Ethics Watch

"Let's Make a Deal"—Settlement Ethics

By Nathan M. Crystal

Plaintiffs who reject settlement offers and go to trial do worse 61 percent of the time, losing an average of $43,000 according to a study published in the September issue of the *Journal of Empirical Legal Studies*. Randall L. Kiser et al., *Let's Not Make a Deal: An Empirical Study of Decision Making in Unsuccessful Settlement Negotiations*, 5 J. Empirical Legal Studies 551 (2008). Defendants were wrong in rejecting settlement offers less often, 24 percent of the time, but the wrong decision was more costly, resulting in an average loss to the defendant of $1.1 million. *Id.* at 566. The results come from a study of more than 2000 trials in the California state courts from 2002 through 2005. *Id.* at 552. Error rates for plaintiffs are higher in contingency fee cases; for defendants error rates increase when the defendant lacks insurance. *Id.* at 577. So, it looks like both plaintiffs and defendants would generally fare better by settling rather than going to trial. But what happens if the client refuses to accept a "reasonable" settlement recommended by counsel or reneges on a settlement agreement made by counsel?

1. How should a lawyer ethically handle a client who unreasonably refuses to accept a settlement offer?

Lawyers are agents of their clients. Under agency law and the rules of professional conduct, clients have the right to decide whether to accept or reject an offer of settlement in a civil case or an offer of a plea agreement in a criminal case. *See* S.C. Rule of Professional Conduct (SCRPC) 1.2(a). In making this decision clients do not always make the best choice, as the empirical evidence mentioned above indicates. In addition, the particular circumstances of plaintiffs and defendants may influence them to make decisions that may appear unwise from the perspective of a reasonable person not affected by such factors. Take the situation of a plaintiff in a personal injury case. A plaintiff who is in need of funds may be willing to accept an offer of settlement that the plaintiff's lawyer considers inadequate. On the other hand, a plaintiff who is not desperate for funds may be willing to reject a good settlement offer and take the risk of a trial in the hope of a big recovery; when the plaintiff's lawyer is handling the case on a contingency fee basis and fronting the expenses, the trial costs a plaintiff nothing. A defendant without substantial insurance may be willing to reject a good settlement offer and risk a trial because the defendant cannot afford to pay the settlement and plans to bankrupt against any judgment if it loses.

So what can a lawyer do if a client acts unreasonably with regard to a settlement offer? One possibility is to move to withdraw from the representation. Withdrawal, however, is questionable both practically and ethically. Practically, if the lawyer moves to withdraw, the lawyer may find it difficult to collect his or her fee. The lawyer's claim for a fee will be reduced to a quantum meruit recovery, rather than the amount set forth in the fee agreement. *See* Robert M. Wilcox & Nathan M. Crystal, Annotated South Carolina Rules of Professional Conduct 52 (2005 ed.). In addition, the lawyer will not have a claim against any insurance company or successor counsel unless the lawyer's engagement agreement has a charging lien. *Id.* at 121. Finally, the client will almost certainly claim that the withdrawal was unjustified, resulting in a forfeiture of the fee.

Ethically, withdrawal is also questionable. A recent ethics opinion from the Oregon State Bar addresses this issue. 68-May Or. St. B. Bull. 9. The opinion considers whether a lawyer may permissibly withdraw under SCRPC 1.16(b) if a client rejects a settlement offer. With some qualifications the opinion concludes that withdrawal would not be ethically permissible under any of the subdivisions of the rule. For example, the rule that is most directly applicable is SCRPC 1.16(b)(4), which allows a lawyer to withdraw if there is a fundamental disagreement with the client. However, the opinion concludes that a lawyer does not have a fundamental disagreement "merely because the client refuses to follow the lawyer's advice or chooses a course the lawyer believes is unwise, particularly where the decision (settlement) is one that is squarely within the client's sole control." The opinion indicates that in many instances the lawyer must "suck it up" and "continue the representation if withdrawal will be more harmful to the client than continuing the representation would be for the lawyer."

