inc. and Shawn Yu*, 7th Circuit Court of Appeals, Nos. 16-2331 and 16-2593, December 14, 2017) We noted the lesson learned in the ADM case is to “understand the scope of the release and to make sure that there are no potential transactions or claims that might unintentionally be released.”

On February 13, the 7th Circuit Court of Appeals issued another case involving a releasing party trying to avoid a release it had signed. The reader of the opinion by Judge Miller is left to wonder how the releasing party could have expected a different result. (*Engineered Abrasives, Inc. v. American Machine Products & Service, Inc., et al.*, 7th Circuit Court of Appeals, No. 17-1429, February 13, 2018)

The principals of American Machine were a father and son who left Engineered Abrasives to start a competing business in 2011. The separation was not amicable and led to litigation - in fact, two lawsuits.

In March, 2015, Engineered Abrasives won a default judgment against American Machine and its principals for \$714,814.04. Engineered Abrasives' claim was theft of trade secrets and infringing trademarks. So far, so good for Engineered Abrasives.

Five months after obtaining the default judgment, Engineered Abrasives sued American Machine and its principals again. This lawsuit ended in a settlement engineered by a magistrate judge. Under the settlement, American Machine's insurer would pay \$75,000 to Engineered Abrasives and a permanent injunction would be entered to prevent future slander by American Machine or its principals against Engineered Abrasives with a \$250,000 liquidated damages clause to give the injunction real enforcement power.

The twist was the settlement agreement the parties signed. Quoted in the opinion, the release read:

“[Engineered Abrasives], on behalf of itself, its parents, subsidiaries, affiliates, officers, directors, employees, agents, successors and assigns, hereby releases [American Machine], their subsidiaries, affiliates, officers, directors, employees, agents, attorneys, shareholders, successors and assigns, of and

from any and all rights, claims, debts, demands, acts, agreements, liabilities, obligations, damages, costs, attorneys' fees, expenses, actions, and/or causes of action of every nature, character and description, whether known or unknown, suspected or unsuspected, **which it ever had, now has, or may hereafter claim to have by reason of any matter, cause or circumstances whatsoever arising or occurring prior to and including the date of the Agreement, including but not limited to the claims and defenses set forth in the Action.**" (emphasis added)

American Machine released Engineered Abrasives using similar language. Significantly, "Action" was defined as the August 2015 lawsuit, i.e., the second lawsuit.

Remember the first lawsuit, the one in which Engineered Abrasives won a default judgment of more than \$700,000? Apparently, Engineered Abrasives decided that, since it had American Machine's attention, now would be a good time to go after that money. So it went back into court on the first case.

As expected, Engineered Abrasives claimed it never intended to release American Machine from the default judgment, citing the definition of Action, which did not reference the first litigation resulting in the default judgment. It also cited evidence outside the settlement agreement. For example, Engineered Abrasives' demand letter that resulted in the settlement never mentioned the first litigation. The first litigation was not discussed during the settlement conference. The settlement amount of \$75,000 was barely 10% of the default judgment and Engineered Abrasives would not have settled for such a low amount. Finally, Engineered Abrasives' attorney objected to any suggestion that the settlement agreement included the default judgment.

The trial court didn't even consider these assertions. Applying Illinois law, the trial court found the settlement agreement unambiguous and released both the second litigation (the "Action") and the first litigation that resulted in the default judgment. On appeal, Judge Miller, writing the opinion for the 7th Circuit, agreed.

Similar to the *ADM* case (although, interestingly, not citing the *ADM* case), Judge Miller analyzed Illinois cases deciding the scope of release language. The scope is controlled by the intent of the parties which, in turn, is determined by the language of the release.

" . . . where both parties were aware of an additional claim at the time of signing the release, courts have given effect to the general release language of the agreement to release that claim as well."

[Judge Miller inadvertently misstated Illinois law in this regard. The 7th Circuit opinion, citing *Farm Credit Bank v. Whitlock*, 581 N.E.2d 664 (Illinois Supreme Court 1991), states: "Illinois courts will look to what each party knew to learn what each party meant: **if the releasing party knew of other** claims not mentioned in the release, a general release can't foreclose the unmentioned claims . . ." But the *Farm Credit Bank* opinion actually states: "**Where the releasing party was unaware of other claims**, Illinois case law has restricted general releases to the specific claim in the release agreement." (emphasis added)]

Finding the release signed by Engineered Abrasives unambiguous, the court enforced the release as written, denying Engineered Abrasives the opportunity to collect the default judgment of more than \$700,000.

Why didn't Engineered Abrasives explicitly exclude the default judgment from the release, if that was truly its intent all along? Maybe Henry Kissinger, the former U.S. Secretary of State under President Nixon, has the answer. According to the Wikipedia entry under "constructive ambiguity":

“Constructive ambiguity is a term generally credited to Henry Kissinger, said to be the foremost exponent of the negotiating tactic it designates. It refers to the deliberate use of ambiguous language on a sensitive issue in order to advance some political purpose. Constructive ambiguity is often disparaged as fudging. It might be employed in a negotiation, both to disguise an inability to resolve a contentious issue on which the parties remain far apart and to do so in a manner that enables each to claim obtaining some concession on it.”

Although speculative, it is possible that Engineered Abrasives knew that if it tried to explicitly exclude the default judgment from the release, American Machine would not sign. So it took a chance using “constructive ambiguity” to dodge the issue to get a resolution in the second litigation.

This goes back to the lesson in the *ADM* case: understand the scope of the release and to make sure that there are no potential transactions or claims that might unintentionally be released. The corollary to this lesson is not to rely on “constructive ambiguity” to limit the scope of the release. Judges and courts look for finality and clarity, not “constructive ambiguity.”