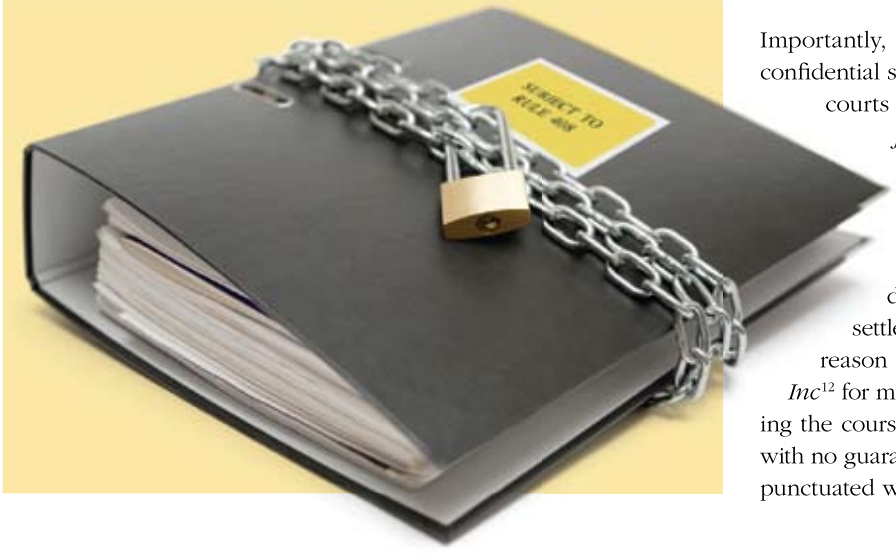
Rule 408: The Privilege is Yours…for Now

By Lynn H. Shecter

Most litigators, having suffered through the throes of discovery, are all too happy to be able to draft The Settlement Letter, secure in the knowledge that putting four magic words in the corner will keep secret any representations made in the letter, should settlement fail. Those words, "Subject to Rule 408," are not magic, however, and are instead subject to diverse interpretations and dissimilar limitations. Simply stating that a representation is subject to FRE 408, the rule governing the admissibility of evidence concerning settlements, does not clothe it in an immutable cloak of invisibility.

FRE 408 provides:

> (a) Prohibited uses.—Evidence of the following is not admissible on behalf of any party, when offered to prove liability for, invalidity of, or amount of a claim that was disputed as to validity or amount, or to impeach through a prior inconsistent statement or contradiction:
> (1) furnishing or offering or promising to furnish—or accepting or offering or promising to accept—a valuable consideration in compromising or attempting to compromise the claim; and
> (2) conduct or statements made in compromise negotiations regarding the claim, except when offered in a criminal case and the negotiations related to a claim by a public office or agency in the exercise of regulatory, investigative, or enforcement authority.
> (b) Permitted uses.—This rule does not require exclusion if the evidence is offered for purposes not prohibited by subdivision (a). Examples of permissible purposes include proving a witness's bias or prejudice; negating a contention of undue delay; and proving an effort to obstruct a criminal investigation or prosecution.



FRE 408(b) does not require exclusion when the evidence is offered for a purpose not prohibited by the rule, but that "other purpose" must not include the validity or amount of the claim.[1] However, be aware that courts have admitted evidence of settlement talks or the settlement agreement itself under the so-called "other purpose" prong of FRE 408, e.g., to rebut a claim that a party did not know of the suit,[2] to establish an agency relationship,[3] or when a wrong has been committed in the course of the settlement negotiations.[4] These are examples of why simply writing "Subject to Rule 408" may not protect your representation, and certainly not your settlement agreement, from being admitted as evidence.

Goodyear Tire & Rubber Co v Chiles Power Supply, Inc,[5] however, was the first federal appellate decision to announce a federal discovery privilege for statements made in the course of and for the purpose of furthering settlement negotiations. While *Goodyear* has proved to be unique, as few courts have followed its lead,[6] its significance is that it demonstrates that the evidentiary rule alone is insufficient to protect settlement agreements.

In *Goodyear,* the United States Court of Appeals for the Sixth Circuit, applying the test of *Jaffee v Redmond*[7] to create a new privilege, held that

> 'in the light of reason and experience,'…a settlement privilege serves a sufficiently important public interest, and therefore should be recognized. There exists a strong public interest in favor of secrecy of matters discussed by parties during settlement negotiations….The ability to negotiate and settle a case without trial fosters a more efficient, more cost-effective, and significantly less burdened judicial system…[and enables parties] to propose the types of compromises that most effectively lead to settlement…confident that their proposed solutions cannot be used on cross examination.[8]

Importantly, the *Goodyear* court also focused on a tradition of confidential settlement communications and the holdings of other courts that have "recognized the existence of some sort of *formal* settlement privilege."[9]

Goodyear relied on *Allen Co, Ohio v Reilly Industries, Inc,*[10] in which the court had denied a defense request for the content of settlement negotiations between the plaintiff and another defendant given the "'well-established privilege relating to settlement discussions.'"[11] *Goodyear* also relied on another reason presented by the court in *Cook v Yellow Freight Sys, Inc*[12] for maintaining the confidentiality of statements made during the course of settlement negotiations: those statements come with no guarantee of veracity. "Settlement negotiations are typically punctuated with numerous instances of puffing and posturing….

