Ethical Issues in Settlement Negotiations

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W hile most practitioners are generally aware of the ethical limitations on making factual and legal representations to a tribunal, there is less consensus on the ethical constraints on an attorney during the course of settlement negotiations.

Settlement negotiations frequently take place in the absence of judicial supervision and are subject to few explicit rules or guidelines, prompting some ethicists to refer to settlement negotiations as the “no-man’s land” of attorney ethics.1

While the Lawyer’s Code of Professional Responsibility (code)2 generally proscribes outright misrepresentations, it is less clear in what circumstances an attorney’s omission can constitute a misrepresentation.

Professional Responsibility

The code, while not explicitly addressing the settlement process, does contain general provisions proscribing fraud or misrepresentations by attorneys. For example, Disciplinary Rule (DR) 1-102(A)(4) prohibits “conduct involving dishonesty, fraud, deceit or misrepresentation.” DR 7-102(A)(5) provides that a lawyer may not, in representing a client, knowingly make a false statement of law or fact. The code further provides that a lawyer may not “[e]nclose or knowingly fail to disclose that which the lawyer is required by law to reveal.” DR 7-102(A)(3). Subsection (B) of the same rule requires a lawyer to reveal a client’s fraud committed in the course of the representation:

A lawyer who intentionally omits material information from discovery may be personally sued for money damages by a defrauded adversary. — ‘Cresswell v. Sullivan & Cromwell’

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Cases on Misrepresentation

Some authorities have examined an attorney’s obligation to refrain from both affirmative misrepresentations and omissions in the course of settlement negotiations. In practice, misrepresentations sometimes contain elements of affirmative statements and material omissions.

A leading illustration is Slotkin v. Citizens Casualty Co., 614 F2d 301 (2d Cir. 1979), in which a lawyer was held liable in fraud for misrepresenting the existence and extent of a client’s insurance coverage. In Slotkin, the lawyer defending a hospital affirmatively stated in settlement negotiations that the full extent of insurance coverage was $200,000, prompting the guardian of a brain-damaged baby to settle the case within the perceived policy limits.

Upon learning of the existence of a $1 million excess policy, the infant’s guardian successfully sued the attorney for fraud. The trial court set aside a verdict in favor of the plaintiffs, reasoning that the settlement of the underlying malpractice case had never been reduced to writing, and that the plaintiffs could not simultaneously affirm the settlement and obtain additional damages. The U.S. Court of Appeals for the Second Circuit reversed, holding that the victims of intentional fraud may elect either to rescind the settlement, or to ratify it and sue for any additional damages caused by the fraud. In addition, the attorney making the misrepresentation about insurance was disciplined.3

Cresswell v. Sullivan & Cromwell, 668 FSupp 166 (SDNY 1987), held that a lawyer who intentionally omitted material information from discovery may be personally sued for money damages by a defrauded adversary. The defendant in Cresswell was a law firm that had previously defended a securities broker-dealer in a securities fraud action. In discovery responses, the lawyers denied that their client was being investigated by any regulators for the same conduct which formed the basis for the civil suit. The law firm withheld from production a previously defended a securities broker-dealer in a securities fraud action. In discovery responses, the lawyers denied that their client was being investigated by any regulators for the same conduct which formed the basis for the civil suit. The law firm withheld from production a recently received letter from the New York Stock Exchange concerning an investigation of its client for the same conduct alleged in the

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Thus, the code requires a lawyer to reveal a fraud occurring in the course of the representation, subject to the confidentiality provisions of DR 4-101. However, as Professor Roy Simon of Hofstra University School of Law has observed, the “secret or confidence” exception to DR 7-102(B) has virtually consumed the rule: “In virtually no circumstances will a lawyer have information about a client’s fraud that will escape DR 4-101(A)’s definition of ‘confidence’ or ‘secret.’”4

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Omitting Insurance Coverage

What about the situation in which an attorney makes a literally correct factual representation to an adversary in unsupervised settlement negotiations, which, nevertheless, is materially misleading? For example, assume that an attorney accurately informs an adversary that a corporate client is in severe financial distress and is on the verge of insolvency which could fully satisfy the adversary’s claims. However, the attorney chooses not to reveal the existence of a substantial insurance policy that could fully satisfy the adversary’s claims. The case is not in litigation, the corporation has not filed for bankruptcy and there is no statutory obligation to disclose the insurance coverage.

The New York County Lawyers’ Association Committee on Professional Ethics considered these principles in Ethics Opinion 731 and concluded that “while the lawyer has no affirmative obligation to make factual representations in settlement negotiations, once the topic is introduced the lawyer may not intentionally mislead.” The NYCLA Ethics Committee distinguished between a factual representation introduced by the lawyer and a representation derived from an outside source. The committee reasoned that while an attorney may not intentionally mislead an adversary, there is no need to enlighten an adversary who is laboring under a self-inflicted misperception of fact.

Thus, while a lawyer may not directly convey or perpetuate false information to an adversary about insurance, there is no duty to correct an adversary who is laboring under a misimpression derived from another source.

Conclusion

Although most settlement negotiations take place in the absence of judicial supervision, an attorney is still bound by the requirement of DR 7-102 to refrain from making false statements of law or fact. A lawyer is further prohibited from concealing or knowingly failing to disclose that which the lawyer is required by law to reveal. While a lawyer is not obligated to prevent an adversary from proceeding on an erroneous assumption of the adversary’s own making, a lawyer is not permitted affirmatively to contribute to an adversary’s misconception, either by misrepresentation or omission.

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5. 571 FSupp at 511.
6. The ABA Model Rules of Professional Conduct are different in some significant respects from the New York Code. New York is currently contemplating adopting a version of the Model Rules.

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