Study K-402 October 27, 2014

Memorandum 2014-45

Relationship Between Mediation Confidentiality and Attorney Malpractice and Other Misconduct: Federal Law

Federal court decisions are an important source of information about mediation confidentiality. This memorandum for the Commission[1] begins to explore federal cases that bear on the relationship between mediation confidentiality and attorney malpractice and other misconduct. It focuses on a federal decision of particular importance in the development of California law in the area: *Olam v. Congress Mortgage Co.*[2]

The *Olam* decision was issued in 1999 by U.S. Magistrate Judge Wayne Brazil, a national and international innovator and leader in the field of alternative dispute resolution. It was one of the first decisions to interpret California law on mediation confidentiality, and to discuss the choice-of-law issues applicable to a mediation confidentiality issue arising in a federal case.

In this memorandum, the staff first describes the facts and procedural background of the case. Next, we explain Judge Brazil's choice-of-law analysis. We then turn to his analysis of the mediation confidentiality issues and how he applied that legal analysis to the facts at hand. Finally, we discuss the current status of *Olam* in California, and offer a few words on how the decision relates to the Commission's ongoing study.

FACTS AND PROCEDURAL BACKGROUND

Olam involved a dispute between a borrower (Donna Olam) and a lender regarding a loan secured by two homes. The lender commenced foreclosure proceedings after the borrower allegedly defaulted on the loan. Thereafter, the

1. Any California Law Revision Commission document referred to in this memorandum can be obtained from the Commission. Recent materials can be downloaded from the Commission's website (www.clrc.ca.gov). Other materials can be obtained by contacting the Commission's staff, through the website or otherwise.

The Commission welcomes written comments at any time during its study process. Any comments received will be a part of the public record and may be considered at a public meeting. However, comments that are received less than five business days prior to a Commission meeting may be presented without staff analysis.

2. 68 F. Supp. 2d 1110 (N.D. Cal. 1999).

borrower and lender engaged in work-out negotiations, these were followed by further foreclosure proceedings and more work-out negotiations, and then the borrower brought suit against the lender and related parties in state court. Because the suit included a claim under the federal Truth in Lending Act, not just state law claims for fraud and breach of fiduciary duty, the defendants were able to remove the case to federal court.

On the agreement of the parties, the case was assigned to Judge Brazil, who eventually referred the matter to mediation under the court-sponsored ADR program, "with the fully voluntary consent of the parties."[3] An extensively trained mediator on the court's staff conducted the mediation. After a long day of negotiations, the parties prepared and signed a Memorandum of Understanding ("MOU"), which "contemplated the subsequent preparation of a formal settlement contract but expressly declared that it was 'intended as a binding document itself.'"[4]

Months passed, but the borrower never signed the formal settlement contract contemplated in the MOU. Consequently, the lender and the other defendants filed a motion to enforce the settlement agreement and enter judgment accordingly. The borrower opposed the motion, alleging that when she signed the MOU she "was incapable (intellectually, emotionally, and physically) of giving legally viable consent."[5] More specifically, she contended that she was subjected to "undue influence" under California law because "she was suffering from physical pain and emotional distress that rendered her incapable of exercising her own free will."[6]

To facilitate resolution of the dispute over the enforceability of the MOU, all of the parties clearly and expressly waived any "mediation privilege" that might attach to communications that were made during the mediation (with some limitations that are not necessary to describe here).[7] To avoid putting the mediator "in an awkward position where he might have felt he had to choose between being a loyal employee of the court, on the one hand, and, on the other, asserting the mediator's privilege under California law," Judge Brazil "proceed[ed] on the assumption that [the mediator] was respectfully and

3. *Id.* at 1116.
4. *Id.* at 1117.
5. *Id.* at 1118.
6. *Id.*
7. *Id.* at 1118-19, 1129-30.

appropriately asserting the mediator's privilege and was formally objecting to being called to testify about anything said or done during the mediation."[8]

CHOICE OF LAW ANALYSIS

Before resolving whether mediation evidence could be used to resolve the parties' dispute over the enforceability of the MOU, Judge Brazil had to decide whose law to apply: state or federal. Understanding the choice-of-law rules applicable in federal court is relevant to this study, because they affect the degree to which California's statutes protecting mediation communications, and the policies underlying those statutes, will be enforced when a dispute is litigated in a federal court rather than a California court. While it is not necessary to get into all of the details of federal jurisdiction, it would be helpful to have a general grasp of the basic principles applied in cases involving mediation evidence. Thus, we briefly explain Judge Brazil's choice-of-law analysis here, and will provide further information on choice-of-law issues in our next memorandum on federal law.

