

THE SETTLEMENT PRIVILEGE: FACT OR FICTION?

That wretched case finally settled! No more legal fees, filing deadlines, or headaches. Time to put that one in the past. But what's this? A subpoena for the settlement materials the company exchanged with the plaintiff? Can't be. Every letter says "408 privileged document" right on its face! Surely this is privileged! Maybe yes, maybe no. One thing is for sure: It's more complicated than you thought.

By John K. Villa

Author of *Corporate Counsel Guidelines*, published by ACC and West



John K. Villa is a partner with Williams & Connolly LLP in Washington, DC. He specializes in corporate litigation (civil and criminal) involving financial services; directors', officers', and lawyers' liabilities; securities; and related issues. He is an adjunct professor at Georgetown Law School and a regular lecturer for ACC. He is also the author of *Corporate Counsel Guidelines*, published by ACC and West, and is available at JVilla@wc.com.

The starting point for our journey is Rule 408 of the Federal Rules of Evidence—which is the model for many state court rules of evidence. Adopted in 1975, FRE 408 was intended to encourage the settlement of disputes by excluding from evidence conduct and statements made in compromise negotiations, rather than excluding only the offers of compromise themselves—as had been the practice under the common law, which deemed statements of fact

made during compromise negotiations to be relevant and admissible, "unless hypothetical, stated to be 'without prejudice,' or so connected with the offer as to be inseparable from it."¹ As one court observed shortly after the rule's adoption, its purpose "is to encourage free and frank discussion with a view toward settling the dispute."² But because of significant limitations in the reach of Rule 408, as well as common misapprehensions of its breadth, the rule does *not* provide the protection that most lawyers expect. At the very least, its application lacks certainty and predictability—which may inhibit the very conduct it is designed to encourage. A lawyer should, therefore, be wary and consider further protective steps.

THE BASIC RULE: ADMISSIBILITY

Rule 408 provides:

Evidence of (1)...offering...or (2) accepting...a valuable consideration

in compromising or attempting to compromise a claim which was disputed as to either validity or amount, is *not admissible* to prove liability for or invalidity of the claim or its amount. Evidence of conduct or statements made in compromise negotiations is likewise *not admissible*. This rule does not require the exclusion of any evidence otherwise discoverable merely because it is presented in the course of compromise negotiations. This rule also does not require exclusion when the evidence is offered for another purpose, such as proving bias or prejudice of a witness, negating a contention of undue delay, or proving an effort to obstruct a criminal investigation or prosecution. (emphasis added)

The rule bars admission of evidence of settlement negotiations, whether between the parties to the suit or between one of the parties and a third

party.³ In some jurisdictions the rule may apply to criminal cases.⁴ Note that the rule literally applies only to the admissibility of evidence—though, as we will see, some courts have interpreted the rule more broadly.

The two prerequisites for Rule 408 are the existence of both a disputed claim and compromise negotiations. Unfortunately, there is no bright line as to when a claim is “disputed,” or at what point discussions become “compromise negotiations.” For example, does a dispute exist when contracting parties meet to state conflicting positions that, depending on the outcome of their discussion, could result in litigation, or are these preliminary discussions mere business communications rather than negotiations covered by Rule 408?⁵ To answer this question, some courts focus on the intent of the parties, while other courts focus on the objective characteristics of the discussions.⁶ The general rule is, however, that a lawsuit is not necessary for a

dispute to exist under Rule 408.⁷ It is sufficient if the parties are contemplating the possibility of litigation when they are discussing the matter.⁸

Where these prerequisites have been met, Rule 408 makes inadmissible offers to settle as well as conduct and statements occurring in the negotiations. An important but overlooked aspect of the 408 protection is that it extends not only to the parties’ communications, but also to material prepared by or for the parties in their effort to reach a settlement. This has included internal memoranda, reports, expert opinions, depositions, and a wide range of other materials.⁹

One limitation on the scope of Rule 408 is that by its terms it excludes settlement evidence only when offered “to prove liability for or invalidity of the claim or its amount,” and not when “offered for another purpose, such as proving bias or prejudice of a witness, negating a contention of undue delay, or proving an effort to obstruct a crimi-

nal investigation or prosecution.”

But even if one of these exceptions is satisfied, settlement evidence is still subject to Rule 402’s requirement of relevance and Rule 403’s requirement that probative value outweigh the danger of unfair prejudice. As one court has observed: “[t]he risks of prejudice and confusion entailed in receiving settlement evidence are such that often Rule 403 and the underlying policy of Rule 408 [to encourage settlement] require exclusion even when a permissible purpose can be discerned.”¹⁰ To further reduce the risk of a finding of admissibility, counsel may want to rely on the traditional common law standards—qualifying statements in settlement materials through the use of hypotheticals or “without prejudice” notations.

