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**“Litigation Avoidance 101:  
What Every Real Estate Lawyer Should Know About Avoiding Litigation”**

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**Michael F. Donner  
Stein & Lubin LLP  
San Francisco, CA**

**TRAPS FOR THE UNWARY:**  
**THE USE OF BOILERPLATE ADR, VENUE, CHOICE OF LAW AND ATTORNEYS'**  
**FEES PROVISIONS IN REAL ESTATE CONTRACTS**

Boilerplate provisions can often be a lawyer's worst nightmare. While transactional attorneys frequently copy the standard provisions of one contract into another, some unfortunately do so without giving much thought to what their client's individual needs might be, how the incorporated provisions might relate to other clauses in the new agreement, or what potential problems the boilerplate provisions might unexpectedly cause. It is a trap for the unwary. At the same time a lawyer believes he or she is acting in the best interests of the client by adding a provision that might be useful in the abstract, the lawyer inadvertently could be doing more harm than good. Costly litigation may arise over the interpretation and enforceability of the boilerplate provisions. Use of the provisions could have unforeseen legal consequences that could alter or deleteriously impact the real estate transaction. If this occurs, the client might potentially look to its attorney to compensate it for losing the deal and to reimburse it for any costs the client incurs in the resulting, unanticipated legal entanglement.

Not only must lawyers carefully assess the nature and potential legal effect of boilerplate provisions, but they should also satisfy themselves that (a) their clients understand the purpose and effect of the provisions, and (b) the scope and nature of the boilerplate provisions comport with their clients' needs and interests. Consider the following: at a time when the parties are binding themselves to the terms of a real estate contract and believe that the transaction will proceed without a hitch, has the attorney explained to his or her client that — by executing an agreement containing a boilerplate (and not carefully drafted) arbitration clause — the client might be giving up its right to trial and/or to appeal the arbitration ruling? Has the attorney made the client aware of alternatives to arbitration or explained any hidden pitfalls with the arbitral process that may affect the client's ability to obtain a remedy in the event a dispute arises? And what about an attorneys' fees provision in the contract? Is the client aware that a purchase agreement, for instance, may potentially create a third-party beneficiary relationship with a non-signatory to the contract, such as a cooperating real estate broker, and that — in the event litigation arises out of the transaction and the client fails to prevail at trial — the client may be exposed to an adverse award of attorneys' fees in favor of the broker?

Although there are many boilerplate clauses that are commonly used by real estate practitioners, these materials will focus only on those provisions dealing with (a) arbitration/mediation; (b) venue/jurisdiction; (c) choice of law; and (d) attorneys' fees. By exploring the hidden "trip wires" and issues attending each of these boilerplate clauses, lawyers can avoid many of the unanticipated and often costly ramifications of their use of these provisions.

**A. BOILERPLATE MEDIATION AND ARBITRATION PROVISIONS**

In the abstract, alternative dispute resolution (“ADR”) seems like a good idea. Over the last 25 years, as the number of lawsuits has increased, litigation, as a traditional dispute resolution mechanism, has come under fire not only from the general public, but also from within the legal profession itself. Today, transactional lawyers frequently attempt — almost as an instinctual reaction — to avoid placing their clients in a position where *litigation* is the sole option in the event a dispute arises out of an agreement. ADR clauses have become so commonplace in real estate contracts that lawyers often insert them into the agreements first and then ask the necessary predicate questions later. When ADR works, it is faster, cheaper and more effective in resolving the parties’ disputes. When it fails (often due to the deficiencies of a poorly-drafted ADR provision), the result can be devastating, both to the underlying real estate transaction and to the parties themselves.

A typical, form boilerplate ADR provision might read something like this:

Arbitration of all Disputes. As a material part of this Agreement, the parties agree that any and all disputes, claims or controversies arising out of or relating to this Agreement or the purchase of the Property, shall be determined by confidential, final and binding arbitration in San Francisco, California, in accordance with the then-existing rules for commercial arbitration of the American Arbitration Association. Disputes, claims, and controversies subject to final and binding arbitration under this Agreement include, without limitation, all those that otherwise could be tried in a court to a judge or jury in the absence of this Agreement. By agreeing to submit all disputes, claims and controversies to binding arbitration, each of the parties expressly waives its rights to have such matters heard or tried in a court before a judge or jury or in any other tribunal. Any award shall be final, binding and conclusive upon the parties, subject only to judicial review provided by statute, and a judgment rendered on the arbitration award may be entered in any state or federal court having jurisdiction thereof. Notwithstanding the foregoing, each party agrees that before undertaking the aforementioned arbitration, they shall submit all disputes, claims or controversies to a mutually agreeable mediator in an attempt to a informally resolve said disputes, claims or controversies without the need for arbitration.

On the surface, this provision appears to protect both parties from the uncertainties and enormous expense of protracted litigation. An attorney advising his or her client to approve this provision might well believe that the clause provides the client with a expedited and cost-effective means of avoiding the expense and uncertainties of the court system in the event a dispute does arise between the parties. This clause, however, like many other boilerplate provisions, is rife with issues that require further examination:

**1. The Difference between Mediation and Arbitration** As a fairly standard boilerplate provision, this clause provides for arbitration as a *backup* in the event an informal mediation of the parties dispute fails. Practitioners often employ such a clause without a clear understanding of the distinction between mediation and arbitration, and whether either or both are appropriate under the circumstances. The difference should be assessed and discussed in detail with the client.