Judge Brazil began his choice-of-law analysis by explaining that "[w]hen pressed to determine whose law to apply, it is important not to proceed in the abstract, but to ask: apply to what?"[9] In *Olam*, he identified four different matters that could require a choice-of-law decision:

(1) What law applies to the borrowers' underlying claims?
(2) What law applies to the defendants' claim that the mediation produced an enforceable contract?
(3) What law applies in determining whether, and to what extent, communications and conduct occurring during the mediation are protected from disclosure or subsequent evidentiary use?
(4) What law dictates which procedures a federal court should use in determining whether to admit evidence that is protected by a privilege under state law?[10]

Judge Brazil answered those questions as described below.

8. *Id.* at 1130.
9. *Id.* at 1119.
10. *Id.*

What Law Applies to the Borrowers' Underlying Claims?

The borrowers' underlying claims were not before the court when Judge Brazil was ruling on the defendants' motion to enforce the MOU. Thus, he did not have to deal with this choice-of-law question.

What Law Applies to the Defendants' Claim that the Mediation Produced an Enforceable Contract?

The ultimate issue in *Olam* was "whether the parties entered an enforceable contract at the close of the mediation session."[11] As Judge Brazil pointed out, "[t]hat is a question of contract law — and there is no general federal law of contracts."[12] Thus, he said that in resolving this issue, "the rule of decision will be supplied by the substantive law of the state of California."

What Law Applies in Determining Whether it is Appropriate to Consider Evidence About What Happened During the Mediation?

Before reaching the ultimate issue in *Olam*, Judge Brazil had to resolve whether to consider evidence of what happened during the mediation, and, if so, how much such evidence to consider. As a threshold matter, he had to decide whether California's mediation confidentiality provisions would govern that determination, or whether federal law would apply instead.

In resolving this choice-of-law issue, he focused on Federal Rule of Evidence 501, which directs that "in civil actions and proceedings, with respect to an element of a claim or defense as to which State law supplies the rule of decision, the privilege of a witness … shall be determined in accordance with State law." His analysis was lengthy, but the crux of it is as follows:

> Defendants' motion to enforce the settlement agreement is a civil proceeding in which state law, and only state law, provides the rule of decision. The only question that motion raises is whether the parties entered an enforceable contract at the conclusion of the mediation — and the rule of decision for resolving this one substantive question will have only one source — the substantive law of the state of California.
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> Given these undisputed and foreseeable circumstances, the parties should have understood, before their mediation, that if, later, one party initiated proceedings designed to secure a determination that the mediation produced an enforceable settlement contract, *disputes about the confidentiality of mediation*

11. *Id.*
12. *Id.*

communications would be resolved in those proceedings by applying the law of the state of California.[13]

What Law Dictates Which Procedures a Federal Court Should Use in Deciding Whether to Admit Evidence Protected by a Privilege Under State Law?

The last choice-of-law issue in *Olam* was whether the federal court was "bound, under [*Erie Railroad Co. v. Tompkins*[14]] and its progeny, or under F.R.E. 501, to follow the procedures that the courts of the state of California would follow when … determining what evidence from the mediation, if any, to admit at the hearing to determine whether the parties entered an enforceable settlement …."[15] In other words, "must federal courts, in crafting procedures designed to invade as little as possible the interests that support the state privilege law, while assaying the evidentiary importance of the otherwise protected communications, use the exact same procedures that California courts have chosen for this purpose?"[16]

Judge Brazil's answer to this question was "no," a federal court does not have to follow the exact same procedures that a state court would use. Rather, he could use a different procedure so long as it "would substantially parallel in *effect* the procedure adopted by the courts of California, and, in that parallelism, would cause no greater harm to substantive privilege interests than California courts would be prepared to cause."[17]

MEDIATION CONFIDENTIALITY ANALYSIS AND APPLICATION OF THAT ANALYSIS TO *OLAM*

Having resolved the choice of law issues, Judge Brazil turned to the mediation confidentiality issues.

