By Jonah Orlofsky

Oral Agreements in Mediation

Making Sure a Mediated Settlement Is Binding

It's 8:00 at night and you've finally settled your five-year-old case, after a long and arduous day of mediation. In a perfect world, the parties would complete a full settlement agreement and be done with the case. Full settlement documentation, however, takes time, and it is common at the conclusion of many mediations to agree on the key terms of the deal, with full documentation to be prepared at a later date. The issue the parties face in this situation is how to ensure that they have a binding agreement so that no one can walk away from the deal between the end of the mediation and the execution of a complete settlement document.

THE FIRST STEP IS To PuT THE KEY TERMS oF THE deal in writing before anyone leaves the mediation. A short, concise, written list of the basic terms of the agreement is not only advisable to avoid disputes about what was agreed to, it is legally required in many instances to create a binding contract. Outside the confines of mediation, oral settlement agreements are legally enforceable so long as the terms of the agreement can be proven. *Dillard v. Starcon Int'l, Inc.*, 483 F.3d 502, 507 (7th Cir. 2007) ("Oral settlement agreements are enforceable under Illinois law"). The problem with relying on an oral agreement in a mediation context, however, is that most mediations in Illinois are subject to the provisions of the Uniform Mediation Act, 710 ILCS 35/1 et seq. (UMA). Section 4 of the UMA provides that all "mediation communications" are privileged and cannot be used in a court proceeding, and "mediation communications" include everything that is said and done in a mediation.

The effect of the UMA privilege provision is that if a mediation concludes with only an oral agreement, and one party decides to back out before a written document is executed, the party that wants to enforce the settlement will have no means of proving that there was an oral settlement agreement. The communications in which the oral agreement was created constitute "mediation communications" under the UMA and will therefore be privileged and inadmissible for any purpose in the court proceeding, including an attempt to enforce an oral settlement agreement. Although no Illinois court has yet ruled on this issue, many courts from other jurisdictions with statutory mediation privileges similar to the UMA have addressed this issue, and they have uniformly concluded that the mediation communication privilege bars any proof of an oral settlement (*e.g.*, *Horner v. Carter*, 981 N.E.2d 1210, 1211-13 (Ind. 2013)).

Section 5 of the UMA provides that the parties can waive the mediation privilege, so theoretically, the creation of an oral settlement agreement could be proven if the parties waive the privilege. Section 5, however, requires both sides to agree to the waiver. As a practical matter, therefore, this waiver provision will rarely come into play because disputes concerning oral settlements arise when one side wants to back out of a deal, and the side that wants to back out will never agree to waive the mediation privilege.

The one exception to this is cases pending in federal court in Illinois. The federal courts have routinely upheld oral settlement agreements reached in mediation (*e.g.*, *Platcher v. Health Professional, Ltd.*, 549 F.Supp.2d 1040 (C.D.Ill. 2008)). This is due in part to the fact that the UMA is not applicable to federal litigation, and the federal courts have not adopted a federal common law mediation privilege. While the local court rules in the Northern District of Illinois provide that statements made in mediation are privileged (*See* LR 16.3(c)), the courts in the Northern District do not view this as a bar to taking testimony of communications that occurred during a mediation when there is a question about whether a settlement was reached. What likely underlies this legal position is the fact that in federal court (including virtually all of the published decisions on this point) the mediations are conducted by federal magistrates. One can see why a court would not hesitate to enforce a settlement if a magistrate confirmed that an agreement was reached.

One possible exception to this rule in federal cases may be the situation in which the parties in a federal case retain a private mediator instead of the magistrate, and the mediation contract contains a provision that mediation communications are privileged. No court in Illinois has yet decided whether such a contractual mediation privilege provision would preclude the use of mediation communications to prove the existence of an oral agreement.

The fact that the federal courts may enforce an oral agreement reached in a mediation, however, is surely no reason to forego putting something in writing. There are quite a few published decisions in which controversies have arisen over the content of an oral settlement agreement in federal cases. There is no downside to putting something in writing and thereby assuring that there will never be a need to waste a client's time and money litigating such an issue. In sum, in Illinois state court cases, a writing is essential to create a binding agreement, and in federal court cases, a writing is highly advisable.

The Writing Must Include All of the Material Terms of the Agreement

Since an oral agreement in insufficient, or at the very least highly

inadvisable, and a complete settlement agreement is frequently not feasible, some middle ground is necessary. This generally takes the form of a term sheet listing what has been agreed upon, signed by the parties to the agreement. It is a fairly simple matter at the end of the mediation to write up such a list, but the question is what needs to be in this abbreviated agreement in order to make it legally binding?

Settlement agreements, mediated or otherwise, are interpreted using the same rules applicable to contracts generally, and there are several basic principles under Illinois law that determine whether a contract has been formed. First, a contract is created only if there is "a meeting of the minds or mutual assent as to all material terms." *Abbott Labs. v. Alpha Therapeutic Corp.*, 164 F.3d 385, 387 (7th Cir. 1999). The key phrase, obviously, is "material terms," and what is material for a settlement will vary from case to case.

Second, it is not necessary that all of the terms and conditions to be spelled out for there to be a binding agreement. "A contract may be enforced even though some contract terms may be missing or left to be agreed upon, but if the essential terms are so uncertain that there is no basis for deciding whether the agreement has been kept or broken, there is no contract. *Acad. Chicago Publishers v. Cheever*, 144 Ill. 2d 24, 30, 578 N.E.2d 981, 984 (1991).

