The Ethics of Negotiating Settlements: What are the Rules?

By Nadia Campion[1] and Geoff R. Hall[2]

The growth and popularity of alternative dispute resolution in Canada are relatively recent phenomena. It is only in the last 45 or 50 years that law firms began to employ retired judges and leading counsel to offer ADR services to clients, and various provincial authorities began to update their rules to reflect the growing popularity and proliferation of ADR processes. During this time, the law has shifted from a not-so-veiled hostility towards dispute resolution outside the courts towards a regime that strongly favours private dispute resolution as a matter of public policy. In 1996 that the Canadian Bar Association (CBA) engaged in a major review of the civil justice system in Canada resulting in numerous recommendations, including the use of ADR to increase efficiency and access to justice. The CBA's task force encouraged the adoption of a "dispute resolution approach to the litigation practice" and described that approach as not only desirable but as a "new professional obligation."[3]

ADR has since become an essential and permanent part of the Canadian judicial system. Its integration into the legal system recognizes the central role played by lawyers in the negotiation and resolution of disputes outside of court. As a result, lawyers must not only be effective negotiators, experienced in all aspects of ADR, but they must also possess a thorough knowledge and understanding of the ethical considerations that underlie strategies used to achieve settlements for their clients, whether by way of party-to-party negotiation or with the assistance of a neutral third-party.

In Ontario, lawyers negotiating settlements are governed by the *Rules of Professional Conduct* of the Law Society of Upper Canada. They are also guided by the CBA Model Code of Professional Conduct (the "Model Code"). These rules define a "competent lawyer" as an individual who has and applies knowledge, skills and attributes in a manner appropriate to each matter on behalf of a client including, among other things, negotiations.[4] Lawyers

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3 Canadian Bar Association, "Task Force Report on Systems of Civil Justice" (Ottawa: CBA, 1996), at p. 64

4 Rule 3.1-1 of the *Rules of Professional Conduct*, Law Society of Upper Canada, available online at http://www.lsuc.on.ca/list.aspx?id=671

are required to advise and encourage their clients to compromise or settle a dispute wherever it is possible to do so on a reasonable basis and to use ADR processes for every dispute.[5]

In representing a client, the lawyer must act resolutely and honourably within the limits of the law while treating the tribunal with candour, fairness, courtesy and respect.[6] When acting as an advocate the lawyer shall not do anything dishonest or dishonourable, misstate facts or law or suppress what ought to be disclosed; knowingly misstate the contents of a document, the testimony of a witness, the substance of an argument or the provisions of a statute or like authority; or knowingly assert as true a fact when its truth cannot reasonably be supported by the evidence or as a matter of which notice may be taken by the tribunal.[7] These duties extend to appearances before boards, administrative tribunals, arbitrators, mediators and others who resolve disputes.[8]

At first blush, the *Rules of Professional Conduct* appear to provide a comprehensive code according to which lawyers should conduct themselves in representing clients. However, a closer analysis reveals that the *Rules* offer little guidance regarding the professional ethics of negotiating settlements. They are silent on the standards of "truth" and "deception" that ought to govern lawyers when advocating for their clients' interests in the settlement negotiation context. In particular, the *Rules* do not assist lawyers in determining the extent to which they can withhold information or positions from the opposite party when resolving disputes or whether there is an affirmative duty to inform of material facts when the opposite party is operating under a misapprehension of their own making.

Many scholars and commentators have written on the topic of disclosure in settlement negotiation and, more recently, have urged regulators to adopt a "code of negotiation ethics". Yet lawyers continue to operate in a grey area using their own moral compass as a guide to point them in the right direction. Of course, not all compasses are created equal with the result that ethical standards in the negotiation context are anything but clear or consistent. There is no consensus in the legal community, at least in Ontario, as to where one should draw the line between acceptable negotiation strategies and unacceptable concealment or deception.[9] The challenge is that, without direction, lawyers are at risk of taking wrong turns to the detriment of their clients who may be better suited to resolving the dispute rather than following the long path to trial.

