Ethics Watch

Confidential Settlement Agreements: What's Ethically Permitted and What's Not

By Nathan M. Crystal

In litigation parties often negotiate for confidentiality provisions in connection with settlement agreements. A wide range of motivations can prompt one or both parties to seek such arrangements. For example, defendants in product liability cases may be worried that publicity about the existence or settlement of litigation could prompt other cases or could increase settlement values. Confidentiality provisions with regard to litigation generally fall into two categories: private confidentiality agreements and court orders providing for confidentiality or sealing of records.

Legal restrictions on confidentiality provisions

In most jurisdictions confidentiality agreements are enforceable and court-ordered confidentiality is permissible. Some jurisdictions allow private confidentiality agreements but restrict the use of court orders sealing documents and settlement agreements to situations in which a court finds that the private interests in confidentiality outweigh the public interest in access to information. South Carolina and Texas have adopted this approach. S.C. R. Civ. Proc. 41.1; Tex. R. Civ. P. 76a. The Florida Sunshine in Litigation Act goes further, prohibiting both court orders and private confidentiality agreements dealing with a "public hazard." Fla. Stat. Ann. §69.081.

Ethical restrictions on confidentiality provisions

To the extent that a confidentiality agreement is regulated by rule of procedure or statutory law, a lawyer must comply with those rules. See SCRPC 3.4(c) (lawyer shall not knowingly disobey an obligation under the rules of a tribunal except for an open refusal based on the assertion that no obligation exists). A South Carolina lawyer who negotiated a confidentiality agreement that calls for court-ordered confidentiality in connection with a case pending in state court must comply with South Carolina Rule of Civil Procedure 41.1. A similar rule (but with some important differences) applies to cases in federal court in South Carolina. See Local Rule 5.03. A South Carolina lawyer appearing *pro hac vice* in a Florida or Texas case would have to comply with the rules of those jurisdictions. See SCRPC 8.5(b)(1) (for conduct in connection with a matter pending before a tribunal, the rules of the jurisdiction in which the tribunal sits govern unless the rules provide otherwise).

Rule of Professional Conduct 5.6

In addition to the legal restrictions on confidentiality agreements, lawyers must comply with Rule 5.6 of the Rules of Professional Conduct. That rule states that a "lawyer shall not participate in offering or making an agreement in which a restriction on the lawyer's right to practice is part of the settlement of a client controversy." The rule applies to both sides of a settlement agreement. Thus, it is improper for a defense counsel to offer a settlement agreement that violates Rule 5.6(b). See Fla. St. Bar Comm. on Prof. Ethics, Op. #04-02 (2005).

Rule 5.6(b) prohibits agreements that directly restrict the practice of law. See ABA Formal Op. #93-371 (settlement agreement prohibiting plaintiff's lawyer from representing future clients against defendant). The rule is based on three policies: First, permitting such provisions restricts the public's access to lawyers of their choice. Second, negotiation of such provisions creates a conflict of interest between current clients, prospective clients, and the personal interests of lawyers. Finally, use of such agreements could provide current clients with benefits that bear little relationship to the merits of their claims. See ABA Formal Op. #93-371. The rule applies not only to private settlement agreements, but also to settlements with government entities. ABA Formal Op. #95-394. Similarly, a provision in the employment agreement of corporate counsel prohibiting counsel from representing anyone in the future against the corporation is improper. ABA Formal Op. #94-381.

The rule has been criticized, however, on two grounds. First, the rule impedes settlement because it prevents the parties from agreeing to a provision that the defendant would find valuable and that the plaintiff and his lawyer may be willing to accept. Second, the policy reasons supporting the rule do not withstand analysis and have no empirical support. For example, the argument that the rule restricts the public's access to lawyers of their choice is dubious because many highly competent lawyers are willing to handle cases against the defendant even if the lawyer who entered into a no-sue agreement could not do so. See Stephen Gillers & Richard W. Painter, Free the Lawyers: A Proposal to Permit No-Sue Promises in Settlement Agreements, 18 Geo. J. Legal Ethics 291 (2005).

