Negotiating With Confidentiality: Supplementing The Protections Of Rule 408

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MOST LITIGANTS RECOGNIZE THAT statements made during settlement negotiations are generally protected from use at trial. Without this protection, the parties could not engage in a candid and honest discussion of the claims and defenses at issue; settlement negotiations would devolve into little more than dress rehearsals for a jury trial. To support open and frank settlement discussions, Federal Rule of Evidence 408 prohibits 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. But Rule 408's protection is less robust than many parties recognize; statements are not barred for all purposes, and the reach of Rule 408 does not extend to confidentiality. Prior to any negotiation, litigants should consider whether additional measures might be necessary to protect the privacy of their settlement communications.

The Scope of Rule 408

Federal Rule of Evidence 408 provides that statements made during settlement negotiations are not admissible as evidence "to prove or disprove the validity or amount of a disputed claim." 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). A party might therefore conclude that Rule 408 will adequately protect its settlement negotiation statements from being disclosed at trial or to third parties. But as some counsel learn too late, there can be serious consequences for relying solely upon Rule 408.

Importantly, Rule 408 only prohibits admitting settlement offers or statements into evidence if they are used "to prove or disprove the validity or amount of a disputed claim." Subsection (b) of Rule 408 explicitly provides that "the court may admit this evidence for another purpose." The rule lists several examples of other purposes, including "proving a witness's bias or prejudice, [and] negating a contention of undue delay." This list is not exhaustive, and a skilled attorney might be able to persuade the court to adopt a generous view of the phrase "another purpose" – 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, as well as for breach of contract. 234 F.3d 357, 359 (8th Cir. 2000). The trial court allowed the plaintiff's former counsel to testify that during a settlement conference, the insurance company refused to offer any amount to settle the breach of contract claim unless the insured agreed to abandon his bad faith claim. The appellate court affirmed, ruling that because state law provided that such a refusal is evidence of bad faith *itself*, the settlement communication "was 'offered for another purpose,' and the district court did not abuse its discretion by admitting it." Id. at 362. The jury awarded a $635,000 judgment to the plaintiff, including $450,000 for punitive damages for the bad faith claim.

More commonly, courts allow settlement communications to be used to prove the amount in controversy, provide a jurisdictional basis for a declaratory judgment action, or to prove a party's knowledge of certain facts. In most complex litigation, at least one issue other than the "validity or amount" of the claim is in dispute. Relying solely on Rule 408 to protect you could, therefore, be your undoing.

Other shortfalls of Rule 408 include:

- Rule 408 is only a rule of evidence, and provides no protection against your counterparty's public disclosure of the terms of your settlement discussions.

- Rule 408 only applies to statements made during "compromise negotiations," so it may not protect statements made as a commercial dispute develops into a legal one.

- Rule 408 cannot be used to shield problematic documents; a court is not required to exclude any evidence simply because it was used in a settlement discussion.

Letter Agreements and their Limits

In light of the limitations of Rule 408, litigants should consider whether additional measures might be necessary to ensure they may negotiate candidly without exposure to the risk of providing admissible evidence. One option is 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 the negotiations take place at a very early stage of a dispute such as before a complaint is filed, the agreement could stipulate that the validity or amount of a claim 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.

Confidentiality letter agreements are contracts, and are susceptible to all the defenses one might normally raise to a contract's enforcement. Furthermore, litigants should always consider how the judge in their case would react to an agreement purporting to limit the evidence admissible in her courtroom. Still, a number of courts across the country 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 also 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 the litigants that placed restrictions on information exchanged during settlement negotiations and other communications between the parties. Case No. 11-CV-178, 2012 WL 5416941 (W.D. Wis. Oct. 29, 2012). The court carefully applied their agreement, excluding all evidence required to be excluded by its terms.

Other courts have also enforced Rule 408-related agreements to exclude evidence or to strike portions of pleadings reflecting information learned in settlement discussions.

Two final warnings: Although a letter agreement may be useful in preventing your counterparty from disclosing settlement communications, in most jurisdictions such letters will not shield those communications from discovery by third parties. Most (but not all) courts have rejected the existence of a "settlement communications privilege" that would operate to prevent disclosure during discovery. Additionally, this article only addresses the Federal Rules of Evidence, but many states have similar rules for their proceedings. Parties must always research any state rules that might apply, and should never assume that simply because the rule bears some facial similarities to the federal rule that it is interpreted similarly.

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.

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