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Mandatory Mediation Enforcement

THIS ISSUE

Most residential purchase agreements contain a mandatory mediation agreement. California courts have upheld this provision, and the resulting waiver of the right to recover attorney fees for breach.

BACKGROUND

In May 2005, we reported on the *Frei v. Davey* decision, in which the court upheld a mandatory mediation clause in a residential purchase agreement.

In that case, a buyer and seller of residential property entered into a standard residential purchase agreement. The seller backed out of the deal claiming that the buyer breached the agreement. After informal negotiations, the buyer demanded mediation pursuant to the terms of the contract. But the seller refused, saying that the buyer was so unreasonable, and their positions were so far apart, that mediation would be a waste of time and money. The buyer sued, and the seller cross-complained against his broker.

After several trials (and appeals), the court entered judgment for the seller, who then tried to recover his attorney fees of nearly $160,000 from the buyer. The court refused, citing the mandatory mediation and loss-of-attorneys'-fees-for-failure-to-mediate provisions of their contract.

The standard residential purchase agreement in use in California requires that parties to the contract must mediate before bringing an action arising out of the facts and circumstances of the contractual dispute. The failure to do so, or the resisting of a request for mediation, means that the party will not be entitled to recover his or her attorney fees, even if he or she prevails in litigation.

This one-way attorney fee provision would seem to violate the provisions of Civil Code section 1717 (d), which says that

any contractual provision that purports to create a one-way attorney fee is void, and all contracts containing an attorney fee provision will be interpreted as being bilateral.

Nevertheless, two appellate district courts are now in synch on this issue, and say that the contract means what it says: if you fail to mediate before brining an action, or resist mediation once it's demanded, you cannot collect prevailing party attorney fees.

NEW CASE INTERPRETING THIS CLAUSE

On June 20, 2008, the Third Appellate District Court published the opinion of *Lange v. Schilling*. In that case, a party to a standard California Residential Purchase Agreement filed an action against the sellers. Unable to locate the sellers, the attorney for the buyer hired a private investigator who found an out-of-state mailbox drop address. The buyer's attorney sent the complaint by mail to that address.

The sellers' attorney contacted the buyer's attorney, who offered to stay the action before the sellers had filed their answer to the complaint, in order to complete the required mediation. His letter concluded: "You will notice that the contract contains a mediation/arbitration clause. Prior to filing the complaint, both my client and my staff undertook research to determine the present address of the [sellers] so that a demand for mediation could be made. We were unsuccessful in finding any address other than the 'mail drop' in Nevada. Your offices are in Stockton so I suspect that the [sellers] may be living close to Stockton. My client is willing to stay the litigation at this point (i.e., default has been entered but no judgment requested) in order to mediate the matter should the [sellers] so desire. Perhaps we could choose a mediator in Concord or some other location halfway between our offices. I have no idea as to whether or not the brokers would participate. Please let me know immediately if your clients do wish to mediate; otherwise, we will assume that both parties are waiving paragraph 17 of the sales agreement in its entirety."

The parties stipulated to set aside the default. Sellers filed an answer on October 22, 2004, and the matter went to trial. The jury returned a mixed verdict on the various causes of action. The court entered a judgment in favor of plaintiff for $13,475.

Plaintiff filed a motion for $113,096.03 in attorney fees, asserting that as the prevailing party, he was entitled to fees under the agreement. Defendants opposed the motion for attorney fees, arguing that plaintiff was not entitled to fees because he did not attempt to mediate the dispute before filing his complaint as required by the agreement.

The trial court held, "Plaintiff offers reasonable justification for failing to offer mediation prior to filing suit: He could not locate the [sellers]. He knew they moved from their last known residence in Copperopolis, CA and were traveling in California and Nevada in an RV. A pre-litigation attempt to locate an address by an internet search was unsuccessful. After suit was filed, plaintiff hired an investigator to locate the [sellers] in order to achieve service of process. The skip-tracer found their address within 16 days."

The trial court further found that the plaintiff substantially complied with the agreement "by offering to stay the litigation in order to mediate the matter. The [sellers] did not respond to plaintiffs' offer. The court cannot say they suffered any prejudice due to the tardy offer to mediate in that, at the time plaintiff offered to mediate, the [sellers] had not filed any responsive pleading."

The court awarded plaintiff $80,710.26 in fees, an amount reflecting the fees incurred after plaintiff's offer to mediate. The defendant appealed.

RULING ON APPEAL

Defendants contended that the clear language of the agreement precludes an award of attorney fees if a party does not attempt mediation before commencing litigation. Because plaintiff filed his lawsuit before offering mediation, they argued, there was no basis to award fees and the court's order must be reversed.

The Court of Appeal agreed, holding that while the agreement authorizes attorney fees to the prevailing party, that right is contingent on compliance with paragraph 17A, which states: "If, for any dispute or claim to which this paragraph applies, any party commences an 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 attorney fees, even if they would otherwise be available to that party in any such action."

Plaintiff filed his complaint first and only later offered mediation. His failure to meet the condition precedent required by paragraph 17A precludes any award of fees.

The Plaintiff argued that his September 2004 offer to mediate constituted "substantial compliance" with paragraph 17A. But the court held that the doctrine of substantial compliance is not applicable in this situation. Paragraph 17A sets forth a clear and unambiguous condition precedent that must be met in order for attorney fees to be awarded: the party must attempt mediation before commencing litigation. By filing his complaint before attempting mediation, plaintiff lost any right to attorney fees.

As the court said, "Paragraph 17A is designed to encourage mediation at the earliest possible time. This provision would become meaningless if a party were allowed to recover attorney fees by making a request for mediation after litigation has begun and then claiming substantial compliance."

WHY IS THIS IMPORTANT?

It is the stated public policy of California to encourage mediation as an effective tool for avoiding litigation, with its attendant costs and risks. But the litigation risks are significantly enhanced when one party can recover prevailing party attorney fees, but the other cannot. Settlement negotiation strategies are significantly affected, making what might otherwise be a risky litigation position into one with relatively low risk.

Moreover, frequently the attorney fees vastly outweigh the amount at issue in the litigation; in the above case, the successful plaintiff was awarded $13,475 by a jury, and brought a motion seeking in excess of $113,000 in attorney fees. In that case, the trial court awarded just over $80,000 in fees, with the difference (over $33,000) being the amount of attorney fees expended prior to the plaintiff's demand for mediation. Clearly, in this case, both parties would have been far better off mediating the matter before that money was spent.

CONCLUSION

It is vitally important for potential litigants to ensure compliance with the pre-litigation mediation obligations of a residential purchase agreement. As the courts have said: it means what it says, and it will be enforced.

NEXT ISSUE

Recent appellate decision on enforceability of real estate option to purchase.

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