Rule 5.6(b) has been applied to indirect as well as to direct restrictions on the practice of law. An indirect restriction is one that does not specifically prohibit a lawyer from representing future clients, but has an impact on the lawyer's ability to do so. The Colorado Bar in Op. #92 (1993) advised that provisions in a settlement agreement preventing counsel for the plaintiff from subpoenaing certain records or fact witnesses, preventing plaintiff's

counsel from using a certain expert, and imposing forum and venue limitations in future cases against the defendant were improper under Rule 5.6(b).

In Ethics Advisory Op. #10-04, the South Carolina Committee advised that another type of indirect restriction on the practice of law was improper. That opinion dealt with a proposed settlement agreement in which the defendant agreed to pay the plaintiff a sum of money. As part of the proposed settlement the defendant sought confidentiality of the amount of the settlement and an agreement from the plaintiff's lawyer in which the lawyer agreed not to use the defendant's name for "commercial or commercially-related publicity purposes." The agreement would allow the attorney to state that a settlement was reached against a certain industry, i.e. trucking. The lawsuit against the defendant was a matter of public record, and nothing was filed under seal. The settlement agreement did not require court approval. In Opinion 505 (1994) the Texas Ethics Committee had found that prohibitions on "solicitations" by lawyers violated Rule 5.6(b) because solicitations were part of the practice of law. The South Carolina Committee went further: "We need not come to the same conclusion, as Rule 5.6 was not intended to merely protect against specific practice-of-law prohibitions but is aimed more broadly at lawyers' access to legal markets and, more importantly, clients' access to lawyers of their choosing." Thus, under the committee's opinion a settlement agreement could not prohibit a lawyer from advertising for clients against a particular defendant. In addition, the committee advised lawyers not to become parties to client settlement agreements: "For Rule-1.6-protected information, the lawyer's participation in the agreement is unnecessary. For unprotected information, the lawyer's participation is improper."

Should indirect restrictions on the practice of law be found to violate Rule 5.6(b)? The answer depends on whether one views the policy arguments in favor of the rule as persuasive. The article by Professors Gillers and Painter makes a strong case that they are not. While Gillers and Painter argue for rule change, that is a long-term, speculative possibility. Their analysis can, however, inform the interpretation of the rule. Under this view indirect restrictions should be narrowly construed.

If the view of this article—that Rule 5.6(b) should be narrowly construed when applied to indirect restrictions on the practice of law—is accepted, how should such restrictions be treated? I suggest three categories. Some indirect restrictions should be per se improper. In this category would fall extreme restrictions that, while not explicitly preventing representation of future clients, would substantially interfere with the handling of future cases. The Colorado opinion discussed above is an example of an indirect restriction that should be per se improper. This restriction interferes with the lawyer's independent professional judgment in handling future cases and is inconsistent with the lawyer's obligation to competently represent future clients.

Similarly, a prohibition on the lawyer's use of information obtained during the representation of a client should be improper. In ABA Formal Op. #00-417, which was cited by the South Carolina Committee in Opinion #10-04, the ABA committee ruled that an agreement by counsel not to use information was improper because it would as a practical matter prevent the lawyer from representing future clients in violation of Rule 5.6(b). However, the committee held that a provision in which a lawyer agreed not to disclose (rather than use) information related to the representation was permissible because such a provision was nothing more than what is required by the Model Rules absent client consent. A settlement agreement prohibiting a lawyer from disclosing information obtained in a prior case, but not barring use of such information, would not prevent a lawyer from taking on new cases involving the same products or defendants. A lawyer could use information obtained in a prior case without disclosing the information in several ways. For example, the lawyer could use his knowledge of a prior case to plan strategy and formulate discovery requests without directly disclosing the information. It is unclear, however, whether courts will accept the distinction drawn by the ABA Committee. Compare *Bassman v. Blackstone Assoc.*, 718 N.Y.S.2d 826 (App.Div.2001) (settlement agreement with confidentiality provision as to terms of settlement and settlement negotiations prohibited the law firm that entered into the agreement from representing future similarly situated clients against the defendant because disclosure of the confidential information is "necessarily implicated" in the future representation) with *Tradewinds Airlines, Inc. v. Soros*, 2009 WL 1321695, at *9 (S.D.N.Y. May 12, 2009) (rejecting *Bassman* at least as applied to a standard confidentiality agreement and finding that such an interpretation would violate New York ethics rules).

