DISTRICT COURT, DENVER COUNTY, COLORADO 1437 Bannock Street Denver, CO 80202	DATE FILED: January 28, 2021 5:46 PM FILING ID: 61B6C8B89632F CASE NUMBER: 2018CV33011
PLAINTIFF: TUNG CHAN, SECURITIES COMMISSIONER FOR THE STATE OF COLORADO v. **DEFENDANTS:** GARY DRAGUL; GDA REAL ESTATE SERVICES, LLC; AND GDA REAL ESTATE MANAGEMENT, LLC	▲ COURT USE ONLY ▲
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BROWNSTEIN HYATT FARBER SCHRECK, LLP'S OPPOSITION TO DEFENDANT GARY DRAGUL'S MOTION FOR LIMITED DISCOVERY REGARDING BROWNSTEIN SETTLEMENT

Brownstein Hyatt Farber Schreck, LLP opposes Gary Dragul's request that the Receiver[1] produce "All communications between (a) the Receiver or its counsel, representatives, or agents, and (b) Brownstein or its counsel, representatives, or agents, relating to the claims alleged in the Brownstein Complaint and/or settlement of those claims" (the "Settlement Communications"), as that request seeks protected settlement communications that are neither admissible at the February 19, 2021 hearing on the Settlement Motion nor relevant to Dragul's objection to that settlement.[2] BHFS therefore submits this brief in opposition to Defendant Gary Dragul's Motion for Limited Discovery Regarding Brownstein Settlement and Request for Expedited Briefing Schedule (the "Discovery Motion").

ARGUMENT

I. THE SETTLEMENT COMMUNICATIONS ARE INADMISSIBLE AT AND IRRELEVANT TO THE HEARING ON THE SETTLEMENT MOTION TO DEMONSTRATE VALUE OF CLAIMS

A. Colorado Rule of Evidence 408 Prohibits Admission of Settlement Communications to Determine the Value of Claims

Colorado Rule of Evidence 408 "prohibits the admission of evidence concerning offers to compromise 'when offered to prove liability for, invalidity of, or amount of a claim that was disputed as to validity or amount.'" *Dorsey & Whitney LLP v.*

[1] Unless separately defined herein, capitalized terms in this Brief have the definitions provided in the Receiver's Motion to Approve Settlement (the "Settlement Motion").

[2] Dragul's second proposed request for production (for evidence of time the Receiver spent investigating claims) does not seek any documents to or from BHFS, other than those included in the first request, so BHFS takes no position on that request.

RegScan, Inc., 2018 COA 21, __ P.3d __, at *12 (Colo. Ct. App. Feb. 22, 2018) (*cert. denied* No. 18SC246, 2018 WL 3974225 (Colo. Aug. 20, 2018)). Such information may only be admitted for purposes unrelated to liability or the value of claims, such as to show bias in some testifying witness.[3]

Unlike most cases addressing the scope of CRE 408 or its federal analogue,[4] here neither the existence of the settlement nor its terms is any secret. The Receiver attached the settlement agreement to his Settlement Motion. Dragul seeks instead the underlying communications regarding that settlement.

Dragul admits that he seeks those Settlement Communications in order to address two issues.[5] One of those issues is: "is the proposed settlement in the interest of the Estate and its creditors?" Discovery Motion at 6. This question turns on the

[3] The "bias" referred to in Rule 408 is "witness bias," i.e. that a witness has a financial incentive to provide false testimony. *See Castro v. Poulton*, No. 2:15-CV-1908 JCM (GWF), 2017 WL 3723651, at *10 (D. Nev. Aug. 29, 2017) (emphasis in original). However, the pretext of "bias" cannot be used to introduce evidence of settlement communications in an attempt to "show[] the value of plaintiff's case," even if a settling party may testify. *Id.* Here, Dragul does not seek discovery to prove that the Receivership Estate has a financial interest in approval of the settlement at the negotiated amount; to the contrary, Dragul's entire objection is premised on the notion that the Receiver should have bargained for more money for the Estate. The bias exception to Rule 408 does not apply here.