In a mediation, a professional — a lawyer, a trained mediator, or someone with industry experience — is retained by the parties to help them reach a settlement. In that regard, a mediation is not a “zero-sum” exercise; there need not necessarily be a winner or loser. The purpose of the mediation is to achieve an informal, voluntary compromise by the parties with the assistance of a professional. Mediations are therefore highly useful in a situation where a lawsuit has not yet been filed and the parties can seize a unique opportunity to resolve their dispute without the need for litigation. Mediation is also helpful where the parties are embroiled in a fierce, emotional dispute and a neutral, respected third-party can stabilize the situation, calm the parties down, and work with them to resolve their dispute.

In sharp contrast, arbitrations are often zero-sum proceedings. The point is often to win, not to compromise. The parties have agreed to take their dispute out of the judicial system and to submit it to one or more neutral arbitrators (a real estate professional, a trained arbitrator, a retired judge, or lawyer) for the purpose of reviewing the evidence and testimony and rendering a ruling that is often binding. Typically, the arbitrator issues an award to be enforced by the courts. The arbitrator’s authority is defined by the agreement of the parties and, to the extent it is applicable, the Federal Arbitration Act, 9 U.S.C. §§ 1-16 (“FAA”), or state arbitration statutes.

**2. Not Every Dispute is Suited for Mediation** Mediation, either as a precursor to the commencement of litigation or as a pre-trial/arbitration ADR mechanism, may have its advantages. In long-term relationships that are typical in the real estate industry, disagreements about things like value and appraisal methods, rate of return, or progress in construction occur frequently. By resolving disputes over such matters at the mediation stage, these long term relationships are often better maintained because the parties’ disputes can frequently be resolved quickly and early through such a pre-litigation/arbitration ADR mechanism. Mediation also offers the parties a chance to resolve their dispute with the help of a mediator who has a unique knowledge of, or perspective on, the real estate industry, and therefore can potentially often evaluate the parties’ respective positions better than a judge or jury can.

Mediation may not be appropriate, however, in every instance. In extremely time-sensitive transactions, for example, such as construction or financing matters, mediation may actually be a *disadvantage*. Some mediation clauses (like the boilerplate provision featured above), *require* the parties to mediate their disputes before commencing litigation, but do not set a deadline by which the mediation must be completed. Practically speaking, such a clause has the potential of being used as an obstacle to actually *preclude* adverse parties from quickly and efficiently obtaining relief. After all, if the clause requires the mediation to occur at a mutually agreeable time and place in front of a mediator to be chosen collectively by the parties, and no time limit or default mechanism is written into the contract in the event the parties are unable to

agree on the terms, one party can delay the other from filing a lawsuit or commencing an arbitration for several months. Under these circumstances, the party seeking to avail itself of judicial and/or arbitral remedies may be forced to file with the courts a motion to compel the mediation and select a mediator. Such actions are not only costly, but they defeat the entire purpose of a mediation in the first place — a speedy and efficient resolution of the parties' dispute. Moreover, if time is of the essence and delay would cause irreparable harm to one party to the contract, a mediation provision that does not contain either a time limit or a carve-out allowing the parties to immediately seek injunctive and other expedited relief from the courts may seriously hamper a client's efforts to avail itself of the appropriate remedies. Under such circumstances the client may lose even before the war has begun.

Practitioners may therefore wish to carefully consider whether their clients will benefit from mediation, either as a predicate requirement to litigation and/or arbitration or at all. If, after weighing the advantages and disadvantages, the client chooses to include a mediation provision in the contract, the attorney should establish with certainty (a) where the mediation is to take place, (b) how the mediator is to be selected, (c) how the parties can quickly move forward with the mediation in the event they are unable to agree on a mediator, and (d) what the scope of the mediation should be. Where the client appears, at the outset of the contractual relationship, to be the one that will more often than not seek to avail itself of judicial and/or arbitral remedies in the event a dispute arises, its attorney may wish to make mediation voluntary rather than mandatory. Where time is of the essence, a carve-out provision should be inserted in the agreement to allow parties to immediately avail themselves of injunctive and other expedited relief in the courts for, among other things, writs of attachment, writs of possession, and an action for specific performance for the appointment of a receiver. Any mediation clause should also provide for the possibility that the mediation will fail, and that the parties will need to move forward, promptly and efficiently, to avail themselves of their rights and remedies.

**3. Not Every Dispute is Suited for Arbitration.** Many transactional lawyers often are so enamored by the potential advantages of arbitration that they lose sight of its disadvantages. On one hand, arbitration may be less expensive and quicker than litigation. The parties can design the scope of their arbitration to meet the particular needs of the transaction and can select an arbitrator to adjudicate the dispute who is familiar with the real estate industry.

