New York Law Journal
September 19, 1996, Thursday

SECTION: OUTSIDE COUNSEL; Pg. 1

LENGTH: 2459 words

HEADLINE: Civil Settlements And Criminal Trials

BYLINE: Carl H. Loewenson Jr.; Carl H. Loewenson, a partner with Morrison & Foerster, was an Assistant U.S. Attorney for the Southern District of New York. Summer associate Jason Mogel assisted in the preparation of this article.

THINKING of settling that civil enforcement action with a federal government agency? You might want to think again, because anything you say may be used against your client in court.

In the June 24, 1996, decision of *Manko v. United States,*[1] the Second Circuit held that Rule 408 of the Federal Rules of Evidence does not require the exclusion of evidence of a civil settlement in a subsequent criminal trial based on the same facts.

The opinion of the court, written by Second Circuit Judge John M. Walker Jr., holds that the purpose of Rule 408, encouraging civil settlement, is insufficient to outweigh the need for a precise determination in a criminal action.

Rule 408 provides: Evidence of (1) furnishing or offering or promising to furnish or (2) accepting or offering or promising to accept, a valuable consideration in compromising or attempting to compromise a claim which was disputed as to either validity or amount, is not admissible to prove liability for or invalidity of the claim or its amount. Evidence of conduct or statements made in compromise negotiations is likewise not admissible. This rule does not require the exclusion of any evidence otherwise discoverable merely because it is presented in the course of compromise negotiations. This rule also does not require exclusion when the evidence is offered for another purpose, such as proving bias or prejudice of a witness, negativing a contention of undue delay, or proving an effort to obstruct a criminal investigation or prosecution.[2]

Bernhard Fred Manko and codefendant Jon Edelman had been convicted in February 1991 after a 16-week jury trial of tax fraud offenses arising from their having effected bogus transactions in government securities that led to approximately $ 432 million in improper tax deductions.

The Second Circuit affirmed the convictions in October 1992.[3] Then, in March 1995, Manko filed a habeas petition under 28 U.S.C. §2255, seeking to vacate his conviction on the ground that newly discovered evidence indicated that the IRS had in fact compromised and settled a civil tax action against Manko based on the same facts and theory as those that underlay the criminal charges, contrary to the testimony of an IRS attorney at an in limine hearing during Manko and Edelman's criminal trial.

The IRS attorney had testified that the IRS's civil claims against Manko and Edelman had not been settled. At the trial, Manko sought to introduce evidence that the IRS had entered into a settlement that had allowed him to deduct 20 percent of the same losses that the government was arguing in the criminal trial were 100 percent false.

Manko wanted to argue to the jury that the fact that the IRS was willing to compromise with him raised doubts about the validity of the criminal charges against him.

---

[1] 87 F.3d 50 (2d Cir. 1996).
[2] Fed. R. Evid. 408.
[3] *U.S. v. Manko*, 979 F.2d 900 (2d Cir. 1992), cert. denied, 509 U.S. 903 (1993).

Southern District Judge Mary Johnson Lowe excluded the evidence at the trial and denied the §2255 motion, ruling that Rule 408 barred the admission of evidence of a civil settlement.

Judge Lowe relied primarily on the holding of the U.S. Court of Appeals for the Sixth Circuit in *Ecklund v. United States*,[4] which held that evidence of a civil settlement had been improperly admitted in a criminal trial.

In overturning the district court's denial of Manko's petition, the Second Circuit held that it was an abuse of discretion to sue Rule 408 to exclude from the criminal trial evidence of Manko's settlement with the IRS. The court did not, however, rule that such evidence was necessarily admissible. Rather, the Second Circuit ordered the district court on remand to balance the probative value of evidence of the civil settlement against the danger of unfair prejudice, confusion or delay, under Rule 403 of the Federal Rules of Evidence.[5]

In *Manko*, the second Circuit declined to follow *Ecklund* and instead expanded on dicta from the Second Circuit's 1984 opinion in *United States v. Gonzalez.*[6] In *Gonzalez*, the district court had allowed the government to introduce evidence of a statement made by defendant Gonzalez in a civil settlement admitting that he had forged the bank note at issue in his trial.

In explaining why Rule 408 did not bar the government from introducing Gonzalez's statements, the *Gonzalez* court stated that "[the] public interest in the disclosure and prosecution of crime is surely greater than the public interest in the settlement of civil disputes."[7]

The *Gonzalez* court went on to note that, because there is nothing in the text of Rule 408 specifically limiting the admissibility of evidence of a civil settlement in a criminal trial, such evidence could be admissible in a criminal proceeding.

