Bending the Truth in Mediation And Settlement Negotiations

Lawyers involved in civil litigation invariably have to deal with settlement negotiations of some kind, often under the aegis of court ordered mediation.

Negotiations involve a great deal of back-and-forth posturing about the claims in the case.

How far can an attorney go in bending the truth—can he exaggerate, make false statements, or conceal important information? And if he or she does, what exposure does he or she have?

A recent New York federal court decision, Otto v. Hearst Communications, 2019 U.S. Dist. LEXIS 35051 (S.D.N.Y. 2019), denied a motion for sanctions against an attorney who supposedly misrepresented certain facts in a settlement conference, although the magistrate judge opined that the case was a "close call," and cautioned the attorney from overstepping in the future.

The line between forbidden misrepresentation and permitted "puffery" is murky. Not surprisingly, some attorneys push the envelope and at times go over the line.

Complicating matters more, lawyers’ representations during settlement negotiations implicate three different legal regimes: ethical duties under the Rules of Professional Responsibility, court rules, with accompanying possibility of sanctions, and civil liability for fraud (by adversaries) and malpractice (by clients).

The ‘Otto’ Case

Jonathan Otto attended a friend’s wedding in June 2017 at the Trump National Golf Club in New Jersey. President Donald Trump, the owner of the venue, crashed the wedding and then lingered at the reception to take photographs with the newlyweds and sign autographs. Otto took the opportunity to capture the moment and snapped a photo on his iPhone, later texting it to another guest. The picture went viral and was published on Instagram and in several media outlets, including Esquire.com, operated by Hearst Communications.

Otto retained counsel, registered the copyright in the image, and filed several copyright infringement suits, including the one against Hearst.

The district court granted Otto summary judgment on liability and rejected Hearst’s fair use defense. 345 F. Supp. 3d 412 (S.D.N.Y. 2018). The case was then sent to mediation before a magistrate judge on the issue of damages.

During the mediation, Otto’s lawyer represented that he was on the verge of licensing the photograph to another media company for $9,500 and suggested that as a fair measure of damages.

But Hearst’s counsel repeatedly asked whether that license was part of a settlement against the other media entity. Otto’s counsel replied in the negative. This turned out to be largely false—the purported license was with another company, Warner Brothers, whom Otto had sued in a separate action. The license, albeit in a separate document, was entered into simultaneously with a settlement agreement which terminated the Warner Brothers litigation.

The mediation did not end in a settlement. Hearst moved for sanctions, arguing that the misrepresentation was sanctionable as a false representation of fact. Otto’s counsel argued that his legal opinion was that the license was a separate agreement from the settlement agreement, and so he had spoken accurately.

In denying sanctions, the judge noted three possible sources of sanctions: Rule 16(f), 28 U.S.C. 1927, and the court’s inherent powers. But each had...
significant legal limitations that could not be met. Also, there was no record of what had actually been said at the settlement conference, so there was no basis to find a misrepresentation. And, Hearst had also not been prejudiced; no settlement was reached and thus Hearst never relied on the misrepresentations.

The court also noted that the Rules of Professional Conduct, while binding on counsel, are not a basis for a court to award sanctions. Still, the court did discuss some of these rules and their application to settlement, which we consider below.

**Ethical Rules**

So, how far can a lawyer go in “bending” the truth in settlement negotiations?

N.Y. Rule of Professional Conduct 4.1 provides that “[i]n the course of representing a client, a lawyer shall not knowingly make a false statement of fact or law to a third person.” Rule 3.3 similarly provides that a lawyer “shall not knowingly: (1) make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer.” (According to several authorities cited in the Otto decision, court annexed mediation is considered to be before a “tribunal.”)

Nevertheless, it seems to be widely accepted that some level of exaggeration is both expected and permitted. No less than the ABA has observed: “[i]t is not unusual in a negotiation for a party, directly or through counsel, to make a statement in the course of communicating its position that is less than entirely forthcoming.” ABA Comm. of Professional Ethics & Grievances, Formal Op. 06-439 (2006). “A party in a negotiation also might exaggerate or emphasize the strengths, and minimize or deemphasize the weaknesses, of its factual or legal position.” Id. The Otto court even cited one commentator who wrote: “consensual deception is the essence of caucused mediation.”

The basis for this distinction appears to be a comment to ABA Model Rule 4.1, which the New York rules incorporate as Comment 2:

Rule [4.1] refers to statements of fact. Whether a particular statement should be regarded as one of fact can depend on the circumstances. Under generally accepted conventions in negotiation, certain types of statements ordinarily are not taken as statements of fact. Estimates of price or value placed on the subject of a transaction and a party’s intentions as to an acceptable settlement of a claim are ordinarily in this category; so is the existence of an undisclosed principal, except where nondisclosure of the principal would constitute fraud. Lawyers should be mindful of their obligations under applicable law to avoid criminal and tortious misrepresentation.

Thus, whether the opposing side (or a neutral mediator) views the statement as a hard factual statement or mere posturing or puffery seems to be the test—which, of course, in practice, can be very hard to apply.

