

Not So Fast: Limits of 'Settlement Negotiation' Protections

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Understanding How and Why 'Settlement Negotiations' May Be Used Against You

To promote honest and open discussions in resolving disputes, courts have adopted rules to specifically safeguard the information disclosed and exchanged during

the course of those discussions. You may recognize the label "**CONFIDENTIAL SETTLEMENT COMMUNICATION**," or something similar if you have been involved in resolving disputes or negotiating deals for businesses. This label is affixed to documents to prevent their use in any ongoing or future litigation against the sending party.

While settlement communications are often inadmissible in court proceedings, it's far too simplistic—and dangerous—to suggest that anything your company considers to be a "settlement negotiation" is going to be kept out of court. For this reason, it is important to understand the limits of the protections afforded to "settlement negotiations." Otherwise, your company may make a statement in what it believes to be a confidential "settlement negotiation" only to have that statement used against it in court. This article explores some of the common situations in which your company may fall into a trap if it doesn't understand the rules regarding protections for settlement negotiations or communications.

The Basis for Protection of Settlement Communications

The protections relating to the admissibility of settlement communications are found in the Federal and North Carolina Rules of Evidence. In the Federal Rules of Evidence (and most state rules, including North Carolina's) Rule 408 (sometimes referred to in this article as the "Rule") is the rule that addresses the admissibility of settlement negotiations. The Rule provides:

(a) Prohibited Uses. Evidence of the following is not admissible—on behalf of any party—either to prove or disprove the validity or amount of a disputed claim or to impeach by a prior inconsistent statement or a contradiction:

- (1) furnishing, promising, or offering—or accepting, promising to accept, or offering to accept—a valuable consideration in compromising or attempting to compromise the claim; and
- (2) conduct or a statement made during compromise negotiations about the claim—except when

offered in a criminal case and when the negotiations related to a claim by a public office in the exercise of its regulatory, investigative, or enforcement authority.

(b) Exceptions. The court may admit this evidence for another purpose, such as proving a witness's bias or prejudice, negating a contention of undue delay, or proving an effort to obstruct a criminal investigation or prosecution.

A quick reading of Rule 408 makes it pretty clear that it doesn't provide the all-encompassing protection for settlement negotiations that many think. In particular, there are three potential traps for your company if it isn't aware of Rule 408's limitation:

- *First*, the Rule only relates to the admissibility of settlement negotiations, it doesn't relate to the discovery of settlement negotiations.
- *Second*, the Rule only protects "compromise negotiations."
- *Third*, the Rule contains express exceptions.

Each one of these potential traps should be considered before assuming that communication relating to a negotiation will be protected.

However, it is worth noting that the Rule is not toothless. In a recent case, the United States Court of Appeals for the Fourth Circuit granted defendants an entirely new trial because the district court erroneously admitted evidence of the parties' "Compromise Statements" (the substance of two phone calls during which a commission, the subject of the lawsuit, was discussed).

Settlement Communications May Not Be Admissible, But They Can Be Discoverable

The first potential trap relating to Rule 408 protection is evident from its plain language. Specifically, Rule 408 says only that settlement communications are "not admissible." However, just because a settlement communication may be inadmissible does not mean that the opposing party can't discover it. This creates a potential issue because your company may tend to be more open and frank in settlement communications because of the belief that they are protected communications. But, you should be cautious because, even if not admissible, your company's settlement communications might be discoverable. A simple hypothetical demonstrates this point:

Plaintiff 1 has sued your company claiming that your company's negligent supervision of an employee caused Plaintiff 1's injury. As part of settlement negotiations, your company sends Plaintiff 1 a communication similar to the following: "Although we could have pre-screened this employee better, we were not negligent in supervising the employee. Therefore, we can only offer 50% of your claimed damages." Plaintiff 1 ultimately agrees and accepts the offer.

Shortly after your company settles with Plaintiff 1, Plaintiff 2 files a lawsuit alleging that the same employee caused Plaintiff 2's injury as well and alleging the same negligent supervision claim against your company. As part of discovery in this lawsuit, Plaintiff 2 asks for "all written communications between your company and Plaintiff 1."

Rule 408 would not protect against disclosure of the communication in which your company admitted it could have better pre-screened the employee. Although this communication wouldn't necessarily be admissible in the trial of Plaintiff 2's case, it would give Plaintiff 2 valuable insight—Plaintiff 2 would know that your company thinks it may not have adequately pre-screened its employee. And this knowledge might give Plaintiff 2 a leg up in the litigation.