In its brief on appeal in *Manko*, the government sought to distinguish *Gonzalez* by noting that in *Gonzalez*, the government had introduced the defendant's statement not to prove that a settlement had been reached, but for a purpose outside of the proscriptions of Rule 408.

The government had used the evidence to establish that Gonzalez had committed a crime, which he had admitted during the civil settlement negotiations.[8]

In contrast, Manko sought to prove that he was not criminally liable based solely on the existence of the civil settlement itself.[9] Unlike Gonzalez, who had essentially

---

[4] 159 F.2d 81 (6th Cir. 1947).
[5] 87 F.3d at 54. Rule 403 provides: "Although relevant," evidence may be excluded if its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury, or by considerations of undue delay, waste of time, or needless presentation of cumulative evidence."
[6] 748 F.2d 74 (2d Cir. 1984).
[7] 748 F.2d at 78.
[8] Brief for the U.S. at 31, Manko (No. 95-2555).

confessed his crime during civil settlement talks, the IRS did not admit in the settlement that Manko was not guilty.

The Second Circuit rejected the government's effort. By holding that evidence of the existence of a settlement should not be excluded as a matter of law under Rule 408, the court in *Manko* expanded *Gonzalez.*

Applying Rule 408

Of course, evidence of settlement negotiations would not be admissible in a trial of the action in which the settlement talks occurred. Manko stands for the narrow proposition that a civil settlement (or a statement made in civil settlement talks) is not inadmissible as a matter of law under Rule 408 in a criminal trial.

Under Fed. R. Crim. P. 11(e)(6) and Fed. R. Evid. 410, plea discussions are still off limits from subsequent criminal or civil trials (subject to the limitations of those rules). And under Fed. R. Evid. 408, the rule at issue in *Manko,* settlements and settlement discussions in a civil case are off limits from the trial of that civil case (again, subject to the limitations in the rule).

The *Manko* court also made it clear that Rule 408 applies evenly to both sides in a criminal trial: it does not bar the admission of settlement evidence, regardless of whether it is offered by the government or by the defense.[10]

The federal circuits are split on the *Manko* issue, which therefore may well be headed to the Supreme Court for resolution. The Fifth Circuit[11] and the Sixth Circuit[12] have held that under Rule 408 evidence of a civil settlement should be excluded in a subsequent criminal trial.

On the other hand, the Second Circuit now joins the Seventh Circuit,[13] which has held that Rule 408 cannot be used to exclude such evidence from a criminal trial. (The Ninth Circuit held in an unpublished 1994 opinion that, given the split among other circuits, the district court did not commit "plain error" in admitting, without objection, a civil consent judgment with the SEC in defendant's criminal trial.)[14]

Rule 403 Escape Hatch

The *Manko* holding does not require the admission of evidence from the civil settlement or settlement discussion in a later criminal proceeding. It just means that Rule

---

[9] Id.
[10] 87 F.3d at 54 (The court noted that in Gonzalez the settlement evidence was offered by the government, while in Manko it was offered by the defendant.).
[11] *U.S. v. Hays*, 872 F.2d 582, 588-89 (5th Cir. 1989).
[12] *U.S.v. Mohney*, 949 F.2d 1397, 1409 (6th Cir. 1991), cert. denied, 504 U.S. 910 (1992); but see *U.S. v. Cohen*, 946 F.2d 430 (6th Cir. 1991) (without discussing Rule 408, admitting at criminal copyright trial a consent decree from a civil copyright infringement action).
[13] *U.S. v. Prewitt*, 34 F.3d 436 (7th Cir. 1994).
[14] *U.S. v. Wheeler*, 29 F.3d 637 (9th Cir. 1994), 1994 WL 384183 (memorandum opinion).

408 alone does not necessarily bar admission of such evidence. In remanding, the Second Circuit invited the district court to take a close look at whether the settlement evidence should be excluded under Rule 403.[15]

The district courts are generally given wide discretion in applying the balancing test of Rule 403 and such decisions will be overturned only if the district judge has acted arbitrarily or irrationally.[16]

Under Rule 403, the trial judge may exclude evidence if the judge finds that the detrimental effect of unfair prejudice, confusion or waste of time substantially outweighs the evidence's probative value. Because district courts are given such wide discretion, Rule 403 may be used in federal criminal cases as a means to exclude settlement evidence that is not excludable under Rule 408 or other rules.