However, arbitration also may not be the answer in every instance. In some cases — particularly those, like actions for injunctive relief, where large-scale discovery is necessary and only an expedited bench trial (as opposed to a jury trial) is available — lawsuits may actually be *preferable*. Under these circumstances, a “wait and see” strategy might work better than an arbitration provision. The parties can agree to ADR after a dispute develops instead of committing themselves at the beginning of their contractual relationship to ADR. If a dispute does arise, the client's transactional lawyer can then consult with a litigator to decide what type of alternative dispute resolution process would best meet the client's needs.

Careful drafting of contractual arbitration provisions is essential. The legal and practical ramifications of signing an agreement containing such a provision. Many arbitration clauses, like the boilerplate one above, are drafted so as to *require* the parties to automatically submit all disputes or controversies arising out of their transactions to binding arbitration. A client may be committed to binding arbitration and give up his right to a trial and to appeal the

arbitration decision without realizing it. When drafting an arbitration clause, practitioners should pay particular attention to the following issues:

**a. Timing and Scope of the Arbitration.** Boilerplate clauses often require binding arbitration of all disputes “arising out of” or “relating to” the transaction. An attorney, however, should consider whether the client intends for all disputes pertaining to the contractual relationship to be arbitrated, or whether, in sharp contrast, it is prudent to narrowly tailor the arbitration provision so that only certain discrete aspects of the relationship are governed by the clause. Because an arbitration is like a trial (but held in less formal surroundings than a court), the attorney must also consider how much time the client’s litigators will require to prepare for the proceeding and what they will need in order to effectively do so. A client’s desire to quickly and efficiently submit the parties’ dispute to an arbitrator for adjudication may backfire if its counsel does not have sufficient time to identify and prepare witnesses, conduct discovery (if any), and prepare for the arbitration proceeding.

**b. Format and Scope of the Arbitration.** Attorneys drafting arbitration provisions should never lose sight of the fact that many aspects of a potential arbitration can be pre-determined by contractual agreement. The authority of the arbitrator can be limited or expanded. The nature, scope and timing of discovery can be restricted or enlarged. The parties may empower the arbitrators to issue subpoenas, set hearing dates, and grant or deny postponements or discovery requests. The number and professional credentials and experience of the arbitrators can also be determined by the parties. They can even define the type of remedy the arbitrators are empowered to award and limit the time in which the arbitrators have to render their award. Time limitations may be useful where there might be a risk of irreparable harm in the event of a delay, or where injunctive or other relief might be necessary. The boilerplate provision above, however, contains none of these provisions.

**c. Rules Governing the Arbitration.** Arbitration clauses, like the one above, frequently state that the arbitration will be governed by the then-operative rules of the American Arbitration Association (“AAA”) or similar organizations. It is important, however, to consider what those rules are and how they may impact the arbitration before the client agrees to be bound by them. If the rules of any private judging organization are to be used, those rules should be carefully reviewed to determine whether they comport with the parties’ objectives in the arbitration. To the extent they do not serve the parties’ needs, counsel may either look to the FAA or state arbitration statutes as “gap-fillers,” or they can agree to handle certain situations that may arise in a contractually-mandated manner.

Consider, for example, that the AAA rules (or those of similar organizations) may not provide for a means to compel arbitration where the parties disagree that the clause covers their dispute. The parties may wish to provide for such a contingency or to rely on the FAA or state rules in such an event. What happens when a party should be named as a defendant in an arbitration, but is not a signatory to the real estate contract, and therefore, is not bound by its arbitration provision? Under such circumstances, the clause should provide for a means of bringing such third parties (e.g., the seller’s broker in an action by the buyer for fraudulent concealment of defect) into the arbitration so that the dispute can be fully and effectively resolved at one time.

Moreover, although the laws of many states provide for the taking of discovery during arbitration, the parties may wish to expand or restrict that discovery. For example, the parties may contractually restrict the number of depositions that can be taken prior to the commencement of an arbitration or limit written discovery to document demands (as opposed to interrogatories, requests for admission, and other discovery devices). The parties can also avoid discovery altogether and simply agree to informally exchange all documents supporting their contentions and damages claims in the event an arbitrated dispute arises.

**d. Issues Involving Arbitration Costs and Fees.** The common wisdom is that arbitrations are often cheaper than trials. This is not always the case. Sometime arbitrations take on a life of their own and become equally or more expensive than court actions. Arbitrators, for example, may be more permissive than judges with respect to preliminary law and motion and discovery. They are also not bound by the rules of evidence or any local “fast track” rules that require parties to bring cases to trial within certain statutorily-mandated time periods. Where the arbitration proceeding is complex and takes place over the course of many days, costs can quickly add up, particularly in an environment where private judges charge as much as \$700 or more per hour in some legal marketplaces. One solution might be to draft the arbitration clause to allow the prevailing party to recover its attorneys’ fees and costs (so long as the client is aware of the risks of losing the arbitration and knows just how much it will be required to pay in attorneys’ fees and costs if it loses).

**e. Award Enforcement and Appeal.** The boilerplate arbitration clauses above, like many others used by practitioners, is silent about the enforcement of awards or the availability of an appellate procedure to challenge awards. This may lead to enormous problems in the event the client loses. Both lawyers and clients should be aware of the issues relating to the enforcement and appeal of arbitration awards.

