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The Settlement Privilege and the Threat of Legal Action

Part One of a Two-Part Article

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Is there a time when extortionate threats of meritless litigation become a criminal act that should be exempt from the settlement privilege?

Some time ago, one of these authors observed that nearly all manner of communication is apt to contain the seedlings of a threat at one time or another. *See* Stanley S. Arkin, "Blackmail and the Practice of Law," *N Y L J* (Feb. 7, 1995). Whether this be a communication between a parent and child ("Eat your vegetables or else!") or a TV commercial, the practice in our discourse of imposing a consequence to coerce a concession, achieve an economic or political end, or resolve a dispute is so commonplace that it may proceed without care or notice, much less analysis. Of course, the laws and regulations designed to punish extortion and blackmail are notable exceptions to this. Our society rejects these efforts to exploit others by virtue of fear-invoking threats that are designed to achieve wrongful objectives.

Uniformly excluded from these laws and regulations, however, are threats levied within the context of settlement negotiations. This is accomplished by application of the so-called "settlement privilege," crafted as it is with the intention of encouraging informal dispute resolution by deeming inadmissible communications made during the course of settlement talks. Statutes ordaining the settlement privilege typically espouse a standard close to (or mirroring) the proscription set for by Rule 408 of the Federal Rules of Evidence — which by its terms excludes from evidence "conduct or a statement made during compromise negotiations" offered "to prove or disprove the validity or amount of a disputed claim."

Part One of this article considers the issue of when a threat to litigate encased by a settlement demand raises the specter of extortion, and the extent to which a potentially extortionate settlement communication should be outside the scope of the privilege. Part Two, which will be featured in next month's issue, examines case law assessing potentially extortionate settlement communications and concludes by suggesting that it may be worthwhile to consider whether an exception for extortionate demands should be made explicit as a means to discourage this manner of criminal activity as well as meritless suits.

Relevant Statutes and Ethical Rules

As noted previously, both federal and state laws criminalize extortion. The Hobbs Act forbids effecting commerce by extortion, which in turn is defined as "the obtaining of property from another, with his consent, induced by wrongful use of actual or threatened force, violence, or fear, or under color of official right." 18 U.S.C. § 1951. Blackmail, a subset of extortion, is covered by 18 U.S.C. § 873, which provides that "whoever, under a threat of informing, or as a consideration for not informing, against any violation of any law of the United States, demands or receives any money or other valuable thing, shall be fined under this title or imprisoned not more than one year, or both."

The New York Penal Code proscribes larceny by extortion. This is defined as any act inducing another to deliver property by instilling a fear that, should the property not be surrendered, the actor will take some action to harm the victim, including but not limited to: 1) accusing the victim of a crime; or 2) exposing a secret that will harm the victim's reputation, career, and/or personal relationships, or otherwise subject the victim to hatred, contempt or ridicule. *See* N.Y. Penal Code § 155.05(2)(e).

For lawyers, the foregoing is enhanced by relevant ethical canons and rules of professional responsibility. For example, Rule 3.1 of the New York Rules of Professional Conduct prohibits an attorney from bringing a claim that is unwarranted by existing law, or that serves merely to harass or maliciously injure another. Similarly, Rule 3.4(e) prohibits a lawyer from "present[ing], participat[ing] in presenting, or threaten[ing] to present criminal charges solely to obtain an advantage in a civil matter."

These statutes make clear that, of course, threatening litigation in order to persuade an adversary to settle a legitimate claim, and warning of the consequences of failing to settle amicably, fall far short of accomplishing an extortion of any sort. But more challenging are the myriad matters that lie beyond this overly simple absolute. For example, what of the threat to an adversary to file a litigation of no genuine legal value that has been cleverly designed as a shakedown for a considerable sum on pain of filing a meritless but nonetheless commercially crippling or defamatory litigation? The prospect of simply moving for legal sanctions — following consequential commercial harm already done — hardly seems satisfactory to the company that is now out of business. Yet this is largely what the law demands.

The Settlement Privilege

Rule 408 of the Federal Rules of Evidence provides, in pertinent part, that "conduct or a statement made during compromise negotiations" is not admissible "to prove or disprove the validity or amount of a disputed claim or to impeach by a prior inconsistent statement or a contradiction." Nonetheless, such evidence may be admitted "for another purpose, such as proving a witness's bias or prejudice, negating a contention of undue delay, or proving an effort to obstruct a criminal investigation or prosecution." Section 4547 of the New York Civil Practice Law and Rules similarly bars admission of settlement discussions to prove "liability for or invalidity of the claim or the amount of damages."

The rationale for these rules is: 1) that settlement discussions are irrelevant, since they "may be motivated by a desire for peace rather than from any concession of weakness of position"; and 2) to promote "the public policy favoring the compromise and settlement of disputes." FED. R. EVID. 408, Notes of Advisory Committee on Proposed Rules.

The settlement privilege "encourages settlement by protecting parties to a settlement agreement or negotiation from having their good-faith efforts to settle a

dispute used against them in subsequent litigation." *Am Soc'y of Composers, Authors & Publishers v Showtime/The Movie Channel, Inc* , 912 F.2d 563, 580 (2d Cir. 1990).

Yet the doctrine, when applied broadly or without a "crime-fraud" exception, can accomplish the unintended result of protecting conduct that may be criminal. Two cases illustrate the conundrum, and, as noted previously, we will discuss them in next month's issue.

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