District Court Denies Enforcement of 'Settlement' Deemed Preliminary and Non-binding

by Thomas E.L. Dewey

In recent years, courts interpreting New York law have grappled with what distinguishes an enforceable agreement from an unenforceable preliminary agreement. An apparent split has emerged between state and federal decisions. Federal courts have applied a classification system of "Type I" and "Type II" preliminary agreements. "Type I" are preliminary only in form, and reflect agreement on all material terms subject to the mere formality of a final document; "Type II" are agreements only to negotiate further toward a final agreement. See, e.g., *Teachers Ins. & Annuity Assoc. of Am. v. Tribune Co.*, 670 F.Supp. 491, 498 (S.D.N.Y. 1987). The Court of Appeals, however, has characterized the federal approach as "rigid" and not useful, and has focused instead on whether the agreement at issue "contemplated the negotiation of later agreements and if the consummation of those agreements was a precondition to a party's performance." *IDT Corp. v. Tyco Grp., S.A.R.L.*, 13 N.Y.3d 209, 213 n.2 (2009).

The law of preliminary agreements—and the divergence between state and federal case law—has special resonance where settlement is concerned, as underscored by *Hawkins ex rel. MedApproach*, No. 13-cv-5434 (ALC) (SDA), 2018 WL 1371404 (S.D.N.Y. Jan. 9, 2018), adopted, 2018 WL 1384502 (S.D.N.Y. Mar. 15, 2018). In *Hawkins*, the defendants sought to enforce a purportedly binding settlement document that had been initialed and signed by the parties and their counsel following face-to-face settlement talks. Magistrate Judge Aaron recommended that the motion be denied because the settlement document was preliminary and non-binding. District Judge Carter adopted Judge Aaron's report and recommendation in full.

Background

Hawkins arose from a "complex web" of business entities created to develop, produce and sell the abortion drug mifepristone, commonly known as "RU-486." The structure of the enterprise was intentionally convoluted, meant to obscure the identities of investors in what was and remains a controversial field. The players included defendants MedApproach Holdings ("Holdings") and its sole owner and officer W. Bradley Daniel, and plaintiff Sharon Hawkins, the majority owner of MedApproach, L.P. (MALP). Holdings was the general partner of MALP, however, through which he exercised majority control over yet another business entity, N.D. Management (NDM).

Disagreements arose between Daniel and Hawkins, who filed dueling lawsuits in the Middle District of Tennessee and the Southern District of New York. In the Tennessee lawsuit, Daniel alleged that Hawkins had failed to pay management fees owed to Holdings. In the New York lawsuit, Hawkins alleged that

Daniel had abused his control of NDM and MALP.

In February 2016, after more than two years of litigation, the parties held face-to-face settlement talks to discuss a global resolution of both lawsuits. The result was a two-page settlement document—a hand-marked copy of an offer made by defense counsel—that was initialed by representatives for both parties and signed by their lawyers. Defendants had offered clear terms on which they would settle the case, which—with one possible exception—the parties either revised or marked "Agreed." There were no disclaimers appended to the settlement document, no explicit references to contemplated final agreements, and no headers stating that the terms were preliminary or that the document was a "draft."

There was one sticking point. In the settlement document, the parties agreed that NDM would be reorganized as an S corporation, with Daniel to receive a voting interest, and Hawkins a non-voting interest, on a pro rata basis equivalent to their current holdings in NDM. But the parties noted that the distribution of shares was "Subject to attorney review and discussion."

The parties disagreed about the meaning of that caveat. Defendants maintained that the review and discussion would be ministerial; the attorneys would merely implement the parties' clear and binding agreement to reorganize NMD and redistribute shares on the same numerical basis as before. Hawkins contended that several additional questions needed to resolve before the contemplated settlement could become final.

There was also some performance under the settlement document by Daniel and Holdings. Holdings discontinued the Tennessee lawsuit, albeit under a separate written agreement. Daniel and Holdings also issued checks to Hawkins as specified in the settlement document, though Hawkins never deposited or cashed them.

