Settlement Negotiation Ethics for Attorney-Advocates in Litigated Cases

Rule 4.1 of the New California Rules of Professional Conduct

By Phillip Neiman, Esq.

At some point after a civil dispute enters the legal system, opposing counsel will likely engage in some form of discussion to resolve the case. If attorneys don't initiate direct negotiations or early mediation, or if they do and the case doesn't resolve, they are likely to receive judicial encouragement at a case management conference to voluntarily explore settlement through a court's alternative dispute resolution program. Separately, courts use meet and confer requirements to promote settlement talks. If a case has not resolved and trial is approaching, attorneys are likely to find themselves at the negotiating table by judicial fiat. California Rules of Court, Rule 3.1380 authorizes a court to set one or more mandatory settlement conferences on its own motion.

Across the span of their careers, most civil litigators will spend more time engaged in settlement talks than they will in trial.[1] For this reason, it's important that they have a solid understanding of their professional duties while engaged in the settlement process, and specifically of new Rule 4.1 under the professional conduct rules that will go into effect on November 10, 2018 ("CRPC-2018.")

Rule 4.1, "Truthfulness in Statements to Others," figures prominently in the context of settlement negotiations. It is counterintuitive to many attorneys, and it can be challenging to apply. By unpacking the rule and the comments and walking through some examples, attorneys will learn how to navigate the ethical dilemmas that often accompany this provision in practice.

Rule 4.1 Truthfulness in Statements to Others

"In the course of representing a client a lawyer shall not knowingly:

(a) make a false statement of material fact or law to a third person; or (b) fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by [Bus. & Prof. Code §6068(e)(1) or Rule 1.6]."

Three definitions are important to a discussion of this rule.

Fraudulent. The concept of client fraud figures prominently in Rule 4.1. Rule 1.0.1(d) states that "fraud" or "fraudulent" shall be defined under the law of the applicable jurisdiction and that the conduct must be with "a purpose to deceive." Rule 1.0.1, comment 3, makes an important qualification, stating: "When the terms 'fraud' or 'fraudu-

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lent' are used in these rules, it is not necessary that anyone has suffered damages or relied on the misrepresentation." Thus, to constitute "fraud" under Rule 4.1, one can look to CACI No. 1900, as modified by Rule 1.0.1, comment 3. The elements are: (a) misrepresentation (false representation, concealment or nondisclosure); (b) knowledge of falsity; and (c) intent to induce reliance.[2]

Materiality. "Materiality" is not defined in Rule 4.1 or in Rule 1.0.1. Using the U.S. Supreme Court's definition, material facts are "all facts which a reasonable [person] might consider important."[3] This is essentially in line with the definition found in the Restatement (Second) of Contracts §162(2) (1979), which provides that a misrepresentation is "material if it would be likely to induce a reasonable person to manifest his assent, or if the maker knows that it would be likely to induce the recipient to do so."

Knowingly. "Knowingly" is defined as "actual knowledge of the fact in question. Knowledge may be inferred from the circumstances." Rule 1.0.1(f).

The Problem of Silence: Rule 4.1(a), Comment 1

Rule 4.1(a) states: "In the course of representing a client a lawyer shall not knowingly…make a false statement of material fact or law to a third person."

In pertinent part, Rule 4.1, Comment 1 provides: "A lawyer is required to be truthful when dealing with others on a client's behalf, *but generally has no affirmative duty to inform an opposing party of relevant facts.*" [Emphasis added.] Attorney A need not do Attorney B's work for her.

However, the comment continues: "A nondisclosure can be the equivalent of a false statement of material fact or law under [Rule 4.1(a)] where a lawyer makes a partially true but misleading material statement or material omission." Thus, *remaining silent is not always acceptable* and in fact constitutes a falsehood if a partially true but ambiguous (or a partially true and partially false) statement is made and then not corrected. The comment also states that a misrepresentation can occur if the lawyer incorporates or affirms the statement of another person [presumably a client] when the lawyer knows that the statement was false.