Typically, once a party has won, the prevailing party files an action and the arbitrator’s award with the court, and then asks the court to interpret and enforce it. This is time-consuming and can open the door to delay and challenges by the losing party. One solution is to write the arbitration clause in such a manner as to require the losing party to execute a stipulated judgment based on the terms of the arbitration award that will be filed with the court. The judgment can include the attorneys’ fees and costs awarded to the prevailing party by the arbitrator.

In most states, there are inherent limits on a client’s ability to appeal an adverse arbitration award. In most jurisdictions, unless otherwise provided in the agreement, an arbitrator may award any remedy reasonably contemplated by the parties, even though a court could not have done so. *See, Advanced Micro Devices Corp. v Intel Corp.*, 9 Cal.4th 362, 36 Cal.Rptr.2d 581 (1994). Notably, an arbitrator need not follow legal rules or laws and apply them to the facts in order to render an arbitration award. *See, Wilco v. Swan*, 346 U.S. 427, 430, 74 S.Ct. 182, 98 L.Ed 128(1953), *overruled on other grounds, Rodriguez Bequijas Beshurson v. American Express, Inc.*, 490 U.S. 477, 484, 109 S.Ct. 1917, 104 L.Ed.2d 526 (1989). Parties who agree by contract to submit to binding arbitration, give up their right to trial and the right to appeal the arbitration order except on very limited grounds. *See, Monmarsch v. Heily & Blase*, 3 Cal.4th 1, 28, 10 Cal. Rptr.2d 183 (1992).

An arbitration award may therefore generally only be appealed in the courts under extremely narrow circumstances, such as where sufficient evidence can be proffered showing that the arbitrator committed fraud in rendering the award. In other words, in many jurisdictions, an arbitrator can get it totally wrong, apply the law incorrectly (or simply ignore it) , and render an adverse award against the party that correctly should have won, and there is nothing anyone can do about it — absent a showing of extrinsic fraud in the arbitral process. Accordingly, before practitioners have their clients sign real estate contracts containing arbitration provisions, they should satisfy themselves that their clients understand the risks and benefits of the ADR process. If appellate rights are to be provided by agreement, the parties should determine how those rights are to be effectuated and the timing for doing so.

With this as background, the boilerplate provision above may be analyzed as follows:

<u>Deficiencies of the Boilerplate Clause</u>	<u>Possible Remedial Language &amp; Strategy</u>
<ul style="list-style-type: none"> <li>• Requires mediation as predicate event</li> <li>• Scope and terms of mediation undefined</li> <li>• Requires arbitration</li> <li>• Scope and terms of mediation undefined</li> <li>• No mention of appellate process</li> </ul>	<ul style="list-style-type: none"> <li>• Make mediation voluntary</li> <li>• Provide for location of mediation; set time limits and default mechanism for selection of mediator; defines terms of mediation and means of selecting mediator</li> <li>• Discuss with client whether mediation is efficient way to resolve dispute</li> <li>• Provide carve-out for injunctive and other expedited relief; specify what discovery can be propounded and deadlines for completing discovery; provide for fall-back on FAA or specific state statutory “gap-fillers”; provide for standards for arbitrators to adjudicate matter and deadline for rendering award; provide mechanism for enforcing award</li> <li>• Specify what can be appealed and how</li> </ul>

**B. BOILERPLATE JURISDICTION AND VENUE PROVISIONS**

Another boilerplate provision commonly used in real estate contracts is the jurisdiction and venue clause. The purpose of such a provision is to provide a client with a geographically-convenient and potentially “favorable” place to adjudicate disputes that might arise out of the contract. Venue and jurisdiction selection clauses because they allow the parties to foresee and therefore plan for possible future litigation by selecting whether those disputes

will be brought in state or federal court or to designate counties and even cities in which the disputes should be adjudicated.

In its simplest form, a venue and jurisdiction clause might read something like this:

Jurisdiction and Venue: The parties agree that any suit, action, or proceeding arising out of this agreement may be submitted to the jurisdiction (both personal and subject matter) of the Federal Courts of the State of New York.

Although it looks somewhat innocuous, this boilerplate provision presents several issues that require further examination.

**1. Jurisdiction Issues.** This boilerplate clause purports to confer subject matter jurisdiction on parties to a contract rather than merely designate a forum in which they may litigate potential disputes. This is problematic because parties generally do not have the power to impose subject matter jurisdiction on a court which would not otherwise have the power to adjudicate the dispute even if the parties agree to that jurisdiction. In the clause above, for example, unless all of the requirements for obtaining federal subject matter jurisdiction have been met (*e.g.*, a federal question exists or there is complete diversity between the parties), the federal courts cannot adjudicate any dispute arising out of the contract.

