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More Than Fraud: Proving Fraud on the Court

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Introduction

In all adversarial proceedings, litigants have a duty of full disclosure and honesty with the court.¹ Typically, where a party obtains a judgment through fraudulent conduct, the only way to overturn that judgment is through a motion to vacate pursuant to Federal Rule of Civil Procedure 60(b)(3).²

A final judgment can also be overturned by a motion, pursuant to Federal Rule of Civil Procedure 60(d)(3), as incorporated into the Bankruptcy Rules by Rule 9024, to vacate a judgment based upon fraud on the court. Fraud on the court is generally limited to instances where “the integrity of the judicial process ha[s] been fraudulently subverted” and does not include fraudulent conduct that only affects a party to the action.³ Fraud on the court is typically limited to the most egregious conduct that implicates an officer of the court.⁴ Courts must further

¹ MODEL RULES OF PROF'L CONDUCT r. 3.3 (AM. BAR ASS'N 1983).

² *Metlyn Realty Corp. v. Esmark, Inc.*, 763 F.2d 826, 832 (7th Cir. 1985) (holding that a Rule 60(b)(3) motion allows a party to overturn a final judgment based upon “fraud” so long as it is filed within one year from the date of judgment).

³ *Hazel-Atlas Glass Co. v. Hartford-Empire Co.*, 322 U.S. 238, 245-246 (1944) (creating the standard for fraud on the court).

⁴ *Rozier v. Ford Motor Co.*, 573 F.2d 1332, 1338 (5th Cir. 1978) (holding that fraud on the court only includes actions “such as bribery of a judge or members of a jury, or the fabrication of evidence by a party in which an attorney is implicated”).

balance the policy of upholding final judgments against the possibility the judgment was obtained by perpetrating a fraud on the court.⁵ Several courts have applied a lower standard for determining whether specific fraudulent conduct rises to the level of fraud on the court.⁶

This memorandum explores the standard necessary to establish a fraud on the court claim as well as what actions constitute fraud on the court. Part I discusses the majority standard for a fraud on the court claim. Part II discusses the minority standard for establishing fraud on the court.

I. Majority Standard: Harm to the Integrity of the Judicial Process

Courts have not explicitly defined the concept of “fraud on the court.”⁷ Federal Rule of Civil Procedure 60 sets forth the grounds under which a judgment may be set aside, but Rule 60(d)(3) states Rule 60 does not limit a court’s power to set aside a judgment for fraud on the court.⁸ Rule 60(d)(3) is the codification of a court’s inherent power to investigate whether a judgment was obtained by fraudulent conduct.⁹ However, final judgments are not often overturned based upon a fraud on the court claim and will typically only occur in extraordinary cases.¹⁰ Further, there is no statute of limitations for a fraud on the court claim and a court may consider such a claim even if no adversarial parties are before the court.¹¹

⁵ *Met-L-Wood Corp. v. Pipin (In re Met-L-Wood Corp.)*, 861 F.2d 1012, 1016 (7th Cir. 1988) (declining to overturn a final sale order notwithstanding a possible fraud on the court claim due in part to the policy of protecting final orders of sale).

⁶ *See, e.g. Levander v. Prober (In re Levander)*, 180 F.3d 1114, 1120 (9th Cir. 1999) (perjury committed by a single non-party witness was so detrimental to the entire bankruptcy proceeding that it was held to be fraud on the court); *In re Cardwell*, No. 09-43121, 2017 WL 2304220, at *5-*6 (Bankr. E.D. Tex. May 25, 2017) (holding that filing false bankruptcy schedules, misrepresenting liabilities on real property, including a co-conspirator, and preparing fraudulent loan documents established fraud on the court). *See also, In re Clinton Street Foods Corp.*, 254 B.R. 523 (Bankr. S.D.N.Y. 2000).

⁷ *United States v. Estate of Stonehill*, 660 F.3d 415, 444 (9th Cir. 2011).

⁸ *In re Roussos*, 541 B.R. 721, 728-29 (Bankr. C.D. Cal. 2015).

⁹ *Universal Oil Products Co. v. Root Ref. Co.*, 328 U.S. 575, 580 (1946).

¹⁰ *Addington v. Farmers Elevator Mut. Co.*, 650 F.2d 663, 668 (6th Cir. 1981).

¹¹ *In re Roussos*, 541 B.R. at 729.