Fast Facts

Even settlement agreements designated as confidential may not be confidential, and additional steps may be necessary if the parties wish to retain the secrecy of their agreements.

The concept of "puffing" and the unreliability of documentation created specifically for settlement purposes under Rule 408 must be reconciled with an attorney's duty under MRPC 4.1.

The discovery of these sort of 'facts' would be highly misleading if allowed to be used for purposes other than settlement."[13]

Applying the "other purpose" prong of FRE 408, *Goodyear* would not exclude from evidence the fact that settlement talks had occurred. The Sixth Circuit noted that if one party denied meeting the other, for example, evidence from settlement talks could be introduced as proof that the parties had met. However, the underlying communications themselves could not be introduced.[14] Confidentiality must be maintained, even if the negotiations had failed.[15]

Despite the lack of support from other circuits, the Sixth Circuit still disfavors the admission of evidence concerning settlement matters. Most recently, the Sixth Circuit reversed a jury verdict, finding substantial prejudice by the admission of an offer of reinstatement that the court held constituted an offer of settlement.[16]

In Michigan, settlement agreements are not exempt from disclosure under the Freedom of Information Act, even with a contract to keep the information confidential, in the absence of a specific statutory exemption for settlement agreements.[17] The Michigan Court of Appeals has affirmed the use of settlement correspondence to prove that the defendant insurance company unreasonably delayed paying claims.[18] The basis for the decision was that since MRE 408 explicitly contemplates the admissibility of evidence of settlement-related discussions for the purpose of "negativing a contention of undue delay," it logically follows that evidence of settlement discussions may also qualify as admissible to *prove* undue delay.[19] (The Court, however, properly raised concerns about the substance of the letters and indicated that they would not be relevant on retrial.)

As far as I can determine, however, the question whether Michigan will accept the *Goodyear* privilege has been neither asked nor decided. Although federal law is not binding on Michigan state courts interpreting Michigan court rules, it can be instructive if the Michigan rules and the federal rules are similar. MRE 408 is quite similar to FRE 408.[20] The Michigan and federal policies underlying the rules are the same: evidence of a settlement is not relevant when determining liability and inadmissibility promotes "the public policy favoring the compromise and settlement of disputes."[21]

Nonetheless, some concerns might be raised regarding the adoption of the *Goodyear* privilege in Michigan. Following a Second Circuit case, *Pierce v FR Tripler & Co,*[22] the Sixth Circuit held that settlement evidence demonstrating a failure to prove or disprove mitigation of damages relates to the amount of the claim[23] and is thus inadmissible under FRE 408.[24] When a party raises an issue concerning the validity or amount of a claim, admitting evidence of settlement offers on this issue violates FRE 408 on its face. Clearly, parties would simply not make settlement offers if confronted with a choice of admitting liability or damages or having the offer admitted.[25]

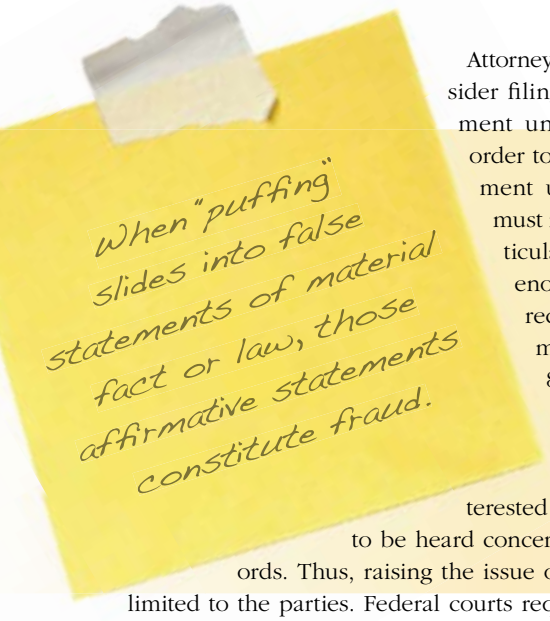
Another concern relates to one of the underpinnings of *Goodyear*: the concept of "puffing" and the basic unreliability of documentation created for the purpose of settlement negotiations. Both of these principles recognize the inherent conflict between confidentiality and secrecy on one hand and the need for these concepts to be reconciled with an attorney's duty under MRPC 4.1: "In the course of representing a client, a lawyer shall not knowingly make a false statement of material fact or law to a third person." The comments to FRE 408 indicate that estimates of price or value, a party's intentions of an acceptable settlement, and the existence of an undisclosed principal (unless nondisclosure of the principal would constitute fraud) are not considered matters of material fact. Further, the comments to FRE 408 note that the evidence is admissible if it is offered to show that a party made fraudulent statements to settle the litigation.

