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FEDERAL COURT REVIEW

Willing to settle? Think twice

Sharing information with the other side could come back to haunt a firm, D.C. Circuit warns.

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WHEN A COMPANY ENGAGES in settlement discussions with the federal government or a civil plaintiff in one case, can those communications be the subject of discovery in a later and different lawsuit? What about documents generated for purposes of facilitating a settlement? Or are settlement statements and materials privileged from subsequent discovery under federal law? Should they be?

In a surprising published decision, the U.S. Circuit Court of Appeals for the District of Columbia recently held that the existence of a federal settlement privilege is an "open question" in federal courts. *In re Subpoena to the Commodity Futures Trading Comm'n*, No. 05-5168, 2006 WL 508066 (D.C. Cir. March 3, 2006). In doing so, the court declined to adopt the lower court's holding that no

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such privilege exists. *In re Subpoena*, 370 F. Supp. 2d 201 (D.D.C. 2005). But the D.C. Circuit also chose not to adopt the reasoning of the 6th Circuit, which expressly affirmed the existence of a federal settlement privilege. *Goodyear Tire & Rubber Co. v. Chiles Power Supply Inc.*, 332 F.3d 976, 977 (6th Cir. 2003).

The position advocated by the United States before the D.C. Circuit was also noteworthy. The Commodity Futures Trading Commission (CFTC), represented by the U.S. Department of Justice, argued both in briefing and at the hearing that communications and documents involving settlement of threatened or actual litigation with the government are not and should not be privileged from disclosure in a subsequent civil case.

The "open question" raised by the D.C. Circuit creates significant uncertainty as to how individuals engaged in settlement discussions should conduct themselves. The issue has far-reaching consequences for all companies that attempt to negotiate a resolution to a dispute before or during litigation, for all practitioners when advising clients concerning settlement protocol, for all federal regulatory agencies that attempt to resolve matters without expensive litigation and for the federal judiciary itself, since even a small reduction in the percentage of settled cases could be overwhelming.

The prospect that settlement communications could be used against a person in a subsequent proceeding means that his or

her attorney must seriously consider at the outset whether engaging in full, frank and substantive discussions is in the client's best interests. The prospect that such discussions could have a potentially more damaging effect in the future is worthy of consideration. The possibility that written materials generated in furtherance of settlement could be discovered in a subsequent lawsuit may caution against their creation in the first place. That settlement proceedings could create potential witnesses also presents a disturbing prospect.

The situation tends to argue against full, frank discussions.

A promise of confidentiality between the parties in the first case does not resolve the problem. Absent the recognition of a federal settlement privilege by the federal courts or by an act of Congress, a promise of confidentiality in one action does not in itself protect documents from discovery by another party in a subsequent proceeding. The new party was not a party to the earlier promise and therefore cannot be bound by it.

Nor does a court order of confidentiality at the time of the settlement ensure sufficient protection. Any such order must have a sufficient basis in law. While the privileged nature of such materials remains an open question in most of the federal

circuits, the enforceability of a confidentiality order in a different forum with a different party remains in doubt. Indeed, *In re Subpoena to the Commodity Futures Trading Commission* involved a situation in which one federal court in the Eastern District of California found that a settlement privilege existed over various materials created for purposes of facilitating settlement, while another federal district court in the District of Columbia, at the urging of the CFTC, found that no settlement privilege existed at all under federal law.

Congress did enact legislation in 1999 to provide for the confidentiality of alternative dispute resolution processes and to prohibit disclosure of confidential communications in these formal proceedings. 28 U.S.C. 651-652. After a civil action is commenced, the participation by a third-party neutral in an attempted resolution through early evaluation, mediation, a minitrial or an arbitration provides an enforceable basis to protect the confidentiality of settlement discussions that take place within the confines of this process.

As a result, 11 of the 13 federal circuit courts of appeals, and a large number of federal district courts, have adopted local rules to promote and protect formal mediation discussions. Furthermore, every state in the union has attempted through legislation to protect the confidentiality of settlement communications and documents that take place in the context of a formal mediation proceeding.

