Negotiating with Confidentiality

Supplementing the Protections of Rule 408

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"First, do no harm" is a maxim associated with the medical profession, but the same holds true for negotiations. The first step in a successful negotiation is to ensure that your statements don't come back to haunt you if the negotiation stalls. Federal Rule of Evidence 408 provides security for parties by prohibiting settlement offers, or other statements made during settlement negotiations, from being admitted as evidence to prove the validity or amount of a claim in dispute.[1] But Rule 408's protection is less robust than parties recognize. Before negotiating, litigants should consider whether additional measures are necessary to protect the privacy of their settlement communications.

The Policy and Protection Afforded by FRE 408

Federal Rule of Evidence 408 provides that settlement offers regarding disputed claims – or other statements made during settlement negotiations – are inadmissible as evidence "to prove or disprove the validity or amount of a disputed claim." For example, if a policyholder in a $100 million coverage action offered to settle for $50 million, the defendant could not use that offer to prove that the policyholder's claim is overstated.

As one court explained, "the rule reflects the reality that permitting consideration of settlement offers as reflecting an admission of liability in the amount of the offer would seriously discourage parties from discussing settlement or making settlement offers." *Cheyenne River Sioux Tribe v. U.S.*, 806 F.2d 1046, 1050 (Fed. Cir. 1986). "[T]o encourage free and frank discussion with a view toward settling the dispute," Rule 408 prevents using these offers to prove the validity or amount of a disputed claim. *United States v. Reserve Mining Co.*, 412 F. Supp. 705, 712 (D. Minn. 1976).

A party might conclude that Rule 408 adequately protects its statements in settlement negotiations. But as parties learn too late, there can be serious consequences for relying solely upon Rule 408.

Admissibility for "Another Purpose"

Importantly, Rule 408 only prohibits admitting into evidence settlement offers or statements used "to prove or disprove the validity or amount of a disputed claim." Rule 408 (b) allows the court to admit this evidence "for another purpose." The rule lists examples of other purposes, including "proving a witness's bias or prejudice, [and] negating a contention of undue delay" that could help a counterparty who seeks to disclose the settlement negotiations. Because this list is not exhaustive, a skilled attorney might persuade the court to view the phrase "another purpose" broadly – to the detriment of your case.

In *Athey v. Farmers Insurance Exchange*, a plaintiff sued his insurer for bad faith denial of his uninsured motorist insurance claim, and for breach of contract. 234 F.3d 357, 359 (8th Cir. 2000). During a settlement conference before a magistrate judge, the insurer refused to offer any amount to settle the breach of contract claim unless the insured agreed to abandon his bad faith claim. The insured's attorney promptly withdrew as counsel, and at trial, testified about the insurer's statements. The insurer argued that Rule 408 protected these statements, but the trial and appellate courts disagreed. The appellate court explained that controlling state law made attempts to condition the settlement of a breach of contract claim on the release of a bad faith claim, *itself* evidence of bad faith, concluding that the settlement communication "was 'offered for another purpose,' and the district court did not abuse its discretion by admitting it." *Id.* at 362. Thus, a $75,000 insurance claim turned into a $635,000 judgment, including punitive damages – based in no small part on a statement the insurer apparently believed to be innocuous, made during a settlement conference. *Id.* at 361.

> *Rule 408 falls short because it "is merely a rule of evidence," and does not protect against your counterparty's public disclosure of the terms of your settlement discussions.*

More commonly, courts allow settlement communications to be used to prove the amount in controversy (*Vermande v. Hyundai Motor Am., Inc.*, 352 F. Supp. 2d 195, 202 (D. Conn. 2004)), to provide a jurisdictional basis for a declaratory judgment action (*Rhoades v. Avon Prods., Inc.*, 504 F.3d 1151, 1161 (9th Cir. 2007)), or to prove a party's knowledge of certain facts (*Kraft v. St. John Lutheran Church*, 414 F.3d 943, 947 (8th Cir. 2005)). In complex litigation, at least one issue other than the claim's "validity or amount" is in dispute. Relying solely on Rule 408 to protect you could, therefore, be your undoing.

Other Limitations: Discovery and Actual Dispute

Rule 408 falls short because it "is merely a rule of evidence," and does not protect against your counterparty's

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public disclosure of the terms of your settlement discussions. *Alpex Computer Corp. v. Nintendo Co.*, 770 F. Supp. 161, 166 (S.D.N.Y. 1991). Furthermore, third parties in subsequent lawsuits may seek e discovery of your settlement communications, as "Rule 408 only protects disputants from disclosure of information to the trier of fact, not from discovery by a third party." *Folb v. Motion Picture Indus. Pension & Health Plans*, 16 F. Supp. 2d 1164, 1171 (C.D. Cal. 1998). Most litigants want their settlement discussions to be confidential, for business or other litigation reasons, and should consider additional measures to protect their privacy.

Given Rule 408's limitations, litigants should consider additional measures available to ensure they may negotiate candidly without the risk of providing admissible evidence.

Because many legal disputes develop slowly out of commercial relationships, parties should also know that Rule 408 only applies to statements made during "compromise negotiations." *Big O Tire Dealers, Inc. v. Goodyear Tire & Rubber Co.*, 561 F.2d 1365, 1372-73 (10th Cir. 1977). Where discussions have not "crystallized to the point of threatened litigation," Rule 408 may not protect them. *Id; but see Weems v. Tyson Foods, Inc.*, 665 F.3d 958, 965 (8th Cir. 2011) (recognizing and adopting lower standard requiring only "'an actual dispute or difference of opinion' regarding a party's liability for or the amount of a claim" to establish a dispute under Rule 408).