Comment 1 concludes by stating that lawyers remain bound by Business and Professions Code, Section 6106 and Rule 8.4 ("Misconduct"). Section 6106 provides: "The commission of any act involving moral turpitude, dishonesty or corruption…constitutes a cause for disbarment or suspension." Under Rule 8.4(a), "It is professional misconduct for a lawyer to…violate these rules or the State Bar Act, knowingly assist, solicit, or induce another to do so, or do so through the acts of another." And, under Rule 8.4(c), "It is professional misconduct for a lawyer to…engage in conduct involving dishonesty, fraud, deceit, or reckless or intentional misrepresentation."[4]

Puffing and Bluffing Are Allowed at the Negotiating Table: Rule 4.1, Comment 2

Rule 4.1, Comment 2 clarifies that not all dishonesty is treated equally. The comment carves out an exception to the Rule 4.1 duty of candor to third parties for certain kinds of misrepresentations.

The comment states: "[Rule 4.1] refers to statements of fact. Whether a particular statement should be regarded as one of fact can depend on the circumstances. For example, *in negotiation, certain types of statements ordinarily are not taken as statements of material 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, and so is the existence of an undisclosed principal except where non-disclosure of the principal would constitute fraud." [Emphasis added.]

Rule 4.1, Comment 2, which allows for bluffing and puffing in negotiations, isn't a novel concept, but CRPC-2018 *did* usher in a nuanced change. In 2015, the State Bar's Standing Committee on Professional Responsibility and Conduct issued Formal Opinion No. 2015-194 ("CA Ethics Opinion No. 2015-194").[5] The opinion addressed whether an attorney, when engaged in negotiations on behalf of a client, is subject to the ethical limitation on not lying to third parties.

The conclusion was that attorneys, when negotiating, are subject to the rules prohibiting dishonesty, deceit and collusion, but that puffery and posturing—including statements about a party's negotiating goals or willingness to compromise—are allowed *because they are not considered statements of fact*.

The fact pattern in CA Ethics Opinion No. 2015-194 involved a court-supervised settlement conference, which complicates matters. Under Evidence Code Section 1117(b)(2), a mandatory settlement conference ("MSC") held pursuant to California Rules of Court, Rule 3.1380 is not a mediation. Mediation confidentiality rules do not apply to MSCs. Of the scenarios presented in that opinion, three involved outright factual misrepresentations by one of the attorneys. If the case resolved, the party who was lied to would have grounds for a motion to set aside the settlement. The lying party would be unsuccessful in excluding evidence of the falsehoods based on Evidence Code Section 1119 because, as noted, an MSC is not a mediation.

CRPC-2018's Rule 4.1 appears to go further and impose a duty of candor in statements to others under all circumstances, including direct negotiations between attorneys and in mediation. It does not carve out private mediation in any case. As such, it makes a broader statement about the value of transparency than CA Ethics Opinion No. 2015-194.

At a minimum, the introduction of Rule 4.1 removes any doubt that the courthouse setting in CA Ethics Opinion 2015-194 rendered the entire opinion meaningless because the falsehoods were admissible in Court to prove fraud in the inducement. It is also important to emphasize that ethics opinions from the State Bar are advisory only.[6] *Now, formally and officially, lawyers may not knowingly misstate material facts (of the non-puffing variety) when engaged in settlement talks.*

The Client Fraud Problem: Rule 4.1(b), Comment 3

Rule 4.1(b) requires some unpacking. It provides: "In the course of representing a client a lawyer shall not knowingly…fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by [Section 6068(e)(1) or Rule 1.6]."

In other words, *a lawyer has an affirmative disclosure obligation if disclosure is necessary to avoid assisting a client's fraud*. Assume a client makes a statement (or conceals something) that rises to the level of fraud. The attorney must correct the statement unless doing so would require the attorney to break a client confidence. The exception may have swallowed up the rule.

Comment 3 to Rule 4.1 states: "Under Rule 1.2.1, a lawyer is prohibited from…assisting a client in conduct that the lawyer knows is…fraudulent. See rule 1.4(a)(4) regarding a lawyer's obligation to consult with the client about limitations on the lawyer's conduct. In some circumstances, a lawyer can avoid assisting a client's…fraud by withdrawing from the representation in compliance with rule 1.16."