So, there's a lesson to learn here. Although settlement communications themselves may not be admissible, an opposing party may be able to discover them. Therefore, your company should not let its guard down when engaged in dispute resolution and should be cautious about its written communications. Otherwise, a future opponent may be able to score valuable intelligence on what your company considers its strengths and, more importantly, its weaknesses.

"Compromise Negotiations" Do Not Include Business Negotiations

The second potential trap relating to Rule 408's protection of settlement communications relates to its vague "compromise negotiations" language. Courts interpreting Rule 408 have found that "compromise negotiations" don't include simple business negotiations. In other words, there must be some existing legal dispute that's being resolved, not just standard back-and-forth negotiations over a matter of routine business. Under this standard, the following are examples of communications that don't qualify for protection as "compromise negotiations":

- General discussions between parties about a contract, the meaning of its terms, or the parties' performance.
- "Settlement offers" regarding "lump sum" payments versus "monthly payments."
- Offers of a "breakup fee" for a contract which is more appropriately a proposal made in the midst of a business communication than a dispute under Rule 408.

What these examples make clear is that even if parties are negotiating over conflicting terms, Rule 408 won't apply unless there's a true legal dispute between the parties. For example, if the parties are disputing whether payment is actually owed under a contract, there may be Rule 408 protections for those communications. However, if the parties agree that payment is due under the contract and are simply negotiating how that payment will be made, Rule 408 may not protect the communications.

Also, be mindful that the existence of a legal dispute between the parties does not automatically protect all compromise negotiations. For example, tolling agreements—an agreement by which a defendant in an ongoing legal dispute agrees to extend the statutory limitations period on a plaintiff's claim to allow for additional time to resolve the dispute outside of court—are not afforded protection under Rule 408.

The takeaway here is that your company shouldn't count on all negotiations being protected from admissibility as "compromise negotiations." Compromise negotiations (as referred to in Rule 408) and business negotiations are not synonymous—even when the business negotiations involve the exchange of conflicting terms.

It's also appropriate to mention here the common "**CONFIDENTIAL SETTLEMENT COMMUNICATION**" label mentioned at the outset of this article. Your company's use of this label potentially could help in convincing a court that the so-labeled communications are actually "compromise negotiations" within the meaning of Rule 408 but this labeling likely will not be dispositive, and the court may ignore it if it's clear that the communications at issue don't involve a true legal dispute. However, your company can use the fact that it labeled the communication as a "**CONFIDENTIAL SETTLEMENT COMMUNICATION**" to indicate that the negotiations at issue related to an actual dispute, and not just conflicting terms.

Exceptions to the Rule

Finally, although Rule 408 expressly identifies exceptions to its protections, these present a third potential trap that is often glossed over. As set forth above, Rule 408 provides that settlement communications are inadmissible to "prove or disprove the validity or amount of a disputed claim or to impeach by a prior

inconsistent statement...." But, settlement communications may be admissible for "another purpose, such as proving a witness's bias or prejudice, negating a contention of undue delay, or providing an effort to obstruct a criminal investigation or prosecution."

One particularly powerful purpose for admitting settlement communications is to show a party's intent. As described above, parties are typically their most candid during settlement communications and are likely to make statements indicative of their true intent. After all that is the public policy behind protecting such communications in the first place. For example, in a recent case, the plaintiff's representative acknowledged during settlement negotiations that the plaintiff's goal was to shut down the defendant's business. Subsequently, the defendant filed an abuse of process claim essentially alleging that the plaintiff had brought its lawsuit for the improper purpose of shutting down the defendant's business. The court found that the statements by the plaintiff's representative during settlement negotiations were admissible as to the plaintiff's intent.

Another purpose for admitting such communications could be a later action to prove the existence of a settlement agreement and one party's breach of its terms.

Once again, the lesson here is that your company should keep its guard up—even if it believes it's engaged in settlement negotiations. And the exceptions to Rule 408 make clear that even statements of bluster and/or perceived strength made during settlement communications could come back to bite your company under certain circumstances.

Conclusion

As demonstrated settlement communications are protected in some, but not, all cases. For this reason, it is best to carefully think through the wording of any disclosures and their implications when you or your business engage in such negotiations.

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