A district court may well find that evidence of a settlement offer or the settlement agreement itself should still be excluded under Rule 403.[17]

It should not be too difficult for a party trying to exclude settlement evidence to show the judge that a full explanation of all of the complex factors that led to the settlement would unduly prolong and complicate the criminal trial.

A jury has a tough enough time, the party might argue, trying to find facts in a criminal case without also trying to sift through all of the factors (many of them not directly related to the merits) that led to an earlier civil settlement.

Deterring Settlement

But it is not always ways to predict how a trial court will rule on the balancing of prejudicial effect versus probative value. Even if Rule 403 may be used to exclude evidence that is not per se inadmissible under Rule 408, individuals facing parallel civil and criminal proceedings should be aware that when they enter into civil settlements, the exclusion of the settlement from a later criminal trial is not a sure thing.

The holding in *Manko* may thus inhibit individuals from settling with the IRS, the Securities and Exchange Commission, the Federal Reserve Commission, the Federal Reserve Bank or other governmental authorities, if the civil claims for regulatory violations eventually could also be prosecuted criminally.

For instance, the subject of an insider trading investigation being conducted by the U.S. Attorney's Office and the SEC may hesitate to settle with the SEC, given that evidence of payment of disgorgement and penalties could be used against him or her at a criminal trial.

---

[15] 87 F.3d at 54.

[16] *U.S. v. Eisen*, 974 F.2d 246, 262, (2d Cir. 1992); cert. denied. 507 U.S. 998, 1029 (1993); see also *U.S. Townsend*, 987 F.2d 927, 930 (2d Cir. 1993); *U.S. Torres*, 901 F.2d 205, 235 (2d Cir.), 498 U.S. 906 (1990).

[17] See *Alpex Computer Corp. v. Nintendo Company, Ltd.*, 1994 U.S. Dist. LEXIS 3343 (S.D.N.Y. 1994) (excluding under Rule 403 settlement evidence that was deemed not inadmissible under Rule 408).

While the typical SEC enforcement settlement contains helpful language that the defendant "neither admits nor denies" the allegations, the criminal jury is likely to focus less on such legal fine points and more on why your client settled and paid a lot of money if he or she really did nothing wrong.

In holding that the policy of encouraging civil settlements is not sufficient to outweigh the need for a full accounting of facts in a criminal trial, the *Manko* court seemed not to give much weight to another rationale for Rule 408.

The Advisory Committee Notes to the 1972 proposed Federal Rules of Evidence state in part that evidence of an offer to compromise a claim "is irrelevant, since the offer may be motivated by a desire for peace rather than from any concession of weakness of position." There are many reasons not related to the merits why someone might decide to settle a civil or administrative matter. A trial is often bad publicity, even if the individual or business is ultimately found to be not liable. Trials are also expensive.

In addition, the defendant may not want collateral evidence to come to light or may not want certain witnesses (a key customer, a family member) to get dragged into court. The defendant may simply not have the time or the money for a lengthy trial and may settle just to get the matter over with as soon as possible. In Wigmore's felictous words:

> The true reason for excluding an offer to compromise is that it does not ordinarily proceed from and imply a specific belief that the adversary claim is well-founded, but rather a belief that the further prosecution of that claim, whether well-founded or not, would in any event cause such annoyance as is preferably avoided by the sum offered. In short, the offer implies merely a desire for peace, not a concession of wrong done. . . . By this theory, the offer is excluded because as a matter of interpretation or inference, it does not signify an admission at all. There is no concession of claim to be found in it, expressly or by implication.[18]

These sentiments, while not enough to lead to an absolute bar under Rule 408, may well convince courts that settlement evidence is not jury-worthy under Rule 403.

Only time will tell whether *Manko* will have a deterrent effect on civil settlements. If such evidence is consistently excluded from later criminal trials under Rule 403, then the decision should not have much of an impact. If judges regularly admit civil settlement evidence against criminal defendants, however, such holdings may deter future civil settlements.

In any event, the interesting relationship between Rules 408 and 403 may not have much of an opportunity to percolate, in the lower courts if the Supreme Court steps in to resolve the conflict among the circuits.

---

[18] 2 Jack B. Weinstein and Margaret A. Berger, *Weinstein's Evidence* P 408[02] (1996).

GRAPHIC: Picture, no caption

LOAD-DATE: September 24, 1996