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MIDCOURSE CORRECTIONS

Revising the Arbitration Clause in Real Estate Contracts

Roger Bernhardt and Jon H. Sylvester

NOTE: Hedges v Carrigan (2004) 117 CA4th 578, 11 CR3d 787, reported in 27 CEB RPLR 107 (July 2004), dealt mainly with the issue of federal preemption of California's CCP §1298 on arbitration clause drafting. But, for me, it generated many questions about the right of brokers to compel their clients to arbitrate which I could not answer because (1) the opinion was only partially published, and (2) the issues required a deeper knowledge of contract law than I possessed. I solved the first problem by obtaining the balance of the opinion and the underlying contract document from William Turner, counsel for the broker. I dealt with the second by inviting my colleague, Professor Jon Sylvester, to collaborate with me in writing this column.

—Roger Bernhardt

The parties' contract in this case was a standard CAR Residential Purchase form that included a clause providing that buyer and seller would arbitrate any disputes between them if they both initialed that clause. Only the buyers initialed, but because the litigation that ensued was between the buyers and the broker, the combination of the buyers' initials and the lack of space for the broker's initials led us to wonder whether the court's holding that the broker could not compel arbitration was based on the absence of his initials, the absence of the seller's initials, or both.

Then, in the unpublished part of the opinion, we read the court's statement that "[b]ecause neither the Weinmans [sellers] nor Mr. Carrigan [broker] initialed the arbitration agreement, it is not enforceable against plaintiffs [buyers]." This is not as clear as we would wish. Was the court imposing an affirmative requirement that both the seller and the broker had to initial the clause for it to be enforceable by the broker against the buyer? Or was it merely saying that, because neither the seller nor the broker initialed the form, the clause was unenforceable? Were both sets of initials really necessary? Did the absence of the seller's initials mean only that the buyer could not force the seller to arbitrate, or that neither of them could force the other to arbitrate, or did it completely invalidate the clause—even with respect to the broker?

Regarding the CAR form in this case, the intent of the form drafters was clear—at least as to broker disputes: Like most arbitration clauses in buy-sell contracts, the clause in the CAR form called for only the buyer and seller—the true parties to the deal—to initial. It referred only to disputes arising "between them," *i.e.*, buyer and seller. Broker disputes were covered in a separate clause, which was located *below* the clause to be initialed, and that clause did require and provide space for the initials of anyone: buyer, seller, or broker. (The 2002 CAR form adds a proviso that the broker arbitration paragraph applies "whether or not the Arbitration provision is initialed," which would seem to make the result desired by the form's drafters even clearer. The form then weakens that very point, however, by placing the boxes for initials *below* the broker

arbitration clause! Nevertheless, it seems apparent that, one way or another, brokers are able to demand arbitration without having initialed the form.)

In a dispute between buyer and seller, it might seem clear that a buyer who had initialed the clause could not enforce it against a seller who had not. But could the seller enforce the clause against the buyer in that situation? One case does hold that a single signature on an arbitration clause lets the non-signer enforce it against the signer if the contract is otherwise enforceable. See *Grubb & Ellis Co. v Bello* (1993) 19 CA4th 231, 23 CR2d 281. However, other courts have disagreed with that conclusion (see, e.g., *Marcus & Millichap Real Estate Inv. Brokerage Co. v Hock* (1998) 68 CA4th 83, 80 CR2d 147), and in at least some circumstances (notably in the employment context), California courts have held clauses requiring one party to arbitrate while the other retains the option of suing in court to be unconscionable. See *Armendariz v Foundation Health Psychcare Servs.* (2000) 24 C4th 83, 99 CR2d 745. But whatever the outcome between the buyer and the seller, it is a separate question whether the absence of the seller's initials makes the clause unenforceable against the buyer by the broker.

Even before the proviso was added to the 2002 CAR form—and afortiori afterward—the wording and positioning of the broker arbitration clause was designed to make clear that the buyer and seller should not expect the absence of either of their initials to render the clause ineffective in a dispute between either of them and one of their brokers. But while the parties' expectations are important in contract interpretation, they are not dispositive; and here, the form was not drafted by either of the principal parties, but by a third party broker. This is why, although the intent is clear, that intent might warrant additional scrutiny.

As mentioned above, California courts disfavor clauses that commit one party to arbitration and leave the other free to sue in court. This lack of “bilateralism” poses an even larger problem when the broker—declared in the contract not to be a party to it (as here)—can still sue in court even though the buyer and seller cannot. Even granting that the arbitration clause remains effective despite the lack of the seller's initials, does that necessarily mean that the broker can compel arbitration against the buyer?

Because the broker is declared not to be a party to the contract, it is unlikely that the buyer or seller could compel the broker to arbitrate a dispute with either of them. Can the broker still compel one of them to arbitrate a dispute with him? Point-by-point reciprocity is not required for a contract to be enforceable, as long as each side has given consideration so as to make the other side's obligations enforceable. In this case, however, the broker has neither given nor promised anything.

The CAR form—both new and old—imposes arbitration on a broker who has “agreed to such mediation or arbitration prior to or within a reasonable time after the dispute or claim is presented” to the broker. That means that the buyer and seller must agree now, but the broker need not agree (or decide to agree) until later. It is not that the broker has made an illusory promise; it's worse: He has promised nothing at all. (The broker might claim to be a third party beneficiary of the language “buyer and seller agree . . . to arbitrate disputes . . . involving . . . brokers,” but that runs afoul of the bilateralism requirement.) The clause fails not because the seller did not initial it or because the broker did not initial it, either, but because the broker would not be bound even if he had put his initials down next to it, since his decision-making moment comes later, when the claim is asserted. Indeed, the clause backfires because, in trying to give the

broker a unilateral option not to arbitrate, it effectively denies him the right to demand arbitration—which is surely more desirable than the right to refuse arbitration.

This brings us to the published part of the opinion, which dealt with the preemption issue. The court majority concluded that California's special statutory requirements for arbitration clauses are invalid as inconsistent with federal law. The state can no longer require separate initialing, as CCP §1298 currently does. But the federal act—United States Arbitration Act (9 USC §2)—does not mandate arbitration, it only invalidates state imposition of such special requirements on arbitration clauses. While the court's preemption analysis prohibits a statutory requirement that arbitration clauses be separately initialed, the parties themselves remain free to provide in their contract that the arbitration clause is effective only if separately initialed. Even if CCP §1298 were repealed entirely, contracts and printed forms could include optional arbitration agreements requiring separate initialing.

Given that brokers have more influence over the contents of printed forms than do buyers and sellers, it may well be that residential contract forms will drop the requirement of separate initials on the arbitration clauses (unless the Commissioner of Real Estate prohibits that). Brokers want arbitration not so much because it is biased in their favor as because it reduces their dispute resolution costs, which—as repeat players—is quite important to them. The combination of federal preemption of the statute and economic incentive by the form drafters may be the one-two punch that kills off arbitration clauses that have to be initialed to take effect.

Based on what we have said, however, that won't help brokers very much. The problem with the CAR clause is not too few initials, but too much discretion. (In that respect, we agree with Judge Mosk's concurring opinion that there was no need to discuss preemption.) If brokers want arbitration, they should delete their option not to arbitrate and make it mandatory for themselves as well as their principals. Once that is done, initialing would not matter. On this issue, what the legislature does about its statutory arbitration act is far less important than how the CAR and the legal publishers revise their form contracts.