Rule 1.2.1 states: "A lawyer shall not knowingly assist in, solicit, or induce any violation of these rules or the State Bar Act." In turn, Rule 1.4(a)(4) states that a "lawyer shall…advise the client about any relevant limitation on the lawyer's conduct when the lawyer knows that the client expects assistance not permitted by the Rules of Professional Conduct or other law."

Finally, Rule 1.16(a)(2) requires withdrawal if a lawyer knows (or should know) that continued representation will result in a violation of the professional conduct rules or the State Bar Act, while Rules 1.16(b)(3) and 1.16(b)(9) permit a lawyer to withdraw if the client insists that the lawyer do something fraudulent or if ongoing representation is likely to result in a violation of the professional conduct rules or the State Bar Act (withdrawal being subject to court approval, as applicable).

Putting these concepts together in the context of a settlement negotiation, if a client misrepresents or conceals a material fact to induce the other party's or opposing counsel's reliance (or arguably to induce reliance by the other party's support person or her expert witness or, for that matter, the mediator's reliance), the client's lawyer cannot participate in the misrepresentation or concealment (Rule 1.2.1) *and must correct it,* unless doing so would result in a breach of client confidentiality, in which case the lawyer should advise the client that she cannot partake in the fraud (Rule 1.4.(a)(4)) and, if the client doesn't relent, then the attorney may be required to move the court to withdraw under Rule 1.16(a)(2) (mandatory) or under Rule 1.16(b)(3) or Rule 1.16(b)(9) (permissive).

The Consequences of a Rule 4.1 Violation: Sanctions Guidelines

As noted, Comment 1 to Rule 4.1 concludes by stating that lawyers remain bound by Section 6106 and Rule 8.4. The former states that "dishonesty…constitutes a cause for disbarment or suspension." The latter states "it is professional misconduct to engage in conduct involving dishonesty, fraud, deceit, or reckless or intentional misrepresentation."

In this system of rules and discipline, an attorney who violates Rule 4.1 isn't labeled "unethical" and required to wear a scarlet "U." Rather, the attorney is subject to the State Bar's sanctions standards for professional misconduct.[7] The standards work like sentencing guidelines, in effect correlating specific punishments with specific types of misconduct. The Supreme Court is not bound to follow a disciplinary recommendation but does so "whenever possible" if consistent with the sanctions standards.[8] For that reason, sanctions are the "presumed" punishment when an attorney commits a particular type of misconduct.

Standard 2.11 appears to cover lying during settlement negotiations. It provides: "Disbarment or actual suspension is the presumed sanction for an act of moral turpitude, dishonesty, fraud, corruption, intentional or grossly negligent misrepresentation, or concealment of a material fact."[9]

Standard 2.12(a) also appears to apply: "(a) Disbarment or actual suspension is the presumed sanction for disobedience or violation of…the duties required of an attorney under Business and Professions Code Section 6068(a)(b)(d)(e)(f) or (h)."[10] In turn, Section 6068(d) states: "It is the duty of an attorney to…employ, for the purpose of maintaining the causes confided to him or her *those means only as are consistent with the truth*." Thus, again, the price of lying while negotiating appears to be disbarment or suspension.

Finally, Standard 1.5 lists aggravating circumstances that, if proven by the State Bar, can act as enhancements to the guideline sanctions. These include (d) intentional misconduct, bad

faith or dishonesty; (e) misrepresentation; and (f) concealment.[11]

Lawyers may wish to review the sanctions standards prior to negotiating with opposing counsel.[12] As noted in Rule 4.1, Comment 3, if a client misrepresents a material fact, a lawyer who would otherwise be prevented from correcting the misrepresentation under the ethical duty of confidentiality follows a protocol of advising the client that she (the attorney) cannot partake in the fraud (Rule 1.4(a)(4)). Citing the sanctions to which an attorney would be subject may be the best way to illustrate to a client that there are limits to what an advocate can do.

