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How to minimize complications when arbitrating real estate disputes

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By Bernard M. Resser

Dispute resolution clauses requiring arbitration of real estate disputes present unique complications when it comes to lis pendens practice in California. But these complications can be reduced with a little foresight and attention to detail.

A lis pendens (aka Notice of Pendency of Action, Code Civ. Proc. §405.2.) is recorded in the County Recorder's Office. Its purpose is to give constructive notice of a pending real estate dispute to third parties who are potential bona fide purchasers (known as BFPs) or encumbrancers (such secured lenders) who are otherwise unaware of the dispute. Code Civ. Proc. § 405.24. If a lis pendens is not recorded when a real estate dispute arises, a BFP may take title to or possession of the subject real estate free and clear of the claim that is the subject of the dispute.

Typically, a lis pendens is recorded by a buyer who wishes to require a seller to complete a real estate transaction (called "specific performance" of the contract). The lis pendens prevents another buyer who is a BFP from taking title free and clear of the first buyer's claim. Because the lis pendens should show up in a title search giving notice of the buyer's claim to ownership, it effectively operates as an injunction barring the seller from reselling the property to another buyer.

Thus, recording a lis pendens when there is a claim involving title to or possession of real property or the use of an easement is critical to protect the rights of the party seeking to enforce such real property rights. Generally, recording a lis pendens at the outset of such claims is a "no brainer."

But with the proliferation of contract forms requiring arbitration of real estate disputes – including those published by the California Association of Realtors (CAR) and AIR/CRE – considerable care is required by both sides of a real estate dispute to pursue rights under the lis pendens law in California.

Why? Because commencement of binding arbitration under the contract's dispute resolution provision does not qualify as a "pending action," which is necessary to record a lis pendens. *Manhattan Loft, LLC v. Mercury Liquors, Inc.* (2009) 173 Cal. App. 4th 1040 [a lis pendens may be recorded only when an action is pending in a

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court of law]. Thus, any lis pendens recorded based solely on the commencement of arbitration is ineffective in giving notice to any BFPs and may even give rise to liability for slander of title.

To record a lis pendens in connection with a dispute subject to binding arbitration, the claimant must also file a court action and "at the same time present[] to the court an application that the action be stayed pending the arbitration of any dispute which is claimed to be arbitrable and which is relevant to the action." Code Civ. Proc. § 1298.5.

But the stay of proceedings that the plaintiff/claimant must seek when commencing the action necessary to support the lis pendens, when granted, will also end the court's jurisdiction to expunge the lis pendens, require a bond by the plaintiff, or allow the seller to "bond around" the lis pendens, (aka lis pendens motion practice). Code Civ. Proc. §§ 405.30 – 405.39.

This becomes an issue primarily for a defendant who wishes to expunge the lis pendens because the real estate claim lacks probable validity, requires the claimant to file a bond, or file a bond as allowed by the lis pendens law. Code Civ. Proc. §§ 405.30 – 405.34.

Thus, if the court action is stayed after the lis pendens is recorded but before any motion to expunge or motion for bond is heard, the court has no jurisdiction to issue an order expunging the lis pendens or requiring a bond. After the stay of the court action, the parties must instead apply to the arbitrator for any such relief, ask the arbitrator to make an interim award granting that relief, and then apply to the court for entry of an enforceable and recordable order based on that interim arbitration award.

The provisions of the California Arbitration Act (CAA) that create an exception to binding arbitration for "provisional remedies" do not solve this complication. Code Ci0 Proc. § 1281.8(b) ["A party to an arbitration agreement may file in the court in the county in which an arbitration proceeding is pending, or if an arbitration proceeding has not commenced, in any proper court, an application for a provisional remedy in connection with an arbitrable controversy, …"]. A lis pendens, while a de facto injunction, is not a "provisional remedy" as defined by the CAA and cannot be the subject of court proceedings while the action is stayed and in arbitration. *Manhattan Loft, LLC v. Mercury Liquors, Inc.*, supra, 173 Cal. App. 4th at 1051 [Section 1281.8 "does not anticipate or allow for the expungement of a lis pendens"].