The second category would consist of indirect restrictions that the client has the right to insist on, even over the objection of the lawyer. A provision requiring the terms of a settlement to be kept confidential as in ABA Opinion #00-17 is an example of such a provision. The client has the right to confidentiality of the terms of the settlement, and the lawyer has no right to disclose this information without client consent.

The third category would involve restrictions on the future activity of the lawyer that the client has no right to control. For example, advertising for future clients, like that involved in S.C. Op. #10-04, is an activity that the client has no right to control. If the defendant offered such a provision, it would be up to the lawyer to decide whether to accept it. The client would have no right to insist that the lawyer accept such a provision. The situation is no different from one in which the client asked the lawyer to cut his fee in order to settle the case. The scope of a lawyer's practice is the lawyer's property. The client is free to ask but cannot demand that the lawyer sell any portion of his right to practice law. The client may

be annoyed, but the fact of client annoyance does not create a client right. See Gillers & Painter, supra at 315-316. Any compensation for the restriction would belong to the lawyer because the lawyer is selling his rights. Of course, any such agreement between the plaintiff's lawyer and the defendant must be fully disclosed to the client, and the client must give informed consent confirmed in writing because the agreement poses a risk of a material impact on the lawyer's representation of the client, Rule 1.7(a)(2) and 1.7(b). The client would, therefore, have a veto right over such an agreement, but could not insist on it.

Under the analysis of this article, an agreement that required plaintiff's counsel to turn over any discovery materials produced during the litigation should not be treated as violative of Rule 5.6(b). Such a provision would have only a negligible impact on the right of plaintiff's counsel to represent future clients because the lawyer could request such materials in future litigation. In the meantime, however, the defendant would have control of the materials. A defendant who reasonably anticipated similar litigation in the future could not, however, destroy such material because the defendant and its counsel would have a duty to institute a litigation hold. See Nathan M. Crystal, Ethical Responsibility and Legal Liability of Lawyers for Failure to Institute or Monitor Litigation Holds, 43 Akron L. Rev. 715 (2010). A provision requiring the plaintiff and its lawyer to turn over the discovery materials in the case would fall into the second category of indirect restrictions discussed above because the client has the right to the file in the case. The client could insist on this provision even over the lawyer's objection. If the proposed agreement required the lawyer to turn over his entire file, including work product, the portion dealing with work product, in which the lawyer has at least a partial property interest, would fall in the third category and would be subject to the lawyer's agreement. Cf. New Mex. Bar Op. 1985-5 (finding that a provision in a settlement agreement requiring plaintiff's counsel to turn over work product material violated DR 2-108(B), predecessor to Rule 5.6(b)).

Some defendants have attempted to avoid the restriction of Rule 5.6(b) by entering into retainer or consulting agreements with counsel for the plaintiff. Through such an agreement, the defendant attempts to become a current client, preventing the adverse counsel from undertaking representation against it under Rule 1.7(a)(1). Of course, if the consulting agreement is a secret arrangement between plaintiff's counsel and the defendant and its counsel, not disclosed to the plaintiff, it should be improper because it violates Rule 1.7 (conflict between multiple clients and conflict arising from lawyer's financial interest). See *Adams v. BellSouth Telecommunications, Inc.*, 2001 WL 34032759, at 5-6 (S.D. Fla. 2001). Even if it is not secret, the lawyer must be careful to comply with the consent and disclosure requirements of the rules in order to engage in multiple representation. See *In re Brandt/Griffin*, 10 P.3d 906 (Or. 2000). However, if the consulting agreement is fully disclosed to the client and the client gives informed consent, it should be proper. Prudent counsel would also disclose the agreement to the court as well. If the consulting agreement is truly not part of the settlement and in fact occurs after the settlement is reached, it should not be subject to Rule 5.6(b).

A tension exists between the public policy in favor of promoting settlements and the policy arguments justifying prohibitions on agreements restricting the practice of law. This article argues that when it comes to indirect restrictions on the practice of law, the policy in favor of settlements should generally prevail. Rule 5.6(b) should be narrowly construed when applied to indirect restrictions. Based on this analysis, the South Carolina Committee's Opinion #10-04 was wrongly decided. Since the opinion is only advisory, lawyers considering this and similar agreement could seek court approval of the provision. ■