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5 *Ibid.* Rule 3.2-4

6 *Ibid.* Rule 5.1-1 and associated Commentary

7 *Ibid.* Rule 5.1-2

8 *Ibid.* Rule 5.1-1

9 Gavin MacKenzie, Lawyers and Ethics: Professional Responsibility and Discipline, 5th ed (Toronto: Carswell/Thomson Reuters Canada, 2009) at 15-2

This paper considers the sources from which lawyers in this province can derive certain standards by which negotiations should be conducted and settlements achieved, including rules that exist in other provinces, judicial opinions and decisions, and, most importantly, the values and norms that already exist and upon which Canada's justice system is built.

The Rules in other Provinces

The starting point in analyzing the appropriate standards that should be applied are the rules that exist in various jurisdictions. With the exception of Alberta, codes of conduct in most, if not all, provinces have adopted and reflect the language in the Model Code, which, as discussed above, provides less than optimal guidance on the ethics of settlement negotiation.

By contrast, in Alberta, the Law Society has adopted a rule that states, "[a] lawyer must not lie to or mislead another lawyer." The commentary to that rule states:

> "[…] In no situation, including negotiation, is a lawyer entitled to mislead a colleague. When a lawyer (in response to a question, for example) is prevented by rules of confidentiality from actively disclosing the truth, a falsehood is not justified. The lawyer has other alternatives, such as declining to answer. If this approach would in itself be misleading, the lawyer must seek the client's consent to such disclosure of confidential information as is necessary to prevent the other lawyer from being misled. The concept of "misleading" includes creating a misconception through oral or written statements, other communications, actions or conduct, failure to act, or silence."[10]

The inevitable question that arises from the commentary is whether a lawyer, acting in Alberta, must disclose their "bottom line" settlement position if asked by the opposite party. While remaining silent is an option, the silence itself may signal to the other side that there is room to negotiate which may undermine the lawyer's negotiating strategy or attempt to achieve the best result for his or her client. On the other hand, those advocating for reform in Ontario along the lines of what is now available in Alberta argue that "trustworthy bottom lines offered in accordance with [Alberta's rule] will foster dispute resolution over prolonged

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[10] Alberta *Code of Professional Conduct*, Rule 7.2-2, available at http://www.lawsociety.ab.ca/docs/default-source/regulations/code.pdf

litigation."[11] The goal is to prevent lawyers from engaging in "puffing" during settlement negotiations on the theory that such tactics prolong the litigation beyond the point when a settlement could otherwise be reasonably achieved. In response to Alberta's rules, some lawyers have taken to advising their clients not to disclose their bottom line settlement position to them. In that way, the lawyer can honestly advise the opposite party that the settlement position disclosed is, to the lawyer's knowledge, the client's "bottom line" offer.

To date, no other Canadian jurisdiction has ventured as far as Alberta in regulating and imposing ethical standards on the manner in which lawyers deal with one another in the negotiation context. However, as discussed in the following section, case law developments in other contexts suggest that there is a general duty of disclosure on negotiating parties as well as a duty to make reasonable efforts to reach an agreement. Negotiating parties should not engage in "receding horizon" or "faux impasse" bargaining, tactics commonly known in the collective bargaining world. Lawyers should take a page from the case law that has developed to help guide them in the ethical issues that arise when negotiating and/or settling disputes.

Case Law Developments

Courts have long recognized that a party has a duty to avoid misrepresentations in negotiations. In *978011 Ontario Ltd. V. Cornell Engineering Co.*[12] the Ontario Court of Appeal suggested that, in certain circumstances, the law will require parties who are negotiating to avoid misleading or omitting information from the other party. Such circumstances may arise where one party relies on the other for information necessary to make an informed decision, and the party in possession of the information has an opportunity, by withholding (or concealing) information, to bring about the choice made by the other party. In that case, the party who possessed the additional information was in a position of dependency with respect to the uninformed party.