Even with the broad procedural powers granted by Rule 60(d)(3), not all fraud is considered fraud on the court.¹² The relevant inquiry is not whether the fraudulent conduct “prejudiced the opposing party” but whether the conduct “harmed the integrity of the judicial process.”¹³ Courts must balance the finality of judgments against the possibility that the judgment was obtained by defrauding the court.¹⁴ Taking that policy into account, a fraud on the court claim can be successfully brought to overturn a final judgment in a bankruptcy proceeding, even years after the judgment has been entered.¹⁵

The Supreme Court, in *Hazel-Atlas Glass Co. v. Hartford-Empire Co.*, created the standard necessary to establish a fraud on the court claim.¹⁶ The Court held that, “only the most egregious misconduct, such as bribery of a judge or members of a jury, or the fabrication of evidence by a party in which an attorney is implicated, will constitute a fraud on the court.”¹⁷ In order to adequately plead a fraud on the court claim, a plaintiff must allege “a scheme by which the integrity of the judicial process had been fraudulently subverted” and must involve far more than an injury to a single litigant.¹⁸

Fraud on the court will, most often, be found where the fraudulent scheme defrauds the “judicial machinery” or is perpetrated by an officer of the court such that the court cannot perform its function as a neutral arbiter of justice.¹⁹ Fraud directed at the “judicial machinery”

¹² *Estate of Stonehill*, 660 F.3d at 444.

¹³ *Id.*

¹⁴ *In re Met-L-Wood Corp.*, 861 F.2d at 1016 (balancing a possible fraud on the court claim with the policy of protecting a 21-year-old final sale order).

¹⁵ *In re Roussos*, 541 B.R. at 729-30.

¹⁶ 322 U.S. at 245-246.

¹⁷ *Id.*

¹⁸ *Addington*, 650 F.2d at 668.

¹⁹ *Martina Theatre Corp. v. Schine Chain Theatres, Inc.*, 278 F.2d 798, 801 (2d Cir. 1960).

can mean conduct that fraudulently coerces or influences the court itself or a member of the court, such that the impartial nature of the court has been compromised.²⁰

An attorney, as an officer of the court, has a duty of honesty towards the court.²¹ Where an attorney neglects that duty and obtains a judgment based on conduct that actively defrauds the court, such judgment may be attacked, and subsequently overturned, as fraud on the court.²²

Fraud on the court can be found where the debtor's attorney proffers a material misrepresentation in order to obtain a judgment.²³ Specifically, in a situation where a debtor's attorney, upon direct inquiry by the court, fails to disclose the close personal relationship between the debtor and purchaser, can rise to the level of fraud on the court.²⁴

In a bankruptcy proceeding, the debtor-in-possession can be considered an "officer of the court."²⁵ The debtor-in-possession is not just a fiduciary to its creditors but to the bankruptcy court itself.²⁶ The debtor is an "officer of the court" because the debtor possesses "a responsibility to act in the best interests of the estate as a whole" and "bears a special responsibility for the proper functioning of the machinery of justice."²⁷ As an officer of the court, the debtor can perpetrate a fraud on the court, much the same as an attorney.²⁸ Specifically, a debtor-in-possession can commit fraud on the court where the debtor petitions the court to sell properties it owns to corporate entities that the debtor secretly controls.²⁹ In a situation such as the one described, where the debtor misrepresents the transaction as an arms-length transaction

²⁰ *Bulloch v. United States*, 721 F.2d 713, 718 (10th Cir.1983).

²¹ *In re Tri-Cran, Inc.*, 98 B.R. 609, 616 (Bankr. D. Mass. 1989).

²² *H.K. Porter Co. v. Goodyear Tire & Rubber Co.*, 536 F.2d 1115, 1119 (6th Cir. 1976).

²³ *In re Tri-Cran*, 98 B.R. at 624.

²⁴ *Id.* at 617.

²⁵ *Id.* at 617.

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.*

²⁹ *In re Roussos*, 541 B.R. at 729.

when, in reality, the debtor is self-dealing, those actions deny the bankruptcy court the ability to impartially adjudge the proposed sale.³⁰

II. Minority Standard: Perjury and Non-Disclosure

A minority of courts, however, have adopted different standards that encompasses a wider range of conduct that can constitute fraud on the court.³¹

The bankruptcy court in *In re Clinton Street Foods*, allowed the trustee's "fraud on the court" claim finding that the four-prong analysis previously set forth by the Second Circuit Court of Appeals was instructive and the facts at hand satisfied such requirements, including that the claim was based on "(1) the defendant's misrepresentation to the court; (2) the denial or grant of the motion based on the misrepresentation; (3) the lack of an opportunity to discover the misrepresentation and either bring it to the court's attention or bring a timely turnover proceeding; and (4) the benefit the defendant derived by inducing the erroneous decision."³² In applying this analysis, the bankruptcy court found that the actions of a litigant alone can invoke the doctrine of fraud on the court and that an officer of the court need not be involved.³³ Specifically, the defendants lied to the bankruptcy court regarding whether any bidding agreements existed which led to the approval of the sale by the Chapter 7 trustee, subsequently allowing the defendants to buy two million dollars worth of property for \$320,000.³⁴