EXTENDING THE RULE: DISCOVERABILITY?

OK so far, but here’s the question: assuming that Rule 408 excludes certain settlement materials from evidence, are such materials also protected from discovery? Surprisingly, some courts hold that the answer is “yes.” Although Rule 408 expressly addresses only the admissibility of settlement offers and statements made in compromise negotiations, some courts have found that the public policy underlying the rule—promoting the private settlement of disputes—supports the extension of Rule 408 protections to the discovery stage of litigation.¹¹ As one court explained:

There is a strong public interest in encouraging settlements and in promoting the efficient resolution of conflicts. This strong public interest outweighs any general public interest in providing litigants broad discovery of facts to support their claims and defenses....The balance of the equities weighs in favor of protecting the

Do Not Miss John K. Villa’s *Corporate Counsel Guidelines* published by ACC and West



In this post-Enron environment, you need the best ethics guidance that you can get. Here it is. *Corporate Counsel Guidelines* is a two-volume treatise written expressly for in-house counsel. This treatise tackles the most common issues facing corporate counsel, even those issues that have no guiding precedent or ethics opinions. Cost: \$220, and ACC members receive a 30% discount. To order, contact West at 800.344.5009 or at www.westgroup.com.

terms of the Agreement and the surrounding circumstances.¹²

In fact, a few courts have adopted a curious rationale for denying the discovery of settlement information—the recognition that settlement discussions do not necessarily involve wholly truthful assertions!

Settlement negotiations are typically punctuated with numerous instances of puffing and posturing[.]...What is stated as fact on the record could very well not be the sort of evidence which the parties would otherwise actually contend to be wholly true. That is, the parties may assume disputed facts to be true for the unique purposes of settlement negotiations. The discovery of these sort of “facts” would be highly misleading if allowed to be used for purposes other than settlement.¹³

Most courts, however, reject an absolute principle that Rule 408 insulates settlement evidence from discovery under Rule 26(b) of the Federal Rules of Civil Procedure, which authorizes discovery of “any matter, not privileged, that is relevant to the claim or defense of any party[.]”¹⁴ Some courts have compromised by applying a heightened standard to the party seeking discovery, citing “the strong public policy of favoring settlements and the congressional intent to further that policy by insulating the bargaining table from unnecessary intrusions[.]” These courts have permitted discovery upon a “particularized showing of a likelihood that admissible evidence will be generated” by discovery.¹⁵ But the result of such a compromise is a disregard of Rule 26(b), which authorizes the discovery of relevant, inadmissible information if “reasonably calculated to lead to the discovery of admissible evidence,” and does not require any such particularized showing.¹⁶

OTHER PROTECTIONS FROM DISCOVERY

In view of the limited reach of Rule 408 and its uneven application, are there other methods—court rules, statutes, agreements—that you can use to protect settlement documents and other exchanges of information during the settlement process? One possibility is an express confidentiality agreement between the negotiating parties. Such agreements can effectively insulate settlement materials from discovery—but they are of limited usefulness, as they do not bind third parties.¹⁷

IN THE FEDERAL ARENA, A STATUTE EXPRESSLY AUTHORIZES LOCAL RULES PROTECTING THE CONFIDENTIALITY OF COMMUNICATIONS DURING THE MEDIATION PROCESS, AND MANY FEDERAL DISTRICTS HAVE ADOPTED SUCH RULES. REMEMBER, HOWEVER, THAT THE APPLICABILITY OF THESE PROVISIONS IS GENERALLY LIMITED TO FORMAL MEDIATIONS CONVENED PURSUANT TO STATUTE.

Another alternative is proceeding under applicable mediation statutes.¹⁸ The relevant Texas statute, for example, provides for the confidentiality of mediation communications as follows:

(a) . . . a communication relating to the subject matter of any civil or criminal dispute made by a participant in an alternative dispute resolution procedure, *whether before or*

after the institution of formal judicial proceedings, is confidential, is not subject to disclosure, and may not be used as evidence against the participant in any judicial or administrative proceeding. (emphasis added)¹⁹

In the federal arena, a statute expressly authorizes local rules protecting the confidentiality of communications during the mediation process, and many federal districts have adopted such rules.²⁰ Remember, however, that the applicability of these provisions is generally limited to formal mediations convened pursuant to statute.

PROTECTING SETTLEMENTS: BEYOND RULE 408

What steps can you take to increase the likelihood that your settlement materials will be protected?