Waiver Analysis

To start, Judge Brazil described California's statutory scheme[18] and, applying California law, carefully determined that the parties had complied with the requirements of Evidence Code Section 1122(a)(1) and thus effectively waived their rights to prevent use of evidence from the mediation.[19]

13. *Id.* at 1121 (emphasis added).
14. 304 U.S. 64 (1938).
15. *Olam*, 68 F. Supp. 2d. at 1125-26 (emphasis in original).
16. *Id.* at 1126.
17. *Id.* (emphasis in original).
18. *Id.* at 1128-29.
19. *Id.* at 1129-30.

He then noted that "California law confers on mediators a privilege that is independent of the privilege conferred on parties to a mediation."[20] Consequently, he explained, "a waiver of the mediation privilege by the parties is not a sufficient basis for a court to permit or order a mediator to testify."[21] Instead, he said that "an independent determination must be made before testimony from a mediator should be permitted or ordered."[22]

As previously discussed, Judge Brazil assumed that the mediator *did not* waive California's protections for mediation communications. He further determined that California Evidence Code Section 703.5, making mediators generally incompetent to testify, should be construed to "impos[e] an independent duty on the courts to determine whether testimony from a mediator should be accepted," regardless of whether the mediator objects to testifying.[23] Thus, he proceeded to explain how the court should conduct the required independent determination.

Two-Stage Balancing Analysis

In deciding how to conduct the required independent determination of whether to compel the mediator to testify, Judge Brazil viewed *Rinaker v. Superior Court*[24] as the "most important opinion by a California court in this arena."[25] He explained that "the *Rinaker* court held that the mediator could be compelled to testify if, after *in camera* consideration of what her testimony would be, the trial judge determined that her testimony might well promote significantly the public interest in preventing perjury and the defendant's fundamental right to a fair judicial process."[26]

Judge Brazil then described in detail his view on the *Rinaker* procedure:

> In essence, the *Rinaker* court instructs California trial judges to conduct a two-stage balancing analysis. The goal of the first stage balancing is to determine whether to compel the mediator to appear at an *in camera* proceeding to determine precisely what her testimony would be. In this first state, the judge considers all the circumstances and weighs all the competing rights and interests, including the values that would be threatened not by public disclosure of mediation communications, but by ordering the

20. *Id.* at 1130.
21. *Id.*
22. *Id.*
23. *Id.*
24. 62 Cal. App. 4th 155, 74 Cal. Rptr. 2d 464 (1998).
25. *Olam,* 68 F. Supp. 2d at 1131.
26. *Id.*

> mediator to appear at an *in camera* proceeding to disclose only to the court and counsel, out of public view, what she would say the parties said during the mediation. At this juncture the goal is to determine whether the harm that would be done to the values that underlie the mediation privileges simply by ordering the mediator to participate in the *in camera* proceedings can be justified — by the prospect that her testimony might well make a singular and substantial contribution to protecting or advancing competing interests of comparable or greater magnitude.
>
> The trial judge reaches the second stage of balancing analysis only if the product of the first stage is a decision to order the mediator to detail, *in camera*, what her testimony would be. A court that orders the *in camera* disclosure gains precise and reliable knowledge of what the mediator's testimony would be — and only with that knowledge is the court positioned to launch its second balancing analysis. In this second stage the court is to weigh and comparatively assess (1) the importance of the values and interests that would be harmed if the mediator was compelled to testify (perhaps subject to a sealing or protective order, if appropriate), (2) the magnitude of the harm that compelling the testimony would cause to those values and interests, (3) the importance of the rights or interests that would be jeopardized if the mediator's testimony was not accessible in the specific proceedings in question, and (4) how much the testimony would contribute toward protecting those rights or advancing those interests — an inquiry that includes, among other things, an assessment of whether there are alternative sources of evidence of comparable probative value.[27]

Judge Brazil also stated that "the fundamental character of the balancing analysis that we are to use to determine whether a mediator should be compelled to testify in a subsequent civil proceeding *is the same* under sections 703.5 and 1119."[28]

