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| **ARBITRATION CLAUSES IN REAL ESTATE TRANSACTIONS: A BUSINESS IMPERATIVE**  **(and how to draft predispute arbitration clauses)** |
| |  |  | | --- | --- | | Attached predispute arbitration clauses for: Earnest Money Agreements Listing Agreements Leases | **\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_** **by James J. Damis** Harvard College (1958); Columbia Law School (1961); Member of the Oregon State Bar since 1962; Sole Practitioner, Portland; Administrator, Arbitration Service of Portland (www.arbserve.com) |   **Summary.** Entering into real estate transactions in today's litigious society without taking advantage of an arbitration clause is like driving a car without a seat belt: it is a dangerous and unnecessary risk. Why would sellers, buyers, landlords, tenants, or realtors ever want to subject themselves to the whims, inexperience, uncertainties, and the prejudices of a jury -- not to mention the horrendous costs and delays of courthouse litigation? The use of a predispute arbitration clause in real estate agreements acts as both a shield and a sword. If properly implemented, mandatory and binding arbitration is a time-tested technique that has proven effective for real estate disputes.  **Private Arbitration.** Private arbitration is the referral of a dispute to an impartial third person chosen by the parties who agree in advance to be bound by the arbitrator's decision after a hearing in which both parties have an opportunity to be heard. Private arbitration requires an agreement to resolve a dispute through arbitration and is expressly authorized by Oregon's private arbitration statute (ORS 36.600-36.740) and the Federal Arbitration Act (9 USC Sections 1-14). An arbitration award may be submitted to the court clerk for confirmation as a judgment of the court. (ORS 36.715; 9 USC Sections 9, 13). Although an oral agreement to arbitrate is enforceable on common law principles (see Halvorson-Mason v. Emerick Const. Co., 304 Or. 407 (1987)), practical considerations require a written agreement.  **Business Clients Favor Arbitration.** A national survey conducted by Business Week found that most business leaders believe that something is seriously wrong with the legal process in this country. Its cover story headlines summarized its findings:  "Too many lawyers, too much litigation, too much waste. Business is starting to find a better way." An overwhelming 97% of the surveyed executives favored a greater use of alternative dispute resolution, such as mediation and arbitration. Trade journals tout ADR. The lawyer who suggests or includes arbitration clauses is viewed by real estate clients as looking out for their interests. The largest law firm in Michigan requires its attorneys to use an ADR clause in every agreement or justify its non-inclusion. Law firms around the country recognize the marketing advantages of proclaiming their expertise in ADR. The Colorado Bar Association has determined that the failure of an attorney to explain ADR options to a client constitutes an ethical violation. A proper predispute arbitration clause permits property buyers, sellers, landlords and realtors to control their dispute resolution destinies by preselecting the forum and procedure for resolving future disputes.  **The Advantages of Private Arbitration.** The construction industry learned decades ago what the business community and those who engage in real estate transactions have also now discovered: compared with litigation, arbitration has the following significant advantages:  Speed: An arbitration hearing usually occurs within 90 days, many months sooner than a court trial could be scheduled (and Oregon's budget crisis will further delay trial scheduling).  Economy: Arbitration's informality and streamlined procedures are designed to quickly get at the crux of a dispute, and eliminate the time-consuming and paper shuffling burdens of formalized litigation, which reduces attorney's fees and costs.  Fairness: An able arbitrator with experience in the subject matter of the dispute is far better equipped to deal with complicated issues than is a jury or an inexperienced trial judge struggling in an unfamiliar area.  Convenience: Arbitration hearings are scheduled promptly according to the convenience and availability of the parties, rather than the vicissitudes and postponements of congested court dockets.  Privacy: Disputants can avoid unfavorable publicity, and all parties involved prefer the privacy, sensitivity and informal setting that arbitration provides.  Settlement Enhancement: The ability to negotiate fair settlements dramatically increases because the speed and predictability brought by the arbitration process are forceful agents of realty.  Finality: Binding arbitration eliminates the delays and costs of appeals that can occur in litigation.  Because real estate disputes often involve complex factual and legal issues, arbitration's defining attribute also offers the most important benefit of all: the opportunity to select as the trier of fact and law a person who possesses high expertise in the subject area of the dispute and who is also intellectually able, conscientious, and impartial.  **Shield and Sword Benefits of Arbitration Clauses.** Because a predispute arbitration clause serves as both a sword and a shield, its importance to real estate clients (including realtors) cannot be over-emphasized.  As a shield, an arbitration clause discourages frivolous suits against your clients (especially "target" defendants) by removing the tantalizing attraction of a jury prejudiced against real estate businesses. Arbitration also dramatically increases the likelihood of a successful and less expensive defense by having such matters decided by a truly impartial person who possesses expertise in the subject area of the dispute.  