In *In re Cardwell*, the court held that a Chapter 7 debtor's actions (without referring to the debtor as an "officer of the court") standing alone can constitute fraud on the court.³⁵ The court looked at all of the debtor's misrepresentations, together, and determined that the debtor

³⁰ *Id.* at 730.

³¹ See *In re Levander*, 180 F.3d at 1120; *In re Clinton Street Foods Corp.*, 254 B.R. 523; *In re Cardwell*, No. 09-43121, 2017 WL 2304220, at *5-*6.

³² 254 B.R. at 533 (citing *Leber-Krebs, Inc. v. Capitol Records*, 779 F.2d 895, 899-900 (2nd Cir. 1985)).

³³ *Id.*

³⁴ *Id.*

³⁵ 2017 WL 2304220, at *5-*6.

used the court to further his fraudulent scheme.³⁶ Specifically, the debtor filed false bankruptcy schedules, misrepresented liabilities on real property, included a co-conspirator, prepared fraudulent loan documents, and violated 18 U.S.C. § § 152 and 157.³⁷

The court in *In re Levander* held that perjury, by a single non-party witness, can rise to the level of fraud on the court.³⁸ However, the perjury must be so detrimental to the entire bankruptcy proceeding that it defiles the court itself.³⁹ Specifically, a single non-party witness, during a deposition, testified that the corporation had not sold any of its assets; in reality, the corporation had previously transferred most of its assets to a related partnership.⁴⁰ The bankruptcy court relied upon that testimony and entered a judgment against the corporation only.⁴¹ This conduct was so detrimental to the underlying proceedings that even without any action by an officer of the court, the court still found that the impartial nature of the court had been subverted.⁴²

Conclusion

Historically, courts have been averse to find fraud on the court where the only injury was to the litigants and the court itself was not actively defrauded.⁴³ Fraud on the court is usually found in only the most egregious of circumstance, bribery of a judge or jury, fabricating evidence that implicates an attorney, or any action directly attacking the judicial machinery.⁴⁴ However, where a litigant can prove that an officer of the court fraudulently coerced or

³⁶ *Id.*

³⁷ *Id.* at *5.

³⁸ 180 F.3d 1114, 1120.

³⁹ *Id.*

⁴⁰ *Id.* at 1116-17.

⁴¹ *Id.*

⁴² *Id.* at 1120.

⁴³ *Hazel-Atlas Glass Co. v. Hartford-Empire Co.*, 322 U.S. at 245-246.

⁴⁴ *Id.*

improperly influenced the impartial nature of the court, fraud on the court can be established.⁴⁵

Even where a valid fraud on the court claim is adequately pled, courts may still choose to not overturn the judgment based upon the policy of upholding final judgments.⁴⁶

Several courts have encompassed a broader definition of fraud on the court.⁴⁷ *Cardwell* and *Clinton Street Foods* both involved the concealment of assets and co-conspirators that resulted in large economic gains for the defendants.⁴⁸ *In re Levander* involved perjury by a single non-party witness that resulted in an active defiling of the bankruptcy court.⁴⁹

Regardless of the standard applied, what is clear is that fraud on the court requires, at a minimum, a showing of “egregious conduct” such as bribing a judge or fabrication of evidence by an attorney. Yet, in a few courts, concealment of assets and filing fraudulent documents may also constitute fraud on the court. If more courts adopt this less stringent standard for fraud on the court, there may be the opportunity to overturn final judgments simply based upon false and misleading statements by a litigant (or even a witness), particularly in situations where the statute of limitations has passed.

⁴⁵ *Bulloch*, 721 F.2d at 718.

⁴⁶ *In re Met-L-Wood Corp.*, 861 F.2d at 1016.

⁴⁷ *In re Levander*, 180 F.3d 1114; *In re Clinton Street Foods Corp.*, 254 B.R. 523 (Bankr. S.D.N.Y. 2000); *In re Cardwell*, No. 09-43121, 2017 WL 2304220 (Bankr. E.D. Tex. May 25, 2017).

⁴⁸ 2017 WL 2304220 at *5-*6; 254 B.R. at 532.

⁴⁹ 180 F.3d at 1121.