

EXCHANGING SHARES TO SETTLE A LAWSUIT: SHOULD A CONFIDENTIALITY AGREEMENT BAR EVIDENCE OF SECURITIES FRAUD?

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I. INTRODUCTION

Suppose that two parties enter into a mediated written settlement, but in a subsequent court proceeding, one party claims to have discovered evidence clearly establishing fraud by the opposing party during the mediation process.¹ When a court has to determine whether or not to enforce a negotiated settlement, do mediation confidentiality rules permit the court to admit one party's evidence of the other party's fraud or misrepresentations during the mediation?²

One recent high-profile case in the United States Court of Appeals for the Ninth Circuit dealt with this question: *Facebook, Inc. v. Pac. Nw. Software, Inc.*³ Cameron Winklevoss, Tyler Winklevoss, and Divya Narendra ("the Winklevosses") sued Facebook and its founder Mark Zuckerberg ("Facebook") in Massachusetts for allegedly stealing the idea for Facebook.⁴ Facebook countersued the Winklevosses and their competing site, ConnectU, for allegedly hacking into Facebook to steal user data and trying to steal users by spamming them.⁵ The district court in California dismissed the Winklevosses claim due to lack of personal jurisdiction and then ordered the parties to begin mediation.⁶ Accordingly, ConnectU, Facebook, and the Winklevosses entered mediation in order to reach a global settlement.⁷ Prior to the start of mediation, the parties signed a Confidentiality Agreement that stipulated that

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¹ See Dennis Sharp, *The Washington, D.C. Lawyer and Mediation Confidentiality: Navigating the Complex and Confusing Waters*, 7 APPALACHIAN J.L. 179 (2008).

² See *Id.*

³ *Facebook, Inc. v. Pac. Nw. Software, Inc.*, 640 F.3d 1034, 1036 (9th Cir. 2011).

⁴ *Id.*

⁵ *Id.*

⁶ *Id.*

⁷ *Id.*

all statements made during mediation would stay privileged, non-discoverable, and inadmissible in any future proceeding.⁸

After a day of negotiations, the parties signed a handwritten Settlement Agreement.⁹ The Winklevosses agreed to give up ConnectU in exchange for cash and shares of Facebook.¹⁰ The parties stipulated that the Settlement Agreement was “confidential,” “binding” and “may be submitted into evidence to enforce [it].”¹¹ The Settlement Agreement also purported to end all disputes between the parties.¹² When the deal fell apart during negotiations over the form of the final deal documents, Facebook moved to enforce the Settlement Agreement.¹³ ConnectU argued that the Settlement Agreement was unenforceable because it lacked material terms and had been procured by fraud.¹⁴ The district court held that the Settlement Agreement was enforceable and ordered the Winklevosses to transfer all ConnectU shares to Facebook. The Court of Appeals affirmed.¹⁵

Facebook, Inc. illustrates the tension between two important public policies: the desire to promote dispute settlement with confidentiality protections during mediation versus society’s interest in preventing fraud.¹⁶ Legislatures and courts, at both the federal and state levels, have struggled to balance the two competing public policies.¹⁷ Mediation confidentiality rules resulting from efforts to strike an appropriate balance between these interests are often complex and confusing.¹⁸

If parties cannot rely on the confidential treatment of everything that transpires during a mediation session, then counsel may conduct themselves in a cautious, secretive, and noncommittal manner more suitable to high-stakes poker players rather than opposing parties trying to come to a just solution of a civil dispute.¹⁹ Proponents of strict mediation confidentiality rules contend that without such protections, parties in settlement negotiations will be less candid and thus less likely to resolve conflicts through this pro-

⁸ *Id.*

⁹ *Facebook, Inc.*, 640 F.3d at 1037.

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Facebook, Inc.*, 640 F.3d at 1042.

¹⁶ Sharp, *supra* note 1, at 179–80.

¹⁷ *Id.* at 180.

¹⁸ *Id.*

¹⁹ *Id.* at 181.

cess.²⁰ Conversely, critics of strict mediation confidentiality cite strong public policy in favor of admission of all relevant and probative evidence in judicial and other adjudicatory proceedings.²¹ Additionally, at least one critic has argued that strict mediation confidentiality rules may unconstitutionally restrict courts from exercising powers specifically delegated to them.²²

II. CONFIDENTIALITY AGREEMENTS AND ENFORCEMENT OF SETTLEMENTS

Public policy encourages private negotiation and settlement of litigated disputes.²³ While private settlement of these disputes is gaining support in the legal profession, it is important for the parties to follow the standards of the judicial process.²⁴ Although alternative dispute resolution (“ADR”) comprises private negotiations, judicial settlement conferences, arbitration, and mediation, legislatures have singled out mediation for substantial confidentiality protection.²⁵ Believing that confidentiality is vital to mediation, “legislatures across the country either have enacted or are considering the passage of legislation providing for broad confidentiality for participants in mediation, including court-connected mediation.”²⁶ While the legislative initiatives vary by state, they typically extend the confidentiality protection provided by evidentiary rules.²⁷ Most state legislatures have enacted some form of mediation confidentiality legislation, some even more expansive than the scope of the confidentiality privilege proposed in the Uniform Mediation Act (“UMA”).²⁸ However, these statutes seldom mention the court’s power to override the confidentiality privilege in order to enforce participation orders, confront claims of misconduct by participants, or prevent the abuse of process or violations of professional ethics.²⁹ In an effort to standardize state laws in

²⁰ *Id.*

²¹ *Id.*

²² Sharp, *supra* note 1, at 181. See also Maureen A. Weston, *Confidentiality’s Constitutionality: The Incursion on Judicial Powers to Regulate Party Conduct in Court-Connected Mediation*, 8 HARV. NEGOT. L. REV. 29, 30–34 (2003).

²³ Weston, *supra* note 22, at 30.

²⁴ *Id.*

²⁵ *Id.* at 32.

²⁶ *Id.*

²⁷ *Id.*

²⁸ Weston, *supra* note 22, at 33.

²⁹ *Id.*

this field and empower courts to provide for protection of confidentiality in mediation, the National Conference of Commissioners on Uniform State Laws (“NCCUSL”) approved the UMA.³⁰ The UMA was proposed for adoption in all fifty states.³¹ The UMA has been enacted in ten states and the District of Columbia, and was introduced in three states this year.³² Despite the growing adoption of the UMA on the state level, there has been little effort to date to either unify state and federal mediation rules, or to reconcile various federal court approaches to this issue.³³

State courts that have considered the issue of mediation confidentiality have developed either privilege or exclusionary rules.³⁴ The UMA drafters adopted the privilege approach, which is similar to attorney-client privilege and doctor-patient privilege.³⁵ The drafters rejected the exclusionary-rule approach followed by some states.³⁶ The privilege approach provides less confidentiality protection to a non-party in a mediation session than an exclusionary rule would.³⁷ For example, in a subsequent court proceeding between a party in mediation and a non-party, the non-party would be precluded from objecting to evidence, offered by its opponent, relating to the mediation.³⁸ The non-party would simply not be a holder of a “privilege.”³⁹ Under an exclusionary rule, anyone may object to the admission of mediation communications.⁴⁰

As for federal courts, there is little uniformity in mediation confidentiality rules.⁴¹ There are two separate approaches employed—the Administrative ADR Act for mediations involving federal agencies and another for cases filed in federal court where the Administrative ADR Act does not apply.⁴² Further complicating mediation confidentiality rules is the fact that each federal

³⁰ Peter Robinson, *Centuries of Contract Common Law Can't Be All Wrong: Why the UMA's Exception to Mediation Confidentiality in Enforcement Proceedings Should Be Embraced and Broadened*, 2003 J. DISP. RESOL. 135, 136 (2003).

