COVENANTS NOT TO SUE IN CLASS ACTION SETTLEMENTS: PRACTICAL AND ETHICAL CONSIDERATIONS

Introduction

A practice has emerged in the settlement of class action disputes in which defendants seek a promise from class counsel not to commence any further claims against them in relation to the same or similar issues to those in dispute. Defendants perceive a need for such a promise in large-scale, commercial disputes where there is the possibility that class counsel may have become aware of the existence of other potential claims, as might occur through class counsel’s consultations with potential class members. The promise — which may take the form of an agreement, covenant or undertaking not to sue — is seen as an effective mechanism to prevent class counsel from settling one claim only to start another, and thereby achieve a meaningful resolution to the dispute.

However, in some jurisdictions, it is unethical for a lawyer to propose or enter into an agreement that would restrict a lawyer’s right to practise. Depending on where they practise, class action lawyers therefore face a potential ethical dilemma in the settlement of their clients’ disputes.

The purpose of this article is to explore the ethical considerations that are raised by covenants not to sue in the class action context, to identify the benefits of their use, and to discuss some of the practical considerations that may arise in their negotiation, court approval and enforcement.

Ethical Framework

With one exception, Canadian rules of professional conduct do not deal explicitly with covenants not to sue. Nor is there any rule addressing the matter in Canadian class proceedings legislation. As a general rule, lawyers have an ethical duty to make legal services available to the public; but only the Law Society of British Columbia (“LSBC”) has gone the further step of prohibiting agreements that restrict a lawyer’s right to practise. Introduced in October 2006 to the LSBC’s Professional Conduct Handbook, chapter 4, rule 7 provides as follows:

Restricting future representation

7. A lawyer must not participate in offering or making an agreement in which a restriction on any lawyer’s right to practise is part of the settlement of a client lawsuit or other controversy.

The BC rule is virtually identical to rule 5.6(b) of the American Bar Association’s (“ABA”) Model Rules of Professional Conduct, which states in relevant part:

Restrictions on Right to Practice

A lawyer shall not participate in offering or making:

... (b) an agreement in which a restriction on the lawyer’s right to practice is part of the settlement of a client controversy.

A brief review of the legislative history of the ABA rule sheds light on the rationale of the prohibition against covenants not to sue. As recounted in Newberg on Class Actions, many class action defendants in the 1960s insisted that class action attorneys representing individual plaintiffs execute covenants not to sue when settling individual claims on behalf of their clients. The ABA Standing Committee on Professional Ethics ruled, in May 1968, that such a covenant was unethical, as it imposes an undue restriction upon the plaintiff’s attorney and also affects the right of the client to obtain the benefit of the services to which he is entitled from his own lawyer. Because of the foregoing it is improper for the attorney representing the defendants to demand this kind of a covenancy and by way of corollary it is improper for plaintiff’s attorney to abandon the interests of other clients, who have depended upon his services through periods that may be invaluable and of long standing.

Shortly after this ruling, in August 1969, the ABA House of Delegates adopted the Model Code of Professional Responsibility, Disciplinary Rule 2-108(B) of which stated as follows:

In connection with the settlement of a controversy or suit, a lawyer shall not enter into an agreement that broadly restricts his right to practice law, but he may enter into an agreement not to accept any other representation arising out of a
transaction or event embraced in the subject matter of the controversy or suit thus settled.\(^9\)

Just six months later, in February 1970, this rule was amended to repeal the boldfaced text, yielding the following version of DR 2-108(B) which is the immediate predecessor provision of ABA rule 5.6(b):

\begin{quote}
In connection with the settlement of a controversy or suit, a lawyer shall not enter into an agreement that restricts his right to practice law.\(^8\)
\end{quote}

The Committee explained that the amendment — which removed the exception for covenants not to sue in respect of future retainers arising from the same subject matter — was necessary because such a covenant would (a) inevitably involve a conflict of interest, and (b) go directly contrary to the spirit of the lawyer’s duty to make legal counsel available to the public.\(^7\)

Thus, since 1970, covenants not to sue have been unethical in the United States.\(^6\)