Judge Brazil's Procedure

As previously explained, in his choice-of-law analysis Judge Brazil decided that a federal court does not have to follow the exact same procedures that a state court would use in determining whether to compel a mediator to testify, so long as the procedures it uses are similar in effect to the state court procedures and cause no greater harm to the interests underlying the mediation confidentiality statute. In the case at hand, he "decided not to hold a separate *in camera* proceeding in advance of the evidentiary hearing to determine what the

27. *Id.* at 1131-32.
28. *Id.* at 1132 (emphasis added).

mediator's testimony would be."[29] A number of case-specific circumstances motivated that decision, including:

- Using the *in camera* approach would have created a substantial risk that the mediator would have to testify twice, first *in camera* and then during the evidentiary hearing itself.
- The mediation had lasted many hours and Judge Brazil had reason to believe that it involved considerable interaction between the mediator and the borrower complaining of undue influence. Consequently, the mediator was likely to have substantial personal knowledge of matters central to the issue at hand.
- It seemed probable that there would be much contradictory testimony and "relative to all the other witnesses, the mediator's testimony was least likely to be infected (unconsciously or otherwise) by self-interest or some other motivation that would raise obvious questions about accuracy."[30]

Instead, Judge Brazil called the mediator to testify at the evidentiary hearing, but only after all of the other key witnesses had testified, and he took the mediator's testimony in closed proceedings, under seal. At that point, he "was positioned to determine much more reliably whether, or to what extent, overriding fairness interests required [him] to use and publicly disclose testimony from the mediator in making [his] decision about whether the parties had entered an enforceable settlement contract."[31]

First Stage Balancing Analysis

In the first stage of the two-part test described above, Judge Brazil decided that "it was necessary to determine (through sealed proceedings) what [the mediator's] testimony would be.[32] In other words, he determined that the factors pointing in favor of requiring the mediator to testify outweighed the factors pointing against such testimony.

His analysis is lengthy, so we do not repeat all of it here. Some of the factors he found that pointed against compelling the mediator's testimony were:

- Requiring a mediator to testify, "even *in camera* or under seal, about what occurred during a mediation threatens values underlying the mediation privileges."[33] The California Legislature enacted its mediation confidentiality statute "in the belief that

29. *Id*. at 1126.
30. *Id*. at 1126-28.
31. *Id*. at 1128.
32. *Id*. at 1133.
33. *Id*.

without the promise of confidentiality it would be appreciably more difficult to achieve the goals of mediation programs."[34] But this state policy has "appreciably less force when, as here, the parties to the mediation have waived confidentiality protections, indeed have asked the court to compel the mediator to testify — so that justice can be done."[35]

Further, Judge Brazil's "partially educated guess" was that "the likelihood that a mediator or the parties in any given case need fear that the mediator would later be constrained to testify is extraordinarily small."[36] Thus, he thought that the level of harm to the interests underlying the mediation confidentiality statute would be commensurate.[37]

- "[O]rdering mediators to participate in proceedings arising out of mediations imposes economic and psychic burdens that could make some people reluctant to agree to serve as a mediator, especially in programs where that service is pro bono or poorly compensated."[38]
- "Good mediators are likely to feel violated by being compelled to give evidence that could be used against a party with whom they tried to establish a relationship of trust during a mediation."[39] "To force them to give evidence that hurts someone from whom they actively solicited trust … rips the fabric of their work and can threaten their sense of the center of their professional integrity."[40] But "the magnitude of these risks can vary with the circumstances," and are reduced when the parties agree to have the mediator testify.[41]
- "The magnitude of the risk to values underlying the mediation privileges that can be created by ordering a mediator to testify … can vary with the nature of the testimony that is sought."[42] In particular, when the mediator is to testify about what a party said, "this kind of testimony could be particularly threatening to the spirit and methods that some people believe are important both to the philosophy and the success of some mediation processes."[43] But in the case at hand, the focus of the mediator's testimony would not be on what the borrower said, but "on how she acted and the mediator's perceptions of her physical, emotional, and mental condition."[44] While "that does not mean that compelling

34. *Id*.
35. *Id*.
36. *Id*. at 1134.
37. *Id*.
38. *Id*. at 1133.
39. *Id*. at 1133-34.
40. *Id*. at 1134.
41. *Id*.
42. *Id*.
43. *Id*. at 1135.
44. *Id*. at 1136.