³¹ Weston, *supra* note 22, at 32.

³² *Enactment Status Map*, UNIFORM LAW COMMISSION OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, <http://www.uniformlaws.org/Act.aspx?title=mediation%20Act> (last visited Feb. 10, 2013).

³³ Sharp, *supra* note 1, at 182.

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Id.* at 183.

³⁸ *Id.*

³⁹ Sharp, *supra* note 1, at 183.

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Id.*

court is allowed to adopt its own mediation confidentiality rules and structural approach for mediations involving federal law.⁴³ Where the district court has not promulgated such rules, the common law privilege principles apply.⁴⁴ Additionally, where state substantive law is primarily at issue (such as in diversity tort or contract cases), federal courts are required to apply that state's mediation confidentiality law.⁴⁵ Taken as a whole, the approach of the federal courts to mediation confidentiality law is muddled and complex.

Typically, when a party disputes a settlement agreement after mediation, the conflict will follow a certain sequence of events. In a court proceeding after mediation, the party seeking to enforce the settlement will present the signed document as proof of the resolution of issues and request the enforcement of the settlement.⁴⁶ The party seeking to invalidate the settlement will object and claim that the signed document does not represent the entire settlement.⁴⁷ The court will insist that the parties intended to wait until after the mediation to create a more formal settlement agreement with all of the terms, including ones not anticipated or discussed during the mediation.⁴⁸ The court has to consider whether it will allow the document into evidence, and then decide whether to allow the mediator, the parties, or other participants to testify to the validity of the settlement and the individual terms.⁴⁹ Some state courts have mediation confidentiality rules containing specific exceptions permitting the admission of written settlement agreements reached in mediation.⁵⁰ Similarly, the Administrative ADR Act's confidentiality provision has an exception that allows for the admission of such evidence.⁵¹ For oral settlements reached during mediation that were not reduced to writing and signed by the parties, courts have generally been reluctant to permit testimony from any of the mediation participants in enforcement proceedings.⁵² However, there has been at least one federal district court to permit a mediator to testify about the parties orally reaching a binding

⁴³ *Id.*

⁴⁴ *Id.* at 183–84.

⁴⁵ Sharp, *supra* note 1, at 183–84.

⁴⁶ *Id.* at 188.

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ *Id.* at 189.

⁵¹ Sharp, *supra* note 1, at 189.

⁵² *Id.*

settlement agreement.⁵³ The UMA also explicitly provides for an exception to mediator confidentiality when enforcing a mediated agreement.⁵⁴ Under the exception in Section 6 of the UMA, no privilege exists if a court determines that the party seeking discovery or the proponent of the evidence has “shown that the evidence is not otherwise available, that there is a need for the evidence that substantially outweighs the interest in protecting confidentiality, and that the mediation communication is sought or offered . . . to prove a claim to rescind or reform or a defense to avoid liability on a contract arising out of mediation.”⁵⁵

The rising prominence of the UMA has led to a clash between traditional contract law and mediation law derived from the UMA or a state equivalent.⁵⁶ Traditional contract law often allows a broad examination of the circumstances surrounding the formation of an agreement, whereas traditional mediation law limits the examination of those circumstances.⁵⁷ One of the central foci of traditional mediation law is the preservation of mediation confidentiality.⁵⁸ An important aspect of mediation confidentiality is its application when enforcing a mediated agreement.⁵⁹ In some jurisdictions, strict mediation confidentiality interferes with the application of contract law when enforcing a mediated agreement.⁶⁰

Parties may also agree, orally or in writing, that all communications made in the course of a settlement negotiation remain confidential.⁶¹ Such confidentiality provisions are typical in agreements to mediate, whether court-ordered or private, and may effectively ensure confidentiality in a non-judicial context.⁶² Disclosure of communications violating such agreements may result in liability as a breach of contract.⁶³ Private agreements between the parties to exclude evidence are not looked upon favorably and may not provide much protection against subpoenas after the court weighs the situation against public policy considerations.⁶⁴ A few states have decided against creating an “absolute shield” around

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ Robinson, *supra* note 30, at 137.

⁵⁶ *Id.*

⁵⁷ *Id.* at 149, 159.

⁵⁸ *Id.* at 137.

⁵⁹ *Id.*

⁶⁰ *Id.* at 142.

⁶¹ Weston, *supra* note 22, at 46.

⁶² *Id.*

⁶³ *Id.* at 46–47.

⁶⁴ *Id.* at 47.

mediation communications so that mediation confidentiality can be breached to prevent fraud or injustice.⁶⁵

A. *The Traditional Role of the Court in
Litigation and Mediation*

The fundamental principle, that a court has the authority to regulate and discipline parties and attorneys based on their conduct in the legal process is conveyed in legislation and procedural rules such as the Federal Rules of Civil Procedure (“FRCP”) and its state equivalents.⁶⁶ These rules empower courts to impose sanctions on parties and their counsel for a variety of pretrial misconduct including abuse of process, violation of subpoenas, failure to cooperate in discovery, or procedural bad faith.⁶⁷ FRCP Rule 16, which articulates the judge’s authority to manage cases, includes the power to command attorneys and parties to participate in pre-trial settlement conferences, and the ability to employ “[s]pecial procedures to assist in resolving the dispute,” such as ADR solutions.⁶⁸ Rule 16 also allows the judge to punish a party or attorney for failing to abide by pretrial orders, attend, adequately prepare for, or participate in good faith settlement conferences mandated by the court.⁶⁹ In the litigation process, courts possess the inherent power to manage and sanction the conduct of the parties and order litigants to participate in ADR processes.⁷⁰ Courts may set the rules for participation, such as requiring the attendance of a party with settlement authority, the submission of position briefs, the attendance of witnesses, or simply good-faith participation.⁷¹ The primary question is whether, and to what extent, these judicial powers rule over court-ordered mediations for which the legislature has accorded a broad confidentiality privilege.⁷² Legislative protection for mediation confidentiality directly conflicts with a court’s inherent power to monitor and sanction parties and attorneys.⁷³ In *Foxgate Homeowners’ Ass’n, Inc. v. Bramalea Califor-*

⁶⁵ Robinson, *supra* note 30, at 137.

⁶⁶ Weston, *supra* note 22, at 34.

⁶⁷ *Id.*

⁶⁸ *Id.*

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² Weston, *supra* note 22, at 34–35.

