Mediated Settlement Agreements – Special Requirements Under California Law for Such Agreements to be Binding and Enforceable

There are special rules in California for oral agreements reached during a mediation to be enforceable (i.e., binding):

Evidence Code Section 1123(c) provides that an oral settlement agreement may be admissible if it satisfies the requirements of Evidence Code Section 1118. Pursuant to Evidence Code Section 1118, an oral agreement made "in accordance Section 1118" must satisfy *all* of the following conditions:

(a) recorded by a court reporter or reliable means of audio recording;

(b) the terms must be recited on the record in the presence of the parties and the mediator, and the parties must express on the record that they agree to the terms so recited;

(c) the parties expressly state on the record that the agreement is enforceable or binding; and

(d) the recording is reduced to writing *and the writing is signed* by the parties within 72 hours after it is recorded.

There are special rules in California for written agreements created during a mediation to be enforceable (i.e., binding):

Evidence Code Section 1119 makes inadmissible as evidence in any proceeding a writing prepared during the mediation. *A written settlement agreement or term sheet memorandum prepared with respect to the settlement is such a writing.*

Evidence Code Section 1123 provides for "waiver" of the Section 1119 confidentiality protections if:

(a) the agreement provides that it is admissible or subject to disclosure or words to that effect;

(b) the agreement provides that it is enforceable or binding or words to that effect;

(c) all parties to the agreement expressly agree in writing to its disclosure; or

(d) the agreement is used to show fraud, duress, or illegality that is relevant to an issue in dispute.

The decision of the Second District Court of Appeal in *Amis v. Greenberg Traurig LLP*, 235 Cal. App. 4th 331 (2015) illustrates just how broad and ironclad the confidentiality protection is under California Evidence Code Section 1119. This has caused some to say that mediated settlement agreements are "super contracts" because they are effectively immune from attack on the grounds that they were induced by fraud,

duress, coercion or other bad conduct related to the circumstances surrounding their formation.

In *Amis*, plaintiff was the former client of defendant Greenberg Traurig LLP. After agreeing to the settlement of a litigation matter in which Greenberg Traurig represented Amis, Amis sued the firm alleging it had committed attorney malpractice by causing him to execute a settlement agreement that converted his company's corporate obligations into Amis' personal obligations without advising him that he had little to no risk of personal liability in the underlying lawsuit.

Greenberg Traurig moved for summary judgment citing Amis' undisputed admission that all advice he received from the firm regarding the settlement was given during mediation. Based on this undisputed fact, Greenberg Traurig argued that 1. Amis could not maintain the lawsuit because he had no admissible evidence to support and prove his claims, and 2. Greenberg Traurig could not produce evidence to defend itself because in both regards, disclosure of what happened during the mediation was barred by the mediation confidentiality statutes.

The trial court agreed with Greenberg Traurig and entered summary judgment for the firm. Amis appealed. To the surprise of no one, given the California Supreme Court's near categorical prohibition against judicially crafted exceptions to the mediation confidentiality statutes "even in situations where justice seems to call for a different result," the 2nd District affirmed the trial court, citing *Cassel v. Superior Court*, 51 Cal. 4th 113, 118 (2011). Looking at the *Cassel* decision, the court noted that the California Supreme Court "has broadly applied the mediation confidentiality statutes and all but categorically prohibited judicially crafted exceptions, even in situations where justice seems to call for a different result." The Court of Appeal concluded that the "*Cassel* rule" against judicially crafted exceptions applied to inferences advanced by Amis that Greenberg Traurig advised him regarding the terms of the settlement documents. "To permit such an inference would allow Amis to attempt to accomplish indirectly what the statutes prohibit him from doing directly – namely proving [the firm] advised him to execute the settlement agreement during the mediation." Further, it "would turn mediation confidentiality into a sword by which Amis could claim he received negligent legal advice during mediation, while precluding [the firm] from rebutting the inference by explaining the context and content of the advice that was actually given."

In *Cassel*, the California Supreme Court decision relied on by *Amis*, the plaintiff alleged that in connection with the mediation of a dispute with his former co-business owner over a license to sell clothing, he met with his attorneys (in advance of the mediation) and it was agreed that Cassel would not accept less than $2 million to release his claims to the license and settle the lawsuit. During the mediation, Cassel alleged that his attorneys informed him that the other side would not pay more than $1.25 million for the license and demanded that he accept the offer. When he refused, Cassel alleged that his attorneys threatened to withdraw from the case which was

scheduled to begin trial a few days later. He further alleged that they refused to allow him to eat or to call his family and, after 14 hours of mediation, presented him with a complicated settlement document that they insisted he sign on the spot. Cassel alleged that he signed the document because he felt he had no choice under these circumstances.