The ethics of covenants not to sue in the specific context of mass tort and other class action settlements came squarely before the ABA Ethics Committee in 1993, in Formal Opinion 93-371. The Committee began by recognizing that the inquiry stemmed from “[t]he pressure to find creative solutions to mass tort litigation”\(^9\) and raised important issues regarding “the intersection between a lawyer’s duty to his or her present clients and impermissible restrictions on the right of a lawyer to practice under Model Rule 5.6.”\(^10\)

In a detailed analysis of the rule and its legislative history, the Committee confirmed that covenants not to sue were impermissible in the class action context, and stated the rationale of the rule as follows:

\begin{quote}
The rationale of Model Rule 5.6 is clear. First, permitting such agreements restricts the access of the public to lawyers who, by virtue of their background and experience, might be the very best available talent to represent these individuals. Second, the use of such agreements may provide clients with rewards that bear less relationship to the merits of their claims than they do to the desire of the defendant to ‘buy off’ plaintiff’s counsel. Third, the offering of such restrictive agreements places the plaintiff’s lawyer in a situation where there is conflict between the interests of present clients and those of potential future clients. While the Model Rules generally require that the client’s interests be put first, forcing a lawyer to give up future representations may be asking too much, particularly in light of the strong countervailing policy favoring the public’s unfettered choice of counsel.\(^11\)
\end{quote}

Thus, from the foregoing review of American authorities, the potential ethical concerns surrounding covenants not to sue may be summarized as follows:

Covenants not to sue could potentially,

1) restrict class counsel’s ethical duty to make legal services available to the public;

2) restrict the access of the public to the best available lawyers;

3) present a conflict of interest between class counsel and the client (i.e., a conflict between, on the one hand, the financial interest of class counsel in obtaining future fees and, on the other hand, the interest of the client in securing a settlement on the most favourable terms);

4) present a conflict of interest between present clients and future clients; and

5) risk an outcome where settlement is driven by the defendant’s desire to “buy off” class counsel, rather than the merits of the case.

On closer analysis, however, the likelihood that these concerns will materialize in any given case would appear to be small. At the outset, in Canadian jurisdictions outside of British Columbia, the only real ethical duty that is potentially directly engaged by covenants not to sue is class counsel’s duty to make legal services available to the public.\(^12\) However, that rule is not absolute. Within the duty to make legal services available is a general right to decline representation, which lawyers may exercise at their discretion.\(^13\)

Lawyers are only cautioned to exercise this right prudently if the probable result would be to make it difficult for a person to obtain legal advice or representation.\(^14\)

It is also unlikely, in today’s class action environment, that a covenant not to sue would materially impact the access of the Canadian public to competent class action counsel. It barely needs mentioning that the plaintiff class action bar in Canada is large, experienced and competitive. Covenants not to sue in class action settlements are therefore arguably not inconsistent with class counsel’s ethical duty to make legal services available to the public.

Nor is there any reason for concern that covenants not to sue may create a conflict of interest between present clients and future clients. This is arguably not the type of conflict contemplated by the rule of professional conduct requiring lawyers to avoid conflicts of interest. Indeed, under the rules, there can be no conflict in
respect of a client that does not exist (i.e., future clients). This concern is therefore more likely in the nature of the second stated concern, that covenants not to sue may restrict the public’s access to legal counsel.

With respect to the potential for conflicts of interest between class counsel and class members, the situation is comparable to the negotiation of class counsel’s fees at settlement. In Dabbs v. Sun Life Assurance Co. of Canada, a similar allegation was raised that class counsel were in a conflict of interest where they negotiated both settlement and counsel fees. Justice Winkler (as he then was) rejected this concern, stating:

> In my view, simultaneous negotiation of fees and settlements will not necessarily create a conflict of interest for class counsel, and the ability of the defendant to consider its total exposure to both damages and fees may encourage settlement. The contrary will unquestionably discourage settlement.

Indeed, the ABA Ethics Committee recognized that covenants not to sue may even be favourable to class members, since defendants will typically be willing to offer more consideration than they might otherwise offer in order to secure the covenant from class counsel.

Moreover, the fact that the court has the final say on any settlement weighs strongly in favour of permitting covenants not to sue in class action settlements. Notably, the court in Dabbs used the same reasoning (i.e., extensive judicial supervision of the settlement process) to dismiss concerns of conflicts of interest in class counsel’s simultaneous negotiation of fees and settlements.