- Reach an express agreement with your opposing party governing discoverability and admissibility of settlement materials.
- Define carefully the materials you expect to be protected by the agreement, including reports of experts and statements of third parties.
- Label external documents with “privileged as pursuant to settlement discussions.”
- Review the statutes and court rules of all applicable jurisdictions to determine if there are mediation procedures that can provide protection. ■

NOTES

1. FED. R. EVID. 408, advisory committee’s notes. See also Wayne D. Brazil, *Protecting the Confidentiality of Settlement Negotiations*, 39 HASTINGS L.J. 955, 959 (July 1988).
2. *United States v. Reserve Mining Co.*, 412 F. Supp. 705, 712 (D. Minn. 1976).
3. See *Hudspeth v. Commissioner of Internal Revenue Service*, 914 F.2d 1207, 1213–1214 (9th Cir. 1990); *Kennon v. Slipstreamer, Inc.*, 794 F.2d 1067,

- 1069–1071 (5th Cir. 1986); *see generally* 2 CHRISTOPHER B. MUELLER & LAIRD C. KIRKPATRICK, *FEDERAL EVIDENCE* § 137 (2d ed. database updated July 2004).
4. *See* *United States v. Bailey*, 327 F.3d 1131, 1144–1146 (10th Cir. 2003).
5. *See* *Big O Tire Dealers, Inc. v. Goodyear Tire & Rubber Co.*, 561 F.2d 1365, 1375 (10th Cir. 1977) (business communications not protected by Rule 408).
6. *See* CHARLES ALAN WRIGHT AND KENNETH W. GRAHAM, 23 *FED. PRAC. & PROC. EVID.* § 5307 (West 2004).
7. *See* *Schlossman & Gunkelman, Inc. v. Tallman*, 593 N.W.2d 374, 378 (N.D. 1999); *Affiliated Mfrs., Inc. v. Aluminum Co. of America*, 56 F.3d 521, 529 (3d Cir. 1995).
8. *See* *Olin Corp. v. Insurance Co. of North America*, 603 F. Supp. 445, 450 (S.D.N.Y. 1985).
9. *See, e.g.,* *Affiliated Mfrs., Inc.*, 56 F.3d at 529 (internal memoranda); *Blu-J, Inc. v. Kemper C.P.A. Group*, 916 F.2d 637, 641–642 (11th Cir. 1990) (independent evaluation of accounting firm's compliance); *see generally* MUELLER & KIRKPATRICK, *supra* n. 3, at § 135.
10. *Stacey v. Bangor Punta Corp.*, 620 F. Supp. 636, 637 (D. Me. 1985); *accord* *Weir v. Federal Ins. Co.*, 811 F.2d 1387, 1395 (10th Cir. 1987); *see also* *Brazil*, *supra* n. 1, at 982–987.
11. *See* *Olin Corp.*, 603 F. Supp. at 450; *see generally* *Brazil*, *supra* n. 1, at 988–990.
12. *Hasbrouck v. BankAmerica Housing Services*, 187 F.R.D. 453, 461 (N.D.N.Y. 1999).
13. *Allen County v. Reilly Indus.*, 197 F.R.D. 352, 353 (N.D. Ohio 2000).
14. *See* *Morse/Diesel, Inc. v. Fidelity and Deposit Co. of Maryland*, 122 F.R.D. 447, 449 (S.D.N.Y. 1988); *NAACP Legal Defense Fund v. Department of Justice*, 612 F. Supp. 1143, 1146 (D.D.C. 1985); *In re Subpoena Issued to CFTC*, 2005 W.L. 1119229 (D.D.C. 2005).
15. *Bottaro v. Hatton Assoc.*, 96 F.R.D. 158, 160 (E.D.N.Y. 1982) (applying the heightened standard to permit discovery of terms of settlement agreement). *See also* *Baby Doe v. Methacton Sch. Dist.*, 164 F.R.D. 175, 177 (E.D. Pa. 1995).
16. *See* *In re Initial Public Offering Sec. Litig.*, 21 MC 92 (SAS), 2004 WL 602690 at *5 (S.D.N.Y. Jan. 12, 2004) (court permitted discovery of Wells' submission, ruling that heightened standard not permitted by FRCP); *Bennett v. La Pere*, 112 F.R.D. 136 (D.R.I. 1986).
17. *See* *Grumman Aerospace Corp. v. Titanium Metals Corp. of America*, 91 F.R.D. 84 (E.D.N.Y. 1981).
18. Under federal law, mediation, or alternative dispute resolution, is authorized by statute. *See* 28 U.S.C. §§ 651 *et seq.*
19. *Tex. Civ. Prac. & Rem. Code* § 154.073 (West 2005). *See also* Kristina M. Kerwin, Note, *The Discoverability of Settlement and ADR Communications: Federal Rule 408 and Beyond*, 12 *REV. LITIG.* 665, 681–684 (Summer 1993).
20. 28 U.S.C. § 652(d). One example of such a rule is Local Rule 301.1(e)(4) of the federal district court in New Jersey.