Third, the question of whether there was a "meeting of the minds" under Illinois law is determined on an objective basis. "It is not compelling that the parties share a subjective understanding as to the terms of the contract; the parties' conduct must indicate an agreement to the terms of same." *Acad. Chicago Publishers v. Cheever*, 144 Ill. 2d 24, 30, 578 N.E.2d 981, 984 (1991). Whatever written document is created at the end of the mediation, therefore, will determine what the agreement was. There will be no testimony by the parties about what they thought the settlement entailed because any subjective understanding of what the parties intended is irrelevant. Indeed, while oral testimony concerning the meaning of a written document is problematic under any circumstances, it would be prohibited in the mediation context because of the UMA's mediation privilege discussed above in connection with oral contracts.

These principles do not, unfortunately, yield hard and fast rules about what needs to be in the term sheet created at the end of a mediation. The document must include any term that would be considered "material" to the settlement, but what is material to a settlement will vary depending upon what is at issue. At one end of the spectrum, the amount of money to be paid is obviously a material term, and at the other end of the spectrum, boilerplate terms such as choice of law provisions and clauses allowing contracts to be signed in counterparts are unlikely to be material clauses.

It is neither possible nor advisable, however, to attempt to create a universal checklist of material clauses that need to be included to make a term sheet binding. What is material in an employment case and a patent case are sure to be quite different. The key take-away from this, therefore, is that counsel need prepare for a mediation by giving careful consideration, in advance, to all of the material clauses that might need to be included in a settlement agreement. The client should be included in these discussions, as clients may focus on the monetary aspects of the settlement to the exclusion of important non-monetary provisions. The non-monetary issues should also be discussed with the mediator at the appropriate time in the mediation so that when the parties attempt to write up a term sheet, most or all of the necessary material terms have been discussed and agreed to.

Material Non-Monetary Terms

Aside from the amount of money to be paid, many non-monetary provisions are material and need to be included in a term sheet to make it binding. The following issues, for example, are very likely to be material:

- The timing and method of any payment.
- The scope of the releases.
- The need for a confidentiality clause.
- The status of any counterclaims.
- How any liens are to be handled.

A Few Additional Considerations

It can be helpful to put something like the following clause at the end of the term sheet: "Although the parties will draft and execute a formal settlement contract, this document constitutes a binding settlement agreement." The benefit of this language is that, while courts will enforce contracts that are less than complete, they will not enforce term sheets, even if they contain all the material terms of an agreement, if the parties did not intend the term sheet to constitute a binding contract. As noted in *Quake Const., Inc. v. Am. Airlines, Inc.*, 141 Ill. 2d 281, 287, 565 N.E.2d 990, 993 (1990), "parties may specifically provide that negotiations are not binding until a formal agreement is in fact executed…. If the parties construe the execution of a formal agreement as a condition precedent, then no contract arises unless and until that formal agreement is executed."

A term sheet that does not specify, one way or the other, whether it is a binding contract may be deemed to be binding. There is no reason, however, to leave the door open for any dispute about whether the term sheet was intended by the parties to be binding. There are many court decisions in which the parties have disputed just this issue, one side arguing the term sheet was binding, and the other, that a formal and complete document was a condition precedent to the creation of a binding contract. A simple statement that the term sheet is binding ends this issue. Of course, if material terms are missing from the term sheet, a statement that the document was intended to be binding will not overcome that deficiency, but such a statement will avoid any controversy over whether the agreement reached at the end of the mediation is binding prior to the execution of the formal settlement agreement.

Finally, the parties should consider who needs to sign the term sheet to make it a binding contract. Just like any contract, it is only binding on those who sign, and those who sign need to be authorized to do so. This is particularly important in the mediation context because, as discussed earlier, no oral testimony will be permitted about what was discussed on these issues. An important issue to consider, in this regard, is the capacity of those signing. If either party to the agreement is an entity such as a corporation, the other side may want the term sheet to reflect that the person signing has the necessary authorization and capacity to do so on behalf of the entity. Similarly, if parties are signing on behalf of themselves as individuals as well as on behalf of an entity, this too can be noted on the term sheet.

After noting these issues, however, it is important to emphasize that the term sheet, even in a complex case, can be a simple one or two-page document. In *Facebook, Inc. v. Pac. Nw. Software, Inc.*, 640 F.3d 1034, 1038 (9th Cir. 2011), the settlement of a massive lawsuit concerning the ownership of Facebook, which included a complex stock purchase, was reflected in a "one-and-a-third page Term Sheet & Settlement Agreement." When a dispute later arose concerning whether there was a binding settlement agreement, the court had little problem concluding that the term sheet created a binding contract. The Court further held that if the parties could not reach agreement on some of the non-material clauses in the final document, the trial court could impose reasonable provisions to fill any gaps.

Preparation is Key

Two key practice pointers emerge from this discussion. First, at the conclusion of a successful mediation, if a full settlement agreement is not feasible, the parties should execute a short, simple term sheet, signed by the necessary parties, reflecting all of the material terms that were agreed to. Second, it is essential that counsel prepare for a mediation by giving careful consideration to all of the non-monetary terms that may be needed. Just as in all other aspects of litigation, careful preparation is necessary to avoid future problems. ■

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