It is acceptable for the parties to dicker about price and value—what they will pay and what they will take. It is not acceptable, as MRPC 4.1 makes clear, for a lawyer to make up stories about the case, even to effect a settlement. When "puffing" slides into false statements of material fact or law, if we can take the comments and rules at face value, those affirmative statements constitute fraud. This, then, is the only way to reconcile MRPC 4.1 with FRE 408 and MRE 408. Eventually, it comes down to the fact that the successful negotiators will be those who recognize the importance of complying with MRPC 4.1. It means that people can accept your word. Perhaps a further analysis of this awaits another day.

Having said this, I note that before practitioners in federal court can apply *Goodyear,*[26] the party seeking discovery must make the showing required by FR Civ P 26(b)(1): that a settlement agreement contains information relevant to a party's claim or defense and is either admissible at trial or reasonably calculated to lead to the discovery of admissible evidence.[27] Lack of relevance is always a reason supporting the exclusion of evidence. Arguably, statements made in furtherance of settlement are never relevant, as they are "motivated by a desire for peace rather than from any concession of weakness of position."[28] However, the specific question before the *Goodyear* court did not involve documents, so the panel did not have to resolve the issue whether FRE 408 protects the confidentiality of documents created or used to further the settlement process. Therefore, as *Westlake Vinyls, Inc v Goodrich Corp* held, *Goodyear* did not create "a broad privilege protecting from discovery any document or communication arguably related to settlement negotiations."[29]

Documents are not privileged if they were exchanged during settlement negotiations but were not authorized or created for the purpose of settlement negotiations.[30] The *Goodyear* privilege was designed to protect documents that were created specifically for settlement negotiations and therefore are considered "inherently unreliable because of the likelihood of puffery."[31]

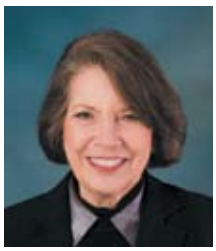
Thus, under *Goodyear,* the settlement agreement itself is not confidential. Practitioners should be aware that even settlement agreements designated as confidential may not be confidential[32] and that additional steps may be necessary if the parties wish to retain the secrecy of their agreements.[33]



Attorneys in state court may consider filing the settlement agreement under seal. However, in order to file a settlement agreement under seal, the parties must make the necessary particularized showing. It is not enough to merely label a record a settlement document. In Michigan, MCR 8.119(F) requires a showing of good cause to seal a document. MCR 8.119(F)(3) gives any interested person the opportunity to be heard concerning the sealing of records. Thus, raising the issue of sealing records is not limited to the parties. Federal courts require a specific showing of substantial personal, competitive, or financial harm as a prerequisite to an order sealing any document.[34] Public access to court documents is a fundamental feature of the American judicial system, which disfavors unwarranted secrecy of court documents.[35] Therefore, it is likely that, without more, a court will not grant the right to seal a garden-variety settlement agreement.

Although starting from the general rule that the public is entitled to every person's evidence and that testimonial privileges are disfavored, the court in *Folb v Motion Picture Industry Pension & Health Plans*[36] found the need for a public good transcending these principles and limited the settlement privilege to communications made in preparation for and during the course of mediation with a neutral mediator. This concept can certainly be applied in Michigan courts, and could be extended to a court-ordered settlement conference.

For now, the privilege remains in federal court. Therefore, I urge practitioners, before they begin serious settlement negotiations, to introduce the subject of the privilege to the trial court judge, especially a state court judge. Since Michigan has not rejected the privilege, and given the broad public policy encouraging settlement negotiations in both state and federal courts, the parties may be able to fashion an appropriate order keeping settlement negotiations, when they occur, confidential. This approach is consistent with what is undoubtedly the parties' expectations, and is the most amenable way to seek resolution without the participants wondering about eavesdroppers at the negotiating table. In this spirit, it may be possible to extend the parties' cooperation to an order that protects the settlement agreement itself. ■



Lynn H. Shecter, a shareholder in Roy, Shecter & Vocht, P.C., Bloomfield Hills, Michigan, litigates in complex and class actions as well as employment and consumer actions. She also represents attorneys in discipline and related matters and appears as an expert witness on attorney ethical issues. She is also an arbitrator.

