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Dealing with Mandatory Mediation Clauses

Christine Tour-Sarkissian

Christine Tour-Sarkissian is a real estate attorney and broker in San Francisco. She is also an Adjunct Professor of Law at Golden Gate University, teaching Real Estate Litigation and Real Estate Transactions.

Frei v Davey

Frei v Davey, reported in this issue at p 48, breaks important new ground in denying attorney fees to real estate sellers who prevailed in a lawsuit brought against them by the buyers because they had not accepted the buyers' earlier mediation request. Attorneys should pay much closer attention to a common provision in real estate contracts that was previously taken as innocuous and inconsequential. Below are some points worth bearing in mind.

If your clients have determined to litigate and there is a mediation clause in the contract, what do you do first?

In light of *Frei* and the cases it follows, you should advise your clients that they have to request mediation before filing the complaint. Send a letter—preferably by certified mail—to the opposing parties, setting forth the request to mediate. The letter may cover other matters, depending on the circumstances of the particular case, but the demand to mediate must be clear. Quote directly from the language of the clause in the purchase contract, rather than merely referring to it. Engaging in actual settlement negotiations, either by letter or in person, is not an adequate substitute for a proper request for mediation.

In your letter, invite the parties to propose names of mediators and provide some names yourself, especially if you have some mediators with whom you have worked and whose judgment you respect. It is best to propose mediators who are from the county where the property is located. It is also necessary to find a mediator who has knowledge and experience in real estate matters and one who has skills that best fit the personalities involved in the case and a style that will be most effective in resolving the particular dispute. Provide any helpful information you may have about them, *e.g.*, whether they are retired judges or practicing attorneys, the organization they belong to (AAA or JAMS), and their hourly rates. Your staff should contact proposed mediators ahead of time so that you can get an idea about their availability and suggest dates in your letter. Most mediation clauses have language about how costs are to be divided; if your clause is silent on the issue, your letter can make a proposal about that as well.

Sometimes, you may be forced to file the action first—*e.g.*, when you have to get a lis pendens on file or the statute of limitations is about to run. In those cases, you should send the mediation request as soon as possible after having filed. If there are situations specifically excluded by the clause (such as for unlawful detainers or mechanics liens), you can still send a request to mediate as a preliminary matter, with a specific date threatened for litigation if the request is not accepted.

If your clients are the ones who have been sued and the contract contained a mediation clause, but the plaintiffs did not invoke it, what do you do?

Study the language of the mediation clause, because that will control what ultimately happens, *i.e.*, the court will honor it. In many cases, the clause will mandate denial of attorney fees both to successful plaintiffs who did not request mediation prior to filing the complaint and to defendants who failed to respond to a request for mediation. (This sanction, of course, won't apply when there is no mediation clause, or when the clause excludes this type of litigation, or-probably-when special circumstances forced the plaintiffs to file first and make their mediation request afterward.)

If your clients are sued, watch closely for any action by opposing counsel that might later be construed as an invitation to mediate. If you see anything that might be treated as that kind of request, respond immediately and offer to do the same. (Don't refuse, as counsel did in *Frei*.)

Should you ask for mediation yourself (if you're representing defendants)?

This depends on how you view the strengths of your defense. If you are fairly certain that your side will prevail, then you probably should make your own request to mediate, so as not to jeopardize your clients' chances of recovering their own fees. While an implication of *Frei* is that a plaintiff's failure to request mediation excuses the defendant from having to request it, that is still taking a risk. The mediation clause in *Frei* provided

> if for any dispute or claim to which this paragraph applies, any party commences action without first attempting to resolve the matter through mediation, or refuses to mediate after a request has been made, then that party shall not be entitled to recover attorneys fees, even if they would otherwise be available to that party in any such action.

With a differently worded clause, the question whether a defendant must ask after the plaintiff has failed to do so could be settled differently. So, if you believe you may win—or even if you think mediation will help—request it regardless of what the plaintiffs have done.

On the other hand, if you have less confidence in your clients' side, then the best thing to do is to proceed without mentioning mediation. You may lose the case, but the plaintiffs' failure to request mediation can be used as a shield against their attorney fees, as it was in *Leamon v Krajkiecz* (2003) 107 CA4th 424, 132 CR2d 362, and *Johnson v Siegel* (2000) 84 CA4th 1087, 1100, 101 CR2d 412.

What do you say to clients when they ask if they should include a mediation clause in their real estate sales contracts?