On the other hand, personal jurisdiction (unlike subject matter jurisdiction) may generally be conferred by agreement. The current rule in most jurisdictions is that an otherwise valid forum selection clause may confer personal jurisdiction on the chosen venue even where the venue *lacks* the minimum contacts over one or the other party. *Voicelink Data Services, Inc. v. Data Pulse, Inc.*, 86 Wash.App. 613, 620-21, 937 P.2d 1158 (1997). (Currently, only Alabama, Iowa, Idaho, and Montana appear to hold “that ‘outbound’ forum selection provisions are per se unenforceable,” and the latter two states do so based solely on their interpretation of state statutes. *See, Professional Insurance Corp. v. Southerland*, 700 So.2d 347, 351 (Ala. 1997).) Under this majority rule, once the parties knowingly enter into a contract containing a valid jurisdiction provision, the courts will likely defer to their agreement and not conduct an extensive analysis of convenience factors.

In *Phoenix Leasing, Inc. v. Kosinski*, 47 Conn.App. 650, 655-56, 707 A.2d 314 (1988), for instance, the plaintiff filed an action and obtained a judgment against the defendant in California based on a jurisdiction/venue clause in the parties’ contract. When the plaintiff attempted to collect on the judgment, the defendant sought to invalidate the clause in the Connecticut courts (Connecticut was where the contract was entered into by the parties) on the grounds that California did not have sufficient minimum contacts over the defendant. The court disagreed, holding that the venue/jurisdiction clause was valid and that, by signing a contract

containing the provision, the defendant had waived its right to contest jurisdiction on convenience grounds.

**2. Due Process Issues.** Jurisdiction/venue provisions will generally not be enforced if they conflict with mandatory venue statutes or if “compelling and countervailing reasons,” such as due process concerns, exist. *M/S Bremen v. Zapata Off-Shore, Co.*, 407 U.S. 1, 15, 92 S.Ct. 1907, 32 L.Ed.2d 513 (1972). Due process requires that venue and jurisdiction must be “foreseeable” and “fair,” and not deny the parties their “day in court.” *Id.*; see also, *Marvel Consultants, Inc. v. Gilbar Engineering Co.*, 1998 Ohio App. Lexis 203 (Ohio App. 1998); *Phoenix Leasing*, 47 Conn.App. at 655-56, 707 A.2d at 314. In *Richards v. Lloyds of London*, 135 F.3d 1289, 1296 (9th Cir. 1997), for example, the plaintiff attempted to invalidate a forum selection clause which mandated that England would be the exclusive venue for all disputes under the contract. The plaintiff contended that the laws of England would be insufficient to provide it with adequate protection. The Ninth Circuit Court of Appeal upheld the validity of the clause, noting that, as English law provided adequate remedies to the plaintiff, the clause did not violate the plaintiff’s due process rights.

To avoid a due process problem, drafters of jurisdiction/venue provisions should require the parties acknowledge in the contract that they are knowingly submitting to the jurisdiction of the chosen state (and the federal or state court therein), regardless of where the contract will be executed or performed by them. The parties should also acknowledge that the jurisdiction/venue clause has been “fully and fairly bargained for” as a necessary part of their agreement. In addition, the drafter should place the clause in the main body of the contract and not in collateral documents, such as fee schedules or exhibits, so as to avoid a challenge to its enforceability on the grounds that it was obtained by fraud or over-reaching. See, *Marvel*, 1998 Ohio App. at 203; *Oxman v. Amoroso*, 172 Misc.2d 773, 780, 659 N.Y.S.2d 963 (1997) (selection clause held unenforceable because it was inconspicuous and in “small, undistinguishable print which is virtually unnoticeable,” in violation of New York’s Consumer Contract statutes).

**3. Other Enforceability Issues.** Finally, attorneys should pay particular attention to the actual language used in the jurisdiction/venue clause to ensure its enforceability. A clause similar to the exemplar featured above was the subject of an enforceability analysis in *Berg v. MTC Electronic Technologies, Co., Ltd.*, 61 Cal.App.4th 349, 359, 71 Cal.Rptr.2d 523 (1998). In that case, the California Court of Appeal held that the clause was deficient in that its language did not *mandate* that all disputes be litigated in the parties’ chosen venue, Los Angeles. Because the clause did not contain mandatory words such as “shall,” “exclusive,” or “only,” the Court refused to enforce it, holding that the provision was merely *permissive* in nature. Hence, a venue/jurisdiction clause can be completely unwound, despite the parties’ apparent agreement at the time of contracting, where the drafter has not adequately dealt with the issue of minimum contacts, the parties’ submission to the jurisdiction of the selected forum, and the permissive versus mandatory nature of the provision itself.

With this as background, the boilerplate provision above may be analyzed as follows:

<u>Deficiencies of the Boilerplate Clause</u>	<u>Possible Remedial Language &amp; Strategy</u>
<ul style="list-style-type: none"> <li>• Purports to create subject matter jurisdiction</li> </ul>	<ul style="list-style-type: none"> <li>• Provide for acknowledgement of personal jurisdiction only</li> </ul>
<ul style="list-style-type: none"> <li>• Potential due process problem</li> </ul>	<ul style="list-style-type: none"> <li>• Provide for acknowledgement that clause was fairly bargained for and place in main agreement</li> </ul>
<ul style="list-style-type: none"> <li>• Lacks mandatory venue language</li> </ul>	<ul style="list-style-type: none"> <li>• Make venue mandatory not voluntary; “may” to “shall”</li> </ul>

### C. BOILERPLATE CHOICE OF LAW PROVISIONS

Rules on interpretation and enforceability of real estate contracts vary from state to state. Thus, the parties should predetermine and designate in their contract which state’s laws will govern in the event a dispute between them arises. A standard, boilerplate choice of law clause might read something like this:

Governing Law: The parties agree that any suit, action, or proceeding arising out of this the law of the State of California shall govern.