The opinion attempts to soothe the psyche of a lawyer who faces such a situation: "We can avoid some of the angst of the situation by endeavoring not to take the client's repudiation personally, and by reminding ourselves that our obligation is to do the client's bidding and pursue the client's interest." While some lawyers may find the counselor's couch comforting, most will be interested in more tangible advice. What can a lawyer do with the "unreasonable" client who refuses to accept an offer that the lawyer strongly believes is favorable? Consider the following:

Aggressive counseling. With regard to the decision to settle, lawyers have the right and the obli-

gation to counsel their clients about all aspects of the proposed settlement. SCRPC 2.1. However, the rules provide no guidance on how a lawyer counsels a client. Lawyers have discretion to be matter-of-fact and relatively neutral with regard to giving advice about a settlement, or they can be more aggressive, strongly counseling the client that rejection of the settlement offer would be unreasonable and foolish. "About half of the practice of a decent lawyer is telling would-be clients they are damned fools and should stop," remarked Elihu Root, a prominent New York lawyer of the early 20th century. Of course, a lawyer who is too aggressive crosses the line from counseling to coercion, but where the line lies is a matter of judgment. In counseling a client, whether neutrally or aggressively, the attorney must take into account the particular circumstances of the client like the ones mentioned above. Lawyers should also consider the insights drawn from psychological studies of the impact of gain or loss on decision making. See *Mind Control: The Psychology of Settlement, How to Get What You Want* (ABA Annual Meeting 2008), www.abanet.org/media/youraba/200808/article04.html (visited September 21, 2008).

Provisions in engagement agreements. Some lawyers have attempted to deal with the problem of the unreasonable client by including in their engagement agreements provisions that transform the contingency fee into an hourly fee if the client rejects a settlement offer recommended by the lawyer (sometimes called "conversion agreements"). Most courts and ethics advisory committees have concluded that such provisions are improper because they interfere with the client's right to decide whether to settle the case. See *Compton v. Kittleson*, 171 P.3d 172 (Alaska 2007) (rejecting hybrid fee agreement as against public policy and citing ethics opinions from several jurisdiction that are in accord).

However, a different provision may meet ethical standards. Suppose the lawyer will be handling the case on a contingency fee basis and advancing expenses. The agreement could provide that the lawyer has total discretion about advancement of expenses. If the lawyer decides not to advance expenses, the lawyer must give the client reasonable notice so that the client has the opportunity to seek funds to pay the expenses. Suppose the client is considering rejecting a settlement offer in a medical malpractice case. (The empirical study cited above finds that the plaintiff's error rate in medical malpractice cases is 81 percent. 5 Journal of Empirical Legal Studies at 577.) If the client refuses the offer, the case can only proceed to trial if the fees of expert witnesses who must testify have been paid. The lawyer could inform the client that the lawyer has decided not to pay the expenses of any experts and that if the client wants to reject the settlement offer, the client will need to come up with the funds to pay the experts or the case will be dismissed. Coercive? Yes, of course it is, but in a different way than an agreement that converts the fee of the lawyer from contingent fee to hourly basis if the client rejects the settlement offer. First, the expense provision is not triggered solely by the client's decision to refuse to settle. The client's rejection of a settlement offer is only one circumstance in which the lawyer could refuse to advance expenses. Second, under a conversion agreement the client would be subject to a "fee surprise" where the amount of the fee owed the lawyer could exceed the settlement. *See Compton v. Kittleson* above. Under the expense provision the client would not owe the lawyer anything. Finally, it seems unlikely that a court would say that a lawyer is ethically required to spend his own money to pay expenses for the client when the fee agreement does not require the lawyer to do so.

Limited engagement agreements. If a lawyer anticipates before the representation begins that the client may be difficult, the lawyer can simply reject the engagement. Another possibility is to represent the client under a limited engagement agreement in which the lawyer agrees to investigate the case and negotiate a settlement, but does not agree to file suit. If a settlement cannot be reached and suit must be filed, the lawyer's engagement for that aspect of the case would be subject to separate agreement. Limited engagement agreements are generally permissible provided they are reasonable under the circumstances. *See* SCRPC 1.2, comments 6-7. One major advantage of the limited engagement agreement is that the lawyer will not be required to obtain court permission to withdraw from the representation because suit has not been filed. *See* S.C. Bar Ethics Advisory Op. #08-01 (advising that lawyer must obtain court permission to withdraw when matter is pending in court). Of course, in many cases meaningful settlement discussions cannot be conducted until after substantial discovery, which generally can only be conducted after the lawyer files suit.

