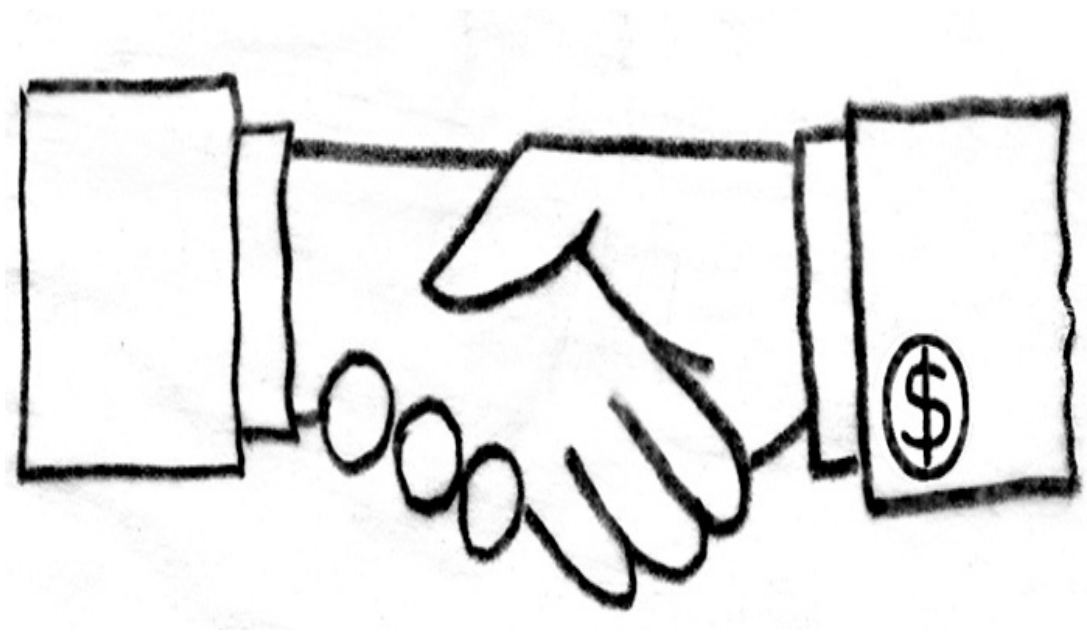
Mediation

ENFORCING AGREEMENTS



By Eleanor Barr

Imagine this scenario: You have spent a full day representing a client in mediation, and after eight long hours, the parties have agreed to a settlement. In order to reap the benefits of your hard work, you want to memorialize the settlement. But you are tired and want to end the day quickly. You decide to jot down the basic terms on a term sheet and include a provision that the parties will enter into a more-detailed contract later. The parties sign the term sheet at the mediation.

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A week later, you send a draft of a more-detailed agreement to your opposing counsel, and you learn that the opposing party will not sign the agreement. In fact, the opposing counsel has informed you that there is no binding agreement and that he will be reporting to the court that the case should be set for trial.

You decide that your best hope is to go to court and enforce the term sheet signed at the mediation. But under California law, is the term sheet enforceable?

The answer: It depends on whether the term sheet (1) states that it is "admissible," "subject to disclosure," "binding" or "enforceable" and (2) sets forth the material terms with reasonable certainty.

Recent California appellate and Supreme Court decisions have grappled with the issue of the enforceability of mediated agreements. Essentially, the courts have focused their analysis in two areas: (1) California's mediation confidentiality statutes; and (2) long-standing principles of contract formation. An important message arises from these cases: Lawyers need to pay close attention to contract drafting when finalizing a settlement agreement in mediation.

Ensuring Admissibility

California Evidence Code Section 1119(b) provides that "[n]o writing that is prepared for the purpose of, in course of or pursuant to" mediation is admissible. Under this section, no documents, including settlement agreements, would be admissible outside of the mediation. However, the California Legislature made an express exception for settlement agreements that were drafted during mediation. Section 1123(a) and (b) provides that a written settlement agreement prepared during mediation is admissible if it is signed by the settling parties and states that it is "admissible or subject to disclosure," "binding, or enforceable" or "words to that effect."

A recent California Supreme Court decision has interpreted Section 1123 very narrowly. *Fair v. Bakhtiari*, 40 Cal.4th 189 (2006).

In *Fair*, the parties entered into a term sheet at the end of the mediation that contained nine provisions. The term sheet did not contain the words "admissible," "subject to disclosure," "binding" or "enforceable," as required by Section 1123. It did, however, refer to "[a]ny and all disputes subject to JAMS arbitration rules." The issue before the Supreme Court was whether this language fell into the catch-all of "words to that effect" under Section 1123.

The appellant argued that the reference to arbitration clearly indicated that the parties intended the settlement agreement to be enforceable and that the reference therefore constituted "words to the effect" under Section 1123(b). Indeed, the appellate court agreed. But the Supreme Court reversed the decision, concluding that "to satisfy the 'words to the effect' provision of section 1123(b), a writing must directly express that parties' agreement to be bound by the document they sign."