In the world of collective bargaining, disclosure obligations are part of a statutory duty to bargain in good faith and to "make every reasonable effort" to make a collective agreement. The Ontario Labour Relations Board has held that an employer must reveal to a trade union any actual decision that may have a significant impact on the bargaining unit and

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11 George Tsakalis, "Negotiation Ethics: Proposals for Reform to the Law Society of Upper Canada's Rules of Professional Conduct", (Toronto: Western Journal of Legal Studies, 2015), Vol, 5, Issue 4, pg. 9

12 (2001), 198 D.L.R. (4th) 615 (Ont. C.A,).

that the employer must answer honestly any questions by the bargaining unit as to whether initiatives are contemplated that would have an effect on the bargaining unit.[13]

Similar to the statutory context, an enforceable duty to negotiate in good faith can arise by contract. In considering an agreement to negotiate in good faith, courts will consider whether the parties intended that any breach of their commitment to negotiate in good faith was to have legal consequences.[14] The issue not whether a court should enforce an obligation to negotiate in good faith as a matter of commercial morality but rather whether the parties themselves understood that they were contractually bound to the obligation to negotiate in good faith. In one case, the court went as far as implying such an obligation in the absence of an express covenant between the parties to negotiate in good faith on the basis that the obligation was a "necessary corollary" to a contractual relationship between the parties.[15] However, the court was clear that in doing so it was not implying new substantive rights into the agreement.

Most important is the recent Supreme Court of Canada decision in *Bhasin v. Hrynew* establishing that good faith is a "general organizing principle" underlying contract law and declaring a new common law duty of honest performance. The duty of honest performance requires the parties to be honest with each other in relation to the performance of their contractual obligations. As stated by the Court, it "means simply that parties must not lie or otherwise knowingly mislead each other about matters directly linked to performance of the contract".[16]

Some commentators have observed the incongruity of finding a duty of good faith in contractual performance but no duty of good faith in negotiations leading up to the contract to be performed. One such commentator noted:

> Notwithstanding the courts' general reluctance to find a duty of good faith in negotiating contracts, there may be a shift in judicial attitudes in light of the recognition of the organizing principle of good faith in contractual performance. It is possible that the basic level of honesty and good faith that commercial parties reasonably expect in contractual dealings could be found to apply (at least to some extent) to the process

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13 *Association of Management, Administrative and Professional Crown Employees of Ontario v. Crown in Right of Ontario*, at para. 69, available at http://www.olrb.gov.on.ca/Decision/3711-09-U_AMAPCEO.pdf

14 *Barclays Bank PLC v. Metcalfe & Mansfield Alternative Investments VII Corp.*, 2013 ONCA 494, 365 D.L.R. (4th) 15; *Molson Canada 2005 v. Miller Brewing Company*, 2013 ONSC 2758, at para. 108.

15 *SCM Insurance Services v. Medisys Corporate Health LP*, 2014 ONSC 2632

16 *Bhasin v. Hrynew*, 2014 SCC 71, at para. 81

> of negotiating contracts. After all, the negotiation process is the very genesis of a contractual relationship. Can it really make sense that, once the parties sign up to a number of promises, they can reasonably expect honesty and fair play on each other's part, but that these expectations are somehow absent while they are negotiating those promises?[17]

While the Court in *Bhasin* did not recognize a duty of honesty or good faith in the context of negotiations, parties do need to be mindful of conduct during negotiations that may be actively misleading or otherwise dishonest.[18] A party cannot "knowingly mislead" another about facts material to their negotiations or allow the other party to persist in a mistaken understanding of fact to which that party has materially contributed. However, a party is likely not otherwise obliged to share relevant information unknown to the other party, or to correct a mistaken belief that he or she has not induced.[19]

The Standards required of a Court-Advocate

Having reviewed the rules and developments in the case law, the question remains: how far can a lawyer go in advocating for his or her client in a settlement negotiation? There is no question that, ethically, a lawyer should not lie or mislead the opposite party no matter the context or circumstances in which they find themselves. In addition, lawyers should not engage in negotiations where the parties' positions are unreasonable, outrageous or entirely defeat the fundamental purpose of engaging in ADR which is to try to resolve disputes in a consensual fashion. As stated by the discipline committee of the Law Society of Upper Canada, "legal disputes should be resolved in an environment of calm and measured deliberation, free from hostility, emotion and other irrational or disruptive influences."[20]