⁷³ *Id.* at 35.

nia, Inc.,⁷⁴ the California Supreme Court refused to recognize a judicially-created exception to a statute that prohibited disclosure of mediation communications, based on a court's inherent power to police the litigation process and to sanction parties for non-compliance with court orders for participation in mediation.⁷⁵ The court deferred to the legislature when dealing with the "policy question" of whether the mediator and the participants of a mediation could report conduct during the mediation that the mediator believes was in bad faith and therefore punishable under a state statute.⁷⁶ *Foxgate* is an example of how strong legislative protection for mediation confidentiality limits the ability of courts to deal with evidence of actions that occurred during mediation that were unethical, fraudulent, or otherwise contrary to court orders.⁷⁷ However, unlike the court in *Foxgate*, some courts believe that they inherently possess the power to admit evidence of misconduct by parties that occurred in court-ordered ADR proceedings.⁷⁸

Given the increasing use of court-ordered ADR proceedings and the accompanying broad mediation confidentiality rules, there is a greater possibility that more parties to an ADR proceeding lacking judicial scrutiny will abuse the process, engage in unproductive conduct, or simply decline to participate.⁷⁹ Some mediation supporters consider misconduct or bad faith participation in a court-ordered mediation as a party's conscious choice to reject the potential benefits of mediation.⁸⁰ Broad protection for mediation confidentiality permits non-compliance with the ADR proceedings that makes a mockery of the court and threatens the integrity of the judicial process.⁸¹ If there is misconduct in a judicial settlement conference or a court-connected arbitration, a court can impose sanctions such as costs, attorney's fees, default judgments, dismissals, or contempt.⁸² However, broad protection for mediation confidentiality essentially prevents the court from investigating the conduct of participants in a mediation proceeding and limits the court's power to ensure a productive process.⁸³ While ADR pro-

⁷⁴ *Foxgate Homeowners' Ass'n, Inc. v. Bramalea California, Inc.*, 25 P.3d 1117 (Cal. 2001).

⁷⁵ Weston, *supra* note 22, at 35.

⁷⁶ *Foxgate*, 25 P.3d at 1128.

⁷⁷ Weston, *supra* note 22, at 35.

⁷⁸ *Id.*

⁷⁹ *Id.*

⁸⁰ *Id.* at 35-36.

⁸¹ *Id.* at 36.

⁸² *Id.*

⁸³ Weston, *supra* note 22, at 36.

ceedings may seem unqualifiedly beneficial, broad mediation confidentiality laws take away power from the court to oversee the process and discipline parties for their misconduct in court-ordered mediation.⁸⁴

B. *The Importance of Contract Law in Enforcement of Settlement Agreements*

With the exception of mediation confidentiality, contract law normally governs the enforcement of settlement agreements.⁸⁵ The law of contracts defines the conditions necessary for the formation of a binding agreement (including capacity, offer, acceptance, and consideration), the voiding of an otherwise binding agreement (including mistake, misrepresentation, duress, and undue influence), and declaring an otherwise binding agreement unenforceable on the grounds of public policy.⁸⁶ Additionally, contract law offers standards defining the meaning of the terms of a binding agreement,⁸⁷ the effect of performance and non-performance,⁸⁸ impracticability of performance and frustration of purpose,⁸⁹ and assignment and delegation.⁹⁰ For agreements formed in the absence of a mediator, issues affecting the enforcement of such settlement agreements would be resolved by applying the suitable doctrines of contract law to each alleged situation.⁹¹

1. Effect of Unsettled or Disputed Terms

Contract law requires a certain level of definiteness in the essential terms of an agreement in order for the agreement to be

⁸⁴ *Id.*

⁸⁵ Robinson, *supra* note 30, at 148 (citing *Kendrick v. Barker*, 15 P.3d 734 (Wyo. 2001); *McEnany v. W. Del. County Cmty. Sch. Dist.*, 844 F. Supp. 523, 534 (N.D. Iowa 1994); *Coulter v. Carewell Corp.*, 21 P.3d 1078, 1082 (Okla. Civ. App. 2001); *Feldman v. Kritch*, 824 So. 2d 274, 277 (Fla. Dist. Ct. App. 2002)).

⁸⁶ Robinson, *supra* note 30, at 148–49.

⁸⁷ *Id.* at 149. This includes interpretation, supplying an omitted essential term, the effect of a written agreement/the parol evidence rule, course of dealing and customary practice, and construing conditions in agreements.

⁸⁸ *Id.* This includes effects on the other party's duties when there is a failure to render or offer performance, partial performance or breach, as well as circumstances significant in determining whether a failure is material.

⁸⁹ *Id.* This includes death or incapacity of person who is necessary for performance, prevention by governmental regulation, and partial and temporary impracticability.

⁹⁰ *Id.*

⁹¹ *Id.*

considered enforceable.⁹² Professor Williston's well-respected formulations of contract law provide a solid foundation.⁹³ Professor Williston stated:

It is a necessary requirement that an agreement, in order to be binding, must be sufficiently definite to enable courts to give it an exact meaning. In particular . . . a provision that some matter shall be settled by future agreement has often caused a promise to be too indefinite for enforcement. The Restatement suggests as an illustration of this a building contract which is definite in all particulars except for a provision that the form of window fastening shall be afterwards agreed upon This would not make the entire building contract unenforceable; by contrast, if the nature of the window fastenings were fixed by the agreement while the dimensions of the building were left to future agreement, there would be no enforceable obligation. Obviously, the question is one of degree.⁹⁴

Facebook, Inc. poses an interesting case for this “question of degree.” The Winklevosses claimed that the Settlement Agreement was unenforceable because of the lack of definite material terms.⁹⁵ The Settlement Agreement specified how the material terms would be defined.⁹⁶ Essentially, it delegated to Facebook the duty to fill in the material terms.⁹⁷ According to the Court of Appeals for the Ninth Circuit, California allows parties to delegate choices over terms as long as the delegation is constrained by the rest of the contract and is subject to the implied covenant of good faith and fair dealing.⁹⁸ Disregarding the reasons why the Winklevosses decided to delegate the duty to fill in the material terms to Facebook, it seems as though the Settlement Agreement left out the settlement amount,⁹⁹ which is a term that more resembles Wil-

⁹² Robinson, *supra* note 30, at 151.

⁹³ Professor Samuel Williston (1861–1963) is widely regarded as one of the greatest teachers and scholars in the history of Harvard Law School. He was one of the most prolific and esteemed legal writers of his age. His text on contracts is the classic in its field, and his work in drafting a uniform law of sales has been used as a basis for statutes on the books in three-quarters of the states. *Samuel Williston, Foremost Legal Scholar, Dies at 101*, THE HARVARD CRIMSON (Feb. 19, 1963), <http://www.thecrimson.com/article/1963/2/19/samuel-williston-foremost-legal-scholar-dies/>.

⁹⁴ 1 SAMUEL WILLISTON, WILLISTON ON CONTRACTS § 4:18, 414–20 (4th ed. 1990); *id.* at § 4:28, 602–05, *quoted in* *Weddington Prod., Inc. v. Flick*, 71 Cal. Rptr. 2d 265, 278 (1998); *cited in* Sharp, *supra* note 1, at 151.

⁹⁵ *Facebook, Inc. v. Pac. Nw. Software, Inc.*, 640 F.3d 1034, 1037 (9th Cir. 2011).

⁹⁶ *Id.* at 1038.