Post-settlement, Cassel sued his attorneys for malpractice. The attorneys filed a motion in limine to prevent the admissibility of any communications between Cassel and them that occurred both during the mediation and the mediation prep session, including those that occurred outside the presence of the mediator and the adverse parties. The trial court granted that motion. On appeal, the court of appeal reversed, holding that the client and his attorneys were a single participant for purposes of the mediation. The California Supreme Court reversed the court of appeal, ruling that the attorneys and Cassel were separate participants and, as such, all oral and written communications between them were covered by the confidentiality statutes because they occurred during or in connection with a mediation, notwithstanding that the conversations at issue occurred outside the presence of the mediator and the adverse parties.

There is no mediation confidentiality protection as a matter of federal law.

While the California courts have taken an all-encompassing view with regard to the scope of mediation confidentiality protection, there is no "like" protection as a matter of federal statute, rule of procedure, or rule of evidence that expressly recognizes or provides confidentiality protection for communications during or in connection with a mediation conducted as part of a federal court proceeding. The only express protection for settlement discussions is provided by Rule 408 of the Federal Rules of Evidence, which makes "conduct or statements made in compromise negotiations regarding the claim" inadmissible to prove liability. Thus, Rule 408 provides an admission standard for proof offered at trial to prove liability or invalidity of a claim and speaks in terms of *relevancy*. Its purpose is "to encourage the compromise and settlement of existing disputes," *Josephs v. Pac. Bell*, 443 F.3d 1050, 1064 (9th Cir. 2006), so as to avoid "the chilling effect" that potential disclosure might have on a party's willingness to make a compromise offer for fear of jeopardizing its case or defense if the matter is not settled. *Molina v. Lexmark Int'l, Inc.*, No. CV 08-04796 MMM (FMx), 2008 WL 4447678, at *11-12 (C.D. Cal. Sept. 30, 2008).

It is important to note that, by its terms, Rule 408(a) applies only to the *admissibility* of evidence at trial and does *not* apply to *discovery* of settlement negotiations or settlement terms. On this issue, the courts are split as to whether Rule 408 precludes discovery. Moreover, Rule 408(b) expressly provides that exclusion is not required if the "offer and compromise" evidence is offered for a purpose that is not expressly prohibited by Rule 408(a). FED. R. EVID. 408(b). Among the "permitted uses" delineated in Rule 408(b) are evidence of settlement and compromise negotiations offered (1) to prove bias or prejudice on the part of a witness; (2) to prove that an

alleged wrong was committed during the negotiations (e.g., libel, assault, unfair labor practice, etc.); (3) to negate a claim of undue delay; or (4) to prove obstruction of a criminal investigation or prosecution. Additionally, a number of courts, including the Ninth Circuit, have concluded that Rule 408 does not make settlement offers inadmissible in the removal context where such offers represent evidence of the amount in controversy for the purpose of establishing the date on which such information was first made available to the defendant and thus started the thirty-day time period for removing a state court action to federal court. See, *Babasa v. LensCrafters, Inc.*, 498 F.3d 972 (9th Cir. 2007) (holding that a letter sent by plaintiffs estimating the amount alleged put defendant on notice of the amount in controversy); *Cohn v. Petsmart, Inc.*, 281 F.3d 837 (9th Cir. 2002) ("A settlement letter is relevant evidence of the amount in controversy if it appears to reflect a reasonable estimate of the plaintiff's claim.").

In sum, Rule 408 is keenly focused on offers of compromise and negotiations involved in making, accepting, or rejecting such offers. As such, Rule 408 appears *not* to provide protection of any sort for prenegotiation communications or exchanges of information that parties might have with or through a mediator, even though the goal of those discussions is to open settlement dialogue.

The only other source of confidentiality protection in federal cases is Rule 501 of the Federal Rules of Evidence. Rule 501 empowers the holder of a recognized privilege to use the legal process to prevent others from disclosing protected communications. It also vests the holder with the right to refuse to produce otherwise relevant evidence. What qualifies as a "recognized privilege" is *not* detailed in Rule 501. In federal question cases under 28 U.S.C. § 1331, the extent to which a privilege exists is governed by federal common law and may not be augmented by local court rules. See *Facebook, Inc. v. Pac. Nw. Software, Inc.*, 640 F.3d 1034, 1040-41 (9th Cir. 2011) ("A local rule, like any court order, can impose a duty of confidentiality as to any aspect of litigation, including mediation. . . . But privileges are created by federal common law.").

In diversity cases under 28 U.S.C. § 1332, where state law provides the rule of decision, the existence of a privilege is a matter of applicable state law. FED. R. EVID. 501. See also *Olam v. Cong. Mortg. Co.*, 68 F. Supp. 2d 1110, 1124-25 (N.D. Cal. 1999). That being said, federal law governs whether a case exceeds the amount in controversy requirement. See *Molina v. Lexmark Int'l, Inc.*, No. CV 08-04796 MMM (FMx), 2008 WL 4447678, at *6 (C.D. Cal. Sept. 30, 2008), citing *Horton v. Liberty Mut. Ins. Co.*, 367 U.S. 348, 352 (1961).