But settlement discussions that take place before the commencement of litigation, and materials generated to facilitate settlement before a lawsuit, are not protected by this congressional act. Neither are communications that take place between parties directly, outside the presence of a mediator or other third-party neutral. Materials generated to attempt to facilitate settlement outside a formal mediation proceeding also are not protected under the 1999 legislation. Yet often, direct communications between counsel or parties before or during a dispute are the most productive and efficient means to achieve an effective resolution.

It's hard to see any principled basis for distinguishing a formal mediation privilege from one that protects similar communications taking place outside such

a proceeding. Encouraging the voluntary resolution of disputes in the federal courts is usually the desired goal. A party arguably should be permitted to let down its guard to facilitate candid discussion in the context of settlement without the real fear that what it says and does in that context can be used against it in a future court of law. A fundamental purpose of the judicial system—the just and efficient resolution of disputes—is served by recognition of a settlement privilege. Until the federal courts decisively recognize a shield over settlement documents and discussions, there is good reason to tread carefully in the settlement process.

A modest reduction in settlements could overwhelm system.

Legal basis for privilege

Federal Rule of Evidence 501 governs the recognition of privileges in federal courts. It provides that, in the absence of some other congressional action, the existence of a privilege “shall be governed by the principles of common law as they may be interpreted by the courts of the United States in the light of reason and experience.” Courts have been vested with flexibility to develop rules of privilege as necessary and appropriate on a case-by-case basis. See, e.g., *Jaffee v. Redmond*, 518 U.S. 1 (1996).

The common law recognized the importance of protecting settlement discussions, documents and related materials. Although Rule 408 of the Federal Rules of Evidence deals only with the exclusion of settlement-related evidence at trial, and hence does not directly address discovery, the three rationales for Rule 408 derive from the common law.

First, Dean John Henry Wigmore expressed that the “true reason” for the exclusion rule is that settlement materials are irrelevant because “the offer implies merely a desire for peace, not a concession of wrong done.” 4 John Henry Wigmore, *Wigmore On Evidence* § 1061 (Chadborn rev. 1972). Put another way,

settlement communications are often punctuated with puffing and posturing, and hence should not necessarily be considered reliable evidence.

Second, fundamental principles from the law of contracts would seem to support the protection of settlement discussions. See 23 Charles Alan Wright et al., *Federal Practice and Procedure* § 5302, at 169 (1980). At common law, if the offeror of settlement prefaced his compromise proposal with the magic words “without prejudice,” it thereby created a unilateral implied contract that the offer and related matter could never be used against the party.

Third, and most pertinent to the current question, there exists “the strong public policy favoring negotiated resolution of disputes.” *Id.* at 170. “[C]onfidential settlement communications are a tradition in this country.” *Goodyear*, 332 F.3d at 980 (citations omitted).

In sum, parties may be deterred from making offers of compromise if those offers could be used against them whether a settlement fails or succeeds. The law attempts to alleviate that fear and encourages the making of offers of compromise by rendering settlement communications and related materials privileged. While Wigmore rejected this basis for Rule 408, Dean Charles T. McCormick argued in favor of this justification and ultimately persuaded the Advisory Committee for the Federal Rules of Evidence. *Id.* See also Christopher B. Mueller & Laird C. Kirkpatrick, *Federal Evidence* § 135 (2d ed. 1994).

McCormick emphasized, “This view that the rule excluding offers of compromise is a rule of privilege designed to encourage the settlement of disputes out of court, and not a rule of competency, is fortified by a number of judicial pronouncements.” McCormick on Evidence § 251 (1954) (citing multiple cases); renumbered at § 274 (1972). After all, it is easy to contemplate situations where documents created to facilitate a resolution may satisfy the broad standard of materiality for discovery or even trial purposes. Hence, the advisory committee observed, “A more consistently impressive ground [than lack of relevancy] is promotion of the public policy favoring the compromise and settlement of

disputes.” Advisory Committee Note, Rule 408.