On the other hand, a lawyer seeking a settlement has an obligation to get the best deal for his or her client. Moreover, as all lawyers know, puffery and misdirection are commonplace in settlement negotiations. Misrepresentation can take multiple forms, including untrue statements, truthful statements that are incomplete, and the omission of information necessary to prevent misunderstandings by the other side. Some misrepresentations may be considered acceptable "puffing". Others are clearly inappropriate. It is not always easy to draw the line, but a line must be drawn in a manner that is consistent with the standards and norms that lawyers currently apply when they appear

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17 Neil Finkelstein et al, "Honour Among Businesspeople: The Duty of Good faith and Contracts in the Energy Sector", 53 Alta. L. Rev. 2

18 *Ibid.* at para. 87

19 Shannon O'Byrne and Ronnie Cohen, "The Contractual Principle of Good Faith and the Duty of Honesty in Bhasin v Hrynew" (2015), 53 Alta. L. Rev. 1

20 2012 ONLSHP 94, at para. 65

court, make submissions and answer questions asked by a judge or other adjudicator. In the absence of such standards, the credibility and integrity of ADR in the eyes of the public will diminish.

These standards were best articulated in 1994 by former Chief Justice Brian Dickson of the Supreme Court of Canada.[21] He stated the following as it relates to ADR and the standards that should permeate the processes that fall within its sphere:

> [...] if the right kinds of cases are being channelled into ADR and if ADR functions effectively, then there is no question that it can play a useful role in promoting justice. But it seems to me that as we round out the judicial process with other settings in which to resolve disputes, *we need to be extremely careful that the values that underlie those other settings are consistent with those that have evolved over many centuries and that lie at the heart of our judicial system*. For it is these values which ensure that our system of justice is respected. If the average person facing one of the few disputes in his or her lifetime that calls for neutral third party intervention does not feel that ADR is delivering justice consistent with the norms that they have always understood to lie at the heart of the justice system in North America, then ADR may well cause more problems than it solves. The risk is that, poorly handled, ADR may undermine the very legitimacy upon which courts rely for their effectiveness. This is not a price that the judiciary can afford to pay.
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> In developing ADR techniques, I believe that we need to think long and hard before dispensing with these values. There may be instances in which complete openness or the full panoply of judicial procedure is unwarranted, but we should start with the assumption that these values are worth preserving and then go on to explore how they can best be reflected in each forum that is pointed to as an alternative to the traditional court based system. Obviously, it will be necessary to accommodate these values to the contours of the setting with which one is dealing. *Careful thought must be given to the way in which they can best be respected rather than simply assuming that because one is no*

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[21] Rt. Hon. Brian Dickson, "ADR, the Courts and the Judicial System: The Canadian Context" (1994) 28 L. Soc'y Gaz. 231, at pg. 236

longer in the courtroom these principles can be dispensed with. [emphasis added]

Based on the above, it is likely the case that, in Ontario, while lawyers and their clients are under no legal or ethical obligation to disclose their negotiating positions or "bottom line", they must avoid any action or conduct that could be viewed as actively misleading the opposite party, whether by way of omission, partial disclosure or active misrepresentation. To the extent that a lawyer knows that the opposite party is operating under a mistaken understanding or belief in respect of a fact that materially impacts what may be a settlement, the lawyer should take reasonable steps to correct the mistaken understanding or belief. The standard that should be applied in such circumstances should be the same as the standard that the lawyer would apply if he or she were facing a judge or other adjudicator operating under a mistaken understanding or belief in respect of a material fact.

Ultimately, prudent lawyers should ensure that they live up to their best practices of acting with honesty and candour in negotiating settlements. This will not only assist their clients in the resolution of disputes, but will preserve and advance the lawyer's reputation in the legal community as effective, forthright and trustworthy counsel, a reputation that we should all strive to achieve and maintain.