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Are Settlement Discussions Soundproof? The Admissibility of Settlement Negotiations and Offers in Extra-Contractual Disputes

I. Confidentiality of Settlement Negotiations

A. What's Protected Varies by Jurisdiction

The rules regarding the confidentiality of mediations and settlement negotiations vary from jurisdiction to jurisdiction. Some jurisdictions have very strict rules protecting confidentially of mediation materials (California). Other jurisdictions provide much less protection for mediation communications and submissions. Many jurisdictions have adopted the Uniform Mediation Act, which was initially drafted by committees from the National Conference of Commissioners on Uniform State Laws and the American Bar Association's Section of Dispute Resolution. Twelve states including Hawaii, Illinois, Idaho, Nebraska, New Jersey, Ohio, South Dakota, Utah, Vermont, Washington and the District of Columbia currently follow the UMA.

The Uniform Mediation Act

The stated purpose of the Uniform Mediation Act is to provide "a privilege that assures confidentiality in legal proceedings." The UMA attempts to balance confidentiality in settlement negotiations with preventing parties from using the mediation to cloak otherwise discoverable or admissible evidence in privilege. The UMA protects "mediation communications" which it defines as "a statement, whether oral or in a record or verbal or nonverbal, that occurs during a mediation or is made for purposes of considering, conducting, participating in, initiating, continuing, or reconvening a mediation or retaining a mediator." It provides that mediation communications are privileged unless the information is other admissible:

UMA - § 4 Privilege against disclosure; admissibility discovery

(a) Except as otherwise provided in Section 6, a mediation communication is privileged as provided in subsection (b) and is not subject to discovery or admissible in evidence in a proceeding unless waived or precluded as provided by Section 5.

(b) In a proceeding, the following privileges apply:

(1) A mediation party may refuse to disclose, and may prevent any other person from disclosing, a mediation communication.

(2) A mediator may refuse to disclose a mediation communication, and may prevent any other person from disclosing a mediation communication of the mediator.

(3) A nonparty participant may refuse to disclose, and may prevent any other person from disclosing, a mediation communication of the nonparty participant.

(c) Evidence or information that is otherwise admissible or subject to discovery does not become inadmissible or protected from discovery solely by reason of its disclosure or use in a mediation.

In addition to making certain mediation communications privileged, the UMA also includes the following confidentiality provision:

UMA - § 8. Confidentiality
Unless subject to the Open Meetings Act or the Freedom of Information Act, mediation communications are confidential to the extent agreed by the parties or provided by other law or rule of this State.

Under the UMA, briefs submitted to the arbitrator, statements made in the mediation, letters between the parties or mediator and confidentiality agreements created for the mediation are both privileged and confidential. Exhibits that were created specifically for the mediation would also be covered. However, any exhibits to briefs that are otherwise discoverable, are not privileged just because they were used in the mediation (although their use in the mediation may be privileged).

California Protections

Under California law, California statutes protect the confidentiality of mediation negotiations and related oral and written materials. California Evidence Code § 1126 ("Anything said, any admission made, or any writing that is inadmissible, protected from disclosure, and confidential under this chapter before a mediation ends, shall remain inadmissible, protected from disclosure, and confidential to the same extent after the mediation ends."); *Simmons v. Ghaderi*, 44 Cal.4th 570, 583 (2008) ("[T]he mediation confidentiality statutes unqualifiedly bar disclosure of certain communications and writings produced in mediation absent an express statutory exception."). California Evidence Code § 1119 applies to communications and writings made for "the purpose of, in the course of, or pursuant to, a mediation or mediation consultation." (Evidence Code § 1119.) California Evidence Code § 1120 provides that "evidence otherwise admissible or subject to discovery outside of a mediation or a mediation consultation shall not be or become inadmissible or protected from disclosure solely by reason of its introduction or use in a mediation or mediation consultation." (Evidence Code § 1120.)