6th Circuit sees privilege

The 6th Circuit, in *Goodyear*, agreed that “a public interest transcending the normally predominant principle of utilizing all rational means for ascertaining truth” exists when a federal settlement privilege is sought to protect, from third-party discovery, materials created for the purpose of settlement. 332 F.3d at 977. As a result, the 6th Circuit held that “statements made in furtherance of settlement are privileged and protected from third-party discovery.” *Id.*

A settlement privilege arguably is rooted in the imperative need for confidence and serves a vital public end. Aside from bringing parties to the settlement table, a federal settlement privilege encourages creative bargaining, allows for the acknowledgment of potential past wrongdoing and facilitates the offering of money and other compromises. See *Goodyear*, 332 F.3d at 980.

Abandon adversarial tendencies

Parties must be able to abandon their adversarial tendencies to achieve an effective resolution without fear that this openness will have other, unintended, consequences. As the 2d Circuit recognized, “[i]f participants cannot rely on the confidential treatment of everything that transpires during these sessions then counsel of necessity will feel constrained to conduct themselves in a cautious, tight-lipped, non-committal manner more suitable to poker players in a high stakes game than to adversaries attempting to arrive at a just resolution of a dispute.” *In the Matter of Lake Utopia Paper Ltd.*, 608 F.2d 928, 930 (2d Cir. 1978).

The strong public policy favoring settlement exists “whether done under the auspices of the court or informally between the parties,” the 6th Circuit said. *Goodyear*, 332 F.3d at 980. One could persuasively argue that to limit the privilege to formal mediation processes after the commencement of litigation undermines the goal of judicial efficiency, by requiring that a lawsuit be filed first and a mediation or other ADR proceeding take place in order to protect settlement materials

from discovery by third parties in a subsequent action. Besides discouraging the efficiencies derived from direct communications between the parties before or after litigation commences, the lack of a privilege harms those who cannot afford the expense of formal ADR processes.

A strong argument could also be made that any potential for abuse of such a privilege is minimal, and certainly does not exceed that associated with other

The potential for abuse of such a privilege is minimal.

recognized privileges, such as that between attorney and client. Like Rule 408, any privilege for discovery purposes should not apply to materials existing prior to the time of the recognition of a dispute and consideration of settlement.

The privilege could be limited to materials created for purposes of facilitating settlement, such as compilations of evidence or the equivalent of mediation briefs, as well as settlement communications themselves. Nor need the fact that Rule 408 recognizes exceptions to the rule of inadmissibility at trial mean that no settlement privilege should exist. Nonliability exceptions to a federal settlement privilege can easily be recognized, just as exceptions exist with regard to the attorney-client privilege.

The “open question” recognized by the D.C. Circuit suggests that, for now, caution in settlement talks is in order. Before litigation, practitioners should make their clients aware of potential risks before choosing to engage in candid party-to-party dealings or generating documents for purposes of facilitating resolution, whether with the federal government or another opposing party. During litigation, the same caution is advisable with regard to discussions that take place outside the formal mediation context.

Certainly, engaging in a mediation or another ADR process with a third-party neutral or a court once litigation has begun should accomplish the protection of

settlement materials from third-party discovery. Short of litigation and a formal mediation process, a party can attempt to protect communications and other written materials by first entering into written agreements acknowledging that both parties are engaging in settlement discussions and that documents are being created and exchanged solely for settlement purposes.

No safe harbor

Yet while these agreements later may be used to demonstrate that discussions and materials relate to settlement, outside the formal mediation process, there is no reliable assurance that such information will be protected from later discovery, except in the 6th Circuit and a few district courts that have recognized the existence of a privilege. Similarly, prior to litigation it may be advisable under the current state of the law to conduct settlement communications in the presence of a third-party neutral. While this circumstance is not encompassed by the 1999 congressional legislation regarding formal mediation, the presence of a mediator may increase the chances that a subsequent court will find that the settlement discussions and materials should be protected. But it certainly is no sure thing.

The bottom line is that only the unequivocal recognition of a federal settlement privilege by the federal courts or by an act of Congress can provide the necessary safe harbor. Until all federal courts decisively recognize protection over settlement documents and discussions, there is good reason to tread carefully in the settlement process before and during litigation.

One would hope that the current state of limbo created by the position of the United States and the recent opinion of the D.C. Circuit will not be “open” for long. **NLJ**