Rule 501 raises a difficult question regarding which law shall apply in federal question cases with pendent state law claims. In the Ninth Circuit, that question has been resolved so that the law of privilege is governed by federal common law, which does not recognize a so-called "mediation privilege" against compelled disclosure. That being said, the Ninth Circuit has also held that "[i]n determining the federal law of

privilege in a federal question case, absent a controlling statute, a federal court may consider state privilege law." See, *Lewis v. United States*, 517 F.2d 236, 237 (9th Cir. 1975) (citations omitted).

In the context of diversity jurisdiction and pendent state law claims, the federal district courts in California have taken a different tact when considering the confidentiality protections afforded by California law. A recent case in point is *Milhouse v. Travelers Commercial Ins. Co.*, 982 F.Supp. 2d 1088 (C.D.Cal. 2013), an insurance bad faith case. After they were unable to settle a claim on their policy for loss from fire, the homeowners filed suit against insurer alleging breach of contract and breach of covenant of good faith and fair dealing, seeking both compensatory and punitive damages. A jury verdict was returned in favor of the plaintiff homeowners awarding them over $1.9 million in damages, but the jury found that the insurer had not acted in bad faith and declined to award punitive damages. At trial, as part of its defense to the bad faith claim and request for punitive damages, Travelers was allowed to present evidence regarding statements made during the course of an early mediation conducted before the lawsuit was filed. In particular, testimony was presented that at the mediation, the plaintiffs made a $7 million demand and asked for $1 million in attorney's fees even though their attorney had only worked on the case for a few weeks.

The district court allowed testimony of plaintiffs' settlement demands and the insurance company's offers at mediation because to deem such evidence inadmissible in the trial of an insurance bad faith case would violate the due process rights of the defendant insurer to provide a defense to its alleged liability for bad faith and punitive damages. "To exclude this crucial evidence would have been to deny Travelers of its due process right to present a defense." Id. at 1108.

> "For the Milhouses, the case was one about a despicable insurance company that had a policy of not fairly and reasonably cooperating with its insured to settle their claims after tragic loss. They now argue that the Court erred by allowing the jury to hear the parties' mediation statements. The Milhouses are wrong. Travelers needed to present the parties' mediation statements to provide a complete defense of its actions and to avoid paying millions of dollars in bad faith and punitive damages for wrongfully refusing to settle the Milhouses' claim…. What the jury could not understand without hearing the parties' respective mediation statements … was why … the parties could not reach a reasonable settlement of the claim. The parties' mediation statements provided an answer for the jury. It was not Travelers who acted unreasonably in settling the claim. Sadly, it was the Milhouses. They demanded way too much money to settle their claim."

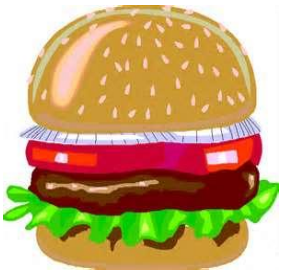
In reaching its decision on the mediation confidentiality issue, the Court found that the case presented a "rare, but serious tension between the dictates of Federal Rule of Evidence 408 and Rule 501." It noted that under Rule 501, in civil cases, where state law provides the rule of decision, state law governs the privilege issue. Because the Court was exercising its diversity jurisdiction in hearing the matter, California substantive law applied and Rule 501 would thus seemingly require the application of California Evidence Code section 1119, which the Court acknowledged bars disclosure of communications made during mediation absent an express statutory exception. Where, as here, a party seeks to introduce mediation statements for a purpose other than proving or disproving the validity of a claim – "for example, to show that its conduct was not taken in bad faith" – the Court found that there was a conflict between Section 1119, applied through Rule 501, and Rule 408, which allows evidence of settlement negotiations to be admitted where offered not to prove liability, but to refute a claim of undue delay or bad faith. On this issue, the Court stated that it did not need to resolve the question given the plaintiffs' waiver, but nevertheless noted that it harbored a doubt "the that Federal Rules of Evidence intended themselves to be subordinated to the application of state evidence law."

Several unreported decisions by California federal district courts have recognized the need or appropriateness of mediation confidentiality, but have been unwilling to grant that protection on as wide a basis as the California courts. For example, in *Haskins v. Employers Ins. of Wausau*, 2015 WL 369983 (N.D. Cal., Jan 28, 2015), Plaintiffs' mediation brief was deemed subject to discovery because it was prepared by or on behalf of fewer than all of the mediation participants and plaintiffs (through their counsel) expressly agreed in writing to its disclosure via a letter written to counsel for plaintiffs' insurer before the mediation, thus satisfying the express waiver requirements of Evidence Code §1122(a)(2).