Examples of misrepresentations that have gotten counsel into trouble have included: (1) failure to alert the other side of changes made in drafting documents; (2) in a personal injury suit, failure to advise that a client died of unrelated causes; (3) statements about the extent of insurance coverage; and (4) statements about assets (or lack of assets) held by one spouse in a divorce case.

What are examples of permissible “puffery?” The above-cited ABA opinion gives an example: “A buyer of products or services, for example, might overstate its confidence in the availability of alternate sources of supply to reduce the appearance of dependence upon the supplier with which it is negotiating.” It also opines that statements about negotiating goals or willingness to compromise (“my client will not settle for less than $X”) are not statements of fact.

Still, the line between the two is not always clear.

**Civil Liability and Professional Discipline**

A New York case from the ‘70s illustrates that counsel can face both civil liability and professional discipline for settlement misrepresentations.

A brain-damaged child and his father brought a medical malpractice suit against a hospital in Kings County Supreme Court. During the trial, the hospital’s counsel represented that the hospital had only $200,000 in insurance and was undergoing liquidation. Just before the close of the plaintiffs’ case, they accepted a settlement of $185,000, largely because of concerns for collectability of a larger judgment.

It later turned out, however, that the hospital had a Lloyd’s of London excess insurance policy of $1 Million.

The plaintiffs then brought suit in federal court against the hospital’s outside and in-house counsel, as well as several reinsurers, for fraud. The jury awarded $680,000, the difference between the settlement value had the insurance been disclosed and the actual settlement. Although the district judge granted judgment for the defendants based on a waiver theory, the U.S. Court of Appeals for the Second Circuit reinstated the jury’s verdict. *Slotkin v. Citizens Cas. Co. of N.Y.*, 614 F.2d 301 (2d Cir. 1979).
Disciplinary proceedings against the outside counsel were then considered by the First Department in *In re McGrath*, 96 A.D.2d 267 (1st Dept. 1983). Oddly, despite the fraud verdict against him, the Appellate Division opined that the attorney did not act in bad faith. However, he was guilty of negligence in handling the malpractice case for not knowing the true extent of his client’s malpractice coverage. Combined with neglect of other, unrelated matters, the lawyer earned a six-months suspension from practice.

The *Slotkin/McGrath* cases illustrate the multiple levels of exposure a lawyer may face for making false representations during settlement negotiations. Fraud claims do not require privity and even can be brought by those involved in arms-length negotiations, like an adversary in litigation. And, even sloppy conduct (negligence) can lead to discipline, not to mention civil liability. (Query whether the hospital had a malpractice claim against its counsel about whom the Appellate Division opined there was “no question” he was “guilty of negligence.”)

**Client Confidentiality**

Another ethical rule that may come into play is Rule 1.6, which bars a lawyer from revealing confidential information, absent consent, or in certain circumstances listed in Rule 1.6(b), which include “(1) to prevent reasonably certain death or substantial bodily harm; (2) to prevent the client from committing a crime; (3) to withdraw a written or oral opinion or representation previously given by the lawyer and reasonably believed by the lawyer still to be relied upon by a third person, where the lawyer has discovered that the opinion or representation was based on materially inaccurate information or is being used to further a crime or fraud.”

So, what happens if the client insists on not disclosing some piece of confidential information that nevertheless may be material to settlement? Here, the attorney is caught between the duty to maintain confidentiality and the duty to not make misrepresentations nor commit a fraud.

In one opinion by the Pennsylvania bar association, a lawyer represented a worker’s compensation claimant. The employer offered to settle for three-years wages. The client told the attorney he wanted to accept, as he had been told that he had only a year to live because of a non-work-related illness. Did the lawyer have to disclose that? The bar association opined not, unless the non-disclosure would constitute a fraud under substantive law. Penn. Bar. Assoc. Comm. On Legal Ethics, Op. No. 2001-26.

**Scenarios**

While the case law and ethics opinions suggest where to draw the line, the issue still remains murky.

The *Otto* opinion quotes a 30-year-old law review, which it opined is still “timely.” The authors interviewed a total of 15 professors, lawyers, and judges about four scenarios and asked them how an attorney was required to act. The results were mixed, and in some cases, there was little consensus on the proper behavior. The four scenarios were:

**Situation 1:** Your clients, the defendants, have told you that you are authorized to pay $750,000 to settle the case. In settlement negotiations after your offer of $650,000, the plaintiffs’ attorney asks, “Are you authorized to settle for $750,000?” Can you say, “No I’m not?”

**Situation 2:** You represent a plaintiff who claims to have suffered a serious knee injury. In settlement negotiations, can you say your client is “disabled” when you know she is out skiing?

**Situation 3:** You are trying to negotiate a settlement on behalf of a couple who charge that the bank pulled their loan, ruining their business. Your clients are quite up-beat and deny suffering particularly severe emotional distress. Can you tell your opponent, nonetheless, that they did?

**Situation 4:** In settlement talks over the couple’s lender liability case, your opponent’s comments make it clear that he thinks plaintiffs have gone out of business, although you didn’t say that. In fact, the business is continuing, and several important contracts are in the offing. You are on the verge of settlement; can you go ahead and settle without correcting your opponent’s misimpression?

So, what do you think?