2. When is a client bound by a settlement agreement made by counsel?

In South Carolina the beginning point for answering this question is Rule 43(k) of the Rules of Civil Procedure, which provides:

> (k) Agreements of Counsel. No agreement between counsel affecting the proceedings in an action shall be binding unless reduced to the form of a consent order or written stipulation signed by counsel and entered in the record, or unless made in open court and noted upon the record. Settlement agreements shall be handled in accordance with Rule 41.1, SCRCP.

Under this rule a client would not be bound unless the settlement agreement complied with the rule. To comply with the rule, the consent order or written stipulation must specify the terms of the agreement. *See Ashfort Corp. v.*

Palmetto Const. Group, Inc., 318 S.C. 492, 458 S.E.2d 533 (1995) (holding that entry stating that "court advised case settled" did not comply with rule).

So far, so clear, but what happens if counsel enters into an agreement that complies with the rule and the client later changes his or her mind? Two situations should be distinguished. Suppose the client had approved the settlement but simply has a change of heart. In that case the lawyer entered into the settlement with actual authority and the client is bound. Opposing counsel could seek a court order to enforce the settlement or bring an independent action on the agreement.

Suppose, however, that the client claims that the lawyer entered into the settlement without authority from the client. What then? The acts of attorneys are binding on their clients through principles of agency law. *Collins v. Bisson Moving & Storage, Inc.*, 332 S.C. 290, 504 S.E.2d 347 (Ct. App. 1998). Lawyers have authority to settle cases on behalf of their clients. Such settlements are binding absent fraud or mistake. *Motley v. Williams*, 374 S.C. 107, 647 S.E.2d 244 (S.C. Ct. App. 2007). The lawyer's authority is limited, however, to claims set forth in the pleadings, and any settlement that goes beyond the pleadings must be expressly agreed to by the client. *Graves v. Serbin Farms, Inc.*, 295 S.C. 391, 368 S.E.2d 682 (Ct. App. 1988). A lawyer who enters into a settlement without client authority may be liable to the client for negligent advice with regard to the settlement. *Crowley v. Harvey & Battey, P.A.*, 327 S.C. 68, 488 S.E.2d 334 (1997).

In other jurisdictions, the situation may be different. *See Makins v. District of Columbia,* 389 F.3d 1303 (D.C. Cir. 2004) (holding that client is not bound by settlement agreement negotiated by attorney when the client has not given the attorney actual authority to settle the case on those terms but has authorized the attorney to attend a settlement conference before a magistrate judge and to negotiate on her behalf and when the attorney leads the opposing party to believe that the client has agreed to those terms). By the way, with regard to authority to enter into settlement negotiations (rather than the authority to enter into settlement agreements), prudent lawyers will include in their engagement agreements a provision authorizing them to enter into settlement negotiations at any time that the attorney believes to be advantageous to the client.

Settlement presents a number of other ethical problems, some of which I will discuss in later columns. One such issue is the scope of the ethical duty to disclose material information during settlement negotiations, as the following story illustrates:

> A big-city lawyer was representing the railroad in a lawsuit filed by an old rancher. The rancher's prize bull was missing from the section through which the railroad passed. The rancher only wanted to be paid the fair value of the bull. The case was scheduled to be tried before the justice of the peace in the back room of the general store. The attorney for the railroad immediately cornered the rancher and tried to get him to settle out of court. The lawyer did his best selling job, and finally the rancher agreed to take half of what he was asking. After the rancher had signed the release and took the check, the young lawyer couldn't resist gloating a little over his success, telling the rancher, "You know, I hate to tell you this, old man, but I put one over on you in there. I couldn't have won the case. The engineer was asleep and the fireman was in the caboose when the train went through your ranch that morning. I didn't have one witness to put on the stand. I bluffed you!" The old rancher replied, "Well, I'll tell you, young feller, I was a little worried about winning that case myself, because that durned bull came home this morning." ■