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Settle Without Making A Few Enemies

The litigation saga of the Winklevosses versus Facebook was depicted in the recent movie *The Social Network*. The high-stakes lawsuit settled in mediation with a handwritten agreement less than one-and-a-half pages in length. The settlement fell apart post-mediation when the parties could not agree to the form of the final deal documents drafted by Facebook. At issue was whether the agreement signed at mediation was enforceable.¹

Facebook attempted to enforce the short “term sheet” agreement, which provided that it would acquire all of the Winklevoss’ ConnectU shares in exchange for cash, a percentage of Facebook stock, mutual releases and a waiver of claims. The Winklevosses asserted that the short agreement was unenforceable because it lacked material terms and was procured by fraud. The missing “material” terms, according to the Winklevosses, were later presented in lengthy stock purchase and shareholder agreements which they refused to sign. The district court found the short agreement enforceable and ordered the Winklevosses to transfer all ConnectU shares to Facebook.

Upon review, the Ninth Circuit distinguished a “necessary term, without which there can be no contract,” from an “important term that affects the value of the bargain.” Omitting the former renders the contract a nullity. However, an agreement that omits the latter is enforceable if the terms are “sufficiently definite for a court to determine whether a breach has occurred, order specific performance or award damages.” The short agreement easily passed this low-threshold test.

The agreement also delegated to Facebook the task of drafting final documents to supply the alleged missing “material” terms. If Facebook were to abuse its contractual delegation duties by drafting unfair or oppressive terms, the court could reject those terms as a breach of the implied covenant of good faith and fair dealing. However, delegation was not necessary for the agreement to be enforceable, “as the court may fill in missing terms by reference to the rest of the contract, extrinsic evidence and industry practice.”

To lock settlement the first time, plan ahead and bring settlement templates and specialized clauses to the mediation. If the circumstances require a “term sheet,” make it as definite as possible so the court won’t have to figure it out later. If a longer final agreement is to follow, comport with the term sheet constraints and don’t overreach.

¹ *Facebook, Inc. v. Pacific Northwest Software, Inc.*, 640 F.3d 1034 (9th Cir. 2011)