California cases construe the phrase, “parties to the mediation,” as used in the California Evidence Code, to include insurers who are actual participants in the mediation. *See, e.g., Travelers Cas. & Sur. Co. v. Super. Ct.*, 126 Cal.App.4th 1131, 1146, n. 18 (2005).

Under California law, communications between the parties that reference mediation and include the mediator are usually protected. *Cassel v. Superior Court*, 51 Cal. 4th 113 (2011). Under the Uniform Mediation Act admissibility is more possible as courts in Washington have ruled mediation communications admissible in multiple cases concerning insurance bad faith. *See, Sharbano v. Universal Underwriters Insurance Company*, 161 P.3d 406 (Wash. Ct. App. 2007) and *Mutual of Enumclaw, et al. v. Cornhusker Casualty Insurance Company* and *Sharbono v. Universal Underwriters Insurance Company*, CV-07-3101-FVS.

B. Party Drafted Confidentiality Agreements

A "*White* Waiver" can protect an insurer from liability arising from allegations that it failed to fulfill its duty of good faith and fair dealing in settlement negotiations. In *White v. Western Title Insurance Co*., 40 Cal. 3d 870 (1985), the California Supreme Court held that a court can properly admit evidence of an insured and insurer's settlement negotiations to prove a failure to process the claim fairly and in good faith. A "White Waiver" entered into before negotiations take place can preclude settlement negotiations from being used as evidence of bad faith and allow the parties greater candor in their negotiations.

There is some disagreement as to whether a White Waiver is necessary, at least under the laws of those jurisdictions that provide greater protections in settlement negotiations, including California. *See, e.g.* Cal. Evidence Code §§1115-1128 and §1152).

II. Extra-Contractual Exposure For Failure To Settle

Every jurisdiction from Alabama to Wyoming recognizes an insurer's duty to settle or compromise a claim made against the insured. The obligation of good faith and fair dealing is implied in the insurance contract and requires an insurer to act fairly and reasonably in investigating, evaluating and paying a claim. Jurisdictions differ as to the standards applicable to an insurer's conduct sufficient to state a claim by the insured for bad faith against the insurer.

In California, the covenant of good faith and fair dealing obligates the insurer to accept reasonable settlement demands within policy limits to avoid exposing the insured to personal liability in excess of those limits. *Comunale v. Traders & Gen. Ins. Co.* 50 Cal.2d 654 (1958). An insurer must also make reasonable efforts to settle a third party's lawsuit against the insured. *PPG Industries Inc. v. Transamerica Ins. Co.* 20 Cal.4th 310 (1999). To establish a claim for bad faith failure to settle, an insured must generally demonstrate that the policy covers the claim to be settled; that the insurer failed to accept a reasonable settlement demand for an amount within the policy's limits of liability; that the claimant made a reasonable settlement offer within the policy limits and the insurer

rejected it; and that a monetary judgment was entered against the insured for an amount in excess of the policy limits. *Blue Ridge Ins. Co. v. Jacobsen,* 25 Cal.4th 489 (2001); see California Judicial Counsel jury instruction 2334 ("A settlement demand is reasonable if (insurer) knew or should have known at the time the settlement demand was rejected that the potential judgment was likely to exceed the amount of the settlement demand based on (claimant's) injuries or loss and (insured's) probable liability.") California regulations also prohibit an insurer from making an unreasonably low settlement offer. 10 Cal.Code of Regs. section 2685.7(g) ("No insurer shall attempt to settle a claim by making a settlement offer that is unreasonably low.").

In Florida, courts have held that an insurer has an affirmative duty to initiate settlement negotiations where the insured's liability is clear and an excess judgment is likely due to the extent of the resulting damage. *Powell v. Prudential Prop. & Ca. Ins. Co.* 584 So. 2d 12 (1991). Tort liability is imposed on an insurer for not attempting in good faith to settle claims if, given the circumstances, the insurer failed to act fairly and honestly toward its insured and with due regard for his interests. *See* Fla. Stat. section 624.155(1)(b)(1); *Gutierrez v. Yochim,* 23 So.3d 1221 (2009).