[4] The federal Sixth Circuit observed in 2003 that it was unaware "of any case where the Rule 408 exceptions have been used to allow settlement communications into evidence for any purpose," as opposed to evidence of "the occurrence of settlement talks or the settlement agreement itself." *Goodyear Tire & Rubber Co. v. Chiles Power Supply, Inc.*, 332 F.3d 976, 981 (6th Cir. 2003) (emphasis in original).

[5] Dragul implies that the discovery he seeks is "possibly" also relevant to the question of whether Dragul's individual claims—if any—are part of the Estate, but he never says why.

value of the claims as compared to the costs of litigation. *See generally In re Kopexa Realty Venture Co.*, 213 B.R. 1020, 1022 (B.A.P. 10th Cir. 1997). But, settlement communications are inadmissible to demonstrate the value of the purported claims. "That's classic CRE 408(a) stuff." *Dorsey & Whitney*, 2018 COA 12 at *12. Because the requested Settlement Communications cannot be used by Dragul for this intended purpose, the Discovery Motion should be denied.

B. Settlement Communications Do Not Reflect The Value of the Claims And Are Therefore Irrelevant

In addition to failing to satisfy CRE 408, Dragul's Discovery Motion seeks information that is entirely irrelevant to his arguments. In both his original Objection and his Reply, Dragul contends the value and manner of the Receiver's settlement with BHFS evince that GDA's claims have merit. A sampling of these statements includes:

- "None of the Receiver's purported reasons for a low probability of success . . . hold water in light of . . . the fact that Brownstein agreed to pay $250,000 to settle them." Obj. at 11 (emphasis in original)
- "[A] $250,000 settlement is clearly enough to show the claims are meritorious[.]" *Id.* at 12.
- "The Receiver and Brownstein are not acting like they believe the claims are meritless. . . . $250,000 is not a nuisance value settlement." Dragul's Reply at 4-5.

- "If the claims are truly time-barred, Brownstein would prevail on a motion to dismiss at a cost of perhaps $10,000 (which it might then recover from the plaintiff)—why settle for $250,000?" *Id.* at 5.
- "Since Brownstein also claims to believe the claims are baseless . . . why would it settle for $250,000? Why not call the Receiver's bluff?" *Id.* at 5 n.4.

Additionally, Dragul submits evidence of a completely separate offer to compromise (in the form of BHFS's proposed release of claims, attached as Exhibit A to Dragul's Reply) as evidence that Brownstein must not "truly believe[] the claims are meritless." *Id.* at 5.

Dragul's insistence that offers and agreements to settle are somehow proof of guilt is directly contrary to Colorado law.[6] The Supreme Court has explained that a party's decisions regarding settlement "cannot be equated with the [party's] valuation of a particular claim." *Silva v. Basin Western, Inc.*, 47 P.3d 1184, 1189 (Colo. 2002) (en banc).

The irrelevance of settlement communications is also one of the foundational principles underlying Rule 408. As the authors of the federal analogue of CRE 408

[6] Far more probative than any settlement conduct or position taken by BHFS or its counsel is how consistently Dragul's Colorado counsel feels the need to remind the Court that they had nothing to do with the lawsuit Dragul filed. *See* Dragul's Objection at 13; Dragul's Reply at 1 n.1. In the most recent submission, his Colorado counsel goes so far as explaining in that they are not "responsible for the portions [of the brief] addressing the underlying merits of that Complaint." Dragul's Reply at 1 n.1.

explained regarding such communications: "The evidence is irrelevant, since the offer may be motivated by a desire for peace rather than from any concession of weakness of position." Fed. R. Evid. 408, 1972 Advisory Committee Notes.

In denying a motion seeking discovery into settlement information, one federal court elaborated:

> From our own experience we know that many factors come into play in reaching and obtaining settlement and, as such, settlement payments could not be a reliable guide for computing the value of a [claim]. For instance, a party may wish to avoid incurring attorney's fees or other litigation expenses. It may wish to avoid the distraction caused by litigation, or avoid the negative publicity which attends litigation. A party may value its privacy, and be willing to settle a case to preclude discovery into its affairs.