> the testimony by the mediator would pose no threat to values underlying the privilege," the degree of harm is not as great as if it would be in a dispute over precisely what was said during the mediation.[45]

On the other side of the equation, Judge Brazil observed that "[t]he interests that are likely to be advanced by compelling the mediator to testify in this case are of considerable importance."[46] He also noted that "some of those interests parallel and reinforce the objectives the legislature sought to advance by providing for confidentiality in mediation."[47]

In particular, he pointed to two main sets of considerations: (1) the interest in doing justice and achieving fundamental fairness, and (2) the interest in building public confidence in the integrity of the court's mediation system. With regard to the first point, he explained:

> [T]he mediator is positioned in this case to offer what could be crucial, certainly very probative, evidence about the central factual issues in this matter. There is a strong possibility that his testimony will greatly improve the court's ability to determine reliably what the pertinent historical facts actually were. Establishing reliably what the facts were is critical to doing justice (here, justice means this: applying the law correctly to the real historical facts). It is the fundamental duty of a public court in our society to do justice — to resolve disputes in accordance with the law when the parties don't. Confidence in our system of justice as a whole, in our government as a whole, turns in no small measure on confidence in the courts' ability to do justice in individual cases. So doing justice in individual cases is an interest of considerable magnitude.[48]

He then fleshed out in concrete terms what "doing justice" would mean from the perspective of each side in the case.[49] In addition, he pointed out that "refusing to compel the mediator to testify might well deprive the court of the evidence it needs to rule reliably on the plaintiff's contentions — and thus might either cause the court to impose an unjust outcome on the plaintiff or disable the court from enforcing the settlement."[50]

With regard to the second point, the interest in building public confidence in the integrity of the court's mediation system, Judge Brazil observed:

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45. *Id*.
46. *Id*.
47. *Id*.
48. *Id*.
49. *Id*. at 1136-37.
50. *Id*. at 1137.

> According to the defendants' pre-hearing proffers, the mediator's testimony would establish clearly that the mediation process was fair and that the plaintiff's consent to the settlement agreement was legally viable. Thus the mediator's testimony, according to the defendants, would re-assure the community and the court about the integrity of the mediation process that the court sponsored.
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> The testimony also would provide the court with the evidentiary confidence it needs to enforce the agreement. A publicly announced decision to enforce the settlement would, in turn, encourage parties who want to try to settle their cases to use the court's mediation program for that purpose. An order appropriately enforcing an agreement reached through the mediation would also encourage parties in the future to take mediations seriously, to understand that they represent real opportunities to reach closure and avoid trial, and to attend carefully to terms of agreements proposed in mediations. In these important ways, taking testimony from the mediator could strengthen the mediation program.
>
> In sharp contrast, … [i]f parties believed that courts routinely would refuse to compel mediators to testify, and that the absence of evidence from mediators would enhance the viability of a contention that apparent consent to a settlement contract was not legally viable, cynical parties would be encouraged either to try to escape commitments they made during mediations or to use threats of such escapes to try to re-negotiate, after the mediation, more favorable terms — terms that they never would have been able to secure without this artificial and unfair leverage.[51]

Having identified the relevant interests on both sides of the equation, Judge Brazil was careful to point out that the analysis did not end there: "[T]he central question is not which values are implicated, but how much they would be advanced by compelling the testimony or how much they would be harmed by not compelling it."[52] Here, he concluded that the balance weighed in favor of requiring the mediator to testify under seal:

> In short, there was a substantial likelihood that testimony from the mediator would be the most reliable and probative on the central issues raised by the plaintiff in response to the defendants' motion. And there was no likely alternative source of evidence on these issues that would be of comparable probative utility. So it appeared that testimony from the mediator would be crucial to the court's capacity to do its job — and that refusing to compel that testimony posed a serious threat to every value identified above. *In this setting, California courts clearly would conclude the first stage balancing analysis by ordering the mediator to testify in camera or under*

51. *Id*.
52. *Id*. at 1138.

seal — so that the court, aided by input from the parties, could make a refined and reliable judgment about whether to use that testimony to help resolve the substantive issues raised by the pending motion.[53]