Significantly, it is unclear whether this boilerplate clause is enforceable. While parties are generally free to contract as they wish and to select the state law that will govern any potential disputes arising out of their contract (*Bolt Information Sciences, Inc. v. Board of Trustees*, 49 U.S. 468, 476, 109 S.Ct. 1248, 103 L.Ed.2d 488 (1989)), the chosen law must have some relationship to the parties, the agreement, or the subject matter of the contract. In addition, the choice of law venue must not offend the public policy of the chosen state. *DeSantis v. Wackenhut Corp.*, 93 S.W.2d 670, 677, 33 Tex.Sup.J. 517 (Tex. 1990), *cert. denied*, 498 U.S. 1048, 111 S.Ct. 755, 112 L.Ed. 2d 775 (1991).

In many states, contractual choice of law provisions will generally be enforced if they were agreed to by the parties in arms-length negotiations, and they comport with the requirements of Restatement 2nd, Conflicts of Laws, § 187, “which reflect a strong policy favoring enforcement.” *Nedlloyd Lines B.V. v. Superior Court*, 3 Cal.4th 459, 464-65, 1 Cal.Rptr.2d 330 (1992). The Restatement enforceability “test” is comprised of two separate analyses. First, a court seeking to enforce a choice of law provision must determine whether (a) the chosen state has a “substantial relationship” to the parties or their transaction, or (b) there is any other “reasonable basis” for the parties’ choice of law. If neither of these tests is met, the inquiry ends and the court cannot enforce the choice of law clause. *Nedlloyd*, 3 Cal.App.4th at 466. If, however, either test is met, the court must next determine whether the chosen state’s law is contrary to a fundamental policy of another state in which the challenging party seeks to have the contract enforced. If the other state does not have a “materially greater interest” than the

chosen state in determining the particular issue, and there is no conflict between the two states' laws, the choice of law provision will be enforced. *See, Tex. Bus. & Comm. Code § 1.105(a)* (allowing parties to select Texas law to govern “when transaction bears a reasonable relation to the state”).

In other states like New York, however, the Restatement enforceability “test” is not applied, and the parties can agree to be bound by the state’s law even if the contract does not bear a “reasonable relation” to the state. *See, N.Y. Gen. Oblig. Law § 5-1401(1)* (where transaction in involves an aggregate of more than \$250,000, the parties can agree to be bound by New York state law even if contract bears no reasonable relation to New York).

Careful consideration of these rules is necessary when drafting choice of law provisions. In those jurisdictions relying on the Restatement enforceability “test,” attorneys should recite foundational facts in the choice of law provision that provide for a justifiable basis by which that state’s law can be applied. In non-Restatement states, lawyers should check the relevant statutes dealing with choice of law issues and satisfy themselves that the transaction complies with all statutory requirements. The parties may also avoid disputes about the sufficiency of “minimum contacts” of the chosen state by including a recitation in the agreement that it has been “prepared, negotiated and executed” in that state. They should also make sure that, where multiple agreements or instruments (such as notes and deeds of trust) are involved in a transaction, the law of the chosen state governs each (if that is the desired result the parties seek).

Attorneys should also give considerable thought to choosing the state law that will govern the transaction. After all, a venue that might be the most convenient *location* for a client to litigate a dispute might not always provide the most advantageous *law* to govern the deal. Lawyers and clients should realize that the mechanics governing real estate closings differ between states. Certain provisions may be enforceable in one jurisdiction, but unenforceable in another. Hence, if the parties intend the transaction to be governed by an out-of-state law, the form and substance of the agreement should be approved in writing before signing by local counsel.

With this as background, the boilerplate provision above may be analyzed as follows:

<u>Deficiencies of the Boilerplate Clause</u>	<u>Possible Remedial Language &amp; Strategy</u>
<ul style="list-style-type: none"> <li>• No foundational facts recited providing basis for application of California law</li> </ul>	<ul style="list-style-type: none"> <li>• Recite foundational facts in the choice of law provision that provide for a justifiable basis by which that state’s law can be applied</li> </ul>
<ul style="list-style-type: none"> <li>• Potential minimum contacts problem</li> </ul>	<ul style="list-style-type: none"> <li>• Recite that contract has been “prepared, negotiated and executed” in that state</li> </ul>
<ul style="list-style-type: none"> <li>• Potential multiple instruments problem</li> </ul>	<ul style="list-style-type: none"> <li>• Recite that all instruments are governed by same law</li> </ul>