Vardon Golf Co. v. BBMG Golf Ltd., 156 F.R.D. 641, 651 (N.D. Ill. 1994).

Because settlements and settlement communications are not probative of the value of a claim, the discovery Dragul seeks is neither "relevant to the claim or defense of any party" nor "proportional to the needs of the case." Colo. R. Civ. P. 26(b)(1). Even if the settlement communications were probative, CRE 408 precludes their use to demonstrate the purported value of the claims, and Dragul's motion should be denied.

II. COURTS REJECT ATTEMPTS TO INJECT SETTLEMENT COMMUNICATIONS INTO HEARINGS ON SETTLEMENT APPROVAL

The second issue to which Dragul says the Settlement Communications are relevant is: "did the Receiver fulfill his fiduciary duty in investigating and then settling the Brownstein claims." Discovery Motion at 6; *see also id.* at 3 ("Limited Discovery Will Show Whether the Receiver Complied with his Fiduciary Duties").

But this is not an independent issue for the Court's consideration in ruling on the Settlement Motion.

As Dragul conceded in his Objection, the four *Kopexa* factors govern the court's determination of the propriety of the settlement. Dragul's Objection at 9 (reciting factors). Whether the Receiver breached a fiduciary duty is not on that list. Nor is the length of time spent investigating the claims or the manner in which settlement negotiations took place.

Similarly, Dragul conceded that questions regarding the depth of the Receiver's investigation were relevant only insofar as Dragul argued the Receiver undervalued the value of the claims' merits. Dragul's Objection at 9-11. And, in accusing the Receiver of collusively settling with BHFS in order to preserve the Estate's claims against Dragul, he suggested the resulting settlement reflected "a tiny fraction" of the claims' value. *Id.* at 3.

Only now that he seeks clearly impermissible discovery does Dragul try to make the process leading to the settlement an independent question for the Court's resolution and an independent basis for discovery. That is not how Rule 408 works.

Cyr v. Reliance Standard Life Ins. Co. is squarely on point. 525 F. Supp. 2d 1165 (C.D. Cal. 2007). In that case, an insurance company argued that its insured collusively settled an employment discrimination claim at an inflated amount, in exchange for the plaintiff's agreement to structure the settlement so that only the insurer—and not the employer—bore any payment obligation. *Id.* at 1169, 1171 n.5. The insurer argued that the employer and plaintiff employee "had a side agreement"

evidencing this collusive settlement. *Id.* at 1170. The insurance company relied on settlement communications between the employer and the plaintiff, arguing that using those documents to prove collusion was "a purpose not prohibited by Rule 408." *Id* at 1169. The court disagreed. It held that "documents created during the settlement negotiations" are "inadmissible under Rule 408," even where used to show "the settlement agreement was collusive." *Id.* at 1176. The court found the insurer's argument "is just another way of asserting that the settlement" did not reflect the true value of the claims for which the insurer should be held liable, "precisely what Rule 408 precludes." *Id.* at 1170; *see also id.* at 1171 n. 5 (using settlement negotiations to prove that employer "inflated" settlement in exchange for "plac[ing] the liability on RSL's shoulders . . . is a prohibited use under Rule 408").[7]

Courts ruling on contested settlements in the analogous bankruptcy context[8] likewise consistently exclude settlement communications and negotiations from

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[7] *See also In re Adelphia Commc'ns. Corp.*, 336 B.R. 610, n.48 (S.D.N.Y. 2006) (in considering a change to the reorganization plan in a Chapter 11 bankruptcy allegedly made in "breach of the fiduciary duties" owed to creditors, court opted "not even to see" evidence of settlement discussions, as those were prohibited by FRE 408); *In re C.M. Meiers Co.*, No. 1:12-bk-10229-MT, 2016 WL 9458553, at *37 (C.D. Cal. Bankr. Dec. 20, 2016) (holding that "the discussions between Trustee and [a settling party] leading to a settlement . . . are privileged" and cannot be admitted as evidence "that the settlement was collusive") (*aff'd* No. 2:17-cv-01400 (C.D. Cal. July 6, 2017)).