As a sword, an arbitration clause enables your clients to seek and obtain their just entitlements far more quickly and less expensively. Having the matter decided by an experienced arbitrator ensures far greater predictability than a quixotic and untrained jury.  **"But there's no appeal!"** Some litigators (zealous defenders of their courtroom turf) are quick to point out that a court cannot change an arbitrator's decision on the facts or the law. True enough. But remember that finality is a great practical benefit. Remember also: most courtroom fact-finding errors rarely rise to the level of reversible unreasonableness; judicial errors are not reversed unless prejudicial; appeals are expensive; most appeals do not succeed; and, successful appeals too often result in the dubious "new trial" reward of having to repeat the same expensive process. Litigators who would sacrifice the benefits of arbitration on the holy grail of appellate review fail to acknowledge a more pragmatic explanation of an adverse award: if they could not persuade an astute arbitrator (or, in large cases, a panel of three able people), perhaps they did not deserve to win. In sum, the right to appeal is vastly overrated.  **Splitting the Baby and Other Unfounded Worries.** An old fallacy (now heard less frequently) is that arbitrators give each side half a loaf. Although a jury must often broker compromises to reach a verdict, a good arbitrator does not split the baby. Statistics of the American Arbitration Association refute this old saw. Arbitration Service of Portland's awards reveal that over 80% of the awards are entirely (or almost entirely) in favor of one of the parties. Another unsupported fear is that claims might increase because initiating an arbitration is so much easier and less expensive than filing a lawsuit. Not so, according to the experience of the Bank of America, which began using predispute arbitration clauses in loan agreements in California many years ago. (The use of arbitration clauses by banks nationwide is now commonplace.) A large New York-California law firm conducted a survey of businesses that used a predispute arbitration clause in their employment agreements, and reached the same conclusion: There was no evidence that an arbitration clause resulted in an increase in claims. (That law firm believes that an employer's use of a predispute arbitration clause is one of the best ways an employer can protect itself and routinely proposes its use.)  **"But Sometimes . . ."** Occasionally you will hear a lawyer say: "But I had one arbitration that ended up taking longer than litigation." So what! Such statements also mean that the reverse is true: most of the time arbitrations are quicker than litigation. Admittedly, an unusual turn of events may occur that causes a particular arbitration to be as expensive or as time-consuming as litigation. But, such exceptions merely prove the rule: arbitration almost always is quicker, less expensive, and more efficient, convenient, and civilized than litigation. Just as importantly, arbitration affords the parties in a real estate dispute a tremendous advantage that a jury trial never offers: the opportunity to have the dispute decided by a person who possesses legal expertise in real estate law and who is also intelligent, fair, and conscientious.  Types of Real Estate Agreements Suitable for Arbitration Clauses. Nearly every real estate agreement is suitable for a predispute arbitration clause, including:   |  |  |  | | --- | --- | --- | |  | joint venture agreements real estate LLC's/partnerships co-ownership agreements inspection/environmental testing contracts | earnest money agreements escrow agreements listing agreements options/first rights of refusal leases |   **The Procedural Rules of Arbitration.** Remember that private arbitration is a substitute for formal litigation's vast array of procedural rules. To be effective, the arbitration clause must ensure an efficient procedural processing and provide for the selection of an appropriate arbitrator. Therefore, the arbitration clause must either designate a specific arbitration organization (and thereby incorporate the rules and arbitrator selection process of that organization) or it must set forth in the arbitration clause itself detailed rules on how the arbitration is to be initiated, the selection, qualifications, and compensation of the arbitrator, discovery, determining the date, site, and procedures of the hearing, etc. Usually one party to a dispute is satisfied with the status quo and too often this reluctant party will take advantage of an incomplete or open-ended arbitration clause to continue to avoid the resolution of the dispute. Disputes governed by incomplete clauses will present continuing procedural problems, and the difficulties encountered will be in direct proportion to the contentiousness of opposing counsel. Those same human frailties (stubbornness, procrastination, unreasonableness, and simple stupidity) that often make settlement impossible also will magnify the problems that can arise from incomplete arbitration procedures. Therefore, the arbitration clause must be drafted to ensure that the arbitration process will move forward quickly and fairly in spite of difficult people.  **Arbitration Organizations and Their Benefits.