Hypotheticals: Rule 4.1 at Work

We'll work with a hypothetical wrongful death case in which the plaintiff's late husband, a 42-year-old commercial roofer with three children, fell while he and his business partner were putting a new roof on a 12-story commercial building owned by the defendant, a performance artist and manicurist in her mid-30s who inherited the property (with significant deferred maintenance and a mortgage with a huge balloon payment due in three months) when her mother passed last year.

The parties are in mediation.

Rule 4.1 – Scenario 1. Defendant's counsel tells the mediator that his client's aunt is paying his fees and he has every intention of leaving the building as soon as "the first outrageous demand is made, meaning anything over $40,000. Under Comment 2, *this is not the type of statement normally taken as fact, but rather, is suggestive of the attorney's subjective intentions. The statement is allowed.*

Rule 4.1 – Scenario 2. Plaintiff tells her lawyer that her late husband was diagnosed with Stage IV pancreatic cancer two weeks before the fall and that his brother in Romania, who was also his doctor, gave him "at most six months to live." In prior discovery responses, Plaintiff disclosed no doctor visits by her husband and stated that he was in perfect health. She tells her attorney not to disclose the information "to anyone, ever." Plaintiff's counsel is in fact required to disclose the diagnosis, but he has a conflicting duty here as well. Rule 4.1(b) states that a lawyer "shall not knowingly fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a… fraudulent act by a client, unless disclosure is prohibited by [Section 6068(e)(1) or Rule 1.6]." False statements on discovery responses fall under the definition of "fraud" set out in Rule 1.0.1, comment 3. Rule 4.1(b), comment 3 addresses this situation: "Under Rule 1.2.1, a lawyer is prohibited from…assisting a client in conduct that the lawyer knows is…fraudulent." The lawyer is instructed to consult with his client and make her aware that he cannot participate in the fraud. Rule 1.4(a)(4) states that a "lawyer shall… advise the client about any relevant limitation on the lawyer's conduct when the lawyer knows that the client expects assistance not permitted by the Rules of Professional Conduct or other law." If the client will not permit disclosure of her late-husband's medical condition, the lawyer's option is to file a motion with the court to withdraw under Rule 1.16. That would require terminating the mediation, which could prejudice his client. If the court refuses to grant the withdrawal request (no noisy withdrawals are permitted), the lawyer is in an even bigger bind. Some of these issues have no workable solution.

Rule 4.1 – Scenario 3. Defendant's counsel tells the mediator that his client's girlfriend saw the decedent and his partner doing "lots and lots of tequila shots" at the bar on the corner before they started work on the roof the morning of the accident. The defendant has a girlfriend, but she was in Tangiers on the day of the accident and was not a witness to any boozing

activity. Therefore, the attorney is not permitted to make this statement. The very existence of the witness was manufactured, and the facts about which she would allegedly testify, that the decedent was intoxicated before he began work on the roof of a 12-story building, are material to the case.

Rule 4.1 – Scenario 4. Plaintiff, who kept her husband's books, brought copies of the financials from the roofing company to mediation. They show average annual income for the last five years of $195,000. The attorney clearly recalls that when he first reviewed the books, average annual income was $325,000 for the last five years, and he brought those copies with him to mediation as well. He asks his client, who says the audit just came back and the new numbers were correct, the business wasn't doing as well as she thought. Defendant's counsel hadn't requested any financials to date. Plaintiff suggests telling the mediator that they have no books and records with them but that she "believes the business was doing very well, around $300,000 per year." Plaintiff's counsel overrules his client and decides to give the mediator the books showing $325,000 per year so he (Plaintiff's counsel) doesn't have to lie directly to the other side, and asks the mediator to share the books with opposing counsel right away. This is not permitted.