#### **D. BOILERPLATE ATTORNEYS' FEES PROVISIONS**

Lawyers are frequently asked by their clients whether the attorneys' fees and costs they have incurred in litigation and/or arbitration are recoverable. Many clients are chagrined to learn that the general rule in the United States is that such fees and costs are not recoverable except as specifically provided by statute or as the parties agree by contract. *Pacific Custom Tools, Inc. v. Turner Construction Co.*, 79 Cal.App.4th 1254, 1267, 94 Cal.Rptr.2d 756 (2000). In light of this general rule, many transactional attorneys often include boilerplate attorneys' fee provisions in real estate contracts to "protect" their clients in the event the other party breaches the agreement. In determining the appropriateness of an attorneys' fee provision, however, lawyers should determine whether their clients are the parties who will most often bring a lawsuit arising out the contract or be sued in connection with it. A typical boilerplate attorneys' fees provision might read something like this:

Attorneys' Fees. The prevailing party may recover its reasonable attorneys' fees in any lawsuit arising out of the breach of this Agreement.

While the attorney drafting this provision may think he or she is helping the client by including such a clause in the parties' real estate contract, the reality is that boilerplate clauses like this one could actually do more harm than good. Consider, for example, the following issues:

**1. Scope of the Provision.** As with any contractual provision, the scope of attorneys' fees clauses can be narrowed or expanded by the specific language of the parties' agreement. A careless drafter might inadvertently limit the provision's application only to those actions arising out of a breach of the agreement itself — as is the case with the example provided above — and thereby deprive his or her client of the opportunity to recover fees and costs in a host of tort and other actions which might potentially be brought in connection with the agreement. The most effective fee clauses are therefore extremely broadly worded to allow for the recovery of fees in both tort and contract claims. Such broadly worded fees clauses typically provide for the recovery of (a) fees *and* costs, (b) in any suits, disputes, controversies, actions (including those for injunctive and declaratory relief) or litigation, (c) "relating to, arising out of, or based on" the real estate transaction. They also expressly provide for the recovery of any fees and costs incurred during the appellate process.

Contractual provisions providing for recovery of fees and costs in any "suit" or "court action" relating to or arising out of the contract have also been held in some jurisdictions to apply to arbitration proceedings. *Tate v. Saratoga Savings and Loan Association*, 216 Cal.App.3d 843, 856-57, 265 Cal.Rptr.2d 440 (1989), *disapproved on other grounds*, *Advanced Micro Devices*, 9 Cal.4th at 362, 31 Cal.Rptr.2d at 581. Nonetheless, to leave no room for doubt on the subject, if the agreement calls for arbitration (instead of litigation), the attorneys' fees

provision should be modified to authorize a prevailing party fee recovery in the event a dispute arises requiring the parties to arbitrate. Further, if the parties enter into several contracts as a part of a single relationship or transaction, an attorneys' fees recovery provision contained in one of the contracts should specifically state that it is applied to the other documents in the transaction and that they should be construed together.

**2. “Be Careful What You Ask For.”** The insertion of an attorneys' fees provision in real estate agreements creates certain risks. A client should be aware that, if it does not prevail in any litigation arising out of the contract, it could end up paying substantial attorneys' fees to the other side. Many clients, especially those who often view an attorneys' fees clause as an instrument to protect *them* in the event of the other parties' breach, frequently do not contemplate this risk.

Lawyers should pay particular attention to applicable state law provisions relating to fee recovery. In California, for example, under Civil Code Section 1717, even if a contract provides that only one party may recover attorneys' fees in litigation to enforce the agreement, the attorneys' fees clause will be read as creating *reciprocal* rights in favor of the prevailing party, regardless of which party initiates the action. *Cal. Civ. Code § 1717(a)*. Section 1717's reciprocal right to fees recovery, however, applies only to actions on the contract containing the attorneys' fees provision. There is no such right to fees if the asserted claims sound in tort and the contract only gives one party the right to an attorneys' fee award in the event he or she prevails in the litigation. *Moallem v. Caldwell Banker Commercial Group, Inc.*, 25 Cal.App.4th 1827, 1831-33, 31 Cal.Rptr.2d 283 (1994).

Accordingly, if the contract is to be governed by California law or the law a state with similar fee recovery statutes, the attorneys' fee provision should be drafted broadly to allow the prevailing party to recover fees regardless of whether the claims sound in tort or contract. To ensure complete protection to the parties, a contractual fee clause should also be drafted to benefit whichever party prevails, rather than only one named party. On the other hand, if the client wants to *restrict* fee recovery solely to litigation related to the parties' contract, a narrowly-worded provision limiting recovery to actions “on the contract” or “to enforce the contract” is recommended.