Finally, the concern that a settlement incorporating a covenant not to sue may not reflect the merits of the case seems to be entirely misplaced. Settlements are not intended nor do they purport to be reflective of the merits of a case (only a judicial decision strives to reflect the merits of the case). Indeed, as the court stated in Dabbs:

> settlements are the product of compromise and a process of give and take and settlements rarely give all parties exactly what they want. Fairness is not a standard of perfection. Reasonableness allows for a range of possible resolutions. A less than perfect settlement may be in the best interests of those affected by it when compared to the alternative of the risks and the costs of litigation.

As noted above, protection from unfair and unreasonable settlements is also afforded to class members by extensive judicial supervision of the settlement, under which the court must be satisfied that in all the circumstances the settlement is fair, reasonable and in the best interests of the class as a whole.

There would therefore appear to be no principled basis on which covenants not to sue should not be permitted.

**Need for the Covenant**

The interest in covenants not to sue among defendants in class actions is driven by the realities of class action practice, and particularly class counsel’s central role in the identification, organization and prosecution of class claims. In the normal course, class counsel will be in touch with multiple potential class members, giving rise to the possibility that class counsel may become aware of the existence of other potential claims against the defendant relating to the issues or subject matter in dispute. At the time of settlement, this may create an informational imbalance between class counsel and the defendant: the defendant, who is expecting to settle a dispute arising from a particular transaction or event, will not know that class counsel has identified (or has obtained the information to identify) another potential claim against the defendant arising from the same transaction or event and raising the same or similar issues. The end result may be that class counsel is able to essentially circumvent the settlement and launch another claim, which would effectively nullify the substantive benefits of the settlement to the defendant.

These realities of class action practice demand creativity on the part of defendants involved in settling class actions. In the circumstances described above, standard release clauses will usually not suffice to prevent class counsel from commencing another proceeding against the same defendant. Therefore, in addition to the usual terms of settlement (e.g. quantum, certification, costs, notice, claims administration, opt-out procedures, releases, disposition and court approval), defendants may wish to secure an agreement, covenant or undertaking from class counsel not to commence any further claims against them in relation to the issues in dispute.

**Benefits of the Covenant**

The benefits to defendants of a covenant not to sue are self-evident. In addition to the discontinuance of the proceeding, the covenant offsets the informational advantage of class counsel (described above) and ultimately achieves a meaningful resolution to the dispute. With a carefully drafted covenant in place, class counsel will not be permitted to return to court with another claim that he or she discovered in the course of prosecuting the settled claim. In today’s class action environment, the value of such a covenant to defendants cannot be understated — especially to those defendants who are repeatedly subjected to threatened or actual class proceedings by a particular law firm.
In addition to their direct benefits to defendants, covenants not to sue also have some appreciable incidental benefits. For instance, they allow for increased flexibility in settlements, which naturally encourages settlement (i.e., the availability of a covenant not to sue may encourage defendants to explore settlement where they otherwise might not). Covenants not to sue may even result in settlements that are more favourable to the class, since defendants may be willing to offer more money in exchange for the promise of counsel not to pursue other claims.

**Practical Considerations**

Several practical considerations arise in the negotiation and drafting of a covenant not to sue. In particular, careful consideration should be given in all cases to the parties, scope and duration of the covenant.

Who should give the covenant? At a minimum, defendants should insist that a covenant be given by class counsel on behalf of members of his or her firm. It is less important to secure a covenant from the representative plaintiff(s), since it is typically class counsel that will be interested in pursuing the other claims. Nonetheless, consideration should still be given to obtaining a similar covenant from the representative plaintiff (who has authority to bind the class).

The scope of the covenant, which will usually be the main area of negotiation between the parties, should be carefully drafted so as to prohibit class counsel from instituting, continuing, maintaining or asserting, either directly or indirectly, whether in Canada or elsewhere, on their own behalf or on behalf of any class or any other person, any action, suit, cause of action, claim or demand against the defendants (including the defendants’ successors, heirs, executors, estate trustees, administrators and assigns) relating to the claim or any matter related to it. To serve the purpose for which it is intended, the covenant should extend to the broad issues in dispute, and not be limited to the claim that is being settled. The objective is to capture all potential claims that might arise from the transaction or event that is the subject matter of the litigation.