Litigants should also know that Rule 408 cannot be used to shield problematic documents. As one court explained, the Rule "does not require exclusion of any evidence otherwise discoverable simply because it is presented in the course of compromise negotiations." *ABM Indus., Inc. v. Zurich Am. Co.*, 237 F.R.D. 225, 228 (N.D. Cal. 2006).

Letter Agreements as a Partial Solution

Given Rule 408's limitations, litigants should consider additional measures available to ensure they may negotiate candidly without the risk of providing admissible evidence. One option: a letter agreement between the parties stipulating to a broader set of protections.

Such an agreement should be drafted to fit the unique circumstances of each litigation, addressing the potential pitfalls discussed above. For example, if negotiations occur at an early stage of a dispute, e.g. before a complaint is filed, the agreement could stipulate that the claim's validity or amount within the meaning of Rule 408 is disputed. The agreement could also protect against future uncertainties, such as the broad reach of the "another purpose" exception.

Judicial Enforcement of Letter Agreements

Scholars have expressed skepticism that courts would enforce such agreements,[2] and a party should consider all possible responses by a presiding judge if such an agreement needs to be enforced. Nonetheless, several U.S. courts have enforced these agreements. In *Victor G. Reiling Associates v. Fisher-Price, Inc.*, the court cited the "strong public policy favoring settlements and encouraging uninhibited settlement negotiations" in determining that "the parties' confidentiality agreement will be enforced." 407 F. Supp. 2d 401, 404 (D. Conn. 2006). Although the court kept out the evidence on Rule 408 grounds, the stipulation provided a strong alternative ground for the court's decision.

Similarly, in *Apple, Inc. v. Motorola Mobility, Inc.*, the court enforced a "Mutual Non-Disclosure and Rule 408 Agreement" between litigants that restricted information exchanged during settlement negotiations and other inter-party communications. Case No. 11-CV-178, 2012 WL 5416941 (W.D. Wis. Oct. 29, 2012). The parties had agreed to bar the use of any documents contained or exchanged in settlement correspondence "in any manner or for any purpose other than in connection with the settlement negotiations between them," as well as other, more tailored restrictions. The court carefully applied their agreement, excluding all evidence relating to the parties' conduct after the agreement was reached except for that conduct allowed by the non-disclosure agreement.

Other courts have also enforced Rule 408-related agreements to exclude evidence (*e.g., Osteotech, Inc. v. Regeneration Techs., Inc.*, No. 3:06-cv-04249, 2008 WL 4449564 (D. N.J. Sept. 25, 2008)) or to strike portions of pleadings reflecting information learned in settlement discussions (*e.g., Pension Advisory Grp., Ltd. v. Country Life Ins. Co.*, 771 F. Supp. 2d 680, 708 (S.D. Tex. 20111)). One federal Court of Appeals even suggested that if a party wishes to make a settlement demand without providing a basis for a declaratory judgment action, it enter into a "suitable confidentiality agreement" to provide broader protection than Rule 408. *SanDisk Corp. v. STMicroelectronics, Inc.*, 480 F.3d 1372, 1375 n.1 (Fed. Cir. 2007).

Remember: confidentiality letter agreements are contracts, susceptible to all normal contract enforcement defenses. *See Osteotech, Inc.*, 2008 WL 4449564 at *3.

Beware of Third Parties

A final warning: Although a letter agreement may help prevent your counterparty from disclosing settlement communications, in most jurisdictions such letters do not shield those communications from

third party discovery. Among federal Courts of Appeals, only the Sixth Circuit has recognized a "settlement communications privilege." *Goodyear Tire & Rubber Co. v. Chiles Power Supply, Inc.*, 332 F.3d 976 (6th Cir. 2003). Most courts have rejected the existence of the privilege, *e.g., In re MSTG, Inc.*, 675 F.3d 1337 (Fed. Cir. 2012), while some take a middle ground, allowing discovery of settlement communications upon a "particularized showing of a likelihood that admissible evidence will be generated" by discovery, *Bottaro v. Hatton Assoc.*, 96 F.R.D. 158, 160 (E.D.N.Y. 1982).

Letter agreements may still serve some purpose in subsequent discovery disputes, such as requiring your counterparty to make all efforts to resist discovery. They may also help persuade the next judge that she should exercise her discretion to prevent the settlement communications from being disclosed. But a party should not assume a confidentiality letter agreement will prevent third parties from obtaining relevant documents in future discovery. ●

Endnotes

1 This article only addresses the Federal Rules of Evidence. Although many states have similar rules governing the admissibility of settlement communications, those rules may be interpreted or implemented differently by the various state courts.

2 *E.g.,* Wayne D. Brazil, *Protecting the Confidentiality of Settlement Negotiations*, 39 Hastings L. J. 955, 1026-1029 (1988).

Butler Rubin hosted an AIRROC Negotiation Workshop at The Standard Club Chicago on February 26, 2014. Professor Lynn Cohn, the Director of the Center on Negotiation and Mediation at Northwestern Law School, led the well-attended all-day program, which included interactive lectures, actual negotiations and the opportunity to get individualized feedback on performance.

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