Ultimately, Hawkins refused to discontinue the New York lawsuit, and Daniel and Holdings filed a motion to enforce the "settlement" that the parties had supposedly reached.

The District Court Refuses to Enforce the Terms of the Settlement Document

In a report and recommendation later adopted in full by Judge Carter, Magistrate Judge Aaron applied federal authority on the law of preliminary agreements, including several cases applying the Type I-Type II classifications, to conclude that no binding settlement agreement arose from the parties' February 2016 negotiations.

Judge Aaron applied the four-factor *Winston* test, which New York federal courts use to decide "whether parties intended to be bound in the absence of a formal written agreement." *Hawkins*, 2018 WL 1371404, at *2. Those factors are: (1) whether there has been an express reservation of the right not to be bound; (2) whether there has been partial performance of the contract; (3) whether all of the terms of the alleged contract have been agreed upon; and (4) whether the agreement at issue is the type of contract that is usually committed to writing. Id. at *3. The court concluded that all four factors favored Hawkins.

First, the court held that the parties had expressly reserved the right not to be bound. Because the parties stated that the ownership of NDM was "[s]ubject to attorney review and discussion," the judge determined that "any settlement was conditional upon further discussion between counsel for the parties." *Id.*

Second, the court held that there had been no partial performance. Yes, the court conceded, Daniel and Holdings had dismissed their Tennessee lawsuit and sent payments to Hawkins. But dismissal of the Tennessee lawsuit had involved a separate settlement document, and Hawkins had neither deposited nor cashed the checks she received.

Third, the court held that not all terms of the alleged contract had been agreed. The issue of the control and ownership of NDM, the court reiterated, had not been resolved, and "no mechanics of the reorganization had been agreed upon." *Id.*

Fourth, the court held that settlement agreements are "generally required to be in writing or, at a minimum, made on the record in open court." *Id*. at *4 (quoting *Ciaramella v. Reader's Digest Ass'n*, 131 F.3d 320, 326 (2d Cir. 2016)). Though Daniel and Holdings contended the parties' agreement had been reduced to a writing, which they were now seeking to enforce, the court determined that this final factor likewise weighed in favor of Hawkins.

Application of New York State Case Law

Would *Hawkins* come out differently in New York state court? Perhaps. While Judge Aaron's ruling was undoubtedly correct under federal law, New York state courts generally do not apply the Winston factors, or the Type I-Type II classifications. Instead, the state approach has been more open-ended, considering whether the agreement at issue "contemplated the negotiation of later agreements and if the consummation of those agreements was a precondition to a party's performance." *Offit v. Herman*, 132 A.D.3d 409 (1st Dep't 2015). That approach may be complementary to the federal approach, but not necessarily so.

Practice Tips

The *Hawkins* case provides at least two useful reminders for New York practitioners negotiating settlement agreements. *First*, the familiar admonition to take a belt-and-suspenders approach applies. Settlement agreements may envision a series of complementary acts that are not simultaneous. The defendant might pay a certain sum, after which the plaintiff might relinquish certain property; one or both of the parties may undertake ongoing responsibilities to be performed well into the future; and so on. Where future acts are required, the parties should take great care to ensure that no material aspect of the performance of those acts is left open.

Second, practitioners should be mindful of the New York forum in which they are settling—state or federal—which may have very real implications for the enforceability of a settlement agreement. Settlement discussions can take on any number of forms and intermediate steps. As the federal and state approaches to the law of preliminary agreements diverge—or converge—preliminary agreements in principle, if memorialized, may edge closer toward binding settlement, depending on whether the federal or state approach is applied. A wily practitioner might even try to forum shop to enforce a settlement agreement not through the court in which the case was litigated, but through a separate action for breach of contract in an alternate forum. Any practitioner should at least consider the possibilities.

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