** Increasingly, most arbitration clauses require arbitration "in accordance with the rules of" a designated arbitration organization. Naming a specific arbitration organization in this manner is the most effective way to avoid the many problems created by incomplete arbitration clauses or quarrelsome participants. Requiring arbitration through an able arbitration organization will ensure an efficient beginning-to-end processing of the dispute by a neutral party.  **Arbitration Service of Portland.** ASP is designated in printed business forms used throughout Oregon by realtor associations, banks, title companies, motor vehicle dealers, and other businesses and employers that use arbitration clauses. Attorneys who draft arbitration clauses also designate ASP. ASP has created arbitrator panels in Portland, Salem, Eugene, Medford, Bend, Pendleton, and elsewhere (over 400 throughout Oregon). ASP was designed and is administered by an Oregon attorney and has the following features:   * High quality arbitrators, each with a minimum of ten years in practice. * Arbitrators are pre-screened for expertise in the subject area of the dispute. * Reasonable fees and costs. (In a typical two-party one-arbitrator dispute less than $250,000, the filing fee is $700. The arbitrator receives his/her regular hourly, but not to exceed $495/hr.) * Sophisticated procedural rules include:   + full discovery (pursuant to ORCP)   + 14-day pre-hearing statement of proof (to avoid "trial by ambush")   + presumed admissibility of certain documents and affidavits   + provisional process is preserved (to allow interim injunctive relief and other provisional remedies from a court pending final resolution through arbitration)   + consolidated hearings of related disputes   ASP administers more private arbitrations in Oregon than any other organization.  **Crafting the Arbitration Clause.** Attached are special predispute arbitration clauses especially designed for earnest money agreements, listing agreements, and leases.  **Mediation: Its Relationship to Arbitration.** When traditional settlement negotiations falter, mediation is always the first alternative to consider. In comparing mediation with arbitration, it is not an "either-or" question. Rather it is the recognition that mediation should be attempted prior to the use of arbitration and that arbitration is a necessary final safeguard. But, mediation is a voluntary and cooperative process and, unlike arbitration, it cannot be forced upon the other party. A dispute resolution clause should not require mediation as a legal condition precedent to arbitration or litigation, because it allows a defendant in bad faith to use the mediation process as a delay tactic. Also, many lawyers who desire to use mediation believe that initiating arbitration at the outset yields two mediation benefits: the other (reluctant) party is more likely to participate in a mediation and is more likely to mediate in good faith, because of the knowledge that a fair and able arbitration soon will decide the issue if the parties do not themselves settle their dispute.  **Attorneys' Fee Clause.** If an attorneys' fee provision is desired, the attorneys' fee clause should specifically cover arbitration:  ***Attorneys' Fees.****In the event suit or action is brought, or an arbitration proceeding is initiated, to enforce or interpret any of the provisions of this agreement, or that is based thereon, the prevailing party shall be entitled to reasonable attorneys' fees in connection therewith. The determination of who is the prevailing party and the amount of reasonable attorneys' fees to be paid to the prevailing party shall be decided by the arbitrator(s) (with respect to attorneys' fees incurred prior to and during the arbitration proceedings) and by the court or courts, including any appellate court, in which such matter is tried, heard, or decided, including a court that hears a request to compel or enjoin arbitration or that hears any exceptions or objections to, or requests to modify or vacate, an arbitration award submitted to it for confirmation as a judgment (with respect to attorneys' fees incurred in such proceedings).*  **Providing for the Selection of the Arbitrator.** In addition to providing for an efficient procedural processing, the arbitration clause also should ensure the selection of an experienced and able person to serve as arbitrator. Quality is paramount. If the predispute arbitration clause requires arbitration pursuant to the rules of a designated arbitration service, a list of proposed arbitrators will be submitted to the disputants by that arbitration organization after an arbitration has been initiated. Although the parties then will have an opportunity to participate in the arbitration or selection process, the quality of the arbitrators being proposed is crucial. Therefore, in addition to reviewing the procedural rules of the arbitration service being proposed, the attorney should ask for a sample list of arbitrators. You pick one; I pick one. Arbitration clauses that do not designate an arbitration service sometimes require that each side select its own (non-neutral) arbitrator, with those two non-neutrals then selecting a third arbitrator. There are defects in this procedure. Selecting the third arbitrator can be time-consuming, and a stalemate will require a request to a court and the like-it-or-lump-it designation of the chief arbitrator. Using three arbitrators, only one of whom is neutral, is unnecessarily expensive and often a distasteful arrangement to the two non-neutrals. Moreover, such clauses rarely establish even minimum qualifications for the arbitrators and lack procedures to monitor any conflicts of interest or to resolve charges that an arbitrator has a conflict of interest. Three person panels. The parties must also decide at what monetary level the dispute should be decided by a panel of three arbitrators rather than a sole arbitrator. Whether the figure should be $50,000 or $100,000 (for example) represents an attorney's assessment of when the additional expense and scheduling complications of a three-person panel is justified.  **Conclusion.** The benefits of arbitration for the resolution of real estate disputes far outweigh the litigative alternative. An informed real estate client rarely would choose courthouse litigation over arbitration. Business and industry is increasing its use of arbitration and other alternative dispute resolution techniques in many different settings and for all the right reasons. Consider these observations by Warren Burger, former Supreme Court Chief Justice:  *"For many claims, trial by adversarial contest must in time go the way of the ancient trial by battle and blood. Our system is too costly, too painful, too destructive, too inefficient for truly civilized people."*  *"The notion that most people want black-robed judges, well-dressed lawyers and fine paneled courtrooms as the setting to resolve their dispute is not correct. People with problems, like people with pains, want relief, and they want it as quickly and inexpensively as possible."*  Not surprisingly, those sentiments are shared by real property buyers, sellers, brokers, landlords and tenants.  For shame, then, on the unenlightened attorney who, by failing to include an arbitration clause, allows the opponent to dictate the forum, procedure, expense, and decision maker. The real estate lawyer should protect the client at the outset by crafting a predispute arbitration clause that will ensure the resolution of any future dispute efficiently, promptly, less expensively, and with a far greater likelihood of a fair result.    **ARBITRATION/MEDIATION CLAUSE SUITABLE FOR EARNEST MONEY AGREEMENTS**  **Arbitration Required (Mediation to be Considered):** Seller, Buyer, and all Brokers involved in this transaction (and "Broker" shall include and mean a real estate broker's officers, employees, and real estate agents) each agree that every claim, controversy, or dispute (including all contract and/or tort claims (including those based upon or created by statute) and/or claims for fees or commissions) arising between or among Seller, Buyer, and/or Broker, including those arising out of or relating to this agreement, or to the interpretation or breach thereof, shall be resolved in accordance with the then effective arbitration rules of, and by filing a claim with, Arbitration Service of Portland, Inc., and any judgment upon the award rendered pursuant to such arbitration may be entered in any court having jurisdiction thereof. The parties acknowledge that mediation often helps parties to themselves settle their dispute. Therefore, prior to initiating arbitration, any party may propose mediation whenever appropriate (through Arbitration Service of Portland or any other mediation process or mediator as the parties may agree upon). The obligations of this paragraph shall survive the closing of this transaction. This paragraph shall not apply to the following matters: (a) judicial or non-judicial foreclosure or any other action or proceeding to enforce a trust deed, mortgage, or land sale contract; (b) a forcible entry and detainer action.  (Note: Any existing Attorney Fee Provision should be modified to include an arbitration proceeding.)    **ARBITRATION/MEDIATION CLAUSE FOR USE IN LISTING AGREEMENTS**  **ARBITRATION IN LIEU OF LITIGATION/MEDIATION TO BE CONSIDERED.** Owner and Broker (including Broker's officers, employees, and agents) each agree that all claims, controversies, or disputes between Owner and Broker, or that relate to any breach or interpretation of this agreement, or that arise out of or are based upon the Owner-Broker relationship, including all contract and/or tort claims and/or claims for fees or commissions (or any defenses or counterclaims relating thereto including alleged misrepresentations, concealment, negligence and/or fraud) shall be resolved by arbitration in accordance with the then effective arbitration rules of, and by filing a claim with, Arbitration Service of Portland, Inc., and any judgment upon the award rendered pursuant to such arbitration may be entered in any court having jurisdiction thereof. The parties acknowledge that mediation often helps parties to themselves settle their dispute. Therefore, prior to initiating arbitration, any party may propose mediation whenever appropriate (through Arbitration Service of Portland or any other mediation process or mediator as the parties may agree upon). The obligations of this paragraph shall survive the closing of this transaction.  (Note: Any existing Attorney Fee Provision should be modified to include an arbitration proceeding.)    **Lease Agreement: Predispute Arbitration Clause**  **Arbitration.** Any claim, controversy or dispute between the parties arising out of or relating to this lease agreement, or to the interpretation or breach thereof, shall be resolved by arbitration in accordance with the then effective arbitration rules of, and by filing a claim with, Arbitration Service of Portland, Inc., and any judgment upon the award rendered pursuant to such arbitration may be entered in any court having jurisdiction thereof, but nothing in this paragraph shall preclude lessor from bringing, maintaining and concluding an action against lessee for forcible entry or wrongful detainer, and this paragraph shall not apply to any dispute which is encompassed within such legal action.  (Note: Any existing Attorney Fee Provision should be modified to include an arbitration proceeding.) |
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