In Nevada, the Nevada Supreme Court has held that an insurer may breach its duty of good faith and fair dealing if an insurer fails to adequately inform an insured of a known reasonable settlement opportunity. If an insurer fails to settle or to inform an insured of a reasonable opportunity to settle, it can be considered the proximate cause of all damages arising from a foreseeable settlement or excess judgment. *Allstate v. Miller,* 212 P.3d 318 (2009).

In New York, courts have held that an insurer breaches the implied covenant of good faith and fair dealing where the insurer's conduct evinces a "gross disregard" of the insured's interests. *Allstate v. Jacobs,* 617 N.Y.S.2d 360 (1994). Bad faith can be established in a variety of ways, including by an insured's demonstration that an insurer failed to communicate the status of settlement offers and negotiations; or that an insurer failed to take into account plaintiff's likelihood of success in proving liability against the insured and the magnitude of damages that the insured may be exposed to as a result of the refusal to settle. *Smith v. General Accident Ins. Co.,* 687 N.E.2d 168 (1998).

III. Use Of Negotiations as Evidence At Trial

In general, evidence of settlements, compromises or offers to compromise are prohibited from disclosure and cannot be admitted at trial to prove liability, the invalidity of a claim or the amount of damages. See, e.g. Cal. Evidence Code §§1115-1128 and §1152; New York Civil Practice Law and Rules §4547. This exclusionary rule reflects the policy goal of promoting full candor and to facilitate open discussions during settlement negotiations. Confidentiality statutes encourage security in communications and serve to encourage a free flow of information and permit parties to admit weakness in their case.

One exception to the general rule that settlement negotiations and communications are protected from disclosure is the use of such evidence to prove an insurer's breach of the implied covenant of good faith and fair dealing. Under California law, evidence of unreasonably low offers to settle or a failure to settle a claim can be admissible as proof of an insurer's bad faith. *See, White v. Western Title,* 40 Cal.3d 870.

However, federal courts have taken conflicting positions on the admissibility of such evidence. In *Clemco Industries v. Commercial Union Ins.*, 665 F.Supp. 816 (1987), judgment affirmed, 848 F.2d 1242 (9th Cir. 1988), the federal court held that Federal Rule of Evidence 408 bars evidence of settlement negotiations and rejected the reasoning of *White*. It should be noted that in *Clemco,* the insurer was attempting to introduce the evidence of settlement negotiations to negate the insured's claim of bad faith and the insured's bad faith claim focused on the insurer's consistent refusal to participate in coverage agreements with other direct carriers for the insured.

IV. Ways To Soundproof Your Settlement Discussions

- Before you agree to mediate in a jurisdiction – know what protections that jurisdiction provides.

- Counsel and parties consider the potentially applicable mediation laws before going to mediation or agreeing to mediate. In this regard, it would behoove the parties to consider and craft their own agreement to mediate that refers to the mediation laws by which they intend to be bound. This may require an up-front choice of law analysis. And, if there is any possibility of a choice of law analysis the participants should consider all potentially applicable law. In particular, if later litigation ends up in Federal Court then under Rule 501, "… state law governs privilege regarding a claim or defense for which state law supplies the rule of decision." Thus the Ninth Circuit has held that in a mixed action presenting Federal and State issues it is Federal rules of evidence that apply to admissibility of what otherwise might be subject to mediation confidentiality/privilege. *Wilcox v. Arpaio,* 753 F.3d 872 (2014)

- Counsel should be deliberate in referring to mediation and including the mediator on communications. The mediator should be included only if the intent is to cloak the communication. While copying the mediator may not effectively shield misconduct in all jurisdictions, the potential consequences of copying the mediator should be carefully considered before doing so.

- Draft a confidentiality agreement that applies to the parties, mediator and any third-parties that might be involved in the mediation.