The holding in *Fair* makes clear that it's best to include at least one of the words "admissible," "binding" or "enforceable" in the mediated settlement agreement.

Let's move to the subtext of *Fair* and ask why one party was disputing the enforceability of the mediated agreement in the first place. This question, I think, is the issue that we lawyers need to reflect on.

The real issue in *Fair* is that, in the course of turning the term sheet drafted at the mediation into a formal settlement agreement, the parties disputed the meaning of one of the provisions in the term sheet. Specifically, the first two terms were as follows:

1. Cash payment of $5.4 million to Fair within 60 days.

2. Payment treated as purchase of all Fair's stock and interests (as capital gain to Fair).

When the lawyers were finalizing the formal settlement agreement, it became clear that the parties had a different understanding of the meaning of Fair's "stock and interests." Further, the lawyers were at an impasse over resolving the tax issues implicated by the settlement.

The Supreme Court in *Fair* did not need to address the issue of whether this material term is uncertain, because it concluded that the agreement was not admissible under Evidence Code Section 1123.

Clarifying Terms

However, two relatively recent unpublished decisions by the 1st District Court of Appeal have explored the issue of whether term sheets were reasonably certain. See *Tender Loving Things Inc. v. Robbins*, A103989 (Cal. App. 1st Dist. 2005); *Goodrich Corp. v. Autoliv ASP Inc.*, 106077 (Cal. App. 1st Dist. 2005).

In both cases, during the mediation, the parties entered into term sheets that contained a provision stating that it was enforceable under Code of Civil Procedure Section 664.6. The issue in dispute was whether the terms were reasonably certain to be enforceable. The same appellate court ruled that one term sheet was enforceable and the other was not.

In *Tender Loving Things*, the parties were in a dispute concerning the manufacture and sales of a massage device called the Tingler. The parties agreed to mediate the dispute and entered into an eight-page stipulation for settlement. Attached to the stipulation for settlement was a term sheet that listed "numerous detailed terms of the agreement regarding manufacturing and marketing of the Tingler."

The stipulation for settlement said "[f]inal agreement to include ADR provisions with mediation, facilitation and arbitration provisions to be agreed between the parties." No such final agreement was completed, despite months of negotiations.

The appellant argued that the disputes arising from the subsequent negotiations for a formal final agreement meant that essential elements were left out and that the stipulation for settlement was simply an agreement to agree rather than a binding agreement.

The appellate court disagreed. The court concluded that the stipulation for settlement contained the requisite material terms such that it was a binding contract. It concluded that the fact that the parties agreed to enter into a more-detailed contract later — one that would contain more provisions, such as a dispute resolution procedure — was simply an omission of details rather than an omission of material terms.

In *Goodrich*, the court reached the opposite conclusion, holding that an essential element in the term sheet was uncertain.

The uncertain term related to the allocation of environmental cleanup costs. It provided that the defendant was required to pay "all environmental remediation costs" and that the plaintiff was required to "contribute to the remediation of the environmental liabilities on the subject property to defray the costs thereof on a dollar for dollar basis up to and not to exceed the following amounts: $300,000 in 2003, $300,000 in 2004 and $400,000 in 2005."

In the course of preparing the formal settlement agreement, the parties disputed the meaning of the cleanup-costs provision. The plaintiff argued that the provision limited its annual contribution, such that it would need to pay the capped amounts only as long as the defendant incurred such amount in each calendar year. The defendant, on the other hand, contended that the payment spread was meant to aid the plaintiff's cash flow and was not intended to prevent the defendant from recovering, if, for example, it incurred all of its cleanup costs in the first year.

The appellate court concluded that the language was susceptible to differing interpretations, that it was fatally uncertain and, therefore, that there was no mutual consent.

The message from these cases is that courts want to enforce agreements; they simply need the evidence to do so. In *Goodrich*, the court was trying hard to find the evidence to support the plaintiff's interpretation, but the plaintiff offered none. The result could have been avoided had the contract included a simple explanation in the term sheet that "any unspent amount from the previous years' contribution was required to be made available in later years."

Lessons Learned

The lesson learned from these cases is that taking time at the end of a mediation to draft an enforceable settlement agreement is essential.

First, as we have learned from *Fair*, including the required language of Code of Evidence Section 1123 is essential. Indeed, an inclusion that the settlement agreement is enforceable under Code of Civil Procedure Section 664.6 would seem not only to satisfy the requirement of Evidence Code Section 1123 but also to take advantage of the court's expedited procedures to enforce the agreement without having to file a separate breach-of-contract action.

Second, the material terms of the agreement must be clear. One way to ensure clarity is to think about potential settlement options before the mediation. If you choose to propose those options, you will have had the opportunity to think through any potential drafting or tax issues. If the settlement would cause tax or other issues, it might be helpful to contact a tax accountant or other appropriate person before the mediation or to have such person available during the mediation.

Finally, bring to the mediation in electronic form a draft agreement that contains the usual terms. Then you can spend your valuable time crafting the essential terms with greater care.

Eleanor Barr is a mediator with ADR Services in Los Angeles.

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