⁹⁷ *Id.*

⁹⁸ *Id.*

⁹⁹ *Id.*

liston's dimensions of the building than the nature of the window fastenings.¹⁰⁰ The settlement amount is what most mediated agreements boil down to.¹⁰¹ If the Settlement Agreement lacked a definite amount (or at least a precise methodology for arriving at a definite amount), the overall contract would fail the test of defining all material terms.¹⁰²

Beyond Williston's traditional approach to contract law, the modern view reflected in the Uniform Commercial Code ("UCC") and the Restatement (Second) of Contracts is to "ask essentially two questions: first, did the parties intend to contract, and second, is there a reasonably certain basis for giving an appropriate remedy."¹⁰³ *Facebook, Inc.* answers the first question in the affirmative. There is little doubt that the Winklevosses and Facebook entered into the Settlement Agreement with the intention of ceasing this line of litigation, and coming to a fair resolution for both sides, including a monetary settlement for the Winklevosses.

Courts have often applied these principles to determine whether mediated agreements should be enforced. Whether to enforce the mediated agreement depends on how essential the alleged indefinite term is. The cases concerning agreement on all essential terms would be resolved by determining whether the disputed term was 'essential enough' to constitute a failure to agree.¹⁰⁴ If the disputed terms were determined to be essential, the mediated agreement would not be enforced for failure to reach a comprehensive agreement. If the additional disputed terms were determined to be non-essential, the mediated agreement would be enforced.

2. Effect of Common Law Fraud or Duress

Contract law voids agreements resulting from fraud.¹⁰⁵ Fraud requires a false representation that is known, or should have been

¹⁰⁰ WILLISTON, *supra* note 94.

¹⁰¹ *Id.*

¹⁰² *Id.*

¹⁰³ *Id.* at 425, *quoted in* Sharp, *supra* note 1, at 151.

¹⁰⁴ Chappell v. Roth, 548 S.E.2d 499 (N.C. 2001) (refusing to enforce entire settlement agreement when a portion of agreement does not constitute "a meeting of the minds"); Weddington Prod., Inc. v. Flick, 71 Cal. Rptr. 2d 265 (1998) (reversing enforcement of mediation agreement after finding a lack of agreement to the essential terms of a licensing agreement, the essence of the parties' conflict); Moore v. Lieberman, 2001 WL 490777 at *1 (Conn. Super. Ct. Apr. 23, 2001) (finding that a failure to agree on the tax structure of a mediated settlement constituted a failure to agree on all essential terms).

¹⁰⁵ Robinson, *supra* note 30, at 155.

known, to be false by the representing party, with the intent to deceive the other party into making a contract.¹⁰⁶ To prove fraud, the defrauded party must show that it believed the falsehood and relied on it in forming the contract.¹⁰⁷ Misrepresentation or concealment may be grounds to invalidate a contract.¹⁰⁸ Courts have applied this principle in determining whether to enforce mediated agreements.¹⁰⁹ The enforceability depends on whether the statements were sufficiently false, whether they were knowingly false, and whether the reliance was justified.¹¹⁰

On its face, the case that the Winklevosses presented would appear to fall under the category of fraud.¹¹¹ The Winklevosses claimed that Facebook and Zuckerberg misled them about Facebook's stock price.¹¹² The Winklevosses seemed to have a plausible case, but their long history of litigation against Facebook and Zuckerberg contributed to the court's cynical assessment of their arguments.¹¹³ Additionally, the Winklevosses employed an army of attorneys and other support personnel that walked them through every step of their litigation.¹¹⁴ The Winklevosses were unlikely to commit a grave misstep with these advisors.¹¹⁵ The Winklevosses' resources and legal savvy likely contributed to the court's dismissal of their fraud argument.¹¹⁶ The court, notwithstanding its cynicism, likely saw the Winklevosses' arguments as those of a desperate litigant simply tossing all of its arguments

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*

¹⁰⁸ *Id.*

¹⁰⁹ *Id.*

¹¹⁰ *Id.* See also *Boyd v. Boyd*, 67 S.W.3d 398 (Tex. App. 2002) (affirming trial court's ruling that divorce settlement was unenforceable because husband failed to disclose a \$230,000 bonus as part of their marital property); *Crupi v. Crupi*, 784 S.2d 611 (Fla. Dist. Ct. App. 2001) (upholding a mediated divorce settlement despite allegations by the ex-wife that her ex-husband had fraudulently misrepresented his financial information during the mediation); *Avary v. Bank of Am.*, 72 S.W.3d 779 (Tex. App. 2002) (determining that there was sufficient evidence of a fraudulently induced settlement agreement to defeat summary judgment and remand for discovery regarding this and other issues); *Brinkerhoff v. Campbell*, 994 P.2d 911, 913 (Wash. Ct. App. 2000) (reversing trial court's order of enforcement and remanding so that an evidentiary hearing could be conducted to determine if misrepresentations were made in a mediation).

¹¹¹ *Facebook, Inc. v. Pac. Nw. Software, Inc.*, 640 F.3d 1034, 1038 (9th Cir. 2011).

¹¹² *Id.*

¹¹³ *Id.* at 1042.

¹¹⁴ *Id.* at 1039.

¹¹⁵ *Id.*

¹¹⁶ *Id.*

against Facebook and Zuckerberg at a wall and seeing what stuck.¹¹⁷

Contract law also recognizes that sometimes one party forces the other party to agree to the terms of a contract.¹¹⁸ When one party forces the other to terms in which they do not agree, there is no meeting of minds; there is only the force of one mind dominating the other in the formation of the written instrument.¹¹⁹ Thus, there is no agreement.¹²⁰ The victimized party can show duress and coercion by proving that the other party pressured them with threats of legal or bodily harm.¹²¹ Duress is shown by a restraint, intimidation, or compulsion to such an extent as to induce another person to commit an act that they are not legally bound to commit and is contrary to their will.¹²² There is an objective standard that some jurisdictions follow that requires the alleged coercive event to be up to a certain level of severity, either threatened, impending, or actually inflicted, so as to overcome the mind and will of a person of ordinary firmness.¹²³ The appropriate test is whether the person has been overcome in such a manner that they acted in a manner contrary to their free will.¹²⁴ If so, the contract may be voided as a result of duress.¹²⁵ The courts must examine the words and actions of the parties involved.¹²⁶ The courts can inquire into whether the complaining party vocalized its concerns during the time of contract formation.¹²⁷

Courts have often applied this principle of contract law to determine whether mediated agreements should be enforced.¹²⁸ The enforceability of the mediated agreement depends on the type and degree of pressure exerted and the effect that pressure had on the other party.¹²⁹ Some courts have required that “duress” must emanate from one who is a party to the contract.¹³⁰ In most cases, the allegation of duress has been rebuffed and the mediated agreement

¹¹⁷ See *Facebook, Inc.*, 640 F.3d at 1042.

¹¹⁸ Robinson, *supra* note 30, at 152.

¹¹⁹ *Id.*

¹²⁰ *Id.*

¹²¹ *Id.*

¹²² *Id.*

¹²³ *Id.* at 152–53.

¹²⁴ Robinson, *supra* note 30, at 153.

