CALIFORNIA ASSOCIATION OF REALTORS®

QUICK GUIDE

Arbitration for the Consumer

Mediation Comes First; Arbitration or Litigation Later

Nobody likes to be involved in a real estate dispute, but sometimes it is unavoidable. If you are the buyer or seller using a C.A.R. Residential Purchase Agreement (RPA) and you cannot resolve a dispute with the other party directly or through your broker, the RPA requires you attempt to mediate before taking any further action.

Mediation involves a third party who helps facilitate a negotiation and settlement. If mediation does not result in a settlement, then you must go to court (litigation) or arbitration to finally resolve the dispute. Going to court usually involves hiring a lawyer and ultimately presenting your case to a judge or jury. Arbitration is both similar and different.

Reasons Why Arbitration is <u>like</u> Litigation:

- you typically hire an attorney to represent you
- you gather information about your case
- you present evidence to a neutral third party who will decide if you or the other side is right, and
- the decision is binding

Reasons Why Arbitration is <u>Different</u> from Litigation:

- The decision maker will not be a sitting judge or jury but rather a trusted person that the parties pick
- there is almost no right to appeal the decision (called an Award)
- the hearing will be conducted in an office or conference room rather than a court,
- it is a private hearing and results are not open to the public, and
- the arbitrator needs to be paid

Arbitrate or Litigate: The Choice is Yours

Making the decision to initial an arbitration clause in the RPA is personal. Statistically, few civil cases that are filed in court are ever heard before a judge and fewer before a jury, and not many cases that are appealed overturn the results of a trial; <u>however</u>, your case, if there is one, is not a statistic and if having those choices is important to you then that is a legitimate concern. If you are unsure about whether to initial the arbitration clause in the RPA then you should discuss the matter with an attorney. Your REALTOR® cannot make the decision for you.

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Liquidated Damages

What are liquidated damages? Liquidated damages are a pre-specified amount of damages identified during the formation of a contract for the injured party to collect as compensation for a specific breach. For example, the C.A.R. Residential Purchase Agreement (Form RPA) provides for liquidated damages as a remedy for a buyer's breach of contract.

If a seller believes a buyer breached a real estate contract, what must the seller do to prove damages?
If liquidated damages are not part of the contract – The seller must prove two things:

(1) The buyer actually breached, and
(2) The amount of damage, or harm, caused by the breach.

If liquidated damages are incorporated into the contract – The seller still must prove that the buyer breached, but there is no requirement to prove damage because both parties have agreed in advance what the damage will be.

When may a liquidated damage clause become part of the contract?
A liquidated damage clause becomes part of the contract only if either:

A. Both parties initial the clause in the purchase agreement; **OR**
B. There is a mutual agreement reached through a counter offer or addendum.

For residential 1-4 property that the buyer intends to occupy, the liquidated damage amount: 1) cannot exceed the deposit paid, regardless of the amount promised, and 2) under the C.A.R. Residential Purchase Agreement (Form RPA), cannot exceed 3% of the purchase price. Thus, it will be the lower of 3% or the deposit paid when the buyer intends to occupy a residential 1–4 property.

Example 1: House sold to buyer. Purchase price is $1,000,000. Deposit required, $100,000. Deposit paid, $50,000.

- If buyer intends to occupy, the maximum liquidated damage is $30,000 (the lower of the deposit paid or 3%).
- If buyer intends to rent the house, the maximum liquidated damage is $50,000 (liquidated damages are limited to no more than the deposit paid).

Example 2: Same as example 1, except the deposit paid = $25,000.

- If buyer intends to occupy, the maximum liquidated damage is $25,000 (the lower of the deposit paid or 3%).
- If buyer intends to rent, the maximum liquidated damage is $25,000 (limited to no more than deposit paid).

Remember, escrow will not automatically release a deposit if the liquidated damage clause signed. The seller still must prove the buyer breached. The seller may need to mediate and then file a lawsuit or go to arbitration to obtain the damage award.

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Distinguishing Mediation from Arbitration

What is mediation?
Mediation is a process in which parties to a dispute hire a neutral third person to help them facilitate a discussion of their dispute and the possible outcomes, with the hope of reaching a settlement and avoiding any further legal proceedings and costs. In mediation, the parties are in control of the outcome and any settlement is by mutual agreement. If mediation does not result in a settlement, the parties are then free to pursue litigation or arbitration, as applicable.

What is arbitration?
Arbitration is a process in which parties to a dispute hire a neutral third person to hold a hearing, listen to evidence and decide who is right and who is wrong. When parties agree to arbitrate, they give up their right to a trial by judge or jury and they give up their right to appeal a decision they do not agree with.

What is the difference between mediation and arbitration?
A mediator uses the power of persuasion to try to steer the dispute to a mutually agreed-upon solution. An arbitrator uses the power of an award (the arbitrator's decision, like a judgment in court) to decide for the parties who wins and who loses.

Does the C.A.R. residential purchase agreement (RPA) address mediation or arbitration or both? If so, how?
Paragraph 22A of the RPA obligates buyers and sellers to try and resolve their differences in mediation before pursuing any other legal action, such as a lawsuit or arbitration. This is a requirement of the contract. It is not optional. It applies even if the parties do not initial the arbitration clause.

Paragraph 22B of the RPA states that the buyers and sellers agree that instead of going to court, they will arbitrate disputes that are not resolved in mediation. This paragraph is only binding on the parties if they each initial the clause or if they incorporate it into a counter offer.

Why would a buyer or seller agree to arbitration if they are giving up some legal rights?
The decision to arbitrate rather than litigate involves trade-offs. Arbitration hearings are private, not open to the public. Arbitration decisions are confidential, not subject to public review. Buyers and sellers can choose their own arbitrator and select, if they desire, a person with subject matter expertise. An arbitration hearing may often take place sooner than a court hearing, and therefore a possibility in saving costs, legal expenses and time by proceeding in arbitration rather than litigation. The parties may find that these factors make up for the loss of the right to trial by jury or right to appeal or both in opting for arbitration.

Should a buyer or seller initial the arbitration clause?
Each buyer and seller must make their own decision and should consult with legal counsel if they have questions about the advantages and disadvantages of arbitration.

Are there any exceptions to mediation or, if applicable, arbitration?
The most often used exemption is for matters within the jurisdiction of the small claims court for amounts under $10,000.

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