FOOTNOTES

1. *Stockman v Oakcrest Dental Ctr,* 480 F3d 791, 798 (CA 6, 2007).
2. *Breuer Electric Mfg Co v Toronado Sys of America, Inc,* 687 F2d 182, 185 (CA 7, 1982).
3. *Prudential Ins Co of America v Curt Bullock Builders, Inc,* 626 F Supp 159, 165 (ND Ill, 1985).
4. *Stockman,* 480 F3d at 798–799.
5. *Goodyear Tire & Rubber Co v Chiles Power Supply, Inc,* 332 F3d 976 (CA 6, 2003).
6. See, e.g., *In re Subpoena Duces Tecum Issued to Commodity Futures Trading Comm,* 370 US App DC 113; 439 F3d 740, 754 (2006).
7. *Jaffee v Redmond,* 518 US 1; 116 S Ct 1923; 135 L Ed 2d 337 (1996).
8. *Goodyear,* 332 F3d at 980.
9. *Id.* at 981 (emphasis in original).
10. *Allen Co, Ohio v Reilly Industries, Inc,* 197 FRD 352 (ND Ohio, 2000).
11. *Id.* at 353, quoting *Cook v Yellow Freight Sys, Inc,* 132 FRD 548, 554 (ED Cal, 1990), rev'd on other grounds by *Jaffee.*
12. *Cook,* n 11 *supra.*
13. *Cook,* 132 FRD at 554.
14. *Goodyear,* 332 F3d at 981–982.
15. *Id.* at 980.
16. *Stockman,* 480 F3d at 794, 797.
17. See *Huron Restoration, Inc v Eastern Michigan Univ Bd of Control,* unpublished opinion per curiam of the Court of Appeals, issued January 22, 1999 (Docket No. 203719), pp 1–2.
18. *Zaremba Equip v Harco Nat'l Ins Co,* 280 Mich App 16; 761 NW2d 151 (2008).
19. *Id.* at 48.
20. MRE 408 provides:

    > Evidence of (1) furnishing or offering or promising to furnish, or (2) accepting or offering or promising to accept, 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, negativing a contention of undue delay, or proving an effort to obstruct a criminal investigation or prosecution.

21. *Windemuller Electric Co v Blodgett Mem Med Ctr,* 130 Mich App 17, 22; 343 NW2d 223 (1983).
22. *Pierce v FR Tripler & Co,* 955 F2d 820, 826–827 (CA 2, 1992).
23. The goal of mitigation is the prevention of unnecessary economic loss. *Stockman,* 480 F3d at 798.
24. *Id.* at 798.
25. *Id.* at 798–799.
26. The nature of the showing required to trigger the *Goodyear* privilege is beyond the scope of this article, but I strongly urge the use of in camera hearings before the court's final ruling. An unfavorable decision could otherwise leave exposed matters that would not have seen the light of the courtroom but for the existence of the *Goodyear* motion.
27. *Westlake Vinyls, Inc v Goodrich Corp,* 2007 WL 1959168, *3 n 1 (WD Ky, June 29, 2007).
28. *Goodyear,* 332 F3d at 983.
29. *Westlake, supra* at *3.
30. *Grupo Condumex v SPX Corp,* 331 F Supp 2d 623, 629 (ND Ohio, 2004).
31. *Id.;* see also *Ramada Dev Co v Rauch,* 644 F2d 1097 (CA 5, 1981) (holding that statements made and documents prepared solely for settlement negotiations are not within the so-called "discovery" exception to FRE 408, which prevents parties from rendering preexisting documents inadmissible simply by bringing them to a settlement conference).
32. *American Guarantee & Liability Ins Co v CTA Acoustics, Inc,* 2008 WL 1924229 (ED Ky, April 29, 2008).
33. None of this discussion is relevant to class actions, in which the course of settlement negotiations is often relevant to determining the fairness of the settlement and therefore open to court scrutiny. See, e.g., *In re Gen Motors Corp Engine Interchange Litigation,* 594 F2d 1106, 1124 (CA 7, 1979).
34. *Tinman v Blue Cross & Blue Shield of Michigan,* 176 F Supp 2d 743, 745 (ED Mich, 2001).
35. *Brown & Williamson Tobacco Corp v Fed Trade Comm,* 710 F2d 1165, 1177 (CA 6, 1983).
36. *Folb v Motion Picture Industry Pension & Health Plans,* 16 F Supp 2d 1164, 1171 (CD Cal, 1998), aff'd 216 F3d 1082 (CA 9, 2000).