¹²⁵ *Id.*

¹²⁶ *Id.*

¹²⁷ *Id.*

¹²⁸ *Id.*

¹²⁹ *Id.*

¹³⁰ Robinson, *supra* note 30, at 168.

enforced.¹³¹ It is a high threshold for a sophisticated party like the Winklevosses to meet. The only arguable “duress” that affected them was that the court forced them into mediation. Once they were dealing with Facebook and Zuckerberg, they were free to take as long as necessary to bargain and resolve the conflict. The Winklevosses possessed broad latitude in striking the right deal and forming a contract to solidify it. While the Winklevosses faced an uphill climb to argue duress, that might not always be the case for smaller investors. Individual investors simply do not have the same bargaining power or the support personnel to defend their interests and negotiate a fair deal. The courts should take a case-by-case approach when deciding these cases, because a one-size-fits-all approach would definitely lead to sub-optimal, or perhaps unfair, outcomes for some mediation participants.

3. Recommended Approaches

The UMA would be an improvement for jurisdictions that maintain strict mediation confidentiality. One designated exception to mediation confidentiality is “a proceeding to prove a claim to rescind or reform a defense to avoid liability on a contract arising out of mediation.”¹³² While this exception allows courts to apply contract law when enforcing mediated agreements, the UMA reflects a strong commitment to mediation confidentiality by imposing numerous conditions and one significant limitation on the implementation of the exception.¹³³

In order to exercise the exception to mediation confidentiality, the UMA requires an *in camera* determination by a judge, administrative agency, or arbitrator that all conditions have been satisfied.¹³⁴ The UMA only permits exceptions to mediation confidentiality after specific findings by a neutral authority.¹³⁵ The evidence sought by breaching mediation confidentiality cannot be available by other means.¹³⁶ Mediation confidentiality should not be pierced just because it is the easier way to acquire evidence that is available by other means.¹³⁷ Thus, the UMA maintains a commitment to protecting mediation confidentiality, but recognizes

¹³¹ *Id.*

¹³² UNIF. MEDIATION ACT § 6(b)(2) (2002).

¹³³ Robinson, *supra* note 30, at 168.

¹³⁴ UNIF. MEDIATION ACT § 6(b).

¹³⁵ Robinson, *supra* note 30, at 168.

¹³⁶ *Id.*

¹³⁷ *Id.*

that acquisition of the necessary evidence may sometimes require the disclosure of the contents of mediation.¹³⁸

The need for the evidence must substantially outweigh the interest in protecting confidentiality. Rule 408 of the Federal Rules of Evidence and its state counterparts provide general evidentiary protection for settlement negotiations.¹³⁹ The Rule prevents the admission of statements and conduct if they were made to advance the underlying substantive claim or defense.¹⁴⁰ The policy reasons for Rule 408's evidentiary exclusion are similar to that of the policy behind mediation confidentiality.¹⁴¹ Rule 408 provides evidentiary protection in order to promote settlement, to foster candor between the parties, and to avoid prejudice where settlement-related statements are construed as an admission of liability or claim of weakness.¹⁴² However, Rule 408 is intentionally limited to the substantive aspects of the underlying claim and does not extend to protect other statements or conduct.¹⁴³ This limiting principle is justified because it promotes an exchange on the underlying merits, but does not provide a cloak for wrongful conduct.¹⁴⁴

III. SECURITIES LAW: MISSTATEMENT AND WAIVER

A. Review of Rule 10b-5

Rule 10b-5 of the Securities Exchange Act of 1934 ("Exchange Act") prohibits fraud, whether by commission or omission, "in connection with the purchase or sale of any security."¹⁴⁵ The Court of Appeals in *Facebook, Inc.* stated, without deciding, that a party negotiating an exchange of shares to settle a lawsuit could violate Rule 10b-5 by misstating or hiding information that would materially change the other side's evaluation of the settlement.¹⁴⁶

Section 29(b) of the Exchange Act voids "[e]very contract made in violation of any provision of [the securities laws] or of any

¹³⁸ *Id.*

¹³⁹ Weston, *supra* note 22, at 44.

¹⁴⁰ *Id.*

¹⁴¹ *Id.*

¹⁴² *Id.*

¹⁴³ *Id.* at 45–46.

¹⁴⁴ *Id.* at 46.

¹⁴⁵ 17 C.F.R. § 240.10b-5 (2012); *see* Green v. Ancora-Citronelle Corp., 577 F.2d 1380, 1382–83 (9th Cir. 1978); Foster v. Fin. Tech., Inc., 517 F.2d 1068, 1071–72 (9th Cir. 1975).

¹⁴⁶ Facebook, Inc. v. Pac. Nw. Software, Inc., 640 F.3d 1034, 1038–39 (9th Cir. 2011).

rule or regulation thereunder, and every contract . . . the performance of which involves [such a] violation.”¹⁴⁷ Section 29 seeks to prevent parties from contractually avoiding the requirements of Rule 10b-5.¹⁴⁸ Under Section 14 of the Securities Act of 1933 (“Securities Act”), any “condition, stipulation, or provision” waiving compliance with either the Securities Act or the Exchange Act is void.¹⁴⁹ The purpose of these sections is to protect investors who must rely on issuers and dealers in securities to make full and fair disclosure of the character of the securities being sold.¹⁵⁰ Issuers and dealers in securities usually have better access than buyers to information concerning the operations, revenues, profitability, and opportunities of a company.¹⁵¹ The advantage that issuers and dealers have is balanced by requiring full disclosure to buyers.¹⁵² The Supreme Court has held that Section 14 was intended to preclude sellers from maneuvering buyers into a position that weakens their ability to recover under the Securities Act.¹⁵³ Allowing a waiver of a party’s right to relief under Rule 10b-5 would be fundamentally inconsistent with Section 14 and Section 29.¹⁵⁴ If one party violated Rule 10b-5, the opposing party would be entitled to a rescission of the agreement.¹⁵⁵

In cases where claims involving a deviation from judicial resolution on the merits are mixed with claims under federal securities laws, there exists a tension: is the claimant entitled to a judicial forum or is the claim subject to a contractual waiver provision that cuts off judicial rights?

Courts will consider the disparity in bargaining power of the parties. Sections 14 and 29(a) were intended primarily to protect the small investor.¹⁵⁶ The courts prioritize the protection of the relatively uninformed individual investor.¹⁵⁷ Critics of this focus contend that it contradicts the directive of the Supreme Court that “[t]o decide issues of law on the size of the person who gets advan-

¹⁴⁷ 15 U.S.C. § 78cc (2010); see *Mills v. Elec. Auto-Lite Co.*, 396 U.S. 375 (1970).

¹⁴⁸ *AES Corp. v. Dow Chem. Co.*, 325 F.3d 174, 184 (3d Cir. 2003) (Clifford, J., concurring).

¹⁴⁹ 15 U.S.C. § 77n (1933).

¹⁵⁰ Samuel H. Gruenbaum, *Avoiding The Protections of the Federal Securities Laws: The Anti-Waiver Provisions*, 20 SANTA CLARA L. REV. 49, 49–52 (1980).

¹⁵¹ *Id.* at 52.

¹⁵² *Id.*

¹⁵³ *Id.* at 54.

¹⁵⁴ *Johnson v. Songwriter Collective, LLC*, 2006 WL 861490 (M.D. Tenn. Mar. 28, 2006).

¹⁵⁵ *Facebook, Inc. v. Pac. Nw. Software, Inc.*, 640 F.3d 1034, 1039 (9th Cir. 2011).