Defendants should also keep in mind that the court will have the final say on the covenant. Although the presence of a covenant not to sue — which affects class counsel far more than the class itself — arguably should not create a bar to court approval of a settlement, defendants should be prepared to offer positive evidence that the covenant is fair, reasonable and in the best interests of the class as a whole (although it is more likely that the court’s inquiry will be directed to the settlement as a whole, rather than its constituent parts).

Finally, advance consideration should be given to the enforcement of the covenant, should the need arise. The ABA’s *Annotated Model Rules of Professional Conduct* indicate that covenants not to sue are regularly enforced in a number of U.S. jurisdictions, even where they do not comply with the ethical rules in those jurisdictions. In those cases, U.S. courts have often made a distinction between enforcing an agreement not to sue and disciplining the lawyers for making it.

As to the manner of enforcement, a covenant not to sue would normally be enforced by an action for breach of the agreement. Injunctive relief may also be available. In the U.S. case, *Richards Lumber & Supply Co. v. U.S. Gypsum Co.*, the defendants in an individual action relating to an alleged price-fixing conspiracy were granted summary judgment on the basis of a covenant not to sue. The covenant had been executed on behalf of a class of which the plaintiff was a member in consideration of the settlement of a prior price-fixing class action against the same defendants. In granting summary judgment to the defendants, the United States Court of Appeals for the Seventh Circuit considered the following factors in enforcing the covenant not to sue, all of which would arguably apply in Canada as well:

1. the plaintiff had notice of the proposed settlement including the terms of the covenant not to sue;
2. the plaintiff did not object to the fairness of the proposed settlement;
3. the plaintiff did not opt out, and when the settlement fund was established, he participated in it;
4. there was no claim of duress in respect of the settlement;
5. the plaintiff was adequately represented in the class action;
6. the plaintiff was well aware of its additional claim at the time of the settlement; and
7. the plaintiff’s interests received additional protection through judicial supervision of the settlement.

**Conclusion**

The increasingly frequent use of covenants not to sue in the settlement of large-scale, commercial class action disputes is a welcome development to class action practice in many respects. These covenants recognize
the underlying realities of class action practice and are a valuable tool for defendants seeking to achieve a final resolution to complex and costly disputes. They also increase the flexibility of settlements, thereby encouraging settlement (a benefit to all concerned) and, in some cases, may even result in a more favourable monetary outcome for class members. They are also consistent with ethical rules governing the conduct of members of the legal profession (at least in Canadian jurisdictions outside of British Columbia). For these reasons, counsel should be encouraged to explore the use of covenants not to sue in the settlement of their clients’ disputes.

1 See for example the Law Society of Upper Canada’s Rules of Professional Conduct (“Ontario Rules”), rule 3.01 available at <http://www.lsoc.on.ca/registration/a/profconduct/> and the Canadian Bar Association’s Code of Professional Conduct (Ottawa: Canadian Bar Association, 2009) (the “CBA Code”), chapter XIV.
5 ABA Formal Op. 93-371, supra note 4 at p. 4.
7 This legislative history of DR 2-108(B) is set out in ABA Formal Op. 93-371, supra note 4, p. 4-5.
8 Newberg on Class Actions, supra note 3 at §12:45.
11 ABA Formal Op. 93-371, supra note 4 at p. 3. To the same effect is the American Law Institute’s Restatement (Third) of the Law Governing Lawyers, §14(2), the commentary to which reads as follows:

Proposing such an agreement would tend to create conflicts of interest between the opposing lawyer, who would normally be expected to oppose such a limitation, and the lawyer’s present client, who may wish to achieve a favorable settlement at the terms offered. The agreement would also obviously restrict the freedom of future clients to choose counsel skilled in a particular area of practice. To prevent such effects, such agreements are void and unenforceable.

Supra note 1.
12 See for example the commentary to Ontario Rules, supra note 1, Rule 3.01 and CBA Code, supra note 1, chapter XIV, comment 6.
13 Ibid.
15 Ibid. at para. 18.
16 Ibid. at para. 19.
23 545 F.2d 18 (7th Cir. 1976).