[8] In connection with the Settlement Motion, both the Receiver and Dragul have recognized and drawn upon federal bankruptcy decisions as analogous to Colorado receivership proceedings. *See* Settlement Motion ¶ 18 (*citing In re Kopexa Realty Venture Co.*, 213 B.R. 1020, 1022 (B.A.P. 10th Cir. 1997) and other federal cases); Dragul's Objection at 9 (citing cases relied on by Receiver and reciting *Kopexa* factors).

consideration under Federal Rule of Evidence 408 in determining whether the settlement is in the best interests of the creditors.[9]

For example, in *In re Tawil*, a bankruptcy court approved a settlement between the trustee and the debtor, over the objection of the debtor's brother (against whom the debtor was pursuing a claim). No. 14-10649, 2017 WL 3309693 (D.N.J. Aug. 1, 2017). The brother objected, arguing that the settlement would improperly and illegally affect his rights. *Id.* at *2. The court rejected the brother's objections and approved the settlement as being in the best interests of the creditors. *Id.* at *2-3. In reaching that conclusion, the court expressly refused to "rely on any of the statements made in settlement negotiations," citing FRE 408. *Id.* at *2 n.16.

And, in *In re Gardens Regional Hospital & Medical Center*, the bankruptcy court affirmatively struck evidence of settlement communications from the record when the objecting creditor included it with its objection. No. 2:16-bk-17463, 2017 WL 2889633 (C.D. Cal. Bankr. July 6, 2017). There, the creditor objected that the settlement amount was too high, depleting the estate of resources to pay other creditors. *Id.* at *2. The objector argued that the debtor's counsel improperly decided to settle, not to fairly resolve the claims in the interests of their client and its creditors, but in order to ensure their fees were paid. *Id.* In support of this argument,

[9] Federal Rule of Evidence 408 is "the counterpart of CRE 408" and the principles governing its application "apply with respect to CRE 408, as well," because "interpretations of federal rules are persuasive authority as to the Colorado rule counterparts." *Hartman v. Cmty Responsibility Ctr., Inc.*, 87 P.3d 202, 206 (Colo. Ct. App. 2003).

the objecting creditor submitted a declaration stating that, during conversations with the creditor, a director of the debtor had said the attorneys had this improper motive. *Id.* The court granted the debtor's motion to strike the declaration, ruling that such settlement communications could not be considered in connection with the settlement approval motion. *Id.* at *7.

The rationale for these various decisions is clear. An objector to a settlement cannot run roughshod over Rule 408 simply by professing a belief there was collusion, especially when the alleged result of that collusion is an over- or under-valuing of the settled claims. The result would be a complete erosion of CRE 408 any time court approval was necessary for a settlement, whether by court order (e.g., in receiverships such as this one), statute (*see, e.g.*, C.R.S. § 15-14-412(1)(b) (settlements with minors and other protected individuals)), or procedural rule (*see e.g.*, Colo. R. Civ. Proc. 23(e) (class action settlements)).

III. BECAUSE THE SETTLEMENT COMMUNICATIONS ARE INADMISSIBLE, THERE IS NO BASIS FOR ORDERING THEIR PRODUCTION

On its face, CRE 408 speaks to the admissibility of evidence, not its discoverability. But, because the Settlement Communications Dragul seeks could neither themselves be admitted at the hearing nor, given the timing of Dragul's request, lead to the discovery of admissible evidence, the Discovery Motion fails the more stringent standard of Colorado's new Rule of Civil Procedure 26(b)(1). Even

under the more lax prior standard,[10] Dragul would be unable to show that disclosure of the Settlement Communications would be "reasonably calculated to lead to the discovery of admissible evidence." *Silva v. Basin Western, Inc.*, 47 P.3d 1184, 1188 (Colo. 2002) (en banc) (citing prior Colo. R. Civ. P. 26(b)(1)). Simply put, Dragul's receipt of inadmissible information cannot possibly have any effect on the February 19 hearing.