¹⁵⁶ Gruenbaum, *supra* note 150, at 60.

¹⁵⁷ *Id.* at 61.

tage or claims disadvantage is treacherous.”¹⁵⁸ In a dissenting opinion, Justice Douglas said that the Exchange Act does not speak in terms of “sophisticated” and “unsophisticated” people dealing in securities and that the rules should be the same for large financial corporations and individual investors.¹⁵⁹

1. A History of Arbitrating Securities Law Claims

While the cases involving the issue of arbitrating securities claims do not directly address the question of confidentiality agreements barring the introduction of evidence of securities fraud, they provide a useful foundation for understanding the changing position of the courts over time. In 1953, the Supreme Court first addressed the issue of arbitrating securities law claims in *Wilko v. Swan*.¹⁶⁰ In *Wilko*, a broker moved to enforce an arbitration agreement that included an investor’s claim under the Securities Act.¹⁶¹ The Supreme Court held that claims arising under Section 12(2) of the Securities Act were not subject to arbitration.¹⁶² The Court recognized that the Securities Act favored investors over brokers by giving investors an express right of action against brokers under Section 12(2)¹⁶³ and an expanded judicial forum to bring an action under Section 22(a).¹⁶⁴ The Court further justified its ruling by citing Section 14 of the Securities Act, which voided provisions or stipulations that waived compliance with any provision of the Act.¹⁶⁵ Thus, an arbitration clause that limited the investor’s choice of judicial forum was invalid and unenforceable under Section 22(a) of the Securities Act.¹⁶⁶ According to the Court, arbitration was an inadequate method of dealing with conflicts between investors and brokers because of the restricted judicial examination of an arbitration decision, the lack of recordkeeping in the arbitration process, and the lack of an explanation for an arbitration determination.¹⁶⁷ Despite Congress’ pro-

¹⁵⁸ *Id.* at 62 (citing *Bruce’s Juices, Inc. v. American Can Co.*, 330 U.S. 743, 753 (1947)).

¹⁵⁹ *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 526 (1974) (Douglas, J., dissenting).

¹⁶⁰ *Wilko v. Swan*, 346 U.S. 427 (1953).

¹⁶¹ *Id.* at 430–31.

¹⁶² *Id.* at 438.

¹⁶³ 15 U.S.C. § 771(2) (1974); *see also Wilko*, 346 U.S. at 431.

¹⁶⁴ 15 U.S.C. § 77v (2010).

¹⁶⁵ *Wilko*, 346 U.S. at 434–35.

¹⁶⁶ *Id.*

¹⁶⁷ *Id.* at 432–35. *See also* A. Robert Lamb, Jr., *Securities-Arbitration-Predispute Arbitration Agreements Enforceable Against Investors Filing Claims Under Section 10(b) of the Securities Exchange Act of 1934*, 19 ST. MARY’S L.J. 753, 758 (1988).

motion of arbitration, *Wilko* created an exception to forced arbitration for claims under the Securities Act.¹⁶⁸

After *Wilko*, federal appeals courts extended *Wilko*'s analysis of Securities Act claims to securities claims brought under the Exchange Act.¹⁶⁹ Courts prohibiting arbitration of Section 10(b) claims reasoned that the anti-waiver provision in the Exchange Act was analogous to the Section 14 waiver provision in the Securities Act.¹⁷⁰ These courts considered both the Securities Act and the Exchange Act to empower investors with a choice of jurisdictions in which to bring securities actions.¹⁷¹ Up until that point, the Supreme Court had never expressly prohibited extending the *Wilko* analysis to Exchange Act claims, but the Supreme Court expressed reservations about the actions of various federal courts in a later case, *Scherk v. Alberto-Culver Co.*

In *Scherk*, the Supreme Court expressed doubt about the extension of *Wilko* to Section 10(b) claims.¹⁷² In the majority opinion, Justice Stewart explained that the Court's skepticism arose from the absence of any specific provision in the Exchange Act that would provide the investor with a right to a "private remedy to redress violations."¹⁷³ The federal appellate courts' extension of *Wilko* to Exchange Act claims would be attacked again ten years after *Scherk*.¹⁷⁴ In *Dean Witter Reynolds, Inc v. Byrd*, Justice White challenged the validity of *Wilko*'s extension to Exchange Act claims with two distinctions.¹⁷⁵ Section 10(b) of the Exchange Act did not expressly provide a cause of action, but judicially implied a private remedy, whereas Section 12(2) of the Securities Act stated an express cause of action.¹⁷⁶ Additionally, Section 27 of the Exchange Act limited jurisdiction to the federal courts, whereas Section 22(a) of the Securities Act extended jurisdiction to both federal and state courts, while prohibiting removal from the state courts.¹⁷⁷ Justice White concluded that because the cause of action and jurisdictional provisions are distinct within each Act, the anti-

¹⁶⁸ *Wilko*, 346 U.S. at 438; See also Lamb, *supra* note 167, at 758.

¹⁶⁹ Lamb, *supra* note 167, at 759.

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 513–14 (1974).

¹⁷³ *Id.* at 513.

¹⁷⁴ Lamb, *supra* note 167, at 761.

¹⁷⁵ *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 216 (1985).

¹⁷⁶ *Id.* at 225. Compare 15 U.S.C. § 78j (1982) (judicially implied right of action), with 15 U.S.C. § 77i (1982) (express cause of action).

¹⁷⁷ *Byrd*, 470 U.S. at 225.

waiver provision in the Exchange Act would not void arbitration of a Section 10(b) claim.¹⁷⁸ The Supreme Court ultimately declined to extend *Wilko*'s express cause of action under Section 12(2) of the Securities Act to Section 10(b) of the Exchange Act.¹⁷⁹

After the Supreme Court's reluctance to extend *Wilko* to Section 10(b) claims, several courts of appeals began to issue conflicting decisions.¹⁸⁰ To resolve the dispute among the circuits, the Supreme Court agreed to hear *Shearson/American Express, Inc. v. McMahon*.¹⁸¹ In *McMahon*, the Supreme Court held that pre-dispute arbitration agreements were enforceable against investors who had filed their claims pursuant to Section 10(b) of the Exchange Act.¹⁸² Writing for the majority, Justice O'Connor relied on the Arbitration Act for support in upholding pre-dispute arbitration agreements.¹⁸³ The Court rejected the contention that Congress intended resolution of Section 10(b) claims to occur in a judicial forum and maintained that Section 27 of the Exchange Act was merely a jurisdictional provision that prescribed no statutory duty on a broker to comply with the Exchange Act.¹⁸⁴ Therefore, a waiver of Section 27 would not result in a waiver under Section 29(a) compliance with any section in the Exchange Act.¹⁸⁵ The Court failed to find legislative intent for the Exchange Act's requirement that Section 10(b) claims be resolved in court rather than through arbitration.¹⁸⁶ Furthermore, the Court maintained that arbitration would not result in an unlawful waiver of an investor's "substantive protections," as these substantive rights would be resolved by an arbitrator rather than in a judicial proceeding.¹⁸⁷

The evolution of the law concerning compelled arbitration of securities claims suggests that the courts have been waiting for Congress to take action in providing a blueprint for the courts to follow. In the absence of a clear congressional mandate or rebuke of higher courts, these judicially-created rules will stand. While the cases in this sequence do not exactly deal with the situation in *Facebook, Inc.*, they are instructive as to the extent to which the

¹⁷⁸ *Id.* at 224–25.