Comment 1 to Rule 4.1 states that a lawyer has *no affirmative duty to inform an opposing party of relevant facts. But here the attorney is providing false information of a material nature to the other side. If he followed his client's suggestion, that too would have been a rule violation because the Comment provides that a misrepresentation can occur if the lawyer affirms the statement of his client when he knows the statement is false. The fact that the attorney used the mediator as a conduit for making the misrepresentation doesn't shield him from responsibility. The plain language of Rule 4.1 is that a lawyer shall not knowingly "make a false statement of a material fact or law to a third person." Thus, the lawyer cannot lie to the mediator either. Even if the rules allowed it, lying to the mediator is bad form and never helps one's client. Mediators need accurate information to help each party make informed decisions around settlement. If instructed not to disclose the information, the mediator would have honored that, but using the mediator to spew a lie to increase the value of one's settlement is a violation of the rules and counterproductive.*

Rule 4.1 – Scenario 5. Defendant's counsel states that the coverage limit on his client's policy is $250,000 when in fact he knows it to be $2.5 million, with a low deductible, and he also mentions that his client intends to file for bankruptcy if she has to spend any of her own money, because "she doesn't have any." *The attorney is not permitted to make the statement about the policy limits, knowing it to be false.* Even though opposing counsel could obtain that information through discovery, *defendant's counsel is not allowed to misrepresent a material fact with the intention that it will be relied upon. The statement about his client's intention to file for bankruptcy is probably allowed, as this is the sort of statement made frequently in negotiations.* The lie about the policy limits and the statement about bankruptcy are treated as two separate issues.

Rule 4.1 – Scenario 6. Plaintiff's counsel states his client's walkway number is "in the neighborhood of $750,000" and mentions to the mediator that he plans to report the defendant to the Department of Consumer Affairs because her manicurist license lapsed several years ago, unless of course he gets his number "or close to it." Under Rule 4.1, Comment 2, *the lawyer's statement about his client's bottom line is posturing and permitted. The threat to report the defendant to DCA for a lapsed license is probably a violation of Rule 3.10 unless the attorney intends to go through with it. The two issues are separate, however.*

Does Rule 4.1 Matter If It Can't Be Proved?

Evidence Code Section 1119 provides that mediation-related communications are confidential: "No evidence of anything said…in the course of, or pursuant to, a mediation or a mediation consultation is admissible or subject to discovery…." Section 1119(c) states: "All communications, negotiations, or settlement discussions by and between participants in the course of a mediation or a mediation consultation shall remain confidential." California courts have consistently upheld these provisions.[13] Even Section 1125(a), which states the conditions under which a mediation ends "for purposes of confidentiality," is swallowed up by Section 1126, which provides: "Anything said…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."

It is unclear how evidence of a material misstatement made by one attorney to another — directly or through the mediator — could be introduced into evidence at a subsequent proceeding to show misrepresentation or fraud. The confidential nature of mediation will probably[14] protect lawyers who make false statements in that setting.

During direct negotiations between attorneys, however, the cloak of secrecy for purposes of Rule 4.1 does not exist. This raises the rather disturbing question of why lying in one forum (mediation) is allowed while lying in another (outside of mediation) is prohibited, particularly when the mediator actually needs to have accurate information to bring about a Pareto optimal settlement.

The notion that a settlement agreement reached in mediation can be set aside if based on fraud in reliance on Section 1123(d) is false. That provision states that a settlement agreement is not made inadmissible if signed by the settling parties and the "agreement is used to show fraud, duress, or illegality that is relevant to an issue in dispute." Section 1123(d) allows the settlement agreement into evidence, but it doesn't by corollary allow mediation communications into evidence.

Lastly, in this discussion, it would be remiss not to mention Evidence Code Section 703.5, which provides that "No person presiding at any judicial or quasi-judicial proceeding, and no arbitrator or mediator, shall be competent to testify, in any subsequent civil proceeding, as to any statement, conduct, decision, or ruling, occurring at or in conjunction with the prior proceeding, except as to a statement or conduct that could (a) give rise to civil or criminal contempt…[or] (c) be the subject of investigation by the State Bar." In theory, an attorney might try to rely on this provision if she felt opposing counsel lied during a mediation, in violation of Rule 4.1. I can't speak for other mediators, but I can't be of any help to the State Bar Court because of the sudden onset of amnesia that hits me every time a mediation ends. I'm unaware of any attempt to compel mediator testimony under Section 703.5(c), although there is precedent for it in other jurisdictions and in federal court.