**3. Prevailing Party Issues.** Where a fee provision allows a “prevailing party” to recover its fees and costs, it is often difficult to determine precisely which of the parties has “prevailed.” In many jurisdictions, except where an action has been voluntarily dismissed, the party receiving the “greater relief” in the action is the “prevailing party” that is entitled to recover its attorneys' fees pursuant to a fee provision. *Sears v Baccaglio*, 60 Cal.App.4th 1136, 1154-55, 70 Cal.Rptr.2d 769 (1998). The party may be entitled to fees even when he or she successfully defends a lawsuit on the grounds that the contract sued upon is invalid and unenforceable so long as the other party would have been entitled to recover attorneys' fees under the alleged contract had he or she prevailed. *Hsu v. Abbara*, 9 Cal.4th 863, 870-871, 39 Cal.Rptr.2d 824 (1995). This rule means that a party who asserts both contract and non-contract causes of action and wins only on the non-contract causes of action might end up paying attorneys' fees to the opposing party who otherwise lost the lawsuit. The party receiving the “greater relief” is not necessarily the party receiving the greater monetary judgment. Some statutes vest trial courts with broad equitable discretion to determine the “prevailing party” in

particular cases, and thus to determine that one party has prevailed for Section 1717 purposes, even though he or she receives no monetary judgment. *Sears*, 60 Cal.App.4th at 1154-55, 70 Cal.Rptr.2d at 769. In some states, no prevailing party can exist for fee recovery purposes if a contract action is voluntarily dismissed pursuant to settlement or otherwise. However, if the contractual fee recovery clause is worded broadly enough to apply to both contract and tort causes of action, the court has discretion to determine the “prevailing party” following the plaintiff’s voluntary dismissal of the action. *Santisas v. Goodin*, 17 Cal.4th 599, 622, 71 Cal.Rptr.2d 830 (1998).

**4. Anticipating Third-Party Claims.** Practitioners should also be aware that non-signatories to real estate contracts containing attorneys’ fees provisions may recover fees as a “prevailing party” in an action. For example, a cooperating broker, successfully suing to obtain a commission under a listing agreement between the listing broker and the seller, may obtain attorneys’ fees if the listing agreement contains an attorneys’ fees clause and the broker is found to be a third-party beneficiary of that clause.

In California and other states, the critical test for determining whether a non-signatory can recover fees under a contract is whether he or she would have been liable for the opposing party’s fees had he or she lost the action. *Real Property Services Corp. v. Pasadena*, 25 Cal.App.4th 375, 382, 30 Cal.Rptr.2d 536 (1994). In the same vein, a prevailing party may enforce a contractual attorneys’ fees provision against a non-signatory to a real estate contract where pertinent portions of the contract refer to the non-signatory and the attorneys’ fees provision “unambiguously included the [non-signatory] within the ambit of its benefit and its performance obligations.” *Pacific Preferred Properties, Inc. v. Moss*, 71 Cal.App.4th 1456, 1463, 84 Cal.Rptr.2d 500 (1999). These rules apply even if the contract itself is later found to be unenforceable. *Hsu*, 9 Cal.4th at 870, 39 Cal.Rptr.2d at 824.

**5. Discretion of the Courts.** Finally, clients should be aware that, in many states, even if a real estate contract appears to provide for attorneys’ fees, the trial courts have discretion to determine the total amount of an attorneys’ fees award, and to limit the award only to what they feel is “reasonable.” This is significant because the ultimate award may end up being for far less than the amount of fees and costs actually incurred by the client in the litigation. In California, for example, where the results of litigation are mixed — *i.e.*, where victories and losses between the parties are evenly divided — there is no mandatory duty to declare a “prevailing party.” *Nasser v. Superior Court*, 156 Cal.App.3d 52, 59, 202 Cal.Rptr. 552 (1984). The courts may also determine whether the amount of attorneys’ fees sought pursuant to an attorneys’ fees clause are “reasonable” in light of market rate measures for legal services. *PLCM Group, Inc., v. Drexler*, 22 Cal. App. 4th 1084, 1094-98, 95 Cal.Rptr.2d 198 (2000).

With this as background, the boilerplate provision above may be analyzed as follows:

<u>Deficiencies of the Boilerplate Clause</u>	<u>Possible Remedial Language &amp; Strategy</u>
<ul style="list-style-type: none"> <li>Limits recovery to lawsuits on contract</li> </ul>	<ul style="list-style-type: none"> <li>Modify language to provide for recovery in “lawsuits, arbitrations, or other proceedings</li> </ul>

<p>Fails to provide for costs or appellate fees and costs</p> <ul style="list-style-type: none"> <li>• Potential multiple documents problem</li> </ul>	<p>arising out of, relating to, or based on in any way” the real estate transaction, including, without limitation, tort actions and actions for injunctive and declaratory relief and specific performance</p> <ul style="list-style-type: none"> <li>• Provide for costs and add appellate language</li> <li>• Recite that all documents are governed by same fee and cost clause</li> </ul>
<ul style="list-style-type: none"> <li>• Allows court to determine what fees are “reasonable”</li> <li>• Potential prevailing party issue</li> </ul>	<ul style="list-style-type: none"> <li>• Replace “reasonable” with “actual” to reduce (but not eliminate) risk that court will reduce fee award</li> <li>• Discuss risks with client and provide carve-out precluding recovery in the event of voluntary dismissal of action</li> </ul>

**E. CONCLUSION**

As highlighted by the examples provided above, boilerplate contract provisions are traps for the unwary. If not drafted carefully, such clauses could have unanticipated legal consequences that might lead to litigation. It is therefore important for all provisions of a real estate contract to be carefully scrutinized and drafted with an eye toward the client’s ultimate objectives in consultation with litigation attorneys and/or local counsel in other states, as the transaction may require.