If this sounds overly complicated, it is. This article addresses how to minimize this complication. But it is worth suggesting here that a better solution would be a legislative amendment to either the CAA or the lis pendens law. Lis pendens practice could be included among the proceedings allowed by Section 1281.8 of the CAA. Better still, the lis pendens law could be amended to allow recordation of a Lis Pendens when an arbitration involving a real property claim is commenced, without requiring commencement of a parallel court action. A motion to expunge would also be heard by the arbitrator instead of a trial judge who would not later try the case. This change would promote both a more efficient arbitration and judicial economy. If arbitration is to accomplish its purpose as a quicker and less costly alternative to court litigation, reforms like these need to be considered. One frustration with arbitration is that it often results in parallel proceedings, with more delay and expense than court proceedings alone. The lis pendens law now requires this duplication. Amendment of the lis pendens law suggested here would avoid parallel proceedings and the unnecessary expenditure of time and money in real estate disputes subject to arbitration in California.

A party essentially has to apply twice for the same relief after the court action is stayed. To make matters worse, in practice it can take weeks or even months for an arbitrator to be appointed after an arbitration is commenced or a court dispute is ordered to arbitration. As such, there may be no arbitrator able to grant such relief for weeks or months following the stay of the court action. Emergency procedures in front of an interim arbitrator may be necessary if allowed by the applicable rules of the arbitral body.

For this reason, attention to detail is required in applying for and responding to any application or stipulation to stay and order to arbitration a real property claim as defined by the lis pendens law. Code Civ. Proc. §405.4.

Often, when an action that is clearly subject to binding arbitration is filed in court, the parties will stipulate to stay the court action and order the dispute to arbitration. But before stipulating to a stay, a defendant should first determine if a lis pendens has been recorded, either by asking the plaintiff's attorney or by obtaining a title search, or both. Even then, complications can arise as described below.

To avoid duplication, any application to stay the court action should be timed so the stay goes into effect after any anticipated lis pendens motion practice.

Another solution, if allowed by the court, would be to exclude any motions to expunge and motions for a bond from the stay Order. However, I found judicial skepticism about the viability of this device.

The Honorable Patricia L. Collins, a retired Los Angeles Superior Court Judge now with ADR Services whom the author consulted for this article, notes that "when a judge sends a case to arbitration, they intend that they not be involved again until there is an Arbitration Award to enter as a judgment." She added: "A judge likely would not want to invite a back and forth between an arbitrator and the court or possibly forum shopping." She concludes: "I anticipate that you are unlikely to get a court to enter a stay with exceptions carved out [for lis pendens practice]."

The author learned about this lis pendens issue the hard way when demanding arbitration on behalf of a seller after a buyer filed a court action for specific performance under a real estate purchase and sale agreement that called for binding arbitration of disputes. In that case, a title search was done at the beginning of the case, but it did not reveal a recorded lis pendens. In addition, the buyer had not properly served the lis pendens. Code Civ. Proc. § 405.22. Unaware of any lis pendens, the seller's side asked the buyer's side to stipulate to a stay of the court action and an order for arbitration. The buyer agreed and an order was entered on the stipulation staying the court action without any exception for possible lis pendens practice.

After the arbitration was pending for a few months, a loan secured by the subject real estate was coming due. When the seller sought to refinance the loan on the property during the pendency of the arbitration, the unknown lis pendens came up on the lender's preliminary title report. The seller then sought to expunge the lis pendens or, alternatively, bond around it to allow the refinancing transaction to proceed. The court declined to hear the lis pendens motion for lack of jurisdiction because of the stipulated stay of court proceedings.

The seller then applied to the arbitrator, got relief from the lis pendens by interim award, and went back to court to get an enforceable and ,0 order. The buyer fought this at each step, even opposing entry of an order on the interim award after losing the motion before the arbitrator. The arbitrator appointed in that case was Retired Judge Patricia L. Collins of ADR Services. Hence, before completing this article, the author inquired of Judge Collins about this situation. Her willingness to act as a sounding board and provide her insights "from the bench" are greatly appreciated.

Because the title search conducted at the time the action was filed missed the recorded lis pendens, the seller's side did not think to include any exception to the stay to allow lis pendens practice. Whether the court would have allowed that exception is unknown. But in hindsight, time and effort of duplicate proceedings might have been avoided with a carve-out for lis pendens motion practice in the order staying the action for arbitration. Even a title search was not precaution enough.

A carve-out or properly timed entry of the stay order will avoid some of these complications in lis pendens practice when arbitrating real property claims in California.