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A Lesson About Settlements

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On April 11, the 9th U.S. Circuit Court of Appeals ruled on a case known loosely as "Winklevoss v. Facebook," acclaimed mostly because of the exposure it received in the Academy-nominated movie, *"The Social Network."* The 9th Circuit rejected Cameron and Tyler Winklevoss' request to set aside the confidential settlement reached at mediation, based on the allegation that critical information was withheld from them.

Initially, the Winklevoss brothers sued Facebook and founder Mark Zuckerberg in Massachusetts, alleging Zuckerberg stole their idea for a social networking site, which later became Facebook. Facebook and Zuckerberg counter-claimed against the Winklevosses and "ConnectU," their competing social networking site established in California, alleging that they had hacked into Facebook and tried to steal their users.

After much protracted litigation, the judge ordered everyone to mediation. At mediation, all attendees signed a confidentiality agreement. A settlement was reached and memorialized by a handwritten "term sheet and settlement agreement" providing that the Winklevosses give up ConnectU in exchange for a monetary payment and shares in Facebook.

While the final agreement was being drafted, Facebook notified the Winklevosses that an internal audit performed, pursuant to Section 409a of the Tax Code, valued Facebook's stock at $8.99 per share. The Winklevoss brothers alleged they were previously told that the value was four times that, and challenged the enforceability of the settlement agreement, claiming they were misled by fraud. In support of their arguments, they cited to Facebook's request that the court order them to sign over 130 pages of documents, including some not specified in the short form agreement, as evidence of their materiality, the omission of which from the earlier documents rendered the agreement unenforceable.

The court upheld the agreement's enforceability, stating that only omission of a term that was necessary to form a contract, would rise to the level of "material" such that an agreement would be nullified. However, omission of other types of terms do not result in nullification, "so long as the terms it does include are sufficiently definite for a court to determine whether a breach has occurred, order specific performance, or award damages." (*Elite Show Services Inc. v. Staffpro Inc.*, 14 Cal. Rptr. 3d 184, 188 (Cal. Ct. of App. 2004)). The 9th Circuit went on to state: "This is not a very demanding test, and the [s]ettlement [a]greement easily passes it." The court quoted from a clause in the settlement agreement, which stated, "Facebook will determine the form and documentation of the acquisition of ConnectU's shares consistent with a stock and cash for acquisition." That clause, the court noted, "leaves no doubt that the Winklevosses and Facebook meant to bind themselves and each other, even though everyone understood that some material aspects of the deal would be prepared later."

Understand that overturning a signed release of claims in a negotiated settlement process will be challenging at best.

Analyzing how this deal fell apart compels a review of the mediation itself. The Winklevosses had tried to introduce evidence of earlier statements made at mediation. The district court excluded these statements under Local ADR Rule 6-11, which it held created a "privilege" for "evidence regarding the details of the parties' negotiations in their mediation." The 9th Circuit, however, stated that privileges are created under and reserved under federal law. Furthermore, this was a private mediation; hence the local ADR rules were inapplicable.

The 9th Circuit also noted that the parties had signed a confidentiality agreement at the outset of the mediation, and that the settlement agreement stipulated that all statements made during mediation were "privileged, non-discoverable and inadmissible...." The parties further agreed that the settlement agreement and terms were "confidential and binding."

The court paid homage to the underlying principle of settlements, which is to bring closure and peace to the parties. It gave strong support to the concept of a "release of all claims," particularly in a setting with a "team of lawyers and a financial advisor." The court stated, "[a]t some point, litigation must come to an end. That point has now been reached."

The take-away from this decision, first and foremost, is that litigants must get as much information as possible about the case and material settlement terms, before coming to the mediation. It often occurs that mediants lack full information with which to evaluate their decision; still, enough information should be known, or at least gleaned during the mediation process, to comfortably reach a settlement. Here, the critical issue to the Winklevosses was the valuation of Facebook. It is not known what information they had, and whether false or accurate information was provided.

Second, understand that overturning a signed release of claims in a negotiated settlement process will be challenging at best.

Last, there will always be a quandary when settlement is reached at mediation, yet rarely do the parties bring their draft settlement agreement and release. Often one side has brought their "standard" agreement, which consists of 20-plus pages of legalese and in need of modification to fit the case in question. Complicating this is the fact that settlements are often reached late in the day when everyone is too tired to pay full attention to the technical terms needed to ensure protection of the parties.

Thus, in most cases, the parties turn to the "short form agreement." These typically do, or at least should, include language that the agreement is enforceable under Code of Civil Procedure Section 664.6, and is admissible pursuant to Evidence Code Section 1123 (or equivalent federal rules) in any proceeding to enforce the agreement. In state court actions, in addition to the full and complete release, it is prudent to add in waivers of Civil Code Section 1542, in the event either party discovers some juicy fact after the mediation and uses that to set aside the agreement.

The basic tenant of all settlements is that the parties are working to buy peace and permanent closure.