For another example, in *Doublevision Entertainment, LLC v. Navigators Specialty Ins. Co.*, 2015 WL 370111 (N.D. Cal., Jan 28, 2015), the court applied California's mediation confidentiality statute in granting a protective order for some – but not all – communications had during, before and after a mediation held in a related state court action, but only two of five pre-mediation emails were protected because the other emails did not discuss mediation strategy and were not prepared for the upcoming mediation. To qualify for protection, the court held that the words "prepared for use in mediation" needed to be stated or the substance had to refer to mediation strategy. With regard to post-mediation communications, the court held that a memorandum was protected because it recounted statements made during mediation, and that "[t]he end of the mediation did not strip the privilege that attached to statements and communications made during the mediation" However, post-mediation emails were held to not be protected because they were exchanged long after the end of the 10-day period prescribed by Evidence Code §1125(a)(5), did not recount anything from the earlier mediation, and could not be prepared for the purpose of or pursuant to a

mediation because no subsequent mediation was scheduled, planned or under discussion.

Don't forget the B-E-E-F!



The scope of mediation confidentiality is so broad in California that even a term sheet or memorandum of understanding setting forth the terms of an agreement reached during the mediation is protected and thus inadmissible. Evidence Code Section 1123 provides a statutory exception to confidentiality for written settlement agreements prepared in the course of, or pursuant to, a mediation if any one of four stated conditions is satisfied. Those enumerated conditions include when the agreement in question expressly states that it is that parties' intent that the writing be enforceable or binding or "words to that effect."

In *Fair v. Bakhtiari*, 40 Cal. 4th 189 (2006), the California Supreme Court had occasion to construe Evidence Code Section 1123 and interpreted it quite strictly and literally. In *Fair*, the parties to a civil dispute mediated their disputes over the course of a two-day period. At the end of the second day, the parties signed a handwritten memorandum which set forth the settlement terms the parties had agreed to. Those terms included a provision requiring the parties to arbitrate any future disputes arising from or related to the settlement. Post-mediation, the parties exchanged formal settlement agreements, but were ultimately unable to reach agreement on the terms for a formal, written settlement agreement, and a dispute arose as to whether there was indeed a settlement. Plaintiff filed a motion seeking to compel arbitration pursuant to the term sheet memorandum. Defendant opposed the motion, arguing that there was no binding agreement to arbitrate, and objected to the admission of the term sheet memorandum on the grounds that it was inadmissible under Evidence Code Section 1119(b) because it represented a writing prepared in the course of a mediation. The trial court sustained defendant's objection and denied plaintiff's motion to compel arbitration of the dispute.

The court of appeal reversed, holding that the inclusion of the provision providing for any and all disputes to be submitted to arbitration could only mean that the parties intended the term sheet to be enforceable and binding. On further appeal to the California Supreme Court, the Supreme Court reversed and held that the court of appeal had erred by concluding that the inclusion of an arbitration clause satisfied the requirements of Evidence Code Section 1123(b). The Court noted that although the Legislature had not provided the courts with a "bright line" concerning what words will qualify as "words to that effect," a narrow interpretation of this clause was required. 40 Cal. 4th at 197. The Supreme Court concluded that in order to fit within the exception to confidentiality provided by Evidence Code Section 1123(b), a settlement agreement must include an affirmative statement using words that connote the intention for it to be "enforceable" or "binding." Id. at 199.

The decision in *Fair v. Bakhtiari* has given rise to the ADR slogan "Don't forget the BEEF in your mediated settlement agreement," encouraging disputants to include the words "binding, enforceable, effective and final" in any settlement agreements / term sheets prepared at mediation if the parties want such writings to be admissible in any later proceedings for purposes of enforcement. Sample language:

> This Memorandum of Understanding is intended as a binding agreement and shall be final, binding, effective and enforceable against the parties hereto pursuant to California Code of Civil Procedure Section 664.6 or comparable Federal Statutes as of the date set forth below.
>
> This Memorandum of Understanding (and any attachments) may be disclosed and is admissible in any action or legal proceeding to show the existence of the agreement and / or to enforce the parties' agreement as set forth herein in accordance with California Evidence Code Section 1123 and / or applicable Federal Statutes or Rules.

If you would like a more detailed / academic analysis of the contrast and differences between mediation confidentiality protections afforded to California litigants depending on whether they are involved in litigation pending in the state or federal courts, please see: Rebecca Callahan, *Mediation Confidentiality: For California Litigants, Why Should Mediation Confidentiality be a Function of the Court in Which the Litigation is Pending?* 12 Pepp. Disp. Resol. L.J. 63 (2012).