Second Stage Balancing Analysis

Once the mediator testified under seal, Judge Brazil "gain[ed] precise and reliable knowledge of what the mediator's testimony would be."[54] Armed with that knowledge, he then considered whether to use and unseal the mediator's testimony. Due to the nature of the mediator's testimony and the other testimony in the case, which was much as he expected in connection with the first stage balancing analysis and selection of procedural approach, "it became clear that the mediator's testimony was essential to doing justice here — so [he] decided to use it and unseal it."[55]

In his opinion, Judge Brazil explained the nature of the testimony in detail and how it bore on the legal requirements for establishing undue influence under California law.[56] He ultimately concluded that "there is no evidence that plaintiff was subjected to anything remotely close to undue pressure."[57] He thus granted the defendants' motion to enforce the MOU reached in the mediation.[58]

AFTERMATH OF *OLAM*

Judge Brazil's decision in *Olam* predated all of the California Supreme Court's decisions on protection of mediation communications. Those decisions make clear that in general courts are to interpret the California statutes on mediation evidence strictly, without judicially creating any exceptions.[59] The Court has not overruled *Olam*, but it has narrowly limited its application.

For example, in *Foxgate v. Homeowners' Ass'n, Inc.*,[60] the Court distinguished *Olam* because the parties in *Foxgate*, unlike the parties in *Olam*, had not waived mediation confidentiality.[61] The Court also distinguished *Rinaker*: That case involved a "minor's due process rights to put on a defense and confront, cross-examine, and impeach [a] witness with his prior inconsistent statements,"

53. *Id*. at 1138-39 (emphasis added).
54. *Id*. at 1132.
55. *Id*. at 1139.
56. *Id*. at 1139-51.
57. *Id*. at 1150.
58. See *id*. at 1151.
59. See Memorandum 2013-39, pp. 18-29.
60. 26 Cal. 4th 1, 25 P.3d 1137, 108 Cal. Rptr. 2d 642 (2001).
61. See *id*. at 16-17.

whereas the *Foxgate* plaintiffs had "no comparable supervening due-process-based right to use evidence of statements and events at the mediation session."[62]

In *Simmons v. Ghaderi*,[63] the Court reiterated that *Olam* and *Rinaker* were of limited application:

> On limited occasions, court have crafted exceptions to mediation confidentiality and compelled mediators to testify in civil actions. However, those instances are very limited.…
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> *Except in cases of express waiver or where due process is implicated,* we have held that mediation confidentiality is to be strictly enforced.… Distinguishing *Rinaker* and *Olam*, we noted [in *Foxgate*] that where a supervening due process right is not implicated or where no express waiver of confidentiality exists, judicially crafted exceptions to mediation confidentiality are not appropriate.… Further, judicial construction of unambiguous statutes is appropriate *only when literal interpretation would yield absurd result*s.[64]

The Court reaffirmed that point in *Cassel*, explaining that "[w]e must apply the plain terms of the mediation confidentiality statutes to the facts of this case unless such a result would *violate due process*, or would *lead to absurd results that clearly undermine the statutory purpose*."[65]

IMPLICATIONS FOR THE COMMISSION'S STUDY

Judge Brazil put much thought into the *Olam* opinion, and **it contains many nuggets that may warrant consideration in the Commission's study.** For example, he extensively discussed "the possibility that a mediator might have interests or motives that could affect the accuracy of his or her testimony" in a case challenging the enforceability of a mediated settlement agreement.[66] He also offered other insights, such as detailed comments on mediation methods.[67]

At present, the Commission is gathering information and building a list of options to consider in this study. **It should add the *Olam* approach to that list, and also consider the possibility of using discrete aspects of that approach, or revising the approach in other respects.**

62. See *id.* at 15-16.
63. 44 Cal. 4th 570, 187 P.3d 934, 80 Cal. Rptr. 3d 83 (2008).
64. *Id.* at 582-83 (emphasis added).
65. 51 Cal. 4th at 119 (emphasis added).
66. See *Olam*, 68 F. Supp. at 1127 n. 22.
67. See *Olam*, 68 F. Supp. at 1135.

Unless the Commission otherwise directs, the staff will **continue its exploration of federal law for the December meeting.** As time permits, we also plan to **complete a few odds and ends relating to the law of other jurisdictions, present some additional information about California law, and commence the Commission's review of scholarly commentary relevant to this study.**

Respectfully submitted,

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