Conclusion

Settlement discussions are generally conducted under the proverbial cone of silence, giving many attorneys the impression that "anything goes." There are, in fact, exceptions. While some degree of gamesmanship on certain topics is permitted, lawyers do not have complete freedom to say whatever they wish to the other side. Puffing and bluffing are allowed, but intentionally misrepresenting a material fact or failing to correct certain misstatements are against

the rules. Crossing the line can lead to sanctions for the attorney, reputational damage and harm to one's client (e.g., if a settlement agreement is set aside based on fraud in the inducement). Banking on not getting caught is generally considered a risky approach. Over time, things have a way of revealing themselves. Given the strong confidentiality protection that mediation receives in California, if an attorney absolutely, positively *must* misrepresent the truth while negotiating the terms of a settlement, doing so in the presence of a mediator may be the only way to accomplish her goal, yet this is by no means foolproof.

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Endnotes

1. Galanter, *The Vanishing Trial: An Examination of Trials and Related Matters in Federal and State Courts* (2004) 1 J. of Empir. Leg. Stud. 459.
2. Because the comments are merely "guidance for interpretation" and "not a basis for discipline" (Rule 1.0 (c)), it may be that the two omitted elements of fraud should be added back in when considering discipline under Rule 4.1 and for that matter under all of CRPC-201.
3. *TSC Industries, Inc. v. Northway, Inc.* (1976) 426 U.S. 438, 439.
4. Two other provisions of the State Bar Act apply. Section 6128(a) states: "Every attorney is guilty of a misdemeanor who…consents to any deceit or collusion, with intent to deceive the court or any party." Section 6068(d) adds: "It is the duty of an attorney to employ, for the purpose of maintaining the causes confided to him or her those means only as are consistent with the truth."
5. State Bar of CA Standing Comm. on Prof. Resp. & Conduct, Form. Opn. No. 2015-194 (September 10, 2014) (hereafter "CA *Ethics Opinion* 2015-194") (See: http://www.calbar.ca.gov/Portals/0/documents/ethics/Opinions/2015-194%20(12-0007)%20Puffing%20 in%20Negotiations%20FINAL%20 12-29-15.pdf.)
6. CRPC-2018, Rule 1.0, Comment 4.
7. Bus. & Prof. Code §§6075-6117. The Rules of the State Bar, Title 5 ("Discipline") include Rules of Procedure and Rules of Practice of the State Bar Court. *The Standards for Attorney Sanctions for Professional Misconduct* are listed in the State Bar Rules of Procedure, Title IV, pages 146-157, accessed at http://www.calbar.ca.gov/Portals/0/documents/ethics/Opinions/2015-194%20(12-0007)%20Puffing%20in%20Negotiations%20 FINAL%2012-29-15.pdf (hereafter, "*State Bar R. Proc.*").
8. *In re Silverton* (2005) 36 Cal. 4th 81, 91. See also *In re Lamb* (1989) 49 Cal. 3d 239, 245.
9. State Bar R. Proc., *supra* at 155.
10. State Bar R. Proc., *supra* at 155.
11. State Bar R. Proc., *supra* at 149. (The author is unclear how an enhancement works in the event of disbarment.)
12. See State Bar R. Proc., *supra* (http://www.calbar.ca.gov/Portals/0/documents/ethics/Opinions/2015-194%20 (12-0007)%20Puffing%20in%20Negotiations%20 FINAL%2012-29-15.pdf).
13. See, e.g., *Amis v. Greenberg Traurig* (2015) 235 Cal.App.4th 331 (hereafter, "*Amis*"); *Cassel v. Superior Court* (2011) 51 Cal.4th 113 (hereafter, "*Cassel*"); *Fair v. Bakhtiari* (2006) 40 Cal.4th 189 (hereafter, "*Bakhtiari*"); *Rojas v. Superior Court* (2004) 33 Cal.4th 407 (hereafter, "*Rojas*"); *Foxgate v. Bramalea* (2001) 26 Cal.4th 1 (hereafter, "*Foxgate*").
14. California courts have not considered Rule 4.1 in the context of mediation (or in any forum); thus, "probably" does not mean "definitely."