¹⁷⁹ *Id.*

¹⁸⁰ Lamb, *supra* note 167, at 762.

¹⁸¹ *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220 (1987).

¹⁸² *Id.* at 237.

¹⁸³ *Id.* at 225.

¹⁸⁴ *Id.* at 228–29.

¹⁸⁵ *Id.*

¹⁸⁶ *Id.* at 227–29.

¹⁸⁷ *Shearson/Am. Express, Inc.*, 482 U.S. at 229.

courts will invalidate provisions waiving the right to introduce evidence of fraud to support a securities claim.

B. *Effect of Confidentiality on Rule 10b-5: Should a Confidentiality Agreement Precluding the Introduction of Evidence be Considered a Waiver?*

If parties can agree that nothing said in their negotiations could ever be evidence of securities fraud, that agreement would essentially be an impermissible advance waiver of any claim of securities fraud to which Sections 14 and 29(b) of the Exchange Act would apply. The remedial aspects of the Securities Act cannot be waived either directly or indirectly.¹⁸⁸

A defendant may argue that a “no-action clause” that prevents either party from bringing an action proving that a resolution was fraudulently acquired does not constitute a “waiver,” but rather establishes a procedure that must be allowed before an action may be brought.¹⁸⁹ The defendant can analogize the “no-action clause” to an arbitration clause and claim that both clauses are merely procedural limitations.¹⁹⁰ However, at least one court has rejected this argument.¹⁹¹ Arbitration clauses are enforceable under federal securities laws because they are procedural in nature and do not serve to waive compliance with provisions of substantive law.¹⁹² According to the Supreme Court in *Shearson/American Express v. McMahon*, the Securities and Exchange Commission (“SEC”) has sufficient statutory authority to ensure that arbitration is adequate to vindicate Exchange Act rights.¹⁹³ A no-action clause in this case can operate to bar a plaintiff from exercising its substantive rights under federal securities law.¹⁹⁴

In *Facebook, Inc.*, the Winklevosses maintained that they did not discover the facts giving rise to their Rule 10b-5 claims until after they signed the release clauses in the Settlement Agreement.¹⁹⁵ They argued that the releases did not preclude their challenge of the Settlement Agreement because Sections 29(a)

¹⁸⁸ *Can-Am Petroleum Co. v. Beck*, 331 F.2d 371, 373 (10th Cir. 1964).

¹⁸⁹ *McMahan & Co. v. Warehouse Entm't, Inc.*, 65 F.3d 1044, 1051 (2d Cir. 1995).

¹⁹⁰ *Id.*

¹⁹¹ *Id.*

¹⁹² *Id.*

¹⁹³ *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220, 238 (1987).

¹⁹⁴ *McMahan & Co.*, 65 F.3d at 1051.

¹⁹⁵ *Facebook, Inc. v. Pac. Nw. Software, Inc.*, 640 F.3d 1034, 1040 (9th Cir. 2011).

prohibits a mutual release of unknown securities fraud claims arising out of negotiations to settle a pending action.¹⁹⁶

Despite the Winklevosses' inability to exercise their substantive rights under the Securities Act and the Exchange Act, the court premised its decision on the sophistication of the parties and the desire for an end to the long saga of litigation.¹⁹⁷ The court believed that the Winklevosses were a sophisticated party that should have known that such a broad release would preclude known and unknown securities violations claims.¹⁹⁸ The court dismissed the Winklevosses' claim that the Confidentiality Agreement was void under Section 29(a) of the Exchange Act as an invalid waiver.¹⁹⁹ According to the court, the Confidentiality Agreement merely precluded both parties from introducing evidence of a certain kind, and did not operate to limit or waive the Winklevosses' right to sue.²⁰⁰

Despite the court's differentiation, the distinction between the Confidentiality Agreement's bar on introduction of evidence and the lack of a limit or waiver on the petitioner's right to sue is almost nonexistent here. If the plaintiffs cannot bring in specific forms of evidence, then their right to sue for violations of securities laws is limited and their claims are frustrated by the weakness of their case and lack of evidence. Their case reaches the same result as if the court had just prevented plaintiffs from bringing a suit in the first place.

The court provides that even if it were to construe the Confidentiality Agreement as a waiver of the Winklevosses' 10b-5 claims, it would not violate Section 29(a) because the plaintiff "affirmatively acted to release another party from any possible liability in connection with a transaction in securities" and thus are "not so concerned with protecting their rights as investors as they [are] with establishing a general peace."²⁰¹ While the court's reasoning is sensible, it is not consistent with the court's position that the Winklevosses, as Facebook's competitors, wanted to gain from litigation what they could not achieve in the marketplace. If the Winklevosses were committed to a long saga of litigation against Facebook, then they would not have agreed to such a restrictive

¹⁹⁶ *Id.* at 1039–40.

¹⁹⁷ *Id.* at 1039.

¹⁹⁸ *Id.*

¹⁹⁹ *Id.* at 1041–42.

²⁰⁰ *Id.* at 1041.

²⁰¹ *See Facebook, Inc.*, 640 F.3d at 1041–42.

Confidentiality Agreement in pursuit of “a general peace,” despite the court order to mediate this dispute.

IV. RECONCILING CONTRACT, MEDIATION AND SECURITIES LAW

Often, fraud claims can be waived by contracts, but that is not necessarily the case in a securities context because a statute is implicated. The Exchange Act is a federal mandate that includes all transactions involving securities. It would seemingly govern here, when corporations are negotiating the release of legal claims in mediated settlements by exchanging securities instead of cash. The courts should not ignore legislative intent and the essential purpose of the Exchange Act—to protect investors who might not have the resources to protect themselves against large institutional brokers and issuers.

It seems unnecessary for courts to prohibit parties absolutely from knowingly agreeing in advance to submit future claims to arbitration or waiving their right to introduce evidence in a subsequent claim related to the enforcement of the settlement.²⁰² The prohibition is sensible when it applies to an unwary and eager investor who signs an agreement filled with exceptions and restrictions in fine print.²⁰³ The majority of cases involving anti-waiver provisions involve investors who have little, if any, understanding of the potential consequences of these complex agreements.²⁰⁴ Not only are investors typically not aware of the consequences of their actions, they have little say in the matter.²⁰⁵ When a subsequent controversy develops, the investor will either proceed to blindly go along with what he thinks is a binding and enforceable agreement or the investor will complain and seek judicial relief from what he believes is unfair.²⁰⁶ Under these circumstances, it makes sense to invalidate prior agreements to arbitrate a future controversy or waive the right to introduce evidence in future proceedings related to the enforcement of a settlement.²⁰⁷

²⁰² See Gruenbaum, *supra* note 150, at 60.