For this reason, "many federal courts that have considered the discoverability of settlement negotiations or agreements have explicitly or impliedly found that Rule 408 expresses the policy of protecting settlement negotiations and agreements from unnecessary intrusions in order to encourage settlements." *Servants of Paraclete, Inc. v. Great Am. Ins. Co.*, 866 F. Supp. 1560, 1576 (D.N.M. 1994) (collecting cases). As a result, these courts "have held that the party moving for discovery of settlement negotiations or agreements must make some particularized showing that the information sought is reasonably calculated to lead to admissible evidence." *Id.* (emphasis added).

And, where the only reason for seeking settlement communications is to use that information as evidence for a prohibited purpose under Rule 408, the discovery

[10] In eliminating the requirement that discovery be "reasonably calculated to lead to the discovery of admissible evidence," the new Rule 26(b)(1) "does not permit broadening the basic scope of discovery" beyond that permitted by its predecessor. Colo. R. Civ. P. 26(b)(1) 2015 cmt. 14 ("Scope of discovery"). To the contrary, the new rule is meant to curb the scope of discovery. "In short, the concept is to allow discovery of what a party/lawyer needs to prove its case, but not what a party/lawyer wants to know about the subject of a case." *Id.* (emphasis in original).

motion should be denied outright. *See, e.g.*, *Goodyear Tire & Rubber Co.*, 332 F.3d at 976 (affirming order preventing discovery into settlement communications); *Castro*, 2017 WL 3723651 at *9-10 (affirming denial of motion to compel discovery of prior settlements, where purpose of discovery was to obtain "evidence of a settlement as proof of the value of a claim"). Under those circumstances, there is no way a party could make a showing (particularized or otherwise) that the information is relevant or will lead to admissible evidence.

Dragul is clear that he seeks the Settlement Communications in order "to make use of" them at the upcoming hearing on the Settlement Motion. Discovery Motion at 7. That was the only basis for his request for expedited briefing. *Id.* Because CRE 408 forbids him from using the information for that purpose, the Discovery Motion should be denied.

IV. BHFS WOULD BE IRREPARABLY HARMED BY THE DISCLOSURE OF THE SETTLEMENT COMMUNICATIONS

As the Receiver explained in his Settlement Motion, BHFS provided to the Receiver during their settlement discussions an outline draft of its motion to dismiss the Nevada Complaint. Settlement Motion ¶ 24. On the chance that the settlement is not approved, Dragul should not be afforded a sneak peek into that motion. The Colorado Supreme Court has recognized that the primary policy "consideration behind CRE 408" is that courts should not "permit[] one party's openness to settlement to be used as a weapon by that party's adversary in ongoing litigation." *City of Aurora v. ACJ P'ship*, 209 P.3d 1076, 1088 (Colo. 2009) (en banc). The federal Seventh Circuit has likewise acknowledged that one of the reasons settlement

communications should be shielded during ongoing litigation is to avoid "giv[ing] a party information about an opponent's strategy." *Mars Steel Corp. v. Cont'l Ill. Nat'l Bank & Trust Co. of Chicago*, 834 F.2d 677, 684 (7th Cir. 1987).

Dragul should not be permitted to obtain discovery in this action that has no relevance to (or admissibility at) the upcoming settlement approval hearing, just so he can get a head start in the Nevada Action.

CONCLUSION

For the reasons described above, BHFS asks the Court to deny Dragul's Discovery Motion as it pertains to the Settlement Communications.

Dated: January 28, 2021

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 28th day of January, 2021, a true and correct copy of the foregoing **BROWNSTEIN HYATT FARBER SCHRECK, LLP'S OPPOSITION TO DEFENDANT GARY DRAGUL'S MOTION FOR LIMITED DISCOVERY REGARDING BROWNSTEIN SETTLEMENT** was filed with the Court and served via Colorado Courts E-Filing System on all counsel of record.

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