Preprinted purchase and sale agreements that are generally available contain many different types of mediation clauses. Some forms include a box giving the parties the choice of initialing it or not; others have language that leads the parties to believe there is no choice. Even when there is such a "mandatory" clause in the contract (as there was in *Frei*), the parties still have the power to amend it or strike it out completely.

In general, I advise clients to include a mediation clause (even though, at the same time, I discourage them from initialing an arbitration clause, especially if the arbitration clause is binding and not clear about the scope of discovery; in those cases, I either redraft the arbitration clause and make it nonbinding and specific regarding the discovery or strike it all out, knowing that we can always arbitrate either by mutual consent or by judicial order) because mediation is usually the most sensible and economical (as well as the least emotionally painful) way of resolving the dispute. Attorney fees can easily outweigh any recovery in real estate litigation.

Sometimes, in the early stages of a case, it may be premature to mediate because the parties are still investigating matters and tallying losses. Still, by getting into mediation early, an effective mediator may be able to guide the parties and reduce losses (and the attorney fees and costs), making the settlement process more efficient and less costly. Mediation sessions might be required as discovery progresses—but even then, the parties may realize some cost savings.

On the other hand, there are arguments against agreeing to mandatory mediation. Clients who have had to compromise may not feel adequately compensated, and may not appreciate the emotional and financial benefits that come from early resolution, especially if they are new to litigation. Some clients feel they did not have their day in court because the mediation was not an evidentiary hearing—they are frustrated that they were unable to "tell their story." Their emotional needs may be such that they insist on going to trial regardless of how sensible a proposed settlement is. Their lawyer and the mediator may attempt to persuade them to approach the process rationally, but a rational result may not be what they are looking for. In that case, the mediation is not likely to get anywhere.

Some attorneys argue against agreeing to mediation at the outset on the ground that they can always seek it later, after a specific dispute has arisen. This tactic invites the risk that the opposing party may not agree or may only agree to accept it much later, after more costs have been incurred.

What do you think of the CAR mediation clause?

The CAR form has taken a significant step forward by making mediation mandatory. This has led to decisions like the one in *Frei*. But the clause does not really go far enough: The fact that litigants have to participate in mediation does not mean they have to take it seriously. If you are involved in drafting an agreement, and you want to ensure effective mediation, add language giving the mediator power to impose sanctions (*e.g.*, monetary penalties, reallocation of mediation costs, issue preclusion, or ultimate loss of attorney fees) on a party who does not meaningfully participate or come prepared to mediate.

What's the best way to assure an effective mediation?

Next to having a competent mediator, the most important factor for a successful mediation is the attorney—namely, one who knows the case as thoroughly as possible, has clearly delineated the legal theories, and has thoroughly analyzed the potential damages and defenses. The best way to negotiate a settlement is to go into the mediation with a good grasp of your case and your opponent's case. Providing a brief to the mediator (but not necessarily to opposing counsel) will save time for everybody.

The other crucial element of successful mediation is client preparation. Clients must be mentally and emotionally ready; they should come in with realistic expectations. The mediator should not be the first one to tell them that they have a wrong theory or that their case has serious weaknesses—that will only reflect badly on their attorney. Bad news may unsettle them and reduce their ability to be receptive. The mediator should be confirming what their attorney has already told them, not disagreeing with it.

Clients must also appreciate ahead of time that the mediation will not be a "mini-trial" with a judge deciding who is telling the truth or who wins. Clients will be less apprehensive if they realize that mediation is only an attempt to settle the case, and that the final decision is up to them, not the mediator. If they are not emotionally ready to talk about compromise, that issue has to be addressed first; but even then, a skillful mediator can be extremely helpful, instilling appropriate fears and saving them from any loss of courage that may occur later—as well as from the prospect of ballooning attorney fees.

For a helpful article on mediation, I refer you to Klingler, Practice Tips: Representing Clients in Real Estate Mediations, 14 Cal Real Prop J 16 (Spring 1996).

So, what's the bottom line?

Mandatory mediation pushes the parties to formulate legal positions, defenses, and damages at an early stage and to search for compromise, and sometimes creative ways of settling disputes, which is usually better for everybody. Another advantage is that, although much depends on the mediator, mediation may induce attorneys to make early assessments of their own positions. Finally, by receiving a "crash course" from the mediator as to the litigation process and its costs, clients can gain reassurance that their attorney is looking at the whole picture and not pushing compromise for the wrong reasons. Thus, through participation in mediation, clients themselves can analytically and realistically evaluate the merits, defenses, and damages of their cases, and thereby be prepared to intelligently assume the risk of full-blown litigation should mediation fail.