²⁰³ *Id.*

²⁰⁴ *Id.*

²⁰⁵ *Id.*

²⁰⁶ *Id.*

²⁰⁷ *Id.*

There is considerably less case law involving two adversarial parties who are both either institutional investors or other large corporate entities. When such well-informed parties to a contract “know and fully appreciate” the potential ramifications of their agreement to arbitrate or resolve future conflicts, former SEC attorney Samuel H. Gruenbaum believes that it would be highly inappropriate to prohibit them from doing so.²⁰⁸ An informed decision to waive certain forms of relief in the event of a future conflict should be binding as part of a bargained-for package of rights and duties.²⁰⁹ Gruenbaum argues that such an agreement does not relieve either party from abiding by the law; it only limits their “avenues of relief” when there is a disagreement.²¹⁰ Gruenbaum concludes that when such a limitation is knowingly imposed as part of an agreed-upon exchange, then the courts should not step in and invalidate the agreement.²¹¹ Interestingly, Gruenbaum does not consider the exact situation posed by *Facebook, Inc.* There are potential situations in which a party has committed fraud and, if the agreement were binding, the victimized party would be unable to introduce evidence of such fraud. Maintaining this agreement would effectively relieve the party that committed fraud of abiding by relevant securities laws. While the parties may have mutually agreed on such a limitation, one party may have begrudgingly agreed, in hopes of completing a deal and ending litigation, only to regret agreeing to the limitation once it realized that it had been defrauded.

In *McMahon*, the plaintiffs’ argument for finding a waiver of their Section 10(b) rights is that arbitration actually “weakens their ability to recover under the [Exchange] Act.”²¹² In a stern dissent, Justice Blackmun assailed the majority’s position that *Wilko* dealt solely with the inadequacies of arbitration as an enforcement mechanism for the Securities Act; that arbitration had improved significantly since *Wilko*; and that, because of these circumstances, *Wilko* was outdated.²¹³ Justice Blackmun pointed out that such a narrow reading of *Wilko* overlooked the importance of creating an exception to arbitration of securities claims.²¹⁴ Justice Blackmun

²⁰⁸ Gruenbaum, *supra* note 150, at 68.

²⁰⁹ *Id.*

²¹⁰ *Id.*

²¹¹ *Id.*

²¹² *Shearson/Am. Express, Inc. v. McMahon*, 482 U.S. 220, 231 (1987).

²¹³ Lamb, *supra* note 167, at 764.

²¹⁴ *Shearson/Am. Express, Inc.*, 482 U.S. at 250 (Blackmun, J., dissenting).

focused on the majority's failure to protect investors.²¹⁵ Additionally, the position that arbitration procedures had greatly improved since *Wilko* is debatable.²¹⁶ Arbitrators typically did not keep records or explain their awards because judicial examination of their awards was relatively infrequent.²¹⁷

Justice Blackmun's argument can be applied to the *Facebook, Inc.* situation with a few modifications. Once mediation is substituted for arbitration, it is evident that mediation confidentiality may fail to protect investors from being taken advantage of and prevent investors from seeking remedies under securities laws. Mediators are protected by the veil of confidentiality and do not need to explain how the parties settled. If an investor was compelled or coerced into mediation and was unable to employ the services of lawyers, bankers and consultants, then the investor would open himself up to being defrauded by brokers who have more resources and more experience in negotiating with clients. Certainly, this debate largely turns on the relative bargaining power of the parties. In *Facebook, Inc.*, the Court of Appeals was aware that the Winklevosses had engaged in years of litigation against Facebook and that both sides were firmly entrenched and likely to bitterly contest every last detail of the settlement. The Ninth Circuit's understanding of the two parties' motivation helped the court resolve the issues between the two sides. However, the explanation for the decision in *Facebook, Inc.* is very fact-specific. Where investors and brokers are not as intimately familiar with each other as are Facebook and the Winklevosses, there is room for the courts to look at the situation through a wider lens and determine that a non-institutional investor may not have the financial resources, technical knowledge and negotiation experience to hold its own.

However, if courts allowed the introduction of evidence as to communications made during the mediation, then one of the fundamental axioms of mediation—confidentiality—would be violated. Confidentiality is considered necessary to foster the neutrality of the mediator and is essential if parties are to participate fully and in good faith in the mediation process.²¹⁸ If there is little protection of confidentiality, then parties will be less likely to seriously

²¹⁵ *Id.* at 245–46.

²¹⁶ *Id.* at 250–51.

²¹⁷ *Id.* at 256.

²¹⁸ Ellen E. Deason, *Enforcing Mediated Settlement Agreements: Contract Law Collides with Confidentiality*, 35 U.C. DAVIS L. REV. 33, 35 (2001).

negotiate, which would essentially defeat the purpose of emphasizing mediation as a form of alternative dispute resolution to avoid the judicial process and conserve judicial resources.

On the other hand, many critics of strict mediation confidentiality rules view the need for a broad confidentiality privilege exclusive to mediation as more axiomatic than proven.²¹⁹ The most commonly stated justification for the heightened protection is that mediation is a unique process, the effectiveness of which depends on the parties' candor, informal exchange, and belief that what takes place in mediation will remain confidential.²²⁰ Legislatures have similarly concluded that according broad confidentiality to mediation proceedings facilitates the resolution of disputes by private negotiations.²²¹ Despite its desirability, protection for confidentiality may shield participants from punishment for unethical or illegal actions in mediation.²²² Legislative involvement also raises constitutional questions and threatens separation of powers and federalism, where statutory confidentiality may potentially infringe on a court's ability to regulate and sanction litigants for abuses or misconduct in court-ordered mediation.²²³

V. CONCLUSION

Ultimately, securities laws should govern because the courts should not allow corporate actors to perpetuate fraud on parties who had no choice, but to participate in court-ordered mediation. While the further promotion and popularization of mediation is a desirable trend for courts and their overloaded dockets, and while confidentiality is a vital part of that development, there should be continued vigilance against parties who take advantage of their sophistication, experiences, and resources in an attempt to prevail in a winner-take-all manner. In an unsettling age of widespread corporate abuses, courts need to reemphasize the importance of securities laws already in place and ensure the efficacy of laws so that smaller, non-institutional parties will be protected, even if it means sacrificing some of the positive aspects of mediation.

²¹⁹ Weston, *supra* note 22, at 33.

²²⁰ *Id.*

²²¹ *Id.*

²²² *Id.*

²²³ *Id.* at 33–34.

It is important to keep in mind the ultimate goal of ADR: to resolve disputes outside of the judicial process. An alternative to a formal court hearing or bitterly contested litigation is not only beneficial to the courts and their unmanageable caseloads, but is also often the most optimal outcome for parties even if both sides have a lot of resources. As technology start-ups continue to proliferate, securities offered in exchange for settlement of disputes will become more popular and correspondingly more contested in the courts. Many start-ups with prospects of blockbuster growth acquire and retain their talent and resolve potentially costly disputes by dangling packages with little present value, but potentially handsome rewards down the line. The best evidence for this phenomenon is Facebook and its highly successful initial public offering. Thus, the more popular that this practice of offering securities in place of regular compensation, the more that large and small companies will be vulnerable to these types of lawsuits. ADR is a way for both parties to resolve these issues quickly, economically, and relatively painlessly. However, ADR must not protect actors who engage in securities fraud against the other party at the cost of the most logical and fair outcome. When that is the case, the federal securities laws concerning fraud